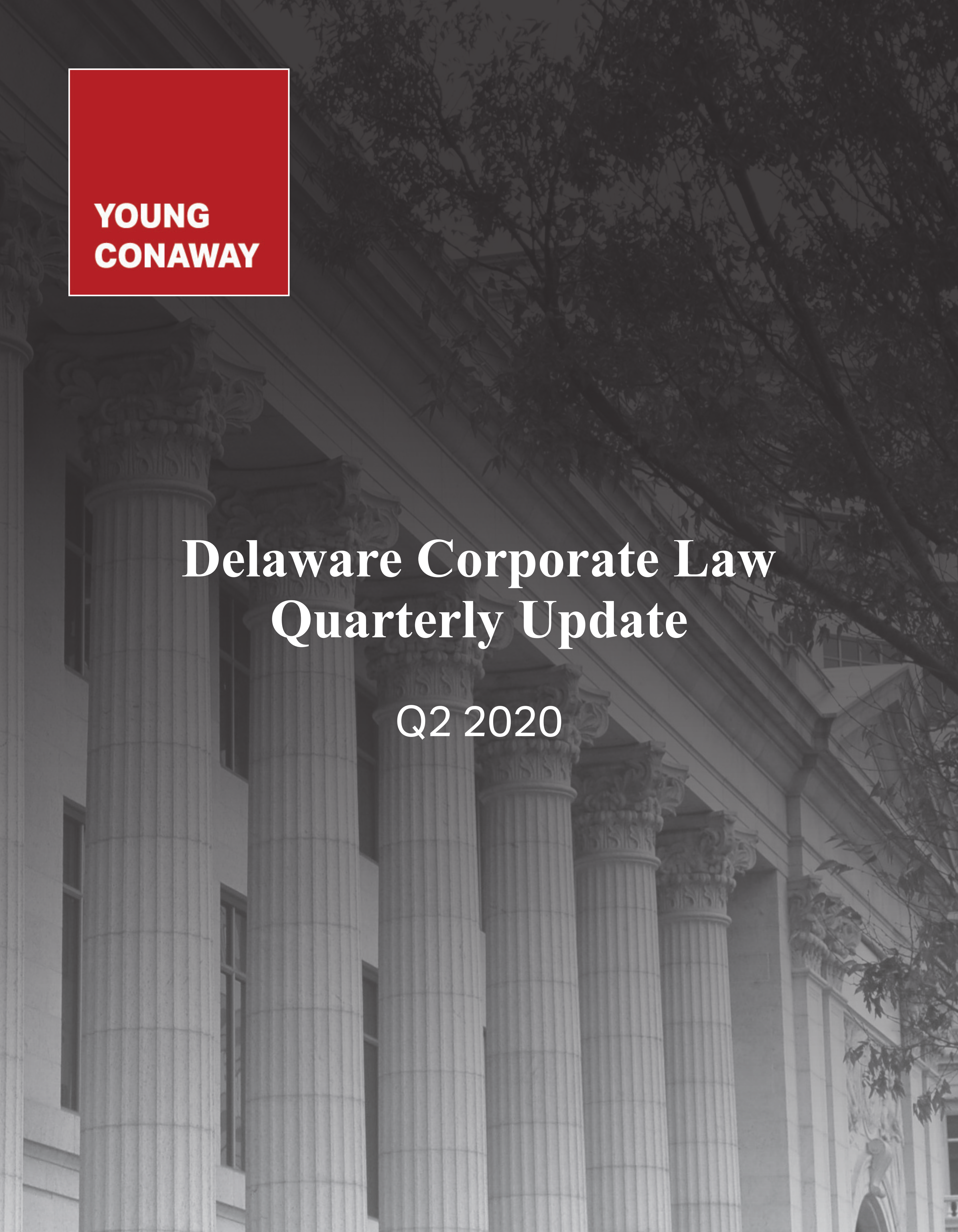

YOUNG CONAWAY

# Delaware Corporate Law Quarterly Update

Q2 2020

Cover Photo: Young Conaway Headquarters, Wilmington, DE

# Delaware Corporate Law Quarterly Update

## Q2 2020

This publication, which summarizes notable corporate and alternative entity cases decided by the Delaware Court of Chancery and Delaware Supreme Court during the second 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.

Attorneys within Young Conaway's Corporate Counseling and Litigation Section have extensive experience in guiding clients through takeover battles, special committee processes, and dissident stockholder situations. Young Conaway attorneys also have extensive experience in the prosecution and defense of litigation involving stockholder challenges to mergers and acquisitions, contests for corporate control, going private transactions, appraisal and valuation issues, indemnification and advancement claims, alternative entity disputes, and every other manner of corporate and alternative entity dispute in the Delaware courts. Some of the higher profile matters in which our attorneys have played an active role include those that produced the landmark Revlon, Time/Warner, QVC, Omnicare and Disney decisions of the Delaware Supreme Court. Columbia Pipeline, Energy Transfer Equity, Morgans Hotel, Ancestry.com, Pine River, and Oxbow are some of the more recent notable matters in which attorneys in the section played a significant role.

For more information, please call or email your regular Young Conaway contacts or one of the members of Young Conaway's Corporate Counseling and Litigation Section listed in the directory at the end of this publication.

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2 *See also Sheehan v. AssuredPartners, Inc.*, 2020 WL 2838575 (Del. Ch. May 29, 2020), which is summarized in the Proceedings to Interpret, Apply, Enforce, or Determine the Validity of Corporate Instruments section.

# Actions Involving Breach of Fiduciary Duty Claims

***Shabbouei v. Potdevin*, 2020 WL 1609177 (Del. Ch. Apr. 2, 2020) (Slights, V.C.)**

In *Shabbouei v. Potdevin*,[1] the Court of Chancery dismissed, for failure to adequately plead demand futility, a stockholder's derivative complaint against the board of directors of lululemon athletica inc. ("lululemon") that alleged the board breached its fiduciary duties in connection with a separation agreement entered into with the company's CEO. The Court, applying the two-prong *Aronson*[2] test, rejected the plaintiff's argument that the board was self-interested because the transaction was entered into with the CEO "as a means to hide Board-level failures."[3] In doing so, although the plaintiff "disavow[ed] any attempt to plead"[4] a *Caremark* claim,[5] the Court analyzed the question of whether the plaintiff pled particularized facts supporting a reasonable inference that the board was self-interested under *Caremark*. The Court concluded the complaint fell far short of pleading a *Caremark* oversight failure and, therefore, the plaintiff failed to adequately plead that the board was self-interested in the separation agreement. The Court also found that the plaintiff failed to plead particularized facts in support of a reasonable inference that the board's decision to enter the separation agreement was not the product of a valid exercise of business judgment.

According to the complaint, lululemon's CEO "created a toxic culture at lululemon and engaged in a pattern and practice of harassment and sexual favoritism while CEO."[6] Multiple whistleblower complaints were filed against the CEO, and ultimately many senior employees left the company because of the CEO's behavior. The complaint alleged the board was also aware of two incidents involving the CEO; but the complaint did not provide any meaningful detail about the incidents. The

1 2020 WL 1609177 (Del. Ch. Apr. 2, 2020).

2 *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984). The *Aronson* test applies "where it is alleged that the directors *made a conscious business decision in breach of their fiduciary duties." In re GoPro, Inc. S'holder Litig.*, 2020 WL 2036602, at *8 (Del. Ch. Apr. 28, 2002). The other demand futility test, as set forth in *Rales v. Blasband,* 634 A.2d 927 (Del. 1993), applies "where the board that would be considering the demand did not make a business decision which is being challenged in the derivative suit," *Rales,* 634 A.2d at 933-34, such as "where the subject of a derivative suit is not a business decision of the Board but rather a failure to act." *In re GoPro*, 2020 WL 2036602, at *8. Under *Aronson,* demand is excused when the plaintiff pleads particularized facts creating a reasonable doubt that "(1) the directors are disinterested and independent" or "(2) the challenged transaction was otherwise the product of a valid exercise of business judgment." *Aronson,* 473 A.2d at 814. Under *Rales,* demand is excused when the plaintiff pleads particularized facts creating "a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand." *Rales,* 634 A.2d at 934.

3 *Shabbouei,* 2020 WL 1609177, at *6 (Del. Ch. Apr. 2, 2020).

4 *Id.* at *1.

5 To carry out one's duties under *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996), "a director must make a good faith effort to oversee the company's operations." *Marchand v. Barnhill*, 212 A.3d 805, 820 (Del. 2019). The establish liability under *Caremark,* a plaintiff must establish either one of two prongs: "(a) the directors utterly failed to implement any reporting or information system or controls; *or* (b) having implemented such a system or controls, 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).

6 *Id.* at *3.

complaint acknowledged that lululemon maintained a code of ethics for all of its employees and that the company maintained a whistleblower hotline for reporting potential violations of the ethics code.

The board of directors hired outside counsel to investigate the CEO's behavior, ultimately receiving a report on the investigation's findings. After receiving and investigating reports of misconduct by the CEO, the board decided to negotiate a separation agreement with the CEO. The board and the CEO reached a separation agreement pursuant to which the CEO received $5 million in exchange for releasing all claims he might have had against the company and the extension of a non-solicitation period that was proscribed by his employment agreement.

After filing a Section 220 action seeking lululemon's books and records, the plaintiff filed a derivative complaint alleging three claims: (1) the board breached its fiduciary duty in approving the severance agreement, (2) the severance agreement constituted waste, and (3) the CEO was unjustly enriched from the severance agreement. The defendants moved to dismiss the complaint for failure to make a demand under Court of Chancery Rule 23.1.

The Court assessed demand futility under the two-prong test articulated in *Aronson*. The plaintiff argued that demand was excused under the first *Aronso*n prong because the board was self-interested in entering into the severance agreement in order to "hide Board-level failures."[7] The Court explained that in order to plead that the board was interested, the plaintiff needed to "plead facts supporting an inference that the Separation Agreement extinguished a *substantial likelihood* of Board liability."[8] Although the plaintiff "disavow[ed] any attempt to plead a *Caremark* claim" and "maintain[ed] that he [sought] to hold Defendants liable only for their affirmative decision to enter into a separation agreement with the CEO,"[9] in evaluating the first *Aronson* prong, the Court viewed the plaintiff's theory of liability underlying the board's supposed self-interest as a *Caremark* claim. The Court remarked:

"I am obliged to do what Plaintiff apparently would prefer I not do—evaluate his failure of oversight allegations."[10]

The Court concluded that the complaint failed to allege a substantial likelihood of liability arising from any underlying failure of oversight by the board. Indeed, the Court stated that the "allegations do not support an inference of any liability exposure, much less a substantial likelihood of liability."[11] To the contrary, the Court emphasized the code of ethics, the whistleblower system, and the board's response to the allegations against the CEO—including hiring counsel to investigate, reviewing counsel's report, authorizing a board member to negotiate the CEO's resignation from the company, and securing the CEO's "departure without litigation or excessive negative publicity"—all defeated such an oversight claim.[12]

The Court similarly concluded that the complaint failed to establish demand futility under *Aronson's* second prong because the complaint did not otherwise support a reasonable inference that the approval of the separation agreement was not a product of valid business judgment by the lululemon board. Lululemon's charter contained a Section 102(b)(7) provision exculpating the directors for duty of care violations—necessitating that the plaintiff plead a breach of the duty of loyalty to establish any likelihood of liability arising from the board's conduct. The plaintiff argued the "[b]oard rushed to negotiate and sign the Separation Agreement after conducting cursory informal meetings (without minutes)."[13] Noting the board's discretion in determining whether to fire the CEO or negotiate a severance package, the Court found the complaint fell far short of adequately alleging a breach of the duty of loyalty.

The Court also dismissed the plaintiff's waste and unjust enrichment claims. As to the waste claim, the Court noted the company received value from the release agreements, possibly avoiding expensive and embarrassing litigation, and therefore it could not be said that the separation agreement could not be attributed to any rational business purpose, as is required to plead a claim for waste. As to the unjust enrichment claim, the

7 *Id.* at *6.

8 *Id.* at *7.

9 *Id.*

10 *Id.* at *7.

11 *Id.* at *8.

12 *Id.*

13 *Id.* at *10.

Court stated that the claim failed for the same reasons that the plaintiff's breach of fiduciary duty claim failed for inadequately pleading demand futility.

***Elburn v. Albanese*, 2020 WL 1929169 (Del. Ch. Apr. 21, 2020) (Slights, V.C.)**

In *Elburn v. Albanese*,[14] the Court of Chancery denied the defendant's motion to dismiss, under Rule 23.1, a derivative suit challenging a corporate board's incentive-based executive compensation award to two officer-directors. Unlike a typical Rule 23.1 motion to dismiss, which focuses on whether the plaintiff has adequately pled demand futility, the parties in *Elburn* raised "the more fundamental question of what is required to plead a fact 'with particularity' under Rule 23.1."[15] In rejecting the defendant's attempt to impose the rigorous "newspaper facts" pleading standard often applied in fraud cases, the Court provided new interpretative guidance on the standard for a derivative plaintiff to plead a fact with particularity sufficient to defeat a motion to dismiss. That standard is stricter than notice pleading, but less stringent than the "newspaper facts" standard.

The plaintiff's claims stemmed from a previous derivative action between the same parties, in which the plaintiff challenged the board's grant of an award of nearly $50 million of stock and restricted stock units to themselves (the "2016 Awards"). Two directors, CEO Kevin Cummings and President and COO Domenick Cama, "received the majority of these awards, about $16.7 million and $13.4 million, respectively."[16] The parties ultimately agreed to settle that litigation, which resulted in Cummings and Cama agreeing to rescind approximately 75% of the 2016 Awards. Prior to the Court of Chancery's approval of the settlement, the board disclosed in its proxy statement in connection with annual board elections that it intended to issue a replacement award to Cummings and Cama, which replaced all of the rescinded restricted stock units and nearly 40% of the rescinded stock options (the "Replacement Awards"). The board approved the Replacement Awards in May of 2019, subject to the Court's approval of the settlement. The Court approved the settlement and the Replacement Awards became effective in July of 2019. Although the proxy statement disclosed the board's intent to issue the Replacement Awards, the board never supplemented this disclosure to inform the stockholders that the Replacement Awards had been approved.

The plaintiff filed suit challenging the Replacement Awards, asserting breach of fiduciary duty and unjust enrichment claims in connection with their issuance and acceptance. Specifically, the plaintiff alleged that the defendants "breached their fiduciary duties by issuing the Replacement Awards in a *quid pro quo* arrangement between Cummings and Cama" and the other members of the board in which "Cummings and Cama agreed to forfeit all of their share of the 2016 Awards in the Settlement so that the [other] directors could pocket more of their own awards, but only after the [other] directors secretly committed to issue the Replacement Awards after the Settlement was consummated."[17] Thus, the plaintiff alleged that the Replacement Awards could not have been the product of valid business judgment, but instead were "the spoils of a devious plan to nullify the effects of the Settlement and harm the Company's stockholders yet again."[18] The plaintiff also brought a separate fiduciary duty claim alleging the directors breached their duties by issuing a materially misleading proxy statement in advance of the annual elections.

Rather than challenge the "legal foundation" for the plaintiff's claims that the Replacement Awards were approved in breach of the defendants' fiduciary duties, the defendants instead "contest[ed] the adequacy of Plaintiff's factual pleading of the supposed *quid pro quo* arrangement between Cummings, Cama and the [other] directors."[19] The defendants argued that the Court should require the plaintiff to plead facts with the same "particularity" as required to plead fraud. In other words, the defendant argued that a derivative plaintiff must plead: "'(1) the time, place, and contents of the false representation; (2) the identity of the person making the representation; and (3) what the person intended to gain by making the representations.'"[20]

The Court rejected the defendant's argument. While recognizing that pleadings under Rule 23.1 are indeed held to a higher standard than non-derivative claims,

14 2020 WL 1929169 (Del. Ch. Apr. 21, 2019).

15 *Id.* at *2.

16 *Id.* at *4.

17 *Id.* at *1.

18 *Id.*

19 *Id.* at *7.

20 *Id.* at *8 (quoting *Abry P'rs V, L.P. v. F & W Acquisition LLC*, 891 A.2d 126, 142 (Del. Ch. 2009)).

the Court held that requiring a derivative plaintiff to plead "so-called 'newspaper facts'" would place too high a pleading standard on such a plaintiff.[21] Requiring such facts, the Court noted, would place derivative plaintiffs' claims at risk of never surviving a motion to dismiss: "derivative plaintiffs would be hard pressed to plead similar 'who, what, when, where and how' facts about fiduciary wrongdoing when they were not in the boardroom and, unlike fraud, were not the direct targets of the wrongful behavior."[22]

Instead, the Court held that a middle ground approach should apply and held that a pleading standard akin to that for allegations of fraudulent omission should apply. In the fraudulent omission context, a plaintiff discharges her pleading burden where the complaint "informs defendants of the *precise transactions at issue*, and the fraud alleged to have occurred in those transactions, so as to place defendants *on notice of the precise misconduct with which they are charged*."[23] This middle ground standard "recogniz[es] that a derivative plaintiff rarely has access, pre-discovery, to the facts that would allow him to recount a fly-on-the-wall's perspective of the alleged fiduciary misconduct he is attempting to plead."[24]

Applying this standard, the Court held that the plaintiff's complaint "plainly describes the specific misconduct in which each Defendant is alleged to have participated and the bases upon which Plaintiff alleges that an illicit *quid pro quo* arrangement led to the Replacement Awards."[25] Moreover, while recognizing that it may not be necessary to survive the motion, the Court noted that the complaint also put defendants "on notice of *when* the alleged misconduct occurred, *who* allegedly participated and *what* motivated the [other] directors to breach their fiduciary duties."[26] Accordingly, the Court denied the defendants' motion to dismiss.

21 *Id.* at *7-8.

22 *Id.* at *8. *See also id.* ("No rational pleading standard can require a plaintiff to plead specific facts that he has no means to know.").

23 *Id.* at *9 (quoting *Kahn Bros. & Co., Inc. Profit Sharing Plan and Tr. v. Fischbach Corp.*, 1989 WL 109406, at *4 (Del. Ch. Sept. 19, 1989) (emphasis in original) (internal quotations omitted).

24 *Id.*

25 *Id.*

26 *Id.* (emphasis in original).

The plaintiff also moved for partial summary judgment on its disclosure claims. First, the plaintiff argued the proxy statement, which stated that consideration of the Replacement Awards had "commenced" was "materially misleading because, at the time the Proxy was issued, the process for approving the Replacement Awards was further along than stockholders were being told."[27] The court rejected this claim, stating that the plaintiff was splitting hairs in arguing "that internal documents showing the Replacement Awards were being substantively negotiated reveal that the Board was doing more than 'considering' the awards, as disclosed in the Proxy."[28]

The plaintiff's second argument, that the defendants should have supplemented the proxy after the board approved the Replacement Awards, in the Court's view, "rest[ed] on firmer ground."[29] However, the Court denied summary judgment on this claim, finding that the question of whether this failure to supplement was material to the stockholders ratifying vote would benefit from further fact discovery.

Thus, in *Elburn*, the Court of Chancery provided new guidance for derivative plaintiffs on what it means, for Rule 23.1 purposes, to plead a fact with particularity. The Court struck a middle ground of requiring more than mere notice pleading, but less than the "newspaper facts" pleading requirement often applied in fraud cases. This guidance should prove useful to parties considering how to plead, and defend against, demand futility allegations.

### *Hughes v. Hu*, 2020 WL 1987029 (Del. Ch. Apr. 27, 2020) (Laster, V.C.)

In *Hughes v. Hu*,[30] the Court of Chancery denied a Rule 23.1 motion to dismiss, holding that pre-suit demand would have been futile because the plaintiff's allegations as set forth in the complaint supported a "reasonable pleading-stage inference of a bad faith failure of oversight" over the company's financial statements and related party transactions by the director-defendants.[31] Four of the defendants made up a majority

27 *Id.* at *10.

28 *Id.*

29 *Id.* at *11.

30 2020 WL 1987029 (Del. Ch. Apr. 27, 2020).

31 *Id.* at *1

of the board that would have considered a demand and "the substantial threat of liability render[ed] them incapable of disinterestedly considering a demand."[32] This decision is the most recent in a string of duty of oversight cases under *Caremark International Derivative Litigation*[33] to survive dismissal in the past year, despite *Caremark* claims being "among the hardest to plead and prove" under Delaware law.[34]

In March 2014, Kandi Technologies Group, Inc. ("Kandi"), a publically traded Delaware corporation based in China, acknowledged in its annual report on Form 10-K for the year ending December 31, 2013, that the company's reporting and oversight procedures were flawed. In particular, the company disclosed that its internal audit department reported to the CEO rather than to the Audit Committee, the Audit Committee and internal audit department failed to communicate, and the company failed to annually review the efficacy of the Audit Committee. The Form 10-K also discussed the company's proposed remedies to address these deficiencies, including requiring the head of the internal audit department to report to the Audit Committee, committing to revising the Audit Committee's charter to require communications between the Audit Committee and the internal audit department, and resolving to evaluate the Audit Committee annually. The company also determined that "its related-party transactions would be subject to review by the Audit Committee."[35]

Notwithstanding the company's stated resolve to remedy these deficiencies, in the three years between March 2014 and March 2017, the Audit Committee met only sporadically for short periods of time to discuss matters such as related-party transactions and the efficacy of the company's internal controls.

Further, in March 2017, Kandi disclosed in its 2016 Form 10K that the company's prior three years of financial records needed to be restated because the company lacked "[s]ufficient expertise relating to technical knowledge of US GAAP requirements and SEC disclosure regulations; [s]ufficient expertise to ensure the completeness of the disclosure of financial statements for equity investments; [s]ufficient expertise to ensure the proper disclosure of related-party transactions; [e]ffective controls to ensure the proper classification and reporting of certain cash and non-cash activities related to accounts receivable, accounts payable, and notes payable; and [s]ufficient expertise to ensure the accuracy of the accounting and reporting of income taxes and related disclosures."[36]

Following this disclosure, the plaintiff, a Kandi stockholder, demanded to inspect the company's books and, upon the company's refusal to cooperate, filed an action with the Court pursuant to Section 220 of the Delaware General Corporation Law. The 220 action was voluntarily dismissed in September 2018 after the company produced certain documents that the plaintiff requested.

In February 2019, the same plaintiff brought derivative claims on behalf of the company against three of the company's directors, who were members of Kandi's Audit Committee, the company's chief executive officer, and the company's then-current chief financial officer and two former chief financial officers. The plaintiff alleged that defendants breached their fiduciary duties by "willfully failing to maintain an adequate system of oversight, disclosure controls and procedures, and internal controls over financial reporting."[37] The defendants moved to dismiss the action for failure to make demand upon the board or plead demand futility under Rule 23.1 and for failure to state a claim under Rule 12(b)(6).

The Court began its analysis by determining whether the *Aronson*[38] test or the *Rales*[39] test for analyzing demand futility applied.[40] The Court stated that while

32 *Id.*

33 698 A.2d 959 (Del. Ch. 1996). *See also Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019); *In re Clovis Oncology, Inc. Derivative Litig.*, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019); *Inter-Marketing Grp. USA, Inc.*, 2020 WL 756965 (Del. Ch. Jan. 31, 2020).

34 *See Clovis*, 2019 WL 4850188 at *12.

35 *Hughes*, 2020 WL 1987029 at *4.

36 *Id.* at *8

37 *Id.* at *9.

38 *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).

39 *Rales v. Blasband*, 634 A.2d 927 (Del. 1993).

40 The *Aronson* test applies "where it is alleged that the directors *made a conscious business decision in breach of their fiduciary duties*." *In re GoPro*, 2020 WL 2036602, at *8 (Del. Ch. Apr. 28, 2020). The *Rales* test applies "where the board that would be considering the demand did not make a business decision which is being challenged in the derivative suit," *Rales*, 634 A.2d at 933-34, such as "where the subject of a derivative suit is not a business decision of the Board but rather a failure to act." *In re GoPro*, 2020 WL 2036602, at *8. Under *Aronson*, demand is excused when the plaintiff pleads particularized facts creating a reasonable doubt that "(1) the directors are disinterested and independent" or "(2) the challenged transaction was otherwise the product of a valid exercise of business

the *Aronson* test was technically appropriate given that a majority of the then-current board were also board members at the time of the alleged wrongdoing, it would evaluate demand futility under the *Rales* test because the complaint did not challenge "a specific transaction or a particular decision"[41] but rather alleged "that there were persistent problems with the Company's system of financial oversight over a prolonged period, leading ultimately to the Company suffering harm."[42] The Court reasoned that a "*Caremark* claim is conceptualized as flowing from an overarching failure by the directors to take the action necessary to protect the corporation, so the more generalized *Rales* standard is routinely applied."[43] Under *Rales*, to adequately plead demand futility, a plaintiff needs to make "a threshold showing through the allegation of particularized facts"[44] that a director faces a substantial likelihood of liability and, as such, has a "disqualifying interest"[45] in considering the demand.

The Court next analyzed whether the complaint alleged sufficient facts showing that a majority of the demand board faced a substantial likelihood of liability. Under *Caremark*, directors face a substantial likelihood of liability if the plaintiff demonstrates that the defendants "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 themselves from being informed of risks or problems requiring their attention."[46] The Court explained that a plaintiff can state a *Caremark* claim by alleging that "the company had an audit committee that met only sporadically and devoted patently inadequate time to its work, or that the audit committee had clear notice of serious accounting irregularities and simply chose to ignore them or, even worse, to encourage their continuation."[47]

The Court held that because the complaint demonstrated that the company's Audit Committee "met sporadically, devoted inadequate time to its work, had clear notice of irregularities, and consciously turned a blind eye to their continuation[,]" the complaint sufficiently alleged particularized facts showing that the board faced a substantial likelihood of liability.[48] The Court noted that even after Kandi publically disclosed weaknesses in the company's reporting and oversight procedures in March 2014, the company failed to take appropriate remedial measures. For example, the Audit Committee met only when "spurred by the requirements of federal securities laws" and, even then, "[t]heir abbreviated meetings suggest[ed] that they devoted patently inadequate time to their work."[49] The Court also found that while the Audit Committee purportedly reviewed and approved a new policy that the company prepared governing related-party transactions, it was reasonable to infer from the company's failure to produce such a policy that it "either did not exist or did not impose meaningful restrictions on the Company's insiders."[50]

In reaching its conclusion, the Court rejected defendants' argument, based on *In re General Motors Company Derivative Litigation*,[51] that because the Company had in place "an Audit Committee, a Chief Financial Officer, an internal audit department, a code of ethics, and an independent auditor[,]" the plaintiff could not "meet its *Caremar*k burden by pleading that board-level monitoring systems existed but that they should have been more effective."[52] The Court distinguished *General Motors*, explaining that in *General Motors* the board was very much involved in maintaining an oversight system whereas here the complaint adequately alleged that the company's board members "did not make a good faith effort to do their jobs."[53]

Given these "persistent and prolonged problems at the Company," the Court found that the defendants faced

judgment." *Aronson*, 473 A.2d at 814. Under *Rales*, demand is excused when the plaintiff pleads particularized facts creating "a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand." *Rales*, 634 A.2d at 934.

41 *Hughes*, 2020 WL 1987029 at *13.

42 *Id.*

43 *Id.*

44 *Rales*, 634 A.2d at 934 (citing *Aronson* 473 A.2d at 811–12).

45 *Id.* at 936 (quoting *Aronson* 473 A.2d at 815).

46 *Hughes*, 2020 WL 1987029 at *14 (quoting *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006)).

47 *Id.* (quoting *Guttman v. Huang*, 823 A.2d 492, 507 (Del. Ch. 2003)).

48 *Id.*

49 *Id.* at *16.

50 *Id.* at *14.

51 2015 WL 3958724 (Del. Ch. June 26, 2015).

52 *Hughes*, 2020 WL 1987029 at *16.

53 *Id.*

"a substantial likelihood of liability under *Caremark* for breaching their duty of loyalty by failing to act in good faith to maintain a board-level system for monitoring the Company's financial reporting."[54] As such, the Court held that demand would have been futile because a majority of the demand board faced a substantial likelihood of liability.

The Court lastly addressed defendants' motion to dismiss for failure to state a claim under Rule 12(b)(6). The Court held that its Rule 23.1 analysis was dispositive because "a complaint that survives a motion to dismiss pursuant to Rule 23.1 will also survive a 12(b)(6) motion to dismiss"[55] since the "standard for pleading demand futility under Rule 23.1 is more stringent than the standard under Rule 12(b)(6)."[56]

***In re GoPro, Inc. S'holder Derivative Litig.*, 2020 WL 2036602 (Del. Ch. Apr. 28, 2020) (Slights, V.C.)**

In *In re GoPro, Inc. Stockholder Derivative Litigation*,[57] the Court of Chancery dismissed a derivative complaint alleging breaches of fiduciary duties by GoPro, Inc. ("GoPro") officers and directors because the derivative plaintiffs failed to plead demand futility with particularity as required under Court of Chancery Rule 23.1. The Court rejected the plaintiffs' arguments that a majority of the demand board was not able to consider a demand because they faced a substantial likelihood of liability for breaches of fiduciary duties and securities law violations for alleged actions and inactions in connection with GoPro's launch of a new product in 2016. The Court also rejected the plaintiffs' argument that a majority of the demand board could not competently consider a demand to prosecute claims against the controlling stockholder because the controlling stockholder could remove the board members at will and therefore the board members lacked independence for demand futility purposes. Therefore, the plaintiffs failed to adequately plead that demand was excused.

In early 2016, GoPro issued full-year revenue guidance to its investors, disclosing that it expected revenue of \$1.35 – \$1.5 billion for 2016. On the same day, GoPro also announced its plan to enter the drone market. GoPro planned to launch two new products in 2016: "a drone that would house state of the art GoPro cameras and the latest iteration of its signature wearable camera."[58] For eight months, management reports to the board showed the company had no drones in inventory and that there were delays with bringing the drone to the market. Yet, the company continued to make positive public statements about the drone and the company's revenue guidance remained the same. After hitting the market, the drone experienced manufacturing defects, and the company struggled to supply inventory to retailers. The company lowered its revenue guidance to \$1.25 - \$1.3 billion as a result, and the market reacted to the drop with GoPro's stock falling 6.5%. The company then recalled the drone due to the defects, causing the stock to drop another 4%. In 2017, the company reported that it had missed its revenue projections, in large part due to the drone launch challenges.

Following the drone launch fallout, certain GoPro stockholders sued GoPro officers in federal court for securities violations. Other GoPro stockholders sought books and records from the company under Section 220 of the Delaware General Corporation Law. After receiving documents from the company in response to their Section 220 demand, and without making a litigation demand on GoPro's board, two GoPro stockholders filed derivative actions against the members of the board, among others, claiming that the members of the board breached their fiduciary duties by failing to disclose GoPro's drone inventory and sales issues, allowing officers to make numerous materially false and misleading statements, and using non-public information to sell company stock.[59]

The defendants moved to dismiss under Rule 23.1 for failure to plead demand futility and under Rule 12(b)(6) for failure to state a claim. Because the plaintiffs elected to forego pre-suit demand, to satisfy Rule 23.1, they had to show demand was excused. The Court noted that the plaintiffs' allegations were imprecise in that they simultaneously characterized the alleged wrongdoing as a failure to act and as an affirmative decision and, as a result, the plaintiffs did not sufficiently articulate

54 *Id.* at *17.

55 *Id.* at *18 (quoting *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 139 (Del. Ch. 2009)).

56 *Id.*

57 2020 WL 2036602 (Del. Ch. Apr. 28, 2020).

58 *Id.* at *1.

59 *Id.* at *7. In Delaware, breach of fiduciary duty claims for trading stock with insider information are commonly called "*Brophy*" claims. *See Brophy v. Cities Serv. Co.*, 70 A.2d 5 (Del. Ch. 1949).

whether *Aronson*[60] or *Rales*[61] should apply to the demand futility inquiry.[62] On the one hand, the plaintiffs alleged that the board made false or misleading statements, knowing that GoPro would not make the launch of its new drone product and would miss revenue guidance because the board had received reports showing no inventory a few weeks before launch. The plaintiffs further alleged that one director, the CEO, engaged in insider trading. On the other hand, the plaintiffs' complaint contained allegations that "walk and talk" like a *Caremark* claim[63] for bad faith failure to oversee GoPro's operations, though the plaintiffs "disclaim[ed] any effort to plead a *Caremark* claim."[64]

Although it was not clear what theory (board action or board inaction) the plaintiffs were relying on or what demand futility test (*Aronson* or *Rales*) the plaintiffs were arguing should apply, the "one clear" argument that the plaintiffs did make was that a majority of the demand board faced a substantial likelihood of liability for their actions or inactions surrounding GoPro's public statements, which inquiry is applicable to both *Aronson* and *Rales*.[65] But the Court found that the plaintiffs' allegations failed to demonstrate a substantial likelihood of liability under either theory.

*First*, the Court found that only one member of the demand board (the CEO and controlling stockholder) was alleged to have made false or misleading statements or engaged in insider trading. The plaintiffs argued that a majority of the demand board engaged in wrongdoing because they contributed to and approved the revenue guidance while knowing that it was impossible for the company to meet projections and that a majority of the demand board lacked independence because they were beholden to the CEO, who as the controlling stockholder could remove them at will. The Court rejected these arguments. The plaintiffs provided no particularized facts to show a majority of the board affirmatively told management to disclose that the company would meet its revenue guidance notwithstanding the manufacturing and inventory issues. The Court stated that the "fundamental problem" with plaintiffs' argument was that "[b]oard *acquiescence* cannot support an inference of *affirmative* [b]oard-level misconduct."[66] The Court explained that "[e]ven if the Board were told by its management that the Company was not going to meet its revenue projections, and then did nothing as management publicly stood by its market guidance, that factual predicate would support a 'classic' *Caremark* claim for failure to respond to 'red flags,' not a claim against the Board for causing the Company to make false disclosures."[67]

The plaintiffs also failed to plead "facts that would allow a reasonable inference that a majority" of the demand board was beholden to the CEO, or any other *Brophy*-claim defendant, "such that they would be motivated to facilitate or cover up illegal insider trading."[68] Those directors were not beholden to the CEO simply by virtue of his removal power as controlling stockholder.[69]

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60 *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).

61 *Rales v. Blasband*, 634 A.2d 927 (Del. 1993).

62 The *Aronson* test applies "where it is alleged that the directors *made a conscious business decision in breach of their fiduciary duties.*" *In re GoPro*, 2020 WL 2036602, at *8. The *Rales* test applies "where the board that would be considering the demand did not make a business decision which is being challenged in the derivative suit," *Rales*, 634 A.2d at 933-34, such as "where the subject of a derivative suit is not a business decision of the Board but rather a failure to act." *In re GoPro*, 2020 WL 2036602, at *8. Under *Aronson,* demand is excused when the plaintiff pleads particularized facts creating a reasonable doubt that "(1) the directors are disinterested and independent" or "(2) the challenged transaction was otherwise the product of a valid exercise of business judgment." *Aronson*, 473 A.2d at 814. Under *Rales*, demand is excused when the plaintiff pleads particularized facts creating "a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand." *Rales*, 634 A.2d at 934.

63 To carry out one's duties under *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996), "a director must make a good faith effort to oversee the company's operations." *Marchand v. Barnhill*, 212 A.3d 805, 820 (Del. 2019). The establish liability under *Caremark,* a plaintiff must establish either one of two prongs: "(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, 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).

64 *In re GoPro*, 2020 WL 2036602, at *11.

65 *Id.* at *9.

66 *Id.* at *10.

67 *Id.*

68 *Id.* at *11.

69 "It is well-settled that a controlling stockholder's voting power and selection of directors do not, without more, render directors beholden to the controller." *Id.* (internal quotations and brackets omitted).

*Second*, the Court found that the plaintiffs' *Caremark*-like allegations were insufficient to subject the defendants to a substantial likelihood of personal liability for a *Caremark* claim. The Court assumed for its analysis that the plaintiffs were asserting claims under *Caremark*'s second prong by arguing that, having implemented an oversight system, the board failed to respond to red flags. But the Court found that the plaintiffs failed to plead any facts "that would allow a reasonable inference a majority of the Demand Board knew GoPro was misleading investors with any of its public statements during 2016."[70] Among other things, the Court explained that management's presentations to the board regularly advised the board that the company was on track to meet the revenue guidance and the board was entitled to rely on that information.

Finding that the plaintiffs failed to adequately allege that demand was excused, the Court dismissed the complaint with prejudice.

### ***Gilbert v. Perlman*, 2020 WL 2062285 (Del. Ch. Apr. 29, 2020) (Glasscock, V.C.)**

In *Gilbert v. Perlman*,[71] the Court of Chancery reiterated that the circumstances under which minority stockholders will be found to be part of a control group (and thus be found to owe fiduciary duties to other stockholders in a transaction) where there already exists an independently controlling stockholder are very limited.[72]

In granting a motion to dismiss breach of fiduciary duty claims brought against two minority stockholders, Chrysalis Ventures II, L.P. ("Chrysalis") (which owned 11% of the company) and David Jones (who owned 0.02% of the company), the Court reasoned that in order for a minority stockholder to be found part of a controlling group along with an independently controlling stockholder, a minority stockholder's participation with the controller in a transaction is alone insufficient. Rather, "the minority-holder's participation must be material to the controller's scheme to exercise control of the entity, leading to the controller ceding some of its control power to the minority-holders."[73]

The claims alleged in the complaint arose from a going private cash-out merger of Connecture, Inc. ("Connecture"). Defendants Francisco Partners IV, L.P. and Francisco Partners IV-A, L.P. ("Francisco Partners"), which were controlled by the same general partner, owned 56% of Connecture. Thus, by virtue of its majority position, Francisco Partners was Connecture's controlling stockholder. In the fall of 2017, Connecture delisted from NASDAQ, a move that resulted in a steep drop of its share price. One month after the delisting, Francisco Partners made an offer to acquire all of Connecture's outstanding stock.

Francisco Partners' ultimate offer contemplated a roll-over of stock held by minority stockholders Chrysalis and Jones into the new acquisition entity. Before the transaction closed, Francisco Partners and Chrysalis entered into a voting agreement that committed their combined stock in favor of the transaction. A special committee of the board was formed that ultimately recommended the proposed transaction, and the board approved a merger agreement the same day it received that recommendation. The transaction was not conditioned on approval of a majority of the minority stockholders. Despite approval by only 9.9% of the company's unaffiliated minority stockholders, the merger closed on April 25, 2018.

On June 25, 2018, two stockholders brought breach of fiduciary duty claims against Francisco Partners, Chrysalis, and Jones in connection with the transaction. Chrysalis and Jones moved to dismiss the claims against them, arguing they did not owe fiduciary duties as minority stockholders. The plaintiffs argued Chrysalis and Jones owed fiduciary duties because they coordinated with Francisco Partners to form a controlling stockholder group.

In analyzing the motion to dismiss, the Court noted that generally a minority stockholder can only be deemed a controller who owes fiduciary duties if the stockholder actually "exercise[s] control over the business affairs

70 *In re GoPro*, 2020 WL 2036602, at *12.

71 2020 WL 2062285 (Del. Ch. Apr. 29, 2020).

72 In fact, the Court quoted a 2018 Court of Chancery decision stating that "the court is aware of [no case] where the analysis for determining the existence of a control group has been applied to glom on to a preexisting controlling stockholder additional stockholders to give them the status of a control group." *Id.* at *7 n. 96 (quoting *Almond v. Glenhill Advisors LLC*, 2018 WL 3954733, at *25-26 (Del. Ch. Aug. 17, 2018), *aff'd Almond v. Glenhill Advisors, LLC*, 224 A.3d 200 (Del. 2019) (TABLE).

73 *Id.* at *7.

of the corporation" as part of a control group.[74] Here, though, there was already an independently controlling stockholder, Francisco Partners. In analyzing whether Chrysalis and Jones acted as part of a control group with Francisco Partners, the Court adopted the analysis set forth by the Court in *Almond v. Glenhill Advisors LLC*,[75] stating:

> [W]here a controlling stockholder takes an action joined by minority stockholders, the latter can be deemed members of a control group, and thus fiduciaries, where two conditions exist. There must be an arrangement between the controller and the minority stockholders to act in consort to accomplish the corporate action, and the controller must perceive a need to include the minority holders to accomplish the goal, so that it has ceded some material attribute of its control to achieve their assistance.[76]

The Court found that the plaintiffs had sufficiently alleged that Francisco Partners acted in concert with Chrysalis and Jones—meeting the first part of the analysis. The plaintiffs pointed to past coordination between the parties where Chrysalis and Jones facilitated the acquisition of a majority stake in Connecture by Francisco Partners through two private placements as well as facilitation between Jones and Chrysalis in the transaction at issue.

But, the Court held that the plaintiffs failed to sufficiently allege the second part of the analysis—that Francisco Partners somehow "shar[ed] or material[ly] self-limit[ed] . . . its control powers, to obtain participation of [Chrysalis and Jones] for [Francisco Partners]' perceived self-advantage."[77] In other words, the Court explained, the plaintiffs were required but failed to show that Francisco Partners needed something material in order to execute its going private scheme and gave up a material part of its control to Chrysalis and Jones to get it.

In addition to the past coordination of the parties, the plaintiffs alleged that Chrysalis and Jones were classified by the SEC as "affiliates" of Connecture and the SEC defines "affiliates" as "a person that directly or indirectly through one or more intermediaries controls, is controlled by, or is under common control with such issuer."[78] The Court rejected this argument, holding that the "SEC determination is not dispositive of the common-law issue of control[.]"[79] The plaintiffs' sole remaining allegations were that Chrysalis and Francisco Partners had a "legally significant relationship" as shown by the voting agreement entered by the two stockholders,[80] and that Francisco Partners limited its control by agreeing to let Chrysalis and Jones join the equity rollover, thereby diluting Francisco Partners' interest in the new company.

In holding that the plaintiffs failed to sufficiently satisfy the second condition of the analysis, the Court found the plaintiffs had alleged "neither *quid* nor *quo*—it describes nothing Francisco Partners needed or ceded to the Moving Defendants, other than the bare right to roll over shares."[81] Further, the Court reasoned that if the plaintiffs' allegations were deemed sufficient, minority stockholders could be tagged as controlling fiduciaries each time minority stockholders participated in a transaction with a controller.

Ultimately, the Court dismissed the claims against Chrysalis and Jones for breaches of fiduciary duty as controlling stockholders, noting that "as with Aesop's lion freed from his constraints by the gnawing of a mouse, a stockholder with voting control might nonetheless be needful of aid from a minority stockholder to complete a control scheme, and might be willing, in order to get it, to cede some if its advantage to such a minority stockholder," but that the plaintiffs' complaint here did not present that rare situation.[82]

### ***Solak v. Welch*, 228 A.3d 690 (Del. Apr. 30, 2020) (TABLE)**

In *Solak v. Welch*,[83] the Delaware Supreme Court affirmed, in a one-page order, the Court of Chancery's

74 *Id.* at *6 (quoting *Kahn v. Lynch Commc'ns Sys., Inc.*, 638 A.2d 1110, 1113-14 (Del. 1994)).

75 2018 WL 3954733 (Del. Ch. Aug. 17, 2018).

76 *Gilbert*, 2020 WL 2062285 at *7.

77 *Id.* at *8.

78 *Id.*

79 *Id.*

80 *Id.*

81 *Id.* at *9.

82 *Id.* at *7.

83 228 A.3d 690 (Del. Apr. 30, 2020) (TABLE).

determination that a letter to the board of directors of Ultragenyx Pharmaceutical Inc. ("Ultragenyx") from an Ultragenyx stockholder constituted a demand for purposes of Court of Chancery Rule 23.1 where the letter, which requested that the board take remedial action to address allegedly excessive compensation to non-employee directors, included a footnote stating that nothing in the letter should be "construed as a pre-suit litigation demand under Delaware Chancery Rule 23.1."[84] The Supreme Court stated that the Court of Chancery decision "should be affirmed on the basis of and for the reasons assigned by the Court of Chancery."[85]

After the Ultragenyx board received the letter from the stockholder requesting that the board take remedial action, the board rejected the request and the stockholder commenced litigation against the board. The stockholder asserted claims for breach of fiduciary duty, unjust enrichment, and corporate waste based on the board's "allegedly excessive non-employee director compensation practices."[86] The defendants moved to dismiss the complaint under Rule 23.1, arguing that the stockholder's pre-suit letter constituted a demand and the stockholder had failed to claim that the board wrongfully refused the demand. The plaintiff opposed the motion, arguing that the letter was not a demand, as evidenced in part by the footnote, and that the demand excusal analysis applied.

In concluding that the stockholder's pre-suit letter to the board constituted a pre-suit demand under Rule 23.1, the Court of Chancery applied *Yaw v. Talley*,[87] which held that "a pre-suit communication is a demand for purposes of Rule 23.1 if it provides '(i) the identity of the alleged wrongdoers, (ii) the wrongdoing they allegedly perpetrated and the resultant injury to the corporation, and (iii) the legal action the shareholder wants the board to take on the corporation's behalf.'"[88] The parties disputed whether the letter satisfied the third criterion. The stockholder argued that because the letter did not expressly demand that the board commence litigation, it could not be construed as a pre-suit litigation demand. The Court disagreed, explaining that such argument was inconsistent with prior Court findings that pre-suit communications that did not expressly demand litigation were sufficient to constitute pre-suit demand. Moreover, the Court found that a determination that the third *Yaw* criterion had been met was supported by the letter's (i) request for remedial action, (ii) statement that Ultragenyx "is more susceptible than ever to shareholder challenges unless it revises or amends its director compensation practices and policies," and (iii) warning that, "absent a response from the [b]oard within thirty days, [the stockholder] would consider all available shareholder remedies."[89] The Court also noted that the stockholder's footnote disclaimer did not obviate the Court's review of the letter's substance, stating that Delaware law's prohibition on a stockholder from both making a demand and pleading demand futility "would become a virtual nullity if a stockholder could avoid a judicial determination that pre-suit demand was made by simply stating 'this is not a demand' in his pre-suit communication."[90]

Having determined that the letter constituted a demand, the Court then looked at whether the stockholder had adequately pled wrongful demand refusal by the board. Because the complaint "fail[ed] to acknowledge . . . the [l]etter or the [board's r]esponse," let alone allege "any facts supporting an inference that the Board wrongfully rejected the demand,"[91] the Court granted the defendant's motion to dismiss.

### ***Frederick Hsu Living Tr. v. Oak Hill Cap. P'rs III L.P.*, 2020 WL 2111476 (Del. Ch. May 4, 2020) (Laster, V.C.)**

In *Frederick Hsu Living Trust v. Oak Hill Capital P'rs III L.P.*,[92] the Court of Chancery held that a controlling stockholder's decision to implement a strategy to accumulate cash in anticipation of a redemption—rather than investing it in the company's business to

84 *Solak v. Welch*, 2019 WL 5588877, at *2 (Del. Ch. Oct. 30, 2019) [hereinafter *Trial Opinion*].

85 228 A.3d 690 (Del. Apr. 30, 2020) (TABLE).

86 *Trial Opinion*, 2019 WL 5588877, at *3.

87 1994 WL 89019 (Del. Ch. Mar. 2, 1994).

88 *Trial Opinion*, 2019 WL 5588877, at *4 (quoting *Yaw*, 1994 WL 89019, at *7).

89 *Trial Opinion*, 2019 WL 5588877, at *6. Beyond the application of *Yaw*, the Court of Chancery found other facts to support its conclusion that the stockholder's pre-suit communication constituted a demand. For example, the stockholder's complaint was "nearly a carbon copy of the [l]etter." *Id.* The similarities between the complaint and letter made it "more likely the communication . . . provided the notice required of a pre-suit demand." *Id.*

90 *Id.* at *5.

91 *Id.* at *8.

92 2020 WL 2111476 (Del. Ch. May 4, 2020).

promote long-term growth—was entirely fair, despite finding that the process used to implement the strategy was not fair. *Frederick Hsu* stands as a reminder that a challenged action can survive entire fairness review despite a finding of an unfair process, as "[t]he economic dimension of the analysis can be 'the predominant consideration in the unitary entire fairness inquiry.'"[93]

Defendant Oak Hill Capital Partners ("Oak Hill") owned a majority of the common stock and all of the Series A Preferred Stock of OND Holding Corporation ("OND"), a holding company for Oversee.net (together with OND, "Oversee"), which gave Oak Hill control of the company at the stockholder and board levels. Oak Hill possessed a redemption right to compel Oversee to redeem its preferred stock at a liquidation preference of $150 million.[94] Traditionally, Oversee "invested its profits in organic growth or used it to make acquisitions[,]" but with the ripening of the redemption right approaching, Oak Hill terminated Oversee's CEO and "instructed management to cut expenses to improve profitability."[95] Afterwards, it "kept the focus on cash generation," selling half of the company's business units without reinvesting the proceeds.[96] Oak Hill then exercised its redemption right and received $45 million. The company's second largest stockholder, Fredrick Hsu, brought suit claiming that this shift towards liquidation and away from its acquisition and growth strategy, which, he alleged, led to a substantial downturn in revenue, constituted a breach of fiduciary duty by Oak Hill and the members of the company's board that went along with the strategy.

In a post-trial opinion, the Court first identified what, if any, conduct taken by Oak Hill was self-interested. The Court ruled that because the redemption right *required* Oak Hill to use "all of its legally available funds for a redemption . . . the actual redemption was not the critical step . . . the critical step was building up the pool of funds that would be available for redemption."[97] The Court found "that Oak Hill caused the Company to accumulate cash so that the funds would be legally available and could be swept up using its Redemption Right[,]" thus subjecting Oak Hill's conduct to scrutiny under the entire fairness standard.[98]

The Court then rejected the defendants' argument that the plaintiff should bear the burden of proving unfairness because of the existence of three special committees on several grounds.[99] First, citing *Americas Mining Corp. v. Theriault*,[100] the Court held that because "defendants did not move for summary judgment on the standard of review or allocation of burden," the defendants "bore the burden of proving entire fairness."[101] Second, the special committees did not address the specific decision that the plaintiff challenged—the decision to "re-orient the Company away from a strategy of reinvesting its net income in growth opportunities and towards a strategy of accumulating cash on the balance sheet."[102] Rather, the special committees addressed decisions that the plaintiff did not challenge, such as the determining the amount of funds that could be used for the redemption and the price at which to sell a business segment. Third, the Court found that the "record gives rise to sufficient concerns about the effectiveness of the special committees. . . ."[103] Factors that the Court considered in determining that the special committees were not well-functioning included one of the committee member's "close ties" to Oak Hill and "longstanding personal connections" with an Oak Hill partner, the special committees' reliance on senior management who had bonus agreements that incentivized them to maximize the proceeds that Oak Hill would receive, and the extent of the direction that senior management took from Oak Hill.[104] Ultimately, although the Court stated that the Court's discussion of these factors "is not to intimate that the special committees were a sham" or that the members acted in bad faith, "a combination of factors raises sufficient doubts about the effectiveness of the committees to prevent them from having burden-shifting effect."[105]

93 *Id.* at *42 (citing *In re Dole Food Co., Inc. S'holder Litig.*, 2015 WL 5052214, at *34 (Del. Ch. Aug. 27, 2015)).

94 *Id.*

95 *Id.* at *1.

96 *Id.*

97 *Id.* at *29.

98 *Id.*

99 "[I]n 'entire fairness' cases, the defendants may shift the burden of persuasion to the plaintiff if . . . they show that the transaction was approved by a well-functioning committee of independent directors." *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635, 642 (Del. 2014), *overruled on other grounds*, *Flood v. Synutra Int'l, Inc.*, 195 A.3d 754 (Del. 2018).

100 51 A.3d 1213 (Del. 2012).

101 *Frederick Hsu Living Tr.*, 2020 WL 2111476, at *33.

102 *Id.*

103 *Id.* at *34.

104 *Id.* at *34-35.

105 *Id.* at *35.

The Court found the "defendants fell short on the [fairness of the process] dimension of the [entire fairness] analysis."[106] The Court noted that Oak Hill "initiated the cash-accumulation strategy[,]"fired the CEO, "told the Operating Committee to make deep cuts[,]" and "pushed management to make further cuts and maintain the Company's margins."[107] It found that "Oak Hill drove the cash accumulation strategy" by controlling all communication: it was "undisputed that Oak Hill had bi-weekly calls with the CEO, communicated regularly with management, met informally with management, and exchanged thousands of emails with the senior management team."[108] The Court concluded that "[t]he traditional indicators of fair dealing were thus lacking in this case" but noted that the plaintiff "attacked the decision to accumulate cash" instead of challenging "the Board's decisions to redeem Oak Hill's shares" or "the transaction prices that the Company obtained for its businesses" which would have caused "the analysis of the fair process dimension [to] have unfolded differently."[109]

The Court then moved on to "the fair price dimension of the entire fairness inquiry."[110] It concluded that "[t]he defendants proved that the cash accumulation strategy was substantively fair."[111] The Court concluded that "[t]he defendants proved that the root cause of Oversee's decline was not self-interested conduct by Oak Hill, but rather intense industry headwinds and competitive pressures that began almost immediately after Oak Hill's first investment in 2008. The weight of the evidence demonstrates that there was no acquisition or growth opportunity that the Company's former executives and directors could have pursued that would have changed the outcome."[112] The Court also relied on expert testimony showing that "the defendants did not sacrifice value when selling assets"; that "Oak Hill's large position in the common stock meant that Oak Hill had a counterbalancing incentive not to harm the value of the common stock"; and that "[r]egardless of the defendants' actions, the common stockholders would have received the same value: nothing."[113]

106 *Id.* at *36.

107 *Id.* at *36.

108 *Id.*

109 *Id.*

110 *Id.*

111 *Id.*

112 *Id.* at *37.

113 *Id.* at *41.

The Court concluded that despite the process deficiencies in the implementation of the cash accumulation strategy, "[t]he strategy thus inflicted no harm on the common stockholders, who are in at least as good a position now as they would have been if the Company had followed a different course. In other words, the defendants' actions were entirely fair" under the unitary entire fairness inquiry.[114] Thus, despite the underlying process deficiencies, the ultimate fairness of the result, for stockholders, meant that the cash accumulation strategy "was not a fiduciary wrong" by the defendants.[115]

**_Gallagher Indus., LLC v. Addy_, 2020 WL 2789702 (Del. Ch. May 29, 2020) (Glasscock, V.C.)**

In *Gallagher Industries, LLC v. Addy*,[116] the plaintiff, Gallagher Industries, LLC ("Gallagher"), alleged that the defendants breached their fiduciary duties in connection with a cash-out merger of ISN Software Company ("ISN"). This action was filed after the Delaware Supreme Court affirmed the Court of Chancery's decision in a separate appraisal action brought by two other ISN stockholders, where the Court of Chancery had found the fair value of ISN to be two and half times greater than the merger price.[117] In the *Gallagher* decision, the Court of Chancery, in a post-trial memorandum opinion, found that Gallagher's claim for breach of fiduciary duty was barred by laches because Gallagher was on inquiry notice of its claims over five years before commencing this action.

In 2012, Gallagher, a private equity firm founded by Charles Gallagher, acquired stock in ISN, a privately held Delaware corporation founded by Defendant William Addy. In 2011, before Gallagher acquired any stock in ISN, ISN had obtained a valuation from Peter J. Phalon of Waterview Advisors, Inc. (the "Phalon Valuation"), which valued ISN at $127 million as of June 30, 2011.

In 2012, prior to Gallagher's acquisition of ISN stock, ISN had only one other outside investor, Ad-Venture Capital Partners, L.P. ("Ad-Venture"). Ad-Venture's controller, Brian Addy (William Addy's brother),

114 *Id.* at *43.

115 *Id.*

116 2020 WL 2789702 (Del. Ch. May 29, 2020).

117 *ISN Software Corp. v. Ad-Venture Capital Partners, L.P.*, 173 A.3d 1047 (Del. Oct. 30, 2017) (Table).

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sought to acquire certain ranch properties owned by a Gallagher affiliate (the "Ranch Properties") in exchange for shares of ISN stock. As part of that transaction, Ad-Venture agreed to pay Gallagher the difference between the value of the ISN shares and $5.2 million, should Gallagher ultimately receive less than that amount for the shares.

While negotiating the transaction with Ad-Venture, Gallagher received two valuations that were prepared by or at the direction of Ad-Venture, which valued ISN at $395 million and $450 million. Gallagher did not receive the Phalon Valuation from ISN and did not prepare its own valuation. Ad-Venture ultimately acquired the Ranch Properties from Gallagher in exchange for 155 shares in ISN.

Less than one month later, at a meeting on January 9, 2013, the ISN board resolved to approve a cash-out merger of shares owned by its minority investors at a price of $38,317 per share, which valued ISN at $138 million.

On January 16, 2013, ISN sent the stockholders a notice of their appraisal rights (the "Notice") and supplemented the Notice with certain disclosure documents, including additional financial information. Although the Notice purported to inform the stockholders how ISN calculated the merger consideration, ISN did not provide stockholders with the Phalon Valuation, the company's adjustments to the Phalon Valuation, or the January 9 board meeting minutes, which William Addy testified were all necessary to understand the merger consideration calculation.

Gallagher received the Notice from ISN on January 17, 2013. After reviewing the Notice and documents provided by ISN, Thomas Loftus, Gallagher's president, calculated an informal valuation range of $250 million to $350 million. While Mr. Loftus testified that the difference in his rough calculations and the actual merger consideration raised "concerns," he ultimately decided to trust ISN's management and did not question the valuation further. Mr. Gallagher and Mr. Loftus discussed the fairness of ISN's assigned value, and although they recognized that the valuation may have been low, their main objective was to satisfy Gallagher's investment goals with respect to the sale of the Ranch Properties. The $5.9 million Gallagher would receive under ISN's valuation exceeded the $5.2 million minimum amount that Gallagher expected in exchange for the Ranch Properties. Mr. Gallagher deposited the merger consideration check the same day that Gallagher received the Notice.

Ad-Venture and Polaris Venture Partners, another ISN stockholder which had purchased ISH shares from Ad-Venture, both opted to petition the Court for appraisal of their stock (the "Appraisal Action"). In connection with the Appraisal Action, Gallagher produced documents and Loftus was deposed as Gallagher's representative. The Court ultimately determined that the fair value of ISN was $357 million, or $98,783 per share, and entered its judgment on January 9, 2017. ISN appealed and the Delaware Supreme Court affirmed the Court of Chancery's decision on October 30, 2017.

Gallagher's counsel sent Loftus copies of the Court of Chancery's decision in the Appraisal Action and the Supreme Court's order affirming the Court of Chancery on December 15, 2017. Loftus and Mr. Gallagher stated that they first became aware of the facts supporting Gallagher's breach of fiduciary duty claims after reading those decisions. Gallagher filed its action on February 14, 2018, alleging that William Addy and another ISN director-officer "breached their fiduciary duties by providing false and misleading disclosures regarding the Merger."[118]

Following trial, the Court found that although the defendants had breached their fiduciary duties in connection with the merger, Gallagher "slept on its rights for a half-decade while red flags not only were raised but snapped crisply in the breeze."[119] The Court determined that the defendants' breaches were apparent when Gallagher received the Notice in January 2013, and Gallagher was on inquiry notice at that time. At trial, Loftus stated that he did not believe that the defendants provided adequate information for him to prepare a valuation and that he discussed this concern with Mr. Gallagher when they received the Notice. Loftus' own rough calculations of ISN's value fell between $250 million to $350 million, and while negotiating the sale of the Ranch Properties, Ad-Venture estimated ISN's value to be between $395 million and $450 million. The Court noted that "Gallagher suspected it was being wronged, and knew it had not been provided the information to find out if this was so. That was a red flag that reasonably ought

118 *Gallagher*, 2020 WL 2789702, at *9.

119 *Id.* at *10.

to have alerted it to the possibility that the Merger was unfair, and the disclosures were inadequate, and thus alerted it of potential entire fairness and disclosure-based claims."[120] Once Gallagher received the Notice, it "had an obligation to diligently investigate and was on notice of everything to which such an investigation would have led."[121]

The Court also found that the Appraisal Action provided Gallagher with additional inquiry notice of its claims, noting that "[e]ven casual attention to the public filings would have revealed further red flags to notify Gallagher of the facts underlying this litigation."[122] Therefore, Gallagher's breach of fiduciary duty claim was barred by latches because it was on inquiry notice over three years before it filed this action.

***Morrison v. Berry*, 2020 WL 2843514 (Del. Ch. June 1, 2020) (Glasscock, V.C.)**

In *Morrison v. Berry*,[123] the Court of Chancery granted and denied certain motions to dismiss directed to claims of aiding and abetting breaches of fiduciary duties. The Court dismissed aiding and abetting claims as to three of the four alleged aider and abettor defendants. The opinion emphasizes the high pleading burden applicable to abetting claims—requiring that plaintiffs plead facts making it reasonably conceivable that the aider and abettor acted with scienter, in order to withstand a motion to dismiss. The case also serves as a reminder of the importance of disclosing potential advisor conflicts to boards in connection with sale transactions. As to the one alleged aider and abettor for which the Court denied a motion to dismiss—a target board's financial advisor—the Court concluded the plaintiff had satisfied its high pleading burden to demonstrate scienter.

The claims arose from a going-private transaction involving Fresh Market, Inc. ("Fresh Market"). Prior to the transaction, Fresh Market's CEO, Ray Berry, together with his son Brett Berry (together, the "Berrys"), held 9.8% of the company's equity. The going-private transaction involved the acquisition of Fresh Market by Apollo Management VIII, L.P. ("Apollo" or the "Apollo Defendants"),[124] with a rollover of the Berrys' existing equity in Fresh Market so that post-transaction the Berrys' owned approximately 22% of the company's equity. J.P. Morgan served as Fresh Market's financial advisor and Cravath, Swaine & Moore, LLP ("Cravath") served as the company's counsel in connection with the transaction. The plaintiff alleged breach of fiduciary duty claims against the Fresh Market officers and directors who negotiated and approved the transaction and alleged claims for aiding and abetting against Brett Berry, Apollo, J.P. Morgan, and Cravath.

The litigation had an extensive history leading up to the Court's ruling on the aiding and abetting claims. In an earlier opinion, following a remand from the Delaware Supreme Court, the Court of Chancery granted in part and denied in part motions to dismiss the plaintiff's claims for breaches of fiduciary duty against the officer and director defendants. The Court of Chancery reserved judgment on the aiding and abetting claims.

In the instant opinion, ruling on the aiding and abetting claims for which it earlier reserved judgment, the Court denied the motion to dismiss filed by J.P. Morgan, but granted the motions to dismiss filed by Brett Berry, Apollo, and Cravath.

With respect to the aiding and abetting claim asserted against J.P Morgan, the Court cited the Delaware Supreme Court's decision in *RBC Capital Markets, LLC v. Jervis*[125] for the proposition that aiding and abetting liability may attach where a board "advisor, with the requisite scienter, caused the board to act in a way that made the transaction process itself unreasonable, under the situational reasonableness standard announced in *Revlon* and its progeny."[126] "In

120 *Id.*

121 *Id.* at *14.

122 *Id.* at *15.

123 2020 WL 2843514 (Del. Ch. June 1, 2020).

124 As noted in the Court's opinion, the Apollo Defendants are comprised of fifteen entities. For ease of reference, this summary refers to all fifteen entities collectively as "Apollo" or the "Apollo Defendants."

125 129 A.3d 816 (Del. 2015).

126 *Morrison*, 2020 WL 2843514 at *9 (citing *RBC Cap. Mkts., LLC v. Jervis*, 129 A.3d 816, 849-50 (Del. 2015)). Under *Revlon, Inc. v. MacAndrews & Forbes Hldgs., Inc.*, 506 A.2d 173 (Del. 1986), and its progeny, in the context of a sale of a company, "the defendant fiduciaries bear the burden of proving that they 'act[ed] reasonably to seek the transaction offering the best value reasonably available to the stockholders,' which could be remaining independent and not engaging in any transaction at all." *In re Rural Metro Corp. S'holder Litig.*, 88 A.3d 54, 83 (Del. Ch. 2014) (quoting *Paramount Commc'ns Inc. v. QVC Network Inc.*,

other words, where a conflicted advisor has prevented the board from conducting a reasonable sales process, in violation of the standard imposed on the board under *Revlon*, the advisor can be liable for aiding and abetting that breach without reference to the culpability of the individual directors."[127] Thus, even if the board acted in good faith and in reliance on its advisors, the advisor can be liable for aiding and abetting a breach of fiduciary duty.

Applying the *RBC* standard, the Court of Chancery denied J.P. Morgan's motion to dismiss. The first step in determining whether J.P. Morgan could be liable for aiding and abetting a breach of fiduciary duty was to evaluate whether Fresh Market's board failed to ensure that the transaction complied with *Revlon*. Before the board made a decision on the transaction, J.P. Morgan provided the board with a memorandum in which it discussed J.P. Morgan's relationship with Apollo and represented that the J.P. Morgan senior deal team members assigned to the transaction were not providing services to Apollo and were not members of the J.P. Morgan coverage team for Apollo. J.P. Morgan did not disclose that during the negotiations between the company and Apollo, Apollo's client executive at J.P. Morgan was communicating with both the J.P. Morgan deal team and Apollo and was "feeding inside information on the bid process to Apollo" and advocating for Apollo.[128] The Court found that, while the board's acceptance of J.P. Morgan's conflict disclosure without asking probing questions of J.P. Morgan on potential conflicts may not have been in bad faith or a breach of the directors' duty of loyalty, there was a reasonable inference that "the Board's failure to comprehend its financial advisor's conflict of interest with the sole bidder conceivably breached duties imposed in the *Revlon* context."[129]

Having found that the plaintiff sufficiently pled that the board failed to comply with its *Revlon* duties, the Court turned to evaluate whether the plaintiff pled facts from which it could be inferred that J.P. Morgan aided and abetted such a breach. The Court concluded that the plaintiff had adequately alleged that J.P. Morgan failed to disclose to the board that it had engaged in the back-channel communications with Apollo, which back-channel communications the Court inferred "influenced the bid process in Apollo's favor."[130] This fact supported the inference that "J.P. Morgan intentionally disguised its communications with Apollo and thus knowingly deceived the Board about its ongoing conflicts[,]" which, if proven on a full record, could establish the scienter requirement of an aiding and abetting claim.[131] The Court also found that the plaintiff adequately pled that J.P. Morgan aided and abetting disclosure violations that constituted a breach of the duty of care. The Court explained that had J.P. Morgan disclosed to the board the back-channel communications, the company could have disclosed the same in its proxy statement and that it was plausible that the company's stockholders would have found that information to be material.

With respect to Cravath, the plaintiff asserted aiding and abetting claims for Cravath's purported assistance in the preparation of an allegedly misleading 14D-9. The Court had in its previous opinion already ruled that the plaintiff had failed to plead that the board intentionally issued a misleading proxy statement. Therefore, the plaintiff was left to make the "difficult argument that Cravath *intentionally and knowingly* caused the Board to *carelessly* draft and release a 14D-9 with material facts omitted."[132] Zeroing in on the scienter requirement, the Court noted that a claim for aiding and abetting "requires adequately pleading actions in bad faith through which the aider knowingly advanced the breach."[133] In an effort to establish that Cravath drafted the allegedly misleading 14D-9 intentionally and knowingly, the plaintiff pointed to Cravath's large transaction fee and significant amount of time spent to determine the content of the 14D-9. These allegations, the Court held, could not establish the requisite scienter—"merely pointing to a fee contingent on closing cannot support a claim for intentional bad-faith aiding and abetting on the part of the lawyers."[134] The Court stated that a "contingent fee and hard work on the proxy are unremarkable."[135]

As to Apollo, the plaintiff's aiding and abetting claims were founded on a predicate breach of fiduciary duty by Fresh Market CEO Ray Berry. In its earlier opinion, ruling on claims for breach of fiduciary duty against the

637 A.2d 34, 43(Del. 1994)).

127 *Morrison*, 2020 WL 2843514 at *9.

128 *Id.* at *5.

129 *Id.* at *10.

130 *Id.*

131 *Id.*

132 *Id.* at *11

133 *Id.*

134 *Id.*

135 *Id.*

officer and director defendants, the Court concluded that the plaintiff had stated a claim for breach of fiduciary duty against Ray Berry for his "'silence, falsehoods, and misinformation' about his relationship with Apollo in a way that conceivably harmed the Company."[136] But despite this well-pled predicate fiduciary breach by Ray Berry, the Court did not find sufficient allegations of scienter by Apollo to support the plaintiff's aiding and abetting claim. The Court emphasized that the plaintiff failed to allege that "Apollo knew Ray Berry withheld from the board the fact that Apollo had approached him."[137] To the contrary, "Apollo informed the Board no less than *five times* that it had partnered with the Berrys."[138] Thus, given Apollo's repeated disclosures that it contemplated a transaction that involved the Berrys' equity rollover, the Court held it could not "reasonably infer that Apollo knowingly advocated or assisted Ray Berry's deceptive communications with the Board."[139]

The Court again found the necessary scienter pleading requirement unsatisfied with respect to the aiding and abetting claims against Brett Berry. Brett Berry had moved to dismiss the aiding and abetting claims against him, both for lack of personal jurisdiction and for failure to state a claim. The plaintiff alleged that Brett Berry could be subject to personal jurisdiction in Delaware under the conspiracy theory of personal jurisdiction set forth in *Istituto Bancario Italiano SpA v. Hunter Engineering Co.*[140] But for Berry to be subject to personal jurisdiction under the conspiracy theory, the Court stated that the plaintiff must show that Brett Berry "knew or had reason to know" of the conspiracy.[141] Here again, the Court concluded the plaintiff's allegations fell short. The Court emphasized that while Brett Berry may have actively participated in securing the rollover opportunity in the transaction, the plaintiff failed to allege that "Brett Berry knew of his father's fiduciary breaches and intentionally aided him in those breaches."[142] Thus, the Court concluded that the plaintiff's allegations were insufficient to establish the scienter necessary to support an aiding and abetting claim and, therefore, the plaintiff failed to establish the predicate conspiracy necessary to support personal jurisdiction over Brett Berry.

136 *Id.* (quoting *Morrison v. Berry*, 2019 WL 7369431, at *22 (Del. Ch. Dec. 31, 2019)).

137 *Id.*

138 *Id.* (emphasis in original).

139 *Id.*

140 449 A.2d 210 (Del. 1982).

141 *Morrison*, 2020 WL 2843514 at *13.

142 *Id.* at *14.

### *Massari v. Meyers*, 2020 WL 2501435 (Del. May 14, 2020)

In *Massari v. Meyers*,[143] the Delaware Supreme Court affirmed the Court of Chancery's bench ruling dismissing plaintiff's complaint challenging the sale of First Marblehead Corp. ("First Marblehead") to its CEO's "buddy."[144] The Court of Chancery held that, although the plaintiff had alleged that First Marblehead's CEO co-owned a yacht with the company's acquirer—which created a "fulcrum of concern" about the transaction—the plaintiff failed to allege facts challenging the effectiveness of the special committee that was set up to "cleanse" the transaction.

According to the complaint, facing a $45 million judgment against him, First Marblehead's CEO caused the company to be sold (the "Buyout") to an entity controlled by the CEO's close friend and business partner, as evidence by their co-ownership of a $30 million yacht. The plaintiff also alleged that, prior to the Buyout, First Marblehead was controlled by a group that included both the CEO and his close friend. Because of the $45 million judgment and the corresponding liquidity need, the CEO allegedly decided to sell the company on the cheap, thereby benefitting his friend at the expense of public stockholders while the CEO received lucrative compensation and satisfied his liquidity need.

The plaintiff did not dispute that the First Marblehead board set up a special committee of independent directors to oversee the process leading to the Buyout. Initially, the committee did not invite the CEO's friend to participate in the process, but after an initial round of outreach to prospective buyers proved unfruitful, the CEO suggested reaching out to his friend. The committee agreed, and the CEO's friend proposed a transaction. The committee then "assert[ed] control over the process," including by conducting "a second market check" to entertain potential topping bids.[145]

143 2020 WL 2501435 (Del. May 14, 2020).

144 *Id.* (citing *Massari v. Meyers*, C.A. No. 2019-0017-JTL, at 71 (Del. Ch. Oct. 29, 2019) (TRANSCRIPT) (hereinafter "Tr.")).

145 Tr. at 74.

When no topping bid emerged, the committee recommended the Buyout, and the board unanimously approved it (a majority of stockholders also approved). As part of the transaction, the CEO remained in his position while receiving a substantial equity award as a severance payment.

The plaintiff alleged multiple breaches of fiduciary duties stemming from the Buyout's allegedly unfair price and numerous conflicts of interest. The plaintiff argued the Court should review the transaction under the entire fairness standard or enhanced scrutiny standard due to the existence of a control group consisting of the CEO, his friend, and other stockholders who had ties to the CEO.

The Court of Chancery dismissed the complaint for two primary reasons. First, the Court rejected the plaintiff's theory that the CEO and other stockholders constituted a control group because the complaint failed to sufficiently plead a control group as required by Delaware law. While the Court did not elaborate on why it found the allegations insufficient or upon what Delaware law it relied to reach that conclusion, the defendants had argued that the Complaint failed to plead that the alleged members of the group were "connected in a legally significant way" by any agreement to act in concert or to exercise control jointly.[146]

Second, the Court rejected the plaintiff's argument that, under the enhanced scrutiny standard of review, "the actions of the board [in pursuing the Buyout] failed to fall within a range of reasonableness."[147] The Court characterized this argument as "the core issue that animates th[e] case," explaining that, "where a co-founder and CEO who is under financial pressure allegedly orchestrates the sale of the company to his good buddy . . . [t]hat's the type of thing that creates a fulcrum of concern."[148] Despite that concern, the Court found that the plaintiff had not "pointed to facts about the sale process which suggest that the CEO acted in a way that this conflict of interest caused [the sale process] to go outside the range of reasonableness."[149] In other words, the plaintiff "failed to allege facts that would make it reasonably conceivable that the involvement of the independent directors did not address the problem and cleanse the conflict."[150]

The Court of Chancery's ruling, affirmed by the Delaware Supreme Court, reinforces the principle that, in a sale transaction where conflicts of interest exist, Delaware courts will nonetheless defer to the judgment of independent directors approving that transaction if no reason is given to question those directors' independence and competence in evaluating the transaction.

***In re Dell Techs. Inc. Class v. S'holders Litig.*, 2020 WL 3096748 (Del. Ch. June 11, 2020) (Laster, V.C.)**

In *In re Dell Technologies Inc. Class V Stockholders Litigation*,[151] the Delaware Court of Chancery denied a motion to dismiss the plaintiffs' claims that Michael Dell ("Mr. Dell."), the founder of Dell Technologies Inc. ("Dell"), Silver Lake Group LLC ("Silver Lake"), a Dell stockholder, and four Dell directors breached their fiduciary duties to Dell's Class V stockholders in connection with a stock redemption. The Court held that it was reasonably conceivable that the transaction at issue lacked multiple stockholder protections outlined by the Delaware Supreme Court in *Kahn v. M & F Worldwide Corp.* ("*MFW*")[152] and that, therefore, the transaction was not entitled to business judgment deference.

In 2013, Mr. Dell and Silver Lake took the predecessor company, Dell, Inc. private in a leveraged buyout. Mr. Dell controlled 73% and Silver Lake controlled 23% of Dell's voting power. In 2016, Dell acquired EMC Corporation ("EMC"). One of EMC's most valuable assets at the time of that acquisition was its ownership of 81.9% of the equity in VMware, Inc. ("VMware"). As part of the EMC acquisition, Dell issued Class V common stock that would trade publicly and track the value of Dell's ownership interest in VMware. These Class V shares were subject to a "Forced Conversion" right. That is, if Dell listed its Class C shares on a national exchange, then Dell had the right to convert the Class V shares into Class C shares according to a pricing formula. Allegedly due to this Forced Conversion right, along with Mr. Dell's negative history with public stockholders, the Class V shares

146 *Id.* at 8.

147 *Id.* at 70.

148 *Id.* at 72.

149 *Id.* at 72-73.

150 *Id.* at 75.

151 2020 WL 3096748 (Del. Ch. June 11, 2020).

152 88 A.3d 635 (Del. 2014).

traded at a discount of approximately 30% to VMware's publicly traded common stock. The complaint referred to this as the "Dell Discount."[153]

In 2017, Dell began to explore ways it could consolidate its ownership of VMware. Three avenues became apparent: (i) a transaction with VMware, (ii) a redemption of the Class V stock, or (iii) a Forced Conversion. In January 2018, Dell decided to pursue a redemption of the Class V stock. Dell's board of directors conditioned any redemption on both committee approval and approval from a majority of the outstanding Class V stockholders.

The Dell board tasked an existing three-person committee with negotiating a redemption of the Class V stock. However, the authority delegated to the committee did not include decisions as to a Forced Conversion. Three months into the negotiation, and after discussions of value, the committee determined that one of its members was conflicted. The Dell board then created a new special committee, consisting of the two other members of the prior committee, and delegated the same authority to the new special committee.

Dell and the committee negotiated a redemption of the Class V shares. After multiple back-and-forth offers, Dell made its "best and final offer." The committee recommended accepting this offer (the "Committee-Sponsored Redemption").

After large holders of Class V stock objected to the Committee-Sponsored Redemption, Dell turned to negotiating directly with certain Class V stockholders instead of continuing to negotiate with the special committee. At the same time, Dell moved forward with plans for a Forced Conversion. Dell and the Class V stockholders reached an agreement more favorable to Class V stockholders than the Committee-Sponsored Redemption (the "Stockholder-Negotiated Redemption").

The committee was aware that the negotiations with stockholders were taking place, but unaware of the result, the committee proposed a redemption transaction at a per-share price higher than the Stockholder-Negotiated Redemption. Dell ignored the committee's proposal. One week later, Dell informed the committee about the Stockholder-Negotiated Redemption. The same night, the special committee met and approved the Stockholder-Negotiated Redemption. The board approved the Stockholder-Negotiated Redemption immediately thereafter.

During a special meeting of the Class V stockholders, holders of 61% of the outstanding Class V shares approved the Stockholder-Negotiated Redemption. Two weeks later, the transaction closed.

Former holders of Class V stock filed this litigation, alleging that Mr. Dell, Silver Lake, and the members of Dell's board breached their fiduciary duties in negotiating and approving the Stockholder-Negotiated Redemption. The defendants filed a motion to dismiss for failure to state a claim, arguing that the transaction was subject to business judgment protection because it met the *MFW*'s six conditions:

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

The Court concluded that, accepting the plaintiffs' allegations as true, it was reasonably conceivable that the transaction did not meet at least four of the *MFW* requirements.

The Court first held that it was reasonably conceivable that the transaction did not meet *MFW*'s first condition. "[C]ritical for the application of the business judgment rule is that the controller accept that no transaction goes forward without special committee and disinterested stockholder approval."[154] The Dell board did not delegate authority relating to the Forced Conversion right to the special committee. Without the authority to say no to this alternative, the committee could not

153 *Dell Class V S'holders Litig.*, 2020 WL 3096748, at *5.

154 *Id.* at *15.

prevent the controller from "achieving [his desired] end" through "alternative means."[155] Moreover, the special committee's role under the *MFW* framework is to "act as the bargaining agent for the minority stockholders, with the minority stockholders rendering an up-or-down verdict on the committee's work."[156] The Court reasoned that when the Class V stockholders objected to the Committee-Negotiated Redemption, "the committee's role [was not] over. . . . . [T]he committee must return to the bargaining table, continue to act in its fiduciary capacity, and seek to extract the best transaction available."[157] The Court concluded that "*MFW*'s dual protections contemplate that the Special Committee will act as the bargaining agent for the minority stockholders, with the minority stockholders rendering an up-or-down verdict on the committee's work. Those roles are complements, not substitutes. A set of motivated stockholder volunteers cannot take over for the committee and serve both roles."[158]

The Court then held that it was reasonably conceivable that the transaction did not satisfy the sixth condition for *MFW* protection—that "there is no coercion of the minority."[159] The Court took the opportunity to delve deep into what it deemed to be five "strands" of coercion found in the case law.

This first strand involves a non-fiduciary in a contractual setting. The Court rejected the position taken by many defense counsel that *Katz v. Oak Industries, Inc.*[160] establishes a high bar for finding coercion in transactions: "*Katz* did not involve fiduciaries or an alleged breach of fiduciary duty, and it is not an apt source of authority for the fiduciary relationship. As discussed below, under strands of coercion jurisprudence involving fiduciaries, transaction structures resembling the offers in *Katz* are treated as coercive."[161] The second strand involves a *Unocal*[162] setting, where a fiduciary responds to threatened coercion from a third party. The Court found that neither the first nor the second strand applied to the present case.

The remaining three strands involve coercion by a fiduciary and look to whether "the fiduciary has taken action which causes stockholders to act—whether by voting or making an investment decision like tendering shares—for some reason other than the merits of the proposed transaction."[163]

The third strand is direct coercion by a fiduciary. "The operative test for this strand of coercion is whether the fiduciary has taken action which causes stockholders to act—whether by voting or making an investment decision like tendering shares—for some reason other than the merits of the proposed transaction . . . . [I]f the stockholders can reject the transaction and maintain the status quo, then the transaction is not coercive."[164]

The fourth strand of coercion is unique to otherwise cleansing stockholder votes and involves less direct forms of coercion, specifically, in the Court's terms, "situational" and "structural" coercion.[165] Structural coercion occurs when the structure of the transaction itself forces stockholders to endorse an unfair portion of the transaction in order to receive benefits from another portion of the transaction. Situational coercion occurs when the company's or the controller's past malfeasance create a status quo situation that is unattractive for stockholders, coercing them to choose the lesser evil of the transaction. With either form, "if a plaintiff can identify a reasonably conceivable basis to doubt that the stockholders made [the] determination [that the transaction was in their own best interests,] then the vote should not be given cleansing effect."[166]

The fifth strand of coercion is in the context of a special committee and occurs when "a controller's explicit or implicit threats . . . prevent a committee from fulfilling its function[.]"[167]

Applying the tests of the various strands of coercion to the approved Stockholder-Negotiated Redemption, the Court concluded that the plaintiffs adequately alleged the existence of the third through fifth forms of coercion. The plaintiffs alleged that Dell

155 *Id.* at *16.

156 *Id.* at *17.

157 *Id.* at *18.

158 *Id.* at *17.

159 *Id.* at *15.

160 508 A.2d 873 (Del. Ch. 1986).

161 *Dell Class V S'holders Litig.*, 2020 WL 3096748, at *21. The Court noted that as a result of defendants' counsel reliance on *Katz* in other cases, "many decisions involving claims for breach of fiduciary duty cite *Katz*." *Id.* at *21.

162 *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

163 *Dell Class V S'holders Litig.*, 2020 WL 3096748, at *25.

164 *Id.*

165 *Id.*

166 *Id.* at *29.

167 *Id.*

repeatedly made statements to the committee and the public suggesting its intent to exercise its Forced Conversion right, an unfavorable alternative from the perspective of the Class V stockholders. Based upon the allegations in the complaint, the Court held that it was reasonably conceivable that this threat could induce the stockholders to approve an unfair redemption transaction for reasons other than the merits of the transaction. The status quo could not be maintained by rejecting the redemption offer if Dell would move forward with the Forced Conversion. The complaint's allegations also supported a reasonable inference that the stockholders faced situational coercion. Their status quo was owning stock the value of which was subject to an alleged "Dell Discount," and therefore, they faced "an impossible choice between an unappealing status quo and an alternative which, although unfair, was better than their existing situation."[168]

The complaint also alleged that the members of the Special Committee, like the Class V stockholders, were cognizant of the threatened Forced Conversion when negotiating with the company. The Court held that based on the complaint's allegations, it was reasonably conceivable that Dell's retention and threat of the Forced Conversion right undermined the committee's authority and negotiating power.

The Court held that these circumstances of alleged coercion negated the *MFW* protections Dell had attempted to put in place.

The Court next held that the complaint pled facts making it reasonably conceivable that the second *MFW* condition—independence of the special committee—was satisfied. The Court found that the plaintiffs sufficiently alleged that neither of the two members of the special committee were independent. With respect to one special committee member, the Court determined that the complaint's allegations that the special committee member's close business ties to Mr. Dell and Silver Lake—including the special committee member being one of three partners in a company that has invested in six companies associated with Mr. Dell and Silver Lake—and his close social ties to the managing partner of Silver Lake—including both belonging to "two of the world's most exclusive and secretive private clubs" and playing together at amateur golf tournaments—"taken as a whole," made it reasonably conceivable that his relationship with Mr. Dell and Silver Lake "compromised his ability to engage in hard-nosed bargaining as a member of the Special Committee."[169]

The Court also found that the complaint sufficiently pled that the other special committee member was not independent because of his "thirty-year friendship and business association with" one of Mr. Dell's closest friends who acted as Dell's "senior advisor" in connection with the events leading up to the Stockholder-Negotiated Redemption.[170] The Court rejected the defendants' argument that the special committee member's relationship with Mr. Dell's friend was irrelevant because the friend was not Mr. Dell or Silver Lake, stating that the "defendants fail to cite any authority that requires a director to have a compromising relationship with the controller himself as opposed to a close advisor or other associate."[171] The Court explained that "[d]rawing such a distinction makes little sense when the advisor acts as the controller's agent."[172] The special committee member "was supposed to be representing the Class V stockholders as their independent bargaining agent in a transaction where . . . his . . . long-time close friend [and business associate] . . . was advising the Company and Mr. Dell on the other side of the negotiating table."[173]

Finally, the Court held that it was reasonably conceivable that the transaction did not meet *MFW*'s fifth condition—a fully-informed vote of the minority. The Court found that the complaint adequately alleged that the proxy statement and supplement issued in connection with the transaction omitted material information or was materially misleading and that, therefore, the stockholder vote was not fully informed. The Court found that it was reasonably conceivable that the proxy statement and supplement excluded material information by not disclosing (i) the special committee's final proposal price, (ii) a valuation the company received three months before the special committee approved the Committee-Sponsored Redemption that allegedly implied a higher price per Class V share than was reflected in the Committee-Sponsored Redemption and the Stockholder-Negotiated Redemption, and (iii)

168 *Id.* at *32.

169 *Id.* at *36.

170 *Id.* at *37.

171 *Id.*

172 *Id.*

173 *Id.*

the compensation arrangement of an advisor to the special committee where the advisor was a "one-person firm operated by someone whose entities had a history of financial difficulties."[174] The Court also found that it was reasonably conceivable that the proxy statement and supplement were materially misleading in describing that same advisor as an "independent industry expert" even though, the Court found, the complaint adequately alleged that he lacked experience.

Without *MFW* protections for the redemption transaction, the Court held that the transaction would be subjected to the entire fairness standard of review. The defendants' motions to dismiss did not address failure to plead a claim in the context of entire fairness, and so the Court denied the motions.

***Brokerage Jamie Goldenberg v. Breyer*, 2020 WL 3484956 (Del. Ch. June 26, 2020) (Bouchard, C.)**

In *Brokerage Jamie Goldenberg v. Breyer*,[175] the Court of Chancery granted the defendants' motion to dismiss the complaint where the plaintiff did not have standing to bring derivative claims on behalf of a corporation because it was not a stockholder of that corporation at the time of the challenged conduct.

This case involved a two-step transaction between Twenty-First Century Fox, Inc. ("Old Fox") and The Walt Disney Company ("Disney") (the "Disney Transaction"). In the first step, Old Fox spun off certain assets to Fox Corporation ("New Fox"), and in the second step, Old Fox sold its remaining assets to Disney. Before the transaction closed, the plaintiff, a holder of Class A common stock in Old Fox, brought a derivative action on behalf of Old Fox alleging breaches of fiduciary duty, unjust enrichment, and waste claims in connection with incentive stock awards that were approved for certain key employees in anticipation of the Disney Transaction. The plaintiff amended its complaint after the Disney Transaction closed, dropping its waste claim and bringing its breach of fiduciary duty and unjust enrichment claims directly on behalf of a putative class of Old Fox stockholders or, in the alternative, derivatively on behalf of New Fox.

The defendants, James W. Breyer, Roderick I. Eddington, James R. Murdoch, K. Rupert Murdoch, Lachlan K. Murdock, Jacques Nasser and Robert S. Silberman, served on the Old Fox board. Rupert, Lachlan and James Murdoch (the "Murdochs") also served as officers of Old Fox. After several months of negotiations with Disney, in December 2017, the Old Fox board determined that Old Fox would proceed with the Disney Transaction. Later that month, the Old Fox Compensation Committee held a call to discuss compensation terms by which certain executives would receive a special grant of restricted stock units ("RSUs") and their performance stock unit ("PSU") awards for the 2016-2018 period would be modified (the "Compensation Terms"). The Compensation Committee ultimately determined that it would support including the Compensation Terms in the merger agreement to be considered by the Old Fox board in connection with the Disney Transaction.[176]

On December 13, 2017, Disney and Old Fox entered into a merger agreement.[177] On February 20, 2018, the Compensation Committee formally approved the Compensation Terms, which included the issuance of 1,943,650 RSUs to certain key employees, 1,500,473 of which were issued to the Murdochs. Old Fox characterized the RSU award as "part of a Company-wide retention program designed to incentivize key employees who might consider leaving Old Fox and its successors due to uncertainty about their future roles to continue their employment through the completion of the [Disney Transaction] and for a period of time thereafter."[178] The Compensation Committee also approved the modification of the PSU award, which provided that the participants in the PSU award program would receive a payout set at a particular performance level.[179] Based on the closing price of Old Fox Class A common stock on the date the Compensation Committee approved the Compensation Terms, the plaintiff alleged that the Murdochs would receive RSUs and PSUs valued at approximately $82.4 million through the approval of the Compensation Terms.[180]

The defendants moved to dismiss the complaint pursuant to Court of Chancery Rules 12(b)(6) and 23.1, arguing that (1) the plaintiff's claims were derivative in nature and therefore the plaintiff did not

174 *Id.* at *40.

175 2020 WL 3484950 (Del. Ch. June 26, 2020).

176 *Id.* at *3.

177 *Id.*

178 *Id.*

179 *Id.* at *4.

180 *Id.* at *5.

have standing to bring claims on behalf of New Fox because it was not a stockholder of New Fox at the time the Compensation Terms were approved; (2) the plaintiff failed to make a pre-suit demand on the New Fox board or plead demand futility; and (3) regardless of whether the claims are direct or derivative, the plaintiff failed to state a claim for relief.[181]

The Court found that the plaintiff's claims were derivative in nature and therefore the plaintiff lacked standing to bring them on behalf of New Fox.[182] The Court noted that under the Delaware Supreme Court's decision in *Parnes v. Bally Entertainment Corp.*, "[a] stockholder who directly attacks the fairness or validity of a merger alleges an injury to the stockholders, not the corporation" and therefore may still bring a breach of fiduciary duty claim even if its stockholder status was extinguished by the merger.[183] However, after examining *Parnes* and other notable and related decisions by Delaware courts,[184] the Court found that the plaintiff's claims were derivative "because the Complaint fail[ed] to plead adequately that Defendants caused the terms of the [Disney] Transaction to be tainted by unfair dealing."[185]

Unlike *Parnes* and its progeny, the approval of the Compensation Terms did not "solely benefit a putative controller or a key fiduciary" but instead were broader in scope.[186] The Complaint also did not allege any causal link between the Murdoch's receipt of the RSUs and PSUs and any unfair dealing in connection with the Disney Transaction. Nor did it allege that the Murdochs refused to support the transaction unless the Compensation Terms were approved. Finally, the amount of money that the Murdochs received through the Compensation Terms (approximately $82.4 million) was one-tenth of one percent of the total consideration received by Old Fox stockholders, and was therefore immaterial in the context of Disney Transaction. The Court found "nothing in the Complaint to support the notion that Defendants tainted the sale process or the negotiations of the Transaction such that they caused anything to be taken off the table that otherwise would have gone to all of Old Fox's stockholders" and therefore it found the plaintiff's claims to be derivative in nature.[187]

Because the complaint only stated derivative claims on behalf of New Fox, the plaintiff did not have standing to bring the claims because it was not a stockholder in New Fox at the time the Compensation Committee approved the Compensation Terms. The plaintiff argued that, despite not owning shares in New Fox at the time of the alleged wrongdoing, it should be able to pursue its claims derivatively on behalf of New Fox because the Disney Transaction "effected a reorganization of Old Fox" and therefore fell under the reorganization exception to the continuous ownership requirement.[188] The Court noted that the reorganization "exception applies where the 'surviving entity is merely the same corporate structure under a new name,'" and does "not apply to a transaction that was 'the result of a merger of two distinct corporations each of which had separate

181 *Id* at *6.

182 *Id.* at *7.

183 *Id.* at *8 (quoting *Parnes v. Bally Ent.*, 722 A.2d 1243, 1245 (Del. 1999)).

184 *Id.* at *8-11 (discussing *Kramer v. Western Pacific Indus., Inc.*, 546 A.2d 348 (Del. 1988), *Golaine v. Edwards*, 1999 WL 1271882, (Del. Ch. Dec. 21, 1999), *Tooley v. Donaldson, Lufkin & Jenretee, Inc.*, 845 A.2d 1031 (Del. 2004), *Houseman v. Sagerman*, 2014 WL 1600724 (Del. Ch. Apr. 16, 2014), *In re Straight Path Commc'ns*, 2018 WL 3120804 (Del. Ch. June 25, 2018)).

185 *Id.* at *11.

186 *Id.*

187 *Id.* at *13. The plaintiff also argued that it stated a direct claim based on a provision in Old Fox's certificate of incorporation that provided that the holders of Class A Common Stock and Class B Common Stock would receive "substantially identical per share consideration" in the event of a merger. *Id.* The plaintiff argued that the Murdochs, Class B holders, received greater consideration in connection with the Disney Transaction. However, all stockholders received the same per share consideration in connection with the Disney Transaction, and the plaintiff did not explain how the award of RSUs and PSUs could be considered "per share consideration" in connection with the Disney Transaction. Therefore, the plaintiff did not state a claim that the Compensation Terms violated Old Fox's certificate of incorporation.

188 *Id.* at *14 There are two exceptions to the "well-settled Delaware law" that "stockholders of Delaware corporations must hold shares not only at the time of the alleged wrong, but continuously thereafter throughout the litigation in order to have standing to maintain derivative claims, and will lose standing when their shares as stockholders of the company is terminated as a result of a merger." *Id.* at *14 (quoting *In re Massey Energy Co. Deriv. & Class Action Litig.*, 160 A.3d 484, 497-98 (Del. Ch. 2017)). One exception is where "the merger itself is the subject of a claim of fraud, being perpetrated merely to deprive stockholders of the standing to bring a derivative action." *Id.* (quoting *Lewis v. Ward*, 852 A.2d 896, 902 (Del. 2004)). The other exception is where "the merger is in reality merely a reorganization which does not affect plaintiff's ownership in the business enterprise." *Id.* (quoting *Lewis*, 852 A.2d at 902).

boards, officers, assets and stockholders.'"[189] The Court found that the plaintiff did not satisfy this exception because New Fox was "vastly different" than Old Fox—New Fox only had a portion of Old Fox's assets and related liabilities.[190] Because the plaintiff did not have standing to bring derivative claims on behalf of New Fox, the Court granted the defendants' motion to dismiss with prejudice.

### *City of Fort Myers General Emps.' Pension Fund v. Haley*, 2020 WL 3529586 (Del. June 30, 2020)

In *City of Fort Myers General Employees' Pension Fund v. Haley,*[191] the Delaware Supreme Court held the Court of Chancery had erred in granting a motion to dismiss a breach of fiduciary duty claim against an inside director where the director was alleged to have, during the course of merger negotiations, failed to disclose material information to the board—specifically, an allegedly "massive" compensation proposal with the post-merger company. While the business judgment rule presumptively applied in this action, the Supreme Court determined that the plaintiffs' allegations had successfully rebutted the presumption. In ruling, the Supreme Court clarified the applicable "materiality" standard and determined that a reasonable board member would have regarded the insider director's material interest in the compensation proposal as a significant fact in evaluating the merger.

In the wake of the 2008 economic crisis, Willis Group Holdings Public Limited Company ("Willis") posted flat earnings, experienced operating margin contraction, and was highly leveraged. ValueAct Capital Management, L.P. ("ValueAct"), which held over ten percent of Willis's outstanding shares by late 2014 and sought to salvage its investment, encouraged Willis to consider strategic alternatives. ValueAct recommended a break-up of Willis or a business combination with Towers Watson & Co. ("Towers"), "which had a robust financial history and outlook that could benefit Willis."[192]

Beginning in January 2015, Dominic Casserley ("Casserley"), CEO of Willis, and John J. Haley ("Haley"), CEO and Chairman of Towers, engaged in discussions about a possible business combination between Willis and Towers. In late March 2015, Haley allegedly unilaterally caused Towers to enter into a nondisclosure agreement with Willis without informing the Towers Board, and on May 3, 2015, Haley hired a financial advisor for Towers. On May 4, 2015, Haley convened Towers' board of directors (the "Towers Board") to discuss the potential merger for the first time. Prior to this meeting, Haley had only apprised one member of the Towers Board, Linda Rabbitt ("Rabbitt"), of his discussions with Casserley.

"Haley originally proposed that Towers own the larger proportion of the post-merger company based on Towers' greater market capitalization."[193] At the time, Towers had recently experienced positive quarterly earnings whereas Willis had recently suffered an investment ratings downgrade from Moody's and missed certain earnings targets. "Willis, however, proposed the ownership should be based on certain financial metrics, which would result in Willis's stockholders owning the majority of the combined entity."[194]

On May 14, 2015, Rabbitt contacted a Willis executive "to propose that Haley serve as CEO of the post-merger entity."[195] On May 15, 2015, the Towers Board convened and "effectively left the task of negotiating the Merger to the now-conflicted Haley."[196] Later that month, Haley and Casserley continued discussing the various terms of the transaction, including: (i) the possibility of a pre-merger special dividend totaling $500 million to Towers stockholders to bridge certain financial gaps between the two companies; (ii) the post-merger board composition, and (iii) "an exchange ratio based on the 60-day volume weighted average price ("VWAP") of the shares that would result in Willis's stockholders owning approximately 51 percent of the combined company and Towers' stockholders owning the remaining 49 percent."[197]

189 *Id.* at *15 (quoting *Bonime v. Biaggini*, 1984 WL 19830, at *2-3 (Del. Ch. Dec. 7, 1984)).

190 *Id.*

191 2020 WL 3529586 (Del. June 30, 2020).

192 *Id.* at *3.

193 *Id.*

194 *Id.*

195 *Id.*

196 *Id.*

197 *Id.* at *4.

Haley and Casserley continued to exchange offers, with Haley submitting, on June 7, 2015, an offer that included a $4.87 per-share special dividend for a total of $337 million, with Willis's stockholders owning 51 percent of the combined company and Towers' stockholders owning the remaining 49 percent. On June 10, 2015, Haley and Casserley agreed to the merger on these terms. Haley allegedly made this agreement without the approval of the Towers Board, without the assistance of Towers' financial advisor, and without considering standard valuation materials or accounting for synergies. On June 29, 2015, the Towers Board convened and was advised by Towers' financial advisor that "the transaction was financially fair to the Towers' stockholders, even though the merger consideration valued each share of Towers stock at $125.13, a nine percent discount to Towers' unaffected trading price."[198] At this meeting, the Towers Board unanimously approved the merger, which was conditioned on stockholder approval. Haley participated in the meeting and voted in favor of the merger.

The merger was announced on June 30, 2015. That day, Towers' stock price dropped almost nine percent. Financial analysts were critical of the merger from Towers' standpoint, noting that the merger represented "a nine percent discount on [Towers'] share price" and commenting that "Willis appeared to be extracting more value from the transaction than Towers."[199] Willis's stock price, on the other hand, rose 3.3 percent from the pre-merger trading price and Moody's upgraded Willis's rating outlook to "stable."[200]

In September 2015, in contemplation of Haley becoming the post-merger entity's CEO, ValueAct presented Haley with a compensation proposal (the "ValueAct Proposal"). According to the plaintiffs, the ValueAct Proposal "would increase [Haley's] long-term equity incentive compensation from the approximately $24 million maximum equity compensation that he could have earned in his last three years as Towers' CEO to upwards of $140 million in his first three years as [the combined entity's] CEO."[201]

198 *Id.*

199 *Id.* at *5.

200 *Id.*

201 *Id.* at *1.

Around the same time, Driehaus Capital Management LLC ("Driehaus"), a Towers stockholder, launched a public campaign in opposition to the merger. In a white paper filed with the SEC and published by the Wall Street Journal, Driehaus contended, among other things, that the merger consideration was inadequate and that Towers had consistently outperformed Willis in prior years. Driehaus also filed an opposition letter with the SEC in October of 2015, noting other shareholders' opposition to the merger and questioning whether Haley's incentives were aligned with other Towers stockholders due to his likely increased compensation in the post-merger entity.

On October 13, 2015, Towers and Willis issued a proxy statement soliciting votes in favor of the merger. Importantly, the proxy statement did not disclose the ValueAct Proposal or the extent of ValueAct's role in the merger process. An investor presentation that Towers filed with the SEC defending the merger also did not mention the ValueAct Proposal. On November 5, 2015, Institutional Shareholder Services ("ISS") and Glass Lewis both issued recommendations that Towers stockholders vote against the merger.

To win over stockholder approval, Haley and ValueAct agreed to increase the special dividend to $10.00 per share. According to the plaintiffs, "Haley viewed the $10.00 special dividend not as the best deal he could get for *Towers stockholders* (to whom he owed fiduciary duties) but, rather, as the minimum necessary to secure the Stockholder Approval he needed to *push the Merger* through so he could secure the massive compensation Proposal [ValueAct] had promised him."[202]

On November 17, 2015, the Towers Board convened to discuss the merger. Haley allegedly did not disclose the ValueAct Proposal at this meeting. The next day, "only 43.45 percent of the then-submitted votes of Towers stockholders were 'for' the merger."[203] Later that day, Willis's board of directors agreed to the special dividend subject to eliminating the termination fee for Willis, and increasing the termination fee for Towers. The Towers Board then met and unanimously approved the new terms, subject to receipt of a fairness opinion. Under the revised terms, the merger consideration valued each share of Towers stock at

202 *Id.* at *7.

203 *Id.* at *8.

$128.30, a seven percent discount to the unaffected trading price. Driehaus, ISS, and Glass Lewis continued to criticize the deal. On November 27, 2015, Towers filed a proxy update that again omitted any reference to the ValueAct Proposal.

On December 11, 2015, at a special stockholders meeting, 62 percent of the Towers stockholders voted in favor of the merger. On the same day, 95.5 percent of the Willis stockholders voted in favor of the merger. The merger closed on January 4, 2016. In March 2016, the post-merger entity, Willis Towers Watson Public Limited Company ("Willis Towers"), reached an employment agreement with Haley which "differed in some ways from the ValueAct Proposal, but notably, the employment agreement provided more potential upside than the Proposal."[204]

Following the merger, the plaintiffs filed a complaint in the Court of Chancery alleging breach of fiduciary duty claims against Haley and the Towers Board, and an aiding and abetting claim against ValueAct and its Chief Investment Officer, Jeffrey Ubben. Although the plaintiffs acknowledged that the business judgment rule presumptively applied, they attempted to rebut that presumption by arguing that Haley suffered a "material conflict" as a result of the ValueAct Proposal, that he failed to disclose the conflict to the other directors, and that a reasonable director would have regarded this conflict as significant in evaluating the merger.[205]

The Court of Chancery dismissed the plaintiffs' claims. The Court held that "the alleged failure to disclose the Proposal failed to rebut the business judgment rule because, at bottom, the Towers Board already knew that Haley would become the CEO of the combined company post-merger, that the combined company would be much larger, and thus, the CEO would be entitled to increased compensation."[206] The Court also held that the plaintiffs "failed to establish that a reasonable director would have considered the Proposal to be significant when evaluating the merger."[207]

On appeal, the Delaware Supreme Court reversed the Court of Chancery's decision. The Supreme Court held that the plaintiffs had adequately alleged that "the Proposal altered the nature of the potential conflict that the Towers Board knew of in a material way."[208] In so holding, the Supreme Court noted that the plaintiffs had adequately alleged that "the Board would have found it material that its lead negotiator had been presented with a compensation proposal of having a potential upside of nearly five times his compensation at Towers, and that he was presented with this Proposal during an atmosphere of deal uncertainty and before they authorized him to renegotiate the merger consideration."[209] The Supreme Court added that it "need not look to the stockholder disclosure cases" to determine the materiality standard for a director's duty of disclosure to fellow board members, because the "materiality inquiry is different in the two contexts."[210] Nevertheless, the Supreme Court concluded that Haley's failure to disclose the Proposal to the Towers Board "would be material in either context."[211]

The Supreme Court rejected the defendants' argument that the failure to disclose the ValueAct Proposal could not have been material because it was not binding. The Supreme Court explained that the fact that the ValueAct Proposal "was not a concrete agreement and had milestones requiring 'Herculean' efforts did not relieve Haley of his duty to disclose to the Towers Board the deepening of his potential conflict, particularly in an atmosphere of considerable deal uncertainty."[212] The Supreme Court also rejected the Court of Chancery's reasoning that the failure to disclose the ValueAct Proposal was not material because the ValueAct Proposal's "pie-in-the-sky" targets were unlikely to be achieved.[213] The Supreme Court emphasized that the "materiality" test is a subjective inquiry, not an objective one, and that the plaintiffs had adequately alleged that Haley believed the "upsides" in the ValueAct Proposal were attainable.[214]

The Supreme Court next held that the plaintiffs adequately alleged that Haley failed to inform the Towers Board of his material conflict. While Haley

204 *Id.* at *9.
205 *Id.* at *10.
206 *Id.*
207 *Id.*

208 *Id.* at *12.
209 *Id.*
210 *Id.* at *13-14.
211 *Id.* at *14.
212 *Id.*
213 *Id.* at *14-15.
214 *Id.* at *15.

may have kept the Towers Board "generally apprised of negotiations," Haley "allegedly did not disclose that he had received the Proposal and had discussed executive compensation with ValueAct and Ubben."[215] The Supreme Court added that Haley's discussion of the ValueAct Proposal with a Towers officer did not change this result.

Finally, the Court held that the plaintiffs adequately alleged that a reasonable director "would have regarded Haley's material interest in the Proposal as a significant fact in evaluating the merger."[216] In so holding, the Supreme Court pointed to deposition testimony of the Chair of the Towers Board's Compensation Committee in a related appraisal action. The committee chair had testified that "he would have wanted to know that Haley was discussing his compensation at the future company with Ubben and ValueAct."[217] The Supreme Court found this information was "significant, particularly given [the director's] position as Chair of the Towers' Compensation Committee."[218]

The Supreme Court remanded the case to the Court of Chancery to consider the plaintiffs' aiding and abetting breach of fiduciary claim, which the Court of Chancery had dismissed for lack of a predicate breach of fiduciary duty, consistent with the Supreme Court's holdings.

Justice Vaughn filed a dissenting opinion, setting forth his view that a reasonable director would not have considered the undisclosed ValueAct Proposal to be a significant fact in the evaluation of the merger. Justice Vaughn explained that the complaint did not allege any facts suggesting that Haley discussed the ValueAct Proposal with Ubben after ValueAct made the Proposal, and that a single director's testimony that he would have wanted to know that Haley was discussing the Proposal with ValueAct did "not, in [his] mind, rise to the level of a well-pled allegation."[219] Justice Vaughn further noted that the Towers Board was generally aware that Haley stood to receive a significant pay increase as CEO of the combined company, and that the fact that the "ValueAct [Proposal] had the potential of a high payout to Haley did not change or significantly add" to what the Towers Board already knew.[220]

215 *Id.* at *16.

216 *Id.*

217 *Id.*

218 *Id.*

219 *Id.* at *18.

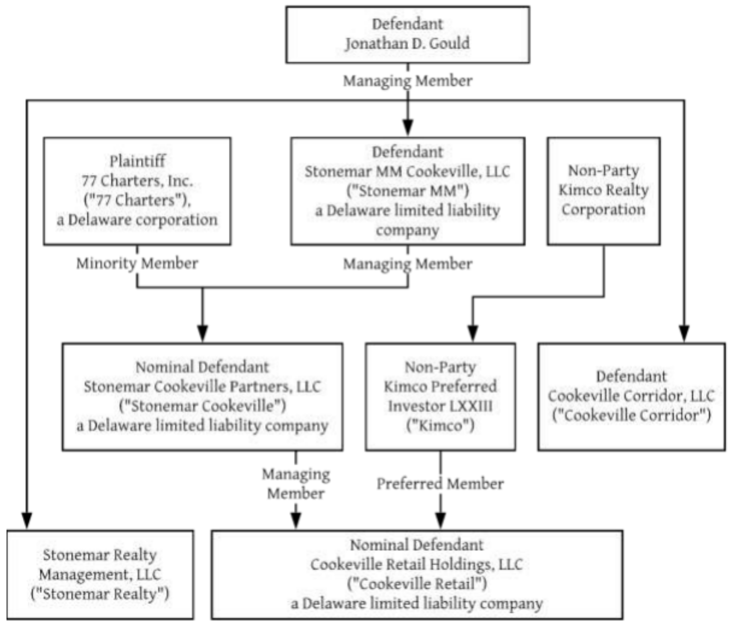
220 *Id.*

# Alternative Entity Litigation

**_77 Charters, Inc. v. Gould_, 2020 WL 2520272 (Del. Ch. May 18, 2020) (Slights, V.C.)**

In *77 Charters, Inc. v. Gould*,[1] the Delaware Court of Chancery denied the defendants' motion to dismiss breach of fiduciary duty claims against the "remote controller" of a limited liability company, Jonathan D. Gould, related to transactions whereby Gould caused the entity he controlled to purchase a preferred interest in the limited liability company from a member and subsequently amended the limited liability company's operating agreement to increase the preferred's distribution percentage, to the detriment of 77 Charters, Inc. ("77 Charters"), a holder of the limited liability company's common interests.

In 2007, Stonemar MM Cookeville, LLC ("Stonemar MM"), as managing member, and other members, including 77 Charters, formed Stonemar Cookeville Partners, LLC ("Stonemar Cookeville"). That same year, as part of an investment in a retail shopping center, Stonemar Cookeville, as managing member, and Kimco Preferred Investor LXXIII ("Kimco"), as the preferred member, formed Cookeville Retail Holdings, LLC ("Cookeville Retail"). Gould was Stonemar MM's managing member. The court included in its opinion the following chart depicting the relationships between the various LLCs and their members:




Under the terms of the Limited Liability Company Agreement of Cookeville Retail (the "CRA"), Kimco received the first allocation of any distributions, equal to nine percent of its capital contributions. Only then did Stonemar Cookeville and its members (including 77 Charters) receive distributions, to the extent there were any.

On July 1, 2013, Kimco sold its preferred interest in Cookeville Retail to Cookeville Corridor, LLC ("Cookeville Corridor"). Gould was the managing member of Cookeville Corridor. Shortly after acquiring the preferred interest, Cookeville Corridor sold a portion of that interest to Eightfold Cookeville Investor, LLC ("Eightfold"). Notably, the amount Eightfold paid for a portion of the preferred interest was equal to the amount Cookeville Corridor paid for

1 2020 WL 2520272 (Del. Ch. May 18, 2020).

the entirety of the preferred interest. After this series of transactions, Gould (who was directly or indirectly the managing member of both of Cookeville Retail's members) caused Cookeville Retail to amend the CRA (the "Amended CRA") to increase the preferred's distribution preference from 9 percent to 12.5 percent. 77 Charters was unaware of the sale of the preferred interest and the amendment to the CRA.

In 2016, 77 Charters chose to investigate the status of its investment in Stonemar Cookeville and requested books and records from Stonemar Cookeville. Unsatisfied with Stonemar Cookeville's response to its request, 77 Charters filed a books and records action in the Delaware Court of Chancery. The parties in the books and records action eventually reached a settlement.

After the conclusion of the books and records action, Cookeville Retail sold the retail shopping center to a third party without informing 77 Charters. The sale proceeds were distributed first to Cookeville Retail's creditors, with the remaining amount distributed to the holders of the preferred interests. Common interest holder Stonemar Cookeville (of which 77 Charters was a member) received nothing from the sales proceeds.

77 Charters filed an action in the Delaware Court of Chancery, alleging a panoply of claims against the defendants, including (among others) breach of fiduciary duty against Gould and Stonemar MM, breach of contract against Stonemar MM, Stonemar Cookeville, and Gould, aiding and abetting against Gould, Eightfold, and Stonemar MM, civil conspiracy against Cookeville Corridor, unjust enrichment against Gould, Stonemar MM, Cookeville Corridor, and Eightfold, and a request for a judicial declaration that the Amended CRA was void. The breach of fiduciary duty claim, civil conspiracy claim, and claim for declaratory judgment survived the defendants' motion to dismiss. The Court dismissed all other claims.

The Court concluded that it was reasonably conceivable that Gould and Stonemar MM owed fiduciary duties to the nonmanaging members of Stonemar Cookeville, notwithstanding the fact that Gould was not the managing member, or even a member, of Stonemar Cookeville or Cookeville Retail. Citing *In re USACafes, L.P. Litigation*,[2] the Court recognized that "remote controllers (such as Gould) will owe limited fiduciary duties if they 'exert control over the assets of that entity.'"[3] The Court found that 77 Charters adequately pleaded a remote controller situation when it alleged that Gould personally caused the purchase and sale of the preferred interest and the adoption of the Amended CRA.

Because this case concerned alternative entities, the Court scrutinzed the terms of the CRA and the Limited Liability Company Operating Agreement of Stonemar Cookeville (the "SCA") to determine whether either eliminated common law fiduciary duties or otherwise protected the defendants from liability. Regarding Stonemar MM's duty under the corporate opportunity doctrine, 77 Charters argued that even though the parties to the SCA (including 77 Charters) waived Stonemar MM's duty to present corporate opportunities and instead allowed Stonemar MM to compete with Stonemar Cookeville's investment in Cookeville Retail, the CRA (an agreement to which 77 Charters was not a party) created an exception that required Stonemar MM to consider the interests of Stonemar Cookeville (and its members) in approving the sale of the preferred interest. The Court held that 77 Charters could not use the CRA to resurrect Stonemar MM's duty to present corporate opportunities, including the sale of the preferred interest, when 77 Charters had unambiguously waived that duty in the SCA. Additionally, the Court interpreted the terms of the CRA and found that it, like the SCA, eschewed the corporate opportunity doctrine. Regarding monetary liability, the Court concluded that the terms of the SCA exempted Stonemar Cookeville's *members* from monetary liability, but that it was not clear that the exemption applied to Stonemar MM when it acted in its capacity as managing member.

With regard to the amendment to the CRA increasing the preferred's distribution percentage, the Court held that other aspects of the duty of loyalty beyond the eschewed corporate opportunity doctrine prevented Stonemar MM from unilaterally approving the amendment. By pleading that Gould had "selfishly amended the CRA and shifted economic value toward Cookeville Corridor and away from 77 Charters," 77 Charters pleaded a reasonably conceivable claim for

2 600 A.2d 43 (Del. Ch. 1991).

3 *77 Charters*, 2020 WL 2520272, at *9 (emphasis omitted) (quoting *Bay Ctr. Apartments Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451, at *9-10 (Del. Ch. Apr. 20, 2009) (quoting *USACafes*, 600 A.2d at 49)).

breach of fiduciary duty.[4] The Court stated that, "While the scope of *USACafes*-type liability is limited, 'it surely entails the duty not to use control over [an entity] to advantage the [controller] at the expense of' the controlled-entity."[5] Because Gould had increased the preferred's distribution preference and then sold only a portion of the Cookeville Corridor's preferred units to Eightfold at a premium, with Cookeville Corridor retaining a portion of the preferred units, and because these transactions were to 77 Charters' detriment, the Court sustained the claim for breach of fiduciary duty against Gould and Stonemar MM.

The Court also sustained 77 Charters' claim of civil conspiracy against Cookeville Corridor. Gould, indirectly a managing member of a preferred interest holder of Cookeville Retail, and Cookeville Corridor, the other preferred interest holder, executed the Amended CRA. Because the amendment increased the preferred distribution, the transaction constituted self-dealing. The Court explained that the agreement to engage in a self-dealing transaction in breach of Gould's and Stonemar MM's fiduciary duties constituted a wrongful act done in furtherance of the conspiracy.

This decision emphasizes, yet again, that Delaware limited liability companies are creatures of contract. The Court gives effect only to clear and unambiguous disclaimers or modifications of fiduciary duty. Additionally, "remote controllers" cannot rely on subsidiary entities to block *USACafes*-type liability.

***HOMF II Inv. Corp. v. Altenberg*, 2020 WL 2529806 (Del. Ch. May 19, 2020) (Laster, V.C.)**

In *HOMF II Investment Corp. v. Altenberg*,[6] the Court of Chancery held, in a post-trial decision, that plaintiffs had proven fraudulent inducement and breach of fiduciary claims in connection with an investment scheme in which a defendant individual ("Altenberg") mismanaged funds the plaintiffs had contributed to a solar project venture that Altenberg controlled. Despite finding that the plaintiffs had proven their fraudulent inducement claim, the Court entered judgment for Altenberg on that claim because the plaintiffs "did not put Altenberg on notice of th[e] [fraudulent inducement] theory before trial, and they did not seek to conform the pleadings to the evidence after trial."[7] The Court also ordered further proceedings on the damages aspect of the plaintiffs' fiduciary duty claim "to clarify the record and assist the court in tailoring an appropriate remedy."[8]

Altenberg had convinced the plaintiffs to invest in a fund he controlled (the "Fund"), whose purpose was "to acquire solar projects, own them through special purpose vehicles, and provide the equity capital necessary to bring them to commercial operation."[9] The plaintiffs were the only investors, and to induce their investments, Altenberg represented to them "that once a project achieved commercial operation, it could be refinanced with long-term debt, which would enable the Fund to recover its equity investment, plus return."[10] Altenberg also made three other representations: (1) that "the Fund's first project would be Project Cali, which he would use to demonstrate that the Fund's business model worked[;]" (2) that "the Fund would acquire projects that could be completed within three to six months so that he could recycle the Fund's capital and generate outsized returns[;]" and (3) that a lender called Open Energy "would be a dedicated source of financing for the Fund."[11]

The Court found that each of these representations was false, and that the plaintiffs had also proven the other elements of fraud (the defendant's knowledge of falsity, intent to induce the plaintiff to act, the plaintiff's reliance, and damages). Despite these findings, the Court entered judgment for Altenberg on procedural grounds because the plaintiffs "never put Altenberg on notice before trial that they were pursuing a claim for fraudulent inducement, Altenberg objected at trial to the introduction of evidence relating to that claim, and the plaintiffs never sought to conform the pleadings to the evidence under Rule 15(b)."[12] The Court also noted that "[t]hroughout post-trial briefing and during post-trial argument, Altenberg maintained that the plaintiffs had not properly asserted a fraudulent inducement claim."[13]

The Court also found that Altenberg breached his fiduciary duty of loyalty in connection with his

4 *Id.* at *14.

5 *Id.* at *15 (quoting *USACafes*, 600 A.2d at 49).

6 2020 WL 2529806 (Del. Ch. May 19, 2020).

7 *Id.* at *1.

8 *Id.*

9 *Id.*

10 *Id.*

11 *Id.* at *27.

12 *Id.*

13 *Id.* at *40.

operation of the Fund. Applying entire fairness review, given Altenberg's undisputed controller status and engagement in self-dealing, the Court held that the following actions (among others) were breaches of Altenberg's duty of loyalty: (1) paying excessive management fees from the Fund to another entity that Altenberg controlled and used as the Fund's management vehicle, (2) holding the Fund's assets in that management vehicle's name, and (3) advancing legal fees to himself.

Although the Court found Altenberg liable for breaches of fiduciary duty, it did not determine the appropriate remedy and requested supplemental submissions for the case's remedial phase. This decision and request was driven in part by the fact that "[t]he parties focused their efforts at trial, in their post-trial submissions, and during post-trial argument primarily on the question of liability and not the issue of remedy.[14]

In sum, the Court of Chancery's decision serves as a reminder that, despite Delaware's rejection of "the requirement that a plaintiff must plead a particular legal theory," a plaintiff must "take[] action at some point to put [a defendant] on notice" that they are pursuing a particular theory.[15] Such action could include "outlin[ing] the claim in [] pretrial briefs[,]" "identify[ing] it as an issue of law in the pretrial order[,]" or "mak[ing] a motion during or after trial to amend the pleadings under Rule 15(b)."[16] The decision also shows that a plaintiff who is successful in proving liability for a breach of fiduciary duty must also be sure to provide the court with sufficient argument and analysis on the issue of damages to enable the court to enter a damages award. Otherwise, a plaintiff will risk spending additional time and money litigating the question of the appropriate remedy post-trial.

***Dohmen v. Goodman*, ----- A.3d -----, 2020 WL 3428213 (Del. June 23, 2020)**

In *Dohmen v. Goodman*,[17] the Delaware Supreme Court considered a certified question of law from the United States Court of Appeals for the Ninth Circuit, which (as rephrased by the Supreme Court) asked:

> Under the stipulated facts of this dispute, does the general partner's request to the limited partner for a one-time capital contribution constitute a request for limited partner action such that the general partner has a duty of disclosure, and if the general partner fails to disclose material information in connection with the request, may the limited partner prevail on a breach of fiduciary duty claim and recover compensatory damages without proving reliance and causation?[18]

The Delaware Supreme Court answered the question in the negative. The Supreme Court clarified that the *per se* damages rule only excuses a plaintiff from proving reliance, causation, and damages in situations where the lack of disclosure impairs the economic or voting rights of stockholders, and even then entitles the plaintiff only to nominal damages.

In 2010, Dohmen started a hedge fund and convinced Goodman to invest $500,000. After Goodman made his first investment, he began to ask Dohmen about other investors in the fund. Dohmen made several misleading statements in response. On December 9, 2011, Goodman made a second investment of $500,000. A few days later, Dohmen indicated that "[p]ersonal friends [had] expressed interest" in investing and were "reviewing the documents."[19] Dohmen knew this statement was false. Eventually, Dohmen informed Goodman that the fund had only two investors, and two years later the value of the fund collapsed.

In January 2015, Goodman sued Dohmen, "alleging common law fraud by misrepresentation, securities fraud, and breach of fiduciary duty."[20] Goodman based his suit on the misrepresentations regarding the number of investors and the fund's strategy in general. The United States District Court for the Central District of California found that, at the time of the second investment, Dohmen knowingly misrepresented the number of investors in the fund. The District Court also found that, while Goodman relied on those misrepresentations, he failed to show loss causation, the final element of common law and securities fraud.

Alternative Entities

14 *Id.* at *53.
15 *Id.* at *26.
16 *Id.*
17 ----- A.3d -----, 2020 WL 3428213 (Del. June 23, 2020).
18 *Id.* at *1.
19 *Id.* at *2. (first alteration in original).
20 *Id.*

Goodman had more success with his breach of fiduciary duty claim based on the same misrepresentations. As Dohmen was the controller of the general partner of the fund, and the partnership did not disclaim the fiduciary duty of loyalty, the District Court found that Dohmen owed fiduciary duties to Goodman, a limited partner. The District Court, relying on *Malone v. Brincat*,[21] characterized the breach of fiduciary duty claim as a misrepresentation made "when seeking [limited] partner action."[22] Citing *Malone*, the District Court held that Goodman did not need to show reliance or causation to support a breach of fiduciary duty claim. As the parties did not dispute that the misrepresentations were material, the District Court awarded Goodman compensatory damages. Dohmen appealed to the United States Court of Appeals for the Ninth Circuit, which certified the above question to the Delaware Supreme Court.

The Supreme Court began its analysis by noting the fiduciary duties of a director (or similarly -situated fiduciary) apply when a director communicates with stockholders. Specifically, when a director requests "stockholder action" the director must "disclose fully and fairly all material facts within their control bearing on the request."[23] A director breaches the duty "when the alleged omission or misrepresentation is material."[24] The Supreme Court noted that a breach in this situation amounts to liability *per se*, meaning a stockholder does not need to prove the traditional elements of reliance, causation, and damages. But it clarified that the *per se* rule only applies if a plaintiff seeks nominal damages.

The Supreme Court reviewed the history of disclosure violations in connection with requests for stockholder action to determine if Dohmen had an affirmative duty to disclose information to Goodman. The Supreme Court ultimately agreed with the Court of Chancery's analysis in *Latesco, L.P. v. Wayport, Inc.*[25] In that case, the Court of Chancery refused to characterize a corporate insider's attempt to exercise a right of first refusal in the sale of a minority stockholder's interest as request for stockholder action. The Court of Chancery found that the stockholder action rule was concerned with the collective action problem often inherent in large transactions, meaning that stockholders would be unable to receive all the information they desired unless there was an affirmative disclosure duty. Here, the Supreme Court explained, Goodman had the ability to ask questions of Dohmen and often received answers. Thus, the Supreme Court held, Dohmen did not have an affirmative duty to disclose the number of investors in the fund, although his decision to provide false information could result in a breach of the duty of loyalty.

The Supreme Court further emphasized that, even if Dohmen did have a fiduciary duty of disclosure, "Goodman would still have to prove reliance and causation to recover the compensatory damages sought in his case."[26] The Court conducted a review of case law addressing the issue of liability *per se* and the duty of disclosure. The Supreme Court reaffirmed that the *per se* damages rule (i) will relieve a plaintiff of showing reliance, causation, and damages "only . . . if there is impairment of economic or voting rights," and (ii) "only applies to nominal damages."[27] The Supreme Court therefore answered the certified question in the negative:

> Under the stipulated facts of this dispute, the general partner's request to a limited partner for a one-time capital contribution does not constitute a request for limited partner action such that the general partner has a fiduciary duty of disclosure. Even if the general partner had a fiduciary duty of disclosure, if the general partner failed to disclose material information in connection with the request, the limited partner cannot recover compensatory damages without proving reliance and causation.[28]

21 722 A.2d 5 (Del. 1998).

22 *Goodman v. Dohman*, 2017 WL 3319110, at *19 (C.D. Cal. Aug. 3, 2017) (quoting *Malone*, 722 A.2d at 12).

23 *Dohman*, 2020 WL 3428213, at *4 (citing *Malone v. Brincat*, 722 A.2d 5, 9 (Del. 1998).

24 *Id.* (citing *Malone*, 722 A.2d at 12).

25 2009 WL 2246793 (Del. Ch. July 24, 2009).

26 *Goodman*, 2020 WL 3428213, at *7.

27 *Id.* at *9.

28 *Id.* at *10.

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

***Borealis Power Holdings Inc. v. Hunt Strategic Util. Inv., L.L.C.*, --- A.3d ----, 2020 WL 2630929 (Del. May 22, 2020)**

In *Borealis Power Holdings Inc. v. Hunt Strategic Utility Investment, L.L.C.*,[1] the Delaware Supreme Court reversed a judgment by the Court of Chancery and held that a right of first refusal that restricted the ability of a unit holder to transfer units in a limited liability company was not triggered by the sale of interests two levels up the corporate chain, even though the right of first refusal's definition of transfer included any direct or indirect transfer of the units.

Borealis Power Holdings Inc. and BPC Health Corporation (together, "Borealis"), Cheyne Walk Investment PTE LTD ("Cheyne Walk"), Hunt Strategic Utility Investment, L.L.C. ("Hunt"), and Sempra Texas Holdings Corp. ("Sempra") owned interests in Oncor Electric Delivery Company LLC ("Oncor") through a complex corporate structure. Borealis and Cheyne Walk each owned 49.5% of Texas Transmission Holdings ("TTHC") and Hunt owned the remaining 1%. TTHC, through an intermediary, owned Texas Transmission Investment (TTI). TTI owned a 19.75% interest in Oncor. Through two intermediaries, Sempra owned the remaining 80.25% of Oncor.

Two agreements were primarily at issue in the case: the TTHC Shareholders' Agreement (the "TTHC SA") and the Oncor Investor Rights Agreement (the "Oncor IRA"). Borealis, Cheyne Walk, and Hunt were parties to the TTHC SA, which contained a right of first offer that gave Borealis and Cheyne Walk a right of first offer over Hunt's interest in TTHC. The TTHC SA also contained a provision entitled "Overriding Prohibition on Transfer," which stated that, notwithstanding anything to the contrary in the TTCH SA, Hunt could not transfer any shares and the other stockholders would not recognize any such purported transfer, if the transfer would breach the Oncor IRA.

Oncor and its equityholders were parties to the Oncor IRA. TTI was party to the Oncor IRA; however, Borealis, Cheyne Walk, and Hunt were not. The Oncor IRA contained a right of first refusal requiring any selling unitholder that intended to "Transfer" LLC units to provide Sempra with written notice of its intent to sell and to present Sempra with an offer to buy the units on the same conditions as the offer from the third party. The Oncor IRA defined "Transfer" as "any direct or indirect transfer ... of any LLC Units (or any interest (pecuniary or otherwise) therein or rights thereto). In the event that any Member that is a corporation, partnership, limited liability company or other legal entity (other than an individual, trust or estate) ceases to be controlled by the Person controlling such Member or a Permitted Transferee thereof, such event shall be deemed to constitute a 'Transfer' subject to the restrictions on Transfer contained or referenced herein."[2]

Hunt decided to sell its interest in TTHC. Hunt and Sempra reached an agreement pursuant to which Sempra would purchase Hunt's shares. Hunt then sent a first offer notice to Borealis and Cheyne Walk, attaching the share purchase agreement. Borealis

1 --- A.3d ----, 2020 WL 2630929 (Del. May 22, 2020).

2 *Id.* at *3.

thereafter informed Hunt that it would exercise its right to purchase Hunt's shares under the TTHC SA. In response, Sempra provided notice that it was exercising its right of first refusal under the Oncor IRA to purchase Hunt's interests. When Hunt continued with its plan to sell its shares to Sempra, Borealis filed a complaint in the Court of Chancery asserting claims against Hunt for breach of the TTHC SA. Borealis also sought a temporary restraining order preventing Hunt from selling its shares to Sempra. Sempra intervened to seek a declaratory judgment against Borealis and Hunt, while Cheyne Walk intervened to seek a declaratory judgment against Sempra and Hunt.

In considering the parties' claims, the Court of Chancery determined "whether Hunt's sale triggered (a) the [right of first refusal] in the Oncor IRA and/or (b) the [right of first offer] in the TTHC SA, and, (c) if both applied, which was to be given priority."[3] The Court of Chancery first held that both the right of first refusal and the right of first offer applied to the sale of Hunt's shares. The Court of Chancery explained that a "sale by Hunt of its shares to Borealis would, in fact, be a 'Transfer' of Oncor LLC Units… under the Oncor IRA."[4] Noting the Oncor IRA contained an extremely broad definition of what constituted a "transfer" of Oncor units, the Court of Chancery concluded that a transfer of TTHC shares constituted an indirect transfer of Oncor units and therefore triggered Sempra's right of first refusal. The Court of Chancery next held that because Sempra sought to exercise its right to purchase the shares from Hunt, a sale by Hunt to Borealis would breach the Oncor IRA. The Court of Chancery explained that the TTHC SA "prohibits transfers that breach the IRA," and therefore Sempra's "exercise of its right to purchase extinguished Borealis' right to purchase."[5] As a result, the Court of Chancery entered judgment for Sempra.

Borealis appealed the Court of Chancery's ruling. Borealis argued that Hunt's sale did not trigger the transfer restrictions in the Oncor IRA because "(1) the sale was not by the parties restricted in Section 3.1; (2) the sale fell outside the definition of 'transfer' as used in those sections; and (3) the sale does not involve 'Oncor LLC Units' as described in the Oncor IRA."[6]

Reviewing the language of the applicable agreements *de novo*, the Supreme Court—through a majority opinion authored by Justice Traynor and joined by Chief Justice Seitz and Justice Valihura, and a concurring opinion authored by Justice Vaughn and joined by Justice Montgomery-Reeves—reversed the Court of Chancery's decision. The Supreme Court began by explaining that although the Oncor IRA was governed by New York law and the TTHC SA was governed by Delaware law, both states give effect to the plain and unambiguous meaning of a contract. The majority noted that the right of first refusal provision in the Oncor IRA stated that "*the Minority Member* and its Permitted Transferees (each a "Selling Member") shall not Transfer their LLC Units…"[7] The majority also noted that the Oncor IRA clearly defined "Minority Member" as TTI, and that neither party argued Hunt was a "Permitted Transferee."[8] Thus, the majority held that if a transfer of Oncor units resulted from Hunt's sale of TTHC shares, then the transfer would be a product of Hunt's actions, not the actions of TTI.

In addition, the majority found that Sempra's right of first refusal was triggered by "TTI's 'intent'—voluntary or involuntary—to transfer LLC units 'or an interest therein or rights thereto,'" and that Hunt's actions did not represent TTI's intent to transfer LLC units.[9] The majority noted that "[t]he subjects (Hunt and TTI) of these two clauses are different and irreconcilable" and "[t]o hold otherwise would be to impute the contractual intentions of a minority member of a company's controller to the company itself—a result that runs contrary to settled corporate-law principles."[10] As Hunt was not defined as the "Minority Member" and, the majority found, Hunt's actions did not create an intent by TTI to sell LLC units, the majority held that Hunt's sale did not trigger Sempra's right of first refusal.

In so holding, the majority rejected Sempra's argument, based on the Oncor IRA's broad definition of "Transfer," applying to both direct and indirect transfers of LLC

3 *Id.* at *4.

4 *Id.* at *5

5 *Id.*

6 *Id.*

7 *Id.* at *6. (emphasis in original).

8 *Id.*

9 *Id.*

10 *Id.*

units, that the intent of the parties "was to bind TTI's upstairs equityholders and restrict their transfers of that upstairs equity."[11] The Supreme Court held that this argument "elide[d] the subject of the operative sentence in Section 3.1 of the Oncor IRA of which the [] verb phrase 'may only Transfer' serves as the predicate."[12] The majority explained that the subject of this sentence was "the Minority Member and its Permitted Transferees," which did not include Hunt.[13] The majority stated that because the right of first refusal "is only triggered by transfers by the Minority Member, it does not matter whether the Hunt sale constitutes a 'transfer' as contemplated by the Oncor IRA, or whether the sale transfers "Oncor LLC Units."[14] The Supreme Court therefore reversed the Court of Chancery's decision and remanded the case back to the Court of Chancery.[15]

The concurring opinion agreed with the majority that when the first sentence of the definition of Transfer ("any direct or indirect transfer") was applied, the right of first refusal is "triggered only when TTI is the transferor."[16] But the concurring opinion found that the "second sentence of the definition of Transfer [the control sentence] brings within it an event which may occur in TTI's chain of ownership."[17] The concurrence noted that "Borealis acknowledges that 'the second sentence of the definition of Transfer, unlike the first sentence, addresses those limited situations where activity that affects the ownership of TTI–rather than activity by TTI itself–is 'deemed to constitute' a Transfer that is 'subject to the restrictions on Transfer' in the IRA.'"[18] However, without elaboration, the concurring justices stated they did not believe, based on the record before the Supreme Court,[19] that it could "be reasonably concluded that, when Hunt sells its shares to Borealis, a party who controlled TTI before that event will cease to control TTI as a result of that event."[20]

11 *Id.*

12 *Id.* at *7.

13 *Id.*

14 *Id.* at *5.

15 *Id.* at *7.

16 *Id.*

17 *Id.*

18 *Id.* at *7.

19 Although the Court of Chancery conducted a full trial, after the trial, the Court of Chancery requested post-trial briefing limited solely to the unambiguous terms of the contracts, and the Court of Chancery ruled on a purely legal basis that the first sentence of the definition of Transfer applied to the sale of Hunt's interest, triggering Sempra's right of first refusal. The record on appeal, therefore, did not include the significant evidentiary record from trial.

### *Sheehan v. AssuredPartners, Inc.*, 2020 WL 2838575 (Del. Ch. May 29, 2020) (LeGrow, J.)

Seven days after the Delaware Supreme Court's opinion in *Borealis Power Holdings Inc. v. Hunt Strategic Utility Investment, L.L.C.*,[21] which held that a right of first refusal that applied to the transfer of interests in an entity was not triggered by the sale of interests two levels up the corporate chain, the Court of Chancery, in *Sheehan v. AssuredPartners, Inc.*,[22] held that a tag-along right that applied to the transfer of interests in an entity was not triggered by the sale of interests two levels down the corporate chain. Both cases gave controlling effect to the subject of the transfer restrictions—the entities that were explicitly bound by the restrictions—without regard to what constituted a transfer under the terms of the relevant agreements.

The plaintiffs in *Sheehan*, Pat and Mark Sheehan, sold their insurance agency to AssuredPartners of Virginia and AssuredPartners, Inc. (together, "AssuredPartners"). As part of the sale, the Sheehans signed employment agreements with AssuredPartners. The new positions offered the ability to purchase and be awarded interests in Dolphin Holdco, L.P. ("Holdco"). The Sheehans both purchased and were awarded interests in Holdco. Pursuant to Holdco's Limited Partnership Agreement (the "Holdco LPA"), those interests had tag-along rights triggered by Holdco's parent—Dolphin Investment, L.P. ("Investment LP")—selling its interests in Holdco—or by the owner of Investment LP selling its interests in Investment LP. The Sheehans were eventually terminated, purportedly for cause, days before the sale of AssuredPartners through a sale of Dolphin Topco, Inc. ("Topco"), a wholly owned subsidiary of Holdco and the parent of Dolphin Midco, Inc. ("Midco"), which in turn was the parent of AssuredPartners (the "GTCR Transaction"). The Sheehans did not receive the benefit of the tag-along rights; receiving instead only the purchase price for their purchased interests and nothing for their awarded interests.

20 *Id.*

21 ---A.3d ---, 2020 WL 2630929 (Del. May 22, 2020).

22 2020 WL 2838575 (Del. Ch. May 29, 2020).

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The Sheehans brought suit for, among other things, breach of their employment agreements and the Holdco LPA, arguing that their termination was a pretext designed to deprive them of the benefit of the sale. The plaintiffs alleged that under the Holdco LPA they were entitled to the benefits of the tag-along rights. The defendants moved to dismiss, arguing that the Sheehans held no equity in Holdco at the time of the GTCR Transaction, and that, even if they did, the tag-along rights in the Holdco LPA were not triggered because the GTCR Transaction did not constitute a "transfer" sufficient to trigger the rights under the terms to the agreement.

After finding that the plaintiffs adequately pled a breach of contract and a breach of the implied covenant of good faith and fair dealing, in connection with the employment agreements based on a theory of wrongful termination, the Court examined whether the Holdco LPA was breached when the Sheehans were not able to exercise their tag-along rights in connection with the GTCR Transaction. Despite finding that the Sheehans adequately pled wrongful termination, the Court ruled that because the Sheehans were terminated and had their interests repurchased or cancelled prior to the date of the GTCR Transaction, they had no rights under the Holdco LPA at the time of the GTCR Transaction and, therefore, had no tag-along rights.

The Court also found that, even if the Sheehans did retain their tag-along rights, the transaction would not have triggered the tag-along rights. The Court ruled that because the GTCR Transaction involved Holdco selling its wholly owned subsidiary, Topco, the sale "did not involve a transfer" by Investment LP necessary to trigger the rights under the Holdco LPA.[23] The Court stated that the Supreme Court's decision in *Borealis* supported its conclusion. The Court wrote that *Borealis* was distinguishable because its "reasoning applies to whether a sale two levels up the corporate chain is a transfer of a subsidiary's interest, the reverse of the factual scenario before this Court."[24] Nevertheless, the Court concluded *Borealis* supported its conclusion, as there "[t]he 'subject' of the right of first refusal . . . controlled the analysis. Similarly, the subject of Section 4.2 [of the Holdco LPA]—[Investment LP]—is important. [Investment LP] did not sell its Class A-1 Units in the GTCR Transaction, and Section 4.2 therefore does not apply."[25]

### *DLO Enters., Inc. v. Innovative Chemical Prods. Grp., LLC*, 2020 WL 2844497 (Del. Ch. June 1, 2020) (Zurn, V.C.)

In *DLO Enterprises, Inc. v. Innovative Chemical Products Group, LLC*,[26] the Court of Chancery considered whether the buyers of substantially all of the asserts of Arizona Polymer Flooring, Inc. ("Flooring Inc.") were entitled to two categories of responsive privileged documents: (i) communications between the sellers and their counsel that were in sellers' possession and that the sellers produced in redacted form ("Category One Documents") and (ii) communications between the sellers and their counsel that the buyers had in their possession because the communications were contained in email systems that were transferred to the buyers in connection with the transaction ("Category Two Documents"). With respect to the Category One Documents, the Court held that, unlike in the merger context, where the default rule is that privilege over pre-merger communications passes to the surviving corporation,[27] "[i]n the asset purchase context, the seller will retain pre-closing privilege regarding the agreement and negotiations unless the buyer clearly bargains for waiver or a waiver right."[28] With respect to the Category Two Documents, the Court held that a subset of documents that consisted of post-closing communications between one of the sellers (who worked for the buyers post-closing) and his counsel on an email system that was transferred to buyers in connection with the asset sale were subject to the four-factor test outlined in *In re Asia Global Crossing, Ltd.*[29] regarding an employee's reasonable expectation of privacy for workplace emails. The Court requested further briefing on a second subset of Category Two Documents—pre-closing communications that were in buyers' possession because they were contained in email systems transferred to the buyers in connection

23 *Id.* at *13.

24 *Id.*

25 *Id.*

26 2020 WL 2844497 (Del. Ch. June 1, 2020).

27 *See Great Hill Equity P'rs IV, LP v. SIG Growth Equity Fund I, LLLP*, 80 A.3d 155 (Del. Ch. 2013); *S'holder Representative Servs. LLC v. RSI Holdco,LLC*, 2019 WL 2290916 (Del. Ch. May 29, 2019).

28 *DLO Enters*., 2020 WL 2844497, at *5.

29 322 B.R. 247, 257 (Bankr. S.D.N.Y. Mar. 21, 2005).

with the transaction—to help the Court determine the appropriate test to apply.

The litigation between the buyers and sellers of Flooring Inc. involved a dispute over which party was liable for defective products that were sold prior to the transaction but returned following the transaction. The buyers argued that the sellers knew of the product defects and knowingly misrepresented that Flooring Inc.'s financial statements contained no undisclosed liabilities and that the products met certain quality standards.

The Court first addressed the Category One Documents. The Court held that the seller retains pre-closing privilege regarding the negotiations surrounding an asset purchase transaction unless the buyer explicitly bargains for waiver of such privilege. The Court acknowledged that, in the merger context, Delaware law holds that, absent "an express carve out, the privilege over all pre-merger communications—including those relating to the negotiation of the merger itself—passe[s] to the surviving corporation in the merger, by plain operation of clear Delaware statutory law under § 259 of the DGCL."[30] But the Court explained that asset purchase transactions are inherently different. In asset purchase transactions, the "seller still exists, holding any assets that were not purchased, together with related privileges" and the parties are "in an adversarial relationship" because "[t]he target company has independent rights that are adverse to the buyer's rights."[31]

The Court stated that the buyers could have bargained for privilege waiver regarding the pre-closing communications between the sellers and their counsel. The buyers argued that they did so, pointing out that the asset purchase agreement gave the buyers privilege-waiver rights relating to the assets purchased and the liabilities assumed in the transaction. But the Court rejected the buyers' argument, finding that the buyers "failed to identify a clear contractual right to the privilege over deal communications."[32] The Court explained that the asset purchase agreement defined "excluded assets" to include "rights under or pursuant to this Agreement," and that such a provision meant that the "sellers retained privilege over communications related to the asset purchase agreement negotiations."[33] As such, the sellers' deal communications were not assets transferred to the buyers pursuant to the agreement, and the sellers were entitled to claim privilege over the Category One Documents.

The Court then turned to the Category Two Documents and first addressed the subset that consisted of post-closing communications between the sellers and their attorneys that were in the possession of the buyers. The dispute surrounding post-closing communications arose because one of the sellers worked for the buyer post-closing and he continued to use his email account to communicate with his attorneys after that account had been transferred to the buyers.

The Court held that the four-factor test regarding an employees' reasonable expectation of privacy in work email as set forth in *Asia Global* and *In re Information Management Services, Inc. Derivative Litigation*[34] was the appropriate test for the post-closing documents in Category Two. The first factor asks whether "the corporation maintain[s] a policy banning personal or other objectionable use" of work email.[35] This factor weighed in favor of waiver because the buyers' employee handbook at the time of the post-closing communications "established that employees did not have an expectation of privacy and, importantly, that the company reserved the right to access employees' email accounts at any time."[36]

The second factor asks whether "the company monitor[s] the use of the employee's computer or email."[37] While the handbook included monitoring provisions, the buyers did not show that the company actually engaged in monitoring email. Therefore, the Court decided to treat this factor as neutral.

The third factor asks whether "third parties have a right of access to the computer or emails."[38] The Court stated that this factor is "largely duplicative of the first

Corporate Instruments

30 *DLO Enters.*. at *3 (quoting *Great Hill Equity P'rs*, 80 A.3d at 162.)

31 *Id.* at *5.

32 *Id.* at *7.

33 *Id.*

34 81 A.3d 278 (Del. Ch. 2013).

35 *DLO Enters.*, 2020 WL 2844497, at *8 (quoting *Asia Global*, 322 B.R. at 257).

36 *Id.*

37 *Id.* at *8 (quoting *Asia Global*, 322 B.R. at 257).

38 *Id.* (quoting *Asia Global*, 322 B.R. at 257).

and second" and as such, "favor[ed] production of the post-closing documents."[39]

Finally, the fourth factor asks whether the corporation "notif[ied] the employee," or the employee was "aware, of the use and monitoring policies."[40] The Court stated that this factor also supported production because at the bottom of the emails at issue there was a disclaimer stating that "messages sent to and from employees in our organization may be monitored."[41]

Following application of the four-factor test, the Court noted that, as explained in *Information Management*, the presence of a jurisdictional statute regarding the confidentiality of work emails may alter the results of the four-factor *Asia Global* analysis. As such, the Court ordered supplemental briefing on the presence of any such statute.

The Court also ordered supplemental briefing to decide whether the pre-closing Category Two Documents should be produced, explaining that the "proper test may be one of inadvertent production, rather than solely a consideration of the employees' expectation of privacy when working for" the target company.[42]

Finally, the Court took issue with the fact that the buyers' counsel reviewed the content of the "potentially privileged Category Two Documents in their possession."[43] The Court stated that the buyers' counsel's review of the documents was "inappropriate" and that they should have "abstained from reviewing" the documents "pending resolution of the privilege dispute."[44] The Court stated that, upon resolution of the motion, the sellers had permission to seek relief "to rectify this wrong" if any of the documents are found to be privileged.[45]

***The Anschutz Corp. v. Brown Robin Cap., LLC*, 2020 WL 3096744 (Del. Ch. June 11, 2020) (Slights, V.C.)**

In *The Anschutz Corp. v. Brown Robin Capital, LLC*,[46] the Court of Chancery held that a Delaware choice of law clause governing the construction and interpretation of a unit purchase agreement also applied to related, but extra-contractual, fraud claims.

The conflict giving rise to these claims arose from "a version of a dispute as old and abiding as commerce itself": a buyer alleged that it was the victim of fraud and breaches of contract, while "the seller maintains it sold the buyer precisely what was bargained for."[47] A collection of individuals and entities sold OnRamp Access, LLC ("OnRamp"), to the buyer, LightEdge Holdings, LLC ("LightEdge"), via a unit purchase agreement (the "UPA"). Prior to closing, one of OnRamp's largest customers made multiple requests for major service reductions. LightEdge only learned of these requests post-closing, when the customer reduced its business with OnRamp by nearly half. LightEdge also discovered that data in OnRamp's sales pipeline was incorrect, as several of the sales opportunities listed in the pipeline were either wholly speculative or had been rejected well before closing. LightEdge alleged that disclosure of the business reduction was required under the UPA and that the pipeline data was falsified, and brought claims for breaches of the UPA's representations and warranties and for extra-contractual fraud based on the same alleged conduct.

LightEdge alleged that its injury occurred in both Texas and Colorado and brought fraud and securities violations based on Texas and Colorado statutes. The sellers moved to dismiss these claims, arguing that because the UPA contained a Delaware choice of law provision, the foreign statutes could not be invoked. In response, LightEdge argued that "the choice of law provision applies only to the construction and interpretation of the UPA, and therefore its other common law and statutory claims are not subject to the provision."[48]

The Court disagreed with LightEdge. Finding that "the fraud claims in this case are entangled at a granular level with the operative contract's allocation of risk," the Court decided that "[t]o try to parse out what exactly should be decided under Delaware law and what falls under another state's law (e.g., Texas, Colorado or some combination of both) would be a foolhardy endeavor almost certain to result in the kind of confusion contractual choice of law provisions are

39 *Id.* at *9.
40 *Id.* at *8 (quoting *Asia Global*, 322 B.R. at 257).
41 *DLO Enters.*, 2020 WL 2844497 at *9.
42 *Id.*
43 *Id.* at *10.
44 *Id.*
45 *Id.*
46 2020 WL 3096744 (Del. Ch. June 11, 2020).
47 *Id.* at *1.
48 *Id.* at *7.

meant to avoid."[49] The Court noted that this endeavor would have been especially difficult in this case, given that "[t]he conduct giving rise to the breach of contract claims is, with one potential exception, identical to the conduct giving rise to the fraud claims" and because "this case involves a separate disagreement between the parties about whether the UPA contains unambiguous anti-reliance language that would bar extra-contractual fraud claims."[50] The Court therefore held that the Delaware choice of law provision applied to the extra-contractual claims and dismissed the claims brought under the Colorado and Texas statutes.

*Anschutz* demonstrates that the application of Delaware choice of law provisions can extend beyond contractual breaches when the allegations underlying fraud and breach of contract claims are sufficiently intertwined.



49 *Id.* at *8.

50 *Id.* (footnote omitted).

# Special Proceedings Under the Delaware General Corporation Law

***Paraflon Invs., Ltd. v. Linkable Networks, Inc.*, 2020 WL 1655947 (Del. Ch. Apr. 3, 2020) (Slights, V.C.)**

In *Paraflon Investments, Ltd. v. Linkable Networks, Inc.*,[1] the plaintiff, Paraflon Investments, Ltd., brought an action in the Court of Chancery pursuant to Section 220 of the Delaware General Corporation Law ("Section 220") against the defendant, Linkable Networks, Inc. ("Linkable"), seeking inspection of certain categories of Linkable's books and records. The *Paraflon* case is significant because the Court emphasized that Paraflon had to demonstrate a credible basis of *non-exculpated* misconduct. This arguably conflicts with the Court's recent holding in *Lebanon County Employees' Retirement Fund v. Amerisourcebergen Corp.*,[2] which the *Paraflon* decision did not directly address.

Paraflon first invested in Linkable in October 2014 and eventually became one of its largest investors. In the years that followed Paraflon's initial investment, Linkable remained unprofitable. Yet, Paraflon's owner and controller, Michael Sarkesian, made an additional investment in Linkable in November 2016.

1 2020 WL 1655947, at *1 (Del. Ch. Apr. 3, 2020).

2 2020 WL 132752, at *23 (Del. Ch. Jan. 13, 2020) ("It would be premature to allow AmerisourceBergen to rely on its exculpatory provision to foreclose an inspection into possible corporate wrongdoing. The inspection could lead to non-exculpated claims."). In *Amerisourcebergen*, the Court dismissed the defendant's Section 102(b)(7) defense and held that "the plaintiffs' inspection rights do not depend on the existence of an actionable claim for damages against the board of directors. The plaintiffs need only establish a credible basis of from which a court can infer possible mismanagement or corporate wrongdoing, which they have done." *Id.* at *19.

Despite Paraflon's additional investment, Linkable was in desperate need of capital and approached Blue Chip Venture Capital ("Blue Chip"), a Linkable investor, for funding. Blue Chip agreed to invest an additional $2.5 million and signed a term sheet on November 8, 2016. Shortly thereafter, however, Linkable founder Thomas J. Burgess notified Mr. Sarkesian that Linkable would not be pursuing the Blue Chip funding because Blue Chip was attempting to "walk back on the term sheet."[3] Linkable did not counter-sign the final Blue Chip investment agreement and did not attempt to enforce the term sheet.

In the beginning of 2017, Linkable's financial condition continued to decline. Linkable's management ultimately decided that Linkable would pursue a sale to a single strategic buyer and signed an asset purchase agreement with Collinson Group ("Collinson"). The transaction with Collinson closed on September 1, 2017. A Linkable co-founder and board member, Francis Correra, entered into a consulting agreement with Collinson after the transaction.

Paraflon sent its Section 220 demand for books and records to Linkable on August 11, 2017 (the "Demand"). The Demand's stated purpose was "to investigate potential mismanagement or wrongdoing at Linkable" and requested financial records, documents related to the Collinson transaction, documents concerning other potential buyers, board minutes, and documents concerning the failed Blue Chip transaction. Linkable made a voluntary production, but Paraflon sought more documents and subsequently filed a complaint in the Court of Chancery on August 24, 2017. Linkable made a second production in an attempt to resolve the

3 *Paraflon*, 2020 WL 1655947, at *2.

litigation,[4] but Paraflon insisted that various categories of document requests remained unaddressed including documents concerning the failed Blue Chip transaction, documents concerning the Collinson transaction, certain financial records,[5] and copies of certain consumer contracts. The request for consumer contracts was not included in Paraflon's Demand.[6]

The Court focused its analysis on whether Paraflon had demonstrated "a credible basis from which a court can infer that mismanagement or wrongdoing may have occurred."[7] The Court noted "[w]here, as here, the corporation's charter contains an exculpatory provision under 8 *Del C.* § 102(b)(7), the stockholder's purpose must target non-exculpated wrongdoing."[8] The Court analyzed whether Paraflon had demonstrated a credible basis of non-exculpated wrongdoing as related to each category of document requests.

First, Paraflon requested documents concerning the Blue Chip financing. Paraflon argued that Linkable's failure to enforce the Blue Chip term sheet given its dismal financial condition could not be attributed to the exercise of business judgment. Paraflon argued that it was possible that Linkable failed to enforce the term sheet as a concession to a board member who was affiliated with Blue Chip, in violation of the duty of loyalty. The Court determined that Paraflon "ha[d] presented some evidence that, in the midst of the imminent demise of [Linkable], the Board elected not to pursue Linkable's rights to access capital for reasons other than the best interests of [Linkable] and its stockholders."[9] The Court therefore held that Paraflon satisfied the low burden to demonstrate a credible basis of a non-exculpated duty of loyalty claim and was entitled to review all Board level documents concerning the failed Blue Chip transaction.

Second, Paraflon requested documents concerning the sale of Linkable to Collinson. Paraflon argued that the fact that Mr. Correra entered into a consulting agreement with Collinson after the transaction provided a credible basis to infer that the Collinson transaction was the result of self-dealing. The Court held that Correra's short-term consulting role with Collinson following the transaction was insufficient to support a credible basis of non-exculpated wrongdoing, and denied Paraflon's request to inspect this category of documents. The Court noted that the record was "devoid of evidence that Correra dominated or controlled the Board, giving him the *de facto* power to control the transaction" and Linkable had "provided evidence that the Collinson transaction was only agreed to after a vigorous, arms-length sales process."[10] The Court concluded that "[i]n the face of an otherwise robust sales process, the mere fact that Correra secured a short-term consulting role with Collinson post-closing does not provide a credible basis to support wrongdoing."[11]

Third, Paraflon requested copies of corporate contracts that Linkable allegedly represented to Paraflon that it had entered into with certain retailers in order to induce Paraflon to invest. The Court held that, as a matter of law, Linkable did not have to produce the contracts because Paraflon did not include a request for those documents in its Demand.

***Martinez v. GPB Capital Holdings, LLC*, 2020 WL 3054001 (Del. Ch. June 9, 2020) (Glasscock, V.C.)**

In *Martinez v. GPB Capital Holdings, LLC*,[12] the Court of Chancery dismissed a books and records action brought by an investment advisor pursuant to Section 17-305 of the Delaware Revised Uniform Limited Partnership Act ("Section 17-305") because the investment advisor (i) lacked standing to pursue a statutory books and records demand and (ii) was not a third-party beneficiary entitled to pursue a contractual books and records demand. The Court also dismissed a related limited partner's demand as statutorily deficient because the demand failed to strictly adhere to the statutory requirements of Section 17-305. However, the Court allowed the limited partner's claim for specific

4 Before making its supplemental production, Linkable moved to dismiss the complaint under Court of Chancery Rule 12(b)(6) and the Court summarily denied the motion. *Id.* n.1. The Court noted that "[a] motion to dismiss a Section 220 complaint for failure to state a claim is, to put it mildly, *irregular." Id.* (emphasis in original).

5 At trial, counsel to Linkable confirmed that Linkable had provided to Paraflon all of its financial statements, and the Court deemed the request satisfied. *Id.* n.35.

6 *Id.* at *3.

7 *Id.* (quoting *Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 121 (Del. 2006)).

8 *Id.*

9 *Id.*

10 *Id.* at *5.

11 *Id.*

12 2020 WL 3054001 (Del. Ch. June 9, 2020).

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performance of the partnership agreement to proceed as a plenary action despite the fact that the complaint was filed as a hybrid summary-plenary action.

The action arose after two plaintiffs sought books and records from GPB Capital LLC ("GPB"), the general partner of several limited partnerships, including GPB Automotive Portfolio, LP; GPB Holdings I, LP; GPB Holdings II, LP ("Holdings II"); and GPB/Armada Waste Management, LP. Plaintiff Hightower Advisors LLC ("Hightower") acted as an investment advisor for investors purchasing interests in the limited partnerships controlled by GPB. Plaintiff Alfredo Martinez owned a limited partner interest in Holdings II.

On August 21, 2019, Hightower made a demand upon GPB pursuant to Section 17-305, claiming GPB failed to provide timely financial information to its limited partners. Hightower made the demand on behalf of its clients that invested in GPB, including Martinez, claiming the purpose of the demand was to determine whether GPB had breached its fiduciary duties. The demand, however, did not identify Hightower's clients or the clients' limited partner interests in the GPB entities.



GPB rejected the demand, stating the demand should have been made by the limited partners directly and asserting that the demand was brought for an improper purpose. Hightower responded by providing affidavits from each of its limited partner clients that stated Hightower was authorized to make the demand on the limited partners' behalf. GPB again refused the demand, asserting the same objections it had in connection with the previous demand.

On December 16, 2019, the plaintiffs filed a complaint seeking to compel inspection of GPB's books and records. The plaintiffs argued they were entitled to the books and records under Section 17-305 as well as provisions in the various limited partnership agreements that allowed the limited partners to examine the partnership's books and records and request additional information necessary to assess the activities of the partnership. GPB moved for judgment on the pleadings, arguing no material facts existed and that it was entitled to judgment as a matter of law.

As a threshold matter, the Court held that Hightower lacked standing to make a demand on any of the GPB entities, based on the ordinary meaning of Section 17-305. In particular, Section 17-305 provides that "if a general partner refuses to permit a limited partner to obtain [information that a limited partner may obtain under Section 17-305(a)] . . . *the limited partner* may apply to the Court of Chancery for an order to compel such disclosure."[13] The Court found the statute unambiguously precluded Hightower from bringing the demand because it was not a limited partner of any of the GPB entities. On that same basis, the Court held that Martinez only had standing to pursue a books and records action on behalf of Holdings II, of which he was a limited partner.

The Court also held that Hightower lacked standing to pursue a books and records demand under the limited partnership agreements because it was not a party to the agreements. The Court explained that such a claim was tantamount to a claim for specific performance, which can only be pursued by (i) a party to a contract and (ii) a third-party beneficiary. The Court held that Hightower failed to plead any of the requirements necessary to show third-party beneficiary status, and that even if it did, the agreements explicitly disclaimed third-party beneficiaries.[14] In so holding, the Court rejected Hightower's argument that it had standing to pursue a books and records action because the limited partnership agreements allowed "designees" of the limited partners to "examine or request" books and records. The Court held that the right to "examine or request" was not equivalent to the right to pursue an action to enforce the contract.

The Court next addressed whether Hightower's demand on behalf of Martinez complied with the statutory requirements of Section 17-305. The Court held that the demand failed to comply with the form and manner requirements of Section 17-305 because it did not include an affidavit stating Hightower was authorized to act on Martinez's behalf at the time of the demand. The Court noted that Section 17-305(d) mandates that a demand be "accompanied by a power of attorney or such other writing which authorizes

13 *Id.* at *5 (quoting 6 Del. C. § 17-305(e) (emphasis in the original)).

14 *Id.* at *6 (noting that the requirements necessary to show third-party beneficiary status include: "(i) the contracting parties intended that the third party beneficiary benefit from the contract, (ii) the benefit was intended as a gift or in satisfaction of a pre-existing obligation to that person, and (iii) the intent to benefit the third party was a material part of the parties' purpose in entering into the contract").

the attorney or other agent to so act on behalf of the limited partner,"[15] and that Delaware requires "strict adherence" to the statutory requirements in order to conserve resources and avoid unnecessary litigation.[16] Drawing from the Delaware Supreme Court's decision in *Central Laborers Pension Fund v. News Corp.*,[17] the Court held that "accompanied by" requires the demand to be accompanied by a power of attorney at the time the demand is made. The Court further held, based on *Central Laborers*, that "a demand that does not fulfill all procedural requirements of the statute *when made* does not and *cannot* comply with the statute" and can no longer be cured, regardless of whether or not litigation on the demand was already initiated.[18] Because Martinez's affidavit was submitted a month after the demand was made, the Court concluded that the demand did not adhere to the strict requirements of Section 17-305(d) and that the deficiencies could not be cured by the subsequent affidavit.

Although the Court dismissed Martinez's statutory claim, it held that Martinez could proceed on his contractual claim. The Court noted that ordinarily contractual claims cannot be brought in a summary books and records proceeding because allowing complex claims would expand the proceedings to a plenary trial that would overwhelm the purpose of the special proceedings under Section 17-305. However, because the statutory books and records claims were dismissed, the Court held Martinez's contractual claim could proceed "outside of the framework of a summary books and records action."[19]

The decision in *Martinez* reaffirms the rule that parties seeking books and records must strictly adhere to Section 17-305's form and manner requirements when making a demand, and that a deficient demand cannot be retroactively cured and instead must be resubmitted. Accordingly, a party issuing a demand should be careful to provide all information in the manner required by the statute at the time the demand is issued in order to avoid dismissal of a complaint that relies on the demand.

15 *Id.* (quoting 6 *Del. C.* § 17-305(d)).

16 *Id.* (quoting *Gay v. Cordon Int'l Corp*, 1978 WL 2491, at *1 (Del. Ch. Mar. 31, 1978)).

17 45 A.3d 139 (Del. 2012) (holding that the subsequent filing would comply with the statute "only if it was submitted with either a new or amended demand").

18 *Martinez*, 2020 WL 3054001, at *8 (emphasis in the original).

19 *Id.*

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