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Delaware Corporate Law Quarterly Update

Q3 2020

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

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Actions Involving Breach of Fiduciary Duty Claims

***In re HomeFed Corp. S'holder Litig.*, 2020 WL 3960335 (Del. Ch. July 13, 2020) (Bouchard, C.)**

In *In re HomeFed Corp. S'holder Litig.*,[1] the Court of Chancery denied the defendants' motions to dismiss former stockholders' claims against the company's directors and controlling stockholder for breaches of fiduciary duty arising from a squeeze-out merger by the controlling stockholder. Although the transaction was formally conditioned on approval by a special committee of the board of directors and on approval of a majority of the minority stockholders, the Court found that the protections of *Kahn v. M & F Worldwide Corp.* ("*MFW*")[2] did not apply because the controlling stockholder had undermined the *MFW* protections by engaging in substantive transaction negotiations before the *MFW* protections were put in place.

This case arose from a transaction whereby Jefferies Financial Group Inc. ("Jefferies"), a corporation then holding 70% of the shares of HomeFed Corporation ("HomeFed"), acquired HomeFed's remaining shares in July 2019. The allegations date back to 2017, when a HomeFed director proposed that Jefferies take HomeFed private by exchanging two shares of Jefferies stock for each share of HomeFed stock held by minority stockholders. That December, the board formed a special committee. The committee subsequently paused its process in March 2018, after Jefferies expressed disinterest in the transaction. For nearly a year thereafter, Jefferies discussed a potential transaction directly with the company's largest minority stockholder, who, in February 2019, signaled support for a 2 to 1 share exchange. Jefferies then proposed the transaction conditioned on approval of both a special committee and a majority of the minority stockholders, and the reactivated special committee later approved the 2 to 1 share exchange.

The plaintiffs, former HomeFed stockholders, asserted claims for breach of fiduciary duty against the HomeFed directors and Jefferies, as the controlling stockholder. The defendants moved to dismiss the complaint for failure to state a claim, arguing that the transaction was conditioned on the dual protections laid out in *MFW* and was thus subject to business judgment review. The plaintiffs countered that the board failed to properly implement the *MFW* protections because the transaction was not conditioned *ab initio*—at the beginning of the process—on the approval of both a majority of the minority stockholders and a special committee.

The principal question before the Court was whether Jefferies, as the controlling stockholder, "commit[ed] to the *MFW* protections before engaging in substantive economic discussions concerning the Transaction."[3] To that end, the parties disputed whether the 2019 transaction, which was conditioned facially on *MFW*'s

1 2020 WL 3960335 (Del. Ch. July 13, 2020).

2 88 A.3d 635, 644 (Del. Mar. 14, 2014). In *MFW*, the Delaware Supreme Court held that "business judgment is the standard of review that should govern mergers between a controlling stockholder and its corporate subsidiary, where the merger is conditioned *ab initio* upon both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care, and the uncoerced, informed vote of a majority of the minority stockholders." *In re HomeFed Corp. S'holder Litig.*, 2020 WL 3960335, at *8 (citing *MFW*, 88 A.3d at 644).

3 *In re Homefed Corp. S'holder Litig.*, 2020 WL 3960335 at *10.

protections, was part of the original 2017 offer, which occurred before the *MFW*'s protections were put in place. The Court found reasonably conceivable the plaintiffs' argument that the offer Jefferies made in February 2019 was a continuation of the process initiated in December 2017. The Court considered several of the allegations to determine that the final transaction spawned from the 2017 offer, including that: (1) the board stated in March 2018 that the original special committee was never disbanded, but was merely "paused"; (2) Jefferies' discussions with the company's largest minority stockholder continued throughout the eleven-month pause; and (3) the February 2019 offer had the same essential terms as the 2017 offer, namely the 2 to 1 share exchange.

However, the Court determined that it ultimately did not matter whether the transaction was a continuation of the 2017 discussions. The Court explained that, even if it were to accept the defendants' argument that the 2019 transaction was separate from the 2017 offer, Jefferies engaged in substantive negotiations with the company's largest minority stockholder beginning in 2018 before Jefferies agreed to subject the transaction to *MFW*'s conditions. Thus, the "*ab initio*" requirement was not satisfied. In response to Jefferies' argument that its discussions with the company's largest minority stockholder were only preliminary, the Court held that a discussion of the exchange ratio in a stock for stock transaction was a negotiation of an essential deal term.

Expounding on *In re Dell Technologies Inc. Class V Stockholders Litigation* ("*Dell*"),[4] the Court also rejected the idea that the claims should be subject to a pleading-stage dismissal because the discussions, which *preceded* enactment of the dual protections, occurred between the controller and a minority stockholder who lacked authority to bind the company. "In *Dell*, the Court held that defendants were not entitled to dismissal under *MFW* where the controller bypassed the special committee" to negotiate directly with stockholders *after* the *MFW* protections were put into effect.[5] In the present case, the Court explained that the controller's negotiations directly with a minority stockholder *prior* to the special committee's activation undermined the effectiveness of the special committee as much as if those negotiations followed activation of a formally authorized special committee, as they did in *Dell*. Thus, the Court concluded that the complaint sufficiently alleged that Jefferies failed to satisfy *MFW*'s conditions and that Jefferies "anchored the negotiations and undermined the Special Committee's ability to bargain effectively as the minority stockholders' agent."[6]

The two director defendants who were not senior employees of Jefferies[7] also argued that they were protected by a Section 102(b)(7) exculpatory provision in HomeFed's certificate of incorporation and that, therefore, the claims should be dismissed against them under *In re Cornerstone Therapeutics Inc. Shareholder Litigation*.[8] The Court found that the plaintiffs pleaded facts supporting a rational inference that, by voting to approve the transaction, the two director defendants acted to advance Jefferies' interests, and could not be presumed to act independently. In so holding, the Court considered allegations against the directors that when they cast their votes: (i) one director was serving as an executive officer of HomeFed; (ii) another director had been receiving consulting fees from HomeFed as his sole employment apart from serving as a HomeFed director; and (iii) "two of their fellow directors had questioned their independence."[9] The Court noted that while "the presence of a controller does not alone overcome the presumption of director independence, it is relevant when considering [the] [p]laintiffs' allegations holistically."[10]

The Court's opinion in this case serves as a reminder that in order to enjoy the benefits of *MFW*, a controlling stockholder must not engage in any substantive negotiations until the *MFW* protections are put in place. And discussions concerning the exchange ratio in a stock-for-stock transaction constitutes substantive negotiations.

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4 2020 WL 3096748, at *17 (Del. Ch. Jun. 11, 2020).

5 *In re HomeFed Corp. S'holder Litig.*, 2020 WL 3960335, at *12 (citing *Dell*, 2020 WL 3096748, at *19-20).

6 *Id.* at *11.

7 Two of the other directors—the members of the special committee—were previously dismissed from the case through stipulation of the parties.

8 115 A.3d 1173 (Del. 2015). "When a director is protected by an exculpatory charter provision, a plaintiff can survive a motion to dismiss by that director defendant by pleading facts supporting a rational inference that the director harbored self-interest adverse to the stockholders' interests, acted to advance the self-interest of an interested party from whom they could not be presumed to act independently, or acted in bad faith." *In re HomeFed Corp. S'holder Litig.*, 2020 WL 3960335, at *12 (citing *Cornerstone*, 115 A.3d at 1179-80).

9 *In re HomeFed Corp. S'holder Litig.*, 2020 WL 3960335, at *14.

10 *Id.*

***In re MetLife Inc. Derivative Litig.*, 2020 WL 4746635 (Del. Ch. Aug. 17, 2020) (Glasscock, V.C.)**

In *In re MetLife Inc. Derivative Litigation.*,[11] the Court of Chancery granted the defendants' Rule 23.1 motion to dismiss, holding that the plaintiffs' failure to make pre-suit demand on the company's board of directors was not excused. In doing so, the Court held that the only argument advanced by the plaintiffs as to why demand was excused—that a majority of the board faced a substantial likelihood of liability under *In re Caremark International Inc. Derivative Litigation* ("*Caremark*")[12] regarding the matters raised in the complaint and were therefore incapable of making a decision on whether the company should pursue litigation—was not sufficiently plead. This case is the latest to demonstrate that, although stockholder plaintiffs have managed to survive dismissal of *Caremark* claims on a handful of occasions over the past two years,[13] pleading a *Caremark* claim remains "among the hardest to plead and prove" under Delaware law.[14]

MetLife Inc. ("MetLife") is a Delaware corporation in the business of insurance and financial services. One of MetLife's business lines is the Pension Risk Transfer Business, which acquires assets of defined benefit pension plans and assumes the responsibility to pay the beneficiaries and identify when the beneficiaries are entitled to begin receiving payments. MetLife is legally and contractually required to keep sufficient funds in reserve accounts to pay all future claims, and it cannot release funds from the reserve accounts and recognize the funds as earnings until a beneficiary is deemed deceased.

MetLife would acquire the addresses for the beneficiaries from the beneficiaries' employers when it obtained the pension obligations, but MetLife did not maintain any sort of contact with beneficiaries, seek updated contact information, or verify the addresses received from the employers. When a beneficiary reached age 65, MetLife would send its first letter to the address on file. If MetLife did not receive a response to the first letter, "it presumed the [beneficiary] had deferred retirement benefits beyond the normal retirement date."[15] At age 70 and a half, MetLife would send a second letter. If MetLife did not receive a response to the second letter, "it labeled the [beneficiary] 'Presumed Dead' and released funds associated with that [beneficiary] from the reserve accounts."[16] "MetLife made no follow-up efforts to confirm these presumptions, even if the letters were returned undeliverable."[17]

This two-letter notice system resulted in MetLife erroneously designating liabilities as assets on its financial statements. In December 2017, MetLife publicly disclosed the issues with its two-letter notice system. In its disclosure, MetLife noted that it would implement new notice procedures, and that such procedures could have a material impact on its financial statements. Following this disclosure, MetLife faced a securities class action in New York and ultimately entered into a settlement agreement that required it to pay a $19.75 million fine to New York and $189 million in restitution to affected beneficiaries. Shortly after entering into the settlement, MetLife issued a press release announcing it would revise previous financials to strengthen its reserves, disclosed an examination by the New York State Department of Financial Services, and disclosed an inquiry by the United States Securities and Exchange Commission.

The plaintiffs, who were MetLife stockholders, filed a derivative complaint in September 2019. The plaintiffs alleged that the defendants, several then-current and former directors and officers of Metlife, breached their fiduciary duties under *Caremark* by consciously disregarding red flags about the two-letter notice system, resulting in reputational and monetary harm to

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11 2020 WL 4746635 (Del. Ch. Aug. 17, 2020).

12 698 A.2d 959 (Del. Ch. 1996). To carry out one's duties under *Caremark*, "a director must make a good faith effort to oversee the company's operations." *Marchand v. Barnhill*, 212 A.3d 805, 820 (Del. 2019). To 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).

13 *See Marchand*, 212 A.3d 805; *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); *Hughes v. Hu*, 2020 WL 1987029 (Del. Ch. Apr. 27, 2020); *Teamsters Local 443 Health Servs. & Ins. Plan v. Chou*, 2020 WL 5028065 (Del. Ch. Aug. 24, 2020).

14 *In re MetLife Inc.*, 2020 WL 4746635 at *14 (quoting In re *Clovis Oncology, Inc. Derivative Litig.*, 2019 WL 4850188, at *12).

15 *Id.*

16 *Id.*

17 *Id.*

MetLife. The plaintiffs also alleged unjust enrichment against all defendants and corporate waste against the director defendants for the salaries and bonuses they received while allegedly violating their *Caremark* duties.

The plaintiffs argued that pre-suit demand was futile under *Rales v. Blasband*[18] because a majority of the board faced "a substantial likelihood of liability for their role in MetLife's improper misconduct."[19]

The Court granted the defendants' motion to dismiss for failure to plead demand futility. The Court explained that, under *Rales*, the plaintiffs must plead "particularized factual allegations 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."[20] The Court held that the plaintiffs failed to do so. The Court began its analysis by noting that "a *Caremark* claim is among the hardest to plead and prove."[21] The Court further explained that because MetLife's certificate of incorporation contained a 102(b)(7) exculpation provision for breaches of the duty of care, in order to prove demand futility, the plaintiffs would need to plead particularized facts showing that a majority of the board violated their *Caremark* duties in bad faith.

The Court then considered two categories of alleged red flags raised by the plaintiffs to support their argument that the demand board faced a substantial likelihood of liability for violating their *Caremark* duties.[22] The first group of alleged red flags related to regulatory inquiries and securities litigation against MetLife in 2011 and 2012. However, the 2011 and 2012 regulatory inquiries and securities litigation were directed at MetLife's life insurance business and related to the tracking of insureds' deaths and the payment of death benefits to beneficiaries upon the death of the insured, not the Pension Risk Transfer Business, where pension payments to beneficiaries would cease upon the beneficiaries' death. Although the Court agreed with the plaintiffs that MetLife's life insurance and Pension Risk Transfer Business were analogous business lines, the Court found that there was nothing in the regulatory inquiries or litigation that put those aware of them on "direct notice of deficiencies in the Pension Risk Transfer Business. . . ."[23]

The Court determined that it was not bad faith for the board to fail to implement into the Pension Risk Transfer Business the new procedures that MetLife adopted for identifying beneficiary deaths in the insurance business as part of a settlement to resolve the regulatory inquiries, even if such a decision was unwise. Further, the Court noted that there were insufficient allegations to find that a majority of the board was aware of the regulatory actions. In doing so, the Court rejected the plaintiffs' argument that it was highly likely that the board knew of the regulatory actions, stating that the Court has "generally rejected constructive knowledge of unlawful conduct as a theory in demand futility cases."[24]

Although four members of the board—a minority—were named defendants in the securities litigation concerning the same issues as the regulatory actions, there was no indication that those directors disclosed the lawsuit or the regulatory actions to other members

18 634 A.2d 927 (Del. 1993). 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, Inc. S'holder Derivative Litig.*, 2020 WL 2036602, at *8 (Del. Ch. Apr. 28, 2020). 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. 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. 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 v. Lewis*, 473 A.2d 805, 814 (Del. 1984.)

19 *In re MetLife Inc.*, 2020 WL 4746635 at *10.

20 *Id.* (internal quotations omitted).

21 *Id.* at *14 (quoting *In re Clovis Oncology, Inc. Derivative Litig.*, 2019 WL 4850188, at *12).

22 The Court held that "[t]o the extent the Plaintiffs attempt to put forward a claim under *Caremark's* first prong [failure to implement any reporting or information system or controls], I find that attempt fails. It is clear from the Complaint that MetLife had an extensive network of internal controls." *Id.* at *13. Thus, the opinion focuses on *Caremark's* second prong: whether having implemented a system of controls, the directors consciously failed to oversee or monitor its operations.

23 *Id.* at *15.

24 *Id.* (citing *Horman v. Abney*, 2017 WL 242571, at *7 (Del. Ch. Jan. 19, 2017)).

of the board. The Court concluded that the plaintiffs "require[d] too many attenuated inferences to transverse from regulatory guidance and settlements on the part of [MetLife], to bad faith on the part of any director with regard to the Pension Risk Transfer Business."[25]

The second group of alleged red flags related to an internal auditor's report presented to MetLife's audit committee in September 2016, a United States Department of Labor ("DOL") investigation that was opened in 2015, and a pilot program initiated by MetLife in December 2017 to search for Pension Risk Transfer Business beneficiaries using methods beyond the business's pre-existing two-letter system. The plaintiffs alleged that the internal auditor's report found weaknesses regarding payments to beneficiaries and that the report set year-end targets for improvement. However, the audit committee did not follow-up on the report and there was no allegation that the report was brought to the attention of the entire board. The DOL investigation was opened after complaints that pensions were going unpaid. In response to the DOL investigation, MetLife created a pilot program which showed that the two-letter notification system was inadequate and proposed new methods to identify and pay beneficiaries. The board reviewed the findings in January 2018, but, by that point, MetLife already publicly announced the shortcomings with the Pension Risk Transfer Business.

The Court concluded that the plaintiffs failed to sufficiently plead that the board "was aware of red flags and ignored them in bad faith."[26] The Court stated that "[c]learly, the Board had notice of the DOL investigation and the Pilot Program in January 2018, and MetLife identified, disclosed, and responded to the problem."[27] With respect to the internal auditor report, the Court stated that the question is not whether the directors "could have saved the Company from embarrassment, fines and securities litigation had the Board been informed of weaknesses at the time of the Internal Auditor Report, and taken prompt action."[28] Rather, the question is whether the directors acted in "conscious disregard of their duties."[29] The Court held that a "failure to undertake immediate remediation of a reported defect, even where immediate action would be wise, is not evidence of bath faith unless it implies a need to act so clear that to ignore it implies a conscious disregard of duty" and that "[s]uch a failure, obviously, can only occur with knowledge of the defect."[30] The Court noted that "[t]he allegation closest to stating indifference in the face of a duty to act is that the Audit Committee failed to ensure that the remediation called for in the Internal Auditor's Report was implemented, and its failure to bring the Internal Auditor's Report to the attention of the full Board."[31] However, to the extent this lack of action implied a duty to act, it "would taint only a minority of the Demand Board" as only three members were on the audit committee.[32]

The Court also held that the plaintiffs failed to establish demand futility with respect to the unjust enrichment and waste claims because both of those claims were premised on the underlying *Caremark* claims. The Court explained that the unjust enrichment claims were "conceived as a form of additional damages dependent on the plaintiff proving the oversight claim…"[33] As a result, the Court determined that because the plaintiffs failed to show that a majority of the board faced a substantial likelihood of liability in connection with the *Caremark* claims, it must conclude the same with respect to the unjust enrichment and waste claims.

***In re Coty Inc. Stockholder Litig.*, 2020 WL 4743515 (Del. Ch. Aug. 17, 2020) (Bouchard, C.)**

In *In re Coty Inc. Stockholder Litigation*,[34] the Court of Chancery denied a motion to dismiss breach of fiduciary duty claims against the directors of Coty Inc. ("Coty") and affiliates of its alleged controller in connection with a tender offer by the alleged controller. In doing so, the Court rejected an abstention defense by directors who did not participate in the board vote to recommend the tender offer, holding that it was reasonably conceivable that those directors "did not totally abstain from the process by which the Tender Offer was approved."[35] The Court also rejected the defendants' argument that there was no harm to stockholders who continued to

25 *Id.* at *16.
26 *Id.* at *18.
27 *Id.* at *17.
28 *Id.* at *18.
29 *Id.*
30 *Id.*
31 *Id.* at *18 n. 228.
32 *Id.*
33 *Id.* at *18 (quoting *Hughes v. Hu*, 2020 WL 1987029, at *17 (Del. Ch. Apr. 27, 2020)).
34 2020 WL 4743515 (Del. Ch. Aug. 17, 2020).
35 *Id.* at *10.

own stock after the tender offer because, accepting the plaintiffs' allegations that the purported controller—a holder of 40 percent of the outstanding shares—controlled the corporation prior to the tender offer, the tender offer did not change how the stockholders were situated (*i.e.*, they were minority stockholders of a controlled corporation both before and after the tender offer). The Court reasoned that it could not, on a motion to dismiss, rule out the possibility that the remaining stockholders "suffered harm when [the alleged controller] secured mathematical control of Coty through the Tender Offer."[36]

In early 2019, JAB, a German conglomerate, and its affiliates owned approximately 40% of the outstanding shares of Coty, a Delaware Corporation that operates in the beauty products industry. Four of Coty's nine board members also served in fiduciary roles at JAB entities (the "JAB Directors"). A fifth director was Coty's CEO. The four remaining directors did not occupy management positions with Coty (the "Outside Directors").

In February 2019, JAB sent a letter informing the Coty board that a JAB affiliate planned to launch a tender offer to acquire up to 150 million shares of Coty at $11.65 per share. The proposed tender offer was "conditioned on the independent directors of the Company approving the Tender Offer and recommend[ing] that the Company's shareholders accept the Tender Offer."[37]

JAB launched the tender offer the day after JAB sent the letter to the board. Coty's board formed a special committee consisting of three of the four Outside Directors to evaluate the tender offer. JAB refused to negotiate a price increase for the tender offer but agreed to enter into a stockholders agreement with "provisions that were intended to protect Coty's minority shareholders."[38]

In March 2019, the special committee recommended approval of the stockholders agreement and the tender offer. That same day, the board voted to accept the special committee's recommendations, and Coty entered into the stockholders agreement with the JAB entities. The JAB Directors recused themselves from the board vote. When the tender offer closed in April 2019, the JAB entities' collective ownership of Coty increased from 40% to 60%.

In May 2019, Coty stockholders filed suit challenging the tender offer. The defendants moved to dismiss under Rule 12(b)(6) for failure to state a claim, raising two notable arguments: (1) whether the complaint "state[d] a claim for breach of fiduciary duty against the JAB Directors" even though they did not participate in the board vote; and (2) whether the complaint sufficiently alleged that the tender offer harmed the stockholders who continued to own stock after the tender offer by virtue of JAB obtaining mathematical control over Coty.[39] The Court answered each in the affirmative, and denied the motion to dismiss.

First, the Court determined that the plaintiffs stated a claim for breach of fiduciary duty against the JAB Directors even though the JAB Directors had recused themselves from the board vote to recommend the transaction. Relying on *In re Tri-Star Pictures, Inc., Litigation*,[40] the JAB Directors argued that the claims against them should be dismissed since they did not serve on the special committee or participate in the board vote. The Court noted that in *Tri-Star*, the Court of Chancery stated that "Delaware law clearly prescribes that a director who plays *no role* in the process of deciding whether to approve a challenged transaction cannot be held liable on a claim that the board's decision to approve that transaction was wrongful."[41] The Court stated that an abstention defense often requires development of the factual record and, therefore, is difficult to apply on a motion to dismiss, noting that *Tri-Star* itself was decided on summary judgment. The Court further explained that in *Voigt v. Metcalf*,[42] the Court of Chancery held that directors "were not entitled to dismissal at the pleading stage simply because they recused themselves from the board's discussion of the challenged transaction and abstained from voting on the deal."[43] Although the JAB Directors recused themselves from the vote, the recommendation statement issued in connection with the tender offer suggested that the JAB Directors participated in the board meeting before the vote,

36 *Id.* at *14.

37 *Id.* (internal quotations omitted).

38 *Id.* at *5.

39 *Id.* at *7.

40 1995 WL 106520, at *2 (Del. Ch. Mar. 9, 1995).

41 *In re Coty Inc.*, 2020 WL 4743515, at *9 (quoting *Tri Star*, 1995 WL 106520, at *2).

42 2020 WL 614999, at *1 (Del. Ch. Feb. 10, 2020).

43 *In re Coty Inc.*, 2020 WL 4743515, at *10.

"unlike the directors in *Tri-Star* and *Voigt*."[44] The Court ultimately denied the JAB Directors' motion to dismiss, explaining that, based on the facts alleged, "it [was] reasonably conceivable that the JAB Directors did not totally abstain from the process by which the Tender Offer was approved," and a "fact-specific analysis" was required.[45]

Second, the Court rejected the defendants' argument that the claims should be dismissed as to stockholders who continued to hold shares after the tender offer because they were not harmed by the tender offer. Specifically, the defendants argued that, "accepting as true Plaintiffs' allegation that JAB controlled Coty before the Tender Offer as the holder of approximately 40% of its shares, the stockholders who continued to own stock in Coty after the Tender Offer were not harmed because they were not differently situated than they were before the Tender Offer."[46] The Court explained that the defendants' argument was derived from "well-settled" Delaware law holding that a stockholder that owns less than a majority of the voting power but "exercises control" owes fiduciary duties.[47] However, the Court further explained that "[t]his legal framework does not mean that a *de facto* controller may not obtain real benefits from securing mathematical control of a corporation in a transaction and, as a corollary, that other stockholders of the corporation potentially may suffer harm as a result of such a transaction."[48] The Court recognized the potential harm for loss of a control premium,[49] determined that it could not "rule out at this stage of the case" that the stockholders "suffered harm when JAB secured mathematical control of Coty through the Tender Offer," and denied the motion to dismiss.[50]

44 *Id.* at *10.

45 *Id.*

46 *Id.*

47 *Id.*

48 *Id.*

49 *Id.* at *14 (quoting *Paramount Communications Inc. v. QVC Network Inc.*, 637 A.2d 34, 42 (Del. 1994) ("When a majority of a corporation's voting shares are acquired by a single person or entity, or by a cohesive group acting together, there is a significant diminution in the voting power of those who thereby become minority stockholders.")).

50 *In re Coty Inc.*, 2020 WL 4743515, at *14-15.

***Teamsters Local 443 Health Servs. & Ins. Plan v. Chou*, 2020 WL 5028065 (Del. Ch. Aug. 24, 2020) (Glasscock, V.C.)**

In *Teamsters Local 443 Health Services & Insurance Plan v. Chou*,[51] on a motion to dismiss, the Court of Chancery held that the plaintiff stockholders had adequately pleaded a *Caremark*[52] claim based on the defendant directors' alleged failure to exercise their oversight and monitoring obligations as to an indirect, wholly-owned subsidiary's drug distribution operations. Despite acknowledging that a *Caremark* claim "is among the most difficult of claims in the Court to plead successfully[,]"[53] *Chou* represents the latest in a string of recent decisions permitting *Caremark* claims to survive past the pleading stage.[54]

The plaintiffs, stockholders in AmerisourceBergen Corporation ("ABC"), alleged certain *Caremark* claims against seven members of ABC's board of directors.[55] The plaintiffs alleged that the director defendants breached their fiduciary duties by failing to oversee the operations of Oncology Supply Pharmacy Services ("Pharmacy"), an indirect wholly-owned subsidiary of ABC, by ignoring "red flags" and permitting "a woefully inadequate reporting system with respect to the business line in which Pharmacy operated" to exist.[56]

51 2020 WL 5028065 (Del. Ch. Aug. 24, 2020).

52 *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996). To carry out one's duties under *Caremark*, "a director must make a good faith effort to oversee the company's operations." *Marchand v. Barnhill*, 212 A.3d 805, 820 (Del. 2019). To 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).

53 *Chou*, 2020 WL 5028065 at *1.

54 *See 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); *Hughes v. Hu*, 2020 WL 1987029 (Del. Ch. Apr. 27, 2020).

55 The plaintiffs also alleged breach of fiduciary duty and unjust enrichment claims against certain officer defendants based on factual allegations that were "congruous" with those alleged in the plaintiffs' Caremark claims. Id. at *26. Because the Court found that demand was excused as to the plaintiffs' Caremark claim, the Court similarly held that demand was excused for the breach of fiduciary duty and unjust enrichment claims. Id.

56 *Id.* at *2.

"Pharmacy's sole function was to create pre-filled syringes of oncology drugs for sale and distribution to health care providers" (the "Pre-Filled Syringe Program").[57] Pharmacy would create the pre-filled syringes "by removing FDA-approved drug products from their original glass vials and repackaging them into single-dose plastic syringes."[58] This process would leave a small amount of drug product left in the original glass vial, known as "overfill," which was not intended for patient use. Pharmacy would then combine the overfill from multiple vials and repackage this "pooled excess drug product" into new syringes, allowing Pharmacy to create and sell more doses than it bought from the original drug manufacturers. Such a process "resulted in some syringes containing particulate or foreign matter" that led to over 32,000 contaminated doses being sold.[59] This practice violated FDA regulations.

Aided with documents obtained in a books and records proceeding under Section 220 of the Delaware General Corporation Law, the plaintiffs claimed that the ABC board "consciously failed to implement and monitor compliance policies and systems and failed to exercise their oversight responsibilities."[60] The plaintiffs further alleged that the director defendants ignored multiple "red flags" that "signaled to the Board that ABC was engaged in illegal conduct in operating the Pre-Filled Syringe Program."[61]

Those alleged red flags included a report from a law firm that had been hired in 2007 to review compliance controls within the company and its subsidiaries. The law firm report indicated that "ABC had no centralized compliance and reporting structure, that there was inadequate documentation and tracking compliance and ethics processes, and that there was inadequate accountability for compliance violations at ABC."[62] According to the plaintiffs, another red flag occurred via a former ABC executive's 2010 *qui tam* action challenging the legality of the Pre-Filled Syringe Program. Prior to his termination, the former executive had raised concerns that the program raised serious compliance concerns to ABC officers and directors.

57 *Id.* at *3.
58 *Id.* at *4.
59 *Id.* at *5.
60 *Id.* at *14.
61 *Id.* at *19.
62 *Id.*

According to the former executive, the ABC board engaged outside counsel to conduct a review of the company's compliance procedures, and the outside counsel made a presentation to the audit committee. But the outside counsel's "findings and recommendations were not presented to ABC's full Board, and neither the Board nor the Audit Committee received subsequent reports on the . . . Pre-Filled Syringe Program."[63]

In its analysis, the Court recognized that "when a company operates in an environment where externally imposed regulations govern its mission critical operations, the board's oversight function must be more rigorously exercised."[64] Keeping in mind this "concept of mission critical compliance risk" that emanates from the Supreme Court of Delaware's decision in *Marchand v. Barnhill*,[65] the Court of Chancery held that because "regulations governing drug health and safety" were matters of "mission critical compliance risk[s],"[66] the plaintiffs had adequately alleged that the director defendants had "consciously ignored red flags rising to the level of bad faith."[67] Accordingly, the Court denied the director defendants' motion to dismiss.

In so ruling, the Court found that the plaintiffs had adequately pled that the director defendants were "on notice of gaps" in ABC's subsidiary's (and Pharmacy's grandparent entity's) compliance following the law firm report.[68] The Court rejected the director defendants' argument that some efforts had been implemented to increase oversight in response to the report. The Court found that the company's audit committee never received any reports specifically addressing the Pre-Filled Syringe Program and that the director defendants had not shown that they took any actions "concerning [the] mission critical drug health and safety regulations[]" recommended by the report.[69] As a result, the Court also found that it was reasonably conceivable that the law firm report "represent[ed] a red flag regarding [ABC's subsidiary's] compliance failures and a potential void permitting illegal activity[.]"[70]

63 *Id.* at *12.
64 *Id.* at *18 (internal quotation marks omitted) (quoting *In re Clovis Oncology, Inc. Derivative Litig.*, 2019 WL 4850188, at *13 (Del. Ch. Oct. 1, 2019)).
65 212 A.3d 805 (Del. 2019).
66 *Chou*, 2020 WL 5028065, at *18.
67 *Id.* at *17.
68 *Id.* at *20.
69 *Id.*
70 *Id.*

The Court further found that the plaintiffs had adequately pled that the director defendants knew of the former executive's allegations contained in the *qui tam* action but "ignored such concerns in bad faith by failing [to] take action regarding the operation of the Pre-Filled Syringe Program in response."[71] In so finding, the Court noted that "the Board *did* sign ABC's 2010 and 2011 Form 10-Ks that disclosed [the former executive's] *qui tam* suit" as well as ABC's 2012 Form 10-K, which disclosed a DOJ subpoena and FDA search warrant that ABC believed related to the *qui tam* suit.[72] Moreover, the plaintiffs' allegations as to the *qui tam* suit were "sufficient to reasonably infer that the Board consciously ignored red flags regarding the Pre-Filled Syringe Program and its attendant mission critical compliance risks."[73]

Given ABC's disclosures on the *qui tam* action, the law firm report, and the board's failure to implement any changes to the Pre-Filled Syringe Program, the Court denied the director defendants' motion to dismiss the plaintiffs' *Caremark* claims and allowed the case to proceed beyond the pleading stage.

In re USG Corp. Stockholder Litig., 2020 WL 5126671 (Del. Ch. Aug. 31, 2020) (Glasscock, V.C.)

In *In re USG Corp. Stockholder Litigation*,[74] the Court of Chancery found that an inadequate proxy disclosure foreclosed the application of *Corwin v. KKR Financial Holdings, LLC*[75] to cleanse defendant directors' alleged breach of fiduciary duty in approving an acquisition, but nonetheless granted the defendant directors' motion to dismiss, holding that the stockholder plaintiffs had failed to plead a non-exculpated claim for breach of fiduciary duty. In so ruling, the Court emphasized that, where a plaintiff pleads facts sufficient to overcome a *Corwin* defense, the plaintiff has not "necessarily cleared the bar of pleading bad faith[.]"[76] The Court explained, "Doctrinally, . . . the concept of bad faith, and the determination of adequate disclosure for *Corwin* purposes, are fundamentally separate."[77] The Court also stated that where defendants are exculpated from monetary liability absent a breach of the duty of loyalty or bad faith, it is not sufficient for a plaintiff to plead that defendants failed to act reasonably to maximize value in a change of control transaction in accordance with *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[78] Rather, a plaintiff must "plead facts that make it reasonably conceivable" that the defendants' failure to do so was "tainted by interestedness or bad faith."[79]

This case arose out of the acquisition of USG Corporation ("USG") by Gebr. Knauf KG ("Knauf"). At the time of the transaction, Knauf beneficially owned approximately 10.6% of USG's outstanding common stock. In March of 2017, Knauf contacted Berkshire Hathaway, the beneficial owner of approximately 31.1% of USG's outstanding common stock, regarding a potential acquisition of USG and learned that Berkshire Hathaway was willing to sell its USG stock for about $40 per share. In November of 2017, Knauf delivered a proposal to USG to acquire all outstanding shares of USG for $40.10 per share in cash. USG's board of directors determined that the offer was inadequate and rejected the offer. In March of 2018, Knauf submitted a revised offer of $42 per share and threatened to approach USG's stockholders directly. Again, the board rejected Knauf's offer.

In April of 2018, Knauf announced a campaign by which it would solicit proxies from USG's stockholders against the election of four USG director nominees. USG's board, after being advised that the director nominees were not likely to receive the votes needed for re-election, authorized discussions with Knauf for a potential transaction within the range of $48.00 to $51.00 per share. While this range was informed by the board's views of USG's intrinsic value, the board decided not to publicly disclose its views.

In the following months, Knauf's campaign against USG's director nominees proved successful, and the parties continued to exchange offers. During this time, USG solicited offers for other potential buyers, none of which proved fruitful. On June 5, 2019, Knauf presented its "best and final" offer of $44.00 per share, and on

71 *Id.* at *24.

72 *Id.* at *21.

73 *Id.* at *24.

74 2020 WL 5126671 (Del. Ch. Aug. 31, 2020).

75 125 A.3d 304, 305-06 (Del. 2015) (affirming holding that "the business judgment rule is invoked as the appropriate standard of review for a post-closing damages action when a merger that is not subject to the entire fairness standard of review has been approved by a fully informed, uncoerced majority of the disinterested stockholders").

76 *USG Corp.*, 2020 WL 5126671, at *1.

77 *Id.*

78 506 A.2d 173 (Del. 1986).

79 *USG Corp.*, 2020 WL 5126671 at *2, *29.

June 10, USG's board unanimously approved the offer. USG then released a proxy statement in connection with the acquisition, and USG's stockholders voted to approve the transaction.

Following the acquisition, the plaintiffs filed suit, asserting a breach of fiduciary duty claim against each member of USG's board at the time of the transaction. The plaintiffs alleged the board failed to obtain the highest value available and that the process was "infected by both a conflicted controlling stockholder (Knauf) and approved in bad faith by an interested (and/or non-independent) Board."[80] The plaintiffs also alleged USG's proxy statement was materially misleading. The defendants moved to dismiss the claim, arguing Knauf was not a controlling stockholder, and that under *Corwin*, the defendants' decision was subject to business judgment review.

The Court began its analysis by addressing the plaintiffs' allegations that Knauf was a controller and that *Corwin* was therefore inapplicable. The Court explained that because Knauf only beneficially owned 10.6% of USG's common stock, it would not be considered a controlling stockholder unless the plaintiffs could plead that "Knauf was a controller under the 'actual control' test."[81] According to the plaintiffs, Knauf was a controller under the actual control test because Knauf and Berkshire Hathaway had formed a control group. The Court disagreed, highlighting that the plaintiffs' operative complaint "does not explicitly allege a control group" and that "Knauf's and Berkshire Hathaway's interests diverged regarding the most important detail of the Acquisition: the price."[82] The Court inferred that "Knauf (as the buyer) sought to pay as little as possible, and Berkshire Hathaway (as USG's largest stockholder) sought to obtain as high a price as possible for its USG stock."[83] At most, the operative complaint pled Knauf and Berkshire Hathaway had a "shared goal of a sale of USG."[84] The Court explained that the "mere concurrence of self-interest among certain stockholders" is not sufficient to allege a control group.[85]

80 *Id.* at *12.

81 *Id.* at *14.

82 *Id.* at *16.

83 *Id.*

84 *Id.*

85 *Id.* (quoting *van der Fluit v. Yates*, 2017 WL 5953514, at *5 (Del. Ch. Nov. 30, 2017)).

The Court next considered whether the stockholder vote was fully informed, so as to invoke the business judgement rule under *Corwin*. The plaintiffs "essentially [pled] that the Board determined USG had an intrinsic value, that the Board did not disclose this material fact, and that by not disclosing its intrinsic valuation the Board's other disclosures, namely its representations that the Acquisition was favorable to USG's stockholders, were rendered materially misleading."[86] The Court agreed, determining that it was "reasonably conceivable that the Defendants created a proxy that was materially misleading to stockholders" and that, therefore, *Corwin* was inapplicable.[87]

The Court then turned to the question of whether the plaintiffs had adequately pled that the defendants breached their fiduciary duties. The Court explained that because USG's charter contained an exculpatory provision under Section 102(b)(7) of the Delaware General Corporation Law, "the [p]laintiffs must plead a non-exculpated breach of fiduciary duty claim, that is, one that implicates the Defendants' duty of loyalty."[88] "The [p]laintiffs allege[d] that the Board breached its duty of loyalty because it lacked independence[,] . . . was interested in the [a]cquisition," and otherwise acted in bad faith in approving the acquisition.[89]

According to the plaintiffs, the defendants "lacked independence from Knauf because of their alleged fear of Knauf."[90] In support of this assertion, the plaintiffs alleged that after Knauf mounted a successful withhold campaign, the board "abandoned its standalone plan for USG, rushed or abandoned other potential buyers, and acceded to the [a]cquisition even though it had 'misgivings' about the deal."[91] Describing the plaintiffs' allegation of fear as conclusory and noting the proxy statement reflected "robust negotiations between USG and Knauf," the Court found that the plaintiffs "allege[d] no facts from which it can be reasonably inferred that the Board's actions were the result of anything other than the corporate merits of the subject."[92] The Court further commented, "'Fear' of a corporate takeover

86 *Id.* at *19.

87 *Id.* at *20.

88 *Id.* at *23 (citing *In re Cornerstone Therapeutics Inc. S'holder Litig.*, 115 A.3d 1173 (Del. 2015)).

89 *Id.*

90 *Id.*

91 *Id.*

92 *Id.*

threat—here fully justified after Knauf's resounding withhold victory—is a nod to reality, not a disabling extraneous influence."[93]

In support of the plaintiffs' contention that eight of the nine defendant directors were interested in the acquisition, the plaintiffs argued that the eight directors "had much to lose from a 'potentially career-ending and reputation killing proxy fight loss,' little to gain from standing up to Knauf, and [that] the [a]cquisition afforded them a liquidity event in the sale of their equity interests in USG."[94] The Court disagreed, finding that it was "not reasonably conceivable that the [eight] Defendants capitulated to Knauf in selfish defense of their outside reputational interests because *USG's directors had already lost a public fight with Knauf*."[95]

And in support of plaintiffs' contention that the defendants had acted in bad faith in approving the acquisition, the plaintiffs pointed to the board's failure to disclose its view on the intrinsic value of USG. The Court rejected the plaintiffs' suggestion that, having successfully pled facts sufficient to overcome a *Corwin* defense, the plaintiffs had also necessarily pled facts giving rise to an inference of bad faith. The Court explained that the standard for pleading bad faith "is entirely distinct from the required pleading to show an uninformed vote under *Corwin*."[96] In the disclosure context, "[a]n adequate pleading of bad faith must plead that the maldisclosure was 'intentional and constitute[d] more than an error of judgment or gross negligence.'"[97] In contrast, the standard for pleading that an uninformed vote occurred under *Corwin* "requires that the complaint 'when fairly read, supports a rational inference that material facts were not disclosed or that the disclosed information was otherwise materially misleading.'"[98] In a *Corwin* analysis, "[t]he focus is on the stockholder-reader, *not the drafter*. But when analyzing bad faith, the creator is the crux of the analysis, and *the why is the locus of the inquiry*."[99]

The Court held it was "not reasonably conceivable that the Proxy Statement 'represents the knowingly-crafted deceit or knowing indifference to duty that would show bad faith.'"[100] In so ruling, the Court pointed to other disclosures in the proxy statement. For example, the board disclosed that it initially approved of negotiations within the range of $48.00 to $51.00 and that such approval was based on the board's view of USG's intrinsic value. The board likewise disclosed that it had chosen not to inform stockholders of its view of USG's intrinsic value. As to this disclosure, the Court commented, "It is near inconceivable (and thus not reasonably conceivable) that an independent and disinterested Board acting disloyally would have professed its bad faith to USG's stockholders in the Proxy Statement."[101]

Finally, the Court addressed the plaintiffs' argument that the defendants failed to comply with their duties imposed under *Revlon*, "to secure the highest value reasonably attainable."[102] The Court rejected the plaintiffs' contention that "if it is reasonably conceivable that the Defendants' actions regarding the [a]cquisition were less than reasonable," the plaintiffs' breach of fiduciary duty claim must survive.[103] The Court explained that the plaintiffs still bore the burden of pleading a non-exculpated breach of the duty of loyalty. The Court ruled that the plaintiffs had failed to adequately state a non-exculpated claim against the defendants for breach of their *Revlon* duties, noting that the "Board authorized negotiations within a range that include[d] what the [p]laintiffs [pled] was USG's actual value" and determining that the operative complaint pled "no facts from which [the Court] can reasonably infer that the negotiation process was a sham or that the Board was not actually seeking a higher price for USG."[104]

***Rudd v. Brown*, 2020 WL 5494526 (Del. Ch. Sept. 11, 2020) (Zurn, V.C.)**

In *Rudd v. Brown*,[105] the Court of Chancery dismissed the plaintiff's action alleging that a company's directors breached their fiduciary duties in connection

93 *Id.* at *24.
94 *Id.*
95 *Id.* at *25.
96 *Id.* at *26.
97 *Id.* at *26 (quoting *Morrison v. Berry*, 2019 WL 7369431, at *18 (Del. Ch. Dec. 31, 2019)).
98 *Id.* (quoting *Morrison v. Berry*, 191 A.3d 268, 282 (Del. 2018)).
99 *Id.*
100 *Id.* at *27.
101 *Id.* at *28.
102 *Id.*
103 *Id.*
104 *Id.* at *30.
105 2020 WL 5494526 (Del. Ch. Sept. 11, 2020).

with a two-step merger, and in doing so rejected the plaintiff's argument that the threat of a proxy contest rendered the directors conflicted with respect to the challenged merger. The Court held that the threat of a proxy contest alone, without any other well-pled facts impugning directors' disinterestedness, does not render the directors conflicted.

Despite strong financial performance in early 2015, Outerwall, Inc. experienced a significant drop in revenue in the third and fourth fiscal quarters. This fallout prompted an activist-investor to purchase enough shares to become the company's second-largest stockholder. In early 2016, the investor released a public letter in which he threatened to oust the board of directors if they did not explore strategic alternatives. After receiving the letter, the company engaged a financial advisor and began a sale process. Shortly thereafter, the board entered into a cooperation agreement whereby the investor agreed to support the board's nominees and abstain from a proxy contest in exchange for the right to appoint three directors. Throughout May 2016, the board communicated with potential acquirers. The eventual buyer bid $50 per share and later increased the offer to $52. In July, the board agreed to a deal for $52 per share in a two-step merger (an all-cash tender offer followed by a short-form merger). Ultimately, 69% of the stockholders tendered, and the short-form merger was consummated in September 2016.

The plaintiff, a former stockholder of the company, asserted a claim for breach of fiduciary duty, alleging that the defendants failed to maximize value in the transaction as required by *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[106] and that the defendants failed to disclose material information about the sale and approved misleading information in the proxy statement.[107] The defendants moved to dismiss for failure to state a claim.

The Court first noted that where, as here, a Section 102(b)(7) exculpatory charter provision protects the directors, the plaintiff must plead a breach of the duty of loyalty and good faith, and cannot rely on a claim "exclusively establishing" a violation of the duty of care, in order to state a claim for monetary damages.[108] This is true even though *Revlon* presumes the application of enhanced scrutiny in certain sale-of-control contexts. Thus, a plaintiff "challenging a transaction under *Revlon* and seeking monetary damages, like the plaintiff here, must plead facts sufficient to state a nonexculpated fiduciary duty claim."[109]

To overcome the exculpatory provision, a plaintiff must show a majority of the board was not disinterested or independent, or otherwise failed to act in good faith. To carry this burden, the plaintiff asserted that the defendant directors were conflicted by virtue of the looming threat of a proxy contest potentially resulting in the ouster of the board. However, the Court observed that in each case where the Court has found it conceivable that directors were conflicted on the basis of a threatened proxy contest, the complaint pleaded additional allegations of disloyalty or gross negligence. Reiterating the Court of Chancery's ruling in *In re Lukens Inc. Shareholders Litigation*,[110] the Court rejected the plaintiff's "barebones conflict theory,"[111] noting the Court's "reluctance to find that the mere threat of a proxy contest renders directors conflicted."[112]

The Court also rejected all of the plaintiff's additional attacks on the independence of certain individual defendants, holding that: (i) as a matter of law, potential receipt of change-in-control payments pursuant to a pre-existing agreement alone does not create a disqualifying interest;[113] (ii) a defendant director was not conflicted merely by virtue of his appointment by the activist investor;[114] and (iii) a director's alleged reputation for being appointed for the purpose of advocating for a merger or acquisition does not sufficiently demonstrate a conflict.[115]

106 506 A.2d 173, 183 (Del. 1986).

107 The plaintiff did not allege that the sale process was defective. Rather, he alleged that the directors sold the company out of self-interest and that the tender offer price was unfair. *Rudd*, 2020 WL 5494526, at *5.

108 *Id.* at *6 (quoting *Emerald P'rs. v. Berlin*, 787 A.2d 85, 91 (Del. Nov. 28, 2001)).

109 *Id.* at *7.

110 757 A.3d 720 (Del. Ch. 1999).

111 *Rudd*, 2020 WL 5494526 at *10 (citing *Lukens*, 757 A.3d 720, 729).

112 *Id.* (citing cases).

113 *Id.* at *11 (citing *In re Novell, Inc. S'holder Litig.*, 2013 WL 322560, at *11 (Del. Ch. Jan. 3, 2013)).

114 *Id.* at *12 (citing *In re KKR Fin. Hldgs. LLC S'holder Litig.*, 101 A.3d 980, 996 (Del. Ch. Oct. 14, 2014); *In re W. Nat. Corp. S'holders Litig.*, 2000 WL 710192, at *15 (Del. Ch. May 22, 2000)).

115 *Id.* at *12 n.119 ("Plaintiff provides no support for the proposition that a director is conflicted purely by virtue of his track record, and I am aware of none.").

Finally, the Court declined to accept the plaintiff's wholly-conclusory allegation that the defendant CFO was conflicted because of his prospect of post-closing employment with the acquirer. The Court noted that the proxy stated that neither the acquirer nor other potential bidders engaged in discussions regarding the retention of executives during the negotiation process and the plaintiff had not "challenged the veracity of this disclosure."[116] The Court stated that "[i]n the absence of well-pled, non-conclusory allegations to the contrary, it would be unreasonable to infer" that the CFO and the acquirer "discussed the terms of post-close employment."[117] Having found that the plaintiff failed to plead facts that the defendants were conflicted, the Court dismissed the complaint.

116 *Id.* at *12.

117 *Id.*

Alternative Entity Litigation

***Murfey v. WHC Ventures, LLC*, 236 A.3d 337 (Del. July 13, 2020)**

In *Murfey v. WHC Ventures, LLC*,[1] the Supreme Court of Delaware, ruling with a 3-2 majority, declined to construe partnership agreements as requiring limited partners' requests for books and records under the agreements to be limited to documents "necessary and essential" to the limited partners' stated purposes where such requirement was not expressly provided. In so ruling, the Court emphasized that it will not imply terms into a partnership agreement when such terms could have been, but were not, included in the agreement.

The plaintiffs, limited partners of multiple Delaware limited partnerships whose ownership percentages had decreased with the addition of new partners, sought books and records under Section 17-305 of the Delaware Revised Uniform Limited Partnership Act ("Section 17-305")—the limited partnership analogue to Section 220 of the Delaware General Corporation Law—and the governing partnership agreements. Tracking the language in Section 17-305, the partnership agreements provided that "[e]ach Limited Partner has the right, on any reasonable request, . . . *to obtain from the General Partner for the purposes reasonably related to the Limited Partner's Interest as a Limited Partner* the information set forth above in Section 12.1. . . ."[2] Section 12.1 of the partnership agreements in turn provided that books and records "available for examination by any Partner," included: (i) "A current list of the full name and last known business or residence address of each Partner, together with Capital Contributions and Partnership Percentage of each of those Partners;" and (ii) "Copies of the Partnership's federal, state and local income tax or information returns and reports, if any, for the six most recent taxable years[.]"[3] The plaintiffs' stated purposes for inspection were "valuing their ownership stake in the partnerships" and "investigat[ing] mismanagement and wrongdoing."[4] The parties reached agreement on the production of all but one category of documents, the Schedule K-1s to the partnership tax returns, and litigation ensued.

Following trial, the Court of Chancery concluded that the plaintiffs "ha[d] no right to the K-1s or the information they contain[ed]" despite having a proper purpose to value their ownership stakes.[5] In its statutory analysis, the Court of Chancery noted, among other things, that in order for the demand to be "for a purpose reasonably related to the limited partner's interest as a limited partner[,] . . . [t]he party requesting records must show the documents are 'necessary and essential' to accomplishing that purpose."[6] Because the Court of Chancery determined that the partnership agreements "limit[ed] a partner's right [to books and records] by requiring a proper purpose in the very same way 6 *Del. C.* § 17-305 does[,]" the Court of Chancery also implied a "necessary and essential" requirement into the partnership agreements.[7] The Court of Chancery found that the K-1s failed that "necessary and essential" test, and declined to order production of the K-1s to the plaintiffs under either Section 17-305 or the partnership agreements. The plaintiffs appealed.

1 236 A.3d 337 (Del. 2020).

2 *Id.* at 342 (emphasis added).

3 *Id.*

4 *Id.* at 339.

5 *Id.* at 340.

6 *Id.* at 341.

7 *Id.* at 343.

On appeal, the plaintiffs contended that "under the Partnership Agreements, so long as their stated purpose is reasonably related to their interest as limited partners, they are entitled to inspect the K-1s, which fall within Section 12.1, and that the Partnership Agreements do not condition a limited partner's inspection rights on proving that the requested documents are 'necessary and essential' to their stated purpose."[8]

The Supreme Court reversed the Court of Chancery's ruling, concluding that the plaintiffs were entitled to the K-1s under the terms of the partnership agreements. The Supreme Court "declin[ed] to import a 'necessary and essential' condition into the agreements."[9] In reviewing the terms of the partnership agreements, the Supreme Court highlighted that the requested K-1s fell within the scope of Section 12.1 and found that the "specific identification of this tax return and capital contribution information highlights the importance of that particular information to investors, and the Partnerships' recognition of that importance."[10] Given the "obvious" importance of the requested information and the partnership agreements' failure to "expressly condition the limited partners' inspection rights on satisfying a 'necessary and essential' condition," the Supreme Court was "not persuaded such a condition should be implied."[11] The Supreme Court cautioned against "implying contractual terms when the contract could easily have been drafted to expressly provide for such terms, limitations or conditions."[12]

***SolarReserve CSP Hldgs., LLC v. Tonopah Solar Energy, LLC*, 2020 WL 4251968 (Del. Ch. July 24, 2020) (Slights, V.C.)**

In *SolarReserve CSP Holdings, LLC v. Tonopah Solar Energy, LLC*,[13] the Court of Chancery held that the former owner of a company had no right to inspect books and records of that company under the company's LLC agreement because the former owner assigned its rights to another entity and was no longer a real party in interest. The Court also held that the assignee had no right to inspect the company's books and records because the LLC agreement granted inspection rights to certain named entities, which did not include the assignee.

The claims arose after the unraveling of a solar power plant project operated by Tonopah Solar Energy ("Tonopah"). Initially, SolarReserve CSP Holdings, LLC ("SolarReserve") was the sole owner of Tonopah. SolarReserve later brought in other investors through a series of transactions that ultimately left SolarReserve with only an indirect ownership interest in Tonopah. Although SolarReserve ceded its direct ownership of Tonopah, a provision was inserted in Tonopah's LLC agreement that permitted SolarReserve to access Tonopah's books and records as a "Sponsor Entity."[14]

The LLC agreement defined "Sponsor Entity" as several entities including "SolarReserve Sponsor" and "Santander Sponsor."[15] The LLC agreement defined SolarReserve Sponsor as "SolarReserve CSP Holdings, LLC excluding any unaffiliated successor."[16] On the other hand, the LLC agreement defined Santander Sponsor as that entity as well as its "*assignees*, transferees and successors."[17]

At the end of 2019, SolarReserve experienced financial difficulties and was forced to wind-down its business. As part of the wind-down, SolarReserve assigned all of its rights and claims against Tonopah to CMB Infrastructure Investment Group IX, L.P. ("CMB"), one of SolarReserve's creditors. On January 28, 2020, SolarReserve submitted a demand to inspect Tonopah's books and records pursuant to the LLC agreement. Tonopah rejected the demand, and SolarReserve filed a claim for breach of the LLC agreement. In a post-trial decision, the Court entered judgment in favor of Tonopah.

The Court began its analysis by considering whether SolarReserve was properly before the Court as a real party in interest. The Court concluded that SolarReserve was not a real party in interest because it assigned all of its claims against Tonopah to CMB. The Court noted

8 *Id.* at 345.
9 *Id.* at 346.
10 *Id.* at 351.
11 *Id.* at 352.
12 *Id.* at 356.
13 2020 WL 4251968 (Del. Ch. July 24, 2020).

14 *Id.* at *2. The relevant section of the LLC agreement stated that "[t]he Company shall keep books and records . . . [and] shall provide to each of the Sponsor Entities access to the books and records or any other information held by the Company reasonably requested by such Sponsor Entity, including the records of all transactions of the Company." *Id.*
15 *Id.*
16 *Id.*
17 *Id.* (emphasis added).

Alternative Entities

that, under Court of Chancery Rule 17(a), the plaintiff should be the assignee where there has been a complete assignment. The Court also found that SolarReserve's assignment to CMB meant that SolarReserve would not be the beneficiary of any relief awarded in the action.

SolarReserve sought to avoid the implications of Rule 17(a) by arguing that CMB was causing SolarReserve to exercise its demand rights, which SolarReserve argued was permissible because the assignment allowed CMB to act as SolarReserve's attorney-in-fact.

The Court rejected SolarReserve's argument. First, the Court explained, because Rule 17(a) provides that an assignor has no right to maintain a lawsuit after a complete assignment, SolarReserve had "*no rights* that are relevant to this action."[18] Second, the Court noted that multiple decisions had found that merely granting a power of attorney does not change the real party in interest rule. Additionally, the Court rejected SolarReserve's argument that Tonopah raised the Rule 17(a) argument too late. The Court explained that Rule 17(a) is not an "affirmative defense that is waived if not raised in the responsive pleadings[,]" but need only be raised in a "timely or seasonable fashion."[19] Accordingly, the Court held that SolarReserve was an improper plaintiff under Rule 17(a) because it had no interest in the proceeding.

The Court then turned to SolarReserve's argument that CMB could be joined to the proceeding as a substitute plaintiff under Court of Chancery Rule 25(c). The Court rejected this argument because Rule 25(c) only allows substitution if the transfer of interest occurs during the proceedings, and SolarReserve had assigned the claims before initiating the action.

Even without this "procedural defect," the Court found no basis for SolarReserve's argument.[20] SolarReserve argued that CMB had a right to Tonopah's books and records because CMB was an assignee of SolarReserve and not an "unaffiliated successor," and thus was not excluded from the right to demand the books and records under the LLC agreement's definition of SolarReserve Sponsor.[21] Accordingly, SolarReserve argued, CMB was entitled to Tonopah's books and records.

The Court rejected this argument, noting that the LLC agreement's exclusionary language ("excluding any unaffiliated successor") did not create a positive right allowing CMB to inspect books and records simply because it was not an "unaffiliated successor."[22] The Court explained that the LLC agreement only granted inspection rights to certain entities defined as "Sponsor Entities," and CMB clearly could not fit that definition.

The Court also held that CMB's status as SolarReserve's assignee did not make the entities the same for inspection rights under the LLC agreement. The Court found that the LLC agreement drafters knew how to include assignees within the definition of Sponsor Entities. Indeed, Santander Sponsor was defined as Santander as well as its "assignees, transferees and successors."[23] The Court found that, under the plain meaning of the LLC agreement, CMB had no information rights because it was not SolarReserve and the definition of SolarReserve did not include its assignees. Accordingly, the Court granted judgment in favor of Tonopah.

The *SolarReserve* decision reminds practitioners that Delaware courts will carefully scrutinize the language of governing documents in determining inspection rights in the alternative entity context. Parties assigning or expecting to assign legal interests should be chary to ensure that the language of the governing documents will give the assignor or assignee the enforcement rights they expect to have.

Fannin v. UMTH Land Dev., L.P., 2020 WL 4384230 (Del. Ch. July 31, 2020) (Fioravanti, V.C.)

In *Fannin v. UMTH Land Development, L.P.*,[24] the Court of Chancery rejected the defendants' argument that the Court of Chancery's decision in *In re USACafes, L.P. Litigation*,[25] which held that the directors and controllers of a limited partnership's general partner owed fiduciary duties to the limited partnership and its limited partners, was wrongly decided and was in conflict with current Delaware law governing alternative entities. The Court stated that the holding in *USACafes* was well established and was relied on by partnerships formed under Delaware law in drafting

18 *Id.* at *5. (emphasis in the original)
19 *Id.*
20 *Id.* at *6.
21 *Id.*
22 *Id.*
23 *Id.* at *7.
24 2020 WL 4384230 (Del. Ch. July 31, 2020).
25 600 A.2d 43 (Del. Ch. 1991), *appeal refused sub nom.*

their partnership agreements and in determining whether to limit fiduciary duties. Having found that the general partner's controllers owed fiduciary duties to the limited partnership and its limited partners, the Court granted in part and denied in part the defendants' motion to dismiss claims for breaches of fiduciary duty, holding that four of the six individual defendants owed fiduciary duties to the limited partnership through their control over the general partner.

The plaintiffs, limited partners of United Development Funding, III, L.P ("UDF III"), part of a family of real estate investment funds, filed a derivative and class action complaint against UMTH Land Development, L.P. ("UMTH LD"), which was UDF III's general partner, several affiliates of UMTH LD, and individuals who indirectly owned UMTH LD. The plaintiffs alleged that the defendants breached their fiduciary duties to UDF III and its limited partners when they used UDF III funds to make loans to benefit other funds so that UMTH LD could maintain the distributions and fees it received from those funds. The defendants moved to dismiss the claims for failure to plead demand futility and failure to state a claim.

The Court denied the defendants' motion to dismiss for failure to plead demand futility, holding that plaintiffs had satisfied the first prong of the *Aronson*[26] test for demand futility. The plaintiffs sufficiently alleged that UMTH LD was not disinterested and independent with respect to the loans because the plaintiffs adequately alleged that UMTH LD derived a financial benefit from the loans that was not shared with UDF III's limited partners and that UMTH LD's actions "were designed to enrich UMTH LD and its controllers at UDF III's expense."[27] The Court found that the "General Partner was involved in a broad scheme that utilized UDF III loans to two favored real estate development firms and their affiliates to maintain partnership distributions at affiliated funds."[28]

The Court also denied several of the individual defendants' Rule 12(b)(6) motions to dismiss based on their argument that they did not owe fiduciary duties to UDF III or its limited partners. In *USACafes*, the Court of Chancery "held that directors and controllers of a corporate general partner owed fiduciary duties to the limited partnership and the limited partners" because they "exert[ed] control over the assets" of the limited partnership.[29] Arguing that *USACafes* was "wrongly decided" and was in "irreconcilable conflict with current Delaware law regarding alternative entities," the individual defendants in this case requested that the Court not follow *USACafes*.[30]

The Court refused the individual defendants' request that the Court not follow *USACafes*, noting that the individual defendants failed to show that *USACafes* reflects "a clear manifestation of error" or establish "urgent reasons" for the Court to not follow the holding.[31] The Court stated that "[i]f *USACafes* is to be jettisoned, that is a determination for the Delaware Supreme Court."[32] The Court went on to reason that Delaware partnerships have the ability to limit or eliminate fiduciary duties and *USACafes* does not remove that choice. Here, the limited partnership made the choice to not eliminate fiduciary duties.

Applying *USACafes*, the Court found that the plaintiffs sufficiently alleged that four of the six individual defendants exercised control over the limited

26 *Aronson v. Lewis,* 473 A.2d 805 (Del. 1984). The parties agreed that the *Aronson* test applied. 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 Derivative Litig.*, 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 v. Blasband*, 634 A.2d 927, 933-34 (Del. 1993), 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.

27 *Fannin*, 2020 WL 4384230, at *29.

28 *Id.* at *33.

29 *Id.* at *19.

30 *Id.* at *18.

31 *Id.* at *19.

32 *Id.*

partnership's assets.[33] The defendants conceded that if *USACafes* applied, then three of the individuals owed fiduciary duties to UDF III. The Court found that the plaintiffs had sufficiently pled facts to support a reasonable inference that a fourth individual owed fiduciary duties given the control the individual exercised over UDF III's assets. The plaintiffs pled that he was the chief operating officer of UMTH LD, was one of three voting members on UMTH LD's investment committee, and participated in all investment and loan decisions on behalf of UDF III. In addition, he was involved in the transactions at issue, including personally executing the loan agreements at issue.

However, the Court also held that the plaintiffs failed to sufficiently allege that two other individual defendants, who were senior officers of UMTH LD, "exerted actual control over" UDF III's assets, and dismissed the fiduciary duty claims against them.[34] The Court found that the statement in UDF III's public filings that UDF III's "success depends to a significant degree on the diligence, experience and skill of certain executive officers and other certain key personnel of our general partner, including [the two individuals]" was "not sufficient to establish a reasonable pleading stage inference that [they] exercised sufficient 'control' over the assets of UDF III to justify the imposition of fiduciary duties on them."[35]

33 Those four individual defendants subsequently sought an interlocutory appeal regarding this issue. The Court denied certification, stating that the appealing defendants' claims did not decide a "substantial issue of material importance that merits appellate review before a final judgment" per Delaware Supreme Court Rule 42(b)(1). *Fannin v. UMTH Land Dev., L.P.*, 2020 WL 5198356, at *1 (Del. Ch. Aug. 28, 2020) (citing Supr. Ct. R. 42(b)(i)).

34 *Fannin*, 2020 WL 4384230, at *20.

35 *Id.*

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

***In re Anthem-Cigna Merger Litigation*, 2020 WL 5106556 (Del. Ch. Aug. 31, 2020) (Laster, V.C.)**

In *In re Anthem-Cigna Merger Litigation*,[1] the Court of Chancery reviewed a failed $54 billion merger and found that, while one of the merger parties had breached certain contractual covenants to try to close the transaction, the breaching party had proven that a necessary condition for closing would fail even without the breach. The Court therefore left the "parties where they stand."[2]

The proposed merger was between Anthem, Inc. and Cigna Corporation, two of the largest health insurance providers in the United States. The merger agreement contained three covenants relevant to the litigation (the "Efforts Covenants"). First, the parties were obligated to use their "reasonable best efforts" to satisfy the conditions for closing (the "Reasonable Best Efforts Covenant").[3] The Reasonable Best Efforts Covenant would be breached by either party "failing to take reasonable steps to consummate the transaction or by not attempting to solve problems."[4] Second, the parties were required to take "any and all actions necessary to avoid" any impediment to the merger that a government entity might assert under various laws (the "Regulatory Efforts Covenant").[5] Third, the agreement "gave Anthem the authority to take the lead in communicating with regulators and developing a regulatory strategy" while obligating Cigna to "follow Anthem's lead and adhere to Anthem's strategy" (the "Regulatory Cooperation Covenant").[6] Further, the parties' obligation to close was conditioned upon, among other things, the merger not being prevented or prohibited by any injunction (the "No Injunction Condition").

The Department of Justice "concluded that the Merger would have anticompetitive effects[,] declined to approve it[,]" and filed a lawsuit in federal district court.[7] "Throughout the Antitrust Litigation, Cigna undermined Anthem's defense[,] opposed Anthem's efforts to mediate and took litigation positions that supported the DOJ."[8] The district court issued a "permanent injunction that prevented the Merger from closing."[9] Cigna purported to terminate the merger and brought an action in the Court of Chancery seeking to establish its right to do so, while Anthem sued in the same court to "keep the Merger Agreement in place so that it could appeal from the District Court's decision[.]"[10] The Court of Chancery issued a temporary restraining order preventing Cigna from terminating, but after the district court's decision was upheld on appeal, the Court of Chancery denied Anthem's request to convert the TRO into a preliminary injunction but stayed its ruling (keeping the TRO in place) so Anthem could appeal to the Delaware Supreme Court. Anthem decided not to appeal and terminated the merger agreement. The cases brought by Cigna and Anthem were consolidated as a damages action. Anthem claimed that Cigna breached

1 2020 WL 5106556 (Del. Ch. Aug. 31, 2020).

2 *Id.* at *6.

3 *Id.* at *91-93.

4 *Id.* at *93.

5 *Id.* at *93-96.

6 *Id.* at *96.

7 *Id.* at *3.

8 *Id.* at *4.

9 *Id.* at *3.

10 *Id.*

the Efforts Covenants and caused $21.1 billion in expectation damages, while Cigna alleged Anthem breached the Regulatory Efforts Covenants and caused $14.7 billion in expectation damages. Cigna also sought a reverse termination fee of $1.8 billion.

The Court determined that Cigna breached the Reasonable Best Efforts Covenant by running a "covert communication campaign against the Merger" and by withdrawing from integration planning.[11] The Court also found that Cigna had breached the Regulatory Efforts and Regulatory Cooperation Covenants by (i) opposing a divestiture to try to address DOJ concerns, (ii) resisting a mediation during the antitrust litigation, and (iii) undermining Anthem's defense of the antitrust litigation.[12] The Court held that, although Anthem failed to establish that "Cigna's covert communication campaign had a significant effect on the DOJ or the courts," Anthem had shown that Cigna's other actions materially contributed to the "non-occurrence of the No Injunction Condition."[13]

But, the Court explained, in accordance with the Restatement (Second) of Contracts, where the performance of a contract is subject to a condition (such as the No Injunction Condition), while the condition may be excused by a breach that contributed materially to the non-occurrence of the condition, the breaching party may still avoid liability by establishing that the condition would have failed regardless of the breach.[14] Thus, "[o]nce Anthem proved that Cigna's breaches of the Efforts Covenants contributed materially to the DOJ's failure to approve the Merger" and to the issuance of the injunction, the "burden then shifted to Cigna to prove that even if Cigna had fulfilled its obligations under the Efforts Covenants, the No Injunction Condition still would have failed."[15] The Court ultimately concluded that Cigna successfully met that burden "by proving that even if Cigna had fulfilled its obligations under the Efforts Covenants, the DOJ would not have approved the Merger because of its effect on the market for the sale of commercial insurance to national accounts," and the merger still would have been enjoined.[16] Anthem therefore was not entitled to any damages, and judgment was entered for Cigna on Anthem's claims.

For its part, Cigna claimed that Anthem had breached the Regulatory Efforts Covenant by not pursuing all possible avenues to change certain rules applicable to Anthem as a member of the association that owned the Blue Cross and Blue Shield trademarks and by omitting certain potential synergies from a white paper on medical cost savings. The Court found Cigna failed to prove a breach of the Regulatory Efforts Covenant relating to the rules because (i) the rules were not a "legal impediment in the sense contemplated by the Regulatory Efforts Covenant[,]" and (ii) even if the Regulatory Efforts Covenant had applied, Anthem followed a reasonable strategy to seek to change the rules, such that it satisfied its obligations.[17] The Court also found that the omission of synergies from the white paper was because Anthem's attorneys could not verify them. The Court also pointed out that, even if Anthem had breached its obligations, it would not have faced any liability because the Merger Agreement limited liability for termination of the agreement to fraud and willful breaches, and Cigna had not established either. The Court therefore granted judgment to Anthem on Cigna's claims.

The Court also entered judgment in Anthem's favor on Cigna's claim that Anthem was liable for a reverse termination fee because Anthem had validly terminated the merger agreement "under a termination right that did not trigger the fee[.]"[18] Cigna argued that this was unfair because it would have been entitled to the fee had it been able to terminate the merger earlier but had been prevented from doing so by the temporary restraining order. The Court responded that the TRO was "put in place because Cigna previously breached its contractual obligations by attempting to terminate the Merger Agreement . . . and moot Anthem's appeal."[19] "Having previously sought to gain a timing advantage of its own in violation of the Merger Agreement," the Court continued, "Cigna cannot now complain about the effects of a TRO that its own conduct made necessary."[20]

11 *Id.* at *97-103.
12 *Id.* at *110-22.
13 *Id.* at *100-22.
14 *Id.* at *90-91.
15 *Id.* at *123.
16 *Id.*
17 *Id.* at *130-31.
18 *Id.* at *6.
19 *Id.* at *140.
20 *Id.*

Anthem demonstrates how causation remains a critical element of a breach of contract claim seeking damages, even in complex commercial transactions where it is clear that one party failed to comply with its covenants. It also reminds practitioners, among other things, that when a party agrees to take "any and all actions" to ensure that a condition occurs, Delaware courts likely will interpret the party's obligations broadly such that if an "action [falls] within the scope of the provision," the party will be "required to take it" even if the action arguably may not be commercially reasonable.[21]

21 *Id.* at *96.

Special Proceedings Under the Delaware General Corporation Law

***Fir Tree Value Master Fund, LP v. Jarden Corp.*, 236 A.3d 313 (Del. July 9, 2020)**

In *Fir Tree Value Master Fund, LP v. Jarden Corp.*,[1] the Delaware Supreme Court affirmed the Court of Chancery's post-trial appraisal decision adopting an acquired corporation's unaffected market price as fair value. In doing so, the Supreme Court rejected the notion that there is a "'long-recognized principle' that a corporation's unaffected stock price cannot equate to fair value"[2] and affirmed that Delaware law does not rule out "using any recognized valuation methods to support fair value."[3] The Court also rejected the petitioners' argument that the deal price served as a floor for the company's fair value.

This appraisal action arose out of the April 2016 sale of Jarden Corporation ("Jarden"), a company founded by Martin Franklin, to Newell Brands for a sale price of $59.21 per share.[4] The Court of Chancery found the sale price "resulted from a flawed sale process"[5] that "raise[d] concerns" and "left much to be desired."[6] The flaws included, among other things, that Franklin had "acted with 'little to no oversight by the Board' and volunteered a 'price range the Board would accept to sell the Company before negotiations began in earnest.'"[7] Additionally, the process lacked "a pre-signing or post-signing market check."[8]

1 236 A.3d 313 (Del. 2020).

2 *Id.* at 316.

3 *Id.* at 323-24.

4 *Id.* at 315.

5 *Id.* at 316.

6 *Id.* at 320 (quoting *In re Appraisal of Jarden Corp.*, 2019 WL 3244085, at *3, *24 (Del. Ch. July 19, 2019)).

7 *Id.* (quoting *Jarden*, 2019 WL 3244085, at *3).

8 *Id.* at 320-21.

After the merger closed, several Jarden stockholders sought appraisal. In a four-day appraisal trial, the Court of Chancery considered testimony from "twenty-five fact witnesses and three expert witnesses."[9] The petitioners' expert "presented a comparable companies analysis and a discounted cash flow analysis" to argue for "a fair value of $71.35 per share on the merger date."[10] Jarden's expert "considered market evidence of Jarden's unaffected stock price and the merger price less synergies" and "examined comparable companies and presented a [discounted cash flow ("DCF")] analysis" to argue "that Jarden's fair value on the merger date was $48.01 per share based on his DCF analysis."[11] Relying on Jarden's unaffected market price, the Court of Chancery determined that the fair value of each share of Jarden stock on the closing date of the merger was $48.31.

On appeal, the petitioners' arguments centered on three main contentions: "the court erred as a matter of law and abused its discretion by relying on unaffected market price; the court should have treated the deal price as a fair value floor; and the court constructed its own flawed DCF model to corroborate its fair value."[12]

First, addressing the petitioners' argument that the Court of Chancery erred in relying on Jarden's unaffected market price, the Supreme Court began by rejecting the notion of a "long-recognized principle in Delaware law . . . that stock price does not equal fair value."[13] The Supreme Court stated that none of its recent appraisal decisions preclude a court from

9 *Id.* at 320.

10 *Id.*

11 *Id.*

12 *Id.* at 323.

13 *Id.* at 323-24 (quoting Petitioners' Opening Br. at 3).

relying on any recognized valuation method to support fair value. The Supreme Court agreed with the Court of Chancery's statement that "[w]hat is necessary in any particular [appraisal] case [ ] is for the Court of Chancery to explain its [fair value calculus] in a manner that is grounded in the record before it."[14] Further, the Supreme Court, quoting its decision in *Dell*, reiterated that, depending on the specific facts, one "single valuation metric" might be the most reliable, or a Court may need to rely on "a variety of methodologies."[15] In all cases, "the trial court must justify its methodology (or methodologies) according to the facts of the case and relevant accepted financial principles."[16]

The Supreme Court further held that, in relying on Jarden's unaffected market price, the Court of Chancery did not err in finding that "the market did not lack material nonpublic information."[17] On appeal, the petitioners conceded that Jarden's stock traded in a semi-strong efficient market, "meaning the market quickly assimilated all publicly available information into Jarden's stock price[,]" but challenged the event study prepared by Jarden's expert, contending that Jarden's value was difficult to assess due to limited public information about the corporation and the corporation's numerous acquisitions.[18] The only non-public information that the petitioners pointed to, however, was Jarden management's internal projections, which merely reflected a difference in opinion as compared to the projections from market analysis. The difference in opinion did not represent a difference in available information.

Second, the Supreme Court rejected the petitioners' argument that the negotiated deal price should have been used by the Court of Chancery as the floor for fair value. In the decision below, the Court of Chancery was persuaded by the petitioners' argument that Franklin's improper deal negotiations may have created an artificial ceiling for the deal price.[19] For that reason, "the Court of Chancery did not rely on the deal price to find fair value."[20] On appeal, the petitioners argued that, because the deal negotiations were flawed, proper negotiations would have resulted in a higher deal price, and thus, the improperly negotiated deal price should have acted as a floor for fair value. Rejecting this argument, the Supreme Court held that, although the flawed process may have capped the deal price under what could have been achieved under ideal conditions, there was evidence that the merger price exceeded fair value. Furthermore, the Supreme Court recognized that the deal price had to be adjusted for synergies.

Finally, the Supreme Court rejected the petitioners' contention that the Court of Chancery erred "by adopting the McKinsey formula" to determine the terminal investment rate in its DCF model, resulting in "a number that lines up with Jarden's unaffected market price."[21] The petitioners argued that the McKinsey formula undervalues corporations with high barriers to entry, such as Jarden. In rejecting this argument, the Supreme Court first stated that, importantly, the Court of Chancery did not rely on its DCF model in finding fair value—it merely used it to "corroborate the unaffected market price."[22] Second, the Supreme Court noted that "the wide swing in value attributed to one input in the DCF model," the terminal investment rate, supported the very reason that the Court of Chancery did not rely on the model—it could not be confident that "the experts were providing reliable economic advice on the inputs driving the DCF model."[23] Third, the contention that "the McKinsey formula undervalued Jarden because it was in a certain class of companies" was not supported by the experts.[24]

Woods v. Sahara Enters., Inc., 238 A.3d 879 (Del. Ch. July 22, 2020) (Laster, V.C.)

In *Woods v. Sahara Enterprises, Inc.*,[25] the Court of Chancery granted a stockholder's request for books and records pursuant to Section 220 of the Delaware General Corporation Law ("Section 220"), and in doing so held that the stockholder established a proper purpose of valuing her interest in the company and that

14 *Id.* at 325 (quoting *Jarden*, 2019 WL 3244085, at *2) (alterations in original).

15 *Id.* (quoting *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd.*, 177 A.3d 1, 22 (Del. 2017)).

16 *Id.* (quoting *Dell*, 177 A.3d at 22).

17 *Id.* at 326.

18 *Id.* at 325-26.

19 *Id.* at 327-28.

20 *Id.* at 327.

21 *Id.* at 334, 332.

22 *Id.* at 334.

23 *Id.* at 334-35.

24 *Id.* at 335.

25 238 A.3d 879 (Del. Ch. 2020).

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she was not required to make a showing of actual intent to value the shares. The Court also held that another of the stockholder's stated purposes for seeking the books and records—to investigate wrongdoing or mismanagement—was "bolstered" by the company's position taken in the litigation that the company was merely a holding company and therefore did not have the books and records sought by the stockholder.[26] The Court held that by taking that position, the company "established a credible basis to suspect corporate wrongdoing" because it "would be an exceptional board of directors that could satisfy its duty of oversight without creating any books and records."[27]

The plaintiff, Avery L. Woods, was the trustee of the Avery L. Woods Trust (the "Trust"), which owned 278 shares of common stock of the defendant, Sahara Enterprises, Inc. ("Sahara"). Sahara was a private investment fund that held 99% of the membership interests in Sahara Investments, LLC ("Sahara Investments"), which in turn held various securities. SMCO, Inc. ("SMCO") was the managing member of Sahara Investments and held the remaining 1% membership interest in Sahara Investments.

The plaintiff grew concerned about Sahara's performance because information provided by Sahara indicated that its investments repeatedly underperformed market indices. Sahara paid outside investment managers to manage its investments, paid directors, officers and employees to manage the investment managers, and paid consultants to help select the investment managers. The plaintiff believed that this arrangement resulted in unnecessary costs and that the stockholders would obtain better returns if investments were instead made in index funds.

The plaintiff made a Section 220 demand in August 2019 and identified three purposes for the inspection: (i) to obtain the names and addresses of the company's stockholders to allow the Trust to communicate with fellow stockholders, (ii) to ascertain the value of the Trust's interest in the company, and (iii) to investigate wrongdoing and mismanagement.

Sahara agreed to provide the plaintiff with a list of the names and addresses of the company's stockholders and a copy of its bylaws but otherwise rejected the demand.

26 *Id.* at 894.

27 *Id.* at 896.

After the plaintiff filed suit, Sahara asserted that the action should be dismissed because SMCO held many of the books and records requested, and because Sahara "had no right, contractual or otherwise, to obtain books and records held by SMCO."[28]

The Court first ruled that the plaintiff's demand for books and records to determine the value of the Trust's stock constituted a proper purpose under Section 220. The Court noted that valuation of shares in a corporation, "particularly where the corporation is privately held, has long been recognized as a proper purpose" under Section 220.[29] The Court rejected Sahara's argument that the plaintiff was required to prove that she actually intended to use the books and records to value the shares. The Court stated that Sahara's argument was "contrary to Delaware law[,]" which does not "require that a stockholder establish both a purpose for seeking an inspection and an end to which the fruits of the inspection will be put."[30] The Court also stated that a stockholder is not required to have taken steps to sell its shares in order to establish that the stockholder has a proper purpose of valuing its shares. Rather, once a stockholder has established a proper purpose, it is the company's burden to prove that the stated purpose is not the stockholder's actual purpose and that the stockholder's actual purpose is improper. A showing of a secondary purpose does not satisfy the company's burden; rather, the company "must prove that the plaintiff pursued its claim under false pretenses, and its primary purpose is indeed improper."[31] The Court found that Sahara "failed to prove that valuing the Trust's shares was not the plaintiff's actual purpose" because it pointed to no documents or circumstances suggesting an improper motive, nor did it choose to depose the plaintiff.[32]

The Court next held that the plaintiff had stated a proper purpose to investigate wrongdoing or mismanagement. The Court began by stating that to state a proper purpose to investigate wrongdoing, a stockholder "need only establish by a preponderance of the evidence that there is a credible basis from which the court can infer a possibility of wrongdoing" and that the stockholder

28 *Id.* at 894-95.

29 *Id.* at 890.

30 *Id.* at 891.

31 *Id.* (quoting *Pershing Square, L.P. v. Ceridian Corp.*, 923 A.2d 810, 817 (Del. Ch. 2007)).

32 *Id.* at 893.

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is not required to establish by a preponderance of the evidence that wrongdoing has actually occurred.[33] The Court noted that while the plaintiff's primary contention that such a credible basis exists because of Sahara's poor performance in relation to market indices could not, without more, establish a credible basis to suspect wrongdoing, Sahara's position that it is merely a holding company and it lacks many of the books and records sought by the plaintiff (and indeed that it might not have any documents), "bolstered [the plaintiff's] investigative purpose."[34]

The Court found that the company's position gave rise to "two bases to suspect possible wrongdoing."[35] First, Sahara's position conflicted with the representations the company made to its stockholders in connection with a reorganization of the company that resulted in the creation of SMCO. In connection with the reorganization, the company stated that the reorganization would not affect the stockholders' ability to obtain information from the company. The Court stated that the "contrast between the Company's current position and its representations to stockholders provides a credible basis to suspect that the Company's directors and officers have engaged in wrongdoing by failing to manage the Company in the manner that they committed they would."[36] Second, Sahara's representation that it did not have responsive books and records "created a credible basis to suspect that the Company's directors have abdicated their statutory responsibilities."[37] The Court stated that if Sahara has no records at least "documenting the board's good faith reliance on and active oversight of SMCO[,]"[38] then there is a possibility that the board has not been fulfilling its oversight duties under *Caremark*,[39] and thus there was a credible basis to suspect corporate wrongdoing.

Finally, in requiring Sahara to produce documents, the Court also ordered that "[w]hen responding to the Demand, the Company shall also produce any documents nominally held by SMCO or Sahara Investments that the human controllers of the Company (its directors and senior officers) can access in the ordinary course of business."[40] The Court found that the record at trial established that the "humans" who control Sahara have control over the books and records necessary to respond to the Section 220 demand.[41] The Court stated that the same individuals sat on the Sahara and SMCO boards, the companies had the same officers and employees, the companies shared office space and an email domain, and the company provides its stockholders with consolidated financial information on both Sahara and SMCO. The Court noted that "[d]irecting the Company to produce documents that the humans who control it can access whenever they wish does not involve any type of veil piercing, nor does it ignore the separate existence of these entities. It rather recognizes that the books and records nominally held by SMCO or Sahara Investments are within the Company's 'possession, custody, or control.'"[42] The Court concluded that corporations are "juridical entit[ies] that only can act through human representatives" and if the "human representatives can access books and records in the ordinary course of business whenever they wish to do so for their own purposes, then they equally can be compelled to do so by court order."[43]

***Applied Energetics, Inc. v. Farley*, 2020 WL 4432271 (Del. Ch. Aug. 3, 2020) (Laster, V.C.)**

In *Applied Energetics, Inc. v. Farley*,[44] the Court of Chancery addressed the Court's ability to validate defective corporate acts under Section 205 of the

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33 *Id.* at 894.

34 *Id.*

35 *Id.* at 895.

36 *Id.*

37 *Id.*

38 *Id.*

39 *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996). To carry out one's duties under *Caremark*, "a director must make a good faith effort to oversee the company's operations." *Marchand v. Barnhill*, 212 A.3d 805, 820 (Del. 2019). To 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).

40 *Id.* at 904.

41 *Id.* at 903.

42 *Id.* at 903-04.

43 *Id.* at 904.

44 2020 WL 4432271 (Del. Ch. Aug. 3, 2020).

Delaware General Corporation Law ("DGCL")[45] and in doing so distinguished between actions performed outside of the corporation's power and actions performed without the proper authorization. Because a former director's unilateral self-issuance of shares and grant of salary were defective acts the former director was not authorized to perform, rather than acts outside the corporation's powers, the Court held that the acts were potentially subject to validation under Section 205.

One of the defendants, George Farley, was a former director of the plaintiff, Applied Energetics, Inc. ("Applied Energetics"). Applied Energetics experienced initial success producing laser-guided-energy applications for the federal government but underwent significant upheaval when its laser failed to meet government specifications. Eventually, five of its six directors resigned, leaving Farley as the sole remaining director. Among other things, as the sole director, Farley issued himself twenty-five million shares and approved his own compensation of $150,000 per year.

Applied Energetics brought a nine-count complaint against Farley, including a claim asserting that all of the actions Farley took in his capacity as the sole director were invalid. Farley brought counterclaims asserting that the Court should exercise its authority under Section 205 of the DGCL to validate those same actions. Applied Energetics moved for partial summary judgment on its invalidity claim and on Farley's counterclaims.

The Court first dealt with the threshold issue of whether Farley's actions were invalid. The Court explained that "[a]lthough Farley was the sole remaining director," Applied Energetics' board had three seats, and its by-laws "required the presence of a majority of the total number of directors to constitute a quorum for action at a meeting."[46] This meant that, "[a]s the sole remaining director, Farley could not meet the quorum requirement and therefore could not take action at a meeting."[47] Nor could Farley "act by unanimous written consent without a meeting, because Delaware law requires that the number of directors acting unanimously by written consent be sufficient to constitute a quorum if the action was taken at a meeting."[48] The Court therefore held that Farley's actions were invalid.

The Court then turned to whether the Court had the "power under Section 205 to validate Farley's acts."[49] Applied Energetics' principal argument was that the Court could not validate Farley's acts because they were not "within the power of a corporation."[50] Applied Energetics argued that the "Company lacked the 'raw corporate power' to take any acts" because "the board lacked a sufficient number of directors to supply a quorum[.]"[51]

The Court disagreed, explaining that "the concept of corporate power refers to whether the entity has been granted the ability to engage in a given act[,]" while "[t]he concept of authorization refers to whether the proper intra-corporate actors . . . have taken the steps necessary to cause the corporation to take the given act."[52] The Court stated that the company's claim that it "lacked the 'raw corporate power' to engage in any of the acts that Farley purported to take because there were insufficient directors in office to constitute a quorum" was "incorrect."[53] "The absence of a quorum is not a question of corporate power."[54] Rather, it "is a failure to comply" with a provision of the DGCL "and the company's charter and bylaws" and, therefore, it is a

45 Sections 204 and 205 of the DGCL first became effective in 2014 with the primary objective of permitting a corporation to correct failures to comply with the DGCL and avoiding the common law's prohibition on ratifying void corporate acts by providing two general mechanisms through which defective corporate acts can be validated. Section 204 allows a company's board of directors to validate defective corporate acts after following specific procedures. Section 205 allows for a judicial validation or invalidation of defective corporate acts upon petition by one of several parties enumerated in Section 205. Section 204(a) states that "no defective corporate act or putative stock shall be void or voidable solely as a result of a failure of authorization if ratified as provided in this section or validated by the Court of Chancery in a proceeding brought under § 205 of this title." *See generally* Emily V. Burton & Paul J. Loughman, *Ratifying Defective Corporate Acts at Common Law and by Statute*, 111 Corporate Practice Portfolio Series (BNA).

46 *Applied Energetics*, 2020 WL 4432271, at *12.

47 *Id.*

48 *Id.*

49 *Id.* at *21.

50 *Id.* at *25.

51 *Id.*

52 *Id.*

53 *Id.* at *28.

54 *Id.*

"failure within the meaning of Section 204(h)(2)."[55]

The Court then stated that the question of whether the company had the corporate power to issue the stock and grant the salary was "answered by" DGCL Section 121, which provides in relevant part that every corporation "shall possess and may exercise all the powers and privileges granted by" the DGCL, including Section 151(a), which grants corporations the power to issues shares, Secction 122(5), which grants corporations the power to pay officers, and Section 141(h), which states that the board of directors shall have the authority to determine the compensation of directors. Thus, "[t]he Company had the raw corporate power" to issue shares and to pay Farley.[56] "[T]he only obstacle to the effectiveness of his actions was the quorum requirement," and "Farley's inability to satisfy those requirements was . . . a failure of authorization that can be validated under Section 205, not an absence of corporate power that cannot."[57] The Court accordingly denied the motion for partial summary judgment on this issue, concluding that the Court had the power under Section 205 to validate the acts and the issue of whether the Court would exercise that power in this case could only be determined after trial.

***JUUL Labs, Inc. v. Grove*, 238 A.3d 904 (Del. Ch. Aug. 13, 2020) (Laster, V.C.)**

In *JUUL Labs, Inc. v. Grove*,[58] the Court of Chancery held that, pursuant to the internal affairs doctrine, stockholder inspection rights for Delaware corporations are governed exclusively by Delaware law, even where another state's law purports to grant stockholder inspection rights. Specifically, the Court concluded that Daniel Grove, a stockholder of JUUL Labs, Inc. ("JUUL"), a Delaware corporation with its principal executive office in California, could not seek inspection of JUUL's books and records under Section 1601 of the California Corporations Code ("Section 1601"), which purports to grant inspection rights to stockholders of corporations with principal executive offices in California regardless of their state of incorporation.

55 *Id.*

56 *Id.* at *29.

57 *Id.* at *33.

58 238 A.3d 904 (Del. Ch. Aug. 13, 2020).

Grove cited Section 1601 in a books and records demand and stated that if JUUL refused to produce the requested documents, then he "may apply to the [California state court] for an order compelling inspection" under California law.[59] JUUL responded by filing suit in the Court of Chancery seeking a declaration that Grove could not exercise any inspection rights under California law because the internal affairs doctrine applied to the books and records demand and, alternatively, because Grove had waived his rights to seek inspection. JUUL also argued that a forum-selection provision in JUUL's certificate of incorporation applied, limiting jurisdiction over actions related to stockholder inspection rights to the Court of Chancery.

The Court, relying on U.S. Supreme Court and Delaware Supreme Court precedent, began its analysis by explaining that the internal affairs doctrine "is a conflict of laws principle which recognizes that only one state should have the authority to regulate a corporation's internal affairs," that a corporation's internal affairs are those matters that are "peculiar to the relationship among or between the corporation and its officers, directors, and shareholders," and that the doctrine requires that the law of the state of incorporation "must govern these relationships."[60] The Court then stated that stockholder inspection rights "are a core matter of internal corporate affairs" and, thus, Delaware law governs any disputes related to those rights where the state of incorporation is Delaware.[61] Thus, the Court concluded that Grove was required to seek inspection solely under Section 220 of the Delaware General Corporation Law ("Section 220") and could not seek inspection of JUUL's books and records under California's Section 1601.

The Court also agreed with JUUL that the exclusive-forum provision applied to Grove's books and records demand. JUUL's certificate of incorporation provided for the exclusive jurisdiction of the Delaware Court of Chancery for any action governed by the internal affairs doctrine. The Court held, therefore, that Grove must pursue any books and records action in the Court of Chancery, not in California state court.

With respect to Grove's purported waiver of his inspection rights, the Court evaluated the waiver provision of two documents Grove had signed when

59 *Id.* at 908.

60 *Id.* at 914.

61 *Id.* at 915.

he received his stock. Because the waiver provisions referred to Section 220 and defined the stockholder's inspection rights "solely in terms of Section 220,"[62] the Court concluded that "the waiver provisions [did] not extend beyond Section 220 and [did] not reach other information rights," such as the stockholder's purported rights under Section 1601.[63] Because Grove had not attempted to make a demand for books and records under Delaware law, the Court declined to address whether a stockholder can waive inspection rights under Section 220. However, the Court noted that while the Delaware courts have historically "rejected efforts by corporations to limit or eliminate inspection rights," those decisions have addressed waivers that appeared in the corporations' constitutive documents" and the Court stated that "there are arguments for distinguishing provisions that appear in those documents and waivers in private agreements."[64]

Although it remains to be seen whether this decision will be followed by courts in states such as California that have statutes that purport to provide inspection rights to stockholders of Delaware corporations, the ruling may prove useful to Delaware corporations faced with demands from stockholders asserting inspection rights pursuant to such statutes. The decision, coupled with forum selection provisions in the corporation's constitutive documents selecting Delaware as the exclusive forum for the adjudication of claims related to the corporation's internal affairs, will help protect Delaware corporations from having to respond to inspection requests in a manner that is beyond what is required under Section 220 and to litigate disputes regarding stockholders' entitlement to inspection outside of Delaware.

62 *Id.* at 910.

63 *Id.*

64 *Id.* at 919.

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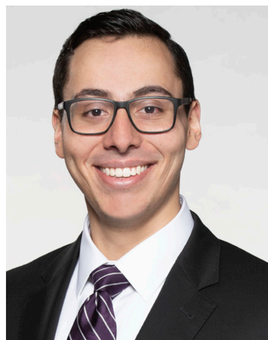

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