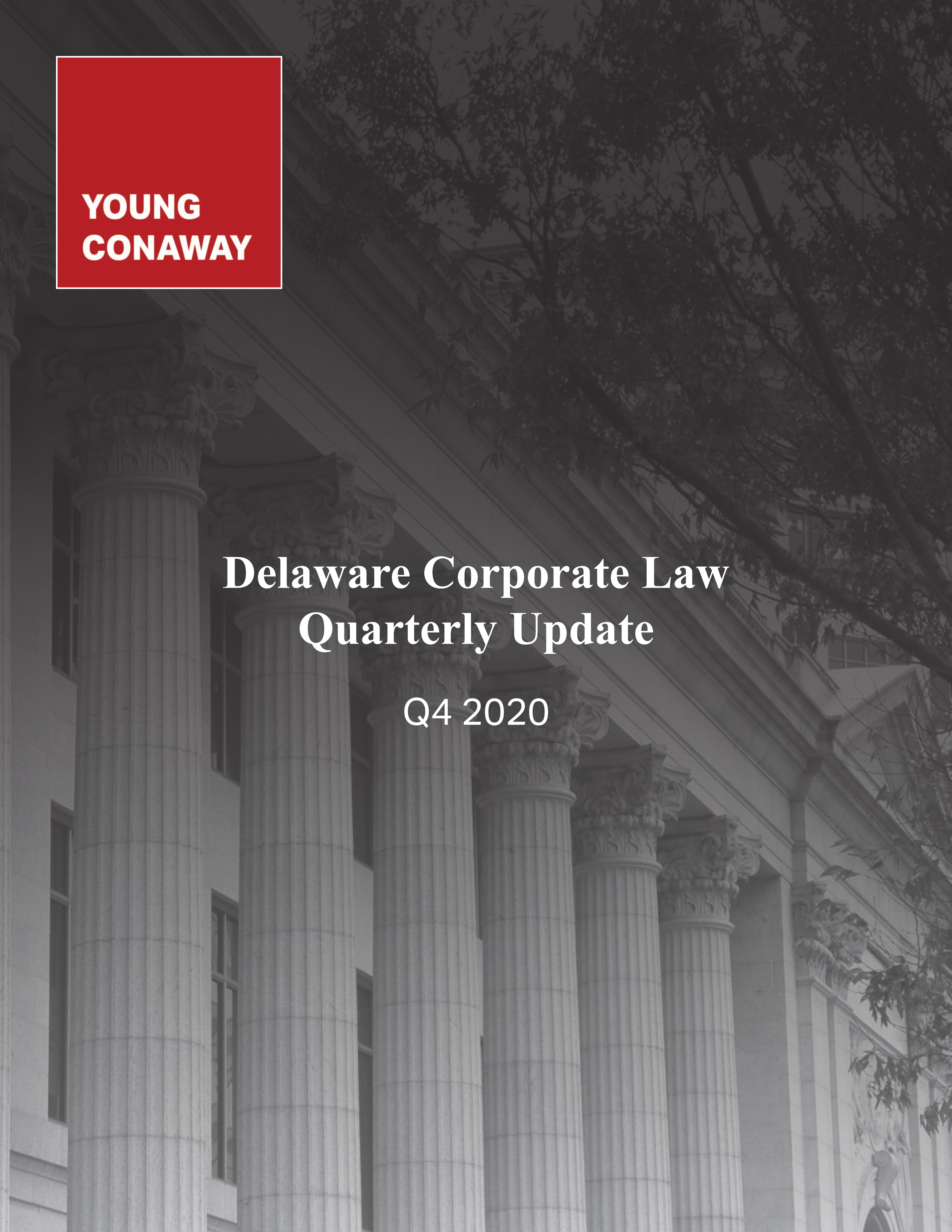

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Delaware Corporate Law Quarterly Update

Q4 2020

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Delaware Corporate Law Quarterly Update

Q4 2020

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

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

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

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

*Young Conaway has omitted from this publication summaries of certain cases in which Young Conaway was involved.

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Actions Involving Breach of Fiduciary Duty Claims

***In re Mindbody, Inc. S'holders Litig.*, 2020 WL 5870084 (Del. Ch. Oct. 2, 2020) (McCormick, V.C.)**

In *In re Mindbody, Inc. Stockholders Litigation*,[1] the Court of Chancery denied the defendants' motion to dismiss a *Revlon*[2] claim against the Chairman and CEO of Mindbody Inc. in connection with the sale of the company because the complaint adequately alleged that he was materially conflicted in the transaction given his liquidity needs and desire to obtain post-merger employment with the buyer, and he failed to disclose his material conflicts to the board. The Court also held that the sale was not cleansed by a stockholder vote under *Corwin*[3] because the proxy statement failed to disclose the Chairman/CEO's conflicts of interest and interactions with the acquirer.

The case arose out of the sale of Mindbody, Inc. ("Mindbody") to Vista Equity Partners ("Vista") on February 15, 2019. Although Mindbody's business was expanding, the complaint alleged its Chairman and CEO, Richard Stollmeyer, was motivated to sell the company because much of his wealth was "locked inside" Mindbody. Stollmeyer wanted to liquidate his stock because his finances were stretched between investments in real estate holdings and family ventures.

In August 2018, Stollmeyer met with an investment banker at Qatalyst Partners ("Qatalyst") and expressed his interest in selling Mindbody to a private equity firm that would retain him post-merger. The banker put Stollmeyer in touch with a representative from Vista. Vista sent Stollmeyer an expression of interest in acquiring Mindbody at "a substantial premium to [its] recent trading range."[4]

With a sale to Vista in mind, Stollmeyer and Mindbody's CFO and COO, Brett White, artificially lowered the company's performance guidance to investors and board members, which caused the stock to fall as low as $25.00. In November 2018, Mindbody retained Qatalyst to explore potential sale options for the company. While Qatalyst contacted several potential bidders, Stollmeyer was in constant communication with Vista and provided it with exclusive, timely financial information.

1 2020 WL 5870084 (Del. Ch. Oct. 2, 2020).

2 *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986). In *Revlon*, the Delaware Supreme Court held that when a business combination amounts to the sale of a company, the directors have a duty to the stockholders to ensure that the transaction will maximize the immediate value of the company's shares. *Id.* at 182. When reviewing a *Revlon* claim, the Court will not defer to the board's business judgment but rather will apply "enhanced scrutiny," which requires the directors to prove that the decision-making process was performed with adequate care and that the decision was reasonable under the circumstances. *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 931 (Del. 2003).

3 *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304 (Del. 2015). In *Corwin*, the Delaware Supreme Court held that business judgment is the appropriate standard of review for a post-closing damages action when a merger that is not subject to entire fairness review "is approved by a fully informed, uncoerced vote of the disinterested stockholders." *Id.* at 309.

4 *Mindbody, Inc.*, 2020 WL 5870084, at *4. Mindbody's thirty-day volume weighted average price at the time Vista made its expression of interest was $38.46.

On December 23, 2018, the Mindbody board accepted Vista's offer to acquire Mindbody for $36.50 per share and began a 30-day go-shop period.[5] During the go-shop period, Stollmeyer took steps to shut out alternative bidders and withheld information Vista used to make its final bid. In January 2019, Mindbody's 2018 Q4 revenues came in above Stollmeyer's artificially lower guidance, but Stollmeyer did not disclose the Q4 results to any of the potential bidders other than Vista. The go-shop period ended with no additional bids, and on February 14, 2019, a majority of Mindbody's stockholders approved the merger with Vista, although they were not informed of Mindbody's Q4 revenues or Stollmeyer's relationship with Vista.

After the merger closed, several Mindbody stockholders filed an action alleging breaches of fiduciary duty against Stollmeyer, White, and Eric Liaw, a Mindbody board member who was appointed to the board by a venture capital stockholder. The defendants filed motions to dismiss, and the Court denied the motions as to Stollmeyer but granted the motion as to Liaw.

In ruling on the defendants' motion to dismiss the claims against Stollmeyer, the Court held that the complaint tracked a "paradigmatic *Revlon* plotline," involving a "conflicted fiduciary who is insufficiently checked by the board and who tilts the sale process toward his own personal interests in ways inconsistent with maximizing stockholder value."[6]

The Court found it was reasonably conceivable that Stollmeyer was conflicted due to his liquidity needs and his employment interest post-merger. Stollmeyer himself said his wealth was "locked inside" Mindbody and expressed frustration with his inability to liquidate his holdings.[7] Stollmeyer's personal expenses were so significant that he told his financial advisor that selling his Mindbody stock was "top of mind" for him.[8] This need for liquidity made it reasonably conceivable that Stollmeyer was willing to "short-change" his holdings for a quick sale.[9] Stollmeyer also expressed a desire for future employment with Vista, telling one advisor that Vista was "in love" with him and vice versa.[10] Additionally, Vista's offer would double management's equity stake after the merger—a proverbial "cherry on top."[11] The Court held that the plaintiffs sufficiently alleged that Stollmeyer was conflicted and harbored interests other than maximizing stockholder value because of his need for liquidity combined with his prospective post-merger employment.

The Court also found that it was conceivable that Stollmeyer tilted the sale process in Vista's favor by artificially lowering Mindbody's performance guidance during earnings calls and working with management to find a "creative way to guide 2019."[12] These decisions took place at the same time Stollmeyer was discussing merger opportunities with Vista. Additionally, Stollmeyer gave strategic advantages to Vista by prioritizing its diligence requests and providing it with financial information that no other bidder received, including Mindbody's Q4 results. These allegations were sufficient to show that Stollmeyer tilted the sale process in Vista's favor.

The Court acknowledged the "general rule" that "a plaintiff 'can only sustain a claim for . . . breach of the duty of loyalty by pleading facts showing that it is reasonably conceivable that each of a majority of the board is conflicted.'"[13] But the Court found that an exception to the general rule—where it is adequately alleged that a conflicted fiduciary fails to disclose material information to the board—applied. In holding that the "fraud on the board" exception applied, the Court noted that "Stollmeyer suffered from material conflicts in the sale process that he failed to disclose to the Board" and "[g]iven the materiality of those conflicts, it is reasonably conceivable that the Board would have viewed them as relevant and of a magnitude to be important in carrying out their decisionmaking process."[14]

5 The price represented a 5.1% discount to Mindbody's 30-day volume weighted average price when Vista first expressed interest.

6 *Id.* at *13-14.

7 *Id.* at *16 ("Stollmeyer could only 'sell tiny bits' of his Mindbody stock pursuant to a 10b5-1 plan—a process he described as 'kind of like sucking through a very small straw.'").

8 *Id.* at *16.

9 *Id.* at *18.

10 *Id.* at *16.

11 *Id.* at *16.

12 *Id.* at *20.

13 *Id.* at *23 (quoting *Nguyen v. Barrett*, 2016 WL 5404095, at *5 (Del. Ch. Sept. 28, 2016)).

14 *Id.* at *24.

The Court also held that the merger was not cleansed by a fully-informed stockholder vote under *Corwin* because Stollmeyer withheld material facts before the merger vote.[15] "[A]n omitted fact is material if there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available."[16] The proxy statement failed to disclose Stollmeyer's post-merger employment plans and the extent to which he favored Vista in the bidding process. Stollmeyer also failed to disclose Vista's initial expression of interest in acquiring Mindbody at a premium over its then-trading price. Finally, Stollmeyer withheld the Q4 results, which would have revealed that Stollmeyer's guidance was artificially low. The Court held that this information was material "because it would have helped the stockholder to reach a materially more accurate assessment of the probative value of the sale process."[17] Accordingly, the Court held the complaint adequately alleged Stollmeyer breached his fiduciary duties.[18]

The Court also denied White's motion to dismiss. White he was not a director, he was not protected by the company's 102(b)(7) exculpatory provision, and thus he was liable for breaches of the duty of care. The Court found that it was "reasonably conceivable that White acted with gross negligence throughout the sale process."[19] In particular, the complaint adequately alleged that White assisted Stollmeyer in artificially lowering Mindbody's performance guidance and shutting out alternative bidders during the go-shop period.

However, the Court granted the motion to dismiss the claims against Liaw, holding that, even assuming he was conflicted by virtue of the 3 to 5 year investment of the venture capital fund that nominated him to the board, the complaint contained no allegations supporting a reasonable inference that he "took any action to tilt the process toward his personal interest."[20]

15 *In re Mindbody*, 2020 WL 5870084, at *31.

16 *Id.* at *26 (quoting *Morrison v. Berry*, 191 A.3d 268, 282-83 (Del. 2018)).

17 *Id.* at *30 (quoting *Morrison*, 191 A.3d at 284.).

18 *Id.* at *31-32.

19 *Id.* at *33.

20 *Id.* at *34.

The *Mindbody* decision provides a helpful reminder that directors should take care to scrutinize officers negotiating a sales process to unearth potential conflicts or favoritism. Similarly, boards should take steps to oversee the negotiation process and limit the risk posed by informal communications.

***United Food & Commercial Workers Union v. Zuckerberg*, 2020 WL 6266162 (Del. Ch. Oct. 26, 2020) (Laster, V.C.)**

In *United Food & Commercial Workers Union v. Zuckerberg*,[21] the Court of Chancery dismissed a derivative complaint filed against the directors of Facebook, Inc. ("Facebook") for failure to plead demand futility. In an in-depth demand futility analysis, the Court ultimately concluded that the *Aronson v. Lewis*[22] test for demand futility "is no longer a functional test," and applied the *Rales v. Blasband*[23] test despite precedent suggesting that *Aronson* supplied the appropriate test under the circumstances of the case. The overall impact of this decision remains to be seen; however, the opinion could mark the beginning of a reformation of Delaware's demand futility jurisprudence. The case also illustrates the ability of defendants (including controlling stockholders), with the benefit of an exculpatory provision pursuant to Section 102(b)(7) of the Delaware General Corporation Law and a board composed of a majority of independent and disinterested directors not acting in bad faith, to obtain dismissal of a derivative action even where the allegations adequately allege that the transaction was not entirely fair to the corporation's stockholders.

In 2015, Facebook founder, CEO, and controlling stockholder Mark Zuckerberg developed a plan to make annual donations of his Facebook stock. The donations would ultimately cause Zuckerberg to lose control of Facebook, so Zuckerberg began to look for a way to make the donations without losing control of Facebook. Facebook's general counsel recommended a reclassification through which Facebook would "authorize new shares of Class C common stock that would not have any voting rights, [and] then distribute shares of Class C common stock to all its existing

21 2020 WL 6266162 (Del. Ch. Oct. 26, 2020).

22 473 A.2d 805, 811 (Del. 1984).

23 634 A.2d 927, 934 (Del. 1993).

stockholders, including Zuckerberg."[24] This would allow Zuckerberg to transfer a portion of his economic interest in Facebook to the Class C common stock and then donate that stock without jeopardizing his voting power.

Facebook's board of directors created a special committee to review and negotiate the reclassification. The special committee was able to extract several concessions from Zuckerberg; however, one of its members was alleged to have passed information to Zuckerberg about the committee's deliberations and coached Zuckerberg during negotiations. On April 13, 2016, the special committee voted to recommend the reclassification to the full board, and the board approved the reclassification the following day. Facebook announced the reclassification on April 27. Shortly thereafter, Facebook stockholders filed suit in the Court of Chancery seeking injunctive relief to block the transaction. Days before trial was set to begin, Facebook abandoned the transaction, but, by that time, Facebook had incurred $21.8 million to pursue and defend the reclassification and agreed to pay a fee award of $68.7 million to plaintiff's counsel.

United Food & Commercial Workers Union, a Facebook stockholder, then filed this derivative action in 2018, alleging that certain Facebook directors breached their fiduciary duties by approving the reclassification and by failing to adequately evaluate the suitability of two of the three special committee members and by appointing them to serve on the committee. The plaintiff did not make a demand on the board to pursue the claim, contending that any demand would be futile. The defendants moved to dismiss the complaint under Court of Chancery Rule 23.1 for failure to plead demand futility.

In order to determine if a demand would be futile under Rule 23.1, the Court applies the *Aronson* or *Rales* test. The *Aronson* test typically applies where a board decision is challenged and the directors who made the decision are the same directors upon whom the plaintiff would make a pre-suit demand. The *Rales* test typically applies "(1) where a business decision was made by the board of a company, but a majority of the directors making the decision have been replaced; (2) where the subject of the derivative suit is not a business decision of the board; and (3) where . . . the decision being challenged was made by the board of a different corporation."[25]

Before determining which test would apply in this action, the Court provided an in-depth examination of the two tests. The Court explained that *Aronson* focuses on "whether the business judgment rule protected the decision being challenged."[26] This focus calls for the Court to answer two questions: (1) "whether a disinterested and independent majority of directors had made [the challenged decision]" and (2) "whether the challenged decision 'was otherwise the product of a valid exercise of business judgment.'"[27] If one of these prongs fails, then the Court would find that demand was futile and therefore excused.

The Court stated that given evolving jurisprudence regarding the application of standards of reviews and exculpatory provisions pursuant to Section 102(b)(7), the *Aronson* test "is no longer a functional test."[28] The Court explained that the *Aronson* court "viewed the standard of review that would apply to the challenged decision as outcome determinative for purposes of demand futility."[29] "If the business judgment rule "governed the challenged decision, then the directors did not face a substantial risk of liability from the lawsuit, and the lawsuit could not disable the directors from exercising business judgment regarding the demand. But if the entire fairness test governed—either because the board lacked a disinterested and independent majority when making the challenged decision or for some other reason—then the *Aronson* court regarded that fact as sufficient to render demand excused."[30] But case law "developed in a different direction," with the Court of Chancery holding in other cases that demand is not rendered futile simply because entire fairness applies.[31]

24 *Zuckerberg,* 2020 WL 6266162, at *2.

25 *Id.* at *18.

26 *Id.* at *9 (citing *Aronson*, 473 A.2d at 812).

27 *Id.* at *10 (citing *Aronson*, 473 A.2d at 814).

28 *Id.* at *16.

29 *Id.* at *11.

30 *Id.*

31 *Id. Aronson* also "pre-dated the Delaware Supreme Court's open recognition of enhanced scrutiny" as an intermediate standard of review, and "authority now holds that demand is not futile simply because enhanced scrutiny applies." *Id.* at *12.

"Perhaps most significantly, *Aronson* predated by two years the enactment of Section 102(b)(7) of the Delaware General Corporation Law, which authorizes the certificate of incorporation of a Delaware corporation to contain a provision eliminating or limiting personal liability of a director . . . for monetary damages for breach of fiduciary duty" except in certain enumerated instances, including breaches of the duty of loyalty.[32] Faced with uncertainty about the extent to which defendants could invoke Section 102(b)(7) at the pleading stage to obtain dismissal, in 2015, "the Delaware Supreme Court clarified how Section 102(b)(7) operates at the pleading stage."[33] In *In re Cornerstone Therapeutics Inc. Stockholder Litigation*,[34] the Supreme Court held that a "plaintiff seeking only monetary damages must plead non-exculpated claims against a director who is protected by an exculpatory charter provision to survive a motion to dismiss, regardless of the underlying standard of review[.]"[35] After *Cornerstone*, to satisfy Rule 23.1's pleading requirements, "a plaintiff seeking to show that a director faces a substantial likelihood of liability for having approved a transaction, no matter what standard of review applies, must plead particularized facts providing a reason to believe that the individual director was self-interested, beholden to an interested party, or acted in bad faith."[36] Therefore, "[t]he application of a standard of review more onerous than the business judgment rule no longer implies the existence of a substantial likelihood of liability, as *Aronson* assumed."[37]

The Court then noted that in *Rales*, the Delaware Supreme Court "confronted a board whose members had not participated in the challenged decision," and the *Aronson* test was therefore not implicated.[38] The Court emphasized that the *Rales* test shifts the inquiry to the board's consideration of the demand, asking whether the complaint "create[s] 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."[39] The Court noted that a director could be incapable of considering a demand if the director was interested in the alleged wrongdoing, lacked independence from someone interested in the alleged wrongdoing, or faced a substantial likelihood of liability.

The Court commented that it may be time to consider *Aronson* as a sub-part of the *Rales* test and to generally apply *Rales* moving forward. The Court noted that in this case, because a majority of directors approved the reclassification, *Aronson* should technically apply. However, *Aronson* would not provide a method for analyzing directors who abstained from the vote or joined the board after the vote. Therefore, the Court applied the *Rales* test, asking for each director, if the director received a benefit from the reclassification, if the director lacked independence from someone who received a material benefit in the reclassification, and if the director faced a substantial likelihood of liability. In considering the substantial likelihood of liability question, the Court considered "*both* the operative standard of review, as called for by the original *Aronson* decision, *and* the potential availability of exculpation, as subsequent re-interpretations of *Aronson* recognize is necessary."[40]

The Court ruled that the plaintiff failed to show that demand was futile. The Court assumed that three of the board's nine directors, including Zuckerberg, could not properly consider demand. The question was therefore whether five of the remaining six directors could properly consider a demand. The Court determined that a least five of the six remaining directors could property consider a demand, and thus demand was not excused.[41] The Court found that the plaintiff failed to plead facts sufficient to raise a doubt as to each of the five directors' disinterestedness in the reclassification and independence from Zuckerberg. The plaintiffs also failed to plead that any of the five faced a substantial threat of liability from the litigation because Facebook's certificate of incorporation contained a Section 102(b)(7) provision that exculpated directors from breaches of

32 *Id.*

33 *Id.* at *14.

34 115 A.2d 1173 (Del. 2015).

35 *Zuckerberg*, 2020 WL 6266162, at *14 (quoting *Cornerstone*, 115 A.2d at 1175-76).

36 *Id.* at *15.

37 *Id.*

38 *Id.* at *16.

39 *Id.* at *16 (quoting *Rales*, 634 A.2d at 934).

40 *Id.* at *19.

41 Having found that five of the six remaining directors were capable of considering a demand, and thus that a majority of the board was capable of considering demand such that demand was not excused, the Court did not evaluate whether the sixth director was independent of Zuckerberg—an issue that the Court characterized as a "comparatively close call." *Id.* at *28.

the duty of care, and the allegations in the complaint, "at most, allege a breach of the duty of care."[42]

Notably, the Court dismissed the complaint for failure to plead demand futility even though the Court assumed, in deciding on the motion, that: (i) the transaction at issue would be subject to entire fairness review; (ii) the back-channeling to Zuckerberg by one member of the special committee "prevented the Committee from functioning effectively," and therefore the burden would be on defendants to establish the reclassification was entirely fair; and (iii) there was a "substantial likelihood" that the Court would conclude after a trial that the reclassification was unfair to Facebook's minority stockholders.[43] Thus, this case illustrates the ability of defendants (including controlling stockholders), with the benefit of a Section 102(b)(7) exculpatory provision and a board composed of a majority of independent and disinterested directors not acting in bad faith, to obtain dismissal of a derivative action even where the allegations adequately allege that the transaction was not entirely fair to the corporation's stockholders.

***In re Baker Hughes Inc. Merger Litig.*, 2020 WL 6281427 (Del. Ch. Oct. 27, 2020) (Bouchard, C.)**

In *In re Baker Hughes Inc. Merger Litigation*,[44] the Court of Chancery dismissed plaintiffs' claims that General Electric Company's oil and gas segment ("GE O&G") aided and abetted breaches of fiduciary duty by the board of Baker Hughes Inc. ("Baker Hughes") by allegedly "creating an informational vacuum that induced the board to enter a bad deal based on GE O&G's unaudited financial statements" that ended up being less favorable than audited financial statements that were created between the signing and closing of the merger pursuant to the parties' agreement.[45] Because the Court found that the complaint failed to plead a predicate breach of fiduciary duty, the Court dismissed the aiding and abetting claim.[46] The Court also ruled that the plaintiffs had sufficiently pled that the failure to include the unaudited financial statements in the proxy statement that Baker Hughes issued in connection with the stockholder vote on the transaction was a material omission. The Court held that the complaint sufficiently alleged that Baker Hughes's CEO breached his fiduciary duty of care in connection with the preparation of the proxy, which he signed as the CEO of Baker Hughes, and the Court therefore denied the CEO's motion to dismiss. However, the Court granted GE O&G's motion to dismiss the plaintiffs' claim that GE O&G aided and abetted breaches of fiduciary duty in connection with the proxy statement.

The plaintiffs, Baker Hughes stockholders, alleged that GE O&G aided and abetted breaches of fiduciary duties by the Baker Hughes board in connection with a merger between Baker Hughes and GE O&G. The plaintiffs also alleged that Baker Hughes's CEO, Martin Craighead, and CFO, Kimberly Ross, breached their fiduciary duties in connection with the board's negotiation, consideration, and approval of the merger and in connection with the disclosures that were made in the proxy statement in connection with the merger.

In October 2016, GE O&G proposed a combination with Baker Hughes that would result in General Electric owning 62.5% of the combined company and Baker Hughes stockholders owning 37.5% of the combined company and receiving a $7.4 billion cash dividend. At the time the offer was made, GE O&G's financials were reported on a consolidated basis as part of General Electric's and, as a result, GE O&G did not have separate audited financial statements. When considering GE O&G's offer, the Baker Hughes board relied on GE O&G's unaudited financials and GE O&G's forecasts that were provided by GE O&G.

In October 2016, the Baker Hughes board unanimously approved the merger agreement, which included a closing condition that obligated GE O&G to provide Baker Hughes with audited financials for GE O&G for the preceding three years by no later than April 15, 2017. The agreement further provided that Baker Hughes could terminate the agreement if the audited financials differed from the unaudited financials in a manner that was "materially adverse" to the intrinsic

42 *Id.* at *27.
43 *Id.* at *21.
44 2020 WL 6281427 (Del. Ch. Oct. 27, 2020).
45 *Id.* at *1.
46 Plaintiffs previously pursued claims against 12 of the 13 members of the Baker Hughes board for breaches of their duty of care, but abandoned those claims because of the presence of a Section 102(b)(7) exculpatory provision in Baker Hughes's certificate of incorporation. The Court held that the plaintiffs' abandonment of those claims amounted to a tacit concession of the independence and disinterestedness of those board members.

value of GE O&G, excluding, among other things, any differences resulting from changes in the amount of goodwill or intangible assets.

In March 2017, after signing but before closing of the merger, GE O&G delivered its audited financial statements to Baker Hughes. The audited financial statements reflected a $2.1 billion goodwill impairment and other impairments, currency translations, and dispositions that showed that the unaudited financials overstated GE O&G's goodwill by approximately $4 billion.

Baker Hughes subsequently issued a proxy statement to its stockholders seeking approval of the merger. While the proxy did contain the audited financial statements, the proxy statements did not disclose the unaudited financials that the board reviewed when negotiating the terms of the merger. The Baker Hughes stockholders approved the merger on June 30, 2017, and the merger closed shortly thereafter.

The plaintiffs claimed that GE O&G aided and abetted the Baker Hughes board's breach of its *Revlon*[47] duties in approving the merger. When considering a *Revlon* claim, the Court applies enhanced scrutiny to evaluate "the adequacy of the decisionmaking process employed by the directors, including the information on which the directors based their decision; and . . . the reasonableness of the directors' action in light of the circumstances then existing."[48] The Court held that enhanced scrutiny was appropriate despite the stockholder vote because the proxy statement contained a material omission and, therefore, the vote was not fully informed and *Corwin*[49] did not apply.

The plaintiffs argued that GE O&G aided and abetted the Baker Hughes directors' breaches of fiduciary duty in connection with the board's approval of the transaction based on the unaudited financials and absence of information about the goodwill impairments. The plaintiffs argued that "GE knowingly participated in the Board's failure to act reasonably in approving the Merger Agreement by creating an informational vacuum" by not providing the board with information regarding the goodwill impairments in the unaudited financials and that the board "blindly relied" on the unaudited financials.[50]

The Court disagreed. The Court noted that, because audited financials were not yet available to the Baker Hughes board, "[a]s a practical matter . . . it was necessary for the Baker Hughes Board to utilize" the unaudited financial statements to negotiate any transaction.[51] Moreover, the board did not blindly rely on the unaudited financials; the merger agreement contained provisions protecting Baker Hughes, such as the requirement for GE O&G to prepare and provide Baker Hughes with the audited financial statements prior to closing and the ability of Baker Hughes to terminate the agreement in the event the audited financial statements differed from the unaudited financial statements in a manner material to the intrinsic value of GE O&G. Thus, the Court held that the board "acted within the range of reasonableness in approving the" merger based on the unaudited financials.[52] The Court also reasoned that the complaint failed to allege facts "suggesting that GE was privy to the internal process of the Baker Hughes" board or "conspired with anyone who was" – facts that had formed the basis for aiding and abetting claims based on an "informational vacuum" argument in past cases.[53] Because the complaint made no allegations that "GE participated – knowingly or otherwise – in any of the

47 *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986). In *Revlon*, the Delaware Supreme Court held that when a business combination amounts to the sale of a company, the directors have a duty to the stockholders to ensure that the transaction will maximize the immediate value of the company's shares. *Id.* at 182. When reviewing a *Revlon* claim, the Court will not defer to the board's business judgment but rather will apply "enhanced scrutiny," which requires the directors to prove that the decision-making process was performed with adequate care and that the decision was reasonable under the circumstances. *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 931 (Del. 2003).

48 *In re Baker Hughes*, 2020 WL 6281427, at *7 (quoting *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 48 (Del. 1994)).

49 *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015). In *Corwin*, the Delaware Supreme Court held that business judgment is the appropriate standard of review for a post-closing damages action when a merger that is not subject to entire fairness review "is approved by a fully informed, uncoerced vote of the disinterested stockholders." *Id.* at 309.

50 *In re Baker Hughes*, 2020 WL 6281427, at *6.

51 *Id.* at *7.

52 *Id.* at *8.

53 *Id.* at *10.

alleged failures of the Baker Hughes" board to obtain audited financials before agreeing to the merger (such as preventing the board from obtaining more information from its advisors after receiving the audited financials), the plaintiffs' aiding and abetting claims failed.[54]

The plaintiffs also argued that the board breached its fiduciary duties by failing to take action after receiving the audited financials. The Court rejected this argument as well, noting that the board minutes did not reflect that the board "did nothing" to "review and consider the potential implications of the Audited Financials" and, again, there were no allegations that GE O&G "participated—knowingly or otherwise—in any of the alleged failures of the Baker Hughes Board to take action after GE provided the Audited Financials to Baker Hughes."[55]

The Court then turned to the disclosure claims against Craighead, Ross, and GE O&G. The plaintiffs alleged that the proxy statement was materially deficient for failing to disclose the unaudited financials that the Baker Hughes board relied upon when evaluating merger. The defendants responded that the unaudited financials were unnecessary because, in effect, the audited financials that were disclosed in the proxy rendered the unaudited financial statements "obsolete."[56] The Court disagreed with the defendants, holding that the unaudited financials "would have been material to Baker Hughes' stockholders to evaluate the fairness of the Merger because they contained the only information concerning GE['s] historical financial performance that was available when the Baker Hughes Board approved the Merger Agreement[,]"[57] and, therefore, the disclosure of the unaudited financials would have allowed the stockholders to assess the differences between the audited and unaudited financials.

Having decided that the failure to disclose the unaudited financials in the proxy statement was a material omission, the Court turned to whether the plaintiffs had adequately stated a claim for damages against Craighead, Ross, or GE O&G. The Court held that the complaint contained "numerous allegations concerning Craighead's involvement in the negotiation of the Merger" and alleges that Craighead signed the proxy statement as CEO of Baker Hughes.[58] The Court found those allegations were sufficient to plead a damages claim against Craighead for disclosure violations. However, the complaint failed to adequately plead a disclosure claim against either Ross or GE O&G. The allegations against Ross "boil[ed] down to the unsubstantiated assertion that she 'would have reviewed and authorized dissemination of the Proxy' because she was CFO," which is insufficient to plead that she was grossly negligent or acted with scienter.[59] And absent from the allegations against GE O&G were any well-pled facts that GE O&G knew the board was acting in breach of its fiduciary duties in not including the unaudited financials in the proxy statement, and thus the complaint failed to plead the required statement of mind for an aiding and abetting claim.

Finally, the Court granted Craighead and Ross's motion to dismiss a claim for breach of fiduciary duty asserted against them for approving the transaction and deciding to continue with the transaction after receiving the audited financial statements. The Court noted that these claims were odd because the claim related to board-level decisions, not decisions that Craighead and Ross were authorized to make as officers of the company. The complaint also did not contain any well-pled allegations that the board was not aware of Craighead and Ross's personal financial interests in the merger and, therefore, even if Craighead and Ross were motivated for self-interested reasons for the company to enter into the merger, there was "no reasonably conceivable set of facts pled in the Complaint that calls into question the decisions of an overwhelmingly independent and disinterested Board to approve and continue to support the Merger."[60]

***In re TerraForm Power, Inc. Stockholders Litig.*, 2020 WL 6375859 (Del. Ch. Oct. 30, 2020) (Glasscock, V.C.)**

In *In re TerraForm Power, Inc. Stockholders Litigation*,[61] the Court of Chancery held that stockholder plaintiffs had adequately pled a direct action for a breach of fiduciary duty, in addition to a derivative action, against

54 *Id.* at *11.
55 *Id.*
56 *Id.* at *12.
57 *Id.*
58 *Id.* at *16.
59 *Id.*
60 *Id.* at *18.
61 2020 WL 6375859 (Del. Ch. Oct. 30, 2020).

directors of the defendant company and its controlling stockholder under the framework of *Gentile v. Rossette*.[62] In coming to this conclusion, the Court relied on *stare decisis* and reaffirmed *Gentile* as controlling precedent, despite subsequent decisions from Delaware courts that have called its applicability into question.

The plaintiffs, stockholders of TerraForm Power, Inc. ("TerraForm"), the nominal defendant corporation, raised direct and derivative claims for breach of fiduciary duty against TerraForm's controlling stockholder, Brookfield Asset Management, Inc. ("Brookfield"), Brookfield's affiliates, TerraForm's CEO, and certain TerraForm directors.[63] These claims arose from a private placement by which, according to the plaintiffs, Brookfield caused TerraForm to issue Brookfield "stock for inadequate value, diluting both the financial and voting interest of the minority stockholders."[64]

Prior to the transaction at issue, Brookfield held 51% of TerraForm's outstanding common stock. In 2018, Brookfield approached TerraForm with a proposal to acquire Saeta Yield, S.A. Initially, Brookfield proposed, and the TerraForm conflicts committee and stockholders approved, a plan to finance the acquisition through a "backstopped equity offering" at $10.66 per share, up to $400 million, in which Brookfield would "participat[e] up to it's [sic] *pro rata* portion of the equity offering" and backstop the equity offering.[65] After TerraForm's 2018 annual meeting, where its stockholders approved the initially proposed transaction, TerraForm changed course and instead completed "a private placement of $650 million of TerraForm stock with Brookfield at $10.66 per share," after which Brookfield "owned 65.3% of TerraForm's outstanding common stock."[66]

TerraForm stockholders filed both direct and derivative claims for breach of fiduciary duty against the defendants. However, in 2020, "all outstanding TerraForm shares not already owned by Brookfield were acquired by Brookfield," and as a result, the Court granted defendants' motion to dismiss the derivative counts for lack of standing. Thereafter, the defendants moved to dismiss the plaintiffs' remaining claims for lack of standing, arguing "that the [p]laintiffs' claims [were] exclusively derivative claims belonging to TerraForm."[67] This left the Court to resolve "whether the Plaintiffs ha[d] adequately alleged that the Private Placement breached fiduciary duties Brookfield owed directly to TerraForm's minority stockholders, or whether the Plaintiffs ha[d] instead alleged claims of harm to TerraForm directly, and the minority stockholders only derivatively."[68]

The Court first laid out the applicable standard, stating that "the determination of whether a stockholder's claim is direct or derivative" turns on "who suffered the alleged harm" and "who would receive the benefit of any recovery or other remedy."[69] The Court rejected the plaintiffs' argument that they had adequately pled a direct claim against the defendants because the private placement entrenched Brookfield. The Court reiterated that dilution claims are ordinarily derivative under *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*[70] and, therefore, an argument "that the [p]rivate [p]lacement injured stockholders simply because it diluted their ownership interest in TerraForm is alone insufficient to state a direct claim[.]"[71] Additionally, the Court found the plaintiffs' theory that the private placement served to entrench Brookfield was "not reasonably conceivable."[72] Thus, "[w]ithout an adequate pleading of entrenchment," the plaintiffs' only remaining harm was that caused by dilution, which is "a classically derivative injury."[73]

Next, the Court addressed the plaintiffs' argument that they had adequately pled direct claims of breach of fiduciary duty under *Gentile*. The plaintiffs contended that the facts at hand were "indistinguishable from" the facts of *Gentile*, where the Delaware Supreme Court held that "where a controller has caused the corporation to issue stock to it for inadequate compensation, the

62 *Id.* at *1. *See Gentile v. Rossette*, 906 A.2d 91 (Del. 2006), discussed *infra*.

63 *In re TerraForm Power*, 2020 WL 6375859, at *7.

64 *Id.* at *1.

65 *Id.* at *4-5.

66 *Id.* at *6. In 2019, TerraForm conducted a public offering that resulted in a reduction of Brookfield's equity percentage to 61.5%. *Id.* at *7.

67 *Id.* at *8.

68 *Id.*

69 *Id.* (quoting *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004)).

70 845 A.2d 1031 (Del. 2004).

71 *In re TerraForm Power*, 2020 WL 6375859, at *9-10.

72 *Id.* at *10-11.

73 *Id.* at *11 (quoting *El Paso Pipeline GP Co., L.L.C. v. Brinckerhoff*, 152 A.3d 1248, 1261 (Del. 2016)).

stockholders have a direct claim for relief[.]"[74] The Supreme Court reiterated the standard for when a claim for breach of fiduciary duty "is both direct and derivative in character[,]" stating that such a "dual character" claim arises where a controlling stockholder causes a corporation to "issue 'excessive' shares of its stock in exchange for assets of the controlling stockholder that have lesser value[,]" resulting in an "increase in the percentage of outstanding shares owned by the controlling stockholder, and a corresponding decrease in the share percentage owned by the public (minority) stockholders."[75]

The Court of Chancery found that the facts alleged by the plaintiffs "fit *Gentile*'s transactional paradigm to a T."[76] Specifically, the plaintiffs "allege[d] that Brookfield—TerraForm's controlling stockholder—caused TerraForm to proceed with the Private Placement and issue shares to Brookfield at an inadequate price."[77] Moreover, the plaintiffs "allege[d] that the Private Placement caused Brookfield's percentage of shares in TerraForm to increase from 51% to 65.3%[,]" and as a result, "TerraForm's minority stockholders suffered a corresponding decrease in their ownership stake in TerraForm."[78] Thus, the Court concluded that the plaintiffs had "state[d] direct claims under *Gentile*'s rationale."[79]

The defendants conceded that the facts at hand were consistent with those in *Gentile*, but argued that the Court "need not follow *Gentile*."[80] The Court first disposed of the defendants' argument that *Gentile* relied on a case that was "disapproved of in *Tooley*[,]" stating that *Gentile* fit "within the analytical framework mandated by *Tooley*."[81] Second, the Court addressed the defendants' argument that the Court "need not follow *Gentile* because it was improperly decided."[82] The Court noted that "[p]ost-*Gentile*, Delaware courts have struggled to define the boundaries of dual-natured claims[,]"[83] and discussed the Court of Chancery's own precedent that called into question "whether *Gentile* will remain the law of Delaware."[84] The Court also examined the Supreme Court's subsequent decision in *El Paso Pipeline GP Co., L.L.C. v. Brinckerhoff*,[85] which instructed that "*Gentile* . . . should be construed narrowly,"[86] and that "*Gentile* must be limited to its facts[.]"[87] The Court maintained, however, that *Gentile* had not been overruled, and thus, consistent with the doctrine of *stare decisis*, the Court of Chancery was bound by the Supreme Court's precedent in *Gentile*.[88]

The Court concluded that this case "is the rare case that perfectly fits the narrow *Gentile* paradigm," and therefore, the Court ruled that the plaintiffs' complaint was sufficient to withstand the motion to dismiss the direct claims.

Gottlieb v. Duskin, 2020 WL 6821613 (Del. Ch. Nov. 20, 2020) (Zurn, V.C.)

In *Gottlieb v. Duskin*,[89] the Court of Chancery held that although a stockholder plaintiff's allegations that a company's directors rejected a premium offer to acquire the company with the intent to entrench themselves triggered enhanced scrutiny under *Unocal Corp. v. Mesa Petroleum Co.*,[90] the application of *Unocal*, on its own, did not excuse demand under Court of Chancery Rule 23.1. Because the plaintiff failed to otherwise satisfy Rule 23.1, the Court granted the defendant directors' motion to dismiss.

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74 *Id.* at *11. In *Gentile*, a case in which a CEO and controlling stockholder "forgave debt the corporation owed to him personally in exchange for additional equity in the corporation[,]" the Supreme Court held that "the plaintiffs pled two independent harms" stemming from a transaction. *Id.* at *11-12. First, "the corporation was caused to overpay (in stock) for the debt forgiveness," and second, "the minority stockholders lost a significant portion of the cash value and voting power of their minority interest." *Id.*

75 *Id.* at *12 (quoting *Gentile*, 906 A.2d at 100).

76 *Id.*

77 *Id.*

78 *Id.*

79 *Id.* at *9.

80 *Id.* at *13.

81 *Id.* (quoting *Gentile*, 906 A.2d at 102).

82 *Id.*

83 *Id.* (quoting *Sciabacucchi v. Liberty Broadband Corp.*, 2018 WL 3599997, at *7 (Del. Ch. July 26, 2018)).

84 *Id.* at *15 (quoting *Mesirov v. Enbridge Energy Co., Inc.*, 2018 WL 4182204, at *8 n.77 (Del. Ch. Aug. 29, 2018)).

85 152 A.3d 1248 (Del. 2016).

86 *In re TerraForm Power*, 2020 WL 6375859 at *16 (quoting *Mesirov*, 2018 WL 4182204 at *8 n.77).

87 *Id.* at *16 (quoting *Sciabacucchi*, 2018 WL 3599997 at *10).

88 *Id.* at *16.

89 2020 WL 6821613 (Del. Ch. Nov. 20, 2020).

90 493 A.2d 946 (Del. 1985).

In November 2018, non-party Justin Yoshimura expressed interest in acquiring the company, Christopher & Banks, at a price of $0.80 per share, which represented a 33% premium to the company's stock price. The plaintiff alleged that immediately after Yoshimura approached the board, management presented the board projections based on a turnaround plan that supported a $2.46 per share stock price. However, in December, the stock price fell to the point that Yoshimura's bid constituted a 150% premium. On December 15, the board engaged an investment bank to evaluate the company. The bank completed a report on December 18, and two days later, the board rejected Yoshimura's bid, electing instead to pursue its turnaround plan.

The plaintiff, a stockholder of the company, brought an action against the company's directors, alleging that they, with the intent to entrench themselves, engaged in a scheme to reject the offer to acquire the company's stock at a premium by commissioning a flawed financial analysis based on management's inflated projections. In addition, the plaintiff alleged that director defendant Johnathon Duskin, who was the CEO of the company's largest stockholder, may have borne "ill will" toward Yoshimura, who had previously outbid the company in a bankruptcy auction. Although the plaintiff did not allege that Duskin was interested in the transaction or lacked independence, the plaintiff demanded in the complaint that the board explore whether he had a conflict of interest and, if he did, exclude him from deliberations concerning the company's strategic alternatives. The plaintiff did not allege that any other director defendant was interested in the transaction or lacked independence.

The defendants moved to dismiss the complaint on the grounds that: (i) their actions were subject to the business judgment rule; and (ii) the plaintiff failed to plead demand futility as required by Court of Chancery Rule 23.1. In a prior oral ruling, the Court held that the plaintiff's allegations that the board took defensive measures to entrench themselves triggered enhanced scrutiny under *Unocal*. The Court also previously held that the plaintiff had pled derivative claims, not direct claims. However, the plaintiff, assuming his claims were direct, had not made a pre-suit demand on the board or plead demand futility. Instead, the plaintiff fleetingly argued that demand was excused because his claims were subject to review under *Unocal*. Because the issue had not been fully briefed, the Court reserved judgment and requested supplemental briefing as to whether allegations that trigger application of *Unocal* are sufficient, on their own, to excuse demand.[91]

In this subsequent letter opinion, the Court discussed the two tests for determining demand futility: *Aronson v. Lewis*[92] and *Rales v. Blasband*.[93] The Court ultimately applied *Aronson*, because "the same directors who would consider [the] demand had made the challenged decision[.]"[94] However, the Court noted that the result would be the same under either inquiry.

Analyzing the facts under *Aronson*, the Court first asked whether the plaintiff alleged "particularized facts creating a reason to doubt that . . . the directors are disinterested and independent."[95] The Court found that the plaintiff failed to satisfy this prong because the plaintiff had not pled particularized facts that any director other than Duskin might have any interest or otherwise lacked independence beyond a "a conclusory

91 The Court also reserved judgment and requested supplemental briefing as to whether enhanced scrutiny under *Unocal* is appropriate where the plaintiff primarily seeks money damages as opposed to injunctive relief, but the court did not reach this issue. *Gottlieb*, 2020 WL 6821613, at *1.

92 473 A.2d 805 (Del. 1984). The Aronson test applies "where it is alleged that the directors made a conscious business decision in breach of their fiduciary duties." *In re GoPro, Inc. S'holder Derivative Litig.*, 2020 WL 2036602, at *8 (Del. Ch. Apr. 28, 2020). 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.

93 634 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. 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.

94 *Gottlieb*, 2020 WL 6821613, at *4.

95 *Id.*

and collective entrenchment theory[.]"[96] Second, the Court considered whether "the challenged transaction was otherwise the product of a valid exercise of business judgment[.]"[97] The plaintiff asserted that the situation was a "rare case" where the decisions at issue were "so egregious" as to be "inexplicable other than bad faith[.]"[98] On the contrary, the Court found that the allegations—particularly with regard to the decision to maintain the course of the turnaround plan—could have had a legitimate business purpose, which was supported by the plaintiff's own allegations that the board continuously, unrelentingly, and optimistically pursued the turnaround plan.

The Court observed that, "[b]oiled down, Plaintiff believes the standard of review, set on notice pleading standards, should dictate the outcome of the futility analysis under Rule 23.1's more onerous pleading standard."[99] The Court rejected this argument, holding instead that the plaintiff's "bare-bones *Unocal* claim" did not "automatically translate into a nonexculpated duty of loyalty claim," nor was it "enough to satisfy the second prong of *Aronson*[,]" and "[t]he fact that a plaintiff has alleged the existence of defensive measures triggering *Unocal* enhanced scrutiny does not amount to a *per se* determination that the transaction is inexplicable other than by bad faith."[100]

***City of Warren Gen. Emps.' Ret. Sys. v. Roche*, 2020 WL 7023896 (Del. Ch. Nov. 30, 2020) (Fioravanti, V.C.)**

In *City of Warren General Employees' Retirement System v. Roche*,[101] the Court of Chancery dismissed a plaintiff stockholder's claim that two officers of Blackhawk Network Holdings, Inc. ("Blackhawk") breached their fiduciary duties by manipulating Blackhawk's board into selling Blackhawk to two private equity firms (the "PE Firms") in order to secure their employment and obtain equity in Blackhawk after the sale. In so ruling, the Court highlighted that the complaint did not contest that ten of the twelve directors who approved the sale were disinterested and independent and that the complaint lacked well-pleaded allegations that the officers were motivated by the prospect of post-closing employment or equity. However, the Court declined to dismiss the plaintiff's claim against another officer who signed the proxy statement issued in connection with the transaction, finding that the plaintiff sufficiently alleged that the officer breached her fiduciary duty of care by approving a materially misleading proxy.

In 2017, Blackhawk, a company involved in the sale of prepaid gift and reward cards, began to explore a potential investment by the PE Firms. In August of that year, Blackhawk retained Sandler O'Neill & Partners, L.P. ("Sandler") as its financial advisor to advise on the potential investment, as well as other strategic acquisition opportunities. By October, Sandler had "determined that there was a 'full range of options to finance an aggressive M&A strategy[.]'"[102] According to the plaintiff, Blackhawk's officers feared that activist investors would disrupt their planned acquisition strategy, but believed "that engineering a sale of Blackhawk to a private equity firm could allow them to profit personally from the pursuit of the acquisition strategy."[103]

In the fall of 2017, the PE Firms indicated that they would pay $47 to $49 per share to acquire Blackhawk and that they would support management in pursuing a post-transaction strategy of aggressive acquisitions. Around the same time, Sandler presented analyses suggesting that Blackhawk would be worth between $45 and $51 per share. After receiving a second indication of interest from the PE Firms at a price between $44 and $45 per share, the Blackhawk board unanimously decided to pursue a transaction with the PE Firms.

In January 2018, the Blackhawk board approved entry into a merger agreement with the PE Firms at a purchase price of $45.25 per share. The merger agreement provided for a go-shop period that allowed Blackhawk to solicit alternative proposals, including a potential proposal from Thoma Bravo, LP ("Bravo"). Two months later, Blackhawk disseminated a proxy statement to its stockholders disclosing the terms of the merger agreement, including the go-shop process and Bravo's indication of interest. The proxy also included financial projections for Blackhawk that were provided to the Blackhawk board during its consideration of the

96 *Id.* at *5.
97 *Id.* at *4.
98 *Id.* at *7.
99 *Id.* at *8.
100 *Id.*
101 2020 WL 7023896 (Del. Ch. Nov. 30, 2020).
102 Id. at *3.
103 *Id.* at *4.

transaction. A supplement to the proxy disclosed that after the transaction closed, Blackhawk management would receive new equity incentive plans. Blackhawk's stockholders approved the merger, with 99.6% of voting shares voting in favor. The transaction closed on June 15, 2018.

After obtaining books and records from Blackhawk following litigation pursuant to Section 220 of the Delaware General Corporation Law, the plaintiff filed a complaint asserting in a single count that Blackhawk officers Talbott Roche (CEO and President) and William Tauscher (Executive Chairman – an executive officer position at the company) breached their fiduciary duties in connection with the merger. In support of its claim, the plaintiff alleged that (i) the defendants manipulated the board to approve the sale in order to secure their employment with and obtain equity in the post-closing entity[104] and (ii) the defendants "breached their fiduciary duties by misleading Blackhawk's stockholders through a materially misleading [p]roxy."[105]

The Court first determined that the plaintiff failed to adequately plead that the defendants breached their fiduciary duties by manipulating the board to approve the sale. The plaintiff alleged that "[d]efendants were self-interested because activist stockholders threatened their employment with Blackhawk."[106] The plaintiff further alleged that the defendants "sought to secure post-closing employment with Blackhawk to earn part of a 'typical management equity pool following a private equity buyout' and then profit from the Company's acquisition strategy."[107]

In determining that it was not reasonably conceivable that the defendants had engineered the sale to avoid activist investor threats, the Court explained that the plaintiff's complaint lacked any allegation that an activist stockholder communicated any threat to remove the defendants from their employment. Moreover, the Court declined to infer that one of Blackhawk's activist stockholders – Jana Partners LLC – posed such a threat, as "Jana had already sold its Blackhawk stock by the time [the PE Firms] submitted the [f]irst [i]ndication of [i]nterest" and Jana was therefore "no longer in a position to exert pressure on the Company or management[.]"[108]

The Court similarly determined that the complaint's allegations were insufficient to support the plaintiff's contention that the defendants acted disloyally in connection with the merger because they sought continued employment and equity in the post-closing entity. Importantly, there were "no allegations that any employment offers were extended or that employment discussions were had prior to closing the transaction."[109] And even if the defendants thought they would be employed by the post-closing entity, there was no "allegation or reasonable inference that they knew or believed that any equity incentive plan would be superior to their prospects with Blackhawk as a standalone entity."[110] Thus, unlike situations like *In re Xura, Inc., Stockholder Litigation*,[111] where the CEO "engaged in unauthorized discussions with the acquirer" and "injured his own company's ability to bargain with a bidder to save his own job[,]" the plaintiff's claim failed to allege that the defendants were self-interested during the sale negotiations.[112]

"Even under the assumption that [the] [d]efendants had a conflict of interest," the Court determined that the complaint did not contain well-pleaded allegations that the board was supine or that the defendants "manipulated or deceived the Board in order to favor [the PE Firms]."[113] The Court explained that the plaintiff did not allege that any of the ten other directors were dominated or controlled by the defendants, the complaint illustrated that the board "met, engaged with management and advisors, and deliberated during regular intervals during" negotiations, and the complaint illustrated that the board, not management, directed and approved of the sales processes.[114] This conduct, the Court noted, did not "support a reasonable inference of a board

104 As recognized by the Court, the plaintiff's first legal theory was "grounded in a line of recognized iconic cases" – stemming from *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261 (Del. 1989) – "that are premised on independent board members not receiving critical information from conflicted fiduciaries and where impartial board members did not oversee conflicted members sufficiently." *Id.* at *10 (internal quotation marks omitted).

105 *Id.*

106 *Id.* at *11.

107 *Id.*

108 *Id.*

109 *Id.* at *13.

110 *Id.*

111 2018 WL 6498677 (Del. Ch. Dec. 10, 2018).

112 *Roche*, 2020 WL 7023896, at *14.

113 *Id.* at *18.

114 *Id.* at *16.

'exhibiting indolent or apathetic inertia or passivity,' or otherwise having been manipulated by [the defendants] during the Buyout process."[115] Furthermore, the Court determined that it was not reasonably conceivable from the allegations pled that defendants misled or deceived the board about matters relevant to the board's approval process, including the contents of management's discussions with the PE Firms and management's projections.

However, the Court did determine that the complaint stated a claim that one of the defendants – Roche – breached her fiduciary duty of care as an officer by approving a materially misleading proxy. In so ruling, the Court conducted a two-step analysis: (i) "whether the Complaint alleges that Defendants were involved in the preparation of the Proxy disclosures" and (ii) "whether the Proxy is materially misleading[.]"[116]

In conducting the first step of the analysis, the Court determined that Roche's signing of the proxy created an inference "that Roche was involved in preparing the disclosures in the Proxy in her capacity as an officer of Blackhawk."[117] In contrast, the Court determined that the complaint was "devoid" of any allegations that Tauscher, who had not signed the proxy, had "any role in drafting or disseminating the Proxy" and therefore ruled that the "[p]laintiff ha[d] not pleaded a claim that Tauscher could have breached any fiduciary duty by issuing a materially deficient proxy."[118]

In the second step of the analysis, the Court determined that the plaintiff had adequately alleged that the proxy was materially misleading in two respects. First, the plaintiff alleged that the proxy "omit[ted] projected earnings from [strategic] acquisitions that were considered by the Board" during the sale process.[119] The Court determined that "[a] reasonable stockholder would have wanted to know information regarding management's projections of the Company's potential earnings from acquisitions"[120] and that such information, if disclosed, "would have altered the 'total mix' of information available because they would have formed a basis against which a reasonable stockholder could compare the price she would receive through the [transaction] and to assess the basis for the Board's recommendation of the [transaction]."[121]

Second, the plaintiff alleged that the proxy inaccurately described the merger agreement's go-shop provisions. The proxy indicated that the board could terminate the agreement to enter into a solicited superior proposal during the go-shop period. In reality, the board "was only allowed to change its recommendation or to terminate the Merger Agreement in response to an unsolicited acquisition proposal."[122] The defendants argued that the merger agreement was attached to the proxy and, therefore, "any person could read the provision" and determine the scope of the go-shop period.[123] The Court disagreed, determining that the attachment of the merger agreement to the proxy did not cure the proxy's "inaccurate and misleading disclosure regarding the go-shop."[124]

***In re Viacom Inc. Stockholders Litig.*, 2020 WL 7711128, (Del. Ch. Dec. 29, 2020), as corrected (Dec. 30, 2020) (Slights, V.C.)**

In *In re Viacom Inc. Stockholders Litigation*,[125] the Court of Chancery, on a motion to dismiss, applied both an entire fairness and business judgment review to breach of fiduciary duty claims concerning the merger of Viacom Inc. ("Viacom") and CBS Corporation ("CBS"). With respect to claims against a controlling stockholder, who was involved on both sides of the transaction, the Court applied the entire fairness standard because the controlling stockholder received a non-ratable benefit from the merger in the form of control of the merged companies. However, for members of a special committee, the Court applied the more deferential business judgment standard. In doing so, the Court analyzed the controlling stockholder's influence on the independence of those directors in approving the merger. Ultimately, as to both the controlling stockholder and the special committee defendants, the Court denied their Rule 12(b)(6) motions to dismiss, holding that the

115 *Id.*
116 *Id.* at *19 (citing *Corwin v. KKR Fin. Hldgs. LLC*, 125 A.3d 304, 312-14 (Del. 2015)).
117 *Id.* at *19.
118 *Id.*
119 *Id.* at *21.
120 *Id.*
121 *Id.*
122 *Id.*
123 *Id.*
124 *Id.*
125 2020 WL 7711128 (Del. Ch. Dec. 29, 2020), as corrected (Dec. 30, 2020).

plaintiffs sufficiently alleged breach of fiduciary duty claims against the controlling stockholder and certain directors in connection with the merger.[126]

Viacom and CBS were two media companies with the same controlling stockholder, National Amusements, Inc. ("NAI"). NAI held "approximately 80% of the Class A voting shares of each company."[127] Shari Redstone ("Ms. Redstone") was both the controlling stockholder and president of NAI, which empowered her to make decisions regarding NAI and Viacom's governance structures. In preparation for an attempted merger, Ms. Redstone replaced NAI trustees "with trustees of her choosing."[128] In turn, NAI replaced certain Viacom directors with merger-friendly directors. At Ms. Redstone's behest, merger attempts between Viacom and CBS began in 2016, culminating in a successful merger in December 2019 after two prior failed merger attempts.

In order to facilitate each merger attempt, Viacom formed a special transaction committee (the "Viacom Committee"), composed of allegedly merger-friendly defendant-directors (the "Viacom Committee Defendants").

The first merger attempt by NAI never gained traction. CBS demanded that NAI relinquish control over the companies and NAI refused. The second merger attempt also failed due to continued governance disputes. Litigation ensued. As a result of a settlement, NAI retained even more control over the CBS board of directors. In 2019, NAI's third and final attempt at a merger was successful. The parties settled on both a governance structure and exchange ratio. In doing so, the Viacom Committee, at Ms. Redstone's direction, prioritized a favorable governance structure at the expense of a favorable exchange ratio. This came at a cost to Viacom stockholders. In exchange for a favorable governance structure, the agreed upon exchange ratio valued Viacom at approximately $1 billion less than the second attempted merger. Thus, while it obtained control over the merged company, Viacom failed to maximize stockholder value.

The plaintiffs, Viacom stockholders, sued NAI, Ms. Redstone, and the Viacom Committee Defendants for breach of fiduciary duty. The Court first turned to the standard of review, which is a "gating question" for purposes of pleadings stage breach of fiduciary duty claims.[129] The plaintiffs argued that the proper standard of review for their claim was entire fairness review. The defendants argued that the deferential business judgment rule was the correct standard. The Court ultimately applied entire fairness review to the claim against NAI and Ms. Redstone, and applied the business judgment rule to the claim against the Viacom Committee Defendants.

In doing so, the Court set forth the factors that trigger entire fairness review for a breach of fiduciary duty claim against a controlling stockholder. First, the Court considers "whether the controller engaged in a 'conflicted transaction.'"[130] "[A] controller engages in a conflicted transaction when (1) the controller stands on both sides; or (2) the controller competes with the common stockholders for consideration."[131]

While a finding under the second prong always warrants entire fairness review, the Court discussed conflicting law on whether a controller's "mere presence" on both sides of a transaction *alone* triggers entire fairness review. The plaintiffs argued that "mere presence" alone should trigger entire fairness review. The defendants argued that something more than "mere presence" is necessary, such as where "'the [controller] has received a benefit to the exclusion and at the expense of the [minority].'"[132] Ultimately, while acknowledging precedent on both sides, the Court held that the "mere presence" debate was irrelevant here because there was more than "mere presence" of the controller on both sides.

Indeed, the Court held that the plaintiffs sufficiently pled that Ms. Redstone and NAI received a non-ratable benefit from the merger. The Court held that "[a] non-ratable benefit exists when the controller receives a 'unique benefit by extracting something uniquely valuable to the controller, even if the controller nominally receives the same consideration as all other

126 The Court, however, granted a motion to dismiss as to the count directed against the CEO of the combined company because none of his actions implicated a breach of any fiduciary duty.

127 *Id.*

128 *Id.* at *6.

129 *Id.*

130 *Id.* at *11.

131 *Id.* (internal quotation marks and citation omitted).

132 *Id.* at *12 (citing *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971)).

stockholders.'"[133] Here, the non-ratable benefit gleaned by Ms. Redstone was control of the merged companies. Ms. Redstone, through NAI, "used the merger as a means to consolidate her control of Viacom and CBS at the expense of the Viacom minority stockholders."[134] Although she controlled a majority of the voting shares of each company prior to the merger, the Court noted that she wished to "solidify her status as a media mogul" and her desire to merge the companies was "fueled in 2016 amid concern that CBS might agree to be acquired by a large technology company."[135] Indeed, the CBS board had rebuffed her previous attempts to merge Viacom and CBS and had attempted to dilute NAI's voting control over CBS. Having received a non-ratable benefit, the Court applied an entire fairness review. The Court stated that the defendants did not seriously argue that the plaintiffs failed to sufficiently plead that the merger was not entirely fair, and, therefore, the motion to dismiss the claim against Ms. Redstone and NAI was denied.

The plaintiffs also alleged that the Viacom Committee Defendants lacked independence, acted in bad faith, and thus breached their fiduciary duties, due to: (1) improper personal relationships with Ms. Redstone; (2) the threat of ouster from Ms. Redstone; and (3) a "controlled mindset" that biased their actions in favor of Ms. Redstone's desires.[136] Instead of entire fairness review, the Court analyzed the Viacom Committee Defendants' actions under the business judgment rule. In doing so, the Court held that "entire fairness review for one does not mean entire fairness review for all[.]"[137] Rather, independent directors are not presumed to lose "'the protection of the business judgment rule solely because the controlling stockholder may itself be subject to liability for breach of the duty of loyalty if the transaction was not entirely fair to the minority stockholders.'"[138]

Accordingly, the Court analyzed whether each director's personal relationship with Ms. Redstone was of a "bias-producing nature"[139] and considered Ms. Redstone's threats and retributive behavior. With respect to a "controlled mindset," the Court analyzed whether the "[committee's] independence [was] 'sterilized' by the domination of a controller."[140] In a challenge to the directors' independence (as opposed to interest), the plaintiffs argued that Ms. Redstone's influences caused the Viacom Committee Defendants to favor "NAI's interests over those of minority stockholders."[141] The Court agreed. Because Viacom's charter contained a provision under Section 102(b)(7) of the DGCL exculpating breaches of fiduciary duty except for loyalty and good faith breaches, the Court focused on whether the plaintiffs plausibly alleged "facts supporting a rational inference that the director[s] . . . 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."[142] Examining the influence of personal relationships, threats of ouster, and a controlled mindset on each defendant's individual actions, the Court held that a totality of these factors "sufficiently plead reasonably conceivable breaches of the duty of loyalty on the part of each Viacom Committee Defendant."[143] Thus, the Viacom Committee Defendants' motion to dismiss the claim against them was also denied.

Richardson as Tr. of Richardson Living Tr. v. Clark, 2020 WL 7861335 (Del. Ch. Dec. 31, 2020) (Glasscock, V.C.)

In *Richardson as Trustee of Richardson Living Trust v. Clark*,[144] the Court of Chancery granted the defendants' Rule 23.1 motion to dismiss, holding that the plaintiff's 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 plaintiff 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*")[145] regarding the matters raised in the

133 *Id.* at *16 (quoting *IRA Tr. FBO Bobbie Ahmed v. Crane*, 2017 WL 7053964, at *7 (Del. Ch. Dec. 11, 2017)).
134 *Id.*
135 *Id.* at *17.
136 *Id.* at *19.
137 *Id.*
138 *Id.* (quoting *In re Cornerstone Therapeutics, Inc. S'holder Litig.*, 115 A.3d 1173, 1182–83 (Del. 2015)).
139 *Id.* at *20.
140 *Id.* at *24.
141 *Id.*
142 *Id.* at *20.
143 *Id.* at *25.
144 2020 WL 7861335 (Del. Ch. Dec. 31, 2020).
145 698 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."

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 few occasions over the past two years,[146] pleading a *Caremark* claim remains "among the hardest to plead and prove" under Delaware law.[147]

MoneyGram International, Inc. ("MoneyGram") is a business that facilitates money transfers between people and businesses worldwide and is held to certain anti-money-laundering ("AML") requirements by the federal government. Beginning in 2009, MoneyGram's AML programs came under scrutiny from federal regulators after the Federal Trade Commission ("FTC") alleged that MoneyGram's agents assisted in perpetrating fraud. Then, in 2012, federal prosecutors charged MoneyGram with "aiding and abetting wire fraud and failing to maintain effective AML procedures."[148] This resulted in MoneyGram entering into a deferred prosecution agreement ("DPA") with the U.S. Department of Justice ("DOJ"). The DPA required MoneyGram to make extensive improvements to its AML processes and pay restitution to fraud victims.

MoneyGram did not succeed in making AML improvements. Although the company implemented several reforms, the reforms did not consistently reduce money laundering activity or fraud. This led to the DOJ extending MoneyGram's DPA to 2021, and MoneyGram was forced to pay an additional $125 million in restitution.

On December 18, 2020, the plaintiff filed a derivative lawsuit against the directors and certain officers of MoneyGram, alleging breaches of fiduciary duties. The defendants moved to dismiss pursuant to Court of Chancery Rule 23.1, on the basis that the plaintiff did not make a demand on the board and failed to adequately plead demand futility.

The plaintiff claimed that demand was futile because the directors faced a substantial likelihood of liability for lack of AML oversight and, therefore, a majority of the demand board was interested in the outcome of the litigation. Because the plaintiff alleged that the board failed to act, the Court analyzed demand futility pursuant to the test articulated in *Rales v. Blasband*.[149] 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."[150] The Court further explained that because MoneyGram's certificate of incorporation contained a Section 102(b)(7) exculpation provision for breaches of the duty of care, in order to prove demand futility the plaintiff needed to

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).

146 *See Marchand v. Barnhill*, 212 A.3d 805, 820 (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); *Teamsters Local 443 Health Servs. & Ins. Plan v. Chou*, 2020 WL 5028065 (Del. Ch. Aug. 24, 2020).

147 *In re MetLife Inc. Derivative Litig.*, 2020 WL 4746635 at *1 (Del. Ch. Aug. 17, 2020).

148 *Richardson as Trustee of Richardson Living Trust v. Clark,* 2020 WL 7861335 at *5.

149 634 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).

150 *Richardson as Trustee of Richardson Living Trust v. Clark*, 2020 WL 7861335 at *7.

plead particularized facts showing that a majority of the board violated their *Caremark* duties in bad faith. The Court held that the plaintiff failed to do so.

Because the plaintiff conceded that the directors had a system of oversight and control in place, the plaintiff's demand futility argument was "solely grounded in the second *Caremark* prong"—that the directors, "having implemented such a system or controls, consciously failed to monitor or oversee operations thus disabling themselves from being informed of risks or problems requiring their attention."[151] The plaintiff argued that there were several red flags concerning the company's compliance with the DPA, the board took no action to correct the deficiencies, and the board, with knowledge of the deficiencies, misrepresented the effectiveness of MoneyGram's DPA compliance to the DOJ. The Court rejected each of those arguments in turn and granted the defendants' motion to dismiss for failure to adequately plead demand futility.

First, the Court held that the complaint made clear that the red flags identified by the plaintiff—the 2009 FTC Order, the DPA, and reports received throughout the term of the DPA—were brought before the board and addressed by the board. The Court noted that the "allegations in the Complaint and documents incorporated therein acknowledge that MoneyGram took numerous actions to improve anti-fraud and AML controls and to reduce the number of fraud complaints."[152] The Court agreed that the directors' attempt to reduce fraud and money laundering was unsuccessful, but stated that "a failed attempt is not itself indicative of a bad-faith attempt."[153]

The Court examined two recent derivative actions that presented the issue of whether demand was excused because there was a substantial likelihood that the demand board faced liability under *Caremark*'s second prong: *Teamsters Local 443 Health Servs. & Ins. Plan v. Chou*[154] and *In re MetLife Inc. Derivative Litigation*.[155] In *Chou*, the complaint contained allegations that the directors did nothing in response to red flags, and the Court held that demand was excused because it was reasonably conceivable that the lack of oversight could lead to a substantial likelihood of liability for a majority of the demand board. In *MetLife*, the Court found that the complaint had pled that no action was taken in response to red flags, but because the Court found that it was not reasonably conceivable that the directors inaction "exhibited a conscious disregard of their duty to act," the Court found that demand was not excused. In contrast to *Chou* and *MetLife*, the Court stated that the plaintiffs did "not allege that the directors did nothing, but that what they did was insufficient," which is not enough to plead that the directors violated their *Caremark* duties in bad faith.[156]

Second, the Court rejected the plaintiff's argument that the board affirmatively concealed deficiencies from the DOJ, while stating that if the board had done so, "that would implicate bad faith."[157] The plaintiff argued that a reasonable inference could be made that the directors engaged in bad-faith concealment from the fact that the company had represented to the DOJ that it had complied with the DPA and the DOJ subsequently found that the company had inadequately disclosed weaknesses in the company's efforts at fraud interdiction. The Court disagreed, stating that a "finding by the DOJ of inadequate disclosure, ... without more, fails to amount to a particularized allegations that the Director Defendants, with scienter, misrepresented problems ... to the DOJ."[158]

***Riskin v. Burns*, 2020 WL 7973803 (Del. Ch. Dec. 31, 2020) (McCormick, V.C.)**

In *Riskin v. Burns*,[159] the Court of Chancery dismissed the plaintiff's direct claim asserting breach of fiduciary duties in connection with a corporate financing in which the controlling stockholder allegedly received stock at an unfair price. The Court rejected the plaintiff's argument that the claim fit within the "dual claim" theory under *Gentile v. Rossette*,[160] and followed the trend in recent

151 *Id.* at *9 (quoting *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006)).
152 *Id.* at *9.
153 *Id.*
154 2020 WL 5028065 (Del. Ch. Aug. 24, 2020).
155 2020 WL 4746635 (Del. Ch. Aug. 17, 2020).
156 *Richardson as Trustee of Richardson Living Trust v. Clark*, 2020 WL 7861335 at *5.
157 *Id.* at *10.
158 *Id.*
159 2020 WL 7973803 (Del. Ch. Dec. 31, 2020).
160 906 A.2d 91 (Del. 2006). In *Gentile*, the Delaware Supreme Court held that, while claims alleging corporate overpayment are normally derivative, a claim challenging a transaction where a controlling stockholder extracts from the minority stockholders both economic and voting power is both derivative

case law to construe *Gentile* narrowly. The Court held that the claim was purely derivative and, therefore, the plaintiff could not pursue the claim directly.

The plaintiff, a stockholder of Health Fidelity, Inc. ("Health Fidelity"), filed suit against a number of defendants including the University of Pittsburg Medical Center ("UPMC"), Health Fidelity's controlling stockholder. The plaintiff alleged breaches of fiduciary duty in connection with a 2017 financing pursuant to which UPMC invested $15 million in exchange for preferred stock and converted bridge financing convertible notes into preferred stock in Health Fidelity.[161] The purchase price represented a 72.24% discount to the purchase price paid for share in connection with Health Fidelity's previous financing that took place from 2014 to 2016.

Defendants move to dismiss the plaintiff's direct claim, arguing that the claim was purely derivative. The plaintiff argued that, under *Gentile*, the claim was both derivative and direct and, therefore, he could pursue a claim against the defendants directly.

The Court held that the claim was purely derivative in nature, and therefore dismissed the claim. The Court explained that *Gentile* seeks to remedy harm when a "controlling stockholder, with sufficient power to manipulate the corporate processes, engineers a dilutive transaction whereby that stockholder receives an exclusive benefit of increased equity ownership and voting power for inadequate consideration."[162] The Delaware Supreme Court has narrowly construed the *Gentile* doctrine, holding that the challenged transactions must result "in an improper transfer of both economic value and voting power from the minority stockholdersto the controlling stockholder."[163] The Court noted that in two previous decisions, *Klein v. H.I.G. Cap., L.L.C.*[164] and *Reith v. Lichtenstein*,[165] the Court of Chancery held that *Gentile* did not apply to the issuance of preferred stock to a controlling stockholder, even though the issuance diluted the common stockholders' voting power, on the basis that there was no transfer of economic value.[166] The Court stated that "*Klein* and *Reith* stand for the proposition that the issuance of convertible preferred stock, pre-conversion, does not constitute a transfer of economic value sufficient to support a direct claim under *Gentile*."[167] The Court noted that there "is room to dispute this proposition," but that *Klein* and *Reith* "are consistent with the current trend in Delaware law of construing *Gentile* narrowly," and the Court "decline[d] to buck the trend."[168] Thus, because the 2017 financing involved the issuance of preferred stock that had not been converted into common stock, there was no "transfer of economic value sufficient to support a claim under *Gentile*."[169]

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and direct, and, therefore, stockholders can pursue such claims directly. *Id.* at 99-100

161 Both the 2017 financing and the prior bridge financing were approved by less than unanimous written consent. Pursuant to Section 228(e) of the Delaware General Corporation Law, stockholders who do not provide written consent must be given "prompt notice" of the taking of the action by written consent. The plaintiff was not provided notice of stockholder consent authorizing the bridge financing until approximately five months after the fact and was not provided notice of the stockholder consent authorizing the 2017 financing until approximately eight months after the fact. The plaintiff sought a declaratory judgment that Health Fidelity failed to comply with the prompt notice requirement of Section 228(e) with respect to both stockholder consents. The defendants moved to dismiss that claim and, in a separate order, the Court denied the motion, finding that it was "reasonably conceivable that delays of this length violated Section 228(e)'s prompt notice requirement." *Riskin v. Burns*, 2020 WL 7861209, at *1 (Del. Ch. Dec. 31, 2010).

162 *Id.* at *13 (quoting *Klein v. H.I.G. Cap., L.L.C.*, 2018 WL 6719717, at *6 (Del. Ch. Dec. 19, 2018) (quoting *Feldman v. Cutaia*, 956 A.2d 644, 657 (Del. Ch. 2007), *aff'd*, 951 A.2d 727 (Del. 2008)).

163 *Id.* at *13 (quoting *El Paso Pipeline GP Co. v. Brinckerhof*, 152 A.3d 1248, 1264 (Del. 2016)).

164 2018 WL 6719717 (Del. Ch. Dec. 19, 2018).

165 2019 WL 2714065 (Del. Ch. June 28, 2019).

166 The buyer of the preferred stock in *Klein* was not the controlling stockholder prior to the transaction at issue, but the Court stated that even if the buyer had been the controlling stockholder before the preferred stock was issued, the transaction would not give rise to a dual-natured claim under *Gentile* because there would be no transfer of economic value unless and until the preferred stock was converted into common stock. *Riskin*, 2020 WL 7973803, at *13.

167 *Id.* at *14.

168 *Id.*

169 *Id.*

Alternative Entity Litigation

***Lipman v. GPB Capital Hldgs. LLC*, 2020 WL 6778781 (Del. Ch. Nov. 18, 2020) (Glasscock, V.C.)**

In *Lipman v. GPB Capital Holdings LLC*,[1] the Court of Chancery held that the plaintiffs' failure to make demand on two limited partnerships' general partner in connection with a derivative suit against the general partner and its controller was excused, and in doing so rejected the defendants' argument that the plaintiffs were required to make allegations concerning the individuals who managed the general partner in order to establish demand futility.[2] The Court stated that where a general partner is an entity, it is sufficient to make demand on the general partner and, in turn, the demand excusal analysis focuses on the entity that is the general partner and not the people who manage it. The Court concluded that demand on the general partner was not excused because it was reasonably conceivable that the general partner was unable to "evaluate a demand using its business judgment" because both the general partner and the general partner's controller faced substantial liability in connection with the litigation.[3]

The plaintiffs alleged that GPB Capital Holdings ("GPB"), which was the general partner of the two limited partnerships of which the plaintiffs were limited partners, and David Gentile, who controlled GPB, breached their fiduciary duties to the limited partnerships in connection with a number self-dealing transactions through which Gentile diverted the limited partnerships' assets to himself. The plaintiffs also alleged that because of the financial misconduct, GDP was unable to pay monthly distributions that were promised to limited partners, and that, to "retain the veneer of being able to pay these distributions," GPB used the limited partners' capital accounts to pay the limited partners "under the guise of 'distributions.'"[4] However, that scheme proved unsustainable, and, in December 2017, GPB informed the limited partners that the partnership failed to meet performance expectations, it would likely have an intangible asset impairment charge, and it would provide more detail in forthcoming financial statements. However, as of January 28, 2020, the date the plaintiffs filed their complaint, GPB had not filed its audited financial statements for the partnerships for the years 2017 or 2018 and failed to restate its financial statements for 2015 and 2016 even though GPB previously stated that it would need to do so.

The defendants filed a motion to dismiss, arguing that demand was not excused and that the plaintiffs failed to state a claim against them for breaches of fiduciary duty. The Court rejected each of the defendants' arguments and held that demand was excused because it was reasonably conceivable that GPB breached its fiduciary duties to the partnerships and that Gentile owed fiduciary duties to the partnership and breached those duties.

The Court first rejected the defendants' argument that demand was not excused because the complaint did not contain allegations regarding the management

1 2020 WL 6778781 (Del. Ch. Nov. 18, 2020).

2 Under 6 *Del. C.* § 17-1001, a limited partner must make a demand on the limited partnership's general partner before pursuing derivative litigation unless the demand would be "not likely to succeed."

3 *Lipman,* 2020 WL 6778781, at *9.

4 *Id.* at *3.

of GPB. The Court explained that the defendants' argument ignored the fact that, pursuant to 6 *Del. C.* § 17-1001, demand would be made on GPB, "and *not* its directors or managers."[5] Likewise, in the LLC context, the demand futility analysis "'focuses on the general partner itself (as an entity),' and not on those who direct corporate affairs."[6] The Court explained that the focus of the inquiry must be on GPB and not its directors or managers because it is the entity that owes fiduciary duties to the limited partnerships. By contrast, the directors' and managers' fiduciary duties were to GPB and its owner, Gentile, and, therefore, they could not be expected to initiate litigation in response to the plaintiffs' demand.

Although the Court held that the focus of the demand analysis was GPB, not its directors or managers, Gentile was GPB's controller and, "[b]y definition, then, GPB [was] not independent of Gentile."[7] And, because the Court found that Gentile faced the risk of substantial liability in connection with the litigation, it was "reasonably conceivable that GPB [was] unable to evaluate a demand using its business judgment."[8] The Court explained that "[a]lthough the Plaintiffs' demands would be made on GPB, Gentile's control of GPB and his substantial likelihood of liability stemming from the Complaint and those facts that may come to light in this litigation are particularized allegations that make it reasonably conceivable that GPB would be unable to exercise its business judgment with regards to any demand made in connection with the Plaintiffs' allegations."[9] In doing so, the Court rejected Gentile's argument that he did not owe fiduciary duties to the partnerships. The Court noted that under *USACafes*,[10] "'a corporate general partner's fiduciary duties to the limited partnership may extend to the general partner's controllers, *if such persons exercise control over the limited partnership's property*.'"[11] The Court held that the complaint sufficiently alleged that Gentile diverted funds that should have gone to the limited partnerships and that, if true, it would mean that he "exercised control over funds that belonged to the Partnerships and thus owed fiduciary duties to the Partnerships."[12]

The Court also found that demand was excused because GPB also faced a threat of substantial liability. The Court explained that a "'general partner has a disabling interest for pre-suit demand purposes when it faces a 'substantial likelihood' of liability in connection with the derivative claim(s) asserted against it.'"[13] The defendants argued that the only allegations against GPB—failure to provide financial statements—related merely a contractual obligation owed to limited partners, and therefore was not relevant to the demand analysis. The Court disagreed, explaining that the complaint alleged that GPB's repeated failure to provide financial statements was part of the scheme to conceal the financial harm Gentile's self-dealing inflicted on the limited partnerships. Thus, GPB's duty to disclose the financial statements may have been contractual, "but a disloyal or grossly negligent failure to meet that contractual obligation invokes fiduciary duties."[14]

***Int'l Rail Partners LLC v. Am. Rail Partners, LLC*, 2020 WL 6882105 (Del. Ch. Nov. 24, 2020) (Fioravanti, V.C.)**

In *International Rail Partners LLC v. American Rail Partners, LLC*,[15] the Court of Chancery held that a Delaware limited liability company was required to advance one of its members its reasonable attorneys' fees and expenses incurred in a case that the company

5 *Id.* at *7.

6 *Id.* at *8 (quoting *Wenske v. Blue Bell Creameries, Inc.*, 2018 WL 3337531, at *18 (Del. Ch. July 6, 2019)).

7 *Id.* at *8.

8 *Id.* at *9.

9 *Id.*

10 *In re USACafes, L.P. Litig.*, 600 A.2d 43 (Del. Ch. 1991).

11 *Lipman*, 2020 WL 6778781, at *12 (emphasis in the original) (quoting *Wenske,* 2018 WL 3337531, at *17).

12 *Id.* at *12. The Court also rejected the defendants' argument that the partnership agreements limited liability for all breaches of fiduciary duty except bad faith. The partnership agreements limited liability for actions taken by GPB or its affiliates "in good faith and in a manner [they] reasonably believed to be in, or not opposed to, the best interests of the Partnership and [their] conduct did not constitute gross negligence, fraud, or willful or wanton misconduct." *Id.* at *10. The defendants argued that liability was limited if conduct was (i) in good faith, *or* (ii) in a manner that is not opposed to the best interests of the partnerships, *or* (iii) not grossly negligent, fraudulent, or willful misconduct. The Court disagreed, stating that a "plain reading of the provision shows that the provision's limitation on liability applies only where *all three* conditions are met, instead of requiring only one condition." *Id.* at *11.

13 *Id.* (quoting *Wenski,* 2018 WL 3337531, at *18).

14 *Id.* at *9.

15 2020 WL 6882105 (Del. Ch. Nov. 24, 2020).

Alternative Entities

filed against the member in the Delaware Superior Court. In doing so, the Court of Chancery rejected the company's argument that an advancement or indemnification provision in an LLC agreement can only cover claims between the company and a person covered by the provision—what the company referred to as "first-party claims"—if the provision expressly says so.

American Rail Partners, LLC ("American Rail") filed suit in the Delaware Superior Court against International Rail Partners LLC ("IRP") and a number of IRP's affiliates. IRP was a member of American Rail and managed American Rail's day-to-day operations pursuant to a management agreement. American Rail asserted claims against IRP and its affiliates for mismanagement and unjust enrichment.

American Rail's LLC agreement provided that "[t]he company shall indemnify, defend, and hold harmless each Covered Person against any losses [and] claims ... (including all reasonable fees and expenses of counsel) ... arising from any and all claims ... actions, suits, or proceedings ... in connection with any matter arising out of or in connection with the Company's business or affairs, or this Agreement or any related document."[16]

After American Rail filed the action in the Superior Court, IRP and its affiliates demanded indemnification and advancement for the attorneys' fees and expenses that they would incur in connection with the Superior Court action. American Rail denied the demand, and IRP and its affiliates then filed a complaint in the Court of Chancery for advancement. The parties moved for judgment on the pleadings.

Although American Rail argued that IRP and its affiliates were not entitled to advancement, American Rail did not dispute that they were "Covered Persons" under the LLC agreement's indemnification and advancement provision. Instead, American Rail argued that the indemnification provision did not expressly provide for indemnification for claims by American Rail against Covered Persons, and American Rail was therefore not obligated to provide advancement or indemnification for such claims. In support, American Rail cited to several Delaware cases, including *TranSched Systems Ltd. v. Versyss Transit Solutions*,[17] which holds that indemnification provisions in bilateral commercial contracts are not presumed to provide for fee-shifting.

The Court rejected American Rail's argument and held that the LLC agreement unambiguously required the company to provide advancement to IRP and its affiliates. The Court explained that if American Rail's position were to be accepted, that would mean that an LLC agreement that used the precise language of the LLC act by stating that it applied to "any and all claims whatsoever," would "not mean what it says."[18] Rather, it would mean only third-party claims (*i.e.*, not "all claims whatsoever") and, in order to cover first party claims, it would need to explicitly say so.

The Court also explained that "[u]nlike typical commercial contracts, indemnification and advancement provisions in LLC agreements are derived from clear statutory authority and apply much more broadly."[19] The Court stated that the Delaware LLC Act's indemnification statute, 6 *Del. C.* § 18-108, allows a limited liability company to "indemnify a person to the fullest extent possible by contract" and that the "only restrictions are those expressly set forth in the contract."[20] The Court also noted that unlike the Delaware General Corporation Law, which distinguishes between indemnification for claims by or on behalf of the company and other claims, the LLC Act makes no such distinction, which demonstrates the contractual flexibility afforded by the LLC Act. Although the Court acknowledged that an LLC agreement is a type of contract, the Court explained that indemnification and advancement provisions serve the broad public policy of "encourage[ing] persons to serve in a company, secure in knowledge that expenses incurred by them in upholding their honesty and integrity will be borne by the corporation they serve."[21] The Court concluded that "[g]iven the statutory framework, the broad language of the LLC Agreement's indemnification provision, and the strong public policy in favor of indemnification and advancement, ... the first-party/third-party claim distinction applied in the *TranSched* line of cases is inapplicable here."[22]

16 *Id.* at *4.
17 2012 WL 1415466 (Del. Super. Mar. 29, 2012).
18 *Int'l Rail Partners*, 2020 WL 6882105 at *7.
19 *Id.* at *6-7.
20 *Id.* at *7.
21 *Id.* at *8.
22 *Id.*

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

***In re Solera Ins. Coverage Appeals*, 240 A.3d 1121 (Del. Oct. 23 2020)**

In *In re Solera Insurance Coverage Appeals*,[1] the Delaware Supreme Court held that an appraisal action pursuant to Section 262 of the DGCL was not a "Securities Claim" within the definition of a corporation's directors and officers insurance policies ("D&O policies"), reversing the Superior Court's decision finding that expenses incurred in an appraisal action were covered under the policies.

The defendants-below/appellants were insurers who issued D&O policies to plaintiff-below/appellee Solera Holdings, Inc. ("Solera"), a Delaware corporation. Under the D&O policies, the insurers agreed to pay for any "Loss resulting solely from any Securities Claim first made against an Insured during the Policy Period for a Wrongful Act. . . ."[2] The policies defined "Securities Claim" as a claim "made against [Solera] for any actual or alleged violation of any federal, state or local statue, regulation, or rule or common law regulating securities. . . ."[3]

In August 2018, shortly after the Court of Chancery completed its appraisal of the fair value of Solera's common stock pursuant to Section 262 (the "Appraisal Action"),[4] Solera filed a complaint against the Insurers in the Superior Court seeking to enforce the D&O policies to recover certain costs incurred in the Appraisal Action, which Solera alleged was a "Securities Claim" under the D&O policies.

The insurers moved for summary judgment, arguing that the D&O policies did not cover the Appraisal Action because "the Appraisal Action did not meet the definition of 'Securities Claim' as defined in the Primary Policy" because "there was no 'violation' of any federal, state, or local statute, regulation, rule, or common law regulating securities."[5] They further "argued that 'Delaware courts consistently distinguish appraisal actions from shareholder class actions' based on allegations of wrongdoing"[6] and that "the Appraisal Action is not a claim 'for' a violation of law because Section 262 does not require any allegation of proof of wrongdoing, and a court in an appraisal action does not grant 'relief' to any party as redress 'for' any wrongdoing."[7] Solera responded that it did not need to allege wrongdoing to succeed on a violation of law claim. It argued that Section 262 set a legal standard that required the company ensure that stockholders receive fair value for their shares and that Section 262 creates a right of action for stockholders who allege a company violated that standard.

The Superior Court denied the defendants' motion for summary judgment and held that the Appraisal Action constituted a "Securities Claim" under the D&O policies. The Superior Court agreed with Solera that a "violation" did not require any allegation of

1 240 A.3d 1121 (Del. 2020).

2 *Id.* at 1125 (internal quotations omitted).

3 *Id.*

4 *See generally In re Appraisal of Solera Holdings, Inc.*, 2015 WL 3997578 (Del. Ch. Aug. 20, 2018).

5 *In re Solera*, 240 A.3d at 1127.

6 *Id.*

7 *Id.*

"wrongdoing" and further noted that some securities violations do not require scienter or wrongdoing.

The insurers filed an interlocutory appeal of the Superior Court's ruling, raising as the primary issue whether the Superior Court erred in holding that the Appraisal Action was a Securities Claim.

The Supreme Court held that the Appraisal Action was not a "Securities Claim" covered by the D&O policies, and reversed the Superior Court's ruling. In so holding, the Supreme Court analyzed the plain meaning of the word "violation" and, disagreeing with the Superior Court, found that the term "involves some element of wrongdoing, even if done with an innocent state of mind."[8] The Supreme Court explained that appraisal actions, in contrast, do "not involve a determination of wrongdoing."[9] Although Section 262 "imposes limited duties on the corporation," the petition in the Appraisal Action "allege[d] no violation by Solera of these requirements, and Solera [did] not contend that section 262 itself was violated."[10]

The Supreme Court further noted that "[a]ppraisal proceedings are neutral in nature."[11] "Unlike most proceedings, '[i]n statutory appraisal proceeding, both sides have the burden of proving their respective valuation positions by a preponderance of evidence.'"[12] Because a stockholder "can receive less than they were entitled to receive upon consummation of the merger," in an appraisal action, "both sides bear some risk."[13]

The Supreme Court rejected Solera's argument that recent rulings, in *Dell*,[14] *DFC*,[15] and *Aruba*,[16] "change[d] the nature of appraisal actions" by requiring appraisal petitions to "show deficiencies in the sale process in order to overcome the contention that the deal price reflected fair value."[17] Instead, the Supreme Court emphasized "an unbroken line of cases that hold an appraisal under section 262 'does not involve any inquiry into claims of wrongdoing.'"[18]

AB Stable VIII LLC v. Maps Hotels and Resorts One LLC, 2020 WL 7024929 (Del. Ch. Nov. 30, 2020) (Laster, V.C.)

In *AB Stable VIII LLC v. Maps Hotels and Resorts One LLC*,[19] the Court of Chancery issued a precedential post-trial decision providing extensive analysis of a merger agreement in the context of the COVID-19 pandemic. The decision is significant because it examines a material adverse effect ("MAE") provision in depth, including how an MAE provision can affect an ordinary course covenant, and provides guidance for avoiding litigation over who bears the risk when an MAE event occurs.

The case arose out of the failed acquisition of fifteen luxury hotels (the "Hotels") owned by Strategic Hotels & Resorts LLC and its parent entities AB Stable VIII LLC and Anbang Insurance Group, Ltd. (collectively, the "Seller"). Pursuant to a sale and purchase agreement, the Seller contracted to sell the Hotels to Mirae Asset Financial Group through its acquisition vehicle MAPS Hotel and Resorts One LLC (collectively, the "Buyer") for $5.8 billion. The Seller began its sale process in late 2018. Around this time, however, a "shadowy and elusive" antagonist named Hai Bin Zhou filed fraudulent deeds on six of the Hotels as part of an elaborate scheme to extort money from the Seller (the "Fraudulent Deeds").[20] The Seller was aware of the Fraudulent Deeds as early as December 2018, but did not disclose the issue to the Buyer when the parties entered into late-stage negotiations in May 2019.

After the Buyer became aware of the Fraudulent Deeds, the Buyer agreed to sign the sale agreement on September 10, 2019, but required the Seller to delay closing until April 17, 2020, so that the Seller

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8 *Id.* at 1132.
9 *Id.*
10 *Id.* at 1134.
11 *Id.* at 1135.
12 *Id.* at 1135-36 (quoting *M.G. Bancorp. Inc. v. Le Beau*, 737 A.2d 513, 520 (Del. 1999)).
13 *Id.* at 1136.
14 *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, 177 A.3d 1 (Del. 2017).
15 *DFC Global Corp. v. Muirfield Value P'rs, L.P.*, 172 A.3d 346 (Del. 2017).
16 *Verition P'rs Master Fund Ltd. v. Aruba Networks, Inc.*, 210 A.3d 128 (Del. 2019).
17 *In re Solera*, 240 A.3d at 1137.
18 *Id.* at 1136 (quoting *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182, 1189 (Del. 1988)).
19 2020 WL 7024929 (Del. Ch. Nov. 30, 2020).
20 *Id.* at *6, *8-9. The Court's decision covers Zhou's scheme in copious detail. Because those facts are highly case-specific, however, this summary focuses on the broader holdings regarding risk allocation and business responses to the COVID-19 pandemic.

could resolve the Fraudulent Deeds by obtaining their judicial invalidation and removal from the chain of title. The Seller failed to resolve the Fraudulent Deeds. Meanwhile, the COVID-19 pandemic spread worldwide, wreaking havoc on the hotel industry and the Seller began limiting the Hotels' operations and closed several of the Hotels completely.

Faced with the continuing Fraudulent Deeds issue and the drastic decline of the hotel industry, the Buyer issued a formal notice of default to the Seller on April 17, 2020, based on (i) the Seller's inability to obtain marketable title on the Hotels and (ii) the Seller's failure to operate the Hotels in the ordinary course of business. The Buyer claimed, on that basis, that it was relieved of its obligation to close. On April 27, 2020, the Seller sued the Buyer, seeking specific performance to compel the Buyer to close or, in the alternative, an award of the Buyer's deal deposit and attorneys' fees and expenses.[21] The Buyer counterclaimed, seeking a declaration that it was not obligated to close and that it validly terminated the sale agreement.[22]

The Court's decision centered on several conditions in the sale agreement that, if satisfied, obligated the Buyer to close. The first condition was the "No-MAE Representation" in which the Seller represented there had been no changes to the business that would have a material adverse effect (an "MAE"). The Vice Chancellor's analysis of this condition provides one of the most detailed reviews of an MAE provision since then-Vice Chancellor Strine's decision in *In re IBP, Inc. Shareholders Litigation*.[23]

The sale agreement defined a "Material Adverse Effect" as "any event, change, occurrence, fact or effect that would have a material adverse effect on the business, financial condition, or results of operations of the Company and its Subsidiaries, taken as a whole[.]"[24] The definition included exceptions for, *inter alia*, "natural disasters or calamities[.]"[25] The Buyer argued that the COVID-19 pandemic constituted an MAE, thereby breaching the Seller's representation that there had been no changes to the business that would have a material adverse effect.

Rather than analyze whether the COVID-19 pandemic constituted an MAE, the Court "assumed" that the pandemic was an MAE and proceeded to analyze whether the pandemic fell within one of the exceptions to the MAE definition.[26] Although none of the exceptions used the word "pandemic," the parties did not exclude pandemic from the exceptions, so this omission was not dispositive. The "natural disasters or calamities" exception defined "calamity" as "[a] state of extreme distress or misfortune, produced by some adverse circumstance or event. Any great misfortune or cause of loss or misery, often caused by natural forces (e.g., hurricane, flood, or the like)."[27] The Court held that the COVID-19 pandemic fit within the plain meaning of "calamity," noting that the pandemic was "a terrible event that emerged naturally in December 2019, grew exponentially, and resulted in serious economic damage and many deaths."[28]

The Court further observed that the MAE definitional structure supported including the pandemic within the calamity exception. The exceptions were structured so that risks specific to the Hotels, such as risks associated with ordinary business operations, were allocated to the Seller, while "systemic risk[s]" were allocated to the Buyer through exceptions for "calamities," "general changes . . . in . . . the industr[y]," and "changes in any applicable [l]aws."[29] Additionally, the MAE definition allocated a "greater-than-normal" range of risks to the Buyer by providing that any subject within the Buyer's knowledge, such as those disclosed during due diligence, could not give rise to an MAE.[30]

The Court also considered studies of similar agreements to determine whether the omission of "pandemic" in the sale agreement was dispositive, noting that for many deal documents in which "pandemic" was used, the term was employed as a subtype of "calamity" or "natural disaster."[31] In other agreements, "calamity"

21 *Id.* at *46.

22 *Id.* at *46. The Buyer similarly sought return of its deal deposit as well as fees and expenses.

23 789 A.2d 14, 22 (Del. Ch. 2001).

24 AB Stable 2020 WL 7024929, at *53.

25 *Id.*

26 *Id.* at *55.

27 *Id.* at *57 (quoting *Black's Law Dictionary* and noting that "[w]hen assessing plain meaning, Delaware courts look to dictionaries").

28 *Id.* at *58.

29 *Id.* at *60.

30 *Id.* at *61-62.

31 *Id.* at *64.

was used as a "catchall" for other events.[32] Based on these and other observations, the Court concluded that the terms "natural disasters" and "calamity" were broad enough to encompass pandemic risks.[33] Because the COVID-19 pandemic fell under the calamity exception, pandemic-related risk was assumed by the Buyer under the sale agreement.

The second condition analyzed by the Court was the ordinary course covenant, which provided that the Seller's business would "be conducted only in the ordinary course of business consistent with past practice[.]"[34] The Buyer argued that the Seller breached this covenant by reducing the Hotels' operations in response to the COVID-19 pandemic. The Seller countered that it was permitted to take steps to preserve its business by engaging in ordinary responses to extraordinary events, such as the pandemic.

The Court held that under Delaware law, representations that a business will be operated "only in the usual and ordinary course of business" meant "[t]he normal routine in managing a trade of business[.]"[35] Traditionally, ordinary course provisions are included "to reassure a buyer that the target company has not materially changed its business or business practices during the pendency of the transaction."[36] Additionally, by including the "consistent with past practice" language, the parties precluded the Court from considering how other companies would respond to the pandemic. Thus, the provision required the Seller to operate as it had ordinarily and routinely operated in the past, and did not allow the Seller to make drastic changes in response to extraordinary events.

The Seller also argued that the ordinary course covenant permitted the Seller to make extraordinary changes as long as those changes did not satisfy the MAE definition. The Seller argued that a different interpretation of the ordinary course covenant would effectively negate the risk carefully allocated to the Buyer in the No-MAE Representation by assigning pandemic-related risk back to the Seller. The Court rejected the Seller's argument, noting that the language of the No-MAE Representation did not authorize the Seller to take extraordinary actions in response to an MAE. The Court also noted that structurally, the ordinary course covenant and the No-MAE Representation were separate provisions implicating different closing conditions and that the sale agreement did not contain any language indicating that one provision operated as a constraint on the other.

The Seller departed from its ordinary course of business by closing several hotels, reducing amenities, cutting staff, and halting capital spending. Additionally, the Seller made these changes without seeking the Buyer's consent. Accordingly, the Court held that the Seller breached the ordinary course covenant through its response to the COVID-19 pandemic, thereby relieving the Buyer of its obligation to close.

Finally, the Court held the title insurance condition failed because the Seller's title insurers would not provide coverage for the Fraudulent Deeds. The Court concluded that the Buyer was entitled to terminate the deal due to the Seller's breach of the ordinary course covenant. The Court did not rest its decision on the Seller's breach of the title insurance condition because the Seller's breach of the ordinary course covenant was sufficient to entitle the Buyer to terminate the sale agreement. To remedy the Seller's breach of the sales agreement, the Court awarded the Buyer the return of its deposit, attorneys' fees and expenses under the sale agreement's fee-shifting provision, and $3.685 million in transaction expenses.

The decision provides contracting parties with helpful guidance for drafting merger agreements in the context of COVID-19. Parties should consider inserting language that addresses whether an MAE event, such as a pandemic, can affect a seller's obligations under an ordinary course covenant. Additionally, parties drafting ordinary course covenants should beware that including the "consistent with past practice" qualifier is likely to be interpreted as representing that the company will not depart from its routine and ordinary operations during the pendency of a transaction.

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32 *Id.*

33 *Id.*

34 *Id.* at *65.

35 *Id.* at *67 (quoting *Ivize of Milwaukee, LLC v. Complex Litig. Support, LLC,* 2009 WL 1111179, at *8 (Del. Ch. Apr. 27, 2009) (citing *Black's Law Dictionary*)).

36 *Id.* at *67 (quoting *Anschutz Corp. v. Brown Robin Capital, LLC,* 2020 WL 3096744 (Del. Ch. June 11, 2020), *reargument granted*, 2020 WL 4249874 (Del. Ch. July 24, 2020)).

***Stream TV Networks, Inc. v. SeeCubic, Inc.*, 2020 WL 7230419 (Del. Ch. Dec. 8, 2020) (Laster, V.C.)**

In *Stream TV Networks, Inc. v. Seecubic, Inc.*,[37] the Court of Chancery, after conducting an in-depth analysis of Section 271 of the Delaware General Corporation Law ("DGCL"), held that Section 271 does not require a stockholder vote prior to a transfer of a company's assets to a secured creditor.

The plaintiff, Stream TV Networks, Inc. ("Stream") is a pre-revenue, development-stage technology company that has historically been controlled at the board level by Mathu and Raja Rajan (the "Rajan Brothers"), and since July 2019, they were the sole directors of Stream. Following Stream's default on over $50 million in debt owed to its secured creditors and pressure from creditors, the Rajan Brothers agreed to appoint four independent outside directors to the board and approved them by unanimous written consent in March 2020.

On May 4, 2020, the board, including the Rajan Brothers, unanimously adopted a resolution stating that "all directors would serve for no less than one year without being removed."[38] The outside directors, with the Rajan Brothers abstaining, also approved a resolution establishing a Resolution Committee with authority to resolve existing and future debt defaults and litigation on behalf of the company.

On May 6, 2020, the Resolution Committee approved an Omnibus Agreement that transferred all of Stream's assets to defendant SeeCubic, Inc. ("SeeCubic"), a company controlled by the secured creditors of Stream. Without the Omnibus Agreement, Stream would have had to file for bankruptcy or Stream's creditors would have foreclosed on its assets.

Stream filed a motion for preliminary injunction seeking to enjoin the closing of the Omnibus Agreement. It argued that the Omnibus Agreement was not enforceable for two reasons: (i) the Resolution Committee acted without authority in entering the Agreement; and (ii) the Omnibus Agreement required stockholder approval, which it did not receive.

Concurrently with Stream's motion for preliminary injunction, SeeCubic filed its own motion for preliminary injunction seeking mirror image relief, asking the Court to enforce the Omnibus Agreement.

In applying the standard applicable to motions for preliminary injunction,[39] the Court stated that since the motions were the mirror image of each other, "there is no dispute about the existence of irreparable harm or the balancing of the hardships[,]" and as such, the Court found that factor to not be outcome-determinative.[40] Instead, the Court focused on "who has established a reasonable probability of success on the merits, which in turn depends on the validity of the Omnibus Agreement."[41]

Stream argued that the Omnibus Agreement is invalid because the Resolution Committee did not have the authority to enter into it, reasoning that (i) the Outside Directors were never validly appointed and/or (ii) the Outside Directors were removed through a stockholder consent before the Omnibus Agreement was entered. The Court rejected each of these arguments.

The Court first rejected Stream's argument that the written consent appointing the independent board members was invalid because it lacked certain corporate formalities.[42] The Court found that as a whole Stream (acting through the Rajan brothers) had a practice of "disregarding corporate formalities" and "Stream cannot now take advantage of Mathu and Raja's informality to achieve a result that would benefit themselves."[43]

The Court then rejected Stream's argument that the Outside Directors did not meet conditions placed on

37 2020 WL 7230419 (Del. Ch. Dec. 8, 2020).

38 *Id.* at *5.

39 *See id.* at *7 ("To obtain a preliminary injunction, the movant must demonstrate (i) a reasonable probability of success on the merits, (ii) a threat of irreparable harm if an injunction is not granted, and (iii) that the balance of the equities favors the issuance of an injunction.").

40 *Id.* at *8.

41 *Id.*

42 The Court noted that, although absent from the written consent, a "Delaware practitioner would want the March Director Consent to (i) refer to the directors' power to act by unanimous written consent, supported by citations to Section 2.8 of the Bylaws and Section 141(f) of the DGCL, (ii) expand the number of seats on the Board from two to six, supported by citations to Section 2.1 of the Bylaws and Section 141(b) of the DGCL, and (iii) state that the directors were filling the newly created directorships with the Outside Directors, supported by citations to Section 2.2 of the Bylaws and Section 223(a)(1) of the DGCL." *Id.* at *10.

43 *Id.*

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their appointments and were only "Interim Directors" because directorships were conditioned on the Outside Directors investing in the company and executing a Director Services Agreement—neither of which occurred. The Court held that (i) Delaware law does not contemplate such a role as "Interim Director" and Stream's bylaws did not create one; (ii) Delaware law does not permit a written consent to impose conditions on the ability to serve as directors and, under Section 141(b), any director qualifications "must appear in the certificate of incorporation or bylaws"; and (iii) "director qualifications must be reasonable," and the conditions set forth in the Director Services Agreement—such as contractual confidentiality obligations that could conflict with the directors' fiduciary duties—were unreasonable.[44]

Even if the Outside Directors were not formally appointed, the Court stated that it was "reasonably probable that this court would conclude after trial that the Outside Directors were *de facto* directors[]" since Stream, the Rajan Brothers and all other relevant parties treated them as such.[45]

Finally, the Court found that the Outside Directors were not removed prior to entering into the Omnibus Agreement. Instead, the Court found that evidence disclosed in discovery indicated that the Stockholder Consent was executed on May 8, at the earliest, and likely backdated to appear to have been drafted on the day the Omnibus Agreement was approved.

After holding that the Omnibus Agreement was properly approved by the Resolution Committee, the Court considered Stream's argument "that the Omnibus Agreement is ineffective because it required stockholder approval" since it transferred all of the company's assets to the defendant and Section 271 of the DGCL requires a stockholder vote for the sale or exchange of all or substantially all of a corporation's assets.[46] Section 271 requires that "the holders of a majority of the outstanding stock of the corporation entitled to vote" must approve by resolution "the [sale] lease or exchange [of] all or substantially all" of a corporation's assets.[47]

The Court determined that Section 271 does not apply where "an insolvent and failing [company] transfers its assets to its secured creditors in lieu of a formal foreclosure proceeding," which is what Stream did through the Omnibus Agreement.[48] The Court noted that prior to Section 271, the common law recognized that a board could sell all assets of a failing company to satisfy its debt. While the statute does not envision such a scenario, "[t]here is no indication that the General Assembly intended to restrict or eliminate authority that already existed at common law, such as the power of the directors of an insolvent and failing corporation to sell its assets."[49]

The Court also considered the types of consideration contemplated in a sale, lease or exchange under Section 271 to determine whether Stream's consideration in its exchange with the defendant was the type permitted in a Section 271 sale. All of Stream's assets were transferred to SeeCubic, a company controlled by Stream's secured creditors. The consideration for the transfer of Stream's assets to SeeCubic was the forgiveness of all of Stream's debts, which the Court noted is not a form of consideration contemplated by Section 271, and as such the statute does not apply to the transaction at issue. "[T]he language of Section 271 has evolved over time ... [but] [t]he statute has never referred to forgiveness of debt as a form of consideration."[50]

The Court finally considered whether a corporation has to obtain stockholder approval before a creditor can foreclose on its security interest under Section 271 even though stockholder approval was not required when they entered into the agreement securing the assets. Stream did not obtain stockholder approval prior to granting a security interest in all of its assets to its secured creditors but then argued that such approval was required when its creditors sought to exercise their right in the security interest. The Court held that such an argument would "undercut the value of the security interest" because stockholders may vote to reject the transfer upon default.[51] To avoid this situation, creditors may insist that a corporation complies with Section 271 before granting the loan, but this would be "contrary to the plain language of Section 272[,]" which does not require stockholder approval for a board to mortgage or

44 *Id.* at *11.
45 *Id.*
46 *Id.* at *13.
47 8 *Del. C.* § 271.
48 2020 WL 7230419, at *19.
49 *Id.* at *16.
50 *Id.* at *20.
51 *Id.* at *20.

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pledge all of a corporation's assets.[52] As such, the Court held that the statutory framework does not suggest that a company is able to grant a security interest to a creditor without stockholder approval in the first instance but is required to obtain stockholder approval for the creditor to foreclose on its security interest in the second instance.[53]

The Court held that because the Omnibus Agreement does not function as a sale or exchange of all or substantially all of Stream's assets, Section 271 does not require stockholder approval prior to effecting the agreement. As such, the defendant's motion for preliminary injunction was granted, and plaintiff's motion was denied.

52 *Id.*
53 *Id.*

Special Proceedings Under the Delaware General Corporation Law

***Brigade Leveraged Capital Structures Fund Ltd. v. Stillwater Mining Co.*, 240 A.3d 3 (Del. 2020)**

In *Brigade Leveraged Capital Structures Fund Ltd. v. Stillwater Mining Company*,[1] an appraisal action pursuant to Section 262 of the Delaware General Corporation Law, the Delaware Supreme Court affirmed the Court of Chancery's decision to defer to the deal price as the most reliable indicator of a corporation's fair value, despite a flawed, "rough and ready" deal process and the presence of fewer indicia of fairness than the deal processes in *DFC*,[2] *Dell*,[3] or *Aruba*.[4] The Supreme Court also affirmed the Court of Chancery's decision not to make an upward adjustment to the corporation's fair value to account for the rise in commodity prices between the signing and closing of the merger. *Stillwater* continues the trend of Delaware courts' deference to deal price in appraisal cases.

The transaction at issue was Sibanye Gold Ltd.'s ("Sibanye") acquisition of Stillwater Mining Co. ("Stillwater"), a publicly traded Delaware corporation that mined and processed metals, such as palladium. When a decrease in the price of palladium caused a decline in Stillwater's stock price, Stillwater's board authorized Stillwater's CEO, Michael McMullen, to inquire into strategic opportunities.

McMullen met with Sibanye's CEO and requested that Sibanye submit an informal proposal outlining the valuation and structure of a potential deal. McMullen did so without the Stillwater board's knowledge or approval, and he failed to inform the board about his discussions with Sibanye at the board's next regularly scheduled meeting.

Sibanye submitted a non-binding indication of interest at $15.75 per share. In response, Stillwater's board directed Stillwater's management "to begin outreach to other potentially interested parties," but McMullen "continued to focus on courting Sibanye."[5] Stillwater's board also retained Bank of America Merrill Lynch ("BAML"), who immediately conducted a market check. BAML reached out to twenty-four parties, but Sibanye was the only party to make an all-cash bid.

After raising its initial offer of $15.75 per share to $17.50-$17.75 per share, Sibanye submitted its "best and final" offer of $18 per share, which represented a 22.6% premium over Stillwater's unaffected trading price and a 24.4% premium over Stillwater's 30-day volume-weighted average price.

Relying on BAML's fairness opinion, Stillwater's board accepted Sibanye's offer and signed the merger agreement. Stillwater's general counsel resigned as a result, citing "concerns about how the deal process unfolded and his belief that McMullen used the process to engage in self-dealing."[6]

Despite an increase in the price of palladium and a resulting increase in Stillwater's stock price between

1 240 A.3d 3 (Del. 2020).

2 *DFC Global Corp. v. Muirfield Value P'rs, L.P.*, 172 A.3d 346 (Del. 2017).

3 *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, 177 A.3d 1 (Del. 2017).

4 *Verition P'rs Master Fund Ltd. v. Aruba Networks, Inc.*, 210 A.3d 128 (Del. 2019).

5 *Stillwater Mining*, 240 A.3d at 7.

6 *Id.* at 8.

the signing of the merger agreement and the stockholder vote, no bids greater than $18 a share emerged during the 138 days between the signing and the stockholder vote. Approximately 75% of eligible shares voted to approve the merger.

In a post-trial opinion following a four-day trial, the Court of Chancery "deferred to the merger price of $18 per share as the most reliable indicator of Stillwater's fair value."[7] The Court also "declined to make an upward adjustment to the price to account for Stillwater's increase in value after signing, holding that petitioners did not prove that they were entitled to a deal price adjustment."[8] Petitioners appealed, arguing that the Court of Chancery "abused its discretion by ignoring the flawed sale process" and "relied on an incorrect conclusion to justify its decision to not adjust the deal price upward to account for rising commodity prices."[9]

The Delaware Supreme Court affirmed the Court of Chancery's ruling that the deal price was the best indication of Stillwater's fair value. The Supreme Court found that the Court of Chancery properly followed the rulings of *Dell*, *DFC*, and *Aruba* in examining whether objective indicia of reliability of the sale process supported the deal price. In particular, the Supreme Court explained that the Court of Chancery "highlighted five key objective indicators that supported the reliability of Stillwater's sale process: (1) 'the Merger was an arm's length transaction with a third party'; (2) 'the Board did not labor under any conflicts of interest'; (3) the buyer 'conducted due diligence and received confidential information about Stillwater's value'; (4) Stillwater 'negotiated . . . multiple price increases'; and (5) 'no bidders emerged during the post-signing phase.'"[10] The Supreme Court concluded that "[a]lthough these indicators are fewer indicia of fairness than this Court identified when reviewing the sale processes in *DFC*, *Dell*, or *Aruba*, the court did not abuse its discretion by determining that 'the objective indicia that were present provide a cogent foundation for relying on the deal price as a persuasive indicator of fair value.'"[11]

In so holding, the Supreme Court rejected petitioners' contention that the Court of Chancery abused its discretion by failing to recognize that certain flaws in the pre-signing process undermined the reliability of the deal price. The Court of Chancery had reasoned that although McMullen's "unsupervised activities" and "personal interests" were "suboptimal," such activities and interests "did not lead him or the Board 'to accept a deal price that left a portion of Stillwater's fundamental value on the table, particularly in light of the effective post-signing market check that Stillwater conducted.'"[12] The Court of Chancery had further reasoned that while the "'abbreviated pre-signing process was not ideal,' . . . it was still 'a positive factor for the reliability of the sale process'" and that "'[t]he negotiations between Stillwater and Sibanye over price, together with Sibanye's refusal to pay more, provide[ ] strong evidence of fair value."[13] The Supreme Court concluded that the Court of Chancery "did not abuse its discretion when it held that the pre-signing process was sufficient to support reliance on the deal price as evidence of fair value."[14]

The Supreme Court also rejected petitioners' challenge to the post-signing process. Petitioners argued that the merger agreement "provided no practical way" for Stillwater's stockholders to receive additional value for the rise of the price of palladium between the signing of the merger agreement and the closing of the merger. The Supreme Court held that the Court of Chancery did not abuse its discretion in holding that Stillwater's stockholders "could have voted down the Merger and kept their shares" had they wanted to capture the increased value of palladium and that the merger agreement properly provided Stillwater's stockholders "with the ability to opt for the comparative certainty of deal consideration equal to $18.00 per share."[15] The Supreme Court also noted with approval the Court of Chancery's reliance on the "absence of a higher bid" during the 138 days between the signing of the merger agreement and the stockholder vote as an indication that "the deal market was already robust" and that "the price [wa]s already at a level that is fair."[16] With respect to Stillwater's merger proxy disclosures, the Supreme Court explained that the Court of Chancery properly concluded that, despite the fact that the proxy should have disclosed McMullen's interest in a

7 *Id.* at 5.
8 *Id.* at 9.
9 *Id.*
10 *Id.* at 12.
11 *Id.*

12 *Id.* at 13.
13 *Id.* at 14.
14 *Id.* at 13-14.
15 *Id.* at 14-15.
16 *Id.* at 15.

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deal with Simbaye and the resignation of Stillwater's general counsel, these facts would not have caused Stillwater stockholders "to revise their assessment of the Company's prospects as a standalone entity or to vote down the Merger in the belief that the Company was more valuable as a going concern in its operative reality as a widely held, publicly traded firm."[17]

Finally, the Supreme Court affirmed the Court of Chancery's decision not to make an upward adjustment to Stillwater's fair value to account for the rise in the price of palladium between the signing of the merger agreement and closing of the merger. The Supreme Court first noted that, as the party seeking the adjustment to the deal price, it was the petitioners' burden to prove the amount that it should be adjusted. In holding that the Court of Chancery did not abuse its discretion in declining to make an adjustment to the deal price, the Supreme Court rejected the petitioners' argument that the Court of Chancery based its decision wholly on the conclusion that the petitioners did not argue for an adjustment. The Supreme Court explained that the Court of Chancery's analysis suggested that the Court of Chancery properly reached its conclusion because it "was unconvinced by Petitioners' conclusory arguments for an adjustment to the deal price and declined to grant the adjustment because Petitioners failed to meet their burden of proof."[18]

***MaD Investors GRMD, LLC v. GR Companies, Inc.*, 2020 WL 6306028 (Del. Ch. Oct. 28, 2020) (Zurn, V.C.)**

In *MaD Investors GRMD, LLC v. GR Companies, Inc.*,[19] the Court of Chancery, considering an issue of first impression, determined whether a Section 220 action was prematurely filed where the complaint was filed before midnight on the fifth business day after demand was made. The Court concluded that the five-day response period defined in Section 220(c) expires at midnight on the fifth day following the demand, and consequently, the action was prematurely filed. The Court further concluded that the five-day response period in Section 220(c) is jurisdictional, and therefore, dismissed the action with prejudice.

The plaintiffs, MaD Investors GRMD, LLC and MaD Investors GRPA, LLC, stockholders of defendant GR Companies, Inc., filed a complaint to compel inspection of the company's books and records to investigate potential wrongdoing in the company's proposed acquisition of Curaleaf Holdings, Inc. The plaintiffs served the Section 220 demand on July 9. The company requested an extension to respond to the demand on July 15, and the plaintiffs filed their Section 220 action in the Court on July 16 at 5:03 p.m. Thereafter, the company filed a motion to dismiss the action, alleging that the plaintiffs failed to comply with Section 220(c) which requires stockholders to wait until the company refuses the demand or to wait "5 business days" after making the demand to file a Section 220 action.[20] The plaintiffs argued that the complaint complied with the statutory response period for two reasons. First, the plaintiffs argued that the company's request for an extension to respond to the demand itself constituted a refusal of the demand. Second, the plaintiffs argued that a "business day," for purposes of Section 220(c), ends at 5:00 p.m., not 12:00 a.m., and therefore their filing at 5:03 p.m. was not premature.

The Court rejected both arguments. The Court first observed that the plaintiffs did not allege the request for an extension in their complaint and instead referenced it for the first time in an unsworn declaration filed in opposition to the dismissal motion. Because the factual assertions in the declaration were "not integral to the complaint[,]" the Court concluded that it could not properly consider whether the company's request for an extension constituted a refusal to the demand.[21] The Court went further and stated that even if it could consider the extension request, "it would not qualify as a refusal under Section 220(c)" because "[o]nly 'affirmative action' by the corporation that reflects a denial of the stockholder's request constitutes a refusal."[22] The Court concluded that the company did not refuse the demand before the plaintiffs filed the complaint.

The Court next concluded that the five-day response period defined in Section 220(c) expires at midnight on the fifth day following the demand, not 5 p.m. Noting that the issue was one of first impression, the

17 *Id.* at 14-15.
18 *Id.* at 16.
19 2020 WL 6306028 (Del. Ch. Oct. 28, 2020).

20 *Id.* at *2.
21 *Id.* at *3.
22 *Id.* (quoting *Katz v. Visionsense Corp.*, 2018 WL 3953765, at *2 (Del. Ch. Aug. 16, 2018).

Court considered the "commonly accepted meaning" of the term "business day" with reference to Black's Law Dictionary and various provisions in the Delaware Code.[23] The Court observed that neither of those sources confined the limits of a business day to business hours. Further, the Court compared the reference in Section 220(b) to "usual hours for business" and the reference in Section 220(c) to "business day" and concluded that they must have distinct meaning.[24] The Court observed that "[w]hen the legislature uses a similar but different term or phrase in a statute, the concept of meaningful variation in statutory interpretation suggests that the legislature intended for that term to have a distinct meaning."[25] Therefore, the Court found that the fifth business day ends at 12:00 a.m., and consequently, the plaintiffs' complaint was prematurely filed.

The Court also rejected the plaintiffs' request for leave to supplement the complaint. The Court held that because the five-day response period is jurisdictional, the statutory response period must be enforced strictly, and, as such, it "cannot entertain Plaintiffs' request to cure the deficiencies of their Complaint."[26] After the plaintiffs filed the action, the company completed a merger that extinguished the plaintiffs' stockholder standing rights, thereby precluding restarting the action. The plaintiffs argued that given the circumstances, "the equities of the case compel leniency[,]" but the Court noted that "Section 220(c) offers no equitable safe harbor"[27] and that "Delaware courts require strict adherence to the . . . inspection demand procedural requirements."[28] Stating that the plaintiffs' failure to comply with the statutory leave period deprived the Court of jurisdiction over the action, the Court dismissed the action with prejudice.

Pettry v. Gilead Sciences, Inc., 2020 WL 6870461 (Del. Ch. Nov. 24, 2020) (McCormick, V.C.)

In *Pettry v. Gilead Sciences, Inc.*,[29] the Court of Chancery, in a post-trial opinion, granted stockholders' requests to inspect the books and records of Gilead Sciences, Inc. ("Gilead") and, in doing so, rejected Gilead's arguments that (i) the stockholders did not have a credible basis to suspect possible wrongdoing, (ii) the stockholders lacked a proper purpose because the stockholders were merely a "passive conduit in a purely lawyer-driven endeavor," and (iii) the stockholders lacked standing because any derivative claims challenging the possible wrongdoing would be dismissed for a variety of reasons.[30] Most notably, the Court criticized what it characterized as a growing trend of aggressive defense strategies in books and records litigation and invited the plaintiffs to file a motion seeking the shifting of attorneys' fees.

Gilead is in the business of discovering, developing, and commercializing antiretroviral therapy for HIV, and its financial success was tied directly to the sale of its HIV treatments. Gilead was the subject of extensive criticism and litigation including antitrust lawsuits accusing it of entering into anticompetitive license agreements and collusive settlement agreements with drug manufacturers, mass tort claims alleging that Gilead intentionally withheld from the market a safer version of its HIV treatment in order to extend the sales window of its existing treatment, patent infringement litigation accusing Gilead of infringing on government patents, and a federal investigation related to allegations that Gilead violated the False Claims Act.

Pursuant to Section 220 of the Delaware General Corporation Law, several Gilead stockholders made written demands to inspect Gilead's books and records, seeking to "investigate possible wrongdoing in connection with aspects of the development and commercialization of Gilead's HIV treatments."[31] The demands specifically sought to investigate four categories of potential wrongdoing: (i) anticompetitive activity that resulted in the antitrust lawsuits, (ii) mass torts that resulted in the mass tort litigation, (iii) infringement of government patents, and (iv) kick-backs in violation of the False Claims Act. Gilead refused to provide the stockholders with any documents, and the stockholders filed suit in the Court of Chancery.

Gilead argued that (i) the stockholders did not have a credible basis to suspect possible wrongdoing, (ii) the stockholders lacked a proper purpose because the stockholders were merely a "passive conduit in a purely lawyer-driven endeavor," and (iii) the stockholders' lacked standing because any derivative

23 *Id.* at *4.
24 *Id.* at *5.
25 *Id.*
26 *Id.*
27 *Id.* at *6.
28 *Id.* (quoting *Katz*, 2018 WL 3953765, at *2).
29 2020 WL 6870461 (Del. Ch. Nov. 24, 2020).
30 *Id.* at *15.
31 *Id* at *8.

claims challenging the possible wrongdoing would be dismissed. The Court rejected each of these arguments.

The Court first held that the stockholders demonstrated a credible basis to suspect wrongdoing. The Court noted that the credible basis standard "imposes 'the lowest possible burden of proof'" and merely requires a stockholder to "establish by a preponderance of the evidence that there is a credible basis to suspect a *possibility* of wrongdoing."[32] "When evaluating whether a credible basis exists, the court may consider on-going lawsuits, investigations, circumstantial evidence, and even hearsay statements evincing possible wrongdoing."[33] The Court found that the antitrust litigation, mass tort litigation, patent infringement litigation, and False Claims Act investigation each presented a credible basis to suspect possible wrongdoing. In particular, the Court noted that Gilead's motion to dismiss in one of the antitrust cases was denied on the basis that the complaint stated a claim upon which relief could be granted. Because the federal motion to dismiss standard is higher than the credible evidence standard, "allegations which survive a motion to dismiss under the federal standard are sufficient to meet the credible basis standard."[34]

The Court then rejected Gilead's argument that the plaintiffs "[were] a passive conduit in a purely lawyer-driven endeavor and thus lack[ed] a proper purpose under *Wilkinson v. A. Schulman, Inc.*"[35] In *Wilkinson*, the Court found that the plaintiff lacked a proper purpose where "the plaintiff's deposition testimony revealed a discrepancy between the plaintiff's actual purpose and the stated purpose in the demand," the plaintiff "did nothing to confirm the accuracy of [the complaint's] allegations and knew nothing about the inspection process or litigation," and the plaintiff "failed to play any meaningful role in the litigation and testified that he was unaware of any facts concerning the wrongdoing that his counsel sought to investigate."[36] The Court found Gilead's arguments did not demonstrate the level of passive involvement seen in *Wilkinson*. Specifically, in contrast to the plaintiff in *Wilkinson*, the stockholder plaintiffs in *Gilead* were knowledgeable about the basis for the demands, remained in contact with their lawyers throughout the process, and "testified that they actually sought to investigate wrongdoing."[37] Although the plaintiffs' lawyers were significantly involved in the entire Section 220 process, the Court noted that it is to be expected and that Delaware law incentivizes plaintiff lawyers to play a significant role in litigation.

The Court then rejected Gilead's argument that the plaintiffs lacked standing to investigate the alleged wrongdoing because "(i) Plaintiffs did not own shares at the time of the alleged wrongdoing; (ii) the derivative claims they seek to pursue are time-barred; and (iii) any derivative claims they seek to pursue would be barred by an exculpatory charter provision."[38] The Court stated that there were "a number of vexing aspects of this argument."[39] These arguments, the Court explained, do not speak to the plaintiffs' standing to pursue a Section 220 claim, "but, rather, to the viability of derivative claims that Plaintiffs might pursue in the future."[40] The Court noted that "Section 220(c) answers the question of *who* has standing to pursue an enforcement action under Section 220(c)—a stockholder."[41] Since it was undisputed that the plaintiffs held Gilead stock when they made their demands and filed their complaints, they had standing.

In response to Gilead's attempt to have the Court evaluate the viability of potential derivative claims, the Court noted that Delaware courts have "repeatedly stated that a Section 220 proceeding does not warrant a trial on the merits of the underlying claim."[42] As the Court recently held in *Lebanon Cty. Employees' Retirement Fund v. Amerisourcebergen Corp.*,[43] the only time a court can consider the merits of a derivative claim in a 220 proceeding is when "the stockholder identifies pursuing a derivative claim as its sole purpose."[44] Here, the Court found that the stockholder plaintiffs

32 *Id.* at *11 (quoting *Seinfeld v. Verizon Comm'ns, Inc.*, 909 A.2d 117, 123 (Del. 2006)).

33 *Id.*

34 *Id.* at *12-13.

35 *Id.* at *15 (citing *Wilkinson v. A. Schulman, Inc.*, 2017 WL 5289553 (Del. Ch. Nov. 13, 2017)).

36 *Id.* at *15.

37 *Id.*

38 *Id.* at *18.

39 *Id.*

40 *Id.* at *19.

41 *Id.* at *18.

42 *Id.* at *19.

43 2020 WL 132752 (Del. Ch. Jan. 13, 2020), *aff'd*, 2020 WL 7266362 (Del. Dec. 10, 2020).

44 *Gilead,* 2020 WL 6870461, at *19 (citing *Amerisourcebergen* 2020 WL 132752, at *12 (Del. Ch. Jan. 13, 2020), *aff'd*, 2020 WL 7266362 (Del. Dec. 10, 2020)).

had identified other purposes for their demands. The Court also rejected Gilead's argument that the plaintiffs' deposition testimony showed that the plaintiffs' "only true purpose is to pursue such a lawsuit."[45] The Court stated that Gilead's argument was based on misleading citations and misrepresentations of the deposition testimony record.

The Court then denied Gilead's attempt to limit the inspection to only formal board materials and, in addition to the formal board materials, ordered Gilead to produce the agreements between Gilead and the drug manufacturers that were at issue in the antitrust litigation, Gilead's policies and procedures concerning its compliance with antitrust regulations and patent law, thirty sets of materials emailed to senior management members prior to meetings, Gilead's high-level communications with government investigators, and director questionnaires.

Finally, criticizing "Gilead's overly aggressive defense strategy" as epitomizing a regrettable trend, the Court *sua sponte* granted the plaintiffs leave to move for fees and expenses.[46] The Court observed that "Gilead exemplified the trend of overly aggressive litigation strategies by blocking legitimate discovery, misrepresenting the record, and taking positions for no apparent purpose other than obstructing the exercise of Plaintiffs' statutory rights."[47] That Gilead had not produced "even a single document" prior to litigation "amplifie[d] the court's concerns."[48]

***AmerisourceBergen Corp. v. Lebanon Cty. Employees' Ret. Fund*, 2020 WL 7266362 (Del. Dec. 10, 2020)**

In *AmerisourceBergen Corp. v. Lebanon County. Employees' Retirement Fund*,[49] the Delaware Supreme Court, affirming an interlocutory judgment of the Court of Chancery, held that an inspection demand under Section 220 of the Delaware General Corporation Law ("Section 220") that otherwise states a proper investigatory purpose need not also identify the particular objective of the stockholder's investigation. The Court also held that a stockholder is not required to show that alleged mismanagement or wrongdoing is actionable in order to assert a valid Section 220 demand, but actionability may be relevant for assessing the credibility of the stated demand purpose where the stated purpose is limited to pursuing litigation.

The plaintiffs, stockholders of AmerisourceBergen Corporation ("AmerisourceBergen"), one of the country's largest opioid distributors, served a Section 220 demand on AmerisourceBergen. The plaintiffs requested board materials related to AmerisourceBergen's operations and its potential involvement in the opioid crisis. The plaintiffs' demand listed various potential investigatory purposes including (i) the investigation of "possible beaches of fiduciary duty," (ii) the consideration of "remedies to be sought," and (iii) the evaluation of "possible litigation or other corrective measures."[50]

After AmerisourceBergen rejected the demand in its entirety, the plaintiffs filed a Section 220 action in the Court of Chancery. The Court of Chancery ruled that the plaintiffs had satisfied their burden of proof under Section 220 and ordered most of the subject records to be produced. The Court of Chancery also granted *sua sponte* the plaintiffs leave to take a Rule 30(b)(6) deposition, after concluding that AmerisourceBergen had "thwarted" the plaintiffs' efforts to determine, through discovery, the appropriate scope of the records at issue. The Court of Chancery then certified, and the Supreme Court granted, AmerisourceBergen's interlocutory appeal.

On appeal, AmerisourceBergen argued that the Court of Chancery erred by: (i) concluding that a stockholder is not required to state the objectives of an investigation in order to state a proper purpose under Section 220; (ii) concluding that a stockholder's purpose need not be "actionable" in order to be valid; and (iii) allowing the plaintiffs to take a post-trial 30(b)(6) deposition.

The Supreme Court rejected all of AmrisourceBergen's challenges and affirmed, in full, the Court of Chancery's ruling.

On the first challenge, the Supreme Court agreed with the Court of Chancery that where a stockholder asserts an investigatory purpose for pursuing a Section 220 demand, the stockholder need not also identify the

45 *Id.* at *20.
46 *Id.* at *2.
47 *Id.* at *30.
48 *Id.*
49 2020 WL 7266362 (Del. Dec. 10, 2020).
50 *Id.* at *3.

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objective of the investigation in order to have a proper purpose for the demand.[51] Here, the Supreme Court observed that "when the purpose of an inspection of books and records under Section 220 is to investigate corporate wrongdoing, the stockholder seeking inspection is not required to specify the ends to which it might use the books and records."[52] The Supreme Court agreed with the Court of Chancery's reasoning that the investigation of corporate wrongdoing is a proper end, "in and of itself," without more.[53]

The Supreme Court next rejected AmerisourceBergen's argument that wrongdoing must be "actionable" in order to support a proper purpose under Section 220. As a threshold matter, the Supreme Court observed that the plaintiffs' demand "contemplated purposes other than litigation"—including "making a demand on the Company's Board of Directors to take action."[54] Viewing that as a proper end, itself, the Supreme Court stated that it "need go no further . . . to dispose of AmerisourceBergen's 'actionability' argument."[55] Nonetheless, the Supreme Court took the "opportunity to dispel the notion that a stockholder who demonstrates a credible basis from which the court can infer wrongdoing or mismanagement must demonstrate that the wrongdoing or mismanagement is actionable."[56]

The Supreme Court acknowledged that the question of actionability has some relevance in the context of assessing a Section 220 demand—but its application is limited to its utility as a possible tool for gauging the credibility of a demand. Thus, the Supreme Court reasoned that "[i]f litigation is the stockholder's sole objective but an insurmountable procedural obstacle unrelated to the suspected corporate wrongdoing bars the stockholder's path, it cannot be said the stockholder's purpose is its actual purpose."[57] But, the Supreme Court emphasized that assessment of actionability must be the exception, not the norm in assessing a plaintiff's proper purposes:

> In the rare case in which the stockholder's sole reason for investigating mismanagement or wrongdoing is to pursue litigation and a purely procedural obstacle, such as standing or the statute of limitations, stands in the stockholder's way such that the court can determine without adjudicating merits-based defenses, that the anticipated litigation will be dead on arrival, the court may be justified in denying inspection. But in all other cases, the court should . . . defer the consideration of defenses that do not directly bear on the stockholder's inspection rights, but only on the likelihood that the stockholder might prevail in another action.[58]

The Supreme Court also held that, to the extent that its summary affirmance in *Southeastern Pennsylvania Transportation Authority v. AbbVie, Inc.*[59] suggested that a stockholder was required to demonstrate actionable wrongdoing, that decision was overruled.

Finally, the Supreme Court upheld the Court of Chancery's allowance of a post-trial 30(b)(6) deposition. The Supreme Court rejected AmerisourceBergen's argument that the Court of Chancery's decision conflicted with *KT4 Partners, LLC v. Palantir Technologies, Inc.*,[60] which stated that "books and records actions" should not involve "extensive discovery."[61] The Supreme Court stated that "*Palantir* did not establish any bright-line rules to be applied in all Section 220 actions."[62] The Supreme Court concluded that the Court of Chancery's allowance of a Rule 30(b)(6) deposition "was a sound exercise of the court's discretion."[63]

51 *Id.* at *6.
52 *Id.* at *7.
53 *Id.* at *6.
54 *Id.* at *8.
55 *Id.*
56 *Id.*
57 *Id.* at *9.
58 *Id.* at *14.
59 2015 WL 1753033 (Del. Ch. Apr. 15, 2015), *aff'd*, 132 A.3d 1, 2016 WL 235217 (Del. Jan. 20, 2016) (TABLE).
60 203 A.3d 738 (Del. 2019).
61 *AmerisourceBergen*, 2020 WL 7266362 at *15 (quoting *Palantir*, 203 A.3d at 754).
62 *Id.* at *15.
63 *Id.* at *14.

***Alexandria Ventures Invs., LLC v. Verseau Therapeautics, Inc.*, 2020 WL 7422068 (Del. Ch. Dec. 18, 2020) (Fioravanti, V.C.)**

In *Alexandria Ventures Investments, LLC v. Verseau Therapeautics, Inc.*,[64] the Court of Chancery ruled that a pair of stockholders' stated purpose of investigating potential wrongdoing in connection with a corporation's rejection of the stockholders' offer to provide financing to the corporation was a proper purpose for an inspection of books and records under Section 220 of the Delaware General Corporation Law.

The plaintiffs, Alexandria Venture Investments, LLC and Alexandria Equities No. 7, LLC (collectively, "Alexandria"), owned 5.1% of the stock of Verseau Theruapeutics, Inc. ("Verseau"). In March 2020, Verseau needed cash "to weather the global pandemic."[65] Alexandria sent Verseau a non-binding term sheet "that generally provided for Alexandria to lead a financing round of $30 million in convertible notes."[66] Among other things, Alexandria conditioned its financing on receiving veto power over any related-party transactions and a prohibition on cash compensation for non-founder directors. Verseau's board rejected the term sheet.

After Verseau rejected the term sheet, Alexandria sent Verseau a Section 220 demand stating that Alexandria sought to investigate whether Board members failed to discharge their duty of care or to act in the best interests of stockholders in the directors' consideration of the Term Sheet and 'Alternative Financing Options.'"[67] Verseau rejected the demand and accused Alexandria of "using its status as a stockholder to obtain 'inside information as to how [the] board assessed its offer and what alternatives the board may be considering or preferring to its offer.'"[68] Alexandria then made a supplemental demand, which, among other things, alleged possible board member conflicts surrounding the rejection of the term sheet. When Verseau failed to respond to the supplemental demand, Alexandria filed its complaint.

Although "Verseau's letter rejecting the Demand asserted that Alexandria's primary interest in seeking inspection was as a bidder, not a stockholder[,] . . . Verseau did not press that theory at trial and did not assert an improper ulterior purpose defense in this action, which would have required Verseau to make a difficult, fact-intensive showing."[69]

Instead, Verseau contended that Alexandria's stated purpose of evaluating "'whether Board members discharged their duty of care and acted in the best interests of Verseau and its stockholders' when the Board considered and rejected the Term Sheet" was not sufficient to compel inspection because "Plaintiffs do not, and cannot, contest . . . that each of the decisions at issue was made by a Verseau Board consisting of a majority of independent and disinterested directors."[70]

The Court rejected this argument, noting that it was an attack on "whether [the plaintiff] will ultimately prevail" rather than "whether [the plaintiff] has a credible basis for believing that corporate wrongdoing occurred."[71] The Court acknowledged that "[t]o some extent, Alexandria's evidentiary support for the alleged director conflicts has a bit of a rabbit-in-the-hat quality to it" as "[t]wo of the three asserted director conflicts arising from rejection of the Term Sheet were Alexandria's own creations": one director's alleged conflict "arose from Alexandria's insistence that no cash compensation could be paid to non-founder directors[,]" while another director's alleged conflict "was created by Alexandria's demand for an effective veto right over related-party transactions."[72]

Nonetheless, the Court found that the "very low threshold necessary to establish a credible basis to suspect that the directors may have favored the interests of certain directors or their affiliates over the Company's interests in rejecting the Term Sheet" was satisfied because (i) the company was in need of cash and no other source of funding appeared to be available at the time of the rejection of the term sheet, (ii) Verseau's CEO signed and agreed to present the board with the term sheet, (iii) a board member represented that his own venture capital firm had interest "in making a financing proposal" at the time of the rejection of the term sheet, and (iv) the

64 2020 WL 7422068 (Del. Ch. Dec. 18, 2020).

65 *Id.* at *2.

66 *Id.*

67 *Id.* at *4.

68 *Id.*

69 *Id.* at *8.

70 *Id.* at *6-7.

71 *Id.* at *7 (quoting *Khanna v. Covad Communications Group, Inc.*, 2004 WL 187274, at *6 (Del. Ch. Jan. 23, 2004)).

72 *Id.* at *8.

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rejection of the term sheet appeared "to coincide with the resignations of the Company's CEO and CFO, both of whom were directly involved in negotiating the Term Sheet."[73]

73 *Id.* at *9.

Members of the Corporate Counseling and Litigation Section

Young Conaway is pleased to announce that the firm's management committee has appointed Tammy L. Mercer to serve as Chair, and James M. Yoch, Jr., to serve as Vice-Chair, of the Corporate Litigation and Counseling Section.

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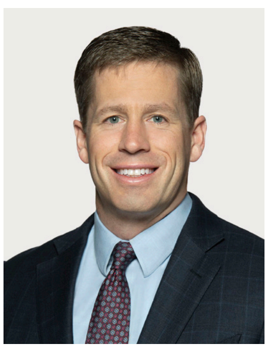

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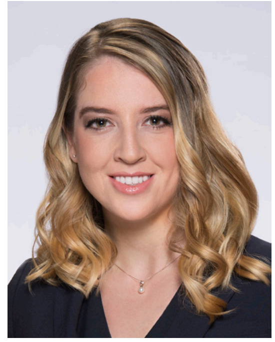

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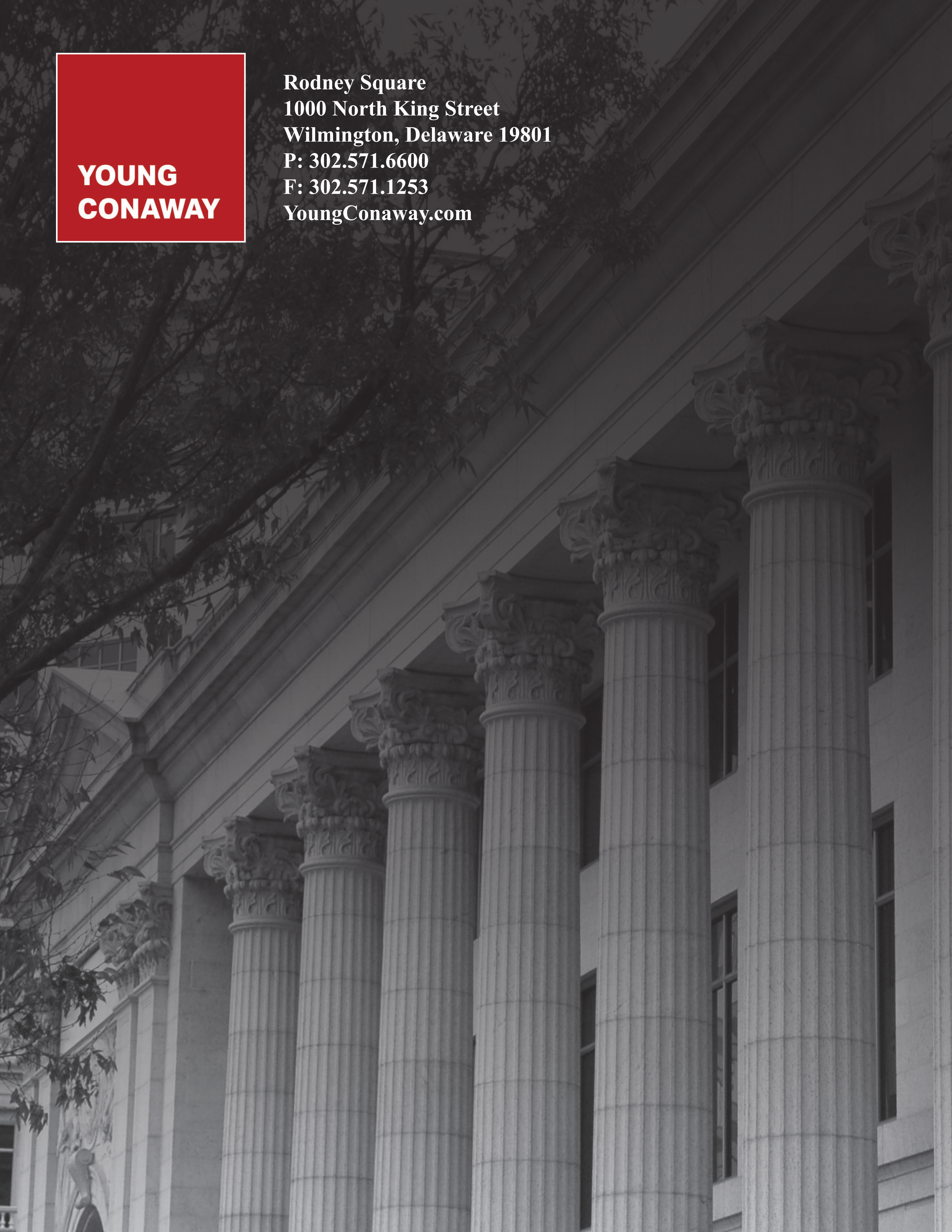

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