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Delaware Corporate Law Annual Update

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Delaware Corporate Law Annual Update 2020

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

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

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

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

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

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

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

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

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

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

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

argued on appeal that the allegations that the board knew Kalanick had a history of ignoring the law in similar transactions, Uber agreed to indemnify Otto employees for pre-signing misconduct, and the board never read the Stroz reports were sufficient to show a substantial likelihood of personal liability.

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

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

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

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

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

After Coster initiated the Section 226 action, the UIP board approved a stock sale in which UIP sold unissued shares to Bonnell. The stock sale made Bonnell a one-third owner of UIP, along with Schwat and Coster. Therefore, if valid, the stock sale would have had the immediate effect of mooting the pending Section 226

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

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

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

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

action. Coster then filed a new action, challenging the stock sale as a breach of the directors' fiduciary duties, and sought to cancel the stock sale. The new action was consolidated with the Section 226 action, and the Court rendered its opinion in the consolidated action following trial.

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

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

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

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

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

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

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

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8 *Id.* at *16.

9 *Id.*

10 *Id.*

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

12 *Id.*

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

14 *Id.* at *25.

15 *Id.* at *26.

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

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

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

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

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

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

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

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

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

20 *Id.* at *5.

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

22 *Id.* at *4.

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

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

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

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

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

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

The stockholders agreement also provided CD&R with "a lengthy list of consent rights," including over

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

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

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

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

27 *Id.* at *14.

28 *Id.* at *16.

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

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

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

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

29 *Id.* at *19.

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

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

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

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

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

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

The self-tender offer was launched on October 6, 2017, at a price of $1.35 per share, and closed on November 17, 2017, with stockholders tendering approximately 23% of LRN's issued and outstanding shares. None of LRN's three directors tendered any shares in the tender offer. Rather, the consummation of the tender offer had the effect of materially increasing the individual defendants' equity holdings in LRN and resulted

32 *Id.* at *28.

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

34 *Id.* at *3.

in Seidman—LRN's founder and chairman of the board—beneficially owning more than 50% of LRN's voting stock.

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

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

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

35 *Id.*

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

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

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

The Court concluded that the plaintiff had adequately alleged three separate disclosure deficiencies in connection with the tender offer. First, the Court held that the plaintiff adequately alleged that the stated purpose of the tender offer—to provide liquidity to stockholders—"served not to enlighten but to obscure the real reasons motivating the Offer."[38] The plaintiff adequately alleged that the directors' true motivation in pursuing the tender offer was to squeeze out LRN's stockholders and facilitate a follow-on cash-out transaction to benefit the directors.

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

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

38 *Id.* at *9.

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

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

In addition to finding that the plaintiff had sufficiently pled disclosure claims against the individual defendants, the Court concluded that the plaintiff had adequately alleged that the self-tender offer was coercive. The Court found that the well-pled disclosure claims were sufficient to support a claim of coercion, stating that "'actionable coercion may inhere in either the disclosures or in the terms of the offer itself.'"[44]
The Court also found that the transaction was structurally coercive. The Court first explained that the "Court has found actionable coercion where the plaintiff 'is forced into a choice between a new position and a compromised position,' and where, under the circumstances, stockholders may have perceived, 'not unreasonably, that unless they tender, they may not realize any return on or value for their investment in the foreseeable future.'"[45]

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

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

Third, the tender offer was structured so that the stock of those who did not participate would be worth less on account of Seidman having "near total control over LRN" following the tender offer.[49] That, coupled with the statements in the offer to purchase that the interests of the directors and officers may cause their interests to diverge with the interests of the remaining stockholders, "forced stockholders to face a coercive choice: either tender at an unexplained price, or risk retaining their interest in a company controlled by a self-interested fiduciary."[50]

39 *Id.*

40 *Id.*

41 *Id.* at *10.

42 *Id.*

43 *Id.*

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

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

46 *Id.*

47 *Id.* at *12.

48 *Id.*

49 *Id.* at *13.

50 *Id.*

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

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

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

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

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

A number of significant stockholders of AmTrust, including Carl Icahn, opposed the merger at the $13.50 per share price. When it became apparent to AmTrust that a majority of the minority stockholders would not vote in favor of the merger, AmTrust cancelled the stockholder meeting that was scheduled for stockholders to vote on the transaction. Thereafter, the controlling stockholders engaged in discussions with Ichan and reached an agreement with him that they would pay $14.75 per share in return for Ichan entering into a settlement agreement pursuant to which he would support the transaction, forgo appraisal rights, and dismiss a fiduciary duty action he filed challenging the $13.50 per share merger agreement. The merger agreement was amended after the special committee and the board approved the transaction at the $14.75 per share price. The stockholder meeting was reconvened and stockholders holding 67.4% of the minority shares

51 *Id.*

52 *Id.*

53 *Id.* at *15.

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

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

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

voted to approve the merger. Several stockholders then filed suit, and the defendants filed motions to dismiss.

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

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

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

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

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

The members of the special committee also argued that they were entitled to dismissal because AmTrust's certificate of incorporation contained a Section 102(b)(7) exculpatory provision and the complaint failed to alleged a non-exculpated breach against them. In *In re Cornerstone Therapeutics Inc, Stockholder Litigation*,[62] the Delaware Supreme Court held that independent directors of a Delaware corporation with a Section 102(b)(7) exculpatory charter provision are entitled to dismissal of a case challenging a controlling stockholder transaction unless the complaint pleads a non-exculpated claim for breach of fiduciary against the directors. However, "[w]hen a director is protected by an exculpatory charter provision, a plaintiff can survive a motion to dismiss by that director defendant by pleading facts supporting a rational inference that the director harbored self-interest adverse to the stockholders' interest, acted to advance the self-interest of an interested party from whom they could not be presumed to act independently, or acted in bad faith."[63]

The Court of Chancery denied the motion to dismiss with respect to the three members of the special committee

57 *Id.* at *10.
58 *Id.* at *11.

59 *Id.*
60 *Id.*
61 *Id.* at *10.
62 115 A.3d 1173 (Del. 2015).
63 *In re AmTrust Fin. Servs.*, 2020 WL 914563, at *13 (quoting *Cornerstone*, 115 A.3d at 1179-80).

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

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

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

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

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

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

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

The Court found that the complaint adequately pled that a majority of the directors were interested in the merger because they had rolled over substantial portions of their equity into the post-merger entity. Thus, the merger could only receive business judgment review if it was approved by (i) a fully empowered, independent special committee (pursuant to *In re Trados Inc. Shareholder Litigation (Trados II)*),[68] or (ii) a fully informed, un-coerced vote of disinterested stockholders (pursuant to *Corwin v. KKR Financial Holdings LLC (Corwin)*).[69]

The Court found that the merger was not cleansed by an independent special committee because the special committee was formed after "substantive economic

64 *Id.*

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

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

67 *Id.* at *4.

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

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

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

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

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

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

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

72 *Id.*

73 *Id.*

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

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

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

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

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

Similarly, the Court held that the 14D-9 omitted material information regarding the abrupt exit of the first financial advisor engaged by the reconstituted special committee to evaluate the merger. The Court held that the compressed time frame in which the merger took place made the departure of the financial advisor "plausibly material."[79] Here, the newly hired financial firm "mysteriously terminated [its] engagement" after a few days of reviewing a fully formed transaction.[80] The Court found that a reasonable stockholder would want to know why a well-known financial advisor walked away from a fully formed transaction, and that it therefore was reasonably conceivable that the 14D-9

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

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

79 *Id.*

80 *Id.* at *17.

omitted material information. Accordingly, the Court held the transaction was not cleansed by a well-informed stockholder vote under *Corwin*.

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

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

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

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

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

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

The Court distinguished *Litle v. Waters*[91] on the basis that while the S-corporation in *Litle* did not declare dividends in order to cover personal tax liabilities passed through the corporation to its stockholders, the Trust's complaint acknowledged that "'in years when the Company was profitable, the Company issued a dividend equal to the amount necessary for stockholders to pay their related tax obligations' and, beyond that, the Company declared a special dividend to all common

81 2020 WL 1522549 (Del. Ch. Mar. 31, 2020).
82 *Id.* at *5.
83 *Id.* at *4
84 *Id.* at *2.
85 *Id.*
86 194 A. 40, 43 (Del. Ch. 1937).
87 *Buckley Family Tr.*, 2020 WL 1522549, at *5.
88 1975 WL 1261 (Del. Ch. Apr. 29, 1975).
89 *Buckley Family Tr.*, 2020 WL 1522549, at *6.
90 *Id.*
91 1992 WL 25758 (Del. Ch. Feb. 11, 1992).

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

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

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

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

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

In *Shabbouei v. Potdevin*,[100] the Court of Chancery dismissed, for failure to adequately plead demand futility, a stockholder's derivative complaint against the board of directors of lululemon athletica inc. ("lululemon") that alleged the board breached its fiduciary duties in connection with a separation agreement entered into with the company's CEO. The Court, applying

92 *Buckley Family Tr.*, 2020 WL 1522549, at *6.
93 *Id.*
94 *Id.* at *7.
95 *Id.*
96 *Id.* at *1.
97 *Id.* at *10.
98 *Id.* at *3.
99 *Id.* at *11.
100 2020 WL 1609177 (Del. Ch. Apr. 2, 2020).

the two-prong *Aronson*[101] test, rejected the plaintiff's argument that the board was self-interested because the transaction was entered into with the CEO "as a means to hide Board-level failures."[102] In doing so, although the plaintiff "disavow[ed] any attempt to plead"[103] a *Caremark* claim,[104] the Court analyzed the question of whether the plaintiff pled particularized facts supporting a reasonable inference that the board was self-interested under *Caremark*. The Court concluded the complaint fell far short of pleading a *Caremark* oversight failure and, therefore, the plaintiff failed to adequately plead that the board was self-interested in the separation agreement. The Court also found that the plaintiff failed to plead particularized facts in support of a reasonable inference that the board's decision to enter the separation agreement was not the product of a valid exercise of business judgment.

According to the complaint, lululemon's CEO "created a toxic culture at lululemon and engaged in a pattern and practice of harassment and sexual favoritism while CEO."[105] Multiple whistleblower complaints were filed against the CEO, and ultimately many senior employees left the company because of the CEO's behavior. The complaint alleged the board was also aware of two incidents involving the CEO; but the complaint did not provide any meaningful detail about the incidents. The complaint acknowledged that lululemon maintained a code of ethics for all of its employees and that the company maintained a whistleblower hotline for reporting potential violations of the ethics code.

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

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

The Court assessed demand futility under the two-prong test articulated in *Aronson*. The plaintiff argued that demand was excused under the first *Aronson* prong because the board was self-interested in entering into the severance agreement in order to "hide Board-level failures."[106] The Court explained that in order to plead that the board was interested, the plaintiff needed to "plead facts supporting an inference that the Separation Agreement extinguished a *substantial*

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

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

103 *Id.* at *1.

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

105 *Id.* at *3.

106 *Id.* at *6.

likelihood of Board liability."[107] Although the plaintiff "disavow[ed] any attempt to plead a *Caremark* claim" and "maintain[ed] that he [sought] to hold Defendants liable only for their affirmative decision to enter into a separation agreement with the CEO,"[108] in evaluating the first *Aronson* prong, the Court viewed the plaintiff's theory of liability underlying the board's supposed self-interest as a *Caremark* claim. The Court remarked: "I am obliged to do what Plaintiff apparently would prefer I not do—evaluate his failure of oversight allegations."[109]

The Court concluded that the complaint failed to allege a substantial likelihood of liability arising from any underlying failure of oversight by the board. Indeed, the Court stated that the "allegations do not support an inference of any liability exposure, much less a substantial likelihood of liability."[110] To the contrary, the Court emphasized the code of ethics, the whistleblower system, and the board's response to the allegations against the CEO—including hiring counsel to investigate, reviewing counsel's report, authorizing a board member to negotiate the CEO's resignation from the company, and securing the CEO's "departure without litigation or excessive negative publicity"—all defeated such an oversight claim.[111]

The Court similarly concluded that the complaint failed to establish demand futility under *Aronson's* second prong because the complaint did not otherwise support a reasonable inference that the approval of the separation agreement was not a product of valid business judgment by the lululemon board. Lululemon's charter contained a Section 102(b)(7) provision exculpating the directors for duty of care violations—necessitating that the plaintiff plead a breach of the duty of loyalty to establish any likelihood of liability arising from the board's conduct. The plaintiff argued the "[b]oard rushed to negotiate and sign the Separation Agreement after conducting cursory informal meetings (without minutes)."[112] Noting the board's discretion in determining whether to fire the CEO or negotiate a severance package, the Court found the complaint fell far short of adequately alleging a breach of the duty of loyalty.

107 *Id.* at *7.
108 *Id.*
109 *Id.* at *7.
110 *Id.* at *8.
111 *Id.*
112 *Id.* at *10.

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

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

In *Elburn v. Albanese*,[113] the Court of Chancery denied the defendant's motion to dismiss, under Rule 23.1, a derivative suit challenging a corporate board's incentive-based executive compensation award to two officer-directors. Unlike a typical Rule 23.1 motion to dismiss, which focuses on whether the plaintiff has adequately pled demand futility, the parties in *Elburn* raised "the more fundamental question of what is required to plead a fact 'with particularity' under Rule 23.1."[114] In rejecting the defendant's attempt to impose the rigorous "newspaper facts" pleading standard often applied in fraud cases, the Court provided new interpretative guidance on the standard for a derivative plaintiff to plead a fact with particularity sufficient to defeat a motion to dismiss. That standard is stricter than notice pleading, but less stringent than the "newspaper facts" standard.

The plaintiff's claims stemmed from a previous derivative action between the same parties, in which the plaintiff challenged the board's grant of an award of nearly $50 million of stock and restricted stock units to themselves (the "2016 Awards"). Two directors, CEO Kevin Cummings and President and COO Domenick Cama, "received the majority of these awards, about $16.7 million and $13.4 million, respectively."[115] The parties ultimately agreed to settle that litigation, which resulted in Cummings and Cama agreeing to rescind approximately 75% of the 2016 Awards. Prior to the Court of Chancery's approval of the settlement, the board disclosed in its proxy statement in connection

113 2020 WL 1929169 (Del. Ch. Apr. 21, 2019).
114 *Id.* at *2.
115 *Id.* at *4.

with annual board elections that it intended to issue a replacement award to Cummings and Cama, which replaced all of the rescinded restricted stock units and nearly 40% of the rescinded stock options (the "Replacement Awards"). The board approved the Replacement Awards in May of 2019, subject to the Court's approval of the settlement. The Court approved the settlement and the Replacement Awards became effective in July of 2019. Although the proxy statement disclosed the board's intent to issue the Replacement Awards, the board never supplemented this disclosure to inform the stockholders that the Replacement Awards had been approved.

The plaintiff filed suit challenging the Replacement Awards, asserting breach of fiduciary duty and unjust enrichment claims in connection with their issuance and acceptance. Specifically, the plaintiff alleged that the defendants "breached their fiduciary duties by issuing the Replacement Awards in a *quid pro quo* arrangement between Cummings and Cama" and the other members of the board in which "Cummings and Cama agreed to forfeit all of their share of the 2016 Awards in the Settlement so that the [other] directors could pocket more of their own awards, but only after the [other] directors secretly committed to issue the Replacement Awards after the Settlement was consummated."[116] Thus, the plaintiff alleged that the Replacement Awards could not have been the product of valid business judgment, but instead were "the spoils of a devious plan to nullify the effects of the Settlement and harm the Company's stockholders yet again."[117] The plaintiff also brought a separate fiduciary duty claim alleging the directors breached their duties by issuing a materially misleading proxy statement in advance of the annual elections.

Rather than challenge the "legal foundation" for the plaintiff's claims that the Replacement Awards were approved in breach of the defendants' fiduciary duties, the defendants instead "contest[ed] the adequacy of Plaintiff's factual pleading of the supposed *quid pro quo* arrangement between Cummings, Cama and the [other] directors."[118] The defendants argued that the Court should require the plaintiff to plead facts with the same "particularity" as required to plead fraud. In other words, the defendant argued that a derivative plaintiff must plead: "'(1) the time, place, and contents of the false representation; (2) the identity of the person making the representation; and (3) what the person intended to gain by making the representations.'"[119]

The Court rejected the defendant's argument. While recognizing that pleadings under Rule 23.1 are indeed held to a higher standard than non-derivative claims, the Court held that requiring a derivative plaintiff to plead "so-called 'newspaper facts'" would place too high a pleading standard on such a plaintiff.[120] Requiring such facts, the Court noted, would place derivative plaintiffs' claims at risk of never surviving a motion to dismiss: "derivative plaintiffs would be hard pressed to plead similar 'who, what, when, where and how' facts about fiduciary wrongdoing when they were not in the boardroom and, unlike fraud, were not the direct targets of the wrongful behavior."[121]

Instead, the Court held that a middle ground approach should apply and held that a pleading standard akin to that for allegations of fraudulent omission should apply. In the fraudulent omission context, a plaintiff discharges her pleading burden where the complaint "informs defendants of the *precise transactions at issue*, and the fraud alleged to have occurred in those transactions, so as to place defendants *on notice of the precise misconduct with which they are charged*."[122] This middle ground standard "recogniz[es] that a derivative plaintiff rarely has access, pre-discovery, to the facts that would allow him to recount a fly-on-the-wall's perspective of the alleged fiduciary misconduct he is attempting to plead."[123]

Applying this standard, the Court held that the plaintiff's complaint "plainly describes the specific misconduct in which each Defendant is alleged to have participated and the bases upon which Plaintiff alleges that an illicit *quid pro quo* arrangement led to the Replacement Awards."[124] Moreover, while recognizing that it may

116 *Id.* at *1.

117 *Id.*

118 *Id.* at *7.

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

120 *Id.* at *7-8.

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

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

123 *Id.*

124 *Id.*

not be necessary to survive the motion, the Court noted that the complaint also put defendants "on notice of *when* the alleged misconduct occurred, *who* allegedly participated and *what* motivated the [other] directors to breach their fiduciary duties."[125] Accordingly, the Court denied the defendants' motion to dismiss.

The plaintiff also moved for partial summary judgment on its disclosure claims. First, the plaintiff argued the proxy statement, which stated that consideration of the Replacement Awards had "commenced" was "materially misleading because, at the time the Proxy was issued, the process for approving the Replacement Awards was further along than stockholders were being told."[126] The court rejected this claim, stating that the plaintiff was splitting hairs in arguing "that internal documents showing the Replacement Awards were being substantively negotiated reveal that the Board was doing more than 'considering' the awards, as disclosed in the Proxy."[127]

The plaintiff's second argument, that the defendants should have supplemented the proxy after the board approved the Replacement Awards, in the Court's view, "rest[ed] on firmer ground."[128] However, the Court denied summary judgment on this claim, finding that the question of whether this failure to supplement was material to the stockholders ratifying vote would benefit from further fact discovery.

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

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

In *Hughes v. Hu*,[129] the Court of Chancery denied a Rule 23.1 motion to dismiss, holding that pre-suit demand would have been futile because the plaintiff's allegations as set forth in the complaint supported a "reasonable pleading-stage inference of a bad faith failure of oversight" over the company's financial statements and related party transactions by the director-defendants.[130] Four of the defendants made up a majority of the board that would have considered a demand and "the substantial threat of liability render[ed] them incapable of disinterestedly considering a demand."[131] This decision is the most recent in a string of duty of oversight cases under *Caremark International Derivative Litigation*[132] to survive dismissal in the past year, despite *Caremark* claims being "among the hardest to plead and prove" under Delaware law.[133]

In March 2014, Kandi Technologies Group, Inc. ("Kandi"), a publically traded Delaware corporation based in China, acknowledged in its annual report on Form 10-K for the year ending December 31, 2013, that the company's reporting and oversight procedures were flawed. In particular, the company disclosed that its internal audit department reported to the CEO rather than to the Audit Committee, the Audit Committee and internal audit department failed to communicate, and the company failed to annually review the efficacy of the Audit Committee. The Form 10-K also discussed the company's proposed remedies to address these deficiencies, including requiring the head of the internal audit department to report to the Audit Committee, committing to revising the Audit Committee's charter to require communications between the Audit Committee and the internal audit department, and resolving to evaluate the Audit Committee annually. The company also determined that "its related-party transactions would be subject to review by the Audit Committee."[134]

Notwithstanding the company's stated resolve to remedy these deficiencies, in the three years between March 2014 and March 2017, the Audit Committee met only sporadically for short periods of time to discuss

125 *Id.* (emphasis in original).
126 *Id.* at *10.
127 *Id.*
128 *Id.* at *11.
129 2020 WL 1987029 (Del. Ch. Apr. 27, 2020).
130 *Id.* at *1
131 *Id.*
132 698 A.2d 959 (Del. Ch. 1996). *See also Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019); *In re Clovis Oncology, Inc. Derivative Litig.*, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019); *Inter-Marketing Grp. USA, Inc.*, 2020 WL 756965 (Del. Ch. Jan. 31, 2020).
133 *See Clovis*, 2019 WL 4850188 at *12.
134 *Hughes*, 2020 WL 1987029 at *4.

matters such as related-party transactions and the efficacy of the company's internal controls.

Further, in March 2017, Kandi disclosed in its 2016 Form 10K that the company's prior three years of financial records needed to be restated because the company lacked "[s]ufficient expertise relating to technical knowledge of US GAAP requirements and SEC disclosure regulations; [s]ufficient expertise to ensure the completeness of the disclosure of financial statements for equity investments; [s]ufficient expertise to ensure the proper disclosure of related-party transactions; [e]ffective controls to ensure the proper classification and reporting of certain cash and non-cash activities related to accounts receivable, accounts payable, and notes payable; and [s]ufficient expertise to ensure the accuracy of the accounting and reporting of income taxes and related disclosures."[135]

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

In February 2019, the same plaintiff brought derivative claims on behalf of the company against three of the company's directors, who were members of Kandi's Audit Committee, the company's chief executive officer, and the company's then-current chief financial officer and two former chief financial officers. The plaintiff alleged that defendants breached their fiduciary duties by "willfully failing to maintain an adequate system of oversight, disclosure controls and procedures, and internal controls over financial reporting."[136] The defendants moved to dismiss the action for failure to make demand upon the board or plead demand futility under Rule 23.1 and for failure to state a claim under Rule 12(b)(6).

The Court began its analysis by determining whether the *Aronson*[137] test or the *Rales*[138] test for analyzing demand futility applied.[139] The Court stated that while the *Aronson* test was technically appropriate given that a majority of the then-current board were also board members at the time of the alleged wrongdoing, it would evaluate demand futility under the *Rales* test because the complaint did not challenge "a specific transaction or a particular decision"[140] but rather alleged "that there were persistent problems with the Company's system of financial oversight over a prolonged period, leading ultimately to the Company suffering harm."[141] The Court reasoned that a "*Caremark* claim is conceptualized as flowing from an overarching failure by the directors to take the action necessary to protect the corporation, so the more generalized *Rales* standard is routinely applied."[142] Under *Rales*, to adequately plead demand futility, a plaintiff needs to make "a threshold showing through the allegation of particularized facts"[143] that a director faces a substantial likelihood of liability and, as such, has a "disqualifying interest"[144] in considering the demand.

The Court next analyzed whether the complaint alleged sufficient facts showing that a majority of the demand board faced a substantial likelihood of liability. Under *Caremark*, directors face a substantial likelihood of

135 *Id.* at *8

136 *Id.* at *9.

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

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

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

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

141 *Id.*

142 *Id.*

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

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

liability if the plaintiff demonstrates that the defendants "utterly failed to implement any reporting or information system or controls; or . . . having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[145] The Court explained that a plaintiff can state a *Caremark* claim by alleging that "the company had an audit committee that met only sporadically and devoted patently inadequate time to its work, or that the audit committee had clear notice of serious accounting irregularities and simply chose to ignore them or, even worse, to encourage their continuation."[146]

The Court held that because the complaint demonstrated that the company's Audit Committee "met sporadically, devoted inadequate time to its work, had clear notice of irregularities, and consciously turned a blind eye to their continuation[,]" the complaint sufficiently alleged particularized facts showing that the board faced a substantial likelihood of liability.[147] The Court noted that even after Kandi publically disclosed weaknesses in the company's reporting and oversight procedures in March 2014, the company failed to take appropriate remedial measures. For example, the Audit Committee met only when "spurred by the requirements of federal securities laws" and, even then, "[t]heir abbreviated meetings suggest[ed] that they devoted patently inadequate time to their work."[148] The Court also found that while the Audit Committee purportedly reviewed and approved a new policy that the company prepared governing related-party transactions, it was reasonable to infer from the company's failure to produce such a policy that it "either did not exist or did not impose meaningful restrictions on the Company's insiders."[149]

In reaching its conclusion, the Court rejected defendants' argument, based on *In re General Motors Company Derivative Litigation*,[150] that because the Company had in place "an Audit Committee, a Chief Financial Officer, an internal audit department, a code of ethics, and an independent auditor[,]" the plaintiff could not "meet its *Caremark* burden by pleading that board-level monitoring systems existed but that they should have been more effective."[151] The Court distinguished *General Motors*, explaining that in *General Motors* the board was very much involved in maintaining an oversight system whereas here the complaint adequately alleged that the company's board members "did not make a good faith effort to do their jobs."[152]

Given these "persistent and prolonged problems at the Company," the Court found that the defendants faced "a substantial likelihood of liability under *Caremark* for breaching their duty of loyalty by failing to act in good faith to maintain a board-level system for monitoring the Company's financial reporting."[153] As such, the Court held that demand would have been futile because a majority of the demand board faced a substantial likelihood of liability.

The Court lastly addressed defendants' motion to dismiss for failure to state a claim under Rule 12(b)(6). The Court held that its Rule 23.1 analysis was dispositive because "a complaint that survives a motion to dismiss pursuant to Rule 23.1 will also survive a 12(b)(6) motion to dismiss"[154] since the "standard for pleading demand futility under Rule 23.1 is more stringent than the standard under Rule 12(b)(6)."[155]

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

In *In re GoPro, Inc. Stockholder Derivative Litigation*,[156] the Court of Chancery dismissed a derivative complaint alleging breaches of fiduciary duties by GoPro, Inc. ("GoPro") officers and directors because the derivative plaintiffs failed to plead demand futility with particularity as required under Court of Chancery Rule 23.1. The Court rejected the plaintiffs' arguments that a majority of the demand board was not able to consider a demand because they faced a substantial likelihood of liability for breaches of fiduciary duties and securities law violations for alleged actions and

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

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

147 *Id.*

148 *Id.* at *16.

149 *Id.* at *14.

150 2015 WL 3958724 (Del. Ch. June 26, 2015).

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

152 *Id.*

153 *Id.* at *17.

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

155 *Id.*

156 2020 WL 2036602 (Del. Ch. Apr. 28, 2020).

inactions in connection with GoPro's launch of a new product in 2016. The Court also rejected the plaintiffs' argument that a majority of the demand board could not competently consider a demand to prosecute claims against the controlling stockholder because the controlling stockholder could remove the board members at will and therefore the board members lacked independence for demand futility purposes. Therefore, the plaintiffs failed to adequately plead that demand was excused.

In early 2016, GoPro issued full-year revenue guidance to its investors, disclosing that it expected revenue of $1.35 – $1.5 billion for 2016. On the same day, GoPro also announced its plan to enter the drone market. GoPro planned to launch two new products in 2016: "a drone that would house state of the art GoPro cameras and the latest iteration of its signature wearable camera."[157] For eight months, management reports to the board showed the company had no drones in inventory and that there were delays with bringing the drone to the market. Yet, the company continued to make positive public statements about the drone and the company's revenue guidance remained the same. After hitting the market, the drone experienced manufacturing defects, and the company struggled to supply inventory to retailers. The company lowered its revenue guidance to $1.25 - $1.3 billion as a result, and the market reacted to the drop with GoPro's stock falling 6.5%. The company then recalled the drone due to the defects, causing the stock to drop another 4%. In 2017, the company reported that it had missed its revenue projections, in large part due to the drone launch challenges.

Following the drone launch fallout, certain GoPro stockholders sued GoPro officers in federal court for securities violations. Other GoPro stockholders sought books and records from the company under Section 220 of the Delaware General Corporation Law. After receiving documents from the company in response to their Section 220 demand, and without making a litigation demand on GoPro's board, two GoPro stockholders filed derivative actions against the members of the board, among others, claiming that the members of the board breached their fiduciary duties by failing to disclose GoPro's drone inventory and sales issues, allowing officers to make numerous materially false and misleading statements, and using non-public information to sell company stock.[158]

The defendants moved to dismiss under Rule 23.1 for failure to plead demand futility and under Rule 12(b)(6) for failure to state a claim. Because the plaintiffs elected to forego pre-suit demand, to satisfy Rule 23.1, they had to show demand was excused. The Court noted that the plaintiffs' allegations were imprecise in that they simultaneously characterized the alleged wrongdoing as a failure to act and as an affirmative decision and, as a result, the plaintiffs did not sufficiently articulate whether *Aronson*[159] or *Rales*[160] should apply to the demand futility inquiry.[161] On the one hand, the plaintiffs alleged that the board made false or misleading statements, knowing that GoPro would not make the launch of its new drone product and would miss revenue guidance because the board had received reports showing no inventory a few weeks before launch. The plaintiffs further alleged that one director, the CEO, engaged in insider trading. On the other hand, the plaintiffs' complaint contained allegations that "walk and talk" like a *Caremark* claim[162] for bad

157 *Id.* at *1.

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

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

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

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

162 To carry out one's duties under *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996), "a director must make a good faith effort

faith failure to oversee GoPro's operations, though the plaintiffs "disclaim[ed] any effort to plead a *Caremark* claim."[163]

Although it was not clear what theory (board action or board inaction) the plaintiffs were relying on or what demand futility test (*Aronson* or *Rales*) the plaintiffs were arguing should apply, the "one clear" argument that the plaintiffs did make was that a majority of the demand board faced a substantial likelihood of liability for their actions or inactions surrounding GoPro's public statements, an inquiry into which is applicable to both *Aronson* and *Rales*.[164] But the Court found that the plaintiffs' allegations failed to demonstrate a substantial likelihood of liability under either theory.

First, the Court found that only one member of the demand board (the CEO and controlling stockholder) was alleged to have made false or misleading statements or engaged in insider trading. The plaintiffs argued that a majority of the demand board engaged in wrongdoing because they contributed to and approved the revenue guidance while knowing that it was impossible for the company to meet projections and that a majority of the demand board lacked independence because they were beholden to the CEO, who as the controlling stockholder could remove them at will. The Court rejected these arguments. The plaintiffs provided no particularized facts to show a majority of the board affirmatively told management to disclose that the company would meet its revenue guidance notwithstanding the manufacturing and inventory issues. The Court stated that the "fundamental problem" with plaintiffs' argument was that "[b]oard *acquiescence* cannot support an inference of *affirmative* [b]oard-level misconduct."[165] The Court explained that "[e]ven if the Board were told by its management that the Company was not going to meet its revenue projections, and then did nothing as management publicly stood by its market guidance, that factual predicate would support a 'classic' *Caremark* claim for failure to respond to 'red flags,' not a claim against the Board for causing the Company to make false disclosures."[166]

The plaintiffs also failed to plead "facts that would allow a reasonable inference that a majority" of the demand board was beholden to the CEO, or any other *Brophy*-claim defendant, "such that they would be motivated to facilitate or cover up illegal insider trading."[167] Those directors were not beholden to the CEO simply by virtue of his removal power as controlling stockholder.[168]

Second, the Court found that the plaintiffs' *Caremark*-like allegations were insufficient to subject the defendants to a substantial likelihood of personal liability for a *Caremark* claim. The Court assumed for its analysis that the plaintiffs were asserting claims under *Caremark*'s second prong by arguing that, having implemented an oversight system, the board failed to respond to red flags. But the Court found that the plaintiffs failed to plead any facts "that would allow a reasonable inference a majority of the Demand Board knew GoPro was misleading investors with any of its public statements during 2016."[169] Among other things, the Court explained that management's presentations to the board regularly advised the board that the company was on track to meet the revenue guidance and the board was entitled to rely on that information.

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

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

In *Gilbert v. Perlman*,[170] the Court of Chancery reiterated that the circumstances under which minority stockholders will be found to be part of a control group

to oversee the company's operations." *Marchand v. Barnhill*, 212 A.3d 805, 820 (Del. 2019). To establish liability under *Caremark*, a plaintiff must establish either one of two prongs: "(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention." *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

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

164 *Id.* at *9.

165 *Id.* at *10.

166 *Id.*

167 *Id.* at *11.

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

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

170 2020 WL 2062285 (Del. Ch. Apr. 29, 2020).

(and thus be found to owe fiduciary duties to other stockholders in a transaction) where there already exists an independently controlling stockholder are very limited.[171]

In granting a motion to dismiss breach of fiduciary duty claims brought against two minority stockholders, Chrysalis Ventures II, L.P. ("Chrysalis") (which owned 11% of the company) and David Jones (who owned 0.02% of the company), the Court reasoned that in order for a minority stockholder to be found part of a controlling group along with an independently controlling stockholder, a minority stockholder's participation with the controller in a transaction is alone insufficient. Rather, "the minority-holder's participation must be material to the controller's scheme to exercise control of the entity, leading to the controller ceding some of its control power to the minority-holders."[172]

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

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

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

In analyzing the motion to dismiss, the Court noted that generally a minority stockholder can only be deemed a controller who owes fiduciary duties if the stockholder actually "exercise[s] control over the business affairs of the corporation" as part of a control group.[173] Here, though, there was already an independently controlling stockholder, Francisco Partners. In analyzing whether Chrysalis and Jones acted as part of a control group with Francisco Partners, the Court adopted the analysis set forth by the Court in *Almond v. Glenhill Advisors LLC*,[174] stating:

> [W]here a controlling stockholder takes an action joined by minority stockholders, the latter can be deemed members of a control group, and thus fiduciaries, where two conditions exist. There must be an arrangement between the controller and the minority stockholders to act in consort to accomplish the corporate action, and the controller must perceive a need to include the minority holders to accomplish the goal, so that it has ceded some material attribute of its control to achieve their assistance.[175]

The Court found that the plaintiffs had sufficiently alleged that Francisco Partners acted in concert with Chrysalis and Jones—meeting the first part of the

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

172 *Id.* at *7.

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

174 2018 WL 3954733 (Del. Ch. Aug. 17, 2018).

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

analysis. The plaintiffs pointed to past coordination between the parties where Chrysalis and Jones facilitated the acquisition of a majority stake in Connecture by Francisco Partners through two private placements as well as facilitation between Jones and Chrysalis in the transaction at issue.

But, the Court held that the plaintiffs failed to sufficiently allege the second part of the analysis—that Francisco Partners somehow "shar[ed] or material[ly] self-limit[ed] . . . its control powers, to obtain participation of [Chrysalis and Jones] for [Francisco Partners]' perceived self-advantage."[176] In other words, the Court explained, the plaintiffs were required but failed to show that Francisco Partners needed something material in order to execute its going private scheme and gave up a material part of its control to Chrysalis and Jones to get it.

In addition to the past coordination of the parties, the plaintiffs alleged that Chrysalis and Jones were classified by the SEC as "affiliates" of Connecture and the SEC defines "affiliates" as "a person that directly or indirectly through one or more intermediaries controls, is controlled by, or is under common control with such issuer."[177] The Court rejected this argument, holding that the "SEC determination is not dispositive of the common-law issue of control[.]"[178] The plaintiffs' sole remaining allegations were that Chrysalis and Francisco Partners had a "legally significant relationship" as shown by the voting agreement entered by the two stockholders,[179] and that Francisco Partners limited its control by agreeing to let Chrysalis and Jones join the equity rollover, thereby diluting Francisco Partners' interest in the new company.

In holding that the plaintiffs failed to sufficiently satisfy the second condition of the analysis, the Court found the plaintiffs had alleged "neither *quid* nor *quo*—it describes nothing Francisco Partners needed or ceded to the Moving Defendants, other than the bare right to roll over shares."[180] Further, the Court reasoned that if the plaintiffs' allegations were deemed sufficient, minority stockholders could be tagged as controlling fiduciaries each time minority stockholders participated in a transaction with a controller.

Ultimately, the Court dismissed the claims against Chrysalis and Jones for breaches of fiduciary duty as controlling stockholders, noting that "as with Aesop's lion freed from his constraints by the gnawing of a mouse, a stockholder with voting control might nonetheless be needful of aid from a minority stockholder to complete a control scheme, and might be willing, in order to get it, to cede some if its advantage to such a minority stockholder," but that the plaintiffs' complaint here did not present that rare situation.[181]

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

In *Solak v. Welch*,[182] the Delaware Supreme Court affirmed, in a one-page order, the Court of Chancery's determination that a letter to the board of directors of Ultragenyx Pharmaceutical Inc. ("Ultragenyx") from an Ultragenyx stockholder constituted a demand for purposes of Court of Chancery Rule 23.1 where the letter, which requested that the board take remedial action to address allegedly excessive compensation to non-employee directors, included a footnote stating that nothing in the letter should be "construed as a pre-suit litigation demand under Delaware Chancery Rule 23.1."[183] The Supreme Court stated that the Court of Chancery decision "should be affirmed on the basis of and for the reasons assigned by the Court of Chancery."[184]

After the Ultragenyx board received the letter from the stockholder requesting that the board take remedial action, the board rejected the request and the stockholder commenced litigation against the board. The stockholder asserted claims for breach of fiduciary duty, unjust enrichment, and corporate waste based on the board's "allegedly excessive non-employee director compensation practices."[185] The defendants moved to dismiss the complaint under Rule 23.1, arguing that the stockholder's pre-suit letter constituted a demand and the stockholder had failed to claim that the board

176 *Id.* at *8.
177 *Id.*
178 *Id.*
179 *Id.*
180 *Id.* at *9.
181 *Id.* at *7.
182 228 A.3d 690 (Del. Apr. 30, 2020) (TABLE).
183 *Solak v. Welch*, 2019 WL 5588877, at *2 (Del. Ch. Oct. 30, 2019) [hereinafter *Trial Opinion*].
184 228 A.3d 690 (Del. Apr. 30, 2020) (TABLE).
185 *Trial Opinion*, 2019 WL 5588877, at *3.

wrongfully refused the demand. The plaintiff opposed the motion, arguing that the letter was not a demand, as evidenced in part by the footnote, and that the demand excusal analysis applied.

In concluding that the stockholder's pre-suit letter to the board constituted a pre-suit demand under Rule 23.1, the Court of Chancery applied *Yaw v. Talley*,[186] which held that "a pre-suit communication is a demand for purposes of Rule 23.1 if it provides '(i) the identity of the alleged wrongdoers, (ii) the wrongdoing they allegedly perpetrated and the resultant injury to the corporation, and (iii) the legal action the shareholder wants the board to take on the corporation's behalf.'"[187] The parties disputed whether the letter satisfied the third criterion. The stockholder argued that because the letter did not expressly demand that the board commence litigation, it could not be construed as a pre-suit litigation demand. The Court disagreed, explaining that such argument was inconsistent with prior Court findings that pre-suit communications that did not expressly demand litigation were sufficient to constitute pre-suit demand. Moreover, the Court found that a determination that the third *Yaw* criterion had been met was supported by the letter's (i) request for remedial action, (ii) statement that Ultragenyx "is more susceptible than ever to shareholder challenges unless it revises or amends its director compensation practices and policies," and (iii) warning that, "absent a response from the [b]oard within thirty days, [the stockholder] would consider all available shareholder remedies."[188] The Court also noted that the stockholder's footnote disclaimer did not obviate the Court's review of the letter's substance, stating that Delaware law's prohibition on a stockholder from both making a demand and pleading demand futility "would become a virtual nullity if a stockholder could avoid a judicial determination that pre-suit demand was made by simply stating 'this is not a demand' in his pre-suit communication."[189]

186 1994 WL 89019 (Del. Ch. Mar. 2, 1994).

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

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

189 *Id.* at *5.

Having determined that the letter constituted a demand, the Court then looked at whether the stockholder had adequately pled wrongful demand refusal by the board. Because the complaint "fail[ed] to acknowledge . . . the [l]etter or the [board's r]esponse," let alone allege "any facts supporting an inference that the Board wrongfully rejected the demand,"[190] the Court granted the defendant's motion to dismiss.

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

In *Frederick Hsu Living Trust v. Oak Hill Capital P'rs III L.P.*,[191] the Court of Chancery held that a controlling stockholder's decision to implement a strategy to accumulate cash in anticipation of a redemption—rather than investing it in the company's business to promote long-term growth—was entirely fair, despite finding that the process used to implement the strategy was not fair. *Frederick Hsu* stands as a reminder that a challenged action can survive entire fairness review despite a finding of an unfair process, as "[t]he economic dimension of the analysis can be 'the predominant consideration in the unitary entire fairness inquiry.'"[192]

Defendant Oak Hill Capital Partners ("Oak Hill") owned a majority of the common stock and all of the Series A Preferred Stock of OND Holding Corporation ("OND"), a holding company for Oversee.net (together with OND, "Oversee"), which gave Oak Hill control of the company at the stockholder and board levels. Oak Hill possessed a redemption right to compel Oversee to redeem its preferred stock at a liquidation preference of $150 million.[193] Traditionally, Oversee "invested its profits in organic growth or used it to make acquisitions[,]" but with the ripening of the redemption right approaching, Oak Hill terminated Oversee's CEO and "instructed management to cut expenses to improve profitability."[194] Afterwards, it "kept the focus on cash generation," selling half of the company's business units without reinvesting the proceeds.[195] Oak Hill

190 *Id.* at *8.

191 2020 WL 2111476 (Del. Ch. May 4, 2020).

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

193 *Id.*

194 *Id.* at *1.

195 *Id.*

then exercised its redemption right and received $45 million. The company's second largest stockholder, Fredrick Hsu, brought suit claiming that this shift towards liquidation and away from its acquisition and growth strategy, which, he alleged, led to a substantial downturn in revenue, constituted a breach of fiduciary duty by Oak Hill and the members of the company's board that went along with the strategy.

In a post-trial opinion, the Court first identified what, if any, conduct taken by Oak Hill was self-interested. The Court ruled that because the redemption right *required* Oak Hill to use "all of its legally available funds for a redemption . . . the actual redemption was not the critical step . . . the critical step was building up the pool of funds that would be available for redemption."[196] The Court found "that Oak Hill caused the Company to accumulate cash so that the funds would be legally available and could be swept up using its Redemption Right[,]" thus subjecting Oak Hill's conduct to scrutiny under the entire fairness standard.[197]

The Court then rejected the defendants' argument that the plaintiff should bear the burden of proving unfairness because of the existence of three special committees on several grounds.[198] First, citing *Americas Mining Corp. v. Theriault*,[199] the Court held that because "defendants did not move for summary judgment on the standard of review or allocation of burden," the defendants "bore the burden of proving entire fairness."[200] Second, the special committees did not address the specific decision that the plaintiff challenged—the decision to "re-orient the Company away from a strategy of reinvesting its net income in growth opportunities and towards a strategy of accumulating cash on the balance sheet."[201] Rather, the special committees addressed decisions that the plaintiff did not challenge, such as the determining the amount of funds that could be used for the redemption and the price at which to sell a business segment. Third, the Court found that the "record gives rise to sufficient concerns about the effectiveness of the special committees. . . ."[202] Factors that the Court considered in determining that the special committees were not well-functioning included one of the committee member's "close ties" to Oak Hill and "longstanding personal connections" with an Oak Hill partner, the special committees' reliance on senior management who had bonus agreements that incentivized them to maximize the proceeds that Oak Hill would receive, and the extent of the direction that senior management took from Oak Hill.[203] Ultimately, although the Court stated that the Court's discussion of these factors "is not to intimate that the special committees were a sham" or that the members acted in bad faith, "a combination of factors raises sufficient doubts about the effectiveness of the committees to prevent them from having burden-shifting effect."[204]

The Court found the "defendants fell short on the [fairness of the process] dimension of the [entire fairness] analysis."[205] The Court noted that Oak Hill "initiated the cash-accumulation strategy[,]" fired the CEO, "told the Operating Committee to make deep cuts[,]" and "pushed management to make further cuts and maintain the Company's margins."[206] It found that "Oak Hill drove the cash accumulation strategy" by controlling all communication: it was "undisputed that Oak Hill had bi-weekly calls with the CEO, communicated regularly with management, met informally with management, and exchanged thousands of emails with the senior management team."[207] The Court concluded that "[t]he traditional indicators of fair dealing were thus lacking in this case" but noted that the plaintiff "attacked the decision to accumulate cash" instead of challenging "the Board's decisions to redeem Oak Hill's shares" or "the transaction prices that the Company obtained for its businesses" which would have caused "the analysis of the fair process dimension [to] have unfolded differently."[208]

196 *Id.* at *29.

197 *Id.*

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

199 51 A.3d 1213 (Del. 2012).

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

201 *Id.*

202 *Id.* at *34.

203 *Id.* at *34-35.

204 *Id.* at *35.

205 *Id.* at *36.

206 *Id.*

207 *Id.*

208 *Id.*

The Court then moved on to "the fair price dimension of the entire fairness inquiry."[209] It concluded that "[t]he defendants proved that the cash accumulation strategy was substantively fair."[210] The Court concluded that "[t]he defendants proved that the root cause of Oversee's decline was not self-interested conduct by Oak Hill, but rather intense industry headwinds and competitive pressures that began almost immediately after Oak Hill's first investment in 2008. The weight of the evidence demonstrates that there was no acquisition or growth opportunity that the Company's former executives and directors could have pursued that would have changed the outcome."[211] The Court also relied on expert testimony showing that "the defendants did not sacrifice value when selling assets"; that "Oak Hill's large position in the common stock meant that Oak Hill had a counterbalancing incentive not to harm the value of the common stock"; and that "[r]egardless of the defendants' actions, the common stockholders would have received the same value: nothing."[212]

The Court concluded that despite the process deficiencies in the implementation of the cash accumulation strategy, "[t]he strategy thus inflicted no harm on the common stockholders, who are in at least as good a position now as they would have been if the Company had followed a different course. In other words, the defendants' actions were entirely fair" under the unitary entire fairness inquiry.[213] Thus, despite the underlying process deficiencies, the ultimate fairness of the result, for stockholders, meant that the cash accumulation strategy "was not a fiduciary wrong" by the defendants.[214]

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

In *Gallagher Industries, LLC v. Addy*,[215] the plaintiff, Gallagher Industries, LLC ("Gallagher"), alleged that the defendants breached their fiduciary duties in connection with a cash-out merger of ISN Software Company ("ISN"). This action was filed after the Delaware Supreme Court affirmed the Court of Chancery's decision in a separate appraisal action brought by two other ISN stockholders, where the Court of Chancery had found the fair value of ISN to be two and half times greater than the merger price.[216] In the *Gallagher* decision, the Court of Chancery, in a post-trial memorandum opinion, found that Gallagher's claim for breach of fiduciary duty was barred by laches because Gallagher was on inquiry notice of its claims over five years before commencing this action.

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

In 2012, prior to Gallagher's acquisition of ISN stock, ISN had only one other outside investor, Ad-Venture Capital Partners, L.P. ("Ad-Venture"). Ad-Venture's controller, Brian Addy (William Addy's brother), sought to acquire certain ranch properties owned by a Gallagher affiliate (the "Ranch Properties") in exchange for shares of ISN stock. As part of that transaction, Ad-Venture agreed to pay Gallagher the difference between the value of the ISN shares and $5.2 million, should Gallagher ultimately receive less than that amount for the shares.

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

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

On January 16, 2013, ISN sent the stockholders a notice of their appraisal rights (the "Notice") and supplemented

209 *Id.*
210 *Id.*
211 *Id.* at *37.
212 *Id.* at *41.
213 *Id.* at *43.
214 *Id.*
215 2020 WL 2789702 (Del. Ch. May 29, 2020).

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

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the Notice with certain disclosure documents, including additional financial information. Although the Notice purported to inform the stockholders how ISN calculated the merger consideration, ISN did not provide stockholders with the Phalon Valuation, the company's adjustments to the Phalon Valuation, or the January 9 board meeting minutes, which William Addy testified were all necessary to understand the merger consideration calculation.

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

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

Gallagher's counsel sent Loftus copies of the Court of Chancery's decision in the Appraisal Action and the Supreme Court's order affirming the Court of Chancery on December 15, 2017. Loftus and Mr. Gallagher stated that they first became aware of the facts supporting Gallagher's breach of fiduciary duty claims after reading those decisions. Gallagher filed its action on February 14, 2018, alleging that William Addy and another ISN director-officer "breached their fiduciary duties by providing false and misleading disclosures regarding the Merger."[217]

Following trial, the Court found that although the defendants had breached their fiduciary duties in connection with the merger, Gallagher "slept on its rights for a half-decade while red flags not only were raised but snapped crisply in the breeze."[218] The Court determined that the defendants' breaches were apparent when Gallagher received the Notice in January 2013, and Gallagher was on inquiry notice at that time. At trial, Loftus stated that he did not believe that the defendants provided adequate information for him to prepare a valuation and that he discussed this concern with Mr. Gallagher when they received the Notice. Loftus' own rough calculations of ISN's value fell between $250 million to $350 million, and while negotiating the sale of the Ranch Properties, Ad-Venture estimated ISN's value to be between $395 million and $450 million. The Court noted that "Gallagher suspected it was being wronged, and knew it had not been provided the information to find out if this was so. That was a red flag that reasonably ought to have alerted it to the possibility that the Merger was unfair, and the disclosures were inadequate, and thus alerted it of potential entire fairness and disclosure-based claims."[219] Once Gallagher received the Notice, it "had an obligation to diligently investigate and was on notice of everything to which such an investigation would have led."[220]

The Court also found that the Appraisal Action provided Gallagher with additional inquiry notice of its claims, noting that "[e]ven casual attention to the public filings would have revealed further red flags to notify Gallagher of the facts underlying this litigation."[221] Therefore, Gallagher's breach of fiduciary duty claim was barred by latches because it was on inquiry notice over three years before it filed this action.

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

218 *Id.* at *10.

219 *Id.*

220 *Id.* at *14.

221 *Id.* at *15.

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

In *Morrison v. Berry*,[222] the Court of Chancery granted and denied certain motions to dismiss directed to claims of aiding and abetting breaches of fiduciary duties. The Court dismissed aiding and abetting claims as to three of the four alleged aider and abettor defendants. The opinion emphasizes the high pleading burden applicable to abetting claims—requiring that plaintiffs plead facts making it reasonably conceivable that the aider and abettor acted with scienter, in order to withstand a motion to dismiss. The case also serves as a reminder of the importance of disclosing potential advisor conflicts to boards in connection with sale transactions. As to the one alleged aider and abettor for which the Court denied a motion to dismiss—a target board's financial advisor—the Court concluded the plaintiff had satisfied its high pleading burden to demonstrate scienter.

The claims arose from a going-private transaction involving Fresh Market, Inc. ("Fresh Market"). Prior to the transaction, Fresh Market's CEO, Ray Berry, together with his son Brett Berry (together, the "Berrys"), held 9.8% of the company's equity. The going-private transaction involved the acquisition of Fresh Market by Apollo Management VIII, L.P. ("Apollo" or the "Apollo Defendants"),[223] with a rollover of the Berrys' existing equity in Fresh Market so that post-transaction the Berrys' owned approximately 22% of the company's equity. J.P. Morgan served as Fresh Market's financial advisor and Cravath, Swaine & Moore, LLP ("Cravath") served as the company's counsel in connection with the transaction. The plaintiff alleged breach of fiduciary duty claims against the Fresh Market officers and directors who negotiated and approved the transaction and alleged claims for aiding and abetting against Brett Berry, Apollo, J.P. Morgan, and Cravath.

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

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

With respect to the aiding and abetting claim asserted against J.P Morgan, the Court cited the Delaware Supreme Court's decision in *RBC Capital Markets, LLC v. Jervis*[224] for the proposition that aiding and abetting liability may attach where a board "advisor, with the requisite scienter, caused the board to act in a way that made the transaction process itself unreasonable, under the situational reasonableness standard announced in *Revlon* and its progeny."[225] "In other words, where a conflicted advisor has prevented the board from conducting a reasonable sales process, in violation of the standard imposed on the board under *Revlon*, the advisor can be liable for aiding and abetting that breach without reference to the culpability of the individual directors."[226] Thus, even if the board acted in good faith and in reliance on its advisors, the advisor can be liable for aiding and abetting a breach of fiduciary duty.

Applying the *RBC* standard, the Court of Chancery denied J.P. Morgan's motion to dismiss. The first step in determining whether J.P. Morgan could be liable for aiding and abetting a breach of fiduciary duty was to evaluate whether Fresh Market's board failed to ensure that the transaction complied with *Revlon*. Before the board made a decision on the transaction, J.P. Morgan provided the board with a memorandum in which it discussed J.P. Morgan's relationship with Apollo and represented that the J.P. Morgan senior deal

222 2020 WL 2843514 (Del. Ch. June 1, 2020).

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

224 129 A.3d 816 (Del. 2015).

225 *Morrison*, 2020 WL 2843514 at *9 (citing *RBC Cap. Mkts., LLC v. Jervis*, 129 A.3d 816, 849-50 (Del. 2015)). Under *Revlon, Inc. v. MacAndrews & Forbes Hldgs., Inc.*, 506 A.2d 173 (Del. 1986), and its progeny, in the context of a sale of a company, "the defendant fiduciaries bear the burden of proving that they 'act[ed] reasonably to seek the transaction offering the best value reasonably available to the stockholders,' which could be remaining independent and not engaging in any transaction at all." *In re Rural Metro Corp. S'holder Litig.*, 88 A.3d 54, 83 (Del. Ch. 2014) (quoting *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 43 (Del. 1994)).

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

team members assigned to the transaction were not providing services to Apollo and were not members of the J.P. Morgan coverage team for Apollo. J.P. Morgan did not disclose that during the negotiations between the company and Apollo, Apollo's client executive at J.P. Morgan was communicating with both the J.P. Morgan deal team and Apollo and was "feeding inside information on the bid process to Apollo" and advocating for Apollo.[227] The Court found that, while the board's acceptance of J.P. Morgan's conflict disclosure without asking probing questions of J.P. Morgan on potential conflicts may not have been in bad faith or a breach of the directors' duty of loyalty, there was a reasonable inference that "the Board's failure to comprehend its financial advisor's conflict of interest with the sole bidder conceivably breached duties imposed in the *Revlon* context."[228]

Having found that the plaintiff sufficiently pled that the board failed to comply with its *Revlon* duties, the Court turned to evaluate whether the plaintiff pled facts from which it could be inferred that J.P. Morgan aided and abetted such a breach. The Court concluded that the plaintiff had adequately alleged that J.P. Morgan failed to disclose to the board that it had engaged in the back-channel communications with Apollo, which back-channel communications the Court inferred "influenced the bid process in Apollo's favor."[229] This fact supported the inference that "J.P. Morgan intentionally disguised its communications with Apollo and thus knowingly deceived the Board about its ongoing conflicts[,]" which, if proven on a full record, could establish the scienter requirement of an aiding and abetting claim.[230] The Court also found that the plaintiff adequately pled that J.P. Morgan aided and abetting disclosure violations that constituted a breach of the duty of care. The Court explained that had J.P. Morgan disclosed to the board the back-channel communications, the company could have disclosed the same in its proxy statement and that it was plausible that the company's stockholders would have found that information to be material.

With respect to Cravath, the plaintiff asserted aiding and abetting claims for Cravath's purported assistance in the preparation of an allegedly misleading 14D-9. The Court had in its previous opinion already ruled that the plaintiff had failed to plead that the board intentionally issued a misleading proxy statement. Therefore, the plaintiff was left to make the "difficult argument that Cravath *intentionally and knowingly* caused the Board to *carelessly* draft and release a 14D-9 with material facts omitted."[231] Zeroing in on the scienter requirement, the Court noted that a claim for aiding and abetting "requires adequately pleading actions in bad faith through which the aider knowingly advanced the breach."[232] In an effort to establish that Cravath drafted the allegedly misleading 14D-9 intentionally and knowingly, the plaintiff pointed to Cravath's large transaction fee and significant amount of time spent to determine the content of the 14D-9. These allegations, the Court held, could not establish the requisite scienter—"merely pointing to a fee contingent on closing cannot support a claim for intentional bad-faith aiding and abetting on the part of the lawyers."[233] The Court stated that a "contingent fee and hard work on the proxy are unremarkable."[234]

As to Apollo, the plaintiff's aiding and abetting claims were founded on a predicate breach of fiduciary duty by Fresh Market CEO Ray Berry. In its earlier opinion, ruling on claims for breach of fiduciary duty against the officer and director defendants, the Court concluded that the plaintiff had stated a claim for breach of fiduciary duty against Ray Berry for his "'silence, falsehoods, and misinformation' about his relationship with Apollo in a way that conceivably harmed the Company."[235] But despite this well-pled predicate fiduciary breach by Ray Berry, the Court did not find sufficient allegations of scienter by Apollo to support the plaintiff's aiding and abetting claim. The Court emphasized that the plaintiff failed to allege that "Apollo knew Ray Berry withheld from the board the fact that Apollo had approached him."[236] To the contrary, "Apollo informed the Board no less than *five times* that it had partnered with the Berrys."[237] Thus, given Apollo's repeated disclosures that it contemplated a transaction that involved the Berrys' equity rollover, the Court held it could not "reasonably infer that Apollo knowingly advocated or

227 *Id.* at *5.
228 *Id.* at *10.
229 *Id.*
230 *Id.*
231 *Id.* at *11
232 *Id.*
233 *Id.*
234 *Id.*
235 *Id.* (quoting *Morrison v. Berry*, 2019 WL 7369431, at *22 (Del. Ch. Dec. 31, 2019)).
236 *Id.*
237 *Id.* (emphasis in original).

assisted Ray Berry's deceptive communications with the Board."[238]

The Court again found the necessary scienter pleading requirement unsatisfied with respect to the aiding and abetting claims against Brett Berry. Brett Berry had moved to dismiss the aiding and abetting claims against him, both for lack of personal jurisdiction and for failure to state a claim. The plaintiff alleged that Brett Berry could be subject to personal jurisdiction in Delaware under the conspiracy theory of personal jurisdiction set forth in *Istituto Bancario Italiano SpA v. Hunter Engineering Co.*[239] But for Berry to be subject to personal jurisdiction under the conspiracy theory, the Court stated that the plaintiff must show that Brett Berry "knew or had reason to know" of the conspiracy.[240] Here again, the Court concluded the plaintiff's allegations fell short. The Court emphasized that while Brett Berry may have actively participated in securing the rollover opportunity in the transaction, the plaintiff failed to allege that "Brett Berry knew of his father's fiduciary breaches and intentionally aided him in those breaches."[241] Thus, the Court concluded that the plaintiff's allegations were insufficient to establish the scienter necessary to support an aiding and abetting claim and, therefore, the plaintiff failed to establish the predicate conspiracy necessary to support personal jurisdiction over Brett Berry.

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

In *Massari v. Meyers*,[242] the Delaware Supreme Court affirmed the Court of Chancery's bench ruling dismissing plaintiff's complaint challenging the sale of First Marblehead Corp. ("First Marblehead") to its CEO's "buddy."[243] The Court of Chancery held that, although the plaintiff had alleged that First Marblehead's CEO co-owned a yacht with the company's acquirer—which created a "fulcrum of concern" about the transaction—the plaintiff failed to allege facts challenging the effectiveness of the special committee that was set up to "cleanse" the transaction.

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

The plaintiff did not dispute that the First Marblehead board set up a special committee of independent directors to oversee the process leading to the Buyout. Initially, the committee did not invite the CEO's friend to participate in the process, but after an initial round of outreach to prospective buyers proved unfruitful, the CEO suggested reaching out to his friend. The committee agreed, and the CEO's friend proposed a transaction. The committee then "assert[ed] control over the process," including by conducting "a second market check" to entertain potential topping bids.[244] When no topping bid emerged, the committee recommended the Buyout, and the board unanimously approved it (a majority of stockholders also approved). As part of the transaction, the CEO remained in his position while receiving a substantial equity award as a severance payment.

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

The Court of Chancery dismissed the complaint for two primary reasons. First, the Court rejected the plaintiff's theory that the CEO and other stockholders constituted a control group because the complaint

238 *Id.*

239 449 A.2d 210 (Del. 1982).

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

241 *Id.* at *14.

242 2020 WL 2501435 (Del. May 14, 2020).

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

244 Tr. at 74.

failed to sufficiently plead a control group as required by Delaware law. While the Court did not elaborate on why it found the allegations insufficient or upon what Delaware law it relied to reach that conclusion, the defendants had argued that the Complaint failed to plead that the alleged members of the group were "connected in a legally significant way" by any agreement to act in concert or to exercise control jointly.[245]

Second, the Court rejected the plaintiff's argument that, under the enhanced scrutiny standard of review, "the actions of the board [in pursuing the Buyout] failed to fall within a range of reasonableness."[246] The Court characterized this argument as "the core issue that animates th[e] case," explaining that, "where a co-founder and CEO who is under financial pressure allegedly orchestrates the sale of the company to his good buddy . . . [t]hat's the type of thing that creates a fulcrum of concern."[247] Despite that concern, the Court found that the plaintiff had not "pointed to facts about the sale process which suggest that the CEO acted in a way that this conflict of interest caused [the sale process] to go outside the range of reasonableness."[248] In other words, the plaintiff "failed to allege facts that would make it reasonably conceivable that the involvement of the independent directors did not address the problem and cleanse the conflict."[249]

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

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

In *In re Dell Technologies Inc. Class V Stockholders Litigation*,[250] the Delaware Court of Chancery denied a motion to dismiss the plaintiffs' claims that Michael Dell ("Mr. Dell."), the founder of Dell Technologies Inc. ("Dell"), Silver Lake Group LLC ("Silver Lake"), a Dell stockholder, and four Dell directors breached their fiduciary duties to Dell's Class V stockholders in connection with a stock redemption. The Court held that it was reasonably conceivable that the transaction at issue lacked multiple stockholder protections outlined by the Delaware Supreme Court in *Kahn v. M & F Worldwide Corp.* ("*MFW*")[251] and that, therefore, the transaction was not entitled to business judgment deference.

In 2013, Mr. Dell and Silver Lake took the predecessor company, Dell, Inc. private in a leveraged buyout. Mr. Dell controlled 73% and Silver Lake controlled 23% of Dell's voting power. In 2016, Dell acquired EMC Corporation ("EMC"). One of EMC's most valuable assets at the time of that acquisition was its ownership of 81.9% of the equity in VMware, Inc. ("VMware"). As part of the EMC acquisition, Dell issued Class V common stock that would trade publicly and track the value of Dell's ownership interest in VMware. These Class V shares were subject to a "Forced Conversion" right. That is, if Dell listed its Class C shares on a national exchange, then Dell had the right to convert the Class V shares into Class C shares according to a pricing formula. Allegedly due to this Forced Conversion right, along with Mr. Dell's negative history with public stockholders, the Class V shares traded at a discount of approximately 30% to VMware's publicly traded common stock. The complaint referred to this as the "Dell Discount."[252]

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

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

245 *Id.* at 8.
246 *Id.* at 70.
247 *Id.* at 72.
248 *Id.* at 72-73.
249 *Id.* at 75.
250 2020 WL 3096748 (Del. Ch. June 11, 2020).

251 88 A.3d 635 (Del. 2014).
252 *Dell Class V S'holders Litig.*, 2020 WL 3096748, at *5.

then created a new special committee, consisting of the two other members of the prior committee, and delegated the same authority to the new special committee.

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

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

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

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

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

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

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

The Court first held that it was reasonably conceivable that the transaction did not meet *MFW*'s first condition. "[C]ritical for the application of the business judgment rule is that the controller accept that no transaction goes forward without special committee and disinterested stockholder approval."[253] The Dell board did not delegate authority relating to the Forced Conversion right to the special committee. Without the authority to say no to this alternative, the committee could not prevent the controller from "achieving [his desired] end" through "alternative means."[254] Moreover, the special committee's role under the *MFW* framework is to "act as the bargaining agent for the minority stockholders, with the minority stockholders rendering an up-or-down verdict on the committee's work."[255] The Court reasoned that when the Class V stockholders objected to the Committee-Negotiated Redemption, "the committee's role [was not] over. . . . [T]he committee must return to the bargaining table, continue to act in its fiduciary capacity, and seek to extract the best transaction available."[256] The Court concluded that "*MFW*'s dual protections contemplate that the Special Committee will act as the bargaining agent for the minority stockholders, with the minority stockholders rendering an up-or-down verdict on the committee's work. Those roles are complements, not substitutes. A set of motivated stockholder volunteers cannot take over for the committee and serve both roles."[257]

253 *Id.* at *15.
254 *Id.* at *16.
255 *Id.* at *17.
256 *Id.* at *18.
257 *Id.* at *17.

The Court then held that it was reasonably conceivable that the transaction did not satisfy the sixth condition for *MFW* protection—that "there is no coercion of the minority."[258] The Court took the opportunity to delve deep into what it deemed to be five "strands" of coercion found in the case law.

This first strand involves a non-fiduciary in a contractual setting. The Court rejected the position taken by many defense counsel that *Katz v. Oak Industries, Inc.*[259] establishes a high bar for finding coercion in transactions: "*Katz* did not involve fiduciaries or an alleged breach of fiduciary duty, and it is not an apt source of authority for the fiduciary relationship. As discussed below, under strands of coercion jurisprudence involving fiduciaries, transaction structures resembling the offers in *Katz* are treated as coercive."[260] The second strand involves a *Unocal*[261] setting, where a fiduciary responds to threatened coercion from a third party. The Court found that neither the first nor the second strand applied to the present case.

The remaining three strands involve coercion by a fiduciary and look to whether "the fiduciary has taken action which causes stockholders to act—whether by voting or making an investment decision like tendering shares—for some reason other than the merits of the proposed transaction."[262]

The third strand is direct coercion by a fiduciary. "The operative test for this strand of coercion is whether the fiduciary has taken action which causes stockholders to act—whether by voting or making an investment decision like tendering shares—for some reason other than the merits of the proposed transaction . . . . [I]f the stockholders can reject the transaction and maintain the status quo, then the transaction is not coercive."[263]

The fourth strand of coercion is unique to otherwise cleansing stockholder votes and involves less direct forms of coercion, specifically, in the Court's terms, "situational" and "structural" coercion.[264] Structural coercion occurs when the structure of the transaction itself forces stockholders to endorse an unfair portion of the transaction in order to receive benefits from another portion of the transaction. Situational coercion occurs when the company's or the controller's past malfeasance create a status quo situation that is unattractive for stockholders, coercing them to choose the lesser evil of the transaction. With either form, "if a plaintiff can identify a reasonably conceivable basis to doubt that the stockholders made [the] determination [that the transaction was in their own best interests,] then the vote should not be given cleansing effect."[265]

The fifth strand of coercion is in the context of a special committee and occurs when "a controller's explicit or implicit threats . . . prevent a committee from fulfilling its function[.]"[266]

Applying the tests of the various strands of coercion to the approved Stockholder-Negotiated Redemption, the Court concluded that the plaintiffs adequately alleged the existence of the third through fifth forms of coercion. The plaintiffs alleged that Dell repeatedly made statements to the committee and the public suggesting its intent to exercise its Forced Conversion right, an unfavorable alternative from the perspective of the Class V stockholders. Based upon the allegations in the complaint, the Court held that it was reasonably conceivable that this threat could induce the stockholders to approve an unfair redemption transaction for reasons other than the merits of the transaction. The status quo could not be maintained by rejecting the redemption offer if Dell would move forward with the Forced Conversion. The complaint's allegations also supported a reasonable inference that the stockholders faced situational coercion. Their status quo was owning stock the value of which was subject to an alleged "Dell Discount," and therefore, they faced "an impossible choice between an unappealing status quo and an alternative which, although unfair, was better than their existing situation."[267]

The complaint also alleged that the members of the Special Committee, like the Class V stockholders, were

258 *Id.* at *15.

259 508 A.2d 873 (Del. Ch. 1986).

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

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

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

263 *Id.*

264 *Id.*

265 *Id.* at *29.

266 *Id.*

267 *Id.* at *32.

cognizant of the threatened Forced Conversion when negotiating with the company. The Court held that based on the complaint's allegations, it was reasonably conceivable that Dell's retention and threat of the Forced Conversion right undermined the committee's authority and negotiating power.

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

The Court next held that the complaint pled facts making it reasonably conceivable that the second *MFW* condition—independence of the special committee—was satisfied. The Court found that the plaintiffs sufficiently alleged that neither of the two members of the special committee were independent. With respect to one special committee member, the Court determined that the complaint's allegations that the special committee member's close business ties to Mr. Dell and Silver Lake—including the special committee member being one of three partners in a company that has invested in six companies associated with Mr. Dell and Silver Lake—and his close social ties to the managing partner of Silver Lake—including both belonging to "two of the world's most exclusive and secretive private clubs" and playing together at amateur golf tournaments—"taken as a whole," made it reasonably conceivable that his relationship with Mr. Dell and Silver Lake "compromised his ability to engage in hard-nosed bargaining as a member of the Special Committee."[268]

The Court also found that the complaint sufficiently pled that the other special committee member was not independent because of his "thirty-year friendship and business association with" one of Mr. Dell's closest friends who acted as Dell's "senior advisor" in connection with the events leading up to the Stockholder-Negotiated Redemption.[269] The Court rejected the defendants' argument that the special committee member's relationship with Mr. Dell's friend was irrelevant because the friend was not Mr. Dell or Silver Lake, stating that the "defendants fail to cite any authority that requires a director to have a compromising relationship with the controller himself as opposed to a close advisor or other associate."[270] The Court explained that "[d]rawing such a distinction makes little sense when the advisor acts as the controller's agent."[271] The special committee member "was supposed to be representing the Class V stockholders as their independent bargaining agent in a transaction where . . . his . . . long-time close friend [and business associate] . . . was advising the Company and Mr. Dell on the other side of the negotiating table."[272]

Finally, the Court held that it was reasonably conceivable that the transaction did not meet *MFW*'s fifth condition—a fully-informed vote of the minority. The Court found that the complaint adequately alleged that the proxy statement and supplement issued in connection with the transaction omitted material information or was materially misleading and that, therefore, the stockholder vote was not fully informed. The Court found that it was reasonably conceivable that the proxy statement and supplement excluded material information by not disclosing (i) the special committee's final proposal price, (ii) a valuation the company received three months before the special committee approved the Committee-Sponsored Redemption that allegedly implied a higher price per Class V share than was reflected in the Committee-Sponsored Redemption and the Stockholder-Negotiated Redemption, and (iii) the compensation arrangement of an advisor to the special committee where the advisor was a "one-person firm operated by someone whose entities had a history of financial difficulties."[273] The Court also found that it was reasonably conceivable that the proxy statement and supplement were materially misleading in describing that same advisor as an "independent industry expert" even though, the Court found, the complaint adequately alleged that he lacked experience.

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

268 *Id.* at *36.
269 *Id.* at *37.
270 *Id.*
271 *Id.*
272 *Id.*
273 *Id.* at *40.

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

In *Brokerage Jamie Goldenberg v. Breyer*,[274] the Court of Chancery granted the defendants' motion to dismiss the complaint where the plaintiff did not have standing to bring derivative claims on behalf of a corporation because it was not a stockholder of that corporation at the time of the challenged conduct.

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

The defendants, James W. Breyer, Roderick I. Eddington, James R. Murdoch, K. Rupert Murdoch, Lachlan K. Murdock, Jacques Nasser and Robert S. Silberman, served on the Old Fox board. Rupert, Lachlan and James Murdoch (the "Murdochs") also served as officers of Old Fox. After several months of negotiations with Disney, in December 2017, the Old Fox board determined that Old Fox would proceed with the Disney Transaction. Later that month, the Old Fox Compensation Committee held a call to discuss compensation terms by which certain executives would receive a special grant of restricted stock units ("RSUs") and their performance stock unit ("PSU") awards for the 2016-2018 period would be modified (the "Compensation Terms"). The Compensation Committee ultimately determined that it would support including the Compensation Terms in the merger agreement to be considered by the Old Fox board in connection with the Disney Transaction.[275]

On December 13, 2017, Disney and Old Fox entered into a merger agreement.[276] On February 20, 2018, the Compensation Committee formally approved the Compensation Terms, which included the issuance of 1,943,650 RSUs to certain key employees, 1,500,473 of which were issued to the Murdochs. Old Fox characterized the RSU award as "part of a Company-wide retention program designed to incentivize key employees who might consider leaving Old Fox and its successors due to uncertainty about their future roles to continue their employment through the completion of the [Disney Transaction] and for a period of time thereafter."[277] The Compensation Committee also approved the modification of the PSU award, which provided that the participants in the PSU award program would receive a payout set at a particular performance level.[278] Based on the closing price of Old Fox Class A common stock on the date the Compensation Committee approved the Compensation Terms, the plaintiff alleged that the Murdochs would receive RSUs and PSUs valued at approximately $82.4 million through the approval of the Compensation Terms.[279]

The defendants moved to dismiss the complaint pursuant to Court of Chancery Rules 12(b)(6) and 23.1, arguing that (1) the plaintiff's claims were derivative in nature and therefore the plaintiff did not have standing to bring claims on behalf of New Fox because it was not a stockholder of New Fox at the time the Compensation Terms were approved; (2) the plaintiff failed to make a pre-suit demand on the New Fox board or plead demand futility; and (3) regardless of whether the claims are direct or derivative, the plaintiff failed to state a claim for relief.[280]

The Court found that the plaintiff's claims were derivative in nature and therefore the plaintiff lacked standing to bring them on behalf of New Fox.[281] The Court noted that under the Delaware Supreme Court's decision in *Parnes v. Bally Entertainment Corp.*, "[a] stockholder who directly attacks the fairness or validity of a merger alleges an injury to the stockholders, not the corporation" and therefore may still bring a breach of fiduciary duty claim even if its stockholder status was

274 2020 WL 3484950 (Del. Ch. June 26, 2020).
275 *Id.* at *3.

276 *Id.*
277 *Id.*
278 *Id.* at *4.
279 *Id.* at *5.
280 *Id* at *6.
281 *Id.* at *7.

extinguished by the merger.[282] However, after examining *Parnes* and other notable and related decisions by Delaware courts,[283] the Court found that the plaintiff's claims were derivative "because the Complaint fail[ed] to plead adequately that Defendants caused the terms of the [Disney] Transaction to be tainted by unfair dealing."[284]

Unlike *Parnes* and its progeny, the approval of the Compensation Terms did not "solely benefit a putative controller or a key fiduciary" but instead were broader in scope.[285] The Complaint also did not allege any causal link between the Murdoch's receipt of the RSUs and PSUs and any unfair dealing in connection with the Disney Transaction. Nor did it allege that the Murdochs refused to support the transaction unless the Compensation Terms were approved. Finally, the amount of money that the Murdochs received through the Compensation Terms (approximately $82.4 million) was one-tenth of one percent of the total consideration received by Old Fox stockholders, and was therefore immaterial in the context of Disney Transaction. The Court found "nothing in the Complaint to support the notion that Defendants tainted the sale process or the negotiations of the Transaction such that they caused anything to be taken off the table that otherwise would have gone to all of Old Fox's stockholders" and therefore it found the plaintiff's claims to be derivative in nature.[286]

Because the complaint only stated derivative claims on behalf of New Fox, the plaintiff did not have standing to bring the claims because it was not a stockholder in New Fox at the time the Compensation Committee approved the Compensation Terms. The plaintiff argued that, despite not owning shares in New Fox at the time of the alleged wrongdoing, it should be able to pursue its claims derivatively on behalf of New Fox because the Disney Transaction "effected a reorganization of Old Fox" and therefore fell under the reorganization exception to the continuous ownership requirement.[287] The Court noted that the reorganization "exception applies where the 'surviving entity is merely the same corporate structure under a new name,'" and does "not apply to a transaction that was 'the result of a merger of two distinct corporations each of which had separate boards, officers, assets and stockholders.'"[288] The Court found that the plaintiff did not satisfy this exception because New Fox was "vastly different" than Old Fox—New Fox only had a portion of Old Fox's assets and related liabilities.[289] Because the plaintiff did not have standing to bring derivative claims on behalf of New Fox, the Court granted the defendants' motion to dismiss with prejudice.

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

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

284 *Id.* at *11.

285 *Id.*

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

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

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

289 *Id.*

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

In *City of Fort Myers General Employees' Pension Fund v. Haley,*[290] the Delaware Supreme Court held the Court of Chancery had erred in granting a motion to dismiss a breach of fiduciary duty claim against an inside director where the director was alleged to have, during the course of merger negotiations, failed to disclose material information to the board—specifically, an allegedly "massive" compensation proposal with the post-merger company. While the business judgment rule presumptively applied in this action, the Supreme Court determined that the plaintiffs' allegations had successfully rebutted the presumption. In ruling, the Supreme Court clarified the applicable "materiality" standard and determined that a reasonable board member would have regarded the insider director's material interest in the compensation proposal as a significant fact in evaluating the merger.

In the wake of the 2008 economic crisis, Willis Group Holdings Public Limited Company ("Willis") posted flat earnings, experienced operating margin contraction, and was highly leveraged. ValueAct Capital Management, L.P. ("ValueAct"), which held over ten percent of Willis's outstanding shares by late 2014 and sought to salvage its investment, encouraged Willis to consider strategic alternatives. ValueAct recommended a break-up of Willis or a business combination with Towers Watson & Co. ("Towers"), "which had a robust financial history and outlook that could benefit Willis."[291]

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

290 2020 WL 3529586 (Del. June 30, 2020).
291 *Id.* at *3.

"Haley originally proposed that Towers own the larger proportion of the post-merger company based on Towers' greater market capitalization."[292] At the time, Towers had recently experienced positive quarterly earnings whereas Willis had recently suffered an investment ratings downgrade from Moody's and missed certain earnings targets. "Willis, however, proposed the ownership should be based on certain financial metrics, which would result in Willis's stockholders owning the majority of the combined entity."[293]

On May 14, 2015, Rabbitt contacted a Willis executive "to propose that Haley serve as CEO of the post-merger entity."[294] On May 15, 2015, the Towers Board convened and "effectively left the task of negotiating the Merger to the now-conflicted Haley."[295] Later that month, Haley and Casserley continued discussing the various terms of the transaction, including: (i) the possibility of a pre-merger special dividend totaling $500 million to Towers stockholders to bridge certain financial gaps between the two companies; (ii) the post-merger board composition, and (iii) "an exchange ratio based on the 60-day volume weighted average price ("VWAP") of the shares that would result in Willis's stockholders owning approximately 51 percent of the combined company and Towers' stockholders owning the remaining 49 percent."[296]

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

292 *Id.*
293 *Id.*
294 *Id.*
295 *Id.*
296 *Id.* at *4.

percent discount to Towers' unaffected trading price."[297] At this meeting, the Towers Board unanimously approved the merger, which was conditioned on stockholder approval. Haley participated in the meeting and voted in favor of the merger.

The merger was announced on June 30, 2015. That day, Towers' stock price dropped almost nine percent. Financial analysts were critical of the merger from Towers' standpoint, noting that the merger represented "a nine percent discount on [Towers'] share price" and commenting that "Willis appeared to be extracting more value from the transaction than Towers."[298] Willis's stock price, on the other hand, rose 3.3 percent from the pre-merger trading price and Moody's upgraded Willis's rating outlook to "stable."[299]

In September 2015, in contemplation of Haley becoming the post-merger entity's CEO, ValueAct presented Haley with a compensation proposal (the "ValueAct Proposal"). According to the plaintiffs, the ValueAct Proposal "would increase [Haley's] long-term equity incentive compensation from the approximately $24 million maximum equity compensation that he could have earned in his last three years as Towers' CEO to upwards of $140 million in his first three years as [the combined entity's] CEO."[300]

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

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

To win over stockholder approval, Haley and ValueAct agreed to increase the special dividend to $10.00 per share. According to the plaintiffs, "Haley viewed the $10.00 special dividend not as the best deal he could get for *Towers stockholders* (to whom he owed fiduciary duties) but, rather, as the minimum necessary to secure the Stockholder Approval he needed to *push the Merger* through so he could secure the massive compensation Proposal [ValueAct] had promised him."[301]

On November 17, 2015, the Towers Board convened to discuss the merger. Haley allegedly did not disclose the ValueAct Proposal at this meeting. The next day, "only 43.45 percent of the then-submitted votes of Towers stockholders were 'for' the merger."[302] Later that day, Willis's board of directors agreed to the special dividend subject to eliminating the termination fee for Willis, and increasing the termination fee for Towers. The Towers Board then met and unanimously approved the new terms, subject to receipt of a fairness opinion. Under the revised terms, the merger consideration valued each share of Towers stock at $128.30, a seven percent discount to the unaffected trading price. Driehaus, ISS, and Glass Lewis continued to criticize the deal. On November 27, 2015, Towers filed a proxy update that again omitted any reference to the ValueAct Proposal.

On December 11, 2015, at a special stockholders meeting, 62 percent of the Towers stockholders voted in favor of the merger. On the same day, 95.5 percent of the Willis stockholders voted in favor of the merger. The merger closed on January 4, 2016. In March 2016, the post-merger entity, Willis Towers Watson Public Limited Company ("Willis Towers"), reached an employment agreement with Haley which "differed in some ways from the ValueAct Proposal, but notably, the employment agreement provided more potential upside than the Proposal."[303]

297 *Id.*
298 *Id.* at *5.
299 *Id.*
300 *Id.* at *1.
301 *Id.* at *7.
302 *Id.* at *8.
303 *Id.* at *9.

Following the merger, the plaintiffs filed a complaint in the Court of Chancery alleging breach of fiduciary duty claims against Haley and the Towers Board, and an aiding and abetting claim against ValueAct and its Chief Investment Officer, Jeffrey Ubben. Although the plaintiffs acknowledged that the business judgment rule presumptively applied, they attempted to rebut that presumption by arguing that Haley suffered a "material conflict" as a result of the ValueAct Proposal, that he failed to disclose the conflict to the other directors, and that a reasonable director would have regarded this conflict as significant in evaluating the merger.[304]

The Court of Chancery dismissed the plaintiffs' claims. The Court held that "the alleged failure to disclose the Proposal failed to rebut the business judgment rule because, at bottom, the Towers Board already knew that Haley would become the CEO of the combined company post-merger, that the combined company would be much larger, and thus, the CEO would be entitled to increased compensation."[305] The Court also held that the plaintiffs "failed to establish that a reasonable director would have considered the Proposal to be significant when evaluating the merger."[306]

On appeal, the Delaware Supreme Court reversed the Court of Chancery's decision. The Supreme Court held that the plaintiffs had adequately alleged that "the Proposal altered the nature of the potential conflict that the Towers Board knew of in a material way."[307] In so holding, the Supreme Court noted that the plaintiffs had adequately alleged that "the Board would have found it material that its lead negotiator had been presented with a compensation proposal of having a potential upside of nearly five times his compensation at Towers, and that he was presented with this Proposal during an atmosphere of deal uncertainty and before they authorized him to renegotiate the merger consideration."[308] The Supreme Court added that it "need not look to the stockholder disclosure cases" to determine the materiality standard for a director's duty of disclosure to fellow board members, because the "materiality inquiry is different in the two contexts."[309] Nevertheless, the Supreme Court concluded that Haley's failure to disclose the Proposal to the Towers Board "would be material in either context."[310]

The Supreme Court rejected the defendants' argument that the failure to disclose the ValueAct Proposal could not have been material because it was not binding. The Supreme Court explained that the fact that the ValueAct Proposal "was not a concrete agreement and had milestones requiring 'Herculean' efforts did not relieve Haley of his duty to disclose to the Towers Board the deepening of his potential conflict, particularly in an atmosphere of considerable deal uncertainty."[311] The Supreme Court also rejected the Court of Chancery's reasoning that the failure to disclose the ValueAct Proposal was not material because the ValueAct Proposal's "pie-in-the-sky" targets were unlikely to be achieved.[312] The Supreme Court emphasized that the "materiality" test is a subjective inquiry, not an objective one, and that the plaintiffs had adequately alleged that Haley believed the "upsides" in the ValueAct Proposal were attainable.[313]

The Supreme Court next held that the plaintiffs adequately alleged that Haley failed to inform the Towers Board of his material conflict. While Haley may have kept the Towers Board "generally apprised of negotiations," Haley "allegedly did not disclose that he had received the Proposal and had discussed executive compensation with ValueAct and Ubben."[314] The Supreme Court added that Haley's discussion of the ValueAct Proposal with a Towers officer did not change this result.

Finally, the Court held that the plaintiffs adequately alleged that a reasonable director "would have regarded Haley's material interest in the Proposal as a significant fact in evaluating the merger."[315] In so holding, the Supreme Court pointed to deposition testimony of the Chair of the Towers Board's Compensation Committee in a related appraisal action. The committee chair had testified that "he would have wanted to know that Haley was discussing his compensation at the future company with Ubben and ValueAct."[316] The Supreme Court

304 *Id.* at *10.
305 *Id.*
306 *Id.*
307 *Id.* at *12.
308 *Id.*
309 *Id.* at *13-14.
310 *Id.* at *14.
311 *Id.*
312 *Id.* at *14-15.
313 *Id.* at *15.
314 *Id.* at *16.
315 *Id.*
316 *Id.*

found this information was "significant, particularly given [the director's] position as Chair of the Towers' Compensation Committee."[317]

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

Justice Vaughn filed a dissenting opinion, setting forth his view that a reasonable director would not have considered the undisclosed ValueAct Proposal to be a significant fact in the evaluation of the merger. Justice Vaughn explained that the complaint did not allege any facts suggesting that Haley discussed the ValueAct Proposal with Ubben after ValueAct made the Proposal, and that a single director's testimony that he would have wanted to know that Haley was discussing the Proposal with ValueAct did "not, in [his] mind, rise to the level of a well-pled allegation."[318] Justice Vaughn further noted that the Towers Board was generally aware that Haley stood to receive a significant pay increase as CEO of the combined company, and that the fact that the "ValueAct [Proposal] had the potential of a high payout to Haley did not change or significantly add" to what the Towers Board already knew.[319]

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

In *In re HomeFed Corp. S'holder Litig.*,[320] the Court of Chancery denied the defendants' motions to dismiss former stockholders' claims against the company's directors and controlling stockholder for breaches of fiduciary duty arising from a squeeze-out merger by the controlling stockholder. Although the transaction was formally conditioned on approval by a special committee of the board of directors and on approval of a majority of the minority stockholders, the Court found that the protections of *Kahn v. M & F Worldwide Corp. ("MFW")*[321] did not apply because the controlling stockholder had undermined the *MFW* protections by engaging in substantive transaction negotiations before the *MFW* protections were put in place.

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

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

The principal question before the Court was whether Jefferies, as the controlling stockholder, "commit[ed] to the *MFW* protections before engaging in substantive

317 *Id.*

318 *Id.* at *18.

319 *Id.*

320 2020 WL 3960335 (Del. Ch. July 13, 2020).

321 88 A.3d 635, 644 (Del. Mar. 14, 2014). In *MFW*, the Delaware Supreme Court held that "business judgment is the standard of review that should govern mergers between a controlling stockholder and its corporate subsidiary, where the merger is conditioned *ab initio* upon both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care, and the uncoerced, informed vote of a majority of the minority stockholders." *In re HomeFed Corp. S'holder Litig.*, 2020 WL 3960335, at *8 (citing *MFW*, 88 A.3d at 644).

economic discussions concerning the Transaction."[322] To that end, the parties disputed whether the 2019 transaction, which was conditioned facially on *MFW*'s protections, was part of the original 2017 offer, which occurred before the *MFW*'s protections were put in place. The Court found reasonably conceivable the plaintiffs' argument that the offer Jefferies made in February 2019 was a continuation of the process initiated in December 2017. The Court considered several of the allegations to determine that the final transaction spawned from the 2017 offer, including that: (1) the board stated in March 2018 that the original special committee was never disbanded, but was merely "paused"; (2) Jefferies' discussions with the company's largest minority stockholder continued throughout the eleven-month pause; and (3) the February 2019 offer had the same essential terms as the 2017 offer, namely the 2 to 1 share exchange.

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

Expounding on *In re Dell Technologies Inc. Class V Stockholders Litigation* ("*Dell*"),[323] the Court also rejected the idea that the claims should be subject to a pleading-stage dismissal because the discussions, which *preceded* enactment of the dual protections, occurred between the controller and a minority stockholder who lacked authority to bind the company. "In *Dell*, the Court held that defendants were not entitled to dismissal under *MFW* where the controller bypassed the special committee" to negotiate directly with stockholders *after* the *MFW* protections were put into effect.[324] In the present case, the Court explained that the controller's negotiations directly with a minority stockholder *prior* to the special committee's activation undermined the effectiveness of the special committee as much as if those negotiations followed activation of a formally authorized special committee, as they did in *Dell*. Thus, the Court concluded that the complaint sufficiently alleged that Jefferies failed to satisfy *MFW*'s conditions and that Jefferies "anchored the negotiations and undermined the Special Committee's ability to bargain effectively as the minority stockholders' agent."[325]

The two director defendants who were not senior employees of Jefferies[326] also argued that they were protected by a Section 102(b)(7) exculpatory provision in HomeFed's certificate of incorporation and that, therefore, the claims should be dismissed against them under *In re Cornerstone Therapeutics Inc. Shareholder Litigation*.[327] The Court found that the plaintiffs pleaded facts supporting a rational inference that, by voting to approve the transaction, the two director defendants acted to advance Jefferies' interests, and could not be presumed to act independently. In so holding, the Court considered allegations against the directors that when they cast their votes: (i) one director was serving as an executive officer of HomeFed; (ii) another director had been receiving consulting fees from HomeFed as his sole employment apart from serving as a HomeFed director; and (iii) "two of their fellow directors had questioned their independence."[328] The Court noted that while "the presence of a controller does not alone overcome the presumption of director independence, it is relevant when considering [the] [p]laintiffs' allegations holistically."[329]

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

323 2020 WL 3096748, at *17 (Del. Ch. Jun. 11, 2020).

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

325 *Id.* at *11.

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

327 115 A.3d 1173 (Del. 2015). "When a director is protected by an exculpatory charter provision, a plaintiff can survive a motion to dismiss by that director defendant by pleading facts supporting a rational inference that the director harbored self-interest adverse to the stockholders' interests, acted to advance the self-interest of an interested party from whom they could not be presumed to act independently, or acted in bad faith." *In re HomeFed Corp. S'holder Litig.*, 2020 WL 3960335, at *12 (citing *Cornerstone*, 115 A.3d at 1179-80).

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

329 *Id.*

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

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

In *In re MetLife Inc. Derivative Litigation.*,[330] the Court of Chancery granted the defendants' Rule 23.1 motion to dismiss, holding that the plaintiffs' failure to make pre-suit demand on the company's board of directors was not excused. In doing so, the Court held that the only argument advanced by the plaintiffs as to why demand was excused—that a majority of the board faced a substantial likelihood of liability under *In re Caremark International Inc. Derivative Litigation* ("*Caremark*")[331] regarding the matters raised in the complaint and were therefore incapable of making a decision on whether the company should pursue litigation—was not sufficiently plead. This case is the latest to demonstrate that, although stockholder plaintiffs have managed to survive dismissal of *Caremark* claims on a handful of occasions over the past two years,[332] pleading a *Caremark* claim remains "among the hardest to plead and prove" under Delaware law.[333]

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

MetLife would acquire the addresses for the beneficiaries from the beneficiaries' employers when it obtained the pension obligations, but MetLife did not maintain any sort of contact with beneficiaries, seek updated contact information, or verify the addresses received from the employers. When a beneficiary reached age 65, MetLife would send its first letter to the address on file. If MetLife did not receive a response to the first letter, "it presumed the [beneficiary] had deferred retirement benefits beyond the normal retirement date."[334] At age 70 and a half, MetLife would send a second letter. If MetLife did not receive a response to the second letter, "it labeled the [beneficiary] 'Presumed Dead' and released funds associated with that [beneficiary] from the reserve accounts."[335] "MetLife made no follow-up efforts to confirm these presumptions, even if the letters were returned undeliverable."[336]

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

330 2020 WL 4746635 (Del. Ch. Aug. 17, 2020).

331 698 A.2d 959 (Del. Ch. 1996). To carry out one's duties under *Caremark*, "a director must make a good faith effort to oversee the company's operations." *Marchand v. Barnhill,* 212 A.3d 805, 820 (Del. 2019). To establish liability under *Caremark*, a plaintiff must establish either one of two prongs: "(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention." *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

332 *See Marchand*, 212 A.3d 805; *In re Clovis Oncology Inc. Derivative Litig.*, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019); *Inter-Marketing Grp. USA, Inc.*, 2020 WL 756965 (Del. Ch. Jan. 31, 2020); *Hughes v. Hu*, 2020 WL 1987029 (Del. Ch. Apr. 27, 2020); *Teamsters Local 443 Health Servs. & Ins. Plan v. Chou*, 2020 WL 5028065 (Del. Ch. Aug. 24, 2020).

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

334 *Id.*

335 *Id.*

336 *Id.*

the New York State Department of Financial Services, and disclosed an inquiry by the United States Securities and Exchange Commission.

The plaintiffs, who were MetLife stockholders, filed a derivative complaint in September 2019. The plaintiffs alleged that the defendants, several then-current and former directors and officers of Metlife, breached their fiduciary duties under *Caremark* by consciously disregarding red flags about the two-letter notice system, resulting in reputational and monetary harm to MetLife. The plaintiffs also alleged unjust enrichment against all defendants and corporate waste against the director defendants for the salaries and bonuses they received while allegedly violating their *Caremark* duties.

The plaintiffs argued that pre-suit demand was futile under *Rales v. Blasband*[337] because a majority of the board faced "a substantial likelihood of liability for their role in MetLife's improper misconduct."[338]

The Court granted the defendants' motion to dismiss for failure to plead demand futility. The Court explained that, under *Rales*, the plaintiffs must plead "particularized factual allegations creating a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand."[339] The Court held that the plaintiffs failed to do so. The Court began its analysis by noting that "a *Caremark* claim is among the hardest to plead and prove."[340] The Court further explained that because MetLife's certificate of incorporation contained a 102(b)(7) exculpation provision for breaches of the duty of care, in order to prove demand futility, the plaintiffs would need to plead particularized facts showing that a majority of the board violated their *Caremark* duties in bad faith.

The Court then considered two categories of alleged red flags raised by the plaintiffs to support their argument that the demand board faced a substantial likelihood of liability for violating their *Caremark* duties.[341] The first group of alleged red flags related to regulatory inquiries and securities litigation against MetLife in 2011 and 2012. However, the 2011 and 2012 regulatory inquiries and securities litigation were directed at MetLife's life insurance business and related to the tracking of insureds' deaths and the payment of death benefits to beneficiaries upon the death of the insured, not the Pension Risk Transfer Business, where pension payments to beneficiaries would cease upon the beneficiaries' death. Although the Court agreed with the plaintiffs that MetLife's life insurance and Pension Risk Transfer Business were analogous business lines, the Court found that there was nothing in the regulatory inquiries or litigation that put those aware of them on "direct notice of deficiencies in the Pension Risk Transfer Business. . . ."[342]

The Court determined that it was not bad faith for the board to fail to implement into the Pension Risk Transfer Business the new procedures that MetLife adopted for identifying beneficiary deaths in the insurance business as part of a settlement to resolve the regulatory inquiries,

337 634 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.)

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

339 *Id.* (internal quotations omitted).

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

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

342 *Id.* at *15.

even if such a decision was unwise. Further, the Court noted that there were insufficient allegations to find that a majority of the board was aware of the regulatory actions. In doing so, the Court rejected the plaintiffs' argument that it was highly likely that the board knew of the regulatory actions, stating that the Court has "generally rejected constructive knowledge of unlawful conduct as a theory in demand futility cases."[343]

Although four members of the board—a minority—were named defendants in the securities litigation concerning the same issues as the regulatory actions, there was no indication that those directors disclosed the lawsuit or the regulatory actions to other members of the board. The Court concluded that the plaintiffs "require[d] too many attenuated inferences to transverse from regulatory guidance and settlements on the part of [MetLife], to bad faith on the part of any director with regard to the Pension Risk Transfer Business."[344]

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

The Court concluded that the plaintiffs failed to sufficiently plead that the board "was aware of red flags and ignored them in bad faith."[345] The Court stated that "[c]learly, the Board had notice of the DOL investigation and the Pilot Program in January 2018, and MetLife identified, disclosed, and responded to the problem."[346] With respect to the internal auditor report, the Court stated that the question is not whether the directors "could have saved the Company from embarrassment, fines and securities litigation had the Board been informed of weaknesses at the time of the Internal Auditor Report, and taken prompt action."[347] Rather, the question is whether the directors acted in "conscious disregard of their duties."[348] The Court held that a "failure to undertake immediate remediation of a reported defect, even where immediate action would be wise, is not evidence of bath faith unless it implies a need to act so clear that to ignore it implies a conscious disregard of duty" and that "[s]uch a failure, obviously, can only occur with knowledge of the defect."[349] The Court noted that "[t]he allegation closest to stating indifference in the face of a duty to act is that the Audit Committee failed to ensure that the remediation called for in the Internal Auditor's Report was implemented, and its failure to bring the Internal Auditor's Report to the attention of the full Board."[350] However, to the extent this lack of action implied a duty to act, it "would taint only a minority of the Demand Board" as only three members were on the audit committee.[351]

The Court also held that the plaintiffs failed to establish demand futility with respect to the unjust enrichment and waste claims because both of those claims were premised on the underlying *Caremark* claims. The Court explained that the unjust enrichment claims were "conceived as a form of additional damages dependent on the plaintiff proving the oversight claim[.]"[352] As a result, the Court determined that because the plaintiffs failed to show that a majority of the board faced a substantial likelihood of liability in connection with the *Caremark* claims, it must conclude the same with respect to the unjust enrichment and waste claims.

343 *Id.* (citing *Horman v. Abney*, 2017 WL 242571, at *7 (Del. Ch. Jan. 19, 2017)).
344 *Id.* at *16.
345 *Id.* at *18.
346 *Id.* at *17.
347 *Id.* at *18.
348 *Id.*
349 *Id.*
350 *Id.* at *18 n. 228.
351 *Id.*
352 *Id.* at *18 (quoting *Hughes v. Hu*, 2020 WL 1987029, at *17 (Del. Ch. Apr. 27, 2020)).

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

In *In re Coty Inc. Stockholder Litigation*,[353] the Court of Chancery denied a motion to dismiss breach of fiduciary duty claims against the directors of Coty Inc. ("Coty") and affiliates of its alleged controller in connection with a tender offer by the alleged controller. In doing so, the Court rejected an abstention defense by directors who did not participate in the board vote to recommend the tender offer, holding that it was reasonably conceivable that those directors "did not totally abstain from the process by which the Tender Offer was approved."[354] The Court also rejected the defendants' argument that there was no harm to stockholders who continued to own stock after the tender offer because, accepting the plaintiffs' allegations that the purported controller—a holder of 40 percent of the outstanding shares—controlled the corporation prior to the tender offer, the tender offer did not change how the stockholders were situated (*i.e.*, they were minority stockholders of a controlled corporation both before and after the tender offer). The Court reasoned that it could not, on a motion to dismiss, rule out the possibility that the remaining stockholders "suffered harm when [the alleged controller] secured mathematical control of Coty through the Tender Offer."[355]

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

In February 2019, JAB sent a letter informing the Coty board that a JAB affiliate planned to launch a tender offer to acquire up to 150 million shares of Coty at $11.65 per share. The proposed tender offer was "conditioned on the independent directors of the Company approving the Tender Offer and recommend[ing] that the Company's shareholders accept the Tender Offer."[356]

JAB launched the tender offer the day after JAB sent the letter to the board. Coty's board formed a special committee consisting of three of the four Outside Directors to evaluate the tender offer. JAB refused to negotiate a price increase for the tender offer but agreed to enter into a stockholders agreement with "provisions that were intended to protect Coty's minority shareholders."[357]

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

In May 2019, Coty stockholders filed suit challenging the tender offer. The defendants moved to dismiss under Rule 12(b)(6) for failure to state a claim, raising two notable arguments: (1) whether the complaint "state[d] a claim for breach of fiduciary duty against the JAB Directors" even though they did not participate in the board vote; and (2) whether the complaint sufficiently alleged that the tender offer harmed the stockholders who continued to own stock after the tender offer by virtue of JAB obtaining mathematical control over Coty.[358] The Court answered each in the affirmative, and denied the motion to dismiss.

First, the Court determined that the plaintiffs stated a claim for breach of fiduciary duty against the JAB Directors even though the JAB Directors had recused themselves from the board vote to recommend the transaction. Relying on *In re Tri-Star Pictures, Inc., Litigation*,[359] the JAB Directors argued that the claims against them should be dismissed since they did not serve on the special committee or participate in the board vote. The Court noted that in *Tri-Star*, the Court of Chancery stated that "Delaware law clearly prescribes that a director who plays *no role* in the process of deciding whether to approve a challenged transaction cannot be held liable on a claim that the board's decision to approve that transaction was wrongful."[360] The

353 2020 WL 4743515 (Del. Ch. Aug. 17, 2020).

354 *Id.* at *10.

355 *Id.* at *14.

356 *Id.* (internal quotations omitted).

357 *Id.* at *5.

358 *Id.* at *7.

359 1995 WL 106520, at *2 (Del. Ch. Mar. 9, 1995).

360 *In re Coty Inc.*, 2020 WL 4743515, at *9 (quoting *Tri*

Court stated that an abstention defense often requires development of the factual record and, therefore, is difficult to apply on a motion to dismiss, noting that *Tri-Star* itself was decided on summary judgment. The Court further explained that in *Voigt v. Metcalf*,[361] the Court of Chancery held that directors "were not entitled to dismissal at the pleading stage simply because they recused themselves from the board's discussion of the challenged transaction and abstained from voting on the deal."[362] Although the JAB Directors recused themselves from the vote, the recommendation statement issued in connection with the tender offer suggested that the JAB Directors participated in the board meeting before the vote, "unlike the directors in *Tri-Star* and *Voigt*."[363] The Court ultimately denied the JAB Directors' motion to dismiss, explaining that, based on the facts alleged, "it [was] reasonably conceivable that the JAB Directors did not totally abstain from the process by which the Tender Offer was approved," and a "fact-specific analysis" was required.[364]

Second, the Court rejected the defendants' argument that the claims should be dismissed as to stockholders who continued to hold shares after the tender offer because they were not harmed by the tender offer. Specifically, the defendants argued that, "accepting as true Plaintiffs' allegation that JAB controlled Coty before the Tender Offer as the holder of approximately 40% of its shares, the stockholders who continued to own stock in Coty after the Tender Offer were not harmed because they were not differently situated than they were before the Tender Offer."[365] The Court explained that the defendants' argument was derived from "well-settled" Delaware law holding that a stockholder that owns less than a majority of the voting power but "exercises control" owes fiduciary duties.[366] However, the Court further explained that "[t]his legal framework does not mean that a *de facto* controller may not obtain real benefits from securing mathematical control of a corporation in a transaction and, as a corollary, that other stockholders of the corporation potentially may suffer harm as a result of such a transaction."[367] The Court recognized the potential harm for loss of a control premium,[368] determined that it could not "rule out at this stage of the case" that the stockholders "suffered harm when JAB secured mathematical control of Coty through the Tender Offer," and denied the motion to dismiss.[369]

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

In *Teamsters Local 443 Health Services & Insurance Plan v. Chou*,[370] on a motion to dismiss, the Court of Chancery held that the plaintiff stockholders had adequately pleaded a *Caremark*[371] claim based on the defendant directors' alleged failure to exercise their oversight and monitoring obligations as to an indirect, wholly-owned subsidiary's drug distribution operations. Despite acknowledging that a *Caremark* claim "is among the most difficult of claims in the Court to plead successfully[,]"[372] *Chou* represents the latest in a string of recent decisions permitting *Caremark* claims to survive past the pleading stage.[373]

Star, 1995 WL 106520, at *2).

361 2020 WL 614999, at *1 (Del. Ch. Feb. 10, 2020).

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

363 *Id.*

364 *Id.*

365 *Id.*

366 *Id.*

367 *Id.*

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

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

370 2020 WL 5028065 (Del. Ch. Aug. 24, 2020).

371 *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996). To carry out one's duties under *Caremark*, "a director must make a good faith effort to oversee the company's operations." *Marchand v. Barnhill*, 212 A.3d 805, 820 (Del. 2019). To establish liability under *Caremark*, a plaintiff must establish either one of two prongs: "(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention." *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

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

373 *See Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019); *In re Clovis Oncology Inc. Derivative Litig.*, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019); *Inter-Marketing Grp. USA, Inc.*, 2020 WL 756965 (Del. Ch. Jan. 31, 2020); *Hughes v. Hu*, 2020 WL 1987029 (Del. Ch. Apr. 27, 2020).

The plaintiffs, stockholders in AmerisourceBergen Corporation ("ABC"), alleged certain *Caremark* claims against seven members of ABC's board of directors.[374] The plaintiffs alleged that the director defendants breached their fiduciary duties by failing to oversee the operations of Oncology Supply Pharmacy Services ("Pharmacy"), an indirect wholly-owned subsidiary of ABC, by ignoring "red flags" and permitting "a woefully inadequate reporting system with respect to the business line in which Pharmacy operated" to exist.[375]

"Pharmacy's sole function was to create pre-filled syringes of oncology drugs for sale and distribution to health care providers" (the "Pre-Filled Syringe Program").[376] Pharmacy would create the pre-filled syringes "by removing FDA-approved drug products from their original glass vials and repackaging them into single-dose plastic syringes."[377] This process would leave a small amount of drug product left in the original glass vial, known as "overfill," which was not intended for patient use. Pharmacy would then combine the overfill from multiple vials and repackage this "pooled excess drug product" into new syringes, allowing Pharmacy to create and sell more doses than it bought from the original drug manufacturers. Such a process "resulted in some syringes containing particulate or foreign matter" that led to over 32,000 contaminated doses being sold.[378] This practice violated FDA regulations.

Aided with documents obtained in a books and records proceeding under Section 220 of the Delaware General Corporation Law, the plaintiffs claimed that the ABC board "consciously failed to implement and monitor compliance policies and systems and failed to exercise their oversight responsibilities."[379] The plaintiffs further alleged that the director defendants ignored multiple "red flags" that "signaled to the Board that ABC was engaged in illegal conduct in operating the Pre-Filled Syringe Program."[380]

Those alleged red flags included a report from a law firm that had been hired in 2007 to review compliance controls within the company and its subsidiaries. The law firm report indicated that "ABC had no centralized compliance and reporting structure, that there was inadequate documentation and tracking compliance and ethics processes, and that there was inadequate accountability for compliance violations at ABC."[381] According to the plaintiffs, another red flag occurred via a former ABC executive's 2010 *qui tam* action challenging the legality of the Pre-Filled Syringe Program. Prior to his termination, the former executive had raised concerns that the program raised serious compliance concerns to ABC officers and directors. According to the former executive, the ABC board engaged outside counsel to conduct a review of the company's compliance procedures, and the outside counsel made a presentation to the audit committee. But the outside counsel's "findings and recommendations were not presented to ABC's full Board, and neither the Board nor the Audit Committee received subsequent reports on the . . . Pre-Filled Syringe Program."[382]

In its analysis, the Court recognized that "when a company operates in an environment where externally imposed regulations govern its mission critical operations, the board's oversight function must be more rigorously exercised."[383] Keeping in mind this "concept of mission critical compliance risk" that emanates from the Supreme Court of Delaware's decision in *Marchand v. Barnhill*,[384] the Court of Chancery held that because "regulations governing drug health and safety" were matters of "mission critical compliance risk[s],"[385] the plaintiffs had adequately alleged that the director defendants had "consciously ignored red flags rising to

374 The plaintiffs also alleged breach of fiduciary duty and unjust enrichment claims against certain officer defendants based on factual allegations that were "congruous" with those alleged in the plaintiffs' Caremark claims. *Chou*, 2020 WL 5028065 at *26. Because the Court found that demand was excused as to the plaintiffs' Caremark claim, the Court similarly held that demand was excused for the breach of fiduciary duty and unjust enrichment claims. Id.

375 *Id.* at *2.

376 *Id.* at *3.

377 *Id.* at *4.

378 *Id.* at *5.

379 *Id.* at *14.

380 *Id.* at *19.

381 *Id.*

382 *Id.* at *12.

383 *Id.* at *18 (internal quotation marks omitted) (quoting *In re Clovis Oncology, Inc. Derivative Litig.*, 2019 WL 4850188, at *13 (Del. Ch. Oct. 1, 2019)).

384 212 A.3d 805 (Del. 2019).

385 *Chou*, 2020 WL 5028065, at *18.

the level of bad faith."[386] Accordingly, the Court denied the director defendants' motion to dismiss.

In so ruling, the Court found that the plaintiffs had adequately pled that the director defendants were "on notice of gaps" in ABC's subsidiary's (and Pharmacy's grandparent entity's) compliance following the law firm report.[387] The Court rejected the director defendants' argument that some efforts had been implemented to increase oversight in response to the report. The Court found that the company's audit committee never received any reports specifically addressing the Pre-Filled Syringe Program and that the director defendants had not shown that they took any actions "concerning [the] mission critical drug health and safety regulations[]" recommended by the report.[388] As a result, the Court also found that it was reasonably conceivable that the law firm report "represent[ed] a red flag regarding [ABC's subsidiary's] compliance failures and a potential void permitting illegal activity[.]"[389]

The Court further found that the plaintiffs had adequately pled that the director defendants knew of the former executive's allegations contained in the *qui tam* action but "ignored such concerns in bad faith by failing [to] take action regarding the operation of the Pre-Filled Syringe Program in response."[390] In so finding, the Court noted that "the Board *did* sign ABC's 2010 and 2011 Form 10-Ks that disclosed [the former executive's] *qui tam* suit" as well as ABC's 2012 Form 10-K, which disclosed a DOJ subpoena and FDA search warrant that ABC believed related to the *qui tam* suit.[391] Moreover, the plaintiffs' allegations as to the *qui tam* suit were "sufficient to reasonably infer that the Board consciously ignored red flags regarding the Pre-Filled Syringe Program and its attendant mission critical compliance risks."[392]

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

386 *Id.* at *17.
387 *Id.* at *20.
388 *Id.*
389 *Id.*
390 *Id.* at *24.
391 *Id.* at *21.
392 *Id.* at *24.

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

In *In re USG Corp. Stockholder Litigation*,[393] the Court of Chancery found that an inadequate proxy disclosure foreclosed the application of *Corwin v. KKR Financial Holdings, LLC*[394] to cleanse defendant directors' alleged breach of fiduciary duty in approving an acquisition, but nonetheless granted the defendant directors' motion to dismiss, holding that the stockholder plaintiffs had failed to plead a non-exculpated claim for breach of fiduciary duty. In so ruling, the Court emphasized that, where a plaintiff pleads facts sufficient to overcome a *Corwin* defense, the plaintiff has not "necessarily cleared the bar of pleading bad faith[.]"[395] The Court explained, "Doctrinally, . . . the concept of bad faith, and the determination of adequate disclosure for *Corwin* purposes, are fundamentally separate."[396] The Court also stated that where defendants are exculpated from monetary liability absent a breach of the duty of loyalty or bad faith, it is not sufficient for a plaintiff to plead that defendants failed to act reasonably to maximize value in a change of control transaction in accordance with *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[397] Rather, a plaintiff must "plead facts that make it reasonably conceivable" that the defendants' failure to do so was "tainted by interestedness or bad faith."[398]

This case arose out of the acquisition of USG Corporation ("USG") by Gebr. Knauf KG ("Knauf"). At the time of the transaction, Knauf beneficially owned approximately 10.6% of USG's outstanding common stock. In March of 2017, Knauf contacted Berkshire Hathaway, the beneficial owner of approximately 31.1% of USG's outstanding common stock, regarding a

393 2020 WL 5126671 (Del. Ch. Aug. 31, 2020).
394 125 A.3d 304, 305-06 (Del. 2015) (affirming holding that "the business judgment rule is invoked as the appropriate standard of review for a post-closing damages action when a merger that is not subject to the entire fairness standard of review has been approved by a fully informed, uncoerced majority of the disinterested stockholders").
395 *USG Corp.*, 2020 WL 5126671, at *1.
396 *Id.*
397 506 A.2d 173 (Del. 1986).
398 *USG Corp.*, 2020 WL 5126671 at *2, *29.

potential acquisition of USG and learned that Berkshire Hathaway was willing to sell its USG stock for about $40 per share. In November of 2017, Knauf delivered a proposal to USG to acquire all outstanding shares of USG for $40.10 per share in cash. USG's board of directors determined that the offer was inadequate and rejected the offer. In March of 2018, Knauf submitted a revised offer of $42 per share and threatened to approach USG's stockholders directly. Again, the board rejected Knauf's offer.

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

In the following months, Knauf's campaign against USG's director nominees proved successful, and the parties continued to exchange offers. During this time, USG solicited offers for other potential buyers, none of which proved fruitful. On June 5, 2019, Knauf presented its "best and final" offer of $44.00 per share, and on June 10, USG's board unanimously approved the offer. USG then released a proxy statement in connection with the acquisition, and USG's stockholders voted to approve the transaction.

Following the acquisition, the plaintiffs filed suit, asserting a breach of fiduciary duty claim against each member of USG's board at the time of the transaction. The plaintiffs alleged the board failed to obtain the highest value available and that the process was "infected by both a conflicted controlling stockholder (Knauf) and approved in bad faith by an interested (and/or non-independent) Board."[399] The plaintiffs also alleged USG's proxy statement was materially misleading. The defendants moved to dismiss the claim, arguing Knauf was not a controlling stockholder, and that under *Corwin*, the defendants' decision was subject to business judgment review.

The Court began its analysis by addressing the plaintiffs' allegations that Knauf was a controller and that *Corwin* was therefore inapplicable. The Court explained that because Knauf only beneficially owned 10.6% of USG's common stock, it would not be considered a controlling stockholder unless the plaintiffs could plead that "Knauf was a controller under the 'actual control' test."[400] According to the plaintiffs, Knauf was a controller under the actual control test because Knauf and Berkshire Hathaway had formed a control group. The Court disagreed, highlighting that the plaintiffs' operative complaint "does not explicitly allege a control group" and that "Knauf's and Berkshire Hathaway's interests diverged regarding the most important detail of the Acquisition: the price."[401] The Court inferred that "Knauf (as the buyer) sought to pay as little as possible, and Berkshire Hathaway (as USG's largest stockholder) sought to obtain as high a price as possible for its USG stock."[402] At most, the operative complaint pled Knauf and Berkshire Hathaway had a "shared goal of a sale of USG."[403] The Court explained that the "mere concurrence of self-interest among certain stockholders" is not sufficient to allege a control group.[404]

The Court next considered whether the stockholder vote was fully informed, so as to invoke the business judgement rule under *Corwin*. The plaintiffs "essentially [pled] that the Board determined USG had an intrinsic value, that the Board did not disclose this material fact, and that by not disclosing its intrinsic valuation the Board's other disclosures, namely its representations that the Acquisition was favorable to USG's stockholders, were rendered materially misleading."[405] The Court agreed, determining that it was "reasonably conceivable that the Defendants created a proxy that was materially misleading to stockholders" and that, therefore, *Corwin* was inapplicable.[406]

The Court then turned to the question of whether the plaintiffs had adequately pled that the defendants breached their fiduciary duties. The Court explained that because USG's charter contained an exculpatory provision under Section 102(b)(7) of the Delaware General Corporation Law, "the [p]laintiffs must plead

399 *Id.* at *12.

400 *Id.* at *14.

401 *Id.* at *16.

402 *Id.*

403 *Id.*

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

405 *Id.* at *19.

406 *Id.* at *20.

a non-exculpated breach of fiduciary duty claim, that is, one that implicates the Defendants' duty of loyalty."[407] "The [p]laintiffs allege[d] that the Board breached its duty of loyalty because it lacked independence[,] . . . was interested in the [a]cquisition," and otherwise acted in bad faith in approving the acquisition.[408]

According to the plaintiffs, the defendants "lacked independence from Knauf because of their alleged fear of Knauf."[409] In support of this assertion, the plaintiffs alleged that after Knauf mounted a successful withhold campaign, the board "abandoned its standalone plan for USG, rushed or abandoned other potential buyers, and acceded to the [a]cquisition even though it had 'misgivings' about the deal."[410] Describing the plaintiffs' allegation of fear as conclusory and noting the proxy statement reflected "robust negotiations between USG and Knauf," the Court found that the plaintiffs "allege[d] no facts from which it can be reasonably inferred that the Board's actions were the result of anything other than the corporate merits of the subject."[411] The Court further commented, "'Fear' of a corporate takeover threat—here fully justified after Knauf's resounding withhold victory—is a nod to reality, not a disabling extraneous influence."[412]

In support of the plaintiffs' contention that eight of the nine defendant directors were interested in the acquisition, the plaintiffs argued that the eight directors "had much to lose from a 'potentially career-ending and reputation killing proxy fight loss,' little to gain from standing up to Knauf, and [that] the [a]cquisition afforded them a liquidity event in the sale of their equity interests in USG."[413] The Court disagreed, finding that it was "not reasonably conceivable that the [eight] Defendants capitulated to Knauf in selfish defense of their outside reputational interests because *USG's directors had already lost a public fight with Knauf*."[414]

And in support of plaintiffs' contention that the defendants had acted in bad faith in approving the acquisition, the plaintiffs pointed to the board's failure to disclose its view on the intrinsic value of USG. The Court rejected the plaintiffs' suggestion that, having successfully pled facts sufficient to overcome a *Corwin* defense, the plaintiffs had also necessarily pled facts giving rise to an inference of bad faith. The Court explained that the standard for pleading bad faith "is entirely distinct from the required pleading to show an uninformed vote under *Corwin*."[415] In the disclosure context, "[a]n adequate pleading of bad faith must plead that the maldisclosure was 'intentional and constitute[d] more than an error of judgment or gross negligence.'"[416] In contrast, the standard for pleading that an uninformed vote occurred under *Corwin* "requires that the complaint 'when fairly read, supports a rational inference that material facts were not disclosed or that the disclosed information was otherwise materially misleading.'"[417] In a *Corwin* analysis, "[t]he focus is on the stockholder-reader, *not the drafter*. But when analyzing bad faith, the creator is the crux of the analysis, and *the why is the locus of the inquiry*."[418]

The Court held it was "not reasonably conceivable that the Proxy Statement 'represents the knowingly-crafted deceit or knowing indifference to duty that would show bad faith.'"[419] In so ruling, the Court pointed to other disclosures in the proxy statement. For example, the board disclosed that it initially approved of negotiations within the range of \$48.00 to \$51.00 and that such approval was based on the board's view of USG's intrinsic value. The board likewise disclosed that it had chosen not to inform stockholders of its view of USG's intrinsic value. As to this disclosure, the Court commented, "It is near inconceivable (and thus not reasonably conceivable) that an independent and disinterested Board acting disloyally would have professed its bad faith to USG's stockholders in the Proxy Statement."[420]

Finally, the Court addressed the plaintiffs' argument that the defendants failed to comply with their duties imposed under *Revlon*, "to secure the highest

407 *Id.* at *23 (citing *In re Cornerstone Therapeutics Inc. S'holder Litig.*, 115 A.3d 1173 (Del. 2015)).
408 *Id.*
409 *Id.*
410 *Id.*
411 *Id.*
412 *Id.* at *24.
413 *Id.*
414 *Id.* at *25.
415 *Id.* at *26.
416 *Id.* (quoting *Morrison v. Berry*, 2019 WL 7369431, at *18 (Del. Ch. Dec. 31, 2019)).
417 *Id.* (quoting *Morrison v. Berry*, 191 A.3d 268, 282 (Del. 2018)).
418 *Id.*
419 *Id.* at *27.
420 *Id.* at *28.

value reasonably attainable."[421] The Court rejected the plaintiffs' contention that "if it is reasonably conceivable that the Defendants' actions regarding the [a]cquisition were less than reasonable," the plaintiffs' breach of fiduciary duty claim must survive.[422] The Court explained that the plaintiffs still bore the burden of pleading a non-exculpated breach of the duty of loyalty. The Court ruled that the plaintiffs had failed to adequately state a non-exculpated claim against the defendants for breach of their *Revlon* duties, noting that the "Board authorized negotiations within a range that include[d] what the [p]laintiffs [pled] was USG's actual value" and determining that the operative complaint pled "no facts from which [the Court] can reasonably infer that the negotiation process was a sham or that the Board was not actually seeking a higher price for USG."[423]

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

In *Rudd v. Brown*,[424] the Court of Chancery dismissed the plaintiff's action alleging that a company's directors breached their fiduciary duties in connection with a two-step merger, and in doing so rejected the plaintiff's argument that the threat of a proxy contest rendered the directors conflicted with respect to the challenged merger. The Court held that the threat of a proxy contest alone, without any other well-pled facts impugning directors' disinterestedness, does not render the directors conflicted.

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

The plaintiff, a former stockholder of the company, asserted a claim for breach of fiduciary duty, alleging that the defendants failed to maximize value in the transaction as required by *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[425] and that the defendants failed to disclose material information about the sale and approved misleading information in the proxy statement.[426] The defendants moved to dismiss for failure to state a claim.

The Court first noted that where, as here, a Section 102(b)(7) exculpatory charter provision protects the directors, the plaintiff must plead a breach of the duty of loyalty and good faith, and cannot rely on a claim "exclusively establishing" a violation of the duty of care, in order to state a claim for monetary damages.[427] This is true even though *Revlon* presumes the application of enhanced scrutiny in certain sale-of-control contexts. Thus, a plaintiff "challenging a transaction under *Revlon* and seeking monetary damages, like the plaintiff here, must plead facts sufficient to state a nonexculpated fiduciary duty claim."[428]

To overcome the exculpatory provision, a plaintiff must show a majority of the board was not disinterested or independent, or otherwise failed to act in good faith. To carry this burden, the plaintiff asserted that the defendant directors were conflicted by virtue of the looming threat of a proxy contest potentially resulting in the ouster of the board. However, the Court observed that in each case where the Court has found it conceivable that directors were conflicted on the basis of a threatened proxy contest, the complaint pleaded additional allegations of

421 *Id.*

422 *Id.*

423 *Id.* at *30.

424 2020 WL 5494526 (Del. Ch. Sept. 11, 2020).

425 506 A.2d 173, 183 (Del. 1986).

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

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

428 *Id.* at *7.

disloyalty or gross negligence. Reiterating the Court of Chancery's ruling in *In re Lukens Inc. Shareholders Litigation*,[429] the Court rejected the plaintiff's "barebones conflict theory,"[430] noting the Court's "reluctance to find that the mere threat of a proxy contest renders directors conflicted."[431]

The Court also rejected all of the plaintiff's additional attacks on the independence of certain individual defendants, holding that: (i) as a matter of law, potential receipt of change-in-control payments pursuant to a pre-existing agreement alone does not create a disqualifying interest;[432] (ii) a defendant director was not conflicted merely by virtue of his appointment by the activist investor;[433] and (iii) a director's alleged reputation for being appointed for the purpose of advocating for a merger or acquisition does not sufficiently demonstrate a conflict.[434]

Finally, the Court declined to accept the plaintiff's wholly-conclusory allegation that the defendant CFO was conflicted because of his prospect of post-closing employment with the acquirer. The Court noted that the proxy stated that neither the acquirer nor other potential bidders engaged in discussions regarding the retention of executives during the negotiation process and the plaintiff had not "challenged the veracity of this disclosure."[435] The Court stated that "[i]n the absence of well-pled, non-conclusory allegations to the contrary, it would be unreasonable to infer" that the CFO and the acquirer "discussed the terms of post-close employment."[436] Having found that the plaintiff failed to plead facts that the defendants were conflicted, the Court dismissed the complaint.

429 757 A.3d 720 (Del. Ch. 1999).

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

431 *Id.* (citing cases).

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

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

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

435 *Id.* at *12.

436 *Id.*

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*,[437] the Court of Chancery denied the defendants' motion to dismiss a *Revlon*[438] 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*[439] 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

437 2020 WL 5870084 (Del. Ch. Oct. 2, 2020).

438 *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).

439 *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.

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."[440]

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.

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.[441] 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."[442]

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.[443] Stollmeyer's personal expenses were so significant that he told his financial advisor that selling his Mindbody stock was "top of mind" for him.[444] This need for liquidity made it reasonably conceivable that Stollmeyer was willing to "short-change" his holdings for a quick sale.[445] Stollmeyer also expressed a desire for future employment with Vista, telling one advisor that Vista was "in love" with him and vice versa.[446] Additionally, Vista's offer would double management's equity stake after the merger—a proverbial "cherry on top."[447] 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."[448] 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

440 *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.

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

442 *Id.* at *13-14.

443 *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.'").

444 *Id.* at *16.

445 *Id.* at *18.

446 *Id.* at *16.

447 *Id.* at *16.

448 *Id.* at *20.

reasonably conceivable that each of a majority of the board is conflicted.'"[449] 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."[450]

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.[451] "[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."[452] 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."[453] Accordingly, the Court held the complaint adequately alleged Stollmeyer breached his fiduciary duties.[454]

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."[455] 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."[456]

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*,[457] 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*[458] test for demand futility "is no longer a functional test," and applied the *Rales v. Blasband*[459] 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

449 *Id.* at *23 (quoting *Nguyen v. Barrett*, 2016 WL 5404095, at *5 (Del. Ch. Sept. 28, 2016)).
450 *Id.* at *24.
451 *In re Mindbody*, 2020 WL 5870084, at *31.
452 *Id.* at *26 (quoting *Morrison v. Berry*, 191 A.3d 268, 282-83 (Del. 2018)).
453 *Id.* at *30 (quoting *Morrison*, 191 A.3d at 284.).
454 *Id.* at *31-32.
455 *Id.* at *33.
456 *Id.* at *34.
457 2020 WL 6266162 (Del. Ch. Oct. 26, 2020).
458 473 A.2d 805, 811 (Del. 1984).
459 634 A.2d 927, 934 (Del. 1993).

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 stockholders, including Zuckerberg."[460] 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.

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

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."[461]

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."[462] 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.'"[463] 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."[464] 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."[465] "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

461 *Id.* at *18.

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

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

464 *Id.* at *16.

465 *Id.* at *11.

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."[466] 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.[467]

"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.[468] 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."[469] In *In re Cornerstone Therapeutics Inc. Stockholder Litigation*,[470] 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[.]"[471] 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."[472] 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."[473]

466 *Id.*

467 *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.

468 *Id.*

469 *Id.* at *14.

470 115 A.2d 1173 (Del. 2015).

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

472 *Id.* at *15.

473 *Id.*

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.[474] 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."[475] 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."[476]

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.[477] The Court found that the plaintiff failed to

474 *Id.* at *16.

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

476 *Id.* at *19.

477 Having found that five of the six remaining directors were capable of considering a demand, and thus that

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 the duty of care, and the allegations in the complaint, "at most, allege a breach of the duty of care."[478]

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.[479] 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*,[480] 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.[481] Because the Court found that the complaint failed to plead a predicate breach of fiduciary duty, the Court dismissed the aiding and abetting claim.[482] 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

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.

478 *Id.* at *27.

479 *Id.* at *21.

480 2020 WL 6281427 (Del. Ch. Oct. 27, 2020).

481 *Id.* at *1.

482 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.

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 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*[483] 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."[484] 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*[485] 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.[486]

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.[487] 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

483 *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).

484 *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)).

485 *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.

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

487 *Id.* at *7.

unaudited financials.[488] 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.[489] Because the complaint made no allegations that "GE participated – knowingly or otherwise – in any of the 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.[490]

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."[491]

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."[492] 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[,]"[493] 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.[494] 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.[495] 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."[496]

488 *Id.* at *8.
489 *Id.* at *10.
490 *Id.* at *11.
491 *Id.*
492 *Id.* at *12.
493 *Id.*
494 *Id.* at *16.
495 *Id.*
496 *Id.* at *18.

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*,[497] 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 directors of the defendant company and its controlling stockholder under the framework of *Gentile v. Rossette*.[498] 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.[499] 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."[500]

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.[501] 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."[502]

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."[503] 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."[504]

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."[505] 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.*[506] 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[.]"[507] Additionally, the Court found the plaintiffs' theory that the private placement served to entrench Brookfield was "not reasonably conceivable."[508] Thus, "[w]ithout an adequate pleading of entrenchment," the plaintiffs' only remaining harm was that caused by dilution, which is "a classically derivative injury."[509]

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497 2020 WL 6375859 (Del. Ch. Oct. 30, 2020).

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

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

500 *Id.* at *1.

501 *Id.* at *4-5.

502 *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.

503 *Id.* at *8.

504 *Id.*

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

506 845 A.2d 1031 (Del. 2004).

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

508 *Id.* at *10-11.

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

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 stockholders have a direct claim for relief[.]"[510] 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."[511]

The Court of Chancery found that the facts alleged by the plaintiffs "fit *Gentile*'s transactional paradigm to a T."[512] 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."[513] 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."[514] Thus, the Court concluded that the plaintiffs had "state[d] direct claims under *Gentile*'s rationale."[515]

The defendants conceded that the facts at hand were consistent with those in *Gentile*, but argued that the Court "need not follow *Gentile*."[516] 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*."[517] Second, the Court addressed the defendants' argument that the Court "need not follow *Gentile* because it was improperly decided."[518] The Court noted that "[p]ost-*Gentile*, Delaware courts have struggled to define the boundaries of dual-natured claims[,]"[519] and discussed the Court of Chancery's own precedent that called into question "whether *Gentile* will remain the law of Delaware."[520] The Court also examined the Supreme Court's subsequent decision in *El Paso Pipeline GP Co., L.L.C. v. Brinckerhoff*,[521] which instructed that "*Gentile* . . . should be construed narrowly,"[522] and that "*Gentile* must be limited to its facts[.]"[523] 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*.[524]

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*,[525] 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

510 *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.*

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

512 *Id.*

513 *Id.*

514 *Id.*

515 *Id.* at *9.

516 *Id.* at *13.

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

518 *Id.*

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

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

521 152 A.3d 1248 (Del. 2016).

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

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

524 *Id.* at *16.

525 2020 WL 6821613 (Del. Ch. Nov. 20, 2020).

triggered enhanced scrutiny under *Unocal Corp. v. Mesa Petroleum Co.*,[526] 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.

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.[527]

In this subsequent letter opinion, the Court discussed the two tests for determining demand futility: *Aronson v. Lewis*[528] and *Rales v. Blasband*.[529] The Court ultimately applied *Aronson*, because "the same directors who would consider [the] demand had made the challenged decision[.]"[530] However, the Court noted that the result would be the same under either inquiry.

526 493 A.2d 946 (Del. 1985).

527 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.

528 473 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.

529 634 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.

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

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."[531] 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 and collective entrenchment theory[.]"[532] Second, the Court considered whether "the challenged transaction was otherwise the product of a valid exercise of business judgment[.]"[533] 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[.]"[534] 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."[535] 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."[536]

***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*,[537] 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[.]'"[538] 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."[539]

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

531 *Id.*
532 *Id.* at *5.
533 *Id.* at *4.
534 *Id.* at *7.
535 *Id.* at *8.
536 *Id.*
537 2020 WL 7023896 (Del. Ch. Nov. 30, 2020).

538 Id. at *3.
539 *Id.* at *4.

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 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[540] and (ii) the defendants "breached their fiduciary duties by misleading Blackhawk's stockholders through a materially misleading [p]roxy."[541]

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."[542] 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."[543]

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[.]"[544]

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."[545] 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."[546] Thus, unlike situations like *In re Xura, Inc., Stockholder Litigation*,[547] 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.[548]

"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]."[549] The Court explained that the plaintiff did not allege

540 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).

541 *Id.*

542 *Id.* at *11.

543 *Id.*

544 *Id.*

545 *Id.* at *13.

546 *Id.*

547 2018 WL 6498677 (Del. Ch. Dec. 10, 2018).

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

549 *Id.* at *18.

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.[550] This conduct, the Court noted, did not "support a reasonable inference of a board 'exhibiting indolent or apathetic inertia or passivity,' or otherwise having been manipulated by [the defendants] during the Buyout process."[551] 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[.]"[552]

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."[553] 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."[554]

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.[555] 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"[556] 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]."[557]

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."[558] 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.[559] 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."[560]

***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*,[561] 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

550 *Id.* at *16.
551 *Id.*
552 *Id.* at *19 (citing *Corwin v. KKR Fin. Hldgs. LLC,* 125 A.3d 304, 312-14 (Del. 2015)).
553 *Id.* at *19.
554 *Id.*

555 *Id.* at *21.
556 *Id.*
557 *Id.*
558 *Id.*
559 *Id.*
560 *Id.*
561 2020 WL 7711128 (Del. Ch. Dec. 29, 2020), as corrected (Dec. 30, 2020).

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 plaintiffs sufficiently alleged breach of fiduciary duty claims against the controlling stockholder and certain directors in connection with the merger.[562]

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."[563] 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."[564] 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.[565] 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.'"[566] "[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."[567]

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].'"[568] Ultimately, while acknowledging precedent on both sides, the Court held that the "mere presence" debate

562 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.

563 *Id.*

564 *Id.* at *6.

565 *Id.*

566 *Id.* at *11.

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

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

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 stockholders.'"[569] 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."[570] 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."[571] 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.[572] 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[.]"[573] 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.'"[574]

Accordingly, the Court analyzed whether each director's personal relationship with Ms. Redstone was of a "bias-producing nature"[575] 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."[576] 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."[577] 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."[578] 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."[579] 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*,[580] 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

569 *Id.* at *16 (quoting *IRA Tr. FBO Bobbie Ahmed v. Crane*, 2017 WL 7053964, at *7 (Del. Ch. Dec. 11, 2017)).

570 *Id.*

571 *Id.* at *17.

572 *Id.* at *19.

573 *Id.*

574 *Id.* (quoting *In re Cornerstone Therapeutics, Inc. S'holder Litig.*, 115 A.3d 1173, 1182–83 (Del. 2015)).

575 *Id.* at *20.

576 *Id.* at *24.

577 *Id.*

578 *Id.* at *20.

579 *Id.* at *25.

580 2020 WL 7861335 (Del. Ch. Dec. 31, 2020).

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*")[581] regarding the matters raised in the complaint and were therefore incapable of making a decision on whether the company should pursue litigation—was not sufficiently plead. This case is the latest to demonstrate that, although stockholder plaintiffs have managed to survive dismissal of *Caremark* claims on a few occasions over the past two years,[582] pleading a *Caremark* claim remains "among the hardest to plead and prove" under Delaware law.[583]

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."[584] 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*.[585] 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

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581 698 A.2d 959 (Del. Ch. 1996). To carry out one's duties under *Caremark*, "a director must make a good faith effort to oversee the company's operations." *Marchand v. Barnhill,* 212 A.3d 805, 820 (Del. 2019). To establish liability under *Caremark,* a plaintiff must establish either one of two prongs: "(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention." *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

582 *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).

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

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

585 634 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).

exercised its independent and disinterested business judgment in responding to a demand."[586] 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 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."[587] 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."[588] 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."[589]

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*[590] and *In re MetLife Inc. Derivative Litigation*.[591] 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.[592]

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."[593] 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."[594]

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

In *Riskin v. Burns*,[595] 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

586 *Richardson as Trustee of Richardson Living Trust v. Clark*, 2020 WL 7861335 at *7.
587 *Id.* at *9 (quoting *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006)).
588 *Id.* at *9.
589 *Id.*
590 2020 WL 5028065 (Del. Ch. Aug. 24, 2020).
591 2020 WL 4746635 (Del. Ch. Aug. 17, 2020).
592 *Richardson as Trustee of Richardson Living Trust v. Clark*, 2020 WL 7861335 at *5.
593 *Id.* at *10.
594 *Id.*
595 2020 WL 7973803 (Del. Ch. Dec. 31, 2020).

unfair price. The Court rejected the plaintiff's argument that the claim fit within the "dual claim" theory under *Gentile v. Rossette*,[596] and followed the trend in recent 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.[597] 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."[598] 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."[599] The Court noted that in two previous decisions, *Klein v. H.I.G. Cap., L.L.C.*[600] and *Reith v. Lichtenstein*,[601] 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.[602] 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*."[603] 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."[604] 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*."[605]

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596 906 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 and direct, and, therefore, stockholders can pursue such claims directly. *Id.* at 99-100

597 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).

598 *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)).

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

600 2018 WL 6719717 (Del. Ch. Dec. 19, 2018).

601 2019 WL 2714065 (Del. Ch. June 28, 2019).

602 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.

603 *Id.* at *14.

604 *Id.*

605 *Id.*

Alternative Entity Litigation

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

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

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

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

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

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

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

Several plaintiffs challenged the transactions and the Court consolidated the separate actions. The plaintiffs alleged that the defendants breached the partnership agreement, the implied covenant of good faith and fair

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

2 *Id.* at *4.

3 *Id.* at *5.

4 *Id.* at *7.

dealing, and/or tortiously interfered in the partnership agreement by engaging in a multi-step scheme designed to lower the cost of the buyout through the exchange offer, the announcement that the call right might be exercised, and the eventual exercise of the call option.

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

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

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

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

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

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

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

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

5 *Id.* at *2.

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

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

8 *Id.* at *16.

9 *Id.* at *16-17.

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

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

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

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

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

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

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

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

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

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

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

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

16 *Id.* at *6.

17 *Id.* at *9.

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

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

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

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

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

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

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

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

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

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

20 *Id.* at *10.

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

22 *Id.* at *15.

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

24 *Id.* at *4.

25 *Id.*

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

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

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

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

26 *Id.* at *4.
27 *Id.* at *5-6.
28 *Id.* at *24.
29 *Id.* at *25.
30 *Id.* at *26 (quoting *Miller v. Am. Real Estate P'rs, L.P.*, 2001 WL 1045643, at *11 (Del. Ch. Sept. 6, 2001)).
31 *Id.* (alterations in original) (quotation marks and citations omitted).
32 *Id.*
33 *Id.* (emphasis in original).
34 *Id.*
35 *Id.*
36 *Id.* (emphasis in original).
37 *Id.*

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

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

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

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

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

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

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

39 *Id.* at *3.

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

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

42 *Id.* at *8.

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

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

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

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

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

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

The plaintiffs argued that the buyout provision is similar to an option contract, whereby the plaintiffs hold open an offer to sell their units to the company and the company, after it accepts the offer, is prevented from revoking its acceptance. Carbon argued that its notice of intent to purchase the plaintiffs' units constituted an offer and, under common law contract principles, the company has the right to revoke that offer prior to the plaintiffs' acceptance.

The Court concluded that the buyout provision is a common law call option, consisting of two parts: (1) an underlying offer for the sale of membership units and

43 *Id.* at *9 (quoting the partnership agreement).
44 *Id.* at *11.
45 *Id.* at *13.
46 *Id.* at *14.
47 *Id.* at *15.
48 2020 WL 1492543 (Del. Ch. Mar. 25, 2020).

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

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

In *77 Charters, Inc. v. Gould*,[49] the Delaware Court of Chancery denied the defendants' motion to dismiss breach of fiduciary duty claims against the "remote controller" of a limited liability company, Jonathan D. Gould, related to transactions whereby Gould caused the entity he controlled to purchase a preferred interest in the limited liability company from a member and subsequently amended the limited liability company's operating agreement to increase the preferred's distribution percentage, to the detriment of 77 Charters, Inc. ("77 Charters"), a holder of the limited liability company's common interests.

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

49 2020 WL 2520272 (Del. Ch. May 18, 2020).

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

On July 1, 2013, Kimco sold its preferred interest in Cookeville Retail to Cookeville Corridor, LLC ("Cookeville Corridor"). Gould was the managing member of Cookeville Corridor. Shortly after acquiring the preferred interest, Cookeville Corridor sold a portion of that interest to Eightfold Cookeville Investor, LLC ("Eightfold"). Notably, the amount Eightfold paid for a portion of the preferred interest was equal to the amount Cookeville Corridor paid for the entirety of the preferred interest. After this series of transactions, Gould (who was directly or indirectly the managing member of both of Cookeville Retail's members) caused Cookeville Retail to amend the CRA (the "Amended CRA") to increase the preferred's distribution preference from 9 percent to 12.5 percent. 77 Charters was unaware of the sale of the preferred interest and the amendment to the CRA.

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

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

77 Charters filed an action in the Delaware Court of Chancery, alleging a panoply of claims against the defendants, including (among others) breach of fiduciary duty against Gould and Stonemar MM, breach of contract against Stonemar MM, Stonemar Cookeville, and Gould, aiding and abetting against Gould, Eightfold, and Stonemar MM, civil conspiracy against Cookeville Corridor, unjust enrichment against

Gould, Stonemar MM, Cookeville Corridor, and Eightfold, and a request for a judicial declaration that the Amended CRA was void. The breach of fiduciary duty claim, civil conspiracy claim, and claim for declaratory judgment survived the defendants' motion to dismiss. The Court dismissed all other claims.

The Court concluded that it was reasonably conceivable that Gould and Stonemar MM owed fiduciary duties to the nonmanaging members of Stonemar Cookeville, notwithstanding the fact that Gould was not the managing member, or even a member, of Stonemar Cookeville or Cookeville Retail. Citing *In re USACafes, L.P. Litigation*,[50] the Court recognized that "remote controllers (such as Gould) will owe limited fiduciary duties if they 'exert control over the assets of that entity.'"[51] The Court found that 77 Charters adequately pleaded a remote controller situation when it alleged that Gould personally caused the purchase and sale of the preferred interest and the adoption of the Amended CRA.

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

Regarding monetary liability, the Court concluded that the terms of the SCA exempted Stonemar Cookeville's *members* from monetary liability, but that it was not clear that the exemption applied to Stonemar MM when it acted in its capacity as managing member.

With regard to the amendment to the CRA increasing the preferred's distribution percentage, the Court held that other aspects of the duty of loyalty beyond the eschewed corporate opportunity doctrine prevented Stonemar MM from unilaterally approving the amendment. By pleading that Gould had "selfishly amended the CRA and shifted economic value toward Cookeville Corridor and away from 77 Charters," 77 Charters pleaded a reasonably conceivable claim for breach of fiduciary duty.[52] The Court stated that, "While the scope of *USACafes*-type liability is limited, 'it surely entails the duty not to use control over [an entity] to advantage the [controller] at the expense of' the controlled-entity."[53] Because Gould had increased the preferred's distribution preference and then sold only a portion of the Cookeville Corridor's preferred units to Eightfold at a premium, with Cookeville Corridor retaining a portion of the preferred units, and because these transactions were to 77 Charters' detriment, the Court sustained the claim for breach of fiduciary duty against Gould and Stonemar MM.

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

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

50 600 A.2d 43 (Del. Ch. 1991).

51 *77 Charters*, 2020 WL 2520272, at *9 (emphasis omitted) (quoting *Bay Ctr. Apartments Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451, at *9-10 (Del. Ch. Apr. 20, 2009) (quoting *USACafes*, 600 A.2d at 49)).

52 *Id.* at *14.

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

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

In *HOMF II Investment Corp. v. Altenberg*,[54] the Court of Chancery held, in a post-trial decision, that plaintiffs had proven fraudulent inducement and breach of fiduciary claims in connection with an investment scheme in which a defendant individual ("Altenberg") mismanaged funds the plaintiffs had contributed to a solar project venture that Altenberg controlled. Despite finding that the plaintiffs had proven their fraudulent inducement claim, the Court entered judgment for Altenberg on that claim because the plaintiffs "did not put Altenberg on notice of th[e] [fraudulent inducement] theory before trial, and they did not seek to conform the pleadings to the evidence after trial."[55] The Court also ordered further proceedings on the damages aspect of the plaintiffs' fiduciary duty claim "to clarify the record and assist the court in tailoring an appropriate remedy."[56]

Altenberg had convinced the plaintiffs to invest in a fund he controlled (the "Fund"), whose purpose was "to acquire solar projects, own them through special purpose vehicles, and provide the equity capital necessary to bring them to commercial operation."[57] The plaintiffs were the only investors, and to induce their investments, Altenberg represented to them "that once a project achieved commercial operation, it could be refinanced with long-term debt, which would enable the Fund to recover its equity investment, plus return."[58] Altenberg also made three other representations: (1) that "the Fund's first project would be Project Cali, which he would use to demonstrate that the Fund's business model worked[;]" (2) that "the Fund would acquire projects that could be completed within three to six months so that he could recycle the Fund's capital and generate outsized returns[;]" and (3) that a lender called Open Energy "would be a dedicated source of financing for the Fund."[59]

The Court found that each of these representations was false, and that the plaintiffs had also proven the other elements of fraud (the defendant's knowledge of falsity, intent to induce the plaintiff to act, the plaintiff's reliance, and damages). Despite these findings, the Court entered judgment for Altenberg on procedural grounds because the plaintiffs "never put Altenberg on notice before trial that they were pursuing a claim for fraudulent inducement, Altenberg objected at trial to the introduction of evidence relating to that claim, and the plaintiffs never sought to conform the pleadings to the evidence under Rule 15(b)."[60] The Court also noted that "[t]hroughout post-trial briefing and during post-trial argument, Altenberg maintained that the plaintiffs had not properly asserted a fraudulent inducement claim."[61]

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

Although the Court found Altenberg liable for breaches of fiduciary duty, it did not determine the appropriate remedy and requested supplemental submissions for the case's remedial phase. This decision and request was driven in part by the fact that "[t]he parties focused their efforts at trial, in their post-trial submissions, and during post-trial argument primarily on the question of liability and not the issue of remedy.[62]

In sum, the Court of Chancery's decision serves as a reminder that, despite Delaware's rejection of "the requirement that a plaintiff must plead a particular legal theory," a plaintiff must "take[] action at some point to put [a defendant] on notice" that they are pursuing a particular theory.[63] Such action could include "outlin[ing] the claim in [] pretrial briefs[,]" "identify[ing] it as an issue of law in the pretrial order[,]" or "mak[ing] a motion during or after trial to amend the pleadings under Rule 15(b)."[64] The decision also shows that a plaintiff who is successful in proving liability for a breach of fiduciary duty must also be

54 2020 WL 2529806 (Del. Ch. May 19, 2020).
55 *Id.* at *1.
56 *Id.*
57 *Id.*
58 *Id.*
59 *Id.* at *27.
60 *Id.*
61 *Id.* at *40.
62 *Id.* at *53.
63 *Id.* at *26.
64 *Id.*

sure to provide the court with sufficient argument and analysis on the issue of damages to enable the court to enter a damages award. Otherwise, a plaintiff will risk spending additional time and money litigating the question of the appropriate remedy post-trial.

***Dohmen v. Goodman*, 234 A.3d 1161 (Del. 2020)**

In *Dohmen v. Goodman*,[65] the Delaware Supreme Court considered a certified question of law from the United States Court of Appeals for the Ninth Circuit, which (as rephrased by the Supreme Court) asked:

> Under the stipulated facts of this dispute, does the general partner's request to the limited partner for a one-time capital contribution constitute a request for limited partner action such that the general partner has a duty of disclosure, and if the general partner fails to disclose material information in connection with the request, may the limited partner prevail on a breach of fiduciary duty claim and recover compensatory damages without proving reliance and causation?[66]

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

In 2010, Dohmen started a hedge fund and convinced Goodman to invest $500,000. After Goodman made his first investment, he began to ask Dohmen about other investors in the fund. Dohmen made several misleading statements in response. On December 9, 2011, Goodman made a second investment of $500,000. A few days later, Dohmen indicated that "[p]ersonal friends [had] expressed interest" in investing and were "reviewing the documents."[67] Dohmen knew this statement was false. Eventually, Dohmen informed Goodman that the fund had only two investors, and two years later the value of the fund collapsed.

In January 2015, Goodman sued Dohmen, "alleging common law fraud by misrepresentation, securities fraud, and breach of fiduciary duty."[68] Goodman based his suit on the misrepresentations regarding the number of investors and the fund's strategy in general. The United States District Court for the Central District of California found that, at the time of the second investment, Dohmen knowingly misrepresented the number of investors in the fund. The District Court also found that, while Goodman relied on those misrepresentations, he failed to show loss causation, the final element of common law and securities fraud. Goodman had more success with his breach of fiduciary duty claim based on the same misrepresentations. As Dohmen was the controller of the general partner of the fund, and the partnership did not disclaim the fiduciary duty of loyalty, the District Court found that Dohmen owed fiduciary duties to Goodman, a limited partner. The District Court, relying on *Malone v. Brincat*,[69] characterized the breach of fiduciary duty claim as a misrepresentation made "when seeking [limited] partner action."[70] Citing *Malone*, the District Court held that Goodman did not need to show reliance or causation to support a breach of fiduciary duty claim. As the parties did not dispute that the misrepresentations were material, the District Court awarded Goodman compensatory damages. Dohmen appealed to the United States Court of Appeals for the Ninth Circuit, which certified the above question to the Delaware Supreme Court.

The Supreme Court began its analysis by noting the fiduciary duties of a director (or similarly -situated fiduciary) apply when a director communicates with stockholders. Specifically, when a director requests "stockholder action" the director must "disclose fully and fairly all material facts within their control bearing on the request."[71] A director breaches the duty "when the alleged omission or misrepresentation is material."[72] The Supreme Court noted that a breach in this situation amounts to liability *per se*, meaning a stockholder does

65 234 A.3d 1161 (Del. June 23, 2020).

66 *Id.* at *1164.

67 *Id.* at *1165-66. (first alteration in original).

68 *Id.* at 1166.

69 722 A.2d 5 (Del. 1998).

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

71 *Dohmen,* 234 A.3d at 1168. (citing *Malone v. Brincat,* 722 A.2d 5, 9 (Del. 1998)).

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

not need to prove the traditional elements of reliance, causation, and damages. But it clarified that the *per se* rule only applies if a plaintiff seeks nominal damages.

The Supreme Court reviewed the history of disclosure violations in connection with requests for stockholder action to determine if Dohmen had an affirmative duty to disclose information to Goodman. The Supreme Court ultimately agreed with the Court of Chancery's analysis in *Latesco, L.P. v. Wayport, Inc.*[73] In that case, the Court of Chancery refused to characterize a corporate insider's attempt to exercise a right of first refusal in the sale of a minority stockholder's interest as request for stockholder action. The Court of Chancery found that the stockholder action rule was concerned with the collective action problem often inherent in large transactions, meaning that stockholders would be unable to receive all the information they desired unless there was an affirmative disclosure duty. Here, the Supreme Court explained, Goodman had the ability to ask questions of Dohmen and often received answers. Thus, the Supreme Court held, Dohmen did not have an affirmative duty to disclose the number of investors in the fund, although his decision to provide false information could result in a breach of the duty of loyalty.

The Supreme Court further emphasized that, even if Dohmen did have a fiduciary duty of disclosure, "Goodman would still have to prove reliance and causation to recover the compensatory damages sought in his case."[74] The Court conducted a review of case law addressing the issue of liability *per se* and the duty of disclosure. The Supreme Court reaffirmed that the *per se* damages rule (i) will relieve a plaintiff of showing reliance, causation, and damages "only . . . if there is impairment of economic or voting rights," and (ii) "only applies to nominal damages."[75] The Supreme Court therefore answered the certified question in the negative:

> Under the stipulated facts of this dispute, the general partner's request to a limited partner for a one-time capital contribution does not constitute a request for limited partner action such that the general partner has a fiduciary duty of disclosure. Even if the general partner had a fiduciary duty of disclosure, if the general partner failed to disclose material information in connection with the request, the limited partner cannot recover compensatory damages without proving reliance and causation.[76]

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

In *Murfey v. WHC Ventures, LLC*,[77] the Supreme Court of Delaware, ruling with a 3-2 majority, declined to construe partnership agreements as requiring limited partners' requests for books and records under the agreements to be limited to documents "necessary and essential" to the limited partners' stated purposes where such requirement was not expressly provided. In so ruling, the Court emphasized that it will not imply terms into a partnership agreement when such terms could have been, but were not, included in the agreement.

The plaintiffs, limited partners of multiple Delaware limited partnerships whose ownership percentages had decreased with the addition of new partners, sought books and records under Section 17-305 of the Delaware Revised Uniform Limited Partnership Act ("Section 17-305")—the limited partnership analogue to Section 220 of the Delaware General Corporation Law—and the governing partnership agreements. Tracking the language in Section 17-305, the partnership agreements provided that "[e]ach Limited Partner has the right, on any reasonable request, . . . *to obtain from the General Partner for the purposes reasonably related to the Limited Partner's Interest as a Limited Partner* the information set forth above in Section 12.1. . . ."[78] Section 12.1 of the partnership agreements in turn provided that books and records "available for examination by any Partner," included: (i) "A current list of the full name and last known business or residence address of each Partner, together with Capital Contributions and Partnership Percentage of each of those Partners;" and (ii) "Copies of the Partnership's federal, state and local income tax or information returns and reports, if any, for the six most

73 2009 WL 2246793 (Del. Ch. July 24, 2009).

74 *Dohmen*, 234 A.3d at 1172.

75 *Id.* at 1174.

76 *Id.* at 1175.

77 236 A.3d 337 (Del. 2020).

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

recent taxable years[.]"[79] The plaintiffs' stated purposes for inspection were "valuing their ownership stake in the partnerships" and "investigat[ing] mismanagement and wrongdoing."[80] The parties reached agreement on the production of all but one category of documents, the Schedule K-1s to the partnership tax returns, and litigation ensued.

Following trial, the Court of Chancery concluded that the plaintiffs "ha[d] no right to the K-1s or the information they contain[ed]" despite having a proper purpose to value their ownership stakes.[81] In its statutory analysis, the Court of Chancery noted, among other things, that in order for the demand to be "for a purpose reasonably related to the limited partner's interest as a limited partner[,] . . . [t]he party requesting records must show the documents are 'necessary and essential' to accomplishing that purpose."[82] Because the Court of Chancery determined that the partnership agreements "limit[ed] a partner's right [to books and records] by requiring a proper purpose in the very same way 6 *Del. C.* § 17-305 does[,]" the Court of Chancery also implied a "necessary and essential" requirement into the partnership agreements.[83] The Court of Chancery found that the K-1s failed that "necessary and essential" test, and declined to order production of the K-1s to the plaintiffs under either Section 17-305 or the partnership agreements. The plaintiffs appealed.

On appeal, the plaintiffs contended that "under the Partnership Agreements, so long as their stated purpose is reasonably related to their interest as limited partners, they are entitled to inspect the K-1s, which fall within Section 12.1, and that the Partnership Agreements do not condition a limited partner's inspection rights on proving that the requested documents are 'necessary and essential' to their stated purpose."[84]

The Supreme Court reversed the Court of Chancery's ruling, concluding that the plaintiffs were entitled to the K-1s under the terms of the partnership agreements. The Supreme Court "declin[ed] to import a 'necessary and essential' condition into the agreements."[85] In reviewing the terms of the partnership agreements, the Supreme Court highlighted that the requested K-1s fell within the scope of Section 12.1 and found that the "specific identification of this tax return and capital contribution information highlights the importance of that particular information to investors, and the Partnerships' recognition of that importance."[86] Given the "obvious" importance of the requested information and the partnership agreements' failure to "expressly condition the limited partners' inspection rights on satisfying a 'necessary and essential' condition," the Supreme Court was "not persuaded such a condition should be implied."[87] The Supreme Court cautioned against "implying contractual terms when the contract could easily have been drafted to expressly provide for such terms, limitations or conditions."[88]

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

In *SolarReserve CSP Holdings, LLC v. Tonopah Solar Energy, LLC*,[89] the Court of Chancery held that the former owner of a company had no right to inspect books and records of that company under the company's LLC agreement because the former owner assigned its rights to another entity and was no longer a real party in interest. The Court also held that the assignee had no right to inspect the company's books and records because the LLC agreement granted inspection rights to certain named entities, which did not include the assignee.

The claims arose after the unraveling of a solar power plant project operated by Tonopah Solar Energy ("Tonopah"). Initially, SolarReserve CSP Holdings, LLC ("SolarReserve") was the sole owner of Tonopah. SolarReserve later brought in other investors through a series of transactions that ultimately left SolarReserve with only an indirect ownership interest in Tonopah. Although SolarReserve ceded its direct ownership of Tonopah, a provision was inserted in Tonopah's LLC agreement that permitted SolarReserve to access Tonopah's books and records as a "Sponsor Entity."[90]

79 *Id.*
80 *Id.* at 339.
81 *Id.* at 340.
82 *Id.* at 341.
83 *Id.* at 343.
84 *Id.* at 345.
85 *Id.* at 346.

86 *Id.* at 351.
87 *Id.* at 352.
88 *Id.* at 356.
89 2020 WL 4251968 (Del. Ch. July 24, 2020).
90 *Id.* at *2. The relevant section of the LLC agreement

The LLC agreement defined "Sponsor Entity" as several entities including "SolarReserve Sponsor" and "Santander Sponsor."[91] The LLC agreement defined SolarReserve Sponsor as "SolarReserve CSP Holdings, LLC excluding any unaffiliated successor."[92] On the other hand, the LLC agreement defined Santander Sponsor as that entity as well as its "*assignees*, transferees and successors."[93]

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

The Court began its analysis by considering whether SolarReserve was properly before the Court as a real party in interest. The Court concluded that SolarReserve was not a real party in interest because it assigned all of its claims against Tonopah to CMB. The Court noted that, under Court of Chancery Rule 17(a), the plaintiff should be the assignee where there has been a complete assignment. The Court also found that SolarReserve's assignment to CMB meant that SolarReserve would not be the beneficiary of any relief awarded in the action.

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

The Court rejected SolarReserve's argument. First, the Court explained, because Rule 17(a) provides that an assignor has no right to maintain a lawsuit after a complete assignment, SolarReserve had "*no rights* that are relevant to this action."[94] Second, the Court noted that multiple decisions had found that merely granting a power of attorney does not change the real party in interest rule. Additionally, the Court rejected SolarReserve's argument that Tonopah raised the Rule 17(a) argument too late. The Court explained that Rule 17(a) is not an "affirmative defense that is waived if not raised in the responsive pleadings[,]" but need only be raised in a "timely or seasonable fashion."[95] Accordingly, the Court held that SolarReserve was an improper plaintiff under Rule 17(a) because it had no interest in the proceeding.

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

Even without this "procedural defect," the Court found no basis for SolarReserve's argument.[96] SolarReserve argued that CMB had a right to Tonopah's books and records because CMB was an assignee of SolarReserve and not an "unaffiliated successor," and thus was not excluded from the right to demand the books and records under the LLC agreement's definition of SolarReserve Sponsor.[97] Accordingly, SolarReserve argued, CMB was entitled to Tonopah's books and records.

The Court rejected this argument, noting that the LLC agreement's exclusionary language ("excluding any unaffiliated successor") did not create a positive right allowing CMB to inspect books and records simply because it was not an "unaffiliated successor."[98] The Court explained that the LLC agreement only granted inspection rights to certain entities defined as "Sponsor Entities," and CMB clearly could not fit that definition.

The Court also held that CMB's status as SolarReserve's assignee did not make the entities the same for inspection rights under the LLC agreement. The Court found that the LLC agreement drafters knew how to include

stated that "[t]he Company shall keep books and records . . . [and] shall provide to each of the Sponsor Entities access to the books and records or any other information held by the Company reasonably requested by such Sponsor Entity, including the records of all transactions of the Company." *Id.*

91 *Id.*

92 *Id.*

93 *Id.* (emphasis added).

94 *Id.* at *5. (emphasis in the original)

95 *Id.*

96 *Id.* at *6.

97 *Id.*

98 *Id.*

Alternative Entities

assignees within the definition of Sponsor Entities. Indeed, Santander Sponsor was defined as Santander as well as its "assignees, transferees and successors."[99] The Court found that, under the plain meaning of the LLC agreement, CMB had no information rights because it was not SolarReserve and the definition of SolarReserve did not include its assignees. Accordingly, the Court granted judgment in favor of Tonopah.

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

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

In *Fannin v. UMTH Land Development, L.P.*,[100] the Court of Chancery rejected the defendants' argument that the Court of Chancery's decision in *In re USACafes, L.P. Litigation*,[101] which held that the directors and controllers of a limited partnership's general partner owed fiduciary duties to the limited partnership and its limited partners, was wrongly decided and was in conflict with current Delaware law governing alternative entities. The Court stated that the holding in *USACafes* was well established and was relied on by partnerships formed under Delaware law in drafting their partnership agreements and in determining whether to limit fiduciary duties. Having found that the general partner's controllers owed fiduciary duties to the limited partnership and its limited partners, the Court granted in part and denied in part the defendants' motion to dismiss claims for breaches of fiduciary duty, holding that four of the six individual defendants owed fiduciary duties to the limited partnership through their control over the general partner.

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

The Court denied the defendants' motion to dismiss for failure to plead demand futility, holding that plaintiffs had satisfied the first prong of the *Aronson*[102] test for demand futility. The plaintiffs sufficiently alleged that UMTH LD was not disinterested and independent with respect to the loans because the plaintiffs adequately alleged that UMTH LD derived a financial benefit from the loans that was not shared with UDF III's limited partners and that UMTH LD's actions "were designed to enrich UMTH LD and its controllers at UDF III's expense."[103] The Court found that the "General Partner was involved in a broad scheme that utilized UDF III loans to two favored real estate development firms and their affiliates to maintain partnership distributions at affiliated funds."[104]

99 *Id.* at *7.

100 2020 WL 4384230 (Del. Ch. July 31, 2020).

101 600 A.2d 43 (Del. Ch. 1991), *appeal refused sub nom.*

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

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

104 *Id.* at *33.

The Court also denied several of the individual defendants' Rule 12(b)(6) motions to dismiss based on their argument that they did not owe fiduciary duties to UDF III or its limited partners. In *USACafes*, the Court of Chancery "held that directors and controllers of a corporate general partner owed fiduciary duties to the limited partnership and the limited partners" because they "exert[ed] control over the assets" of the limited partnership.[105] Arguing that *USACafes* was "wrongly decided" and was in "irreconcilable conflict with current Delaware law regarding alternative entities," the individual defendants in this case requested that the Court not follow *USACafes*.[106]

The Court refused the individual defendants' request that the Court not follow *USACafes*, noting that the individual defendants failed to show that *USACafes* reflects "a clear manifestation of error" or establish "urgent reasons" for the Court to not follow the holding.[107] The Court stated that "[i]f *USACafes* is to be jettisoned, that is a determination for the Delaware Supreme Court."[108] The Court went on to reason that Delaware partnerships have the ability to limit or eliminate fiduciary duties and *USACafes* does not remove that choice. Here, the limited partnership made the choice to not eliminate fiduciary duties.

Applying *USACafes*, the Court found that the plaintiffs sufficiently alleged that four of the six individual defendants exercised control over the limited partnership's assets.[109] The defendants conceded that if *USACafes* applied, then three of the individuals owed fiduciary duties to UDF III. The Court found that the plaintiffs had sufficiently pled facts to support a reasonable inference that a fourth individual owed fiduciary duties given the control the individual exercised over UDF III's assets. The plaintiffs pled that he was the chief operating officer of UMTH LD, was one of three voting members on UMTH LD's investment committee, and participated in all investment and loan decisions on behalf of UDF III. In addition, he was involved in the transactions at issue, including personally executing the loan agreements at issue.

However, the Court also held that the plaintiffs failed to sufficiently allege that two other individual defendants, who were senior officers of UMTH LD, "exerted actual control over" UDF III's assets, and dismissed the fiduciary duty claims against them.[110] The Court found that the statement in UDF III's public filings that UDF III's "success depends to a significant degree on the diligence, experience and skill of certain executive officers and other certain key personnel of our general partner, including [the two individuals]" was "not sufficient to establish a reasonable pleading stage inference that [they] exercised sufficient 'control' over the assets of UDF III to justify the imposition of fiduciary duties on them."[111]

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

In *Lipman v. GPB Capital Holdings LLC*,[112] 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.[113] 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

105 *Id.* at *19.
106 *Id.* at *18.
107 *Id.* at *19.
108 *Id.*
109 Those four individual defendants subsequently sought an interlocutory appeal regarding this issue. The Court denied certification, stating that the appealing defendants' claims did not decide a "substantial issue of material importance that merits appellate review before a final judgment" per Delaware Supreme Court Rule 42(b)(1). *Fannin v. UMTH Land Dev., L.P.*, 2020 WL 5198356, at *1 (Del. Ch. Aug. 28, 2020) (citing Supr. Ct. R. 42(b)(i)).

110 *Fannin,* 2020 WL 4384230, at *20.
111 *Id.*
112 2020 WL 6778781 (Del. Ch. Nov. 18, 2020).
113 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."

and the general partner's controller faced substantial liability in connection with the litigation.[114]

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.'"[115] 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 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."[116] 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."[117] 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."[118] 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."[119] 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."[120] 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*,[121] "'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*.'"[122] 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."[123]

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

115 *Id.* at *3.

116 *Id.* at *7.

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

118 *Id.* at *8.

119 *Id.* at *9.

120 *Id.*

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

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

123 *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

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.'"[124] 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."[125]

***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*,[126] 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 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."[127]

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*,[128] 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

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.

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

125 *Id.* at *9.

126 2020 WL 6882105 (Del. Ch. Nov. 24, 2020).

127 *Id.* at *4.

128 2012 WL 1415466 (Del. Super. Mar. 29, 2012).

LLC act by stating that it applied to "any and all claims whatsoever," would "not mean what it says."[129] 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."[130] 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."[131] 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."[132] 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."[133]

129 *Int'l Rail Partners*, 2020 WL 6882105 at *7.
130 *Id.* at *6-7.
131 *Id.* at *7.
132 *Id.* at *8.
133 *Id.*

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

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

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

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

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

The Supreme Court reversed the Court of Chancery's decision, holding that "Saba had an obligation to respond to the request before the expiration of the deadline."[3] In response to Saba's arguments (and the Court of Chancery's decision) regarding the improper over-breadth of the questionnaire, the Supreme Court stated that "the record does not suggest that the Questionnaire's over-breadth precluded a timely response."[4] And the Supreme Court noted that although there were questions in the questionnaire that were

1 224 A.3d 964 (Del. 2020).
2 *Id.* at 968.
3 *Id.* at 978.
4 *Id.* at 979.

not relevant to the qualifications for prospective board members pursuant to the bylaws, it was undisputed that at least one-third of the questions were directly relevant, and, therefore: "If, after reviewing the Questionnaire, Saba believed that the Questionnaire exceeded the limits [of the bylaws], it should have raised the concern with the Trusts before the expiration of the deadline. What it could not do, without risking disqualification of its nominees, was to stay silent, do nothing, and let the deadline pass."[5]

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

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

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

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

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

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

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

5 *Id.*

6 *Id.* at 980.

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

8 *Id.* at *2.

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

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

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

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

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

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

Salzberg v. Schiabacucci, 227 A.3d 102 (Del. 2020).

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

Federal Forum Provisions are a recent development that were intended to reduce the cost of litigating 1933 Act cases by locating them exclusively in the federal courts that are claimed to have greater expertise in these cases and therefore can process them more efficiently. Three Silicon Valley companies, incorporated in Delaware, adopted Federal Forum Provisions in their post-IPO

11 *Id.* at *10.

12 *Id.*

13 *Id.*

14 *Id.*

15 *Id.* at *11-12.

16 *Id.* at *13.

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

18 227 A.3d 102 (Del. 2020).

charters. An action was filed in the Delaware Court of Chancery, claiming that those charter provisions were facially invalid as a matter of Delaware law.

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

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

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

20 *Id.* at *21.

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

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

21 *Salzberg,* 227 A.3d at 113 (emphasis removed).

22 Id. at 116-24. "Internal claims" (the "inner band" of the continuum) are as defined by the United States and the Delaware Supreme Court in decisions cited in the opinion, as well as DGCL Section 115 ("Claims . . . (i) based on a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction on the Court of Chancery."). The "external claims" category falls into the "outer band" of the continuum. The "inter-corporate claims" category falls within the inner and outer bands and was coined in *ATP Tour, Inc. v. Deutscher Tennis Bund,* 91 A.3d 554 (Del. 2014), which involved the validity of a fee-shifting provision in the bylaws of a non-stock Delaware corporation. That provision applied where a member sued the corporation and lost. The Supreme Court described this scenario as "inter-corporate litigation" and ultimately held that 1933 Act litigation falls into this category, which may validly be regulated under Section 102(b)(1).

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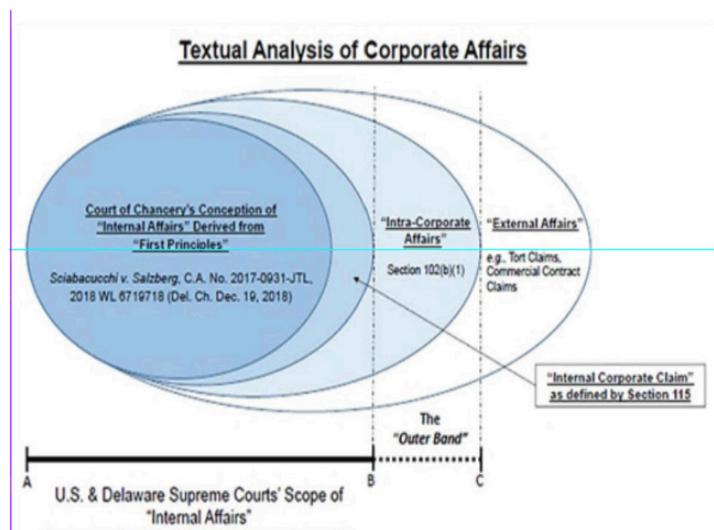
To illustrate that continuum, the Supreme Court provided in its opinion a Venn diagram that is reproduced below:



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

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

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

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

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

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

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

23 490 U.S. 477 (1989).

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

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

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

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

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

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

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

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

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

25 *Id.* at *3.
26 *Id.* at *6.
27 *Id.* at *8.

28 *Id.* at *7.
29 *Id.* at *10.
30 *Id.* at *11.

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

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

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

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

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

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

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

31 *Id.* at *10.
32 *Id.*
33 *Id.* at *13.
34 *Id.*
35 *Id.* at *12.
36 *Id.* at *14 (emphasis in original).
37 *Id.* (emphasis in opinion).
38 *Id.* (quoting *Trenwick Am. Litig. Tr. v. Ernst & Young, L.L.P.*, 906 A.2d 168, 173 (Del. Ch. 2006), aff'd sub nom. *Trenwick Am. Litig. Tr. v. Billett*, 931 A.2d 438 (Del. 2007)).
39 C.A. No. 2020-0232-JTL (Del. Ch. Mar. 30, 2020) (TRANSCRIPT).

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

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

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

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

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

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

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

40 *Id.* at 34.

41 *Id.* at 10.

***Borealis Power Hldgs. Inc. v. Hunt Strategic Util. Inv., L.L.C.*, 233 A.3d 1 (Del. 2020)**

In *Borealis Power Holdings Inc. v. Hunt Strategic Utility Investment, L.L.C.*,[43] the Delaware Supreme Court reversed a judgment by the Court of Chancery and held that a right of first refusal that restricted the ability of a unit holder to transfer units in a limited liability company was not triggered by the sale of interests two levels up the corporate chain, even though the right of first refusal's definition of transfer included any direct or indirect transfer of the units.

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

Two agreements were primarily at issue in the case: the TTHC Shareholders' Agreement (the "TTHC SA") and the Oncor Investor Rights Agreement (the "Oncor

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

43 233 A.3d 1 (Del. 2020).

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

Oncor and its equityholders were parties to the Oncor IRA. TTI was party to the Oncor IRA; however, Borealis, Cheyne Walk, and Hunt were not. The Oncor IRA contained a right of first refusal requiring any selling unitholder that intended to "Transfer" LLC units to provide Sempra with written notice of its intent to sell and to present Sempra with an offer to buy the units on the same conditions as the offer from the third party. The Oncor IRA defined "Transfer" as "any direct or indirect transfer ... of any LLC Units (or any interest (pecuniary or otherwise) therein or rights thereto). In the event that any Member that is a corporation, partnership, limited liability company or other legal entity (other than an individual, trust or estate) ceases to be controlled by the Person controlling such Member or a Permitted Transferee thereof, such event shall be deemed to constitute a 'Transfer' subject to the restrictions on Transfer contained or referenced herein."[44]

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

44 *Id.* at 6.

In considering the parties' claims, the Court of Chancery determined "whether Hunt's sale triggered (a) the [right of first refusal] in the Oncor IRA and/or (b) the [right of first offer] in the TTHC SA, and, (c) if both applied, which was to be given priority."[45] The Court of Chancery first held that both the right of first refusal and the right of first offer applied to the sale of Hunt's shares. The Court of Chancery explained that a "sale by Hunt of its shares to Borealis would, in fact, be a 'Transfer' of Oncor LLC Units… under the Oncor IRA."[46] Noting the Oncor IRA contained an extremely broad definition of what constituted a "transfer" of Oncor units, the Court of Chancery concluded that a transfer of TTHC shares constituted an indirect transfer of Oncor units and therefore triggered Sempra's right of first refusal. The Court of Chancery next held that because Sempra sought to exercise its right to purchase the shares from Hunt, a sale by Hunt to Borealis would breach the Oncor IRA. The Court of Chancery explained that the TTHC SA "prohibits transfers that breach the IRA," and therefore Sempra's "exercise of its right to purchase extinguished Borealis' right to purchase."[47] As a result, the Court of Chancery entered judgment for Sempra.

Borealis appealed the Court of Chancery's ruling. Borealis argued that Hunt's sale did not trigger the transfer restrictions in the Oncor IRA because "(1) the sale was not by the parties restricted in Section 3.1; (2) the sale fell outside the definition of 'transfer' as used in those sections; and (3) the sale does not involve 'Oncor LLC Units' as described in the Oncor IRA."[48]

Reviewing the language of the applicable agreements *de novo*, the Supreme Court—through a majority opinion authored by Justice Traynor and joined by Chief Justice Seitz and Justice Valihura, and a concurring opinion authored by Justice Vaughn and joined by Justice Montgomery-Reeves—reversed the Court of Chancery's decision. The Supreme Court began by explaining that although the Oncor IRA was governed by New York law and the TTHC SA was governed by Delaware law, both states give effect to the plain and unambiguous meaning of a contract. The majority noted that the right of first refusal provision in the Oncor IRA stated that "*the Minority Member* and

45 *Id.* at 7-8.

46 *Id.* at 8.

47 *Id.*

48 *Id.*

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its Permitted Transferees (each a "Selling Member") shall not Transfer their LLC Units…"[49] The majority also noted that the Oncor IRA clearly defined "Minority Member" as TTI, and that neither party argued Hunt was a "Permitted Transferee."[50] Thus, the majority held that if a transfer of Oncor units resulted from Hunt's sale of TTHC shares, then the transfer would be a product of Hunt's actions, not the actions of TTI.

In addition, the majority found that Sempra's right of first refusal was triggered by "TTI's 'intent'—voluntary or involuntary—to transfer LLC units 'or an interest therein or rights thereto,'" and that Hunt's actions did not represent TTI's intent to transfer LLC units.[51] The majority noted that "[t]he subjects (Hunt and TTI) of these two clauses are different and irreconcilable" and "[t]o hold otherwise would be to impute the contractual intentions of a minority member of a company's controller to the company itself—a result that runs contrary to settled corporate-law principles."[52] As Hunt was not defined as the "Minority Member" and, the majority found, Hunt's actions did not create an intent by TTI to sell LLC units, the majority held that Hunt's sale did not trigger Sempra's right of first refusal.

In so holding, the majority rejected Sempra's argument, based on the Oncor IRA's broad definition of "Transfer," applying to both direct and indirect transfers of LLC units, that the intent of the parties "was to bind TTI's upstairs equityholders and restrict their transfers of that upstairs equity."[53] The Supreme Court held that this argument "elide[d] the subject of the operative sentence in Section 3.1 of the Oncor IRA of which the [] verb phrase 'may only Transfer' serves as the predicate."[54] The majority explained that the subject of this sentence was "the Minority Member and its Permitted Transferees," which did not include Hunt.[55] The majority stated that because the right of first refusal "is only triggered by transfers by the Minority Member, it does not matter whether the Hunt sale constitutes a 'transfer' as contemplated by the Oncor IRA, or whether the sale transfers "Oncor LLC Units."[56] The Supreme Court therefore reversed the Court of Chancery's decision and remanded the case back to the Court of Chancery.[57]

The concurring opinion agreed with the majority that when the first sentence of the definition of Transfer ("any direct or indirect transfer") was applied, the right of first refusal is "triggered only when TTI is the transferor."[58] But the concurring opinion found that the "second sentence of the definition of Transfer [the control sentence] brings within it an event which may occur in TTI's chain of ownership."[59] The concurrence noted that "Borealis acknowledges that 'the second sentence of the definition of Transfer, unlike the first sentence, addresses those limited situations where activity that affects the ownership of TTI–rather than activity by TTI itself–is 'deemed to constitute' a Transfer that is 'subject to the restrictions on Transfer' in the IRA.'"[60] However, without elaboration, the concurring justices stated they did not believe, based on the record before the Supreme Court,[61] that it could "be reasonably concluded that, when Hunt sells its shares to Borealis, a party who controlled TTI before that event will cease to control TTI as a result of that event."[62]

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

Seven days after the Delaware Supreme Court's opinion in *Borealis Power Holdings Inc. v. Hunt Strategic Utility Investment, L.L.C.*,[63] which held that a right of first refusal that applied to the transfer of interests in an entity was not triggered by the sale of interests two levels up the corporate chain, the Court of Chancery, in *Sheehan v. AssuredPartners, Inc.*,[64] held that a tag-along right that applied to the transfer of interests in an entity

49 *Id.* at 9 (emphasis in original).
50 *Id.*
51 *Id.*
52 *Id.* at 10.
53 *Id.*
54 *Id.*
55 *Id.*
56 *Id.* at 9.
57 *Id.* at *7.
58 *Id.* at 11.
59 *Id.*
60 *Id.*
61 Although the Court of Chancery conducted a full trial, after the trial, the Court of Chancery requested post-trial briefing limited solely to the unambiguous terms of the contracts, and the Court of Chancery ruled on a purely legal basis that the first sentence of the definition of Transfer applied to the sale of Hunt's interest, triggering Sempra's right of first refusal. The record on appeal, therefore, did not include the significant evidentiary record from trial.
62 *Id.*
63 233 A.3d 1 (Del. 2020).
64 2020 WL 2838575 (Del. Ch. May 29, 2020).

was not triggered by the sale of interests two levels down the corporate chain. Both cases gave controlling effect to the subject of the transfer restrictions—the entities that were explicitly bound by the restrictions—without regard to what constituted a transfer under the terms of the relevant agreements.

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

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

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

The Court also found that, even if the Sheehans did retain their tag-along rights, the transaction would not have triggered the tag-along rights. The Court ruled that because the GTCR Transaction involved Holdco selling its wholly owned subsidiary, Topco, the sale "did not involve a transfer" by Investment LP necessary to trigger the rights under the Holdco LPA.[65] The Court stated that the Supreme Court's decision in *Borealis* supported its conclusion. The Court wrote that *Borealis* was distinguishable because its "reasoning applies to whether a sale two levels up the corporate chain is a transfer of a subsidiary's interest, the reverse of the factual scenario before this Court."[66] Nevertheless, the Court concluded *Borealis* supported its conclusion, as there "[t]he 'subject' of the right of first refusal . . . controlled the analysis. Similarly, the subject of Section 4.2 [of the Holdco LPA]—[Investment LP]—is important. [Investment LP] did not sell its Class A-1 Units in the GTCR Transaction, and Section 4.2 therefore does not apply."[67]

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

In *DLO Enterprises, Inc. v. Innovative Chemical Products Group, LLC*,[68] the Court of Chancery considered whether the buyers of substantially all of the assets of Arizona Polymer Flooring, Inc. ("Flooring Inc.") were entitled to two categories of responsive privileged documents: (i) communications between the sellers and their counsel that were in sellers' possession and that the sellers produced in redacted form ("Category One Documents") and (ii) communications between the sellers and their counsel that the buyers had

65 *Id.* at *13.
66 *Id.*
67 *Id.*
68 2020 WL 2844497 (Del. Ch. June 1, 2020).

in their possession because the communications were contained in email systems that were transferred to the buyers in connection with the transaction ("Category Two Documents"). With respect to the Category One Documents, the Court held that, unlike in the merger context, where the default rule is that privilege over pre-merger communications passes to the surviving corporation,[69] "[i]n the asset purchase context, the seller will retain pre-closing privilege regarding the agreement and negotiations unless the buyer clearly bargains for waiver or a waiver right."[70] With respect to the Category Two Documents, the Court held that a subset of documents that consisted of post-closing communications between one of the sellers (who worked for the buyers post-closing) and his counsel on an email system that was transferred to buyers in connection with the asset sale were subject to the four-factor test outlined in *In re Asia Global Crossing, Ltd.*[71] regarding an employee's reasonable expectation of privacy for workplace emails. The Court requested further briefing on a second subset of Category Two Documents—pre-closing communications that were in buyers' possession because they were contained in email systems transferred to the buyers in connection with the transaction—to help the Court determine the appropriate test to apply.

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

The Court first addressed the Category One Documents. The Court held that the seller retains pre-closing privilege regarding the negotiations surrounding an asset purchase transaction unless the buyer explicitly bargains for waiver of such privilege. The Court acknowledged that, in the merger context, Delaware law holds that, absent "an express carve out, the privilege over all pre-merger communications—including those relating to the negotiation of the merger itself—passe[s] to the surviving corporation in the merger, by plain operation of clear Delaware statutory law under § 259 of the DGCL."[72] But the Court explained that asset purchase transactions are inherently different. In asset purchase transactions, the "seller still exists, holding any assets that were not purchased, together with related privileges" and the parties are "in an adversarial relationship" because "[t]he target company has independent rights that are adverse to the buyer's rights."[73]

The Court stated that the buyers could have bargained for privilege waiver regarding the pre-closing communications between the sellers and their counsel. The buyers argued that they did so, pointing out that the asset purchase agreement gave the buyers privilege-waiver rights relating to the assets purchased and the liabilities assumed in the transaction. But the Court rejected the buyers' argument, finding that the buyers "failed to identify a clear contractual right to the privilege over deal communications."[74] The Court explained that the asset purchase agreement defined "excluded assets" to include "rights under or pursuant to this Agreement," and that such a provision meant that the "sellers retained privilege over communications related to the asset purchase agreement negotiations."[75] As such, the sellers' deal communications were not assets transferred to the buyers pursuant to the agreement, and the sellers were entitled to claim privilege over the Category One Documents.

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

The Court held that the four-factor test regarding an employees' reasonable expectation of privacy in work email as set forth in *Asia Global* and *In re Information*

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

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

71 322 B.R. 247, 257 (Bankr. S.D.N.Y. Mar. 21, 2005).

72 *DLO Enters.*, 2020 WL 2844497, at *3 (quoting *Great Hill Equity P'rs*, 80 A.3d at 162).

73 *Id.* at *5.

74 *Id.* at *7.

75 *Id.*

Management Services, Inc. Derivative Litigation[76] was the appropriate test for the post-closing documents in Category Two. The first factor asks whether "the corporation maintain[s] a policy banning personal or other objectionable use" of work email.[77] This factor weighed in favor of waiver because the buyers' employee handbook at the time of the post-closing communications "established that employees did not have an expectation of privacy and, importantly, that the company reserved the right to access employees' email accounts at any time."[78]

The second factor asks whether "the company monitor[s] the use of the employee's computer or email."[79] While the handbook included monitoring provisions, the buyers did not show that the company actually engaged in monitoring email. Therefore, the Court decided to treat this factor as neutral.

The third factor asks whether "third parties have a right of access to the computer or emails."[80] The Court stated that this factor is "largely duplicative of the first and second" and as such, "favor[ed] production of the post-closing documents."[81]

Finally, the fourth factor asks whether the corporation "notif[ied] the employee," or the employee was "aware, of the use and monitoring policies."[82] The Court stated that this factor also supported production because at the bottom of the emails at issue there was a disclaimer stating that "messages sent to and from employees in our organization may be monitored."[83]

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

The Court also ordered supplemental briefing to decide whether the pre-closing Category Two Documents should be produced, explaining that the "proper test may be one of inadvertent production, rather than solely a consideration of the employees' expectation of privacy when working for" the target company.[84]

Finally, the Court took issue with the fact that the buyers' counsel reviewed the content of the "potentially privileged Category Two Documents in their possession."[85] The Court stated that the buyers' counsel's review of the documents was "inappropriate" and that they should have "abstained from reviewing" the documents "pending resolution of the privilege dispute."[86] The Court stated that, upon resolution of the motion, the sellers had permission to seek relief "to rectify this wrong" if any of the documents are found to be privileged.[87]

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

In *The Anschutz Corp. v. Brown Robin Capital, LLC*,[88] the Court of Chancery held that a Delaware choice of law clause governing the construction and interpretation of a unit purchase agreement also applied to related, but extra-contractual, fraud claims.

The conflict giving rise to these claims arose from "a version of a dispute as old and abiding as commerce itself": a buyer alleged that it was the victim of fraud and breaches of contract, while "the seller maintains it sold the buyer precisely what was bargained for."[89] A collection of individuals and entities sold OnRamp Access, LLC ("OnRamp"), to the buyer, LightEdge Holdings, LLC ("LightEdge"), via a unit purchase agreement (the "UPA"). Prior to closing, one of OnRamp's largest customers made multiple requests for major service reductions. LightEdge only learned of these requests post-closing, when the customer reduced its business with OnRamp by nearly half. LightEdge also discovered that data in OnRamp's sales pipeline was incorrect, as several of the sales opportunities

76 81 A.3d 278 (Del. Ch. 2013).
77 *DLO Enters.*, 2020 WL 2844497, at *8 (quoting *Asia Global*, 322 B.R. at 257).
78 *Id.*
79 *Id.* at *8 (quoting *Asia Global*, 322 B.R. at 257).
80 *Id.* (quoting *Asia Global*, 322 B.R. at 257).
81 *Id.* at *9.
82 *Id.* at *8 (quoting *Asia Global*, 322 B.R. at 257).
83 *DLO Enters.*, 2020 WL 2844497, at *9.
84 *Id.*
85 *Id.* at *10.
86 *Id.*
87 *Id.*
88 2020 WL 3096744 (Del. Ch. June 11, 2020).
89 *Id.* at *1.

listed in the pipeline were either wholly speculative or had been rejected well before closing. LightEdge alleged that disclosure of the business reduction was required under the UPA and that the pipeline data was falsified, and brought claims for breaches of the UPA's representations and warranties and for extra-contractual fraud based on the same alleged conduct.

LightEdge alleged that its injury occurred in both Texas and Colorado and brought fraud and securities violations based on Texas and Colorado statutes. The sellers moved to dismiss these claims, arguing that because the UPA contained a Delaware choice of law provision, the foreign statutes could not be invoked. In response, LightEdge argued that "the choice of law provision applies only to the construction and interpretation of the UPA, and therefore its other common law and statutory claims are not subject to the provision."[90]

The Court disagreed with LightEdge. Finding that "the fraud claims in this case are entangled at a granular level with the operative contract's allocation of risk," the Court decided that "[t]o try to parse out what exactly should be decided under Delaware law and what falls under another state's law (e.g., Texas, Colorado or some combination of both) would be a foolhardy endeavor almost certain to result in the kind of confusion contractual choice of law provisions are meant to avoid."[91] The Court noted that this endeavor would have been especially difficult in this case, given that "[t]he conduct giving rise to the breach of contract claims is, with one potential exception, identical to the conduct giving rise to the fraud claims" and because "this case involves a separate disagreement between the parties about whether the UPA contains unambiguous anti-reliance language that would bar extra-contractual fraud claims."[92] The Court therefore held that the Delaware choice of law provision applied to the extra-contractual claims and dismissed the claims brought under the Colorado and Texas statutes.

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

90 *Id.* at *7.
91 *Id.* at *8.
92 *Id.* (footnote omitted).

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

In *In re Anthem-Cigna Merger Litigation*,[93] the Court of Chancery reviewed a failed $54 billion merger and found that, while one of the merger parties had breached certain contractual covenants to try to close the transaction, the breaching party had proven that a necessary condition for closing would fail even without the breach. The Court therefore left the "parties where they stand."[94]

The proposed merger was between Anthem, Inc. and Cigna Corporation, two of the largest health insurance providers in the United States. The merger agreement contained three covenants relevant to the litigation (the "Efforts Covenants"). First, the parties were obligated to use their "reasonable best efforts" to satisfy the conditions for closing (the "Reasonable Best Efforts Covenant").[95] The Reasonable Best Efforts Covenant would be breached by either party "failing to take reasonable steps to consummate the transaction or by not attempting to solve problems."[96] Second, the parties were required to take "any and all actions necessary to avoid" any impediment to the merger that a government entity might assert under various laws (the "Regulatory Efforts Covenant").[97] Third, the agreement "gave Anthem the authority to take the lead in communicating with regulators and developing a regulatory strategy" while obligating Cigna to "follow Anthem's lead and adhere to Anthem's strategy" (the "Regulatory Cooperation Covenant").[98] Further, the parties' obligation to close was conditioned upon, among other things, the merger not being prevented or prohibited by any injunction (the "No Injunction Condition").

The Department of Justice "concluded that the Merger would have anticompetitive effects[,] declined to approve it[,]" and filed a lawsuit in federal district court.[99] "Throughout the Antitrust Litigation, Cigna undermined Anthem's defense[,] opposed Anthem's efforts to mediate and took litigation positions that

93 2020 WL 5106556 (Del. Ch. Aug. 31, 2020).
94 *Id.* at *6.
95 *Id.* at *91-93.
96 *Id.* at *93.
97 *Id.* at *93-96.
98 *Id.* at *96.
99 *Id.* at *3.

supported the DOJ."[100] The district court issued a "permanent injunction that prevented the Merger from closing."[101] Cigna purported to terminate the merger and brought an action in the Court of Chancery seeking to establish its right to do so, while Anthem sued in the same court to "keep the Merger Agreement in place so that it could appeal from the District Court's decision[.]"[102] The Court of Chancery issued a temporary restraining order preventing Cigna from terminating, but after the district court's decision was upheld on appeal, the Court of Chancery denied Anthem's request to convert the TRO into a preliminary injunction but stayed its ruling (keeping the TRO in place) so Anthem could appeal to the Delaware Supreme Court. Anthem decided not to appeal and terminated the merger agreement. The cases brought by Cigna and Anthem were consolidated as a damages action. Anthem claimed that Cigna breached the Efforts Covenants and caused $21.1 billion in expectation damages, while Cigna alleged Anthem breached the Regulatory Efforts Covenants and caused $14.7 billion in expectation damages. Cigna also sought a reverse termination fee of $1.8 billion.

The Court determined that Cigna breached the Reasonable Best Efforts Covenant by running a "covert communication campaign against the Merger" and by withdrawing from integration planning.[103] The Court also found that Cigna had breached the Regulatory Efforts and Regulatory Cooperation Covenants by (i) opposing a divestiture to try to address DOJ concerns, (ii) resisting a mediation during the antitrust litigation, and (iii) undermining Anthem's defense of the antitrust litigation.[104] The Court held that, although Anthem failed to establish that "Cigna's covert communication campaign had a significant effect on the DOJ or the courts," Anthem had shown that Cigna's other actions materially contributed to the "non-occurrence of the No Injunction Condition."[105]

But, the Court explained, in accordance with the Restatement (Second) of Contracts, where the performance of a contract is subject to a condition (such as the No Injunction Condition), while the condition may be excused by a breach that contributed materially to the non-occurrence of the condition, the breaching party may still avoid liability by establishing that the condition would have failed regardless of the breach.[106] Thus, "[o]nce Anthem proved that Cigna's breaches of the Efforts Covenants contributed materially to the DOJ's failure to approve the Merger" and to the issuance of the injunction, the "burden then shifted to Cigna to prove that even if Cigna had fulfilled its obligations under the Efforts Covenants, the No Injunction Condition still would have failed."[107] The Court ultimately concluded that Cigna successfully met that burden "by proving that even if Cigna had fulfilled its obligations under the Efforts Covenants, the DOJ would not have approved the Merger because of its effect on the market for the sale of commercial insurance to national accounts," and the merger still would have been enjoined.[108] Anthem therefore was not entitled to any damages, and judgment was entered for Cigna on Anthem's claims.

For its part, Cigna claimed that Anthem had breached the Regulatory Efforts Covenant by not pursuing all possible avenues to change certain rules applicable to Anthem as a member of the association that owned the Blue Cross and Blue Shield trademarks and by omitting certain potential synergies from a white paper on medical cost savings. The Court found Cigna failed to prove a breach of the Regulatory Efforts Covenant relating to the rules because (i) the rules were not a "legal impediment in the sense contemplated by the Regulatory Efforts Covenant[,]" and (ii) even if the Regulatory Efforts Covenant had applied, Anthem followed a reasonable strategy to seek to change the rules, such that it satisfied its obligations.[109] The Court also found that the omission of synergies from the white paper was because Anthem's attorneys could not verify them. The Court also pointed out that, even if Anthem had breached its obligations, it would not have faced any liability because the Merger Agreement limited liability for termination of the agreement to fraud and willful breaches, and Cigna had not established either. The Court therefore granted judgment to Anthem on Cigna's claims.

The Court also entered judgment in Anthem's favor

100 *Id.* at *4.
101 *Id.* at *3.
102 *Id.*
103 *Id.* at *97-103.
104 *Id.* at *110-22.
105 *Id.* at *100-22.
106 *Id.* at *90-91.
107 *Id.* at *123.
108 *Id.*
109 *Id.* at *130-31.

on Cigna's claim that Anthem was liable for a reverse termination fee because Anthem had validly terminated the merger agreement "under a termination right that did not trigger the fee[.]"[110] Cigna argued that this was unfair because it would have been entitled to the fee had it been able to terminate the merger earlier but had been prevented from doing so by the temporary restraining order. The Court responded that the TRO was "put in place because Cigna previously breached its contractual obligations by attempting to terminate the Merger Agreement . . . and moot Anthem's appeal."[111] "Having previously sought to gain a timing advantage of its own in violation of the Merger Agreement," the Court continued, "Cigna cannot now complain about the effects of a TRO that its own conduct made necessary."[112]

Anthem demonstrates how causation remains a critical element of a breach of contract claim seeking damages, even in complex commercial transactions where it is clear that one party failed to comply with its covenants. It also reminds practitioners, among other things, that when a party agrees to take "any and all actions" to ensure that a condition occurs, Delaware courts likely will interpret the party's obligations broadly such that if an "action [falls] within the scope of the provision," the party will be "required to take it" even if the action arguably may not be commercially reasonable.[113]

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

In *In re Solera Insurance Coverage Appeals*,[114] 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. . . ."[115] 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. . . ."[116]

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"),[117] 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."[118] They further "argued that 'Delaware courts consistently distinguish appraisal actions from shareholder class actions' based on allegations of wrongdoing"[119] 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."[120] 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

110 *Id.* at *6.
111 *Id.* at *140.
112 *Id.*
113 *Id.* at *96.
114 240 A.3d 1121 (Del. 2020).
115 *Id.* at 1125 (internal quotations omitted).
116 *Id.*
117 *See generally In re Appraisal of Solera Holdings, Inc.*, 2015 WL 3997578 (Del. Ch. Aug. 20, 2018).
118 *In re Solera*, 240 A.3d at 1127.
119 *Id.*
120 *Id.*

Corporate Instruments

D&O policies. The Superior Court agreed with Solera that a "violation" did not require any allegation of "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."[121] The Supreme Court explained that appraisal actions, in contrast, do "not involve a determination of wrongdoing."[122] 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."[123]

The Supreme Court further noted that "[a]ppraisal proceedings are neutral in nature."[124] "Unlike most proceedings, '[i]n statutory appraisal proceeding, both sides have the burden of proving their respective valuation positions by a preponderance of evidence.'"[125] 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."[126]

The Supreme Court rejected Solera's argument that recent rulings, in *Dell*,[127] *DFC*,[128] and *Aruba*,[129] "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."[130] 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.'"[131]

121 *Id.* at 1132.
122 *Id.*
123 *Id.* at 1134.
124 *Id.* at 1135.
125 *Id.* at 1135-36 (quoting *M.G. Bancorp. Inc. v. Le Beau*, 737 A.2d 513, 520 (Del. 1999)).
126 *Id.* at 1136.
127 *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, 177 A.3d 1 (Del. 2017).
128 *DFC Global Corp. v. Muirfield Value P'rs, L.P.*, 172 A.3d 346 (Del. 2017).
129 *Verition P'rs Master Fund Ltd. v. Aruba Networks, Inc.*, 210 A.3d 128 (Del. 2019).

***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*,[132] 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").[133] 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

130 *In re Solera*, 240 A.3d at 1137.
131 *Id.* at 1136 (quoting *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182, 1189 (Del. 1988)).
132 2020 WL 7024929 (Del. Ch. Nov. 30, 2020).
133 *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.

on September 10, 2019, but required the Seller to delay closing until April 17, 2020, so that the Seller 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.[134] The Buyer counterclaimed, seeking a declaration that it was not obligated to close and that it validly terminated the sale agreement.[135]

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*.[136]

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[.]"[137] The definition included exceptions for, *inter alia*, "natural disasters or calamities[.]"[138] 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.[139] 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)."[140] 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."[141]

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."[142] 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.[143]

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

134 *Id.* at *46.

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

136 789 A.2d 14, 22 (Del. Ch. 2001).

137 AB Stable 2020 WL 7024929, at *53.

138 *Id.*

139 *Id.* at *55.

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

141 *Id.* at *58.

142 *Id.* at *60.

143 *Id.* at *61-62.

"natural disaster."[144] In other agreements, "calamity" was used as a "catchall" for other events.[145] Based on these and other observations, the Court concluded that the terms "natural disasters" and "calamity" were broad enough to encompass pandemic risks.[146] 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[.]"[147] 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[.]"[148] 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."[149] 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.

144 *Id.* at *64.
145 *Id.*
146 *Id.*
147 *Id.* at *65.
148 *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*)).
149 *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.*,[150] 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."[151] 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,[152] 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.[153] 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."[154]

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.[155] 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."[156]

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

150 2020 WL 7230419 (Del. Ch. Dec. 8, 2020).

151 *Id.* at *5.

152 *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.").

153 *Id.* at *8.

154 *Id.*

155 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.

156 *Id.*

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.[157]

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.[158]

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.[159] 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.[160]

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.[161] 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."[162]

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."[163]

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.[164] 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

157 *Id.* at *11.
158 *Id.*
159 *Id.* at *13.
160 8 *Del. C.* § 271.
161 2020 WL 7230419, at *19.
162 *Id.* at *16.
163 *Id.* at *20.
164 *Id.* at *20.

to mortgage or pledge all of a corporation's assets.[165] 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.[166]

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.

165 *Id.*
166 *Id.*

Special Proceedings Under the Delaware General Corporation Law

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

In *In re Appraisal of Panera Bread Co.*,[1] the Court of Chancery found after trial in a statutory appraisal proceeding that the fair value of respondent Panera Bread Co.'s stock was the deal price minus synergies, rejecting the petitioners' fifteen-percent-higher proposed value and ascribing "no weight to other valuation metrics" such as discounted cash flow ("DCF"), comparable companies, and precedent transactions analyses.[2] *Panera* continues the Delaware courts' trend in appraisal proceedings to give weight to deal price where, despite imperfections, the process contains "indicia of reliability" such as arms'-length negotiations, an unconflicted board, multiple rounds of price increases, and the absence of topping bids in the post-signing period.[3]

1 2020 WL 506684. (Del. Ch. Jan. 31, 2020).

2 *Id.* at *1.

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

The petitioners sought appraisal of their Panera stock after JAB holdings, B.V. purchased Panera for $315 per share. The petitioners argued that Panera's fair value was $361 per share, based primarily on their expert's DCF analysis.[4] In support of their argument that the Court should adopt their expert's analyses and disregard the deal price as an indicator of fair value, the petitioners pointed to three primary alleged problems in Panera's sale process: (1) the Panera board's "apathy, ignorance, and flat-footed[ness]," (2) the Panera CEO's desire to exit his position and retire, which incentivized him to sell Panera for less than fair value, and (3) Panera's financial advisor's conflicts of interest.[5]

The Court rejected the petitioners' arguments and found that, although the transaction had flaws, those "flaws d[id] not undermine its numerous indicia of reliability," which included "an arm's length negotiation, a disinterested and independent board, numerous price increases, no emerging [topping] bidders . . . , and outreach to all logical buyers."[6]

First, the deal process was not undermined by what the petitioners characterized as the board's "apathy, ignorance, and flat-footed[ness]."[7] While the Court found it problematic that the board "gave early guidance" to the would-be acquirer on a potential price

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

5 *Id.* at *24-35.

6 *Id.* at *24.

7 *Id.*

range that may have been too low, the Court reasoned that "this pricing guidance was not a potentially binding counteroffer, and did not set a ceiling on the price."[8] The petitioners also criticized Panera's board for moving too quickly in compliance with the acquirer's proposed timeline, but the Court found that the acquirer's "desire for speed benefitted" Panera because it minimized managerial distraction and potential disruption of Panera's operations.[9] The Court also found that Panera's board negotiated "less restrictive deal protections," including a no-shop with a fiduciary out, matching rights, and a 3.0% termination fee (negotiated down from 4.0%)—all standard deal terms that provided flexibility to Panera.[10] Finally, the Court rejected the petitioners' argument that the board's decision to pursue a "logical buyer universe" of only two buyers was "absurd," holding that the board "possessed a robust body of evidence that it used to determine the universe of logical buyers" and "the absence of a wider canvass or go-shop d[id] not change the reliability of Panera's outreach."[11] In sum, "[t]he board's performance d[id] not render Panera's pre-signing process unreliable."[12]

Second, even though Panera's CEO, Ronald Shaich, "led the negotiations" and "wanted to exit Panera," his "desire to retire did not undermine the deal process or diminish Panera's standalone value."[13] Rather, the Court found that Shaich was "intent on driving the price upwards" and credited testimony that he was "supremely focused on finding a good home for the company and preserving [Panera's] legacy."[14]

Third, the Court rejected the petitioners' arguments that Panera's financial advisor, Morgan Stanley, undermined the deal process. Although Morgan Stanley had previously done work for the acquirer, this was disclosed to the Panera board, and the petitioners presented no evidence that Morgan Stanley preferred the acquirer's interests. Moreover, Morgan Stanley provided competent advice that informed Panera's negotiating strategy. Finally, the fact that "the board had very little time with Morgan Stanley's valuation" before approving the merger did not undermine the sale process.[15]

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

After finding that the deal process was not undermined and contained numerous indicia of reliability, the Court conducted a synergies analysis and deducted $11.56 from the deal price to arrive at a "deal price minus synergies valuation method" that yielded a price of $303.44 per share.[16] The Court further reasoned that, "in the context of a persuasive deal price," the petitioners' expert's alternative valuation methodologies (DCF, comparable companies, and precedent transactions) were unreliable and deserved no weight.[17]

Although the Court held that the deal price minus synergies was Panera's fair value, the Court noted that Panera had chosen to pre-pay the petitioners the deal price of $315 per share.[18] The Court rejected Panera's request that the Court require the petitioners to refund the difference between the $315-per-share payment and the Court's fair value determination of $303.44 per share, finding that such request had no basis in the appraisal statute and that the respondent had provided no other grounds on which the difference would be recoverable. This holding serves as a warning to appraisal respondents that, if they decide to pre-pay the deal consideration to petitioners, they will not be entitled to a refund of any difference between that deal price and a lower fair value determination (absent contractual agreement otherwise).

8 *Id.* at *27.
9 *Id.* at *28.
10 *Id.* at *29.
11 *Id.* at *24.
12 *Id.* at *29.
13 *Id.* at *31.
14 *Id.* at *30.
15 *Id.* at *35.
16 *Id.* at *35-40.
17 *Id.* at *40-43.
18 *Id.* at *43.

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

In *Paraflon Investments, Ltd. v. Linkable Networks, Inc.*,[19] the plaintiff, Paraflon Investments, Ltd., brought an action in the Court of Chancery pursuant to Section 220 of the Delaware General Corporation Law ("Section 220") against the defendant, Linkable Networks, Inc. ("Linkable"), seeking inspection of certain categories of Linkable's books and records. The *Paraflon* case is significant because the Court emphasized that Paraflon had to demonstrate a credible basis of *non-exculpated* misconduct. This arguably conflicts with the Court's recent holding in *Lebanon County Employees' Retirement Fund v. Amerisourcebergen Corp.*,[20] which the *Paraflon* decision did not directly address.

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

Despite Paraflon's additional investment, Linkable was in desperate need of capital and approached Blue Chip Venture Capital ("Blue Chip"), a Linkable investor, for funding. Blue Chip agreed to invest an additional $2.5 million and signed a term sheet on November 8, 2016. Shortly thereafter, however, Linkable founder Thomas J. Burgess notified Mr. Sarkesian that Linkable would not be pursuing the Blue Chip funding because Blue Chip was attempting to "walk back on the term sheet."[21] Linkable did not counter-sign the final Blue Chip investment agreement and did not attempt to enforce the term sheet.

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

Paraflon sent its Section 220 demand for books and records to Linkable on August 11, 2017 (the "Demand"). The Demand's stated purpose was "to investigate potential mismanagement or wrongdoing at Linkable" and requested financial records, documents related to the Collinson transaction, documents concerning other potential buyers, board minutes, and documents concerning the failed Blue Chip transaction. Linkable made a voluntary production, but Paraflon sought more documents and subsequently filed a complaint in the Court of Chancery on August 24, 2017. Linkable made a second production in an attempt to resolve the litigation,[22] but Paraflon insisted that various categories of document requests remained unaddressed including documents concerning the failed Blue Chip transaction, documents concerning the Collinson transaction, certain financial records,[23] and copies of certain consumer contracts. The request for consumer contracts was not included in Paraflon's Demand.[24]

The Court focused its analysis on whether Paraflon had demonstrated "a credible basis from which a court can infer that mismanagement or wrongdoing may have occurred."[25] The Court noted "[w]here, as here, the corporation's charter contains an exculpatory provision under 8 *Del C.* § 102(b)(7), the stockholder's purpose must target non-exculpated wrongdoing."[26] The Court

19 2020 WL 1655947, at *1 (Del. Ch. Apr. 3, 2020).

20 2020 WL 132752, at *23 (Del. Ch. Jan. 13, 2020) ("It would be premature to allow AmerisourceBergen to rely on its exculpatory provision to foreclose an inspection into possible corporate wrongdoing. The inspection could lead to non-exculpated claims."). In *Amerisourcebergen,* the Court dismissed the defendant's Section 102(b)(7) defense and held that "the plaintiffs' inspection rights do not depend on the existence of an actionable claim for damages against the board of directors. The plaintiffs need only establish a credible basis of from which a court can infer possible mismanagement or corporate wrongdoing, which they have done." *Id.* at *19.

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

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

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

24 *Id.* at *3.

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

26 *Id.*

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analyzed whether Paraflon had demonstrated a credible basis of non-exculpated wrongdoing as related to each category of document requests.

First, Paraflon requested documents concerning the Blue Chip financing. Paraflon argued that Linkable's failure to enforce the Blue Chip term sheet given its dismal financial condition could not be attributed to the exercise of business judgment. Paraflon argued that it was possible that Linkable failed to enforce the term sheet as a concession to a board member who was affiliated with Blue Chip, in violation of the duty of loyalty. The Court determined that Paraflon "ha[d] presented some evidence that, in the midst of the imminent demise of [Linkable], the Board elected not to pursue Linkable's rights to access capital for reasons other than the best interests of [Linkable] and its stockholders."[27] The Court therefore held that Paraflon satisfied the low burden to demonstrate a credible basis of a non-exculpated duty of loyalty claim and was entitled to review all Board-level documents concerning the failed Blue Chip transaction.

Second, Paraflon requested documents concerning the sale of Linkable to Collinson. Paraflon argued that the fact that Mr. Correra entered into a consulting agreement with Collinson after the transaction provided a credible basis to infer that the Collinson transaction was the result of self-dealing. The Court held that Correra's short-term consulting role with Collinson following the transaction was insufficient to support a credible basis of non-exculpated wrongdoing, and denied Paraflon's request to inspect this category of documents. The Court noted that the record was "devoid of evidence that Correra dominated or controlled the Board, giving him the *de facto* power to control the transaction" and Linkable had "provided evidence that the Collinson transaction was only agreed to after a vigorous, arms-length sales process."[28] The Court concluded that "[i]n the face of an otherwise robust sales process, the mere fact that Correra secured a short-term consulting role with Collinson post-closing does not provide a credible basis to support wrongdoing."[29]

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

27 *Id.*

28 *Id.* at *5.

29 *Id.*

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

In *Martinez v. GPB Capital Holdings, LLC*,[30] the Court of Chancery dismissed a books and records action brought by an investment advisor pursuant to Section 17-305 of the Delaware Revised Uniform Limited Partnership Act ("Section 17-305") because the investment advisor (i) lacked standing to pursue a statutory books and records demand and (ii) was not a third-party beneficiary entitled to pursue a contractual books and records demand. The Court also dismissed a related limited partner's demand as statutorily deficient because the demand failed to strictly adhere to the statutory requirements of Section 17-305. However, the Court allowed the limited partner's claim for specific performance of the partnership agreement to proceed as a plenary action despite the fact that the complaint was filed as a hybrid summary-plenary action.

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

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

GPB rejected the demand, stating the demand should have been made by the limited partners directly and

30 2020 WL 3054001 (Del. Ch. June 9, 2020).

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

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

As a threshold matter, the Court held that Hightower lacked standing to make a demand on any of the GPB entities, based on the ordinary meaning of Section 17-305. In particular, Section 17-305 provides that "if a general partner refuses to permit a limited partner to obtain [information that a limited partner may obtain under Section 17-305(a)] . . . *the limited partner* may apply to the Court of Chancery for an order to compel such disclosure."[31] The Court found the statute unambiguously precluded Hightower from bringing the demand because it was not a limited partner of any of the GPB entities. On that same basis, the Court held that Martinez only had standing to pursue a books and records action on behalf of Holdings II, of which he was a limited partner.

The Court also held that Hightower lacked standing to pursue a books and records demand under the limited partnership agreements because it was not a party to the agreements. The Court explained that such a claim was tantamount to a claim for specific performance, which can only be pursued by (i) a party to a contract and (ii) a third-party beneficiary. The Court held that Hightower failed to plead any of the requirements necessary to show third-party beneficiary status, and that even if it did, the agreements explicitly disclaimed third-party beneficiaries.[32] In so holding, the Court rejected Hightower's argument that it had standing to pursue a books and records action because the limited partnership agreements allowed "designees" of the limited partners to "examine or request" books and records. The Court held that the right to "examine or request" was not equivalent to the right to pursue an action to enforce the contract.

The Court next addressed whether Hightower's demand on behalf of Martinez complied with the statutory requirements of Section 17-305. The Court held that the demand failed to comply with the form and manner requirements of Section 17-305 because it did not include an affidavit stating Hightower was authorized to act on Martinez's behalf at the time of the demand. The Court noted that Section 17-305(d) mandates that a demand be "accompanied by a power of attorney or such other writing which authorizes the attorney or other agent to so act on behalf of the limited partner,"[33] and that Delaware requires "strict adherence" to the statutory requirements in order to conserve resources and avoid unnecessary litigation.[34] Drawing from the Delaware Supreme Court's decision in *Central Laborers Pension Fund v. News Corp.*,[35] the Court held that "accompanied by" requires the demand to be accompanied by a power of attorney at the time the demand is made. The Court further held, based on *Central Laborers*, that "a demand that does not fulfill all procedural requirements of the statute *when made* does not and *cannot* comply with the statute" and can no longer be cured, regardless of whether or not litigation on the demand was already initiated.[36] Because Martinez's affidavit was submitted a month after the demand was made, the Court concluded that the demand did not adhere to the strict requirements of Section 17-305(d) and that the deficiencies could not be cured by the subsequent affidavit.

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

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

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

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

35 45 A.3d 139 (Del. 2012) (holding that the subsequent filing would comply with the statute "only if it was submitted with either a new or amended demand").

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

Although the Court dismissed Martinez's statutory claim, it held that Martinez could proceed on his contractual claim. The Court noted that ordinarily contractual claims cannot be brought in a summary books and records proceeding because allowing complex claims would expand the proceedings to a plenary trial that would overwhelm the purpose of the special proceedings under Section 17-305. However, because the statutory books and records claims were dismissed, the Court held Martinez's contractual claim could proceed "outside of the framework of a summary books and records action."[37]

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

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

In *Fir Tree Value Master Fund, LP v. Jarden Corp.*,[38] the Delaware Supreme Court affirmed the Court of Chancery's post-trial appraisal decision adopting an acquired corporation's unaffected market price as fair value. In doing so, the Supreme Court rejected the notion that there is a "'long-recognized principle' that a corporation's unaffected stock price cannot equate to fair value"[39] and affirmed that Delaware law does not rule out "using any recognized valuation methods to support fair value."[40] The Court also rejected the petitioners' argument that the deal price served as a floor for the company's fair value.

This appraisal action arose out of the April 2016 sale of Jarden Corporation ("Jarden"), a company founded by Martin Franklin, to Newell Brands for a sale price of $59.21 per share.[41] The Court of Chancery found the sale price "resulted from a flawed sale process"[42] that "raise[d] concerns" and "left much to be desired."[43] The flaws included, among other things, that Franklin had "acted with 'little to no oversight by the Board' and volunteered a 'price range the Board would accept to sell the Company before negotiations began in earnest.'"[44] Additionally, the process lacked "a pre-signing or post-signing market check."[45]

After the merger closed, several Jarden stockholders sought appraisal. In a four-day appraisal trial, the Court of Chancery considered testimony from "twenty-five fact witnesses and three expert witnesses."[46] The petitioners' expert "presented a comparable companies analysis and a discounted cash flow analysis" to argue for "a fair value of $71.35 per share on the merger date."[47] Jarden's expert "considered market evidence of Jarden's unaffected stock price and the merger price less synergies" and "examined comparable companies and presented a [discounted cash flow ("DCF")] analysis" to argue "that Jarden's fair value on the merger date was $48.01 per share based on his DCF analysis."[48] Relying on Jarden's unaffected market price, the Court of Chancery determined that the fair value of each share of Jarden stock on the closing date of the merger was $48.31.

On appeal, the petitioners' arguments centered on three main contentions: "the court erred as a matter of law and abused its discretion by relying on unaffected market price; the court should have treated the deal price as a fair value floor; and the court constructed its own flawed DCF model to corroborate its fair value."[49]

First, addressing the petitioners' argument that the Court of Chancery erred in relying on Jarden's unaffected market price, the Supreme Court began by rejecting the notion of a "long-recognized principle in Delaware law . . . that stock price does not equal fair value."[50] The Supreme Court stated that none of

37 *Id.*
38 236 A.3d 313 (Del. 2020).
39 *Id.* at 316.
40 *Id.* at 323-24.
41 *Id.* at 315.
42 *Id.* at 316.
43 *Id.* at 320 (quoting *In re Appraisal of Jarden Corp.*, 2019 WL 3244085, at *3, *24 (Del. Ch. July 19, 2019)).
44 *Id.* (quoting *Jarden*, 2019 WL 3244085, at *3).
45 *Id.* at 320-21.
46 *Id.* at 320.
47 *Id.*
48 *Id.*
49 *Id.* at 323.
50 *Id.* at 323-24 (quoting Petitioners' Opening Br. at 3).

its recent appraisal decisions preclude a court from relying on any recognized valuation method to support fair value. The Supreme Court agreed with the Court of Chancery's statement that "[w]hat is necessary in any particular [appraisal] case [ ] is for the Court of Chancery to explain its [fair value calculus] in a manner that is grounded in the record before it."[51] Further, the Supreme Court, quoting its decision in *Dell*, reiterated that, depending on the specific facts, one "single valuation metric" might be the most reliable, or a Court may need to rely on "a variety of methodologies."[52] In all cases, "the trial court must justify its methodology (or methodologies) according to the facts of the case and relevant accepted financial principles."[53]

The Supreme Court further held that, in relying on Jarden's unaffected market price, the Court of Chancery did not err in finding that "the market did not lack material nonpublic information."[54] On appeal, the petitioners conceded that Jarden's stock traded in a semi-strong efficient market, "meaning the market quickly assimilated all publicly available information into Jarden's stock price[,]" but challenged the event study prepared by Jarden's expert, contending that Jarden's value was difficult to assess due to limited public information about the corporation and the corporation's numerous acquisitions.[55] The only non-public information that the petitioners pointed to, however, was Jarden management's internal projections, which merely reflected a difference in opinion as compared to the projections from market analysis. The difference in opinion did not represent a difference in available information.

Second, the Supreme Court rejected the petitioners' argument that the negotiated deal price should have been used by the Court of Chancery as the floor for fair value. In the decision below, the Court of Chancery was persuaded by the petitioners' argument that Franklin's improper deal negotiations may have created an artificial ceiling for the deal price.[56] For that reason, "the Court of Chancery did not rely on the deal price to find fair value."[57] On appeal, the petitioners argued that, because the deal negotiations were flawed, proper negotiations would have resulted in a higher deal price, and thus, the improperly negotiated deal price should have acted as a floor for fair value. Rejecting this argument, the Supreme Court held that, although the flawed process may have capped the deal price under what could have been achieved under ideal conditions, there was evidence that the merger price exceeded fair value. Furthermore, the Supreme Court recognized that the deal price had to be adjusted for synergies.

Finally, the Supreme Court rejected the petitioners' contention that the Court of Chancery erred "by adopting the McKinsey formula" to determine the terminal investment rate in its DCF model, resulting in "a number that lines up with Jarden's unaffected market price."[58] The petitioners argued that the McKinsey formula undervalues corporations with high barriers to entry, such as Jarden. In rejecting this argument, the Supreme Court first stated that, importantly, the Court of Chancery did not rely on its DCF model in finding fair value—it merely used it to "corroborate the unaffected market price."[59] Second, the Supreme Court noted that "the wide swing in value attributed to one input in the DCF model," the terminal investment rate, supported the very reason that the Court of Chancery did not rely on the model—it could not be confident that "the experts were providing reliable economic advice on the inputs driving the DCF model."[60] Third, the contention that "the McKinsey formula undervalued Jarden because it was in a certain class of companies" was not supported by the experts.[61]

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

In *Woods v. Sahara Enterprises, Inc.*,[62] the Court of Chancery granted a stockholder's request for books and records pursuant to Section 220 of the Delaware General Corporation Law ("Section 220"), and in doing so held that the stockholder established a proper purpose of valuing her interest in the company and

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

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

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

54 *Id.* at 326.

55 *Id.* at 325-26.

56 *Id.* at 327-28.

57 *Id.* at 327.

58 *Id.* at 334, 332.

59 *Id.* at 334.

60 *Id.* at 334-35.

61 *Id.* at 335.

62 238 A.3d 879 (Del. Ch. 2020).

that she was not required to make a showing of actual intent to value the shares. The Court also held that another of the stockholder's stated purposes for seeking the books and records—to investigate wrongdoing or mismanagement—was "bolstered" by the company's position taken in the litigation that the company was merely a holding company and therefore did not have the books and records sought by the stockholder.[63] The Court held that by taking that position, the company "established a credible basis to suspect corporate wrongdoing" because it "would be an exceptional board of directors that could satisfy its duty of oversight without creating any books and records."[64]

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

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

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

Sahara agreed to provide the plaintiff with a list of the names and addresses of the company's stockholders and a copy of its bylaws but otherwise rejected the demand. After the plaintiff filed suit, Sahara asserted that the action should be dismissed because SMCO held many of the books and records requested, and because Sahara "had no right, contractual or otherwise, to obtain books and records held by SMCO."[65]

The Court first ruled that the plaintiff's demand for books and records to determine the value of the Trust's stock constituted a proper purpose under Section 220. The Court noted that valuation of shares in a corporation, "particularly where the corporation is privately held, has long been recognized as a proper purpose" under Section 220.[66] The Court rejected Sahara's argument that the plaintiff was required to prove that she actually intended to use the books and records to value the shares. The Court stated that Sahara's argument was "contrary to Delaware law[,]" which does not "require that a stockholder establish both a purpose for seeking an inspection and an end to which the fruits of the inspection will be put."[67] The Court also stated that a stockholder is not required to have taken steps to sell its shares in order to establish that the stockholder has a proper purpose of valuing its shares. Rather, once a stockholder has established a proper purpose, it is the company's burden to prove that the stated purpose is not the stockholder's actual purpose and that the stockholder's actual purpose is improper. A showing of a secondary purpose does not satisfy the company's burden; rather, the company "must prove that the plaintiff pursued its claim under false pretenses, and its primary purpose is indeed improper."[68] The Court found that Sahara "failed to prove that valuing the Trust's shares was not the plaintiff's actual purpose" because it pointed to no documents or circumstances suggesting an improper motive, nor did it choose to depose the plaintiff.[69]

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

63 *Id.* at 894.
64 *Id.* at 896.

65 *Id.* at 894-95.
66 *Id.* at 890.
67 *Id.* at 891.
68 *Id.* (quoting *Pershing Square, L.P. v. Ceridian Corp.*, 923 A.2d 810, 817 (Del. Ch. 2007)).
69 *Id.* at 893.

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is not required to establish by a preponderance of the evidence that wrongdoing has actually occurred.[70] The Court noted that while the plaintiff's primary contention that such a credible basis exists because of Sahara's poor performance in relation to market indices could not, without more, establish a credible basis to suspect wrongdoing, Sahara's position that it is merely a holding company and it lacks many of the books and records sought by the plaintiff (and indeed that it might not have any documents), "bolstered [the plaintiff's] investigative purpose."[71]

The Court found that the company's position gave rise to "two bases to suspect possible wrongdoing."[72] First, Sahara's position conflicted with the representations the company made to its stockholders in connection with a reorganization of the company that resulted in the creation of SMCO. In connection with the reorganization, the company stated that the reorganization would not affect the stockholders' ability to obtain information from the company. The Court stated that the "contrast between the Company's current position and its representations to stockholders provides a credible basis to suspect that the Company's directors and officers have engaged in wrongdoing by failing to manage the Company in the manner that they committed they would."[73] Second, Sahara's representation that it did not have responsive books and records "created a credible basis to suspect that the Company's directors have abdicated their statutory responsibilities."[74] The Court stated that if Sahara has no records at least "documenting the board's good faith reliance on and active oversight of SMCO[,]"[75] then there is a possibility that the board has not been fulfilling its oversight duties under *Caremark*,[76] and thus there was a credible basis to suspect corporate wrongdoing.

Finally, in requiring Sahara to produce documents, the Court also ordered that "[w]hen responding to the Demand, the Company shall also produce any documents nominally held by SMCO or Sahara Investments that the human controllers of the Company (its directors and senior officers) can access in the ordinary course of business."[77] The Court found that the record at trial established that the "humans" who control Sahara have control over the books and records necessary to respond to the Section 220 demand.[78] The Court stated that the same individuals sat on the Sahara and SMCO boards, the companies had the same officers and employees, the companies shared office space and an email domain, and the company provides its stockholders with consolidated financial information on both Sahara and SMCO. The Court noted that "[d]irecting the Company to produce documents that the humans who control it can access whenever they wish does not involve any type of veil piercing, nor does it ignore the separate existence of these entities. It rather recognizes that the books and records nominally held by SMCO or Sahara Investments are within the Company's 'possession, custody, or control.'"[79] The Court concluded that corporations are "juridical entit[ies] that only can act through human representatives" and if the "human representatives can access books and records in the ordinary course of business whenever they wish to do so for their own purposes, then they equally can be compelled to do so by court order."[80]

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

In *Applied Energetics, Inc. v. Farley*,[81] the Court of Chancery addressed the Court's ability to validate defective corporate acts under Section 205 of the Delaware General Corporation Law ("DGCL")[82] and

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70 *Id.* at 894.

71 *Id.*

72 *Id.* at 895.

73 *Id.*

74 *Id.*

75 *Id.*

76 *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996). To carry out one's duties under *Caremark*, "a director must make a good faith effort to oversee the company's operations." *Marchand v. Barnhill*, 212 A.3d 805, 820 (Del. 2019). To establish liability under *Caremark*, a plaintiff must establish either one of two prongs: "(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention." *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

77 238 A.3d at 904.

78 *Id.* at 903.

79 *Id.* at 903-04.

80 *Id.* at 904.

81 2020 WL 4432271 (Del. Ch. Aug. 3, 2020).

82 Sections 204 and 205 of the DGCL first became effective in 2014 with the primary objective of permitting a corporation to correct failures to comply with the DGCL and avoiding the common

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

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

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

The Court first dealt with the threshold issue of whether Farley's actions were invalid. The Court explained that "[a]lthough Farley was the sole remaining director," Applied Energetics' board had three seats, and its by-laws "required the presence of a majority of the total number of directors to constitute a quorum for action at a meeting."[83] This meant that, "[a]s the sole remaining director, Farley could not meet the quorum requirement and therefore could not take action at a meeting."[84] Nor could Farley "act by unanimous written consent without a meeting, because Delaware law requires that the number of directors acting unanimously by written consent be sufficient to constitute a quorum if the action was taken at a meeting."[85] The Court therefore held that Farley's actions were invalid.

The Court then turned to whether the Court had the "power under Section 205 to validate Farley's acts."[86] Applied Energetics' principal argument was that the Court could not validate Farley's acts because they were not "within the power of a corporation."[87] Applied Energetics argued that the "Company lacked the 'raw corporate power' to take any acts" because "the board lacked a sufficient number of directors to supply a quorum[.]"[88]

The Court disagreed, explaining that "the concept of corporate power refers to whether the entity has been granted the ability to engage in a given act[,]" while "[t]he concept of authorization refers to whether the proper intra-corporate actors . . . have taken the steps necessary to cause the corporation to take the given act."[89] The Court stated that the company's claim that it "lacked the 'raw corporate power' to engage in any of the acts that Farley purported to take because there were insufficient directors in office to constitute a quorum" was "incorrect."[90] "The absence of a quorum is not a question of corporate power."[91] Rather, it "is a failure to comply" with a provision of the DGCL "and the company's charter and bylaws" and, therefore, it is a "failure within the meaning of Section 204(h)(2)."[92]

The Court then stated that the question of whether the company had the corporate power to issue the stock and grant the salary was "answered by" DGCL Section 121,

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

83 *Applied Energetics*, 2020 WL 4432271, at *12.
84 *Id.*
85 *Id.*
86 *Id.* at *21.
87 *Id.* at *25.
88 *Id.*
89 *Id.*
90 *Id.* at *28.
91 *Id.*
92 *Id.*

which provides in relevant part that every corporation "shall possess and may exercise all the powers and privileges granted by" the DGCL, including Section 151(a), which grants corporations the power to issue shares, Section 122(5), which grants corporations the power to pay officers, and Section 141(h), which states that the board of directors shall have the authority to determine the compensation of directors. Thus, "[t]he Company had the raw corporate power" to issue shares and to pay Farley.[93] "[T]he only obstacle to the effectiveness of his actions was the quorum requirement," and "Farley's inability to satisfy those requirements was . . . a failure of authorization that can be validated under Section 205, not an absence of corporate power that cannot."[94] The Court accordingly denied the motion for partial summary judgment on this issue, concluding that the Court had the power under Section 205 to validate the acts and the issue of whether the Court would exercise that power in this case could only be determined after trial.

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

In *JUUL Labs, Inc. v. Grove*,[95] the Court of Chancery held that, pursuant to the internal affairs doctrine, stockholder inspection rights for Delaware corporations are governed exclusively by Delaware law, even where another state's law purports to grant stockholder inspection rights. Specifically, the Court concluded that Daniel Grove, a stockholder of JUUL Labs, Inc. ("JUUL"), a Delaware corporation with its principal executive office in California, could not seek inspection of JUUL's books and records under Section 1601 of the California Corporations Code ("Section 1601"), which purports to grant inspection rights to stockholders of corporations with principal executive offices in California regardless of their state of incorporation.

Grove cited Section 1601 in a books and records demand and stated that if JUUL refused to produce the requested documents, then he "may apply to the [California state court] for an order compelling inspection" under California law.[96] JUUL responded by filing suit in the Court of Chancery seeking a declaration that Grove could not exercise any inspection rights under California law because the internal affairs doctrine applied to the books and records demand and, alternatively, because Grove had waived his rights to seek inspection. JUUL also argued that a forum-selection provision in JUUL's certificate of incorporation applied, limiting jurisdiction over actions related to stockholder inspection rights to the Court of Chancery.

The Court, relying on U.S. Supreme Court and Delaware Supreme Court precedent, began its analysis by explaining that the internal affairs doctrine "is a conflict of laws principle which recognizes that only one state should have the authority to regulate a corporation's internal affairs," that a corporation's internal affairs are those matters that are "peculiar to the relationship among or between the corporation and its officers, directors, and shareholders," and that the doctrine requires that the law of the state of incorporation "must govern these relationships."[97] The Court then stated that stockholder inspection rights "are a core matter of internal corporate affairs" and, thus, Delaware law governs any disputes related to those rights where the state of incorporation is Delaware.[98] Thus, the Court concluded that Grove was required to seek inspection solely under Section 220 of the Delaware General Corporation Law ("Section 220") and could not seek inspection of JUUL's books and records under California's Section 1601.

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

With respect to Grove's purported waiver of his inspection rights, the Court evaluated the waiver provision of two documents Grove had signed when he received his stock. Because the waiver provisions referred to Section 220 and defined the stockholder's inspection rights "solely in terms of Section 220,"[99] the Court concluded that "the waiver provisions [did] not extend beyond Section 220 and [did] not reach other information rights," such as the stockholder's purported

93 *Id.* at *29.
94 *Id.* at *33.
95 238 A.3d 904 (Del. Ch. Aug. 13, 2020).
96 *Id.* at 908.
97 *Id.* at 914.
98 *Id.* at 915.
99 *Id.* at 910.

rights under Section 1601.[100] Because Grove had not attempted to make a demand for books and records under Delaware law, the Court declined to address whether a stockholder can waive inspection rights under Section 220. However, the Court noted that while the Delaware courts have historically "rejected efforts by corporations to limit or eliminate inspection rights," those decisions have addressed waivers that appeared in the corporations' constitutive documents" and the Court stated that "there are arguments for distinguishing provisions that appear in those documents and waivers in private agreements."[101]

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

Special Proceedings

***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*,[102] 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*,[103] *Dell*,[104] or *Aruba*.[105] 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."[106] 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

100 *Id.*

101 *Id.* at 919.

102 240 A.3d 3 (Del. 2020).

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

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

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

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

unfolded and his belief that McMullen used the process to engage in self-dealing."[107]

Despite an increase in the price of palladium and a resulting increase in Stillwater's stock price between 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."[108] 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."[109] 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."[110]

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.'"[111] 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.'"[112]

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.'"[113] 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."[114] 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."[115]

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."[116] 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

107 *Id.* at 8.
108 *Id.* at 5.
109 *Id.* at 9.
110 *Id.*
111 *Id.* at 12.
112 *Id.*
113 *Id.* at 13.
114 *Id.* at 14.
115 *Id.* at 13-14.
116 *Id.* at 14-15.

"the price [wa]s already at a level that is fair."[117] 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 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."[118]

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."[119]

Special Proceedings

***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.*,[120] 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.[121] 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.[122] 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."[123] The Court concluded that the company did

117 *Id.* at 15.
118 *Id.* at 14-15.
119 *Id.* at 16.
120 2020 WL 6306028 (Del. Ch. Oct. 28, 2020).

121 *Id.* at *2.
122 *Id.* at *3.
123 *Id.* (quoting *Katz v. Visionsense Corp.*, 2018 WL 3953765, at *2 (Del. Ch. Aug. 16, 2018).

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 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.[124] 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.[125] 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."[126] 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."[127] 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"[128] and that "Delaware courts require strict adherence to the . . . inspection demand procedural requirements."[129] 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.

124 *Id.* at *4.
125 *Id.* at *5.
126 *Id.*
127 *Id.*
128 *Id.* at *6.
129 *Id.* (quoting *Katz*, 2018 WL 3953765, at *2).

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

In *Pettry v. Gilead Sciences, Inc.*,[130] 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.[131] 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."[132] 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

130 2020 WL 6870461 (Del. Ch. Nov. 24, 2020).
131 *Id.* at *15.
132 *Id* at *8.

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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 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."[133] "When evaluating whether a credible basis exists, the court may consider on-going lawsuits, investigations, circumstantial evidence, and even hearsay statements evincing possible wrongdoing."[134] 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."[135]

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.*"[136] 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."[137] 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."[138] 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."[139] The Court stated that there were "a number of vexing aspects of this argument."[140] 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."[141] 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."[142] 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."[143] As the Court recently held in *Lebanon Cty. Employees' Retirement*

133 *Id.* at *11 (quoting *Seinfeld v. Verizon Comm'ns, Inc.*, 909 A.2d 117, 123 (Del. 2006)).
134 *Id.*
135 *Id.* at *12-13.
136 *Id.* at *15 (citing *Wilkinson v. A. Schulman, Inc.*, 2017 WL 5289553 (Del. Ch. Nov. 13, 2017)).
137 *Id.* at *15.
138 *Id.*
139 *Id.* at *18.
140 *Id.*
141 *Id.* at *19.
142 *Id.* at *18.
143 *Id.* at *19.

Fund v. Amerisourcebergen Corp.,[144] 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."[145] Here, the Court found that the stockholder plaintiffs 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."[146] 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.[147] 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."[148] That Gilead had not produced "even a single document" prior to litigation "amplifie[d] the court's concerns."[149]

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

In *AmerisourceBergen Corp. v. Lebanon County. Employees' Retirement Fund*,[150] 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."[151]

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

144 2020 WL 132752 (Del. Ch. Jan. 13, 2020), *aff'd*, 2020 WL 7266362 (Del. Dec. 10, 2020).

145 *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)).

146 *Id.* at *20.

147 *Id.* at *2.

148 *Id.* at *30.

149 *Id.*

150 2020 WL 7266362 (Del. Dec. 10, 2020).

151 *Id.* at *3.

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 objective of the investigation in order to have a proper purpose for the demand.[152] 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."[153] 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.[154]

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."[155] Viewing that as a proper end, itself, the Supreme Court stated that it "need go no further . . . to dispose of AmerisourceBergen's 'actionability' argument."[156] 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."[157]

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."[158] 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.[159]

The Supreme Court also held that, to the extent that its summary affirmance in *Southeastern Pennsylvania Transportation Authority v. AbbVie, Inc.*[160] 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.*,[161] which stated that "books and records actions" should not involve "extensive discovery."[162] The Supreme Court stated that "*Palantir* did not establish any bright-line rules to be applied in all Section 220

152 *Id.* at *6.
153 *Id.* at *7.
154 *Id.* at *6.
155 *Id.* at *8.
156 *Id.*
157 *Id.*
158 *Id.* at *9.
159 *Id.* at *14.
160 2015 WL 1753033 (Del. Ch. Apr. 15, 2015), *aff'd*, 132 A.3d 1, 2016 WL 235217 (Del. Jan. 20, 2016) (TABLE).
161 203 A.3d 738 (Del. 2019).
162 *AmerisourceBergen*, 2020 WL 7266362 at *15 (quoting *Palantir*, 203 A.3d at 754).

actions."[163] 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."[164]

***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.*,[165] 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."[166] Alexandria sent Verseau a non-binding term sheet "that generally provided for Alexandria to lead a financing round of $30 million in convertible notes."[167] 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.'"[168] 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.'"[169] 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."[170]

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."[171]

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."[172] 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."[173]

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)

163 *Id.* at *15.
164 *Id.* at *14.
165 2020 WL 7422068 (Del. Ch. Dec. 18, 2020).
166 *Id.* at *2.
167 *Id.*
168 *Id.* at *4.
169 *Id.*
170 *Id.* at *8.
171 *Id.* at *6-7.
172 *Id.* at *7 (quoting *Khanna v. Covad Communications Group, Inc.*, 2004 WL 187274, at *6 (Del. Ch. Jan. 23, 2004)).
173 *Id.* at *8.

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 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."[174]

174 *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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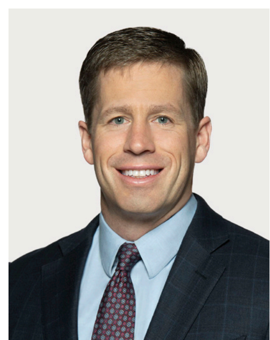

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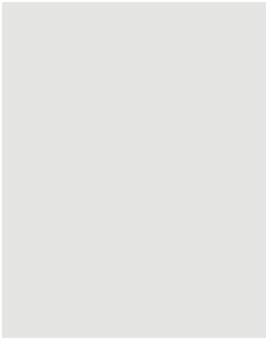

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