Delaware Corporate Law Annual Review

2021

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This publication is provided compliments of Young Conaway's Corporate Counseling and Litigation Section.

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

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

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The Court of Chancery at a Glance

The Composition of the Court of Chancery

One Chancellor and six Vice Chancellors sit on the Court of Chancery. Two of the Vice Chancellor positions were established in 2018 in response to the Court's growing case load. Two Masters in Chancery assist the Chancellor and Vice Chancellors in adjudicating and managing disputes. In April 2021, then-Chancellor Andre G. Bouchard retired after having served on the Court for nearly seven years. In May 2021, then-Vice Chancellor Kathaleen St. J. McCormick was sworn in as the new Chancellor. Chancellor McCormick's investiture was a historic moment for Delaware, as she is the first woman to lead the Court in its more than 200-year history. Also in May 2021, now-Vice Chancellor Lori W. Will was sworn in as a Vice Chancellor, making her the newest member of the Court. In early 2022, Vice Chancellor Joseph R. Slights III announced his plans to retire. It is anticipated that he will retire in the second quarter of 2022.

As of March 1, 2022, the members of the Court of Chancery are: Chancellor Kathaleen St. J. McCormick (2018), Vice Chancellor J. Travis Laster (2009), Vice Chancellor Sam Glasscock III (2011), Vice Chancellor Joseph R. Slights III (2016), Vice Chancellor Morgan T. Zurn (2018), Vice Chancellor Paul A. Fioravanti, Jr. (2020), Vice Chancellor Lori W. Will (2021), Master in Chancery Patricia W. Griffin (2017), and Master in Chancery Selina E. Molina (2019).

The Court of Chancery Guidelines

To aid attorneys practicing before the Court of Chancery and minimize disputes over process, the Court of Chancery issues "Guidelines to Help Lawyers Practice in the Court of Chancery" ("Guidelines"). In August 2021, the Court of Chancery issued a revised version of its Guidelines (available at https://courts.delaware.gov/Chancery/guidelines.aspx). These revised Guidelines reflect the Court's expectations and best practices for moving cases forward and are a must-read. Described below are some of the notable changes.

The Court of Chancery added a new section entitled "Expectations for Remote Hearings and Trials," noting that the Court "frequently handles hearings by means of remote communication" and "has begun conducting evidentiary hearings and trials by means of remote communication."[1] The section highlights that the Court generally uses four platforms for remote hearings and trials: (1) conference calls using a standard conference bridge, (2) conference calls using CourtSolutions, (3) video conferences using Zoom, and (4) video conferences hosted by CourtScribes. The section further explains that standard practices for in-person proceedings generally apply to remote proceedings.[2] For example: a remote hearing will generally not be allocated more than ninety minutes absent special request; counsel should provide hard copies of any documents and exhibits counsel seeks to have the Court use during a hearing (three

1 Guidelines § B.
2 *Id.* § B(2).

flash drives and three paper sets); and Delaware lawyers should generally make introductions and state who will be making argument for their clients at the start of each hearing. However, attorneys need not stand when the Court joins a remote proceeding, and attorneys may choose whether to stand to present argument or question a witness. In addition to the remote proceeding practices described in the Guidelines, some Court of Chancery judges may send counsel their specific preferences for remote proceedings in advance of such a proceeding.

The Court also updated its guidance regarding summary judgment motions. The Court recommends: "Counsel should evaluate whether a case is better suited for summary judgment or trial. If the case is more suited for summary judgment, then the parties should craft a schedule that leads up to a summary judgment hearing without also providing for a trial date. . . . By contrast, if the case is more suited for trial, then the parties should craft a schedule that proceeds to trial."[3] With respect to the timing of summary judgment motions, the Court cautioned that the parties should raise such a motion "sufficiently early in the proceedings so that resolving the motion will result in efficiencies for the Court and the litigants."[4] And to help determine whether summary judgment proceedings will be productive, the parties may include or the Court may impose in a scheduling order, "provisions requiring that parties seek leave before moving for summary judgment."[5]

In addressing discovery, the Court now recommends that parties, regardless of whether a matter is expedited, should attempt to facilitate third-party discovery involving their non-party agents and affiliates. This is particularly so where parties "involve themselves in the productions of their agents and affiliates to address issues such as privilege."[6] The Court notes that facilitating third-party discovery "recognizes that the parties to a case often could be required to obtain and produce documents over which they have control, even if an agent or affiliate has custody of the documents."[7]

Further, while the Court continues to provide alongside the Guidelines sample single-tier and two-tier confidentiality stipulations and proposed orders to govern the production and exchange of information in matters, the Court now expects that if the parties depart from these forms, they will "submit a marked/redline version to the Court reflecting the changes" and "[i]f a change is material, the parties shall advise the Court in a letter and explain why the change is being made."[8]

Finally, in addressing trial matters, the Court notes that "[p]re-trial briefing generally should consist of a total of two pretrial briefs, one from the plaintiffs and one from the defendants[,]" but recommends that if "the parties do not anticipate post-trial briefing, the parties should propose a sequence of pre-trial briefs that will present the matter to the Court for decision" (e.g., in a books and records action or an advancement action).[9] With respect to pre-trial orders, the Court notes that it finds "it helpful for parties to use their best efforts to prepare stipulated facts, with a particular focus upon the parties' identities, the relevant entities (including capital structure, as appropriate), a general timeline of critical events or other key dates, and the nature and dates of key documents and/or agreements."[10] And on the topic of trial records, the Court flags that the failure to reference exhibits or portions of transcripts in briefs or at trial "can raise questions about the scope of the record before the trial court."[11] "To address this issue," the Court notes that the parties may "specify in the pre-trial order that the record for the purposes of the trial court's decision includes only those exhibits or portions of depositions that are used at trial or cited in post-trial briefs or at post-trial arguments (subject

3 *Id.* § C(5)(e)(iii)(B)-(C).
4 *Id.* § C(5)(e)(iii)(D).
5 *Id.* § C(6)(d)(ii).
6 *Id.* § C(7)(d)(iii)(A).
7 *Id.* § C(7)(d)(iii)(B).
8 *Id.* § C(7)(f)(iv).
9 *Id.* § C(9)(a).
10 *Id.* § C(9)(b)(i).
11 *Id.* § C(9)(b)(iii).

to the resolution of any objections)" or "agree to prepare a Schedule of Evidence after trial, briefing, and post-trial argument that lists the exhibits and deposition excerpts that form the record for purposes of the trial court's decision."[12]

Nature of Cases Filed in the Court of Chancery

The Court of Chancery handles a variety of matters ranging from breach of contract and breach of fiduciary duty actions to land disputes. The below chart provides a high level overview of the number and types of cases filed in 2021.[13]

CASE TYPE	NO. FILED
Breach of Fiduciary Duties	**212**
Inspection of Books & Records	**171**
Breach of Contract	**107**
Declartory Judgment	**106**
Injunctive Relief	**105**
Civil Action	**103**
Advancement of Legal Fees & Expenses	**40**
Specific Performance	**34**
Partition	**26**
Quiet Title	**26**
Petition for Sale to Pay Debts	**21**
Dissolution	**20**
Appointment of Receiver	**19**
Estate	**15**
Real Estate	**14**
Confirm Arbitration Award	**12**
Compel a Shareholders Meeting	**10**
Deed Restriction Pursuant to 10 Del. C. Sec. 348	**9**
Appraisal	**8**
Petition for Instructions	**8**

CASE TYPE	NO. FILED
Petition for Adjudication of Preseumed Death	**6**
Petition for Review	**6**
Petition to Appoint a Successor Trustee	**6**
Petition for Admission - Copy of Decendents Will	**5**
Caveat against allowance of Intrument's Will	**3**
Petition to Reform a Trust	**3**
Rapid Arbitration (Rules 96,97)	**3**
Restraining Order	**3**
Trust Agreement	**3**
Appeal	**2**
Contract	**2**
Deed Restrictions	**2**
Land Disputes	**2**
Petition for Elective Share	**2**
Petition for Review of Proof of Will	**1**
Accounting	**1**
Decree of Distribution	**1**
Petition for RTSC to Compel Return of Assets	**1**
Resultant Trust	**1**
Total	**1120**

12 *Id.*

13 This chart was prepared based upon Bloomberg data on Court of Chancery case filings.

Noteworthy Delaware Corporate Law Cases in 2021[14]

2021 represents a noteworthy year of judicial energy and effort by the Delaware courts. The Court of Chancery alone issued approximately 215 opinions in 2021.[15] This section discusses certain notable cases decided by the Court of Chancery and the Delaware Supreme Court during 2021.

Advance Notice Bylaw Provisions

Advance notice bylaws typically set requirements that stockholders must fulfill in order to nominate directors for election. The Court of Chancery's recent decision in *Rosenbaum v. CytoDyn Inc.* confirms that where an advance notice bylaw was adopted "on the proverbial clear day," and not with the purpose of thwarting the stockholders' rights to vote, the stockholders must abide by the bylaw's requirements in order to properly nominate directors for election.[16]

***Rosenbaum v. CytoDyn Inc.*, 2021 WL 4775140 (Del. Ch. Oct. 13, 2021) (Slights, V.C.).**

In *CytoDyn*, the Court of Chancery denied the dissident stockholder plaintiffs' application for a mandatory injunction compelling CytoDyn Inc. to allow plaintiffs' slate of nominees to stand for election. The company's bylaws required stockholders to provide advance notice of any matters they want to have put on the agenda for the annual meeting, including any nominations for election to the board. The Court found that plaintiffs' nomination notice, submitted on the eve of the deadline, was "fatally incomplete" because it failed to disclose, as the bylaws required, the identity of persons supporting plaintiffs' efforts and any information concerning potential—or even obvious—conflicts.[17] As such, the plaintiffs' advance notice "did not provide 'Timely Notice[,]'" and the board justifiably rejected the nomination notice and refused to allow the plaintiffs' board nominees to stand for election.[18]

CytoDyn is a rare post-trial Delaware court decision addressing informational deficiencies in an advance nomination notice. As such, it provides important guidance for public companies with similar advance notice bylaws, and for stockholders seeking to comply with such bylaws and to avoid (or prevail in) litigation.

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

15 This figure accounts for the issuance of Opinions, Memorandum Opinions, Letter Opinions, and Letter Decisions, but not Orders, Letter Orders, or Master's Reports.

16 2021 WL 4775140, at *2 (Del. Ch. Oct. 13, 2021) (internal quotation marks omitted).

17 *Id.*

18 *Id*.

Ancillary Jurisdiction

Although the Court of Chancery is a court of limited jurisdiction with the ability to assert subject matter jurisdiction where (i) a party invokes an equitable right, (ii) a party requests an equitable remedy, or (iii) a statute specifically vests the Court with jurisdiction, the Court also has ancillary jurisdiction to hear and determine certain related matters at law. The common-law established "clean-up doctrine" is the source of this ancillary jurisdiction. It empowers the Court to hear and determine matters at law that are part of the same controversy over which the Court otherwise has subject matter jurisdiction. The clean-up doctrine is intended to promote judicial efficiency and consistency, and to avoid piecemeal litigation. In *FirstString Research, Inc. v. JSS Medical Research Inc.*, the Court of Chancery addressed a challenge to the Court's exercise of ancillary jurisdiction on the basis that it violated a party's right to a jury trial, and although it is not the first time the Court addressed the issue, the decision provides a helpful historical analysis of the issue and reaffirms previous decisions by the Court holding that a party is not entitled to a jury trial on claims over which the Court has jurisdiction pursuant to the clean-up doctrine.

***FirstString Rsch., Inc. v. JSS Med. Rsch. Inc.*, 2021 WL 2182829 (Del. Ch. May 28, 2021) (McCormick, C.).**

In *FirstString Research*, the Court of Chancery held that its valid exercise of ancillary jurisdiction, pursuant to the clean-up doctrine, displaced a party's right to a jury trial. The plaintiff filed claims in the Court of Chancery for breach of contract, and the defendant filed mirror image claims in the Superior Court. In the Superior Court action, the defendant also demanded a jury trial. The defendant argued that the Court of Chancery action should be dismissed in favor of the Superior Court action on the grounds that the defendant's right to a jury trial in the Superior Court trumped the Court of Chancery's ability to exercise jurisdiction over the litigation pursuant to the clean-up doctrine. The Court of Chancery rejected the argument. The Court affirmed that, under established Delaware precedent, a litigant is not entitled to a jury trial on claims over which the Court of Chancery otherwise has equitable jurisdiction.[19]

In reaching its conclusion, the Court surveyed the historical backdrop of the clean-up doctrine and the right to a jury trial under Delaware law. The Court assessed Delaware law relative to other states and observed that just as states had diverged with respect to the question of whether to merge courts of law and equity, states had also diverged with respect to the question of whether the clean-up doctrine would trump the right to a jury trial. In concluding its analysis, the Court observed that Delaware had maintained "the viability of the clean-up doctrine over a right to [a] jury trial," just as it had "buck[ed] the mid-nineteenth century trend of merging courts of law and equity[.]"[20]

Appraisal

Under Delaware's appraisal statute, Section 262 of the Delaware General Corporation Law ("DGCL"), former stockholders of Delaware corporations that were the subject of certain mergers are entitled to determinations by the Court of Chancery as to the "fair value" of their shares, provided that the former stockholders satisfied a number of statutory requirements. Decisions by the Delaware Supreme Court and Court of Chancery over the past few years, and commentary on those decisions, largely centered on the methodologies used to determine "fair value." While a discounted cash flow analysis was the most relied upon methodology for many years, deal price has taken primacy as the most reliable indicator of "fair value" following several decisions in recent years, including *DCF Global Corp. v. Muirfield Value Partners, L.P.*, 172 A.3d 346 (Del. 2017) and *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd*, 177 A.3d 1 (Del. 2017). Although that trend continued through 2021, *see, e.g.*, *In re Appraisal of Regal Entertainment Group*, 2021 WL 1916364 (Del. Ch. May 13, 2021) (deal price minus synergies most reliable metric), we focus our commentary here on two other developments: In *Manti Holdings, LLC v. Authentix Acquisition Co.,*

19 To be sure, the Court qualified its holding with a caveat that "the outer boundary of this court's equitable jurisdiction also delineates the scope of a right to trial by jury in civil actions with limited exceptions not applicable here." 2021 WL 2182829, at *10.

20 *Id.*

Inc., the Supreme Court held that a stockholder's right to appraisal may be waived under certain circumstances, and in *Manichaean Capital, LLC v. Exela Technologies, Inc.*, the Court of Chancery held that Delaware law permits reverse veil-piercing and held that it is reasonably conceivable that former stockholders who received an approximately $60 million appraisal award would be able to pierce the respondent corporation's corporate veil to pursue the assets of its subsidiary.

***Manti Holdings, LLC v. Authentix Acquisition Co., Inc.*, 261 A.3d 1199 (Del. 2021).**

In *Manti*, the Delaware Supreme Court affirmed a Court of Chancery decision enforcing an *ex ante* waiver of appraisal rights in a stockholder agreement. In a four-to-one decision, the Supreme Court held that the "sophisticated and informed" stockholders, who owned 100% of the company, had agreed to "clear" language that constituted a waiver of their statutory appraisal rights granted by Section 262 of the DGCL.[21] The majority further reasoned that, where a restriction is contractually imposed upon the stockholders as opposed to the shares, the waiver does not constitute a stock restriction that must be included in the company charter under the DGCL. Justice Valihura disagreed, urging that under the DGCL, appraisal rights are mandatory and cannot be waived.

This decision reinforces Delaware's public policy favoring broad contract rights, particularly in circumstances where all the contracting parties are sophisticated. The reach and limits of this new waiver doctrine in the appraisal context is unclear and will likely generate further litigation, and perhaps also an effort to settle the waivability issue legislatively.

***Manichaean Cap., LLC v. Exela Techs., Inc.*, 251 A.3d 694 (Del. Ch. 2021) (Slights, V.C.).**

In *Manichaean*, the Court of Chancery addressed "the highly unusual circumstance where an appraisal judgment debtor cannot or will not pay[.]"[22] There, the plaintiffs, former stockholders of the judgment debtor, sought to pierce the judgment debtor's corporate "veil to reach downwards to its wholly owned subsidiaries."[23] In a matter of first impression, the Court formally recognized that plaintiffs can state a legally viable claim for third party "reverse veil-piercing" where subsidiaries are deployed "to perpetuate fraud or injustice against a judgment creditor of their parent[,]" where veil-piercing will not cause harm to innocent third-party stockholders or creditors, and where no other legal or equitable remedies are available.[24]

The *Manichaean* decision validates the ability and willingness of the Court of Chancery to enforce the maxim that equity will not suffer a wrong without affording a remedy. But the Court's willingness to exercise that power is constrained and limited to cases involving clearly compelling circumstances that justify disregarding corporate separateness.

Books and Records Demands & Actions

In 2021, the Court of Chancery continued to see an increase in the number of books and records actions being filed. While the Court continued to hold that the statutory requirements to bring books and records demands must be met by stockholders, the Court also reminded parties that overly aggressive defenses by companies could be met with consequences, including fee shifting.

***Gross v. Biogen Inc.*, 2021 WL 1399282 (Del. Ch. Apr. 14, 2021) (Fioravanti, V.C.).**

In *Biogen Inc.*, a stockholder of a defendant corporation served a written demand on the corporation under 8 *Del. C.* § 220. The stockholder's stated purpose was to investigate potential wrongdoing relating to a federal investigation and a wrongful termination suit. The corporation rejected the demand on the ground that it did not satisfy

21 261 A.3d at 1216, 1221.
22 251 A.3d at 699-700.
23 *Id*. at 700.
24 *Id*. at 714-17.

Section 220's form and manner requirements and that the demanding stockholder lacked a proper purpose for seeking inspection. The corporation thereafter rejected two subsequent supplemental demands sent by the stockholder, in each case objecting on grounds of form and manner and purpose and scope. The corporation maintained that position in subsequent Section 220 litigation filed by the plaintiff, and the corporation refused to produce any documents in response to the demand. The Court ultimately rejected the corporation's defenses, finding that the stockholder had satisfied the statutory form and manner requirements and stated a proper purpose, and that the documents sought were necessary and essential for the plaintiff's purpose for seeking inspection.

Nonetheless, the Court declined to order a full inspection of all of the documents sought. Specifically, the Court declined to require the production of emails and texts messages between board members. Rather, it limited the production to formal board-level materials, because the plaintiff failed to show "that the formal board materials would be insufficient for him to investigate the alleged wrongdoing."[25]

The Court utilized this case as a vehicle to reiterate its earlier admonition in *Pettry v. Gilead Sciences, Inc.*, 2020 WL 6870461 (Del. Ch. Nov. 24, 2020), that corporations defending against Section 220 books and records actions should avoid adopting "overly aggressive" defensive strategies.[26]

***Jacob v. Bloom Energy Corp.*, 2021 WL 733438 (Del. Ch. Feb. 25, 2021) (Slights, V.C.).**

In *Bloom Energy*, the Court of Chancery issued a post-trial opinion denying outright Section 220 inspection relief to a stockholder who had failed to satisfy Section 220's form and manner requirements, which include submitting documentary evidence of stock ownership. The stockholder served the company a written demand to inspect specified books and records for the purpose of investigating possible mismanagement and wrongdoing. After the company refused the demand, the stockholder filed suit and the case went to trial. A critical issue was whether the documents attached to the written demand constituted proof of stock ownership. Under Section 220, a demand must be accompanied by "documentary evidence of beneficial ownership of the stock" that "should be at a point proximate to the date of the Demand."[27] The attachment to the demand was an account statement indicating that the plaintiff had held shares between October 12 and October 31, 2018; however, the demand was dated November 25, 2019—more than one year later. The Court held that the stale account statement was, on its face, insufficient proof of ownership.

Although the account statement was accompanied by an affidavit, which Section 220(b) requires to verify that the documentary evidence is "true and correct," that affidavit, standing alone, does not establish proof of ownership, but merely verifies the truthfulness of what the documentary evidence "purports to be."[28]

This case reemphasizes the importance of strict adherence to the statutory form and manner requirements in Section 220 actions. As the Court recognized, those requirements impose only a minor burden on stockholdersand "must be fulfilled."[29]

***Employees' Ret. Sys. of Rhode Island v. Facebook, Inc.*, 2021 WL 529439 (Del. Ch. Feb. 10, 2021) (Slights, V.C.).**

In *Facebook*, the Court of Chancery ordered the production of *non-privileged* emails and text message correspondence between Facebook, Inc. ("Facebook") and the Federal Trade Commission (the "FTC") concerning settlement

25 2021 WL 1399282, at *16.

26 *Id.* at *5 (internal quotation marks omitted). In July 2021, the Court in *Gilead Sciences*, following its November 2020 decision, granted the stockholder plaintiffs' request for shifting of attorneys' fees under the bad faith exception to the American Rule on the basis that the defendant engaged in "glaringly egregious litigation conduct." *Pettry v. Gilead Sciences, Inc.*, 2021 WL 3087027, at *2 (Del. Ch. July 22, 2021).

27 2021 WL 733438, at *4 (internal quotation marks omitted).

28 *Id.* at *5.

29 *Id.*

negotiations, but declined to compel production of *privileged* records falling within the same category, for failure to satisfy the requirements of the exception carved out by *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970).

Facebook and the FTC had previously agreed to a settlement "whereby Facebook agreed to pay $5 billion in exchange for a release of claims against both the Company and [CEO Mark] Zuckerberg" that arose in connection with an investigation by the FTC into Facebook's data privacy breaches following the Cambridge Analytica incident.[30] Following up on reports suggesting that Facebook had paid an excessive share of the settlement to protect Zuckerberg from personal liability, a Facebook stockholder sought company books and records for the stated purpose of investigating possible wrongdoing. The company denied the inspection request, leading to the stockholder's pursuit of a Section 220 action.

Before the Court, the company defended on the basis that in a prior proceeding involving *Caremark* claims, it had already produced formal, non-privileged board-level materials related to the Cambridge Analytica breach. However, the Court rejected that argument, on the grounds that the previously produced books and records were insufficient to satisfy the plaintiff's proper purpose here, "namely to discern what informed the Board's decision to bargain to protect Zuckerberg or to pay $5 billion, and what alternatives to the ultimate settlement agreement, if any, were available."[31] The Court ordered the inspection of non-privileged electronic communications between Facebook and the FTC.

But the Court declined to compel inspection of privileged documents to which the plaintiff claimed entitlement under the privilege exception carved out by *Garner* and adopted by the Delaware Supreme Court in *Wal-Mart Stores, Inc. v. Indiana Electrical Workers Pension Trust Fund IBEW*, 95 A.3d 1264, 1278-79 (Del. 2014). The Court of Chancery held that because the plaintiff had not seen the non-privileged documents, it could not honestly assert that the privileged documents were the only source of necessary information, as the *Garner* decision requires.

This case shows that Delaware courts will require compliance with any conditions permitting an exception to the privilege (in this case, *Garner*).

Caremark Claims

A claim that directors violated their fiduciary duties by failing to exercise oversight over the corporation (often referred to as a "*Caremark* claim") remains one of the most difficult corporate law claims to prevail on. Two 2021 opinions, with opposite outcomes at the motion to dismiss stage, provide insight into the circumstances that may give rise to a viable *Caremark* claim.

In *In re Boeing Co. Derivative Litigation*, the Court denied a motion to dismiss a *Caremark* claim based on allegations that the directors of Boeing breached their fiduciary duties to oversee mission-critical aircraft safety.

In contrast, in *Firemen's Retirement System of St. Louis on behalf of Marriott International, Inc. v. Sorenson*, the Court granted a motion to dismiss a *Caremark* claim against the directors of Marriott International, Inc. in connection with a massive consumer data breach where the directors had taken affirmative (if imperfect) steps to evaluate and mitigate cybersecurity risks.

***In re Boeing Co. Deriv. Litig.*, 2021 WL 4059934 (Del. Ch. Sept. 7, 2021) (Zurn, V.C.).**

Boeing is one of a handful of cases where a *Caremark* claim has been found sufficient to survive a motion to dismiss. There, the Court of Chancery held that The Boeing Company stockholders' *Caremark* claims related to the manufacture and production of the 737 MAX aircraft satisfied the onerous dismissal standard, because the plaintiffs

30 2021 WL 529439, at *3.
31 *Id.* at *7.

had sufficiently pled that the company's directors had failed to establish an adequate reporting system for airplane safety and alternatively, had "turn[ed] a blind eye to a red flag representing airplane safety problems."[32] The Court emphasized that "the Board has a rigorous oversight obligation where safety is mission critical, as the fallout from the Board's utter failure to try to satisfy this 'bottom-line requirement' can cause 'material suffering[.]'"[33] And in *Boeing*, the alleged consequence—a preventable significant risk to health and safety—had resulted in the loss of human life. Throughout its opinion, the Court cited and relied upon multitudinous documents, obtained in an earlier Section 220 books and record action, that supported the *Caremark* claims.

Although *Caremark* claims are the most difficult to pursue, the *Boeing* case involved a unique set of well-pled facts which were supported by extensive documents incorporated by reference, demonstrating that mission critical oversight process failures and serious consequences, supported by substantial documentary evidence, can suffice to overcome the formidable *Caremark* barrier.

***Firemen's Ret. Sys. of St. Louis on behalf of Marriott Int'l, Inc. v. Sorenson*, 2021 WL 4593777 (Del. Ch. Oct. 5, 2021) (Will, V.C.).**

In *Firemen's Retirement*, the Court dismissed *Caremark* claims brought against the directors of Marriott International, Inc. ("Marriot") relating to a massive breach of consumer data, observing that the plaintiff had fallen "well short" of their high pleading burden.[34] Even after accepting as true the plaintiff's allegations that certain of Marriott's cybersecurity practices fell short of recommended industry standards, the Court concluded that the plaintiff had failed to allege the necessary scienter to sustain its pleading burden. The Court observed that the plaintiff had alleged neither that the directors had "utterly failed" to fulfill their cybersecurity oversight responsibilities nor that the directors had turned a blind eye to cybersecurity "red flags."[35]

The Court emphasized the growing risks posed by cybersecurity threats, the far-reaching corporate implications of such threats, and the need for corporate governance to evolve to counter such threats. But even while sounding caution, the Court also emphasized that "[t]he growing risks posed by cybersecurity threats do not, however, lower the high threshold that a plaintiff must meet to plead a *Caremark* claim."[36]

Demand Futility

As the Delaware Supreme Court stated in *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), "[a] cardinal precept of the General Corporation Law of the State of Delaware is that directors, rather than shareholders, manage the business and affairs of the corporation."[37] The authority granted to directors by the DGCL includes the "managerial authority to make decisions regarding corporate litigation."[38] Consistent with that authority, a stockholder who seeks to have a corporation assert claims is expected to make a demand on the board to take action. But, if a stockholder can establish that demand would be futile, the stockholder may pursue the claims on behalf of the corporation without first making a demand.

To establish demand futility, the stockholder "must impugn the ability of at least half of the directors in office when it initiated [its] action (*i.e.,* the Demand Board) to have considered a demand impartially."[39] For many decades, Delaware

32 2021 WL 4059935, at *1.
33 *Id*. at *33.
34 2021 WL 4593777, at *12.
35 *Id.* at *13.
36 *Id.* at *12.
37 *Aronson*, 473 A.2d at 811.
38 *Id.* at 813.
39 *Teamsters Union 25 Health Servs. & Ins. Plan v. Baiera*, 119 A.3d 44, 57 (Del. Ch. 2015).

demand futility law has confounded analysis by offering a binary choice of distinct but overlapping tests, the first under *Aronson*, and the second under *Rales v. Blasband*, 634 A.2d 927 (Del. 1993). In *United Food & Commercial Workers Union & Participating Food Industry Employers Tri-State Pension Fund v. Zuckerberg*, the Delaware Supreme Court adopted the Court of Chancery's reformulation of the demand futility analysis to create a unified test.

***United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg*, 262 A.3d 1034 (Del. 2021).**

In a thoughtful and scholarly opinion, the Court of Chancery, concluded that *Aronson* was no longer a functional test for assessing demand futility. The Court then reformulated the analysis by applying "a three-part test for demand futility that blended the *Aronson* test with the test articulated in *Rales*[.]"[40] On appeal, the Delaware Supreme Court adopted the Court of Chancery's three-part test, resolving the issue of which test—*Aronson* or *Rales*—should apply in future cases. Specifically, "courts should ask the following three questions on a director-by-director basis when evaluating allegations of demand futility: (i) whether the director received a material personal benefit from the alleged misconduct that is the subject of the litigation demand; (ii) whether the director faces a substantial likelihood of liability on any of the claims that would be the subject of the litigation demand; and (iii) whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct that would be the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand."[41]

Zuckerberg, like *Brookfield* (discussed below), demonstrates that the Delaware courts are committed to upholding the time-honored tradition of simplifying and rationalizing the common law both to adapt to new circumstances and to eliminate doctrinal uncertainty and confusion created by the application of previously articulated holdings.

Dual-Natured Claims

Whether a stockholder's claim is determined to be direct or derivative can have a significant impact on the ability of the stockholder to assert the claim. For example, if a claim is derivative, the stockholder must first make a demand on the board or plead demand futility, but there is no such requirement for a direct claim. Further, a plaintiff who ceases to be a stockholder loses standing to assert a derivative claim, but the same is typically not true for a direct claim. The determination of whether a claim is direct or derivative depends on "who suffered the alleged harm" and "who would receive the benefit of any recovery or other remedy."[42] However, for more than twenty years, Delaware law held that a claim challenging a transaction on the grounds that a controlling stockholder caused the corporation to issue shares of its stock in exchange for assets of the controlling stockholder worth less than the issued shares and diluted the minority stockholders, is both direct and derivative. The Delaware Supreme Court revisited such "dual-natured" claims in *Brookfield Asset Management v. Rosson*.

***Brookfield Asset Mgmt. v. Rosson*, 261 A.3d 1251 (Del. 2021).**

In *Brookfield*, the Delaware Supreme Court overruled its earlier decision in *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006), which had held that claims that fiduciaries caused a corporation to overpay for an asset were "dual natured" (both direct and derivative), where they involve a "controlling stockholder and transactions that resulted in an improper transfer of both economic value and voting power from the minority stockholders to the controlling stockholder."[43] The Supreme Court held that any such claims are "exclusively derivative," consistent with the holding of *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), that a determination of whether a claim is direct or derivative turns

40 *Zuckerberg*, 262 A.3d at 1040.
41 *Id*. at 1059.
42 *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004).
43 *Brookfield*, 261 A.3d at 1264.

on whether the alleged harm was suffered by the corporation or the stockholders, and which party would receive the benefit of any recovery.[44]

This decision is a must-read, not only because it thoughtfully clarifies the analysis distinguishing "direct" and "derivative" claims, but also because of the scholarly insights it provides into the limits of *stare decisis*.

Equitable Challenge to Entire Fairness

Generally, a transaction that is not subject to the business judgment rule (because, for example, it involved a controlling stockholder or self-interested directors) will still be respected by Delaware courts if determined to be entirely fair to the stockholders. In 2021, the Delaware Supreme Court reminded practitioners that even a transaction at a fair price resulting from a fair process may still be subject to further review and equitable relief if the purpose of the transaction was inequitable.

***Coster v. UIP Cos., Inc.*, 255 A.3d 952 (Del. 2021).**

In *Coster*, the Delaware Supreme Court reviewed a Court of Chancery determination that a contested sale of a company did not constitute a breach of the directors' fiduciary duties because the sale was entirely fair, both as to process and price. Although the Supreme Court did not disturb that determination, it remanded the case to the Court of Chancery to consider the plaintiff's additional claims that the sale, even if economically fair, was done to further an inequitable purpose under *Schnell v. Chris-Craft Industries, Inc.*, 285 A.2d 437 (Del. 1971), as well as under *Blasius Industries Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988), which held that where a board acts for "the primary purpose of impeding stockholders' franchise rights, the board must prove a 'compelling justification' for its actions."[45]

The doctrinal lesson from this decision is that as a matter of equity jurisprudence, "entire fairness" is not an all-inclusive doctrinal umbrella that subsumes all alternative forms of equitable challenges to a business acquisition transaction.

Material Adverse Effect/Material Adverse Change & Ordinary Course Covenants

Against the backdrop of the COVID-19 pandemic, buyers considered whether they could terminate or renegotiate M&A transactions that they had entered into by invoking material adverse effect ("MAE")/material adverse change ("MAC") provisions. A flurry of break-up litigation followed in the Court of Chancery, where the Court was asked to determine whether actions taken by sellers in response to the COVID-19 pandemic could justify buyers' decisions to walk away from deals. In 2021, the Delaware courts issued two notable opinions in this area. In one, the Court of Chancery declined to allow a buyer to terminate a deal based on the seller's purported breaches of a MAE/MAC provision. In the other, the Delaware Supreme Court affirmed the Court of Chancery's holding that the seller had violated an ordinary course covenant by not seeking the buyer's contractually required consent to take actions in response to the COVID-19 pandemic. Together, these opinions provide useful guidance on the high standard required to trigger a MAE/MAC provision and the significance of the language used to draft such provisions.

***Snow Phipps Grp., LLC v. KCAKE Acquisition, Inc.*, 2021 WL 1714202 (Del. Ch. Apr. 30, 2021) (McCormick, V.C.).**

In *KCAKE*, the buyers attempted to terminate an agreement to purchase a cake decorating company after the company experienced a drop in performance at the beginning of the COVID-19 pandemic. The seller sought specific performance of the parties' purchase agreement. In a post-trial decision, the Court of Chancery "order[ed] the buyers to close on

44 261 A.3d at 1276.
45 255 A.3d at 963.

the purchase agreement."[46] The Court rejected the buyers' defenses that the seller had violated two covenants to closing, namely, that the COVID-19 pandemic had created a MAE and that the company had failed to operate in the ordinary course of business. The Court found that the pandemic's impact was limited, and that the company's reduced performance was insufficient to show a "sustained drop" in business performance.[47] Moreover, the buyers' argument that the seller had failed to satisfy a condition precedent—namely, a debt-financing condition—was barred because the buyers' own breach materially contributed to the sellers' failure to satisfy it.

As the Chancellor quite accurately observed, this decision can be chalked up to "a victory for deal certainty," as it reinforces Delaware's extremely high standards for finding a breach of MAE and ordinary course provisions, even in the face of a global pandemic.[48]

***AB Stable VIII LLC v. MAPS Hotels & Resorts One LLC*, 2021 WL 5832875 (Del. Dec. 8, 2021).**

AB Stable involved a stock purchase agreement under which the buyer's subsidiary would acquire an interest in the seller's subsidiary, which owned and operated a luxury hotel business. The "ordinary course" covenant of the agreement provided that the seller was to operate the hotels "only in the ordinary course of business consistent with past practice in all material respects."[49] The covenant further provided that any departure from this requirement would require the buyer's consent which would not be "unreasonably withheld."[50] Six months after the parties signed the agreement, but before closing, the seller took unprecedented steps in response to the COVID-19 pandemic, including closing certain hotels and sharply reducing hotel services, without having sought the buyer's consent. The buyer refused to close, claiming that its refusal was justified by the seller's breach of the ordinary course covenant. The seller sued for specific performance. Ruling in favor of the buyer, the Court of Chancery held—and the Delaware Supreme Court concurred on appeal—that the seller had breached the ordinary course covenant, whose plain language "created a standard that looks exclusively to how the business has operated in the past."[51] In affirming the Court of Chancery's ruling, the Supreme Court noted that although the seller's conduct was reasonable in light of the unprecedented and exigent circumstances, that fact was irrelevant and insufficient to change the outcome because the contracting parties could have, but did not, include a "reasonableness" qualifier in the covenant.[52] Moreover, the seller could have avoided the harshness of the ordinary course requirement by seeking the consent of the buyer, which could not be "unreasonably withheld."[53]

The critical takeaway is that Delaware courts will not rewrite the plain language of a purchase agreement and will enforce the terms to which the parties agreed, even if that leads to a harsh outcome.

Primedia Standing

In 2021, as set forth below, the Delaware Supreme Court adopted and clarified the Court of Chancery's *Primedia* test for determining whether, and under what circumstances, a derivative plaintiff who had lost standing to assert derivative claims due to a merger may directly challenge the merger on the ground that the merger price does not reflect the value of the derivative claims. The *Morris v. Spectra* decision is a must-read for anyone advising boards on assessing the value of derivative claims in connection with merger negotiations or advising companies on how to defend post-merger challenges.

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46 2021 WL 1714202, at *2.
47 *Id*. at *34.
48 *Id*. at *2.
49 2021 WL 5832875, at *8.
50 *Id*.
51 *Id*. at *7.
52 *Id*. at *10.
53 *Id*. at *15.

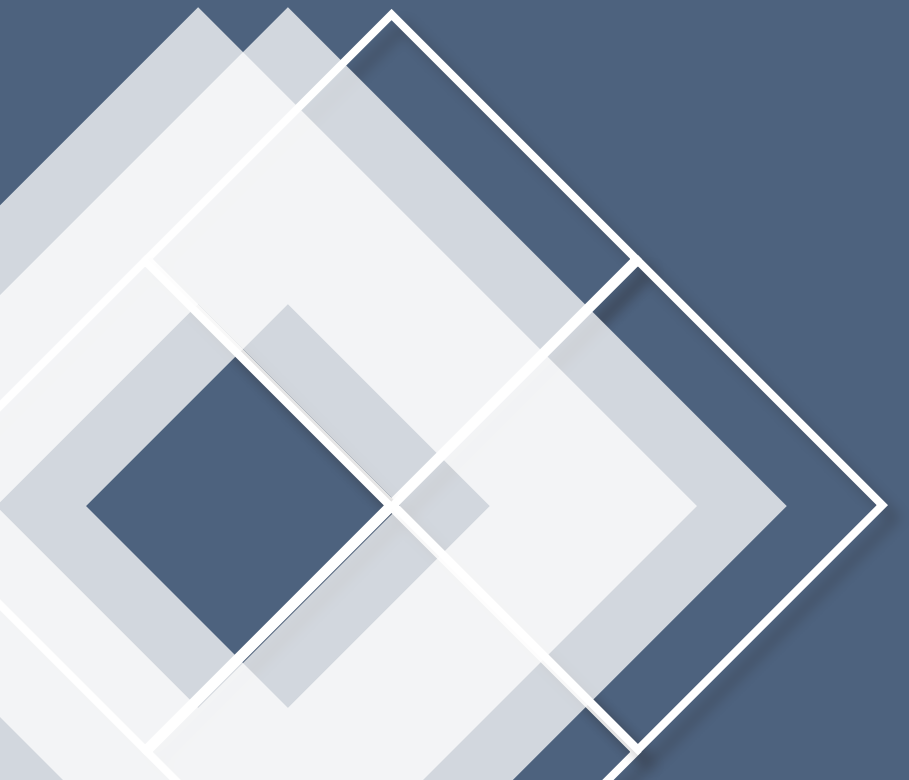
***Morris v. Spectra Energy Partners (DE) GP, LP*, 246 A.3d 121 (Del. 2021).**

In *Spectra*, the Delaware Supreme Court adopted and provided guidance on how properly to apply the standard, as articulated in *In re Primedia, Inc. Shareholders Litigation*, 67 A.3d 455 (Del. Ch. May 10, 2013), for determining when pre-merger stockholders have standing to pursue post-merger claims. The *Primedia* standing analysis, which specifically "applies to claims challenging a merger because the equity owners are not being fairly compensated for the value of material derivative claims[,]" requires the court to consider whether the derivative claim: (1) is viable and material to the overall transaction; (2) will not be pursued by the buyer; and (3) is not reflected in the merger consideration.[54] In *Spectra*, the Supreme Court reversed the Court of Chancery's dismissal of a post-merger action. The Court of Chancery had determined (under the first prong) that the plaintiff's extinguished derivative claims were immaterial. The Supreme Court held that the Court of Chancery had erroneously misapplied the *Primedia* test at the motion to dismiss stage by failing to draw all reasonable materiality-related inferences in the plaintiff's favor by improperly undervaluing the claims to reflect the plaintiff's likelihood of recovery on the derivative claims, and then by comparing the plaintiff's claimed damages to the overall merger price rather than to the consideration paid to the public unitholders.

The takeaway is that claim-extinguished lawsuits may be difficult to dispose of at the dismissal stage because of the fact-intensive nature of the required claim valuation process.

54 246 A.3d at 127.

Directory



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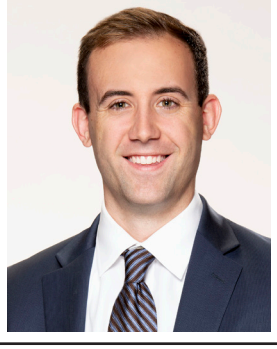

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