Delaware Corporate Law

2023 Year in Review

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2023: DELAWARE CORPORATE JURISPRUDENCE IN REVIEW

2023 was a significant year for the Delaware courts. The Delaware Supreme Court added two new members, Justice Abigail M. LeGrow and Justice N. Christopher Griffiths, to fill the vacancies created by Justice Montgomery-Reeves and Justice Vaughn's departures from the Court. Justice LeGrow joins the Supreme Court with extensive judicial experience, having served as a Superior Court Judge since 2016 in its Complex Commercial Litigation Division. Prior to that, she was a Master in Chancery from 2011 to 2016, coming to the bench from Potter Anderson. Justice Griffiths joined the Court from Connolly Gallagher LLP, where he was a partner specializing in litigation, administrative and municipal law, and bankruptcy.

Meanwhile, the Court of Chancery completed its first year with ten members. The increase in the Court's size has been welcome with the Court's caseload continuing to increase—having over 1,300 cases filed in 2023. The Delaware judiciary has continued to explore ways to manage this growing caseload. In February, the Supreme Court issued an order permitting the judges sitting on the Superior Court's Complex Commercial Litigation Division to serve as temporary Vice Chancellors in actions filed pursuant to 8 *Del. C.* § 111, the statute that gives the Court of Chancery jurisdiction over actions interpreting or enforcing agreements by Delaware corporations relating to the sale of stock or the sale of assets requiring stockholder consent. The members of the Complex Commercial Litigation Division are all experienced and sophisticated jurists well-suited to handle these disputes. The Court's increasing workload has also come at the same time as it has seen more high-profile, expedited cases that have garnered substantial public interest, including the AMC stockholder litigation over which Vice Chancellor Zurn ably presided.

The Court of Chancery has also sought to make other improvements, including by commencing a multi-year project to update its rules, issuing amendments to fifteen rules in September. The Court expects to issue more amendments in tranches before completing the project in 2025.

2024 promises to be another significant year for Delaware corporate law. Of particular note is that the Supreme Court is expected to issue a ruling in *In re Match Group, Inc. Derivative Litigation* in which it is expected to opine on the applicability of the business judgment review in non-squeeze out transactions involving a controlling stockholder where there is either approval by a special committee of independent directors or the holders of a majority of the disinterested and independent stockholders, or whether both prophylactic measures would be required for the business judgment rule to apply under *MFW*. Many are hopeful that this opinion will provide guidance for corporate boards and their advisors in transactions involving controlling stockholders moving forward.

Advance Notice Bylaws and Proxy Contests

Kellner v. AIM ImmunoTech Inc. et al.[1]

C.A. No. 2023-0879-LWW (Del. Ch. Dec. 28, 2023) (Vice Chancellor Will).

In this opinion, the Court considered claims and a counterclaim related to an attempt by Plaintiff Ted D. Kellner ("Plaintiff" or "Kellner"), to nominate directors to the board of AIM ImmunoTech Inc. ("AIM" or the "Company"). The Company rejected Plaintiff's nomination notice because Plaintiff failed to comply with AIM's advance notice bylaws. Plaintiff brought suit challenging the decision by AIM's board of directors (the "Board") to reject the notice. The Court ruled that (1) certain of AIM's advance notice bylaws were invalid; and (2) still, the Company's rejection of Plaintiff's nomination notice was lawful and not inequitable.

In 2022, Kellner was involved in a related action against AIM brought by Jonathan Jorgl (the "Jorgl Action"). In August 2022, Jorgl had submitted a nomination notice purporting to nominate an opposing slate of directors to the Board. AIM rejected Jorgl's notice for failing to disclose certain information required under the bylaws – specifically, other persons with whom there were arrangements or understandings concerning the nominations. Jorgl sued in the Court of Chancery seeking a preliminary injunction that would require AIM to allow Jorgl to nominate his slate of directors. In its opinion denying Jorgl's motion for preliminary injunction, the Court noted Ted Kellner's involvement relating to Jorgl's nomination attempt and his relationships with certain persons that helped advance Jorgl's nomination. Ultimately, the Court ruled against Jorgl, noting that his request amounted to a claim for mandatory injunctive relief, which required Jorgl to show he was entitled to judgment in his favor as a matter of law based on undisputed facts. The Court found that Jorgl's case contained "a myriad of factual disputes that [made] the imposition of mandatory relief impossible."

In December 2022, following Jorgl's failed nomination attempt and litigation, his former counsel contacted counsel for AIM on behalf of Jorgl's nominees to discuss the possibility of naming Jorgl's nominees—or other "mutually agreeable" persons—to the Board. During the call, Jorgl's former counsel indicated that if AIM did not agree to this request that his clients would be ready to come back next year "better organized"

[1] Potter Anderson represented the defendants in this action. The factual recitation herein is based upon the Court's factual findings. Nothing in this summary is intended to express agreement or disagreement with the Court's factual findings or its analysis or holdings.

and “guns blazing.” AIM understood the call to mean that persons involved with the past nomination attempt, would engage in a proxy fight in connection with AIM’s 2023 annual meeting.

In March 2023, AIM amended its bylaws, including the advance notice bylaw (“ANB”). The Company cited a number of reasons for the amendments, including (1) to update and modernize the bylaws, (2) to bring the bylaws in line with recent changes to the General Corporation Law of the State of Delaware, and (3) to respond to “significant activist activity,” including the nomination attempt by Jorgl and his co-conspirators who “engag[ed] in efforts to conceal who was supporting and who was funding the nomination efforts and to conceal the group’s plan for the Company.”

In early August 2023, Kellner submitted a letter to AIM purporting to nominate an opposing slate of directors for election at the Company’s 2023 annual meeting (the “Kellner Notice”). It appeared to the Company that Kellner’s nomination attempt was a continuation of Jorgl’s failed attempt. AIM rejected the Kellner Notice on several bases, including that it failed to disclose information required under the amended ANB. Following the Company’s rejection, Kellner filed suit in the Court of Chancery seeking a declaration that (1) AIM’s ANB was invalid, (2) AIM’s decision to reject the Kellner notice was unlawful and inequitable, and (3) AIM’s directors breached their fiduciary duties by adopting the amended ANB and rejecting the Kellner Notice. AIM filed a counterclaim seeking a declaratory judgment that the ANB was valid and lawful and that the directors had acted properly in rejecting the Kellner notice.

Regarding the lawfulness of the amendments to the ANB, the Court determined that the ANB was not amended on a clear day because it was revised following Jorgl’s nomination attempt and the threat of a renewed 2023 proxy fight. Accordingly, the Court applied enhanced scrutiny under the recently pronounced standard in *Coster v. UIP Companies, Inc.*, which requires the application of *Unocal* that integrates the spirit of *Blasius* and *Schnell*. Accordingly, the Court considered (1) “whether the board faced a threat ‘to an important corporate interest or to the achievement of a significant corporate benefit’” and (2) “whether the board’s response to the threat was reasonable in relation to the threat posed and was not preclusive or coercive to the stockholder franchise.” The Court explained that Defendants bore the burden of proof.

The Court found that while Defendants had proven that they reasonably identified a threat to proper corporate objectives, they had failed to show that certain provisions of AIM’s amended ANB were proportionate in relation to those objectives. Specifically, of the six provisions challenged by Plaintiff, the Court ruled that four did not, as drafted, afford stockholders a fair opportunity to nominate board candidates. Those provisions required disclosures concerning (1) agreements, arrangements, or understandings relating to a nomination (the “AAU Provision”), (2) agreements, arrangements, or understandings between the nominator (or a nominator-assoicated person) on the

one hand, and any nominee on the other, regarding consulting, investment advice, or a previous nomination for a publicly traded company within the last 10 years, (3) known supporters of the nominator and nominees, and (4) the nominator's ownership in AIM stock, including beneficial, synthetic, derivative, and short positions as well as "legal, economic, or financial" interests "in any principal competior" (which term was undefined and created ambiguity). The Court found that Defendants proved that the two remaining provisions in the amended ANB were not unreasonable or preclusive. Those provisions required (1) disclosures regarding the first dates of contact among those involved in the nomination effort (the "First Contact Provision") and (2) the nominees to complete a form of D&O questionnaire (the "Questionnaire Provision").

Regarding the Board's decision to reject the Kellner Notice, the Court determined that the rejection was lawful because the Notice failed to comply with AIM's ANB provisions. Because the Court had ruled that the amended AAU Provision was invalid, it looked to the prior iteration of the AAU Provision, which did "not suffer from the same flaws as the amended version" and which was "fully within and narrower than the [] AAU Provision." Due to the risk associated with a nominator concealing agreements, arrangements or understanding relating to the nomination, the Court determined that it would "risk inequity to excuse the Kellner Notice from disclosing them when AIM had a validly enacted provision in place pre-amendment" and therefore assessed the Kellner Notice under the prior iteration of the AAU Provision. The Court found that Kellner's representation that he and his nominees had not begun planning their nomination efforts until July 2023 was false because evidence at trial showed that Kellner and his nominees had established a "tacit understanding" to run a 2023 proxy contest well before July. Accordingly, the Kellner Notice was deficient under the prior iteration of the AAU Provision. Additionally, the Court also noted that the Kellner Notice (1) violated the First Contact Provision by failing to provide even an approximate date of first contact between Kellner and his nominees and (2) did not comply with the Questionnaire Provision because the questionnaires submitted by Kellner and his nominees contained certain factual inaccuracies. The Court also ruled that the Board's rejection of the Kellner Notice was equitable because the notice concealed arrangements and understandings that went "to the heart of a nomination effort," and such concealment risked "undermining the essential disclosure function of advance notice bylaws."

As to the conduct of AIM's directors, the Court ruled that Board "did not breach its fiduciary duties in enforcing valid advance notice bylaws," and further, that the Board acted "reasoably and equitably" in rejecting the Kellner Notice because Kellner and his co-conspirators had engaged in "manipulative conduct" in pursuing their nomination efforts.

On January 3, 2024, Kellner filed a notice of appeal of the Court's decision. On January 19, Defendants filed a notice of cross appeal.

Takeaways

Determination of whether a party complied with advance notice bylaws is a fact intensive inquiry that ordinarily is not amenable to resolution on a summary judgment standard: In the *Jorgl* Action, the only relief requested by plaintiff was to have the Court enter a preliminary injunction ordering the defendants to acknowledge his nominees as valid, permit his nominees to stand for election, and include his nominees on a universal proxy card. Because such relief amounted to a request for a mandatory injunction, Jorgl had to make the "more onerous" summary judgment-standard showing that he was entitled to such relief as a matter of law based on undisputed facts. Jorgl failed to make that showing. Vice Chancellor Will, who decided *Jorgl*, also decided *Paragon Technologies, Inc. v. Terence J. Cryan, et al.* approximately a year later. Like Jorgl, the plaintiff in *Paragon* sought mandatory injunctive relief on a preliminary record. The Court determined the case was "rife with factual disputes" and denied plaintiff's motion for preliminary injunction. In the *Kellner* case, Plaintiff's disputes regarding the amendments to the ANB provisions and Kellner's notice were resolved with the benefit of a full trial record.

The Court will consider the adoption or amendment of advance notice bylaws on a "cloudy day" and board determinations that a stockholder notice fails to comply with advance notice bylaws under a modified *Unocal* standard that "integrates the spirit of *Blasisus* and *Schnell*": Because the Court determined it was not a "clear day" when AIM adopted its amended bylaws, it applied a two-part test that considered (1) whether the Board faced a threat to an important corporate interest or to the achievement of a significant corporate benefit; and (2) whether the Board's response to the threat was reasonable in relation to the threat posed and was not preclusive or coercive to the stockholder franchise. The Court noted that "fundamentally, the standard to be applied is one of reasonableness."

In the context of advanced notice bylaws, Delaware courts recognize that there are legitimate reasons for companies to institute or update their advance notice bylaws, including order and disclosure. However, bylaws that place constraints on the stockholder power to nominate director must be reasonably tailored to a legitimate corporate purpose, as "[b]ylaws that 'unduly restrict the stockholder franchise or are applied inequitably [] will be struck down.'"

Paragon Technologies, Inc. v. Terence J. Cryan, et al.[2]

C.A. No. 2023-1013-LWW
(Vice Chancellor Will)

In August 2023, plaintiff Paragon Technologies, Inc. ("Paragon"), an activist investor and stockholder of Ocean Power Technologies, Inc. ("OPT"), delivered a purported notice of director nomination (the "Notice") seeking to nominate five individuals for election as directors at OPT's 2023 annual meeting of stockholders. The Board rejected the Notice for failure to comply with OPT's advance notice bylaws (the "Bylaws"). Additionally, Paragon requested that OPT grant an exemption (the "Exemption Request") from OPT's Section 382 Tax Benefits Preservation Plan (the "Section 382 Plan"), which the OPT Board denied on October 12, 2023. Thereafter, Paragon filed suit in the Court of Chancery requesting that the Court issue declaratory and preliminary mandatory injunctive relief permitting its nominees to stand for election at OPT's annual meeting and directing the defendants to grant the Exemption Request. Following expedited discovery and a preliminary injunction hearing, the Court issued a post-hearing decision denying the request for a preliminary injunction.

The Bylaws, which were adopted two months before the Notice, included an advance notice provision that imposed requirements on a stockholder nominating director candidates for election. Among them were requirements that the nominating stockholder disclose (1) a description of any plans or proposals of the nominating stockholder that would be required to be disclosed under Item 4 of Schedule 13D; (2) events, occurrences, and/or circumstances that could impact the proposed nominees' ability to receive a security clearance; (3) any business or personal interests that could create a potential conflict of interest between OPT and the proposed nominee; and (4) information about the proposed nominees required to be included in a proxy statement under Regulation 14A. The Bylaws also required that the notice be in proper form, including that such notice include a completed questionnaire with a written representation and agreement in the form provided by OPT. Around the time of the adoption of the Bylaws, OPT's Board of Directors (the "Board") also announced its adoption of the Section 382 Plan to preserve OPT's net operating loss ("NOL") carryovers that would result in significant dilution of OPT common stock should any person or entity acquire more than 4.99% of OPT's outstanding common stock.

After the Board rejected the Notice and the Exemption Request, Paragon brought suit, alleging that the Board breached its fiduciary duties through those rejections. Paragon requested that the Court declare that its nominees could stand for election

[2] Potter Anderson represented the defendants in this action. The factual recitation herein is based upon the Court's factual findings. Nothing in this summary is intended to express agreement or disagreement with the Court's factual findings or its analysis or holdings.

at the 2023 annual meeting and grant the Exemption Request by way of a preliminary mandatory injunction.

Based on the paper record, the Court found there were material issues of fact related to at least two alleged deficiencies with the Notice: (1) Paragon's alleged failure to disclose its plans or proposals for OPT and (2) Paragon's alleged failure to disclose any related conflicts of interest between OPT and the proposed nominee. As to the disclosure of plans or proposals requirement, the Court reasoned that Paragon, as the nominating stockholder, failed to prove that it had adequately described its plans or proposals for OPT, as the Bylaws required. The Court cited, among other things, text messages between Paragon directors, in which Hesham Gad, Paragon's chairman, indicated that he saw a "path" to "acquire the entire company stock for stock," contradicted deposition testimony by Paragon's witnesses, as well as a gap in the factual record due to Gad's deletion of text messages and Paragon's failure to produce any board materials. As to the disclosure of conflicts of interest requirement, Paragon failed to prove that it had provided responsive disclosures about whether the proposed nominees serving as Paragon directors might have a conflict of interest in choosing between Paragon and OPT if they were elected to the Board.

Having found that Paragon failed to prove that the Notice complied with the requirements of the Bylaws, the Court then considered whether the Board's rejection of the Notice could withstand enhanced scrutiny under the *Unocal* standard of review based on the limited factual record. In ruling that the rejection withstood scrutiny, the Court noted that several of the Bylaw amendments were enacted after Paragon's emergence as a "significant stockholder" and when the "potential proxy contest was known to the Board," but reasoned that several of the Bylaws incorporated provisions related to the universal proxy rules and included additional disclosures that promoted the disclosure function of advance notice bylaws.

The Court then applied *Unocal* to evaluate the rejection of the Exemption Request. Under that standard, the Court found that Paragon had not shown through the limited factual record that it was entitled to relief because the Board had identified that granting the Exemption Request could pose a threat to the Company's ability to use its NOLs and denying the Exemption Request was a reasonable response to that threat.

The Court noted that Paragon "chose to seek a preliminary mandatory injunction on fact-intensive matters and a limited record." Applying that standard, the Court held that Paragon did not meet the heightened standard for mandatory injunctive relief and denied the motion for injunctive relief.

Takeaways

Establishing a sufficient factual record for a challenge to advance notice bylaws is very difficult at the preliminary injunction stage: In both *Paragon* and *Kellner*,

the Court of Chancery recognized stockholders' overarching fundamental right to participate in the election of directors and the right to nominate directors. However, while the plaintiff in *Kellner* was at least partially successful in having the Court declare certain portions of the advance notice bylaw invalid, Paragon was not, even though Vice Chancellor Will presided over both actions. A key factor in this was that the ruling in *Paragon* was at the preliminary injunction stage, while *Kellner* came after a trial.

A preliminary mandatory injunction of the type that Paragon sought is subject to a summary judgment standard, requiring that there be no genuine dispute of material fact. The Court has made it clear that it is not likely to grant such requested relief when presented with a limited factual record. Thus, a plaintiff should think carefully before seeking a preliminary injunction when challenging the rejection of a nomination notice and advance notice bylaws and consider whether a sufficient factual record exists, given the likelihood that the discovery record will result in issues of material fact.

Post-Trial Fiduciary Duty Opinions with Alleged Controlling Stockholders

In re Oracle Corporation Derivative Litigation
C.A. No. 2017-0337-SG
(Vice Chancellor Glasscock)

Larry Ellison founded Oracle Corporation ("Oracle" or the "Company") in 1977 and has served on its board since that time. He also served as CEO until 2014, when he passed the baton to Safra Catz and became Oracle's Chief Technology Officer. In 1998, Ellison co-founded NetSuite, Inc. ("NetSuite"). While Oracle and NetSuite operated in the same market, they were only marginally competitive because NetSuite typically sold its products to mid-size and smaller businesses. At the time an acquisition of NetSuite by Oracle became a possibility, Ellison owned a larger comparative stake in NetSuite. Ellison expressed his opinion on the transaction, but he recused himself from the decision-making process at both companies prior to any negotiations. Oracle's Board of Directors (the "Board") created a special committee (the "Special Committee") to consider the transaction. Prior to and during the acquisition process, both Ellison and Catz failed to report to the Special Committee conversations they had with Evan Goldberg, NetSuite's co-founder. After some halts in negotiations, the companies agreed to a purchase price of $109 per share. The transactions closed on November 7, 2016.

The plaintiffs alleged, among other things, that Ellison controlled Oracle and forced the acquisition through to benefit himself as a proportionally larger stockholder of NetSuite. The plaintiffs also alleged breaches of fiduciary duties against other Oracle officers and directors and certain officers and directors at NetSuite for complicity in Ellison's scheme. Over the course of more than five years of litigation, all defendants were dismissed except for Ellison and Catz, who went to trial in November 2022.

In its post-trial opinion, the Court determined that Ellison was not a controller of Oracle either generally or specifically for the NetSuite acquisition. Further, the Court found that neither Ellison nor Catz breached their fiduciary duty of loyalty because they did not defraud Oracle's Special Committee, as alleged by the plaintiffs. Based on those determinations, the Court held that the business judgment rule applied.

In analyzing control, the Court noted that Ellison lacked "hard control" because he did not possess a majority voting stake. The Court also found he lacked "general control"

based on evidence that the Board regularly pushed back on his propositions and were not afraid to "vigorously debate[]" Ellison's assumptions and his vision for the Company. While the Court found that Ellison would likely be able to exert control over a specific transaction, it found he did not do so with regard to the NetSuite acquisition. Moreover, the Court found that Ellison neither originated the transaction nor exerted control through his undisclosed phone calls with Goldberg or through Catz.

The Court also determined that neither Ellison nor Catz committed fraud on the Board or the Special Committee. The plaintiffs alleged that Ellison breached his fiduciary duties because he did not disclose to the Board that he believed Oracle's and NetSuite's trajectories were on a collision course in the market, and Oracle would "crush" NetSuite. The Court found the companies were only marginally competitive, and NetSuite's responsive strategies were already being implemented at the time of the transaction, such that the Special Committee knew of and could independently evaluate them. The Court similarly discredited the plaintiffs' allegations that Ellison withheld information of post-closing plans for NetSuite. Oracle used its standard metrics in evaluating the acquisition, and it invested heavily in NetSuite after the closing. Finally, Ellison's undisclosed communications with Goldberg were not fraud on the Board because they were communications with the target and were not pertinent to the Special Committee process at Oracle. Likewise, none of Catz's undisclosed communications with NetSuite constituted price negotiations or otherwise material information that would have influenced the Special Committee's process or conclusions. As a result of the lack of control over the transaction or fraud upon the Board, the business judgment rule applied to the transaction, and the Court ruled in favor of Ellison and Catz.

Takeaways

Influence Doesn't Always Equal Control: Being the influential face of a company does not equate to control under Delaware law. The Court admitted to some ambiguity in Delaware's case law regarding what constitutes general control over a corporation. Despite Ellison's admitted outsized influence at Oracle, his status as the founder, his 28.4% stake as a stockholder, and statements from the CEO that Ellison defined Oracle's "vision" and was its "guiding light," the Court found he did not exercise general control over Oracle. Instead, it took into account other factors like the board's history of independence and how easily Ellison could implement or block agendas at the Company. Boards of companies with an influential major (but not majority) stockholder should be sure to and build a record of acting independently from that stockholder. That type of behavior will help support a finding that a significant stockholder is not a controller, potentially resulting in a more defendant-friendly standard of review.

A pleading-stage determination that someone is a controller is not permanent: The Court had previously denied a motion to dismiss on the basis that the plaintiffs

had alleged sufficient facts supporting their contention that Ellison was a controller of Oracle. However, after trial, the Court determined that Ellison was not a controller. Thus, while a pleadings-stage determination that someone is a controller is significant for surviving a motion to dismiss, parties should still work to develop a robust record regarding control at trial.

Tornetta v. Musk et al.,
C.A. No. 2018-0408-KSJM
(Chancellor McCormick)

In 2018, the board of directors of Tesla, Inc. ("Tesla" or the "Company") unanimously approved a multi-year compensation package for its CEO, Elon Musk, which had a potential value of over $55 billion (the "Grant"). Plaintiff, a Tesla stockholder, brought a derivative suit on behalf of the Company alleging that the board of directors breached its fiduciary duties in approving the unprecedented package. The Court found that Defendants, Musk and six Tesla directors, failed to meet their burden of establishing that the Grant was entirely fair. As a result, the Court ordered recission of the Grant.

The Grant was performance-based and provided Musk the opportunity to secure twelve total tranches of Tesla options, each representing 1% of Tesla's total outstanding shares as of January 21, 2018, the day the Grant was approved. In order for a tranche to vest, Tesla's market capitalization would have to increase by $50 billion and Tesla would have to achieve certain EBITDA or revenue targets in four consecutive financial quarters. The grant date value was $2.6 billion with a potential maximum value of $55.8 billion, making the Grant "250 times larger than the contemporaneous median peer compensation plan and over 33 times larger than the plan's closest comparison."

Although Musk owned a non-majority equity stake (21.9%) of Tesla, the Court found he was a controller with respect to the adoption of the Grant in light of the "enormous influence" Musk had over the Company and the directors that approved the Grant. Accordingly, the Court applied the entire fairness standard of review.

Defendants argued that the burden to prove issuance of the Grant was *not* entirely fair should be shifted to Plaintiff because the Grant was conditioned on a majority-of-the-minority vote. But the Court found that the vote was not fully informed because the proxy statement inaccurately identified certain key directors as independent and failed to provide key details about the process leading to the approval of the Grant by the Tesla board of directors. Accordingly, Defendants retained the burden of proving the Grant was the product of a fair process and constituted a fair price.

Regarding the process, the Court noted that Musk had extensive ties with the directors negotiating on behalf of Tesla, including a 15-year relationship with the compensation committee chair. Another compensation committee member had a 20+ year business relationship with Musk and was so personally connected to him that the two had vacationed with each other and their families on regular basis. With respect to the other two compensation committee members, the Court noted that the compensation each received as a Tesla director was either "life-changing" or a "large portion of his wealth," and that, although market-rate compensation does not compromise a director's independence, outsized compensation can. Tesla's general counsel, who acted as the primary communicator between Musk and the compensation committee, was Musk's former divorce attorney and was moved to tears by his admiration of Musk during his deposition. In addition to those close professional and personal ties, the Court found that Tesla's negotiators did not view the process as adversarial and, instead, considered the process to be "cooperative" with Musk. The Court also noted that Musk influenced the process by, for example, dictating its timing and making last minute changes to the timeline or altering substantive terms of the Grant immediately before several of the compensation committee's meetings. The Court applied those facts to the "*Weinberger* factors" (from *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983)), which consider how the transaction was initiated and timed, how it was structured and negotiated, and how it was approved. Under the *Weinberger* factors, the Court found Defendants failed to demonstrate the process leading to the Grant was fair.

As to the price, Defendants argued that (1) the Grant was "all upside" for Tesla stockholders because they only had to "give" Musk an additional 6% equity stake in order to "get" $600 billion in value, (2) the unique set of circumstances in this case warranted an unprecedented Grant, (3) the Grant aligned Musk's interests with Tesla's stockholders, (4) the milestones required for each tranche to vest were ambitious, (5) the Grant was an exceptional deal as compared to private equity compensation plans, (6) the stockholder vote was an indicator of fair price, and (7) the Grant helped deliver what was promised to Tesla's stockholders. The Court ruled that all of Defendants' arguments failed. In reaching its decision, the Court considered that Musk already had a sizable equity stake in Tesla without the Grant and, therefore, the Grant was not required to align his interests with those of Tesla's stockholders. Additionally, the Court noted that if a goal of the Grant was to incentivize Musk to prioritize Tesla over his other ventures, the Grant failed to include any "guardrails" on how much time or energy Musk would be required to put into Tesla. Furthermore, the milestones were not so ambitious as to support the Grant's size because Tesla's internal projections anticipated a 70% likelihood that some of the milestones would be achieved soon after approval of the Grant. The Court also did not agree that the Grant should or even could be compared to private equity compensation plans. Finally, the Court found that Defendants failed to show that the Grant caused Tesla to achieve certain of the milestones or show why Musk should be entitled to 1% per tranche as opposed to some lesser value. For these reasons, the Court concluded the Grant did not fall within a range of fairness.

After deciding that Defendants had failed to prove the Grant was entirely fair, the Court ruled that the most appropriate remedy would be recission. The Court considered recission "reasonable, appropriate, and practicable" under the circumstances because (1) no third-party interests would be implicated and (2) the entire Grant sat unexercised and undisturbed.

Takeaways

Determining control is not a one-size fits all inquiry: *Tornetta* provides a contrast with *Oracle*, as Chancellor McCormick found that the other "indicia of effective control" when determining whether Musk, a non-majority shareholder, was a controller, included: ownership of a significant equity stake, the right to designate directors, decisional rules in governing documents that enhance the power of minority stockholder or board-level positions, and the ability to exercise outsize influence in the board room, such as through high-status roles like CEO, Chairman, or founder. Thus, while some of these factors were similar to those present with respect to Larry Ellison at Oracle, these cases show that the determination of control is a fact-specific determination.

Companies should provide detailed disclosures regarding the adoption of compensation plans: A majority-of-the-minority vote will not shift the burden of proof back to plaintiffs in an entire fairness transaction if the Court finds the vote was not fully informed due to material disclosure deficiencies, even in the non-merger context. *Tornetta*, therefore, demonstrates the importance of providing a fulsome description of the process for approving compensation in public disclosures. This is particularly important because, as noted in *Tornetta*, a stockholder vote based on deficient disclosures is not an indicator of fair price in the entire fairness analysis.

In re Sears Hometown and Outlet Stores Inc. Stockholder Litigation[3]

(Consolidated) C.A. No. 2019-0798-JTL (Vice Chancellor Laster).

In 2012, Sears Holdings Corporation ("Holdings") spun off Sears Hometown and Outlet Stores (the "Company") as a separate, publicly traded entity. As the holder of the majority of Holdings' common stock, Edward S. Lampert ("Lampert"), through investment vehicles, received a majority of the Company's common stock, which he maintained. The Company conducted business through two segments: (i) the Sears Hometown and Hardware Segment ("Hometown") and (ii) the Sears Outlet

[3] Potter Anderson represented the defendants in this action. The factual recitation herein is based upon the Court's factual findings. Nothing in this summary is intended to express agreement or disagreement with the Court's factual findings or its analysis or holdings.

Segment ("Outlet"). Hometown was the larger segment, representing approximately two-thirds of the Company's assets, and it sourced most of its merchandise directly from Holdings. Hometown's stores were operated independently by dealers under agreements with a Company subsidiary (the "Dealer Agreements"). Each Dealer Agreement was terminable only on default, required individual arbitration for each dispute, and ran for three to five years. Outlet, on the other hand, held a unique scratch-and-dent strategy and was less-reliant on Holdings for its products.

After the spinoff, the Company's financial performance deteriorated significantly. By 2018, Hometown had closed over half of its original stores and generated negative EBITDA year-after-year. The Company's stock price tracked the poor performance, sinking from a high of $50 per share to below $2 per share for extended periods. While Outlet too struggled, it had a breakthrough in 2018, generating positive EBITDA of $25 million. When Holdings filed for bankruptcy in October 2018, management of the Company began to consider strategic alternatives, including a potential acquisition by Lampert and the liquidation of the Hometown segment while running Outlet as a standalone business. The Board of Directors of the Company (the "Board") then determined that any transaction with Lampert should be led by a previously formed Special Committee of the Board (the "Special Committee"). Lampert ultimately acquired all of Holdings' assets out of bankruptcy, but the Company continued its decline.

In April of 2019, management called an emergency Board meeting whereupon it reconsidered strategic alternatives. The Special Committee authorized management to engage with Lampert, while preparing to liquidate the Hometown segment and run Outlet as a standalone business. Management received various assessments from its advisors as to the net proceeds of a potential Hometown liquidation, but those analyses were incomplete and based on outdated information. With a positive view of liquidation in mind, on April 1, 2019, the Board and the Special Committee gave Lampert a deadline—he and the Company must come to an agreement on the acquisition of Hometown or the Company as a whole by April 15 or the Company would move forward with liquidating the Hometown segment.

Lampert, wielding extensive experience in the retail industry, thought a Hometown liquidation would destroy stockholder value and should be considered only in the absence of any alternatives. He credibly believed that management and its advisors dramatically overestimated the proceeds of a mass-liquidation and underestimated the liabilities that would ensue as a result of breaching the Dealer Agreements. Lampert saw a big difference between closing small tranches of stores and closing all Hometown stores at once and anticipated massive expenses arising from the breaches of the Dealer Agreements. Lampert was also skeptical that Outlet could succeed as a standalone. Yet management and its advisors had no answers to his points. Concerned that management failed to consider the full implications of a Hometown segment liquidation, Lampert subsequently submitted an offer to purchase

the entire Company for $2.25 per share, which represented a 23.6% premium to the Company's 5-day volume-weighted average share price.

While Lampert thought that his offer would start a negotiation, the Special Committee refused to engage, telling Lampert that it believed a per share valuation in the "mid to high single digits" was appropriate based on management's projections for its Hometown liquidation plan. Frustrated, Lampert met with the Board and Special Committee. He proposed various structures to bridge the valuation gap and emphasized that it was inappropriate to force through a value-destroying liquidation over the objection over a majority stockholder. But with the "deadline" a week away, the Special Committee never made a serious counteroffer. The Special Committee countered with a proposal for a whole-company sale at $9.50 per share (despite the Company trading under $2 per share), informing Lampert that management would proceed with the Hometown liquidation unless it reached a deal with Lampert. Lampert, believing that management was serious, acted to prevent a Hometown liquidation, which he believed would be a disaster for the Company and its stockholders (including himself, as the largest stockholder).

On April 15, 2019, Lampert, as the majority stockholder, took action by written consent to protect against what he believed to be an ill-conceived Hometown liquidation (the "Intervention") by (1) amending the Company's bylaws to require certain procedural steps for the Board to proceed with a liquidation, including two near-unanimous Board votes, taken thirty business days apart, and (2) removing two directors from the Board, who served as two of the three Special Committee members and who were the most insistent upon the liquidation plan, and filling the Board vacancies. The result of the bylaw amendment was to practically preclude a liquidation. Following the Intervention, the remaining Special Committee member resumed negotiations with Lampert. The parties considered various structures in an attempt to bridge the valuation gap, which was largely a result of varying valuations of Outlet, although Lampert refused to increase the base $2.25 per share price. Ultimately, the parties agreed to a cash-out merger with a go-shop for Outlet. Lampert purchased the Company at a base price of $2.25 per share, and Outlet was sold to a third-party in connection with the go-shop process. When both portions of the transaction closed, the Company's stockholders received total consideration of $3.21 per share.

After close, stockholder plaintiffs filed suit in the Court of Chancery, alleging that (1) Lampert breached his fiduciary duties by using his stockholder voting power to block management's liquidation plan through the Intervention and (2) the end-stage cash-out merger was not entirely fair.

Regarding the Intervention, the Court found that Lampert's action was a reasonable response to the threat posed by the liquidation strategy, and not a breach of fiduciary duty. The Court first explained that when a controller exercises its voting power to

affirmatively change the status quo, "a controlling stockholder owes a fiduciary duty of loyalty which requires that the controller not intentionally harm the corporation or its minority stockholders, plus a fiduciary duty of care that requires that the controller not harm the corporation or its minority stockholders through grossly negligent action." The Court then considered what standard of review, if any, applies to a controller's exercise of stockholder voting power. The Court noted that no prior decisions identify a standard review for a controller's unilateral action to amend bylaws or remove directors. Accordingly, the Court turned to a standard of review typically utilized for judicial review of certain director action, finding that enhanced scrutiny "makes sense" here, where a controller takes action to impair the rights of directors or a stockholder minority. Thus, applying the enhanced scrutiny standard, the Court found that Lampert, as controlling stockholder, must show that he acted in good faith for a legitimate objective, that he had a reasonable basis believing action was necessary, and that he acted through reasonable means. The Court found that Lampert proved at trial that he acted in good faith for a legitimate objective (to protect the Company from a value-destroying liquidation) and had a reasonable basis for believing that action was necessary. Further, the Court found that Lampert did not engage in a negligent manner—he acted consistently with his fiduciary duties in engaging in discussions and negotiations and had sufficient information to make a well-informed assessment. And, in response to the threat, the Court found that Lampert "made a reasonable choice among the debatable tactical alternatives."

The Court next addressed the cash-out merger that followed the Intervention, which was subject to entire fairness, noting that "[i]f the story ended [with the Intervention] and the company had continued in the status quo that existed before the controller intervened, then judgment would be entered in favor of the defendants." But, the Court found that the Intervention had "tilted the playing field, and the fallout from that game-changing action was too great," such that the parties failed to bargain over the value of Hometown. The Court held that Lampert failed to prove both fair dealing and fair price of that transaction, ordering Lampert to pay the difference between the transaction price and the sum of the fair value of the Hometown segment and the consideration received for the Outlet segment in the go-shop (as the Court found that the market tested value for Outlet was fair). The Court found that figure amounted to $1.78 per share, for an aggregate award of $18,314,800 million.

On January 31, 2024, Defendants filed a motion for reargument regarding certain aspects of the Court's damages analysis, which motion remains pending.

Takeaways

A controller's exercise of power to affirmatively change the status quo is subject to enhanced scrutiny judicial review, and a controller who satisfies that standard may take stockholder-level action to protect against board actions with which the controller disagrees without breaching fiduciary duties: When exercising stockholder-level voting power, a controller must act in accordance with

fiduciary duties, owing (i) a duty of good faith not to harm the corporation or its minority stockholders intentionally; and (ii) a duty of care not to harm the corporation or its minority stockholders through grossly negligent action. When a controller takes more affirmative actions that change the status quo by preventing or restricting board action, the Court will apply enhanced scrutiny review: a controller must prove that (i) they acted "in good faith, after a reasonable investigation, to achieve a legitimate objective"; and (ii) they "chose a reasonable means" for achieving the proper objective. The door remains open for what other types of affirmative controller interventions may trigger enhanced scrutiny.

A controller is still at risk for fallout liability following a fair intervention: Even where an intervention by a controlling stockholder does not breach fiduciary duties, a controller must be wary of the potential fallout caused by such actions, which may "cast a shadow" over ensuing negotiations such that the process may be considered unfair, regardless of the controller's subjective belief as to fairness.

Covenants Not to Sue

New Enterprise Associates 14, L.P. v. Rich

C.A. No. 2022-0406-JTL
(Vice Chancellor Laster)

In 2014, a group of investment funds sponsored by New Enterprise Associates (the "Funds") invested in a startup called Fugue, Inc. (the "Company"). Approximately six years after their investment, the Funds encouraged the Company to run a sales process. After that process failed, the Company needed capital, but the Funds were unwilling to increase their investment. Following a review of the alternatives, management of the Company indicated that a recapitalization led by George Rich (the "Recapitalization") was the only option for the Company. Rich indicated that he would only commit to the Recapitalization if (i) all existing preferred stock were converted to common stock, (ii) a new class of preferred stock was issued to Rich and his fellow investors, and (iii) the Funds and other significant stockholders entered into a voting agreement in connection with the Recapitalization (the "Voting Agreement"). The Funds accepted the terms proposed by Rich but declined to participate in the Recapitalization. The Voting Agreement contained a drag-along provision, which was based on the model NVCA voting agreement and required the parties to not bring claims against Rich and his affiliates for a breach of fiduciary duty (the "Covenant") in connection with a sale transaction that met eight criteria and was approved by the Company's board of directors (the "Board") and a majority of the Company's preferred stockholders (a "Drag-Along Sale").

In February 2022, the Company announced it had entered into a merger agreement and closed the merger, which qualified as a Drag-Along Sale under the Voting Agreement. A few days later, the Funds received a waterfall distribution for the consideration to be paid in the merger that revealed certain insider transactions. The Funds alleged that these transactions were the product of unfair self-dealing. The Funds asserted claims for breach of fiduciary duty against members of the Board as well as Rich and his affiliates, as controlling stockholders, in connection with the approval of the merger.

The Funds acknowledged that the merger met the requirements to qualify as a Drag-Along Sale under the Voting Agreement and therefore the Covenant was implicated. In addition, the Funds acknowledged that the Covenant covered their claims in connection with the approval of the merger. The Funds argued, however, that the Covenant was facially invalid.

Looking to the principles of trust law, agency law, the DGCL and Delaware common law, the Court found that that the Covenant was not facially invalid under Delaware fiduciary duty law and explained that stockholders may agree to "more constraints on their ability to exercise stockholder-level rights than corporate planners can impose through the charter or bylaws" in a private agreement. However, even though the Covenant was a permissible form of fiduciary tailoring, the Court held that the Covenant was invalid to the extent it purported to preclude claims for an *intentional* breach of fiduciary because of public policy limitations on contracting.

Borrowing from the factors the Delaware Supreme Court's described in *Manti Holdings, LLC v. Authentix Acquisition Co.*, the Court determined that the Covenant was facially valid because (1) it was narrowly tailored to a specific type of transaction and (2) the enforcement of the Covenant was reasonable, taking into consideration a number of factors. First, the Covenant was set forth in an express provision of the Voting Agreement, which the Funds agreed to. The Court noted here that the Covenant did not appear to be a "take-it-or-leave-it provision" like one might see in a pre-IPO certificate of incorporation nor was the Covenant "imposed through a midstream charter amendment that the Funds voted against." The Funds freely agreed to the Covenant. Second, the Covenant is clear and there is no dispute that it applies to the claims made by the Funds. Third, the Funds are sophisticated repeat players who understood the implications of the Covenant. In addition, the Covenant tracks language in the model NVCA voting agreement and New Enterprise Associates is a member of the NVCA. The Court went on to speculate that discovery might even show that the Funds or their sponsors had deployed similar provisions in other transactions.

Fourth, the Funds had an opportunity to reject the Covenant. At the time of the Recapitalization, the Funds could have blocked the transaction and sought a different deal, but they did not. Further, they could have invested along-side Rich but choose not to and instead signed the Voting Agreement. Fifth and finally, the Voting Agreement, including the Covenant, was agreed to in order to induce Rich to fund the Recapitalization. In other words, the Covenant was part of bargained-for consideration between the parties to the Recapitalization and invalidating the Covenant would shift value to the Funds by permitting them to pursue rights they voluntarily agreed to forego.

Despite finding the Covenant facially valid, the Court warned that "[a] broad waiver of any ability to assert claims for breach of fiduciary duty would be a non-starter" and that "[e]ven a narrowly tailored provision would likely be unreasonable if it appeared in an agreement that purported to restrict the rights of retail stockholders."

Ultimately, based on the public policy limitations relating to intentional torts, the Court denied the defendants' motion to dismiss because the Funds' claims "could

support liability for a bad faith breach of duty." The Court noted that the Covenant would bar the claims if the defendants had engaged in a self-dealing transactions with the good faith belief that the transactions "were not contrary to the best interests of the Company."

Takeaways

Sophisticated stockholders may agree not to sue for breaches of fiduciary duty for specified types of transactions, but Delaware Courts will closely examine any such agreement: "The DGCL allows more space for fiduciary tailoring and greater limits on fiduciary accountability than is widely understood." Stockholders may agree to more constraints on their ability to exercise stockholder-level rights in a private agreement than can be imposed through a certificate of incorporation and bylaws. That said, even though sophisticated repeat players may contractually agree to a covenant not to sue for breach of fiduciary duty in connection with certain specified types of transaction, the Court cautioned that parties should expect a "hard look" at these covenants by Delaware courts.

As a general matter, contractual exemptions for liability arising from a future intention tort will not be enforceable: A party may not contractually protect itself against liability for the party's own bad faith actions or fraudulent acts. Because a breach of fiduciary duty claim is an equitable tort, a covenant not to sue for breaches of fiduciary duty will not be enforceable in respect of claims for bad faith breaches of fiduciary duties.

Special Litigation Committees

Teamsters Local 443 Health Services & Insurance Plan v. Chou ("Teamsters II")
C.A. No. 2019-0816-SG
(Vice Chancellor Glasscock)

This memorandum opinion follows an August 24, 2020 opinion ("*Teamsters I*") in which the Delaware Court of Chancery denied a motion to dismiss plaintiff stockholders' *Caremark* claims against the Board of Directors ("Board") of AmerisourceBergen Corporation ("ABC"). In this opinion, the Court granted a motion to dismiss recommended by ABC's single-member special litigation committee ("SLC").

ABC, now known as Cencora, Inc., is one of the largest pharmaceutical distributors in the United States and has several subsidiaries. Plaintiffs alleged that the Board breached its fiduciary duty of oversight by failing to prevent one of its subsidiary companies, Medical Initiatives, Inc. d/b/a Oncology Supply Pharmacy Service ("MI Pharmacy"), from repackaging cancer medication from single-dose vials into syringes for distribution to physicians, resulting in hundreds of millions of dollars in criminal and civil penalties. In *Teamsters I*, on a motion to dismiss, Vice Chancellor Glasscock held that plaintiffs had satisfied their burden of stating a claim for breach of fiduciary duty and that the majority of the Board faced a substantial risk of liability for failure to properly oversee the MI Pharmacy operations, thus excusing the demand as futile.

In response to *Teamsters I*, the Board established the SLC, comprised of one director, Dennis Nally, to investigate the allegations and determine whether prosecuting the action was in ABC's best interest. After a seven-month investigation encompassing a collection of over 12 million documents, 77 interviews of 67 witnesses, and a 365-page report with 420 exhibits, the single-member SLC recommended dismissal of the action.

The SLC determined that the Board did not fail to implement and monitor reporting or information systems, or otherwise exercise their oversight duties, but rather had "implemented a system of reporting that was more than adequate to meet the *Caremark* standards" as demonstrated by ABC's Audit Committee having clear reporting lines and the Company repeatedly updating the compliance program as the Company grew. The SLC also concluded that the officer defendants did not knowingly operate an illegal business model, did not fail to inform the Board, nor were they grossly negligent in their management of MI Pharmacy.

The Court reviewed the SLC's determination under the two-pronged analysis established in *Zapata Corporation v. Maldonado*. The mandatory first prong evaluates the independence and good faith of the special litigation committee and the bases

supporting its conclusions. Under the discretionary second prong, the Court applies its own independent business judgment as to whether the motion should be granted." Due to the "inherently suspect" nature of a single-member committee, the Court examined the recommendation under an even stronger microscope than *Zapata* typically calls for.

Despite the heightened scrutiny, the Court concluded that the SLC conducted a reasonable investigation and that the grounds for the SLC's conclusions were reasonable. Next, the Court held that Nally was independent. Plaintiffs challenged Nally's independence because he had a membership at the same golf club as the former chairman of the Board, Richard Gozon, who served as ABC's chairman from 2006 to 2016. The Court emphasized that Gozon was not a named defendant in the action and therefore not an interested director for purposes of *Zapata*'s first-prong analysis. Moreover, the Court stated that Nally's and Gozon's service on the board of the golf club was "insufficient to compromise Nally's independence" and found the relationship too attenuated to disable reliance of Nally's exercise of judgment in the best interest of ABC. The Court also rejected Plaintiffs' argument that Nally was not able to be impartial because of his previous involvement in a fraud suit at a previous employer and purported hostility to plaintiff's lawyers due to a history of adversarial litigation.

The Court then applied its own judgment and found that prong two of *Zapata* was satisfied. Consequently, it dismissed the litigation.

Takeaways

Single member Special Litigation Committees can survive scrutiny: Single-member Special Litigation Committees (SLC), although inherently suspicious, are not inherently invalid and can survive a heightened scrutiny review by the Court of Chancery if the SLC conducts a diligent and thorough investigation that yields a reasonable conclusion. While multi-member SLCs are preferable, *Teamsters II* shows that the single-member committee can be a viable alternative. However, because a disabling conflict for the individual serving on a single-member SLC would cause it to fail the *Zapata* test, corporations should carefully scrutinize any potential members before creating a single-member SLC.

A related settlement, guilty plea or conviction does not automatically mean *Carmark* duties have been violated: The Court found that the SLC's conclusion that ABC did not knowingly violate the law was reasonable. In reaching that conclusion, the Court rejected an argument from plaintiffs that the director defendants had knowingly operated an illegal business model due to a 2017 federal guilty plea by ABC because that plea was for a strict liability offense. When considering *Caremark* claims based on settlements, guilty pleas, or convictions, parties should consider the level of knowledge or scienter they imply. Because *Caremark* claims require that the defendants acted in bad faith, any implication of knowledge from a settlement, plea, or conviction could increase the likelihood of a Court finding a breach of *Caremark* duties.

Standard of Review for Board Action Regarding Director Elections and Contests for Corporate Control

Coster v. UIP Companies, Inc., et al.

C.A. No. 2018-0440
(Chief Justice Seitz)

Marion Coster ("Coster") and Steven Schwat ("Schwat") each owned fifty percent of UIP Companies, Inc. ("UIP") and entered into negotiations for Coster to exit UIP. Following the failure of those negotiations, each of the stockholders proposed changes to the composition of the UIP board of directors (the "Board"). However, Coster and Schwat were unable to agree on changes to the composition of the Board, and each of the subsequent stockholders meetings ended in deadlock.

Coster then filed a complaint in the Court of Chancery seeking appointment of a custodian under Section 226(a)(1) of the General Corporation Law of the State of Delaware. Instead of requesting the appointment of a custodian with narrowly tailored powers to address the stockholder deadlock, Coster requested that the custodian have "broad oversight and managerial powers." The Court of Chancery later found that the appointment of a custodian with such broad powers would have given rise to termination rights in certain of UIP contracts and would have threatened UIP's revenue stream. In order to moot the custodian action, the Board approved a sale of shares to a long-term employee of UIP so that Coster, Schwat and the employee each owned one-third of the outstanding stock. Coster subsequently filed suit requesting that stock sale be canceled.

The Court of Chancery initially upheld the stock sale under the entire fairness standard of review. In the first appeal, the Supreme Court did not disturb the entire fairness decision but remanded with instructions to review the stock sale under *Schnell v. Chris Craft Industries ("Schnell")* and *Blasius Industries, Inc. v. Atlas Corp ("Blasius")*. The Supreme Court explained that the entire fairness standard of review is "'not [a] substitute for further equitable review' under *Schnell* and *Blasius* when the board interferes with director elections[.]" The Court of Chancery subsequently found that the Board had not acted for inequitable purposes under *Schnell* and had compelling justifications under *Blasius*.

In the second appeal, the Supreme Court first reviewed how *Schnell* and *Blasius* have historically been applied as well as how the *Blasius* standard of review has been "folded into" the standard of review under *Unocal Corporation v. Mesa Petroleum Company ("Unocal")*. Among other cases, the Supreme Court specifically discussed how *Mercier v. Inter-Tel* opted to apply *Unocal*'s "reasonableness" review but applied it with greater sensitivity to the interests at stake because the actions of the directors could have had affected the outcome of an election of directors or other stockholders votes that could have consequences for corporate control. This trend continued when the Court of Chancery in *Pell v. Kill* applied this "modified *Unocal* review" and explained that the shift from the "reasonable" standard to the "compelling" standard required that the directors show a "closer fit between means and ends."

Corporate law in Delaware is not static. The Supreme Court explained that precedent showed that *Schnell* and *Blasius* review can, and has been, folded into *Unocal* to accomplish the same end—"enhanced judicial scrutiny of board action that interferes with a corporate election or a stockholder's voting right in contests for control." Accordingly, when a stockholder challenges an action by the board that interferes with either the election of directors or a stockholder vote in a contest for corporate control, the board will bear the burden to prove the following:

- First, the board was faced with a threat "to an important corporate interest or to the achievement of a significant corporate benefit." The threat must be one that is real and not a pretext for action, and the board must show that its motivations were proper and not disloyal or selfish.

- Second, the board's response to the threat must be reasonable in relation to the threat posed and may not be preclusive or coercive to the stockholder franchise. In other words, the board must tailor its response to only what is necessary to counter the threat and "cannot deprive the stockholders of a vote or coerce the stockholders to vote a particular way."

In the present case, the Court of Chancery found that UIP faced an "existential crisis" through the deadlock of the stockholder vote and the risk of a custodian being appointed, and, although there were certain reasons for the stock sale that were problematic, the Board was "properly motivated" when responding to the threat. The Court of Chancery also found that the response was reasonable and proportionate based on the unique circumstances that the appointment of a custodian could jeopardize key commercial contracts. The Court of Chancery noted that more aggressive options were available to the Board but not utilized. Finally, the Court of Chancery found that the Board's response to the threat was not preclusive or coercive. While the stock sale broke the deadlock, the new one-

third owner was not bound to vote in a particular way, which meant that Coster could convince the new owner to swing the vote in Coster's favor.

Although Coster tried to pick apart some of the factual findings of the Court of Chancery, the Supreme Court ultimately affirmed the findings of the Court of Chancery.

Takeaways

Schnell **and** ***Blasius*** **have been incorporated into a unified standard under** ***Unocal*****:** When stockholders seek to challenge board action that interferes with the election of directors or implicates corporate control, the action will be reviewed under a modified *Unocal* standard. Streamlining these standards provides clarity on the standard of review to be applied in connection with such actions.

The entire fairness standard of review is not a substitute for further equitable review: Even though the entire fairness standard of review is Delaware's most onerous standard of review, it is not a substitute for equitable review when the stockholder franchise is threatened.

Aiding and Abetting Liability

In re Columbia Pipeline Group, Inc. Merger Litigation

C.A. No. 2018-0484-JTL
(Vice Chancellor Laster)

In 2015, Columbia Pipeline Group, Inc. ("Columbia"), a wholly owned subsidiary of NiSource Inc. ("NiSource"), spun off from its parent. Two individuals drove the transaction: (i) Robert Skaggs, Jr., who served as the CEO and chairman of NiSource's board, and (ii) Stephen Smith, who served as the CFO of NiSource. As their desired retirement dates approached, the two began to consider a spinoff of the Columbia business unit, which would enable them to receive benefits provided for in change-in-control agreements they had with NiSource.

Preparation for the spinoff began in 2014, and Skaggs and Smith were promised positions with Columbia, in which they would receive change-in-control agreements similar to those they had with NiSource. Potential buyers soon emerged, and five days after the spinoff, Skaggs received messages from two potential buyers, both of whom were interested in discussing a deal.

TransCanada, the ultimately successful bidder, began its efforts in September 2015. Francois Poirier, TransCanada's Senior Vice President for Strategy and Corporate Development, acted as TransCanada's main negotiator. Poirier, who had a long-term business relationship with Smith, contacted Smith in the hopes of pursuing a deal.

In October 2015, Columbia considered two possible options for its future: (i) preparing for a stock offering or (ii) exploring a sale transaction. Columbia's Board of Directors (the "Board"), considering each option, elected to pursue an equity offering unless they could obtain $28 per share. After meetings with certain potential bidders, on November 24, Columbia received an offer for an all-cash acquisition ranging from $25 to $26 per share from TransCanada. This offer fell short of Columbia's desired $28 per share, causing the Board to terminate the sale process. Following the end of the sale process, a standstill set forth in a non-disclosure agreement precluded TransCanada from contacting Columbia about a deal unless Columbia initiated contact.

Soon after, Poirier called Smith in clear violation of the standstill. However, Smith failed to raise the standstill and proceeded to convey confidential information to Poirier. Due to Smith's willingness to share, "TransCanada possessed unique information about Columbia's continuing interest in a deal and the timeline for further negotiations." This conversation, like many others that would follow between Columbia and TransCanada, was not disclosed in the proxy statement. Over the

span of the negotiations, Smith repeatedly divulged sensitive information to Poirier. Poirier and TransCanada were cognizant that with each initiated conversation, they were breaching the standstill.

In December 2015, Poirier contacted Smith with a potential offer of $28 per share; he also requested a meeting with Smith. On January 5, 2016, Smith sent Poirier 190 pages of confidential company information without Board approval. Further, during a meeting held two days later, Smith provided Poirier with his copy of talking points and supplied other information, including how the Board and management felt about selling Columbia, its desired timeline, and even that TransCanada "was unlikely to face competition." After this meeting, Smith and Poirier spoke almost daily.

TransCanada subsequently offered between $25 to $28 per share on January 25, 2016. Skaggs conveyed this offer to the Board but did not inform it about the various meeting between the two parties, or that TransCanada had been engaged in due diligence since January 9. While the Board considered meeting with other bidders, management told the Board that the current offer was enough to move forward and to grant TransCanada exclusivity. The Board agreed.

The parties continued to meet throughout February, but the negotiations began to crumble. During a Board meeting, the directors questioned whether management "might have a financial interest in seeing a deal happen," but despite receiving information about how significant this financial interest was, they did not act to monitor management's next steps.

TransCanada notified Columbia about the potential for a drop in its bid price, but it still secured an extension of its exclusivity period by portraying itself as capable of bidding within Columbia's expected range. However, TransCanada then offered $24 per share. Smith counteroffered, without the Board's authority to do so, and TransCanada quickly raised its offer to $25.25 per share, which the Board rejected.

The negotiation process again resumed, however, with Smith trying to convince Poirier to offer $26 per share. TransCanada's board eventually accepted this price and approved of an offer which would consist of 90% cash and 10% TransCanada stock. Poirier informed Smith of this offer, which Smith orally accepted.

Days later, the *Wall Street Journal* published an article on the negotiations between Columbia and TransCanada. Smith told Poirier that the story had caused the Board to panic and to seek a deal as quickly as possible. As TransCanada sought an additional period of exclusivity, another bidder re-entered the picture and contacted Columbia about a potential deal. Simultaneously, Skaggs created a script to be used with any other bidders, informing them that Columbia would only be interested in entertaining serious written offers. Skaggs and Smith perceived this script as a means of deterring bidders and told TransCanada that this script

would facilitate the transaction. The Board then elected to extend TransCanada's exclusivity for a week.

On March 14, 2016, Poirier offered $25.50 per share. He conditioned this offer, however, on the Board responding within three days and with the promise that should the Board not accept, TransCanada would notify the public that the deal was dead. The Board approved the merger agreement, with the $25.50 per share price, on March 16, 2016.

Two months later, Columbia issued its proxy statement, seeking stockholder approval of the merger. Skaggs and Smith reviewed the proxy statement more than ten times, and TransCanada also had the opportunity to assist in drafting and reviewing the statement. TransCanada contractually committed to provide all necessary information and to correct any misleading or incorrect statements. Poirier reviewed the statement and noted his communications with Skaggs and Smith, but Russ Girling, the President and CEO of TransCanada, essentially felt that the proxy was Columbia's responsibility, not theirs, and TransCanada did not seek to amend the proxy statement.

The final proxy statement did not include, among other things, references to the don't-ask-don't-waive elements of the standstill, the various meetings between the parties, Skaggs and Smith's intention to retire in 2016, or the insights that Smith provided to Poirier over several months. A few days after the merger closed, Skaggs and Smith retired.

The plaintiffs sued Skaggs, Smith, and the former members of the Board for breach of their fiduciary duties of care and loyalty during the sale process and the duty of disclosure in connection with the proxy statement. The plaintiffs also alleged that TransCanada aided and abetted these breaches. At this stage of the litigation, TransCanada was the only remaining defendant.

In analyzing whether TransCanada aided and abetted the breaches of fiduciary duty that occurred during the sale process and during the issuance of the proxy statement, the Court considered four elements, namely whether there was: "(i) the existence of a fiduciary relationship giving rise to a duty to the plaintiff, (ii) a breach of that duty by the fiduciary, (iii) knowing participation in the breach by the defendant, and (iv) damages proximately caused by the breach."

The Court first analyzed the aiding and abetting allegation as it pertained to the breaches of fiduciary duties that occurred during the sale process. The Court noted that Skaggs, Smith, and the outside directors had a fiduciary relationship with the stockholders and that those individuals breached their duties under an enhanced scrutiny standard of review because: (i) Skaggs and Smith's actions were driven by their desire to retire and receive change-in-control benefits which

in turn "led them to take steps that fell outside the range of reasonableness" and (ii) because the outside directors failed to oversee the sale process. The Court then turned to the third element required for aiding and abetting claims, knowing participation, which requires proof of knowledge and culpable participation. As to the knowledge element, the Court found that TransCanada had, at the very least, constructive knowledge of Skaggs and Smith's breach of the duty of loyalty and the outside directors' breach of the duty of care, largely because of Poirier's expansive experience with merger deals and his observation of the atypical behavior exhibited by Columbia's officers, an observation that was witnessed and confirmed by other TransCanada officers. As to culpable participation, the Court held that TransCanada actively "exploited" the breaches by reneging on its $26 offer and replacing it with the $25.50 offer that was conditioned on a short timeline and a "coercive threat." Lastly, the Court found that the plaintiffs sufficiently proved "causally related" damages. The Court awarded $1.00 per share in damages, which was derived from calculating the deal price, $25.50, with what the stockholders would have received at closing, $26.50.

The Court then addressed the aiding and abetting allegation as it pertained to the breaches of the duty of disclosure that occurred in connection with the proxy statement. As the Court recounted, a breach of the duty of disclosure requires proving (i) "a request for stockholder action" and (ii) "a material misrepresentation or omission." The Court again concluded that the plaintiffs proved that Skaggs, Smith, and the Board members breached their fiduciary duties because they, as fiduciaries in their role as officers and directors, sought a stockholder vote after issuing a proxy statement that was rife with "material misstatements and omissions" about the negotiation process. Next, the Court agreed that plaintiffs established that TransCanada knowingly participated in these disclosure violations because it reviewed the proxy and detected a lack of detail that it had an obligation to correct, yet failed to supply.

Lastly, the Court analyzed damages. While the Court concluded that plaintiffs could not obtain their requested rescissory damages based on plaintiffs' failure to abide by the Court's prior instruction to prove the stockholders' reliance on the proxy statement, the Court, in its role as a court of equity, still determined that plaintiffs were entitled to $0.50 in damages. The Court arrived at this amount by relying on precedent, including the recent *Mindbody* opinion, and explaining that $0.50 represented the difference between the price per share that was initially agreed to, $26, and the price per share that was received, $25.50.

Finally, the Court addressed the $1.00 sale process damages and the $0.50 disclosure damages, finding that Delaware law historically does not award both types of damages, but instead whichever value is greater. Therefore, the Court awarded $1.00 per share.

In re Mindbody, Inc. Stockholder Litigation
C.A. No. 2019-0442-KSJM
(Chancellor McCormick)

In a post-trial opinion, the Court of Chancery held that Richard Stollmeyer, the founder and CEO of Mindbody, Inc. (the "Company"), breached his fiduciary duties by tilting the sale process in favor of a preferred private equity firm and by failing to disclose material information about the sale process. Plaintiffs argued that Stollmeyer was irredeemably conflicted under *Revlon*, and that *Corwin* cleansing did not save the transaction due to material disclosure violations. The Court found that the acquiror did not aid and abet Stollmeyer's fiduciary duty violations with respect to the sale process, but that it did aid and abet the disclosure violations. As a result, Stollmeyer and the acquiror were found jointly and severally liable for damages of $1.00 per share.

Early in 2018, Stollmeyer had grown "physically and emotionally exhausted" from running the Company, a software support business for the wellness industry, over the course of almost twenty years. He also was searching for a liquidity event to unlock what he perceived to be substantial financial resources tied up in his ownership of the Company. Bolstered by an indication that the Company's largest stockholder was interested in divesting its holdings due to the sunset of its super-voting stock, Stollmeyer led a sale process in October 2018 that ultimately culminated with a definitive agreement between the Company and Vista Equity Partners ("Vista") in December 2018 pursuant to which Vista would acquire all outstanding shares for a 68% premium to the market price.

However, Stollmeyer had engaged extensively with Vista prior to the Company initiating the process. After reconnecting with Vista during the summer of 2018, Stollmeyer became enamored with Vista's approach to investing in portfolio companies and the benefits founders of those companies realized. During September and October of 2018, Stollmeyer met with Vista multiple times, attended a summit hosted by Vista, and engaged in substantive discussions with Vista and their financial advisors about the Company. Although he informed the Company's Board of Directors (the "Board") about his contact with Vista, Stollmeyer did not give a full recounting of the depth of his interactions with Vista or his desire to make a deal with Vista. Once Vista provided a formal indication of interest to acquire the Company, Stollmeyer waited more than a week before informing the Board.

Even once the Company initiated a formal sale process and established a Transaction Committee, Stollmeyer continued to steer the process in favor of Vista. Stollmeyer tipped Vista that the Company had commenced a process, violated the Company's adopted guidelines for communication with potential acquirors by

engaging with principals at Vista, and even suggested a price target to Vista. When publicly announcing revenue and financial guidance for the Company in late 2018, Stollmeyer intentionally downgraded projections in an apparent attempt to depress the Company's stock price, thereby making the Company a more attractive target based on Vista's investment philosophy.

Stollmeyer's engagement gave Vista a head start on presenting an offer for the Company. Three days after the data room was opened to potential acquirors, Vista submitted a binding and time-limited offer. Vista's internal communication revealed that they had been able to conduct substantial work before the formal process even launched, facilitating its rapid bid and leaving other bidders behind the curve. Other potential bidders dropped out of consideration after receiving access to the data room. With only Vista remaining as a potential acquirer, the Transaction Committee negotiated a small increase to the initial offer and the Board approved the transaction.

Once the transaction was approved, a significant Company stockholder attempted to put together a competing bid. Stollmeyer tipped Vista to the attempt and took action to stonewall what he perceived as the "low likelihood" outcome that the stockholder would be able to compete with Vista's offer, including instructing the Company's management team to decline requests for presentations while he left for vacation.

Following the Company's proxy filing, the Company's 2018 fourth quarter results demonstrated strong financial performance that beat market expectations and Company guidance. The Company determined not to release those financial results prior to the special meeting of stockholders held to vote on the transaction, which transaction was approved at the special meeting. The transaction closed in February 2019.

By the time trial began in early 2022, Plaintiffs asserted breaches of fiduciary duty against Stollmeyer in respect of the process and the disclosures related to the transaction, as well as aiding and abetting claims against Vista related to both the process and disclosure claims.

The Court found that Stollmeyer suffered from disabling conflicts of interest. Trial evidence established that Stollmeyer had a pressing need for liquidity in early 2018, and that he had become "uniquely smitten" with Vista well in advance of the formal sale process. Further, the Court found Stollmeyer was uniquely motivated by the impending deadline of the super-voting sunset and a resulting shakeup of the Board and dismissed Stollmeyer's contention that his ownership of a large amount of Company stock necessarily aligned his interests with those of stockholders generally.

The Court also determined that Stollmeyer breached his fiduciary duty under the *Revlon* framework by engineering the sale process in favor of Vista rather than attempting to maximize value for the stockholders generally. He created significant advantages for Vista before a formal process was ever initiated, and then steered both the Board and the Transaction Committee toward Vista as the best acquisition partner once the process began in earnest. Meanwhile, he did not inform the Board of his conflict of interest and the Board was therefore unable to address or mitigate his impact on the process.

Because Stollmeyer's conflict was not disclosed to the Board, the public disclosures provided to the Company's stockholders did not identify it. Stollmeyer reviewed and signed off on the deficient disclosures, even though his fiduciary duties obliged him to make full and accurate disclosures about his dealings with Vista. Although a vote of the unaffiliated stockholders approved the transaction with Vista, the lack of disclosure about Stollmeyer's conflicts of interest and how he steered the process in favor of Vista made *Corwin* cleansing inapplicable.

Under a similar theory, the Court found that Vista aided and abetted Stollmeyer's disclosure violations. Vista was aware of Stollmeyer's disabling conflict and reviewed and approved the public filings that failed to adequately disclose those conflicts. However, the Court found that Plaintiffs failed to timely raise aiding and abetting claims against Vista for the process violations.

With respect to damages, the Court conceded that establishing the "lost-transaction" damages is a difficult exercise. Plaintiff argued in favor of the target price that Stollmeyer gave to Vista early in the process. However, compelling evidence at trial showed that other unaffiliated bidders saw "no path" to that number and that it would have been the absolute top end of value ranges Vista was willing to consider. Citing internal communication by the "most knowledgeable" members of the deal team, the Court determined that Vista likely would have paid a price higher than the final deal price had Stollmeyer not tilted the process in their favor. The Court found further support for this assessment in the contemporaneous assessment of the Company's financial advisor and determined that the applicable damages were $1.00 per share. The Court also found that although the "precise extent of the harm cannot be established," the $1.00 per share damages were sufficient to remedy both the process and disclosure violations. Because Vista was not found liable for aiding and abetting Stollmeyer's process violations, he alone was responsible for the damages award with respect to those claims. However, because Plaintiffs are only entitled to recover once, Stollmeyer and Vista were ultimately found jointly and severally liable for the entirety of the damages because Vista aided and abetted the disclosure violations.

Takeaways

Internal communications can provide evidence of fair price and fair process, especially when they do not align with the final result: Bidders, especially private equity funds, should be cautious about how they internally discuss pricing of major acquisitions. The Court in *Mindbody* looked to the Company's financial advisor and their modelling, but also placed significant weight on both official and unofficial communication about potential deal price by the team at the private equity buyer, despite attempts to mitigate the contemporaneous communication by later backstopping the final deal price. Moreover, parties should be especially careful about using text messages, as text messages were a substantial portion of the record on which the Court relied in *Mindbody*. Caution about use and preservation of text messages is particularly important in light of the recent Court of Chancery opinion in *Goldstein v. Denner*, C.A. No. 2020-1061-JTL (Del. Ch. Jan. 26, 2024). In that opinion, Vice Chancellor Laster found that defendants had committed spoliation by failing to preserve text messages related to a corporate sale, and he issued evidentiary and financial sanctions as a result.

Proving that a third-party acquirer has aided and abetted a fiduciary breach is difficult: In analyzing TransCanada's knowledge of Skaggs and Smith's breaches of fiduciary duty, and TransCanada's choice to take advantage of these breaches of fiduciary duty, the Court explained that "[w]ithout the final act of reneging on the $26 Deal, making the $25.50 Offer, and adding a coercive threat that violated the NDA, TransCanada's accumulated actions would not have toppled over into the line of liability." This statement highlights, therefore, just how high of a burden it is to prove an aiding and abetting claim, especially given how extensive the negotiations were, how TransCanada repeatedly and knowingly violated the standstill, and how TransCanada took advantage of Smith's openness. To establish a claim, plaintiffs will likely need to tie any breaches of fiduciary duty to specific actions by the third-party acquiror that impacted price or negotiations in a material way.

Acquirors should take an active role in preparation of the proxy statement: Even though TransCanada and Vista did not make the disclosures at issue in *Columbia Pipeline* and *Mindbody*, respectively, the Court still found that they aided and abetted breaches of fiduciary duty by reviewing the disclosures but not correcting material omissions or inaccurate disclosures when they had a contractual obligation to do so. Acquirors should carefully review and ensure that the proxy statements do not omit material information or contain inaccuracies, instead of relying on the issuing party. Additionally, because a fully informed stockholder vote can result in application of the business judgment rule under *Corwin*, ensuring that the proxy statement is accurate and does not contain material omissions will likely make it harder for stockholder plaintiffs to establish breaches of fiduciary duty that could form the basis for an aiding and abetting claim.

Duty of Obedience

Cygnus Opportunity Fund, LLC v. Washington Prime Group

C.A. No. 2022-0718-JTL
(Vice Chancellor Laster)

In fall 2020, Washington Prime Group, LLC (the "Company"), which at the time was a publicly traded Indiana corporation, negotiated a restructuring of its unsecured senior notes (the "Notes") with Strategic Value Partners ("SVP"), who subsequently acquired a majority of the Notes. Although the Notes did not mature until 2024 and the Company had enough cash on hand to make its regular payment in February 2021, the Company elected to withhold its payment. In June 2021, the Company entered into a restructuring agreement sponsored by SVP and filed for bankruptcy under Chapter 11 with a plan of reorganization. In September 2021, the Company emerged from bankruptcy as a privately held Delaware limited liability company and SVP owned 87% of the Company's outstanding equity. The former holders of preferred and common equity received 9% of the equity in the Company (the "Minority Unitholders").

The post-bankruptcy Company was governed by a limited liability company agreement (the "LLC Agreement") that created a governance structure mimicking that of a corporation. The LLC Agreement provided that board of managers (the "Board") directed the business and affairs of the Company and directed the Company's officers. In addition, so long as there were equity holders other than SVP, the LLC Agreement required that at least one manager be an "Independent Manager" who was independent from SVP. The LLC Agreement also set forth certain restrictions on actions by SVP, including limitations on the ability of SVP to acquire all of the outstanding shares of the Company (a "Squeeze Out") without "Specified Approval" by either (i) "the majority of the Independent Managers (whether or not acting as a Board Committee of Independent Managers)" or (ii) "a majority of the votes cast on the matter by Members other than SVP[.]" If SVP elected to engage in a Squeeze Out within eighteen months of emerging from bankruptcy, the LLC Agreement also provided for a "Challenge Right" of the fairness of such transaction unless the Squeeze Out received approval of a majority of the Members other than SVP or the approval of the "Minority Approved Independent Manager," who was specified on a schedule to the LLC Agreement. The Court noted that only SVP had the right to remove and replace directors.

In November 2021, nineteen days after the Company emerged from bankruptcy, SVP launched a tender offer to purchase the Minority Unitholders' units, which

would have increased its ownership interests to 95% (the “Tender Offer”). SVP also reserved the right to purchase additional units at its sole discretion and recognized that the Tender Offer might be a considered a Squeeze Out. SVP did not obtain Specified Approval or give notice as contemplated by the Challenge Right in respect of the Tender Offer. SVP also acknowledged the price may not reflect fair value, and no one provided financial information to the Minority Unitholders. As a result of the Tender Offer, SVP increased its ownership stake to 88.2%. Following the Tender Offer, one of the plaintiffs, a Minority Unitholder, requested contact information for the Minority Approved Independent Manager and was denied by the Company’s outside counsel, who noted that the Minority Approved Independent Manager was not required to communicate with him.

In June 2022, the Company informed the Minority Unitholders that, pursuant to a merger with SVP, their units had been converted into the right to receive cash (at a slightly higher price than the Tender Offer) without interest and with no right to appraisal (the “Merger”). The disclosures to the Minority Stockholder consisted of a three-page cover letter and a “skeletal” information statement that was five pages. In the disclosures, the Company provided it had received a proposal from SVP two months after the Tender Offer closed (and three and half months after the Company emerged from bankruptcy) and appointed a one-member special committee consisting of the Minority Approved Independent Manager to negotiate the Merger. The disclosures did not describe the negotiations leading up the Merger, and, although the disclosures stated that a fairness opinion was obtained, the disclosures did not include the fairness opinion or provide a fair summary of the opinion. The disclosures asserted that the Challenge Right did not apply because the Minority Approved Independent Manager approved the Merger. The same plaintiff sought additional information from Company counsel and received no such information. Following a formal demand for information about the Merger, the Company denied the request because the plaintiff was no longer an equityholder and had no informational rights.

The plaintiffs subsequently brought claims alleging breach of fiduciary duty against the members of the Board, the Company’s officers and SVP and claims for a breach of express provisions of the LLC Agreement as well as a breach of the implied covenant of good faith and fair dealing. The plaintiffs also asserted claims against the members of the Board and SVP for aiding and abetting breaches of fiduciary duty by the officers of the Company. The Court quickly disposed of the claims for breach of duty against the members of the Board and SVP based on the unambiguous waiver of fiduciary duties for the Board and SVP (but not the officers) in the LLC Agreement.

The plaintiffs argued that the officers of the Company breached their duty of disclosure in connection with both the Tender Offer and the Merger. The Court

noted that the duty of disclosure is "a contextual manifestation of the duties of loyalty and care." Because the duty of disclosure is situational in nature, the scope and requirements of the duty of disclosure will depend on the context. In the case of a tender offer by a third party, the Court explained that directors, as well as officers, have an affirmative obligation to respond to threats to the corporation and it was reasonably conceivable that a severely underpriced tender offer could trigger a duty of disclosure. For an officer, when evaluating a duty of disclosure, the Court must also take into account an officer's duty of obedience. While the duty of obedience provides that an officer may not act contrary to the board of directors' express desires, the duty of obedience does not require an officer to act in a way that an officer believes would constitute a breach of fiduciary duty. The Court ultimately determined that, in connection with the Tender Offer, it was reasonably conceivable that the officers had a duty to disclose certain information and failed to do so. As a result, the claims relating to the Tender Offer against the officers survived the motion to dismiss.

In respect of the Merger, although the unitholders were not required to vote or otherwise act, the Court was "not prepared to rule as a matter of law that a fiduciary can take the property of its beneficiary without some level of disclosure, even in the absence of any request for action." Looking to trust law, the Court explained that fiduciaries have a duty to keep their beneficiaries informed of important developments. While not creating a regular reporting obligation, the Court determined that such a duty could "mandate disclosure about extraordinary events" and if such a duty to inform could apply, it would apply in a transaction where the fiduciary unilaterally effects a cash out of the beneficiary's interest. The Court also explained that, even if the Board and officers had no duty to speak, Delaware law requires that once a fiduciary chooses to speak, it must do so candidly and completely. Accordingly, once the Board and officers determined to provide disclosures regarding the Merger, they had a duty to provide the information required by Delaware law. The Court determined that the disclosures fell short of this standard, noting that the documents "disclosed *what* the Squeeze-Out Merger was, but did not disclose any information that would explain how the Company made this decision or *why* this was an appropriate course of action." As a result, the claims relating to the Merger against the officers survived the motion to dismiss.

As to the claims of breach of the express terms of the LLC Agreement, the Court determined it was reasonably conceivable that neither the Tender Offer nor the Merger received the required "Specified Approval" and therefore neither the Tender Offer nor the Merger complied with the LLC Agreement.

On the implied covenant of good faith and fair dealing, the Court first noted that, although the doctrine of caveat emptor typically applies to investments in

alternative entities, here the context was different. The Minority Unitholders bought shares in a corporation and only through an "engineered" bankruptcy proceeding did the Minority Unitholders end up holding interested in an alternative entity. The Court suggested this context potentially created greater room in which the implied covenant could operate. Here, the plaintiffs argued that the defendants breached the implied covenant by choosing to obtain approval of the Merger by the Independent Managers as opposed to approval of the majority of the votes cast by the members other than SVP. The Court explained that the LLC Agreement provided the Board with discretion over which path to take to approve the Merger and that the implied covenant of good faith and fair dealing required the Board to exercise its discretion reasonably. The plaintiffs then argued that they would have never agreed that the Board could seek approval in this context from an Independent Manager "who (i) joined the SVP-affiliated members of the Board in remaining silent through the Tender Offer, (ii) who was not willing to speak with one of the Minority Unitholders, and (iii) owes his livelihood to maintaining good relations with firms like SVP." The Court ultimately determined that it was reasonably conceivable that the defendants breached the implied covenant of good faith and fair dealing.

Takeaways

An officer's duty of obedience to the board of directors only extends so far: Although an officer has a duty to comply with directives from the board of directors, the duty of obedience has limitations. "[T]he duty of obedience does not require compliance with directives that would expose an officer to criminal or civil sanctions or liability." Accordingly, if an officer believes that complying with a directive from the board of directors would constitute a breach of the officer's fiduciary duty, the officer does not have a duty to comply with such directive.

Beware when exercising contractual discretion: The implied covenant of good faith and fair dealing constrains a party's exercise of discretion under an agreement as it requires a party to a contract not to act in an arbitrary or unreasonable way such that the effect of the action will prevent the counterparty from receiving the fruits of its bargain. As a result, when exercising contractual discretion, the party must, at a minimum, "use good faith in making that determination."

Section 242 and Class Voting

In re Fox Corporation/Snap Inc. Section 242 Litigation
(Consolidated) C.A. Nos. 2022-1007; 2022-1032
(Chief Justice Seitz)

Following an amendment to Section 102(b)(7) of the General Corporation Law of the State of Delaware (the "DGCL") in 2022, each of Fox Corporation ("Fox") and Snap Inc. ("Snap") adopted amendments to their respective certificates of incorporation providing for the exculpation of their officers for monetary damages for breaches of the duty of care. The capital stock of Fox was comprised of two classes of stock—Class A Common Stock, which had no voting rights, and Class B Common Stock, which entitled the holders thereof to one vote per share. Snap, on the other hand, had three classes of capital stock—Class A Common Stock, which had no voting rights, Class B Common Stock, which entitled the holders thereof to one vote per share, and Class Common Stock, which entitled the holders thereof to ten votes per share. When seeking stockholder approval of the amendment, neither Fox nor Snap sought a separate class vote of the holders of their non-voting shares. Holders of Class A Common Stock of each of Fox and Snap filed suit against their respective companies seeking a declaration that the adoption of the amendments did not comply with Section 242(b)(2) of the DGCL and therefore were invalid. The matters were consolidated.

Section 242(b)(2) provides, in relevant part:

> The holders of the outstanding shares of a class shall be entitled to vote as a class upon a proposed amendment, whether or not entitled to vote thereon by the certificate of incorporation, if the amendment would increase or decrease the aggregate number of authorized shares of such class, increase or decrease the par value of the shares of such class, or ***alter or change the powers, preferences, or special rights of the shares of such class so as to affect them adversely.***

The plaintiffs asserted that stockholders have three fundamental powers—the power to vote, to sell and to sue. By depriving the stockholders of the right to sue officers for monetary damages for a breach of the duty of care, the amendments, according to plaintiffs, triggered a separate class vote of the holders of Class A Common Stock under Section 242(b)(2) of the DGCL. Plaintiffs pursued a plain language argument and argued that "powers" should be read broadly to include the power to sue. Plaintiffs also argued that *Hartford Accident & Indemnity Co. v. W.S. Dickey Clay Mfg. Co. ("Dickey Clay")* and *Orban v. Field ("Orban")*, two

seminal cases interpreting Section 242(b)(2) were not applicable because they addressed changes to a corporation's capital structure, not "the elimination of a personal power (or even a right) appurtenant to ownership of that stock."

The Court of Chancery granted summary judgment in favor of the defendants, determining that the amendments did not require a separate class vote of the Class A Common Stock under Section 242(b)(2) of the DGCL. Although the Court of Chancery found the plaintiffs' plain language argument had merit, the decisions in *Dickey Clay* and *Orban* had established the understanding of how Section 242(b)(2) of the DGCL functions and, because the amendment did not affect a power, preference or special right that was set for expressly in the certificate of incorporation, the amendment did not trigger a separate class vote of the holders of Class A Common Stock.

On appeal, the plaintiffs argued that "the Court of Chancery erred by (1) rejecting the Class A Stockholders' plain-meaning argument that the word 'powers' in Section 242(b)(2) includes the ability to sue officers for damages for breaching their duty of care; (2) holding that 'fealty' to *Dickey Clay* and *Orban* dictated the outcome; and (3) considering long-standing expectations of commentators and practitioners to support its decision."

After a review of the history of Section 242(b)(2) of the DGCL, the Supreme Court focused on Sections 151(a) and 102(a)(4) of the DGCL and how those provisions interact with Section 242(b)(2) of the DGCL. The Supreme Court recognized that the words "powers," "preferences," and "special rights" of a class of stock are unique to these statutory provisions and "it was not by accident that the same sequence of words was used[.]" The Supreme Court determined that the three statutory provisions work together to limit the class votes required by Section 242(b)(2) of the DGCL to votes on amendments to express rights set forth in the certificate of incorporation under Sections 151(a) and 102(a)(4) of the DGCL.

The Supreme Court also disagreed with the plaintiffs' reliance on one dictionary definition of "powers" that was very broad and noted that the dictionary definition offered lacked context. The sections of the DGCL that address the power to sue all explicitly define the ability to sue within the section and each speak to a different subject matter than powers of shares of a class.

On *Dickey Clay* and *Orban*, the Supreme Court explained that "[f]or three quarters of a century, *Dickey Clay* has stood for two points: 1) that rights incidental to stock ownership are not a peculiar characteristic of the shares of a class of stock, and 2) that Section 242(b)(2) should be read considering other provisions of the DGCL." *Orban* reinforced that Section 242(b)(2) of the DGCL applies to the peculiar or special rights of the class of shares.

Finally, the Supreme Court dismissed the claims that the Court of Chancery put too much emphasis on the expectations of commentators and practitioners, stating that recognition of practitioner experience was not central to the Court of Chancery's ruling.

Takeaways

Section 242(b)(2) of the DGCL requires a separate class vote only when an amendment to the certificate of incorporation affects a peculiar or special characteristic of such class of stock, not rights that are incidental to stock ownership: A class vote of stockholders will be required if the amendment to the certificate of incorporation adversely affects the powers, preferences or special rights of a class of shares that is express in the certificate of incorporation or the DGCL, which is a part of the certificate of incorporation of every Delaware corporation pursuant to Section 394 of the DGCL.

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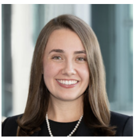

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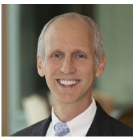

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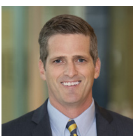

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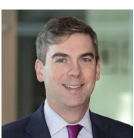

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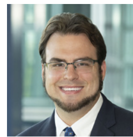

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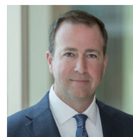

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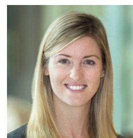

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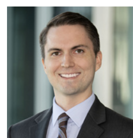

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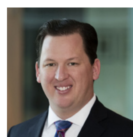

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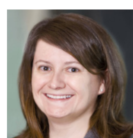

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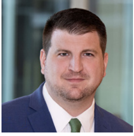
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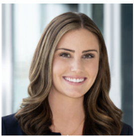
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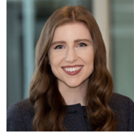
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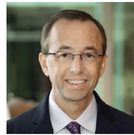
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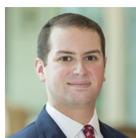

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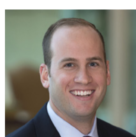

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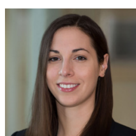

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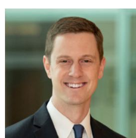

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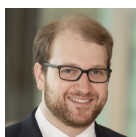

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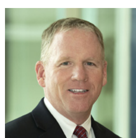

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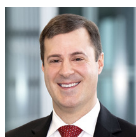

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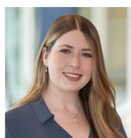

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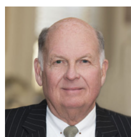

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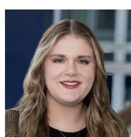

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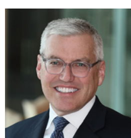

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