Delaware Corporate Law
2018 Year in Review

Potter Anderson Corroon LLP

YOUR DELAWARE ADVANTAGE

2018 Year in Review

For corporate law practitioners, 2018 saw significant change in the Delaware practice, as well as important developments in the case law. Perhaps most noteworthy, the Court of Chancery added two new judges: Vice Chancellors Morgan T. Zurn and Kathaleen S. McCormick. Vice Chancellors Zurn and McCormick are, respectively, the third and fourth women to serve on the Court of Chancery since its establishment in 1792. They are a welcome addition to an already stellar bench.

The addition of the two new Vice Chancellors will enable the Court to continue its tradition of exemplary service, albeit with a slightly different breed of cases than seen in recent years. In 2018, 959 civil cases, comprised primarily of corporate and commercial matters, were filed in the Court of Chancery. Not surprisingly, the number of appraisal cases declined dramatically. Only 26 appraisal cases were filed, no doubt as a result of the 2017 decisions establishing the primacy of the deal price as an indicator of fair value. Similarly, deal litigation has declined; in the wake of the *Trulia* and *Corwin* decisions, would-be stockholder plaintiffs no longer indiscriminately challenge every deal and its attendant disclosures, instead focusing on deals involving alleged controlling stockholder conflicts. And, as deal cases are down, books and records cases are up, as stockholders seek to first probe deals potentially subject to challenge. In 2018, 89 books and records cases were filed in the Court of Chancery, as compared to 75 in 2017 and 76 in 2016.

Our Top 7 Cases of 2018 (and early 2019)

2018 also saw the issuance of a number of very significant decisions, each important in their own way to both litigators and deal lawyers alike. Here are our picks for the top 7 cases (in chronological order), most of which Potter Anderson had the good fortune to participate in:

California State Teachers' Retirement System v. Alvarez (Del. Jan. 25, 2018)

The Delaware Supreme Court affirmed the Court of Chancery's dismissal of a derivative action on the basis of collateral estoppel, concluding that, under existing federal due process law, an exception to the general rule against nonparty preclusion was appropriate where the interests of the plaintiffs in Arkansas and the plaintiffs in Delaware were sufficiently aligned and the Arkansas plaintiffs were adequate class representatives. For a more detailed overview of *Alvarez*, see page 5.

***Morrison v. Berry* (Del. July 9, 2018)**

The Delaware Supreme Court reversed a decision of the Court of Chancery relying on *Corwin* to dismiss breach of fiduciary duty claims, finding that the disclosures at issue omitted material information and were misleading, which led to a stockholder vote that was not fully informed. For a comprehensive discussion of *Morrison*, see page 6.

***Flood v. Synutra International, Inc.* (Del. Oct. 9, 2018)**

In *Synutra*, the Delaware Supreme Court clarified *MFW*'s *ab initio* requirement for cleansing a going-private transaction by a controlling stockholder. The Court held that, so long as the requisite procedural protections are in place prior to the commencement of "economic negotiations" on the proposed transaction, *MFW*'s *ab initio* requirement will be satisfied. For a more detailed overview of *Synutra*, see page 9.

***Akorn v. Fresenius* (Del. Ch. Oct. 17, 2018, affirmed by order of the Delaware Supreme Court on Dec. 7, 2018)**

For the first time ever, the Court of Chancery found that between the signing and closing of a merger agreement, the target company had experienced a Material Adverse Effect allowing the termination of the merger agreement. The Court further held the target's breaches of a regulatory representation and ordinary course covenant permitted the termination of the merger. For a more detailed overview of *Fresenius*, see page 10.

***Sciabacucchi v. Salzberg* (Del. Ch. Dec. 19, 2018)**

In *Salzberg*, the Court of Chancery invalidated forum selection provisions in the certificates of incorporation of three Delaware corporations that required any claim brought under the Securities Act of 1933 to be brought in federal court. The Court determined that, although a Delaware corporation can adopt a forum selection clause for claims involving the internal affairs of the corporation, a Delaware corporation cannot adopt forum selection clauses for claims external to the corporation, such as a federal law claim. For a more detailed overview of *Salzberg*, see page 11.

***In re Oxbow Carbon LLC Unitholder Litigation* (Del. Jan. 17, 2019)**

In *Oxbow*, the Delaware Supreme Court found that the Court of Chancery erred in employing the implied covenant of good faith and fair dealing as an equitable remedy to rebalance economic interests. As a result, the Court reversed a post-trial decision of the Court of Chancery that permitted minority investors in Oxbow to force a contractual "Exit Sale" of the company under the LLC Agreement. For a more detailed overview of *Oxbow*, see page 13.

KT4 Partners LLC v. Palantir Technologies, Inc. **(Del. Jan. 29, 2019)**
In this early 2019 decision, the Delaware Supreme Court held that a company's failure to adhere to corporate formalities and to properly document corporate actions justified the production of emails in a books and records action. For a more detailed overview of *Palantir*, see page 15.

The 20th Anniversary of *Corporate and Commercial Practice in the Delaware Court of Chancery*

2018 also marked the 20th Anniversary of the publication of *Corporate and Commercial Practice in the Delaware Court of Chancery* (Lexis Law Publishing), authored by our colleagues Don Wolfe and Mike Pittenger. The annually updated treatise has long benefited from the contributions of many Potter Anderson colleagues. For the new edition, the authors also worked with three executive editors: partners Brad Davey and Matt Belger and associate Jacqueline Rogers. In recognition of this milestone, the authors and contributors have extensively revised and updated the work, re-writing many of its chapters and sections, breaking up long chapters and reorganizing others so as to make the book easier to navigate. The Second Edition increases the focus on more recent case law and developments in Chancery practice, while continuing to recognize that much of the older case law cited in the First Edition retains its relevance even today. We hope that you will find the new edition a valuable resource.

We take great pride in the work we do with and for our clients and co-counsel. And we appreciate the trust they put in us to address issues they are facing and to develop creative strategies and solutions. If we have worked with you in the past, we look forward to working with you again this year. If we have not worked with you before, we hope that you reach out when you need solutions to Delaware legal issues.

Our Top 7 Cases of 2018 (and early 2019)

California State Teachers' Retirement System v. Alvarez

(Del. Jan. 25, 2018)

In this unanimous opinion, the Supreme Court of Delaware affirmed the Court of Chancery's decision to dismiss a derivative action on the basis of collateral estoppel. In that lower court decision, the Court of Chancery held that derivative claims filed by Walmart stockholders in Delaware were precluded because a federal court in Arkansas had already dismissed a derivative complaint filed by different Walmart stockholders for failure to satisfy the demand requirement. In affirming the Court of Chancery, the Supreme Court also concluded that the application of collateral estoppel did not violate the federal Due Process rights of the Delaware plaintiffs.

The derivative actions in Arkansas and Delaware were filed following news reports suggesting that employees of a foreign subsidiary of Walmart had bribed government officials. The defendants, faced with parallel litigation, obtained a stay of the Arkansas action in favor of the Delaware action. After the stay order was vacated by the Eighth Circuit, the Arkansas defendants filed a motion to dismiss for failure to plead demand futility, which the court granted with prejudice. Shortly after that ruling, the Delaware plaintiffs, who had until then been pursuing books and records in an attempt to bolster their demand futility allegations, filed an amended complaint in the Court of Chancery. The Delaware defendants moved to dismiss on the grounds, among others, that the Delaware plaintiffs were collaterally estopped from arguing that demand was futile because that issue had been finally decided in Arkansas federal court. The Court of Chancery granted the motion to dismiss, finding that the preclusive effect of the Arkansas federal court's dismissal was governed by Arkansas state law, subject to Constitutional standards of Due Process, and that all of the requisite elements for preclusion under Arkansas law, including privity and adequacy of representation, had been satisfied.

On appeal, the Supreme Court directed the Court of Chancery to reconsider the Due Process implications of giving preclusive effect to the dismissal by the Arkansas federal court. In answering the question posed by the Supreme Court, the Court of Chancery concluded that the Delaware plaintiffs' Due Process rights were not violated under existing law, but nonetheless recommended that the Supreme Court adopt a rule that would not give preclusive effect in Delaware to prior dismissals based on demand futility. In so recommending, the Court of Chancery relied on the then-recent decision in *In re EZCORP Inc. Consulting Agreement Derivative Litigation*, 130 A.3d 934 (Del. Ch. 2016), which suggested in dicta that, as a matter of Delaware law and Due Process, a derivative plaintiff may not bind a later derivative plaintiff unless and until the first derivative plaintiff survives a motion to dismiss, or the board of directors has given the plaintiff authority to proceed by declining to oppose the suit.

The Supreme Court declined to adopt the Court of Chancery's recommendation, however, and instead affirmed the Court of Chancery's original decision to dismiss the Delaware action on the basis of collateral estoppel. The Supreme Court concluded that, under existing federal Due Process law, an exception to the general rule against nonparty preclusion was appropriate because the interests of the plaintiffs in Arkansas and Delaware were sufficiently aligned and the Arkansas plaintiffs were adequate representatives, despite their decision not to seek books and records.

This opinion is consistent with the Delaware Supreme Court's prior decisions acknowledging that, although Delaware has an "undisputed interest" in governing the internal affairs of its corporations, on occasion that interest "must yield to the stronger national interests that all state and federal courts have in respecting each other's judgments." In addition, while this decision emphasizes Delaware courts' repeated encouragement of stockholders to use the "tools at hand," including books and records, to substantiate allegations in a derivative complaint, it also confirms that a stockholder's failure to seek books and records will not necessarily render that stockholder an "inadequate" representative in stockholder litigation.

Morrison v. Berry

(Del. July 9, 2018)

In this decision, the Delaware Supreme Court reversed the Court of Chancery's dismissal of a stockholder challenge to a going-private merger, which was based on a claim that material information was excluded from a Schedule 14D-9 Solicitation/Recommendation Statement (the "14D-9"). Specifically, the Court held that the Company failed to disclose troubling facts that "shed light on the depth of [] commitment" of the founder to the private equity firm that purchased the company. This relationship, the Court concluded, may have placed pressure on the board that "may have impacted the structure of the sale process."

In October 2015, The Fresh Market (the "Company") received an unsolicited preliminary non-binding indication of interest to purchase the Company for

$30 per share in cash from Apollo, a private equity firm. The indication of interest stated that Apollo had an exclusive partnership with the founder of the Company. The Company's Board met to review the proposal and authorized a Strategic Transaction Committee (the "Committee"). At the formation of the Committee, the Board explicitly asked the founder if he had an agreement with Apollo, to which the founder responded no. The founder recused himself from that meeting, and all future Board meetings until the Company entered into the merger agreement.

Apollo withdrew its proposal after a lapsed deadline in October 2015, but reissued the proposal in November 2015. The reissued proposal stated that the transaction was being pursued by Apollo alongside the founder. In response, the Company's lawyers emailed the founder's counsel, seeking clarity on the new proposal and the founder's status with Apollo because the proposal seemed to contradict his statements at the Board meeting in October 2015. The reply email referred to an agreement between the founder and Apollo in October, contradicting the founder's prior statements to the Board. The sale process, nonetheless, began in December 2015 and concluded in March 2016 with an agreement to sell the Company to Apollo, a two-step tender offer/merger process.

The Company filed its 14D-9 in March 2016. After the filing, the Plaintiff demanded books and records under Section 220, but the Company denied her request. The tender offer subsequently closed in April 2016.

The Plaintiff brought a Section 220 action in the Court of Chancery where she obtained documents, including a damaging November 2015 email. Plaintiff then sued, identifying several problems that rendered the 14D-9 materially misleading, including:

1. The November 2015 email contradicted the founder's representations to the Board in October 2015 concerning his relationship with Apollo;

2. The founder's omitted "statements expressing a clear preference" for a deal with Apollo and "reluctance" to deal with another buyer;

3. The November 2015 email contained a threat that the founder "would sell his shares" if the Board refused to start a sale process; and

4. The Board "misrepresented the reasons the Board formed the Committee, because the 14D-9 failed to state the directors were motivated by existing activist pressure."

Defendants moved to dismiss, claiming that the transaction was "cleansed" under *Corwin v. KKR Fin. Holdings LLC*. The Court of Chancery agreed, and held that Plaintiff's complaint had to be dismissed because the facts regarding the founder's involvement with Apollo were disclosed, and thus the auction was not a sham.

Reviewing that decision *de novo*, the Supreme Court held that the Court of Chancery erred in applying the business judgment rule because Defendants did not meet their burden under *Corwin*.

The Court explained that, at the pleading stage, *Corwin* doctrine "requires [the Court] to consider whether Plaintiff's complaint, when fairly read, supports a rational inference that material facts were not disclosed or that the disclosed information was otherwise materially misleading." And that, "[a]n omitted fact is material if there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." The materiality test, however, "does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote."

The Court further explained that, "just as disclosures cannot omit material information, disclosures cannot be materially misleading." And that, "[e]ven a non-material fact can, in some instances, trigger an obligation to disclose additional, otherwise non-material facts, in order to prevent misleading the stockholders."

The Court determined that the Complaint satisfied the pleading standard, finding that Plaintiff "unearthed and pled in her complaint, specific, material, undisclosed facts that a reasonable stockholder is substantially likely to have considered important in how to vote." The Court further explained that stockholders would have found such material "important because it would have helped the stockholder to reach a materially more accurate assessment of the probative value of the sales process." Moreover, there was "a substantial likelihood that [full disclosure] would have altered the total mix of information available to the stockholders."

The Court reiterated its recent decision in *Appel v. Berkman*, indicating that full disclosure is required before Defendants may avail themselves of the business judgment rule under the *Corwin* doctrine. The Supreme Court reversed and remanded the case to the Court of Chancery for proceedings consistent with its opinion.

Flood v. Synutra International, Inc.

(Del. Oct. 9, 2018)

In a significant development for controlling stockholder transactions, the Delaware Supreme Court has held that the *MFW ab initio* requirement is satisfied so long as the controller conditions its offer on both of the requisite procedural protections prior to the commencement of any economic negotiations between the special committee and the controlling stockholder. In *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) ("*MFW*"), the Supreme Court established that the business judgment rule will apply to a going-private transaction proposed by a controlling stockholder when the controller conditions the transaction *ab initio* on two key procedural protections—approval by an independent, adequately empowered special committee that complies with its duty of care *and* the uncoerced, informed vote of a majority of the minority stockholders.

Confronted with a situation where the controller did not include the requisite conditions in his initial written offer, the Court nevertheless found that the *MFW* requirements were satisfied because the controller's second offer contained the requisite conditions and preceded any economic negotiations with the special committee. Further, the Court overruled its prior dicta in footnote 14 of the *MFW* opinion in which the Court suggested that a plaintiff, in asserting a due care claim, may avoid application of the business judgment rule by challenging the sufficiency of the price. The Court clarified that "a plaintiff can plead a duty of care violation only by showing that the Special Committee acted with gross negligence, not by questioning the sufficiency of the price."

The *Synutra International* case involved a proposal by Liang Zhang to acquire the approximately 36.5% of the stock of Synutra International that he did not already own. Zhang's initial offer to Synutra was not conditioned on either special committee approval or a vote of a majority of the minority stockholders. Shortly after the formation of a special committee, however, Zhang sent a second letter to the newly formed special committee that did contain these requisite conditions. As the Supreme Court explained in affirming the Court of Chancery's dismissal of the action based on compliance with *MFW*, this second letter satisfied the *ab initio* formulation, coming as it did in the "beginning" of the process and before economic negotiations commenced.

As the Court stated, "so long as the controller conditions its offer on the key protections at the germination stage of the Special Committee process, ... and has not commenced substantive economic negotiations with the controller, the purpose of the pre-condition requirement of *MFW* is satisfied."

In a lengthy dissent, Justice Karen Valihura took issue with the Majority's adoption of a "when the negotiations begin" test. In Justice Valihura's view, in order to obtain the benefits of the *MFW* standard, the dual protections must be contained in the controller's initial formal written proposal. Advocating for a more bright-line approach, Justice Valihura observed that the Court may have "muddied the waters" when it summarily affirmed a dismissal in *Swomley v. Schlecht*, where the dual *MFW* conditions were satisfied at the start of the negotiations. Justice Valihura indicated that her "initial formal written proposal" approach would aid the courts in ascertaining the proper standard of review.

Akorn v. Fresenius
(Del. Ch. Oct. 17, 2018, affirmed by order of the Delaware Supreme Court on Dec. 7, 2018)

In this post-trial memorandum opinion, the Delaware Court of Chancery made an unprecedented finding that a merger target, Akorn, Inc. ("Akorn"), had experienced a material adverse effect ("MAE") within the meaning of its merger agreement with Fresenius Kabi AG ("Fresenius") and further held that Akorn's breaches of a regulatory representation and ordinary course covenant permitted Fresenius to terminate the merger agreement. The opinion notes that "[t]his case is markedly different" from typical MAE claims where buyers have second thoughts about an acquisition after "cyclical trends or industrywide effects negatively impacted their own businesses, and who then filed litigation in an effort to escape their agreements without consulting with the sellers." Here, the Court found that Fresenius responded to "a dramatic, unexpected, and company-specific downturn in Akorn's business" and "whistleblower letters that made alarming allegations about data integrity issues at Akorn." Moreover, while Fresenius properly conducted an investigation into Akorn's downturn and data-integrity issues, it nevertheless continued to move forward with the merger. As the first post-trial decision of the Delaware Court of Chancery to find an MAE, this case will likely set the standard for future litigants seeking to prove the occurrence of an MAE.

The Court made three key findings in support of the conclusion that Fresenius was not required to close the merger and had properly terminated the merger agreement: First, "Fresenius validly terminated the Merger Agreement because Akorn's representations regarding its compliance with regulatory requirements were not true and correct, and the magnitude of the inaccuracies would reasonably be expected to result in a Material Adverse Effect." Second, "Fresenius validly terminated because Akorn materially breached its obligation to continue operating in the ordinary course of business between signing and closing." And third, "Fresenius properly relied on the fact that Akorn has suffered a Material Adverse Effect as a basis for refusing to close." The Court also found that Fresenius had fulfilled its own contractual obligations, a material breach of which would have prevented Fresenius from exercising its termination right.

The Court's opinion centered on the material deterioration of Akorn's financial condition after the parties signed the merger agreement. For example, Akorn's financial performance declined substantially, with its EBITDA declining 86%. The Court held that the underlying causes of the decline were durationally significant and were specific to Akorn, rather than the result of industrywide conditions. Moreover, Akorn's regulatory compliance problems were significant because of "overwhelming evidence of widespread regulatory violations and pervasive compliance problems" that existed at signing and worsened thereafter. Significantly, the Court held that Akorn failed to use commercially reasonable efforts to operate in the ordinary course of business. The Court found that, as soon as the parties signed the Merger Agreement, Akorn cancelled regular audits, assessments, and inspections of known problems specifically because of the pending merger. Akorn also did not maintain its data integrity system and submitted regulatory filings with inaccurate data, none of which was done in the ordinary course. The Court found that these ordinary course violations were material because, among other reasons, they cost Akorn "a year of what could have been meaningful remediation efforts."

Sciabacucchi v. Salzberg
(Del. Ch. Dec. 19, 2018)

In this memorandum opinion, the Delaware Court of Chancery invalidated forum selection provisions contained in the certificates of incorporation of three Delaware corporations that required any claim brought under the Securities Act of 1933 to be brought in federal court.

Prior to filing an initial public offering, the nominal defendants in this case—Blue Apron Holdings, Inc., Roku, Inc., and Stitch Fix, Inc.—each adopted a charter-based forum selection provision (the "Federal Forum Provisions") that purported to require any claim brought under the 1933 Act to be filed in federal court. Plaintiff Matthew Sciabacucchi, an owner of common stock at each entity, subsequently challenged the validity of these provisions.

Ruling on cross-motions for summary judgment, Vice Chancellor Laster held that the Federal Forum Provisions are ineffective to the extent they require any claim brought under the 1933 Act to be filed in federal court. The Court explained that the "constitutive documents of a Delaware corporation cannot bind a plaintiff to a particular forum when the claim does not involve rights or relationships that were established by or under Delaware's corporate law." Here, because the Federal Forum Provisions sought to accomplish that exact purpose—*i.e.*, mandate a forum for claims that do not arise out of or implicate the internal affairs of the corporation—the provisions were determined to be ineffective and invalid.

The Court's decision relied heavily on then-Chancellor Strine's seminal decision in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.* regarding the validity of forum-selection provisions and, more particularly, its distinction between internal and external claims. The *Boilermakers* decision upheld the validity of forum-selection provisions that covered four types of actions: (i) derivative actions or proceedings; (ii) claims asserting breach of fiduciary duty; (iii) claims arising pursuant to the DGCL; and (iv) claims governed by the internal affairs doctrine.

According to then-Chancellor Strine, the forum-selection provisions easily fell within the scope of Section 109(b) because they addressed "internal affairs claims" and governed the rights of "stockholders *qua* stockholders." The distinction between internal and external claims was further clarified by contrasting the forum-selection provisions at issue with tort or contract claims, which fall outside the scope of the statutory language because they do "not deal with the rights or powers of the plaintiff-stockholder *as a stockholder*." *Boilermakers* thus validated the ability of a corporation to adopt a forum-selection provision, but drew a distinction with claims involving internal affairs of a corporation.

Consistent with the *Boilermakers* decision, the Court in *Sciabacucchi* held that the nominal defendants could not use the Federal Forum Provisions to specify a forum for 1933 Act claims. The Court reached this conclusion by first determining that the result in *Boilermakers*, which was subsequently codified by the Delaware General Assembly, applies equally to charter-based provisions based on the parallelism between DGCL Sections 109(b) and

102(b)(1) and the fact that "the[se] provisions are generally viewed as covering the same broad subject matter." Further, because "[a] claim under the 1933 Act does not turn on the rights, powers, or preferences of the shares, language in the corporation's charter or bylaws, a provision in the DGCL, or the equitable relationships that flow from the internal structure of the corporation," it necessarily follows that 1933 Act claims are external in nature and distinct from an internal affairs claim "brought by stockholders *qua* stockholders."

Though the Court recognized that "[m]any aspects of the corporation's business affairs involve external relationships," it nonetheless rejected the nominal defendants' argument that "issuing securities and defending against securities lawsuits involve the business and affairs of the corporation." Instead, the Court noted that "the predicate act" for a claim under the 1933 Act is the purchase of the share and, at the time the predicate act occurs, the "purchaser is not yet a stockholder and lacks any relationship with the corporation that is grounded in corporate law." Thus, the Court held that the Forum Selection Provisions cannot govern claims arising under the 1933 Act and entered judgment in favor of the plaintiff.

In re Oxbow Carbon LLC Unitholder Litigation

(Del. Jan. 17, 2019)

In this unanimous *en banc* decision, the Supreme Court of Delaware held that the Court of Chancery erred in deploying the implied covenant of good faith and fair dealing to imply a seller top-off right in an LLC agreement. The Court found that there was simply no gap in the agreement for the implied covenant to fill.

The case involved a dispute over whether certain minority members (the "Minority Members") of Oxbow Carbon LLC had a right to compel an "Exit Sale" of the Company under the terms of Oxbow's governing LLC Agreement. The Court of Chancery held that the plain language of the LLC Agreement permitted the Minority Members to force a sale of the Company only if the sale price met or exceeded the contractually mandated floor price and if all members received the same terms and conditions in a sale. This would allow certain later added members (the "Small Holders"), who were admitted years after the LLC Agreement was negotiated, to prevent a sale unless it met certain payment conditions. The Court of Chancery, however, found a contractual gap in the LLC Agreement because Oxbow's board did not specify the terms and conditions under which the Small Holders acquired their units when they were admitted. Deploying the implied covenant to fill that gap, the Court of Chancery concluded that an implied right existed for the Minority Members to force an Exit Sale by topping-off the Small Holders so that they received the contractually mandated floor price.

On appeal, the Supreme Court considered whether the implied covenant was properly used to include the top-off provision in the LLC Agreement to allow the Minority Members to force an Exit Sale. The Minority Members argued that the LLC Agreement contains such a gap because the provision allowing the board to admit new members gives the board discretion to determine the rights of the newly admitted members, and the board failed to define those rights.

The Supreme Court rejected this argument, explaining that the implied covenant only comes into play in two situations: 1) where, as argued in this case, a "situation has arisen that was unforeseen by the parties and where the agreement's express terms do not cover what should happen;" and 2) "when a party to a contract is given discretion to act as to a certain subject and it is argued that the discretion has been used in a way that is impliedly proscribed by the contract's express terms." The Court found that the "LLC Agreement delegates responsibility to the Board to set the terms of admission and permits—but does not require—the Board to issue units with different rights and classes." Thus, absent the imposition of different rights, newly admitted members have the same rights as all members. In addition, the Court noted that it has "declined in other cases to imply new contract terms merely because a contract grants discretion to a board of directors" and that such a grant of discretion is more appropriately viewed as a contractual choice—not a gap. Further, the Court found that there was no argument that the board exercised its contractual discretion in bad faith in admitting the new members. And, at the time of contracting, the parties expressly contemplated that new members could be admitted and placed certain restrictions on the admission process, indicating that they expressly considered the issue. Thus, no gap existed for the implied covenant to fill. The Court concluded by reiterating "that the implied covenant should not be used as 'an equitable remedy for rebalancing economic interests'—particularly where, as here, the parties are sophisticated business persons or entities."

KT4 Partners LLC v. Palantir Technologies, Inc.

(Del. Jan. 29, 2019)

In this decision, the Delaware Supreme Court affirmed in part and reversed in part the Court of Chancery's final order and judgment concerning the production of emails in response to a stockholder's books and records request under Section 220 of the General Corporation Law of the State of Delaware (the "DGCL").

Palantir Technologies Inc. ("Palantir"), KT4 Partners LLC ("KT4"), and certain other Palantir stockholders were parties to an investors' rights agreement that, among other things, granted KT4 the right to inspect Palantir's books and records and a right of first offer as to future Palantir stock offerings. After KT4 and Palantir's relationship soured, KT4 attempted to sell its stake in Palantir. However, the sale was not consummated because, according to KT4, Palantir intentionally foiled the transaction.

After the failed sale attempt, KT4 sought to inspect Palantir's books and records under the investors' rights agreement. Palantir responded that it was reviewing the request and would respond "soon." Instead of responding, however, Palantir amended the investors' rights agreement to, among other things, retroactively eliminate KT4's inspection rights and right of first offer (the "Amendments"). With its contractual informational rights retroactively abolished, KT4 sued under Section 220 of the DGCL to inspect Palantir's books and records for the purpose of investigating alleged wrongdoing related to, among other things, the Amendments.

The Court of Chancery's post-trial opinion held that KT4 had stated several proper purposes for its inspection demand under Section 220, including investigating suspected wrongdoing in connection with the Amendments. The Court further held that KT4 was entitled to inspect "all books and records relating to" the Amendments. The parties, however, were unable to agree on a form of implementing order with respect to several issues, including whether the books and records that the Court held KT4 was entitled to inspect included emails and other electronically stored information. The Court resolved the dispute by ruling, among other things, that "the inspection of electronic mail is not essential to fulfilling KT4's stated investigative purpose" and that KT4 was only entitled to receive board-level documents relating to the Amendments. KT4 appealed, arguing that the Court of Chancery erred by holding that emails were not necessary for its investigative purpose.

The Delaware Supreme Court reversed the Court of Chancery, in part, explaining that emails and other electronic communications were necessary for KT4 to investigate purported wrongdoing related to the Amendments because KT4 satisfied its burden by presenting "some evidence" of wrongdoing. On appeal, Palantir did not dispute that it had a history of failing to adhere to corporate formalities and conducting business informally over email and, specifically, that much of the alleged wrongdoing relating to the Amendments had occurred over email. In other words, because there were no traditional board-level documents relating to the Amendments, the only information that Palantir had related to the Amendments—which was in the form of emails—was necessarily essential for KT4's investigative purpose.

Echoing prior Supreme Court and Court of Chancery opinions, the Supreme Court reaffirmed that emails will not be ordered to be produced in a Section 220 action if there are sufficient board-level documents available for a stockholder to investigate a proper purpose. However, "[i]f a respondent in a § 220 action conducts formal corporate business without documenting its actions in minutes and board resolutions or other formal means, but maintains its records of the key communications only in emails, the respondent has no one to blame but itself for making the production of those emails necessary."

The Supreme Court found no error with respect to two additional issues raised by KT4, and affirmed the Court of Chancery.

The *Palantir* decision reiterates the importance of adhering to corporate formalities to prevent intrusive productions in response to Section 220 actions. The case also highlights the fact that Section 220 is a living statute, the application of which necessarily evolves with companies' use of modern technologies, including email.

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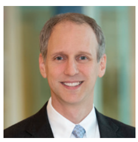

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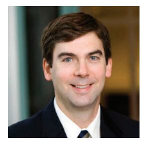

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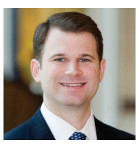

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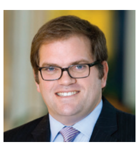

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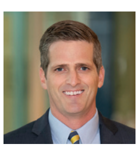

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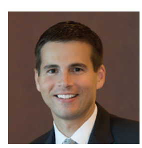

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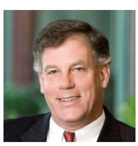
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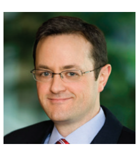
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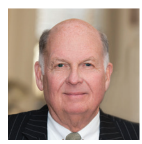
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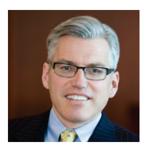
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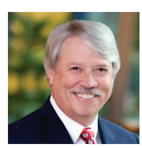
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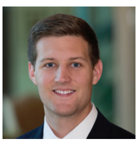

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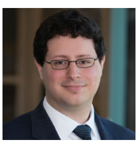

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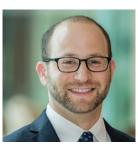

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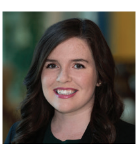

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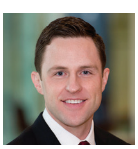

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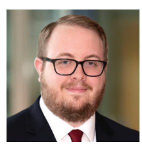

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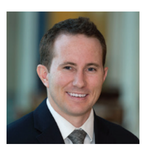

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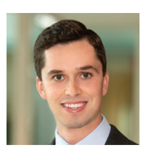

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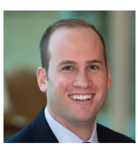

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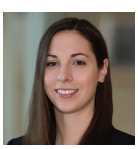

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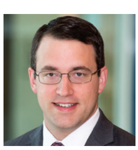

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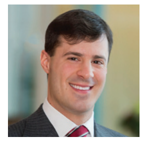

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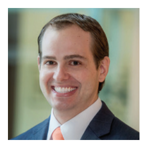

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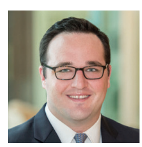

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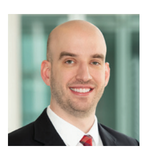

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