Delaware Corporate Law
2019 Year in Review

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YOUR DELAWARE ADVANTAGE

2019: THE YEAR IN REVIEW "WHAT'S OLD IS NEW"

In looking back on 2019, it occurred to us that a number of seminal Delaware corporate law cases have stood the test of time in providing a framework for emerging corporate disputes. Such cases include *Caremark* and *Zapata v. Maldonado*, among others. It is for that reason we have chosen to highlight some of the recent cases emblematic of "what's old is new." Before doing so, however, we would be remiss in failing to note the major changes to the Delaware bench that occurred in 2019. In July, Chief Justice Leo Strine, Jr. announced that he would step down from the Supreme Court. His October 2019 retirement ended a twenty-year career on the Delaware bench, first as a Vice Chancellor in the Court of Chancery, then as Chancellor, and finally as Chief Justice, a position he held since 2014. Unquestionably, Chief Justice Strine has had a profound and positive impact on Delaware corporate law, for which we are all grateful.

Delaware's new Chief Justice, Collins J. Seitz, Jr., ascended to the role after serving as an Associate Justice since 2015. Vice Chancellor Tamika Montgomery-Reeves was appointed to fill the open Supreme Court seat, becoming Delaware's first African-American Supreme Court Justice.

To fill the opening left by Vice Chancellor Montgomery-Reeves' appointment, Governor Carney nominated Paul Fioravanti, Jr. On January 15, 2020, the Delaware Senate confirmed him as the newest member of the Court of Chancery. Vice Chancellor Fioravanti joins the bench after twenty years with Prickett, Jones & Elliott, P.A., where he had extensive experience representing both plaintiffs and defendants in corporate litigation, making him a natural fit for the Court of Chancery.

2019 also marked the first full year in which the Court of Chancery was staffed with seven judges. Vice Chancellor Morgan Zurn and Vice Chancellor Kathaleen McCormick have been welcome additions as the Court's caseload has continued to increase, with 1,049 new civil cases filed in 2019. As part of its busy caseload in the last year, the Court has considered numerous complex corporate and commercial cases that required it to revisit long-standing doctrines in unusual circumstances. We were fortunate to represent parties in many of these cases.

Below is a discussion of three lines of cases illustrative of the reemergence of important and doctrinal precedent, dating to the early 1980s; they include broken-deal litigation, *Caremark* claims, and special litigation committees.

BROKEN-DEAL LITIGATION

Broken-deal litigation has long been a Court of Chancery mainstay. Seminal cases such as *In re IBP, Inc. Shareholders Litig.*, 789 A.2d 14 (Del. Ch. 2001), *Frontier Oil v. Holly Corp.*, C.A. No. 20502 (Del. Ch. Apr. 29, 2005), and *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, 965 A.2d 715 (Del. Ch. 2008), have explored the obligations and rights of buyers and sellers when one party seeks to terminate a merger agreement. This year, prominent broken-deal cases brought renewed focus to previously-litigated deal terms, including: (i) notice provisions, (ii) termination fees, (iii) non-solicitation provisions, (iv) Material Adverse Effects ("MAEs"), and (v) reasonable efforts provisions.

Vintage Rodeo Parent, LLC v. Rent-A-Center, Inc.
C.A. No. 2018-0927-SG (Del. Ch. Mar. 14, 2019)
(Glasscock, V.C.) ("*Rent-A-Center*")

On June 17, 2018, Vintage Rodeo agreed to acquire Rent-A-Center, a competitor in the rent-to-own market, in a deal worth over $1 billion. The merger agreement provided an end date, six months from signing, after which time either party could unilaterally terminate the merger agreement if FTC approval had not yet been obtained. However, if FTC review was still ongoing six months from signing, each party had the unilateral right to extend the end date by giving the other side notice of its election to extend prior to the end date occurring. The merger agreement's notice provision governed the manner of giving notice.

As of the end date, neither side had elected to extend the end date and FTC approval had not yet been obtained. By that time, Rent-A-Center's board of directors had determined that consummating the merger was no longer in the best interests of its stockholders. Accordingly, the day after the end date, Rent-A-Center sent Vintage a termination notice and demanded a reverse termination fee of $126.5 million. The Court of Chancery held that Rent-A-Center validly terminated the merger agreement, finding that Vintage simply forgot to give notice of its election to extend the end date. The Court deferred ruling on whether Rent-A-Center was entitled to payment of the reverse termination fee, and the matter subsequently settled, rendering a ruling on this issue unnecessary.

Takeaways

Notice Provisions Will Be Strictly Enforced: The *Rent-A-Center* Court rejected Vintage's contention that the notice provision was a mere formality whose purpose Vintage had substantially satisfied through a submission to the FTC contemplating a closing of the merger after the end date. The Court explained that finding in Vintage's favor would render meaningless the parties' reciprocal right to extend the end date by providing notice pursuant to the procedures set forth in the merger agreement. In so holding, the Court emphasized its reluctance to rewrite an unambiguous merger agreement to alter rights that the parties had secured at the bargaining table. The decision confirms that the Delaware courts will not credit allegedly substantial compliance with a contractual notice provision where literal compliance is possible.

Commercially Reasonable Efforts Do Not Require Reminders: The *Rent-A-Center* Court rejected Vintage's argument that Rent-A-Center had a duty to warn Vintage of the impending extension deadline because the parties had contracted to use commercially reasonable efforts to consummate the merger. The Court found that Rent-A-Center had no reason to believe that Vintage had forgotten or misunderstood its options under the merger agreement, and that the agreement did not include a provision requiring advance notice of a decision to terminate. Practitioners should take care to include the full scope of obligations they intend to capture with a reasonable efforts provision.

Reverse Termination Fees: As noted, in *Rent-A-Center*, the Court did not ultimately need to decide whether Rent-A-Center was entitled to the specified $126.5 million reverse termination fee. Practitioners should note, however, that the Court requested supplemental briefing on whether the implied covenant of good faith and fair dealing should apply for a reverse termination fee in a circumstance where the buyer remains willing and able to proceed toward closing.

Genuine Parts Co. v. Essendant Inc.
C.A. No. 2018-0730-JRS (Del. Ch. Sept. 9, 2019)
(Slights, V.C.) ("*Essendant*")

In 2018, Genuine Parts Co. ("GPC") agreed to acquire Essendant, a competitor in the office supply business. Five days after GPC and Essendant signed the merger agreement, Sycamore Partners offered to acquire Essendant, allegedly at a premium. Essendant accepted Sycamore's offer, terminated its deal with GPC, and paid GPC a $12 million termination fee. GPC accepted the fee, and Essendant closed the deal with Sycamore.

GPC filed suit contending that Essendant had breached a non-solicitation provision in the merger agreement and that the termination fee was not the exclusive remedy. The Court of Chancery denied Essendant's motion to dismiss, holding that the merger agreement did not clearly and unambiguously limit GPC's remedy to recovery of the termination fee under circumstances in which Essendant breached the non-solicitation provision, which GPC had adequately pled.

Takeaways

Termination Fees And Breach Of Contract Claims: In *Essendant*, the merger agreement at issue provided that the $12 million termination fee was GPC's sole and exclusive remedy for termination if Essendant terminated the merger after (i) receiving a competing proposal that did not arise from a breach of the agreement's non-solicitation provision, and (ii) Essendant's board of directors had determined that the competing offer represented a superior proposal. Essendant argued that, by accepting the termination fee, GPC acknowledged that the fee was paid in accordance with the relevant sections of the merger agreement.

The Court rejected that argument, holding that GPC adequately pled that Essendant materially breached the non-solicitation provision by soliciting a revised offer from Sycamore, and nothing in the merger agreement explicitly provided that acceptance of the termination fee precluded GPC from pursuing breach of contract claims. The Court's strict construction of the agreement teaches that drafters who intend a termination fee to be an exclusive remedy for termination must state those intentions clearly and unconditionally.

Stockholder Challenges When The Seller Terminates: In a subsequent decision arising from the same transaction as in *Essendant*, *In re Essendant, Inc. Stockholder Litigation*, C.A. No. 2018-0789-JRS (Del. Ch. Dec. 30, 2019) (Slights, V.C.), the Court of Chancery granted a motion to dismiss a stockholder suit claiming that the directors of Essendant breached their fiduciary duties by terminating the deal with GPC (a stock-for-stock transaction) in favor of an allegedly inferior all-cash proposal from Sycamore. The Court found that the plaintiffs failed to plead that a majority of Essendant's directors breached their duty of loyalty in accepting Sycamore's proposal. Essendant's legal challenges serve as a reminder that sellers who walk away from deals may face legal battles on two fronts. The results may vary, however, due to the different standards applicable to fiduciary duty and contractual claims.

Channel Medsystems, Inc. v. Boston Scientific Corp., et al
C.A. No. 2018-0673-AGB (Del. Ch. Dec. 18, 2019) (Bouchard, C.) ("*Boston Scientific*")

Practitioners may have wondered whether last year's landmark decision in *Akorn, Inc. v. Fresenius Kabi AG* (Del. Ch. Oct. 1, 2018), *aff'd,* 198 A.3d 724 (Del. 2018), signaled a new era in Delaware's interpretation of MAE provisions in merger agreements. In *Akorn*, the Court of Chancery found—for the first time ever—that a buyer validly terminated a merger agreement based upon an MAE suffered by the seller. But *Boston Scientific* demonstrates that the standard for proving an MAE remains difficult to meet, notwithstanding the result in *Akorn*.

In 2017, Boston Scientific agreed to acquire Channel, a developer of a medical device under FDA review. Approximately one month after signing the merger agreement, Channel discovered that one of its employees had falsified reports contained in Channel's submissions to the FDA. Channel notified the FDA and Boston Scientific promptly after learning of the fraud. Channel then commenced an internal investigation and submitted a remediation plan to the FDA, which the FDA accepted. Boston Scientific then decided to terminate the merger. The Court of Chancery held that Boston Scientific was not entitled to terminate its merger agreement with Channel based on an alleged MAE, instead finding that Boston Scientific breached its contractual obligation to use commercially reasonable efforts to consummate the deal.

Note: As of this writing, *Boston Scientific* is on appeal.

Takeaways

Material Misrepresentations Do Not Necessarily Create MAEs: In *Boston Scientific*, the Court found that the employee's fraud rendered a number of Channel's contractual representations materially inaccurate as of the date of the merger agreement. The Court explained that the falsified reports submitted to the FDA would alter the total mix of information available to a reasonable acquirer. Yet the Court declined to apply a similar disclosure-based materiality standard in assessing whether Channel suffered an MAE. Adopting the Court's analysis in *Akorn*, the Court held that "material" in the context of an MAE means an effect that would substantially threaten the value of a target company in a durationally-significant manner measured in years, not months. Practitioners should be mindful of these different materiality standards when drafting merger agreements.

Buyers Still Face A Steep Climb In Proving MAEs: The *Boston Scientific* Court found that Boston Scientific failed to prove that Channel's misrepresentations had, or would reasonably be expected to have, an MAE on Channel as of the date Boston Scientific sent its notice of termination. The FDA's prior acceptance of Channel's remediation plan strongly signaled to Boston Scientific that the employee's fraud would not cause the FDA to decline to approve Channel's device. This confirms that the Court of Chancery will assess the existence or nonexistence of an MAE under a typically worded MAE provision as of the time a party decides to terminate a merger agreement, and a short-term drop in profitability does not constitute an MAE.

Material Misrepresentations And The Obligation To Close: The *Boston Scientific* Court held that Boston Scientific breached the merger agreement by failing to use commercially reasonable efforts to consummate the merger. The Court emphasized that, upon learning of the employee's fraud and Channel's remediation efforts, Boston Scientific declined numerous invitations to meet with Channel to discuss a potential path forward. *Boston Scientific* demonstrates that if a counterparty's breach of the agreement does not give rise to a termination right, a contractual obligation to use commercially reasonable efforts requires a party to continue to make a meaningful attempt to keep a deal on track—even one in which a counterparty made material misrepresentations.

CAREMARK CLAIMS

In *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996), the Court of Chancery established the framework for director liability for breach of fiduciary duty in connection with a board of directors' oversight responsibilities. The *Caremark* standard was subsequently confirmed by the Delaware Supreme Court in *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006). Under *Caremark,* for a stockholder-plaintiff to succeed in establishing director liability in connection with an oversight claim, the plaintiff must show (i) that the directors utterly failed to implement information reporting systems or internal controls regarding the corporation's operation and compliance, or (ii) having implemented such a system or controls, the directors consciously failed to monitor or oversee the company's operations and compliance. The Court of Chancery had interpreted this standard as requiring a stockholder to establish that the directors "acted with a state of mind consistent with a conscious decision" to breach their fiduciary duties. *Desimone v. Barrows*, 924 A.2d 908, 935 (Del. Ch. 2007).

Traditionally, *Caremark* claims are among the hardest to plead and prove in Delaware. In 2019, however, complaints under both *Caremark* categories survived motions to dismiss, potentially signaling a somewhat less stringent approach to judicial review of *Caremark* claims, at least in some contexts. Two cases illustrate this trend, highlighting new considerations for boards' oversight duties in certain circumstances. Moreover, another case suggests that it may be easier than previously thought for stockholders to obtain books and records through Section 220 inspection demands related to *Caremark* claims.

Marchand v. Barnhill, 212 A.3d 805 (Del. 2019) ("*Marchand*")

In *Marchand*, the Delaware Supreme Court reversed and remanded the Court of Chancery's dismissal of *Caremark* claims. The underlying complaint alleged *Caremark* violations against the board of Blue Bell Creameries for failing to oversee the company's food safety in the wake of a listeria outbreak. The Court of Chancery held that the complaint failed to plead adequate facts to support the allegations that the Blue Bell board "utterly failed" to adopt oversight systems.

On appeal, the Supreme Court emphasized that Blue Bell was a "monoline company that makes a single product—ice cream." Despite the importance of food safety to Blue Bell, the Supreme Court found that the complaint adequately pleaded a failure of oversight at the board level to implement appropriate safety procedures and compliance protocols.

The complaint alleged multiple instances of red flags regarding food safety over a period of years, including citations from regulatory inspectors and positive tests for listeria. Eventually, a listeria outbreak related to Blue Bell's ice cream led to consumer death and a CDC-mandated recall of Blue Bell's products.

The Supreme Court found that the complaint fairly pled that, throughout this period: (i) Blue Bell did not have a board committee to oversee food safety, (ii) Blue Bell's board lacked a process to devote time to food safety compliance issues, and (iii) Blue Bell's board did not have any oversight protocol for management to report food safety issues. Importantly, the Supreme Court noted that documents produced through a Section 220 demand indicated almost no board level discussion regarding food safety. While there was some evidence that management (as opposed to the board) had safety and compliance protocols in place, the Supreme Court emphasized the importance of protocols at the board level. The Supreme Court held that having sufficiently alleged an absence of oversight at the board level and the lack of protocols for management to report to the board, the complaint adequately pled Blue Bell's board had "utterly failed" to establish "reasonable compliance systems and reporting protocols" regarding the "obviously most central consumer safety and legal compliance issue facing the company." Accordingly, the Supreme Court reversed the dismissal of the complaint.

In re Clovis Oncology, Inc. Deriv. Litig.
C.A. No. 2017-0222-JRS (Del. Ch. Oct. 1, 2019)
(Slights, V.C.) ("*Clovis*")

In *Clovis*, a decision rendered after the Supreme Court's reversal in *Marchand*, the Court of Chancery allowed another *Caremark* claim to survive a motion to dismiss. Like *Marchand*, the company in *Clovis* had a single critical product. Clovis was a pharmaceutical startup company with one promising drug in its pipeline undergoing FDA clinical trials.

As in *Marchand*, plaintiffs utilized Section 220 to obtain documents before bringing their *Caremark* complaint. The complaint alleged that the Clovis board knew that management had deviated from FDA protocol, which would preclude approval of its only potential product. Further, the Clovis board allegedly did not take appropriate steps despite knowing of altered data that was reported both to the FDA and to the public, including information about the drug's potential side effects. The drug's development was delayed when the FDA learned of these deviations from its protocol.

Interpreting *Marchand*, the Court emphasized that the duty of oversight, including the duty to monitor regulatory controls, is heightened when "a monoline company operates in a highly regulated industry." However, unlike in *Marchand*, the *Clovis* board implemented a series of controls and a protocol for regulatory and safety oversight at the board level. For example, a board committee was "specifically charged with providing general compliance oversight with respect to federal health care program requirements and FDA requirements." Thus, the Court of Chancery evaluated whether the board had consciously failed to monitor its oversight system. The Court found that the complaint sufficiently alleged that the board was aware of the importance of complying with FDA protocol in order to successfully launch the company's "mission critical product" to the market, as well as the company's deviation from the FDA protocol, but did not act. Accordingly, the Court found that the complaint adequately pled that the board failed to monitor its oversight systems and denied the motion to dismiss.

Takeaways

Has The *Caremark* Standard Changed?: Taken together, *Marchand* and *Clovis* suggest that a board's duty of oversight is heightened in heavily regulated companies, particularly those with a "mission critical product." For example, in interpreting *Marchand*, the *Clovis* court noted that under those circumstances, "the board's oversight function must be *more rigorously exercised*." However, *Marchand* and *Clovis* both involved a specific set of circumstances: a monoline company with a mission critical product in a heavily regulated industry, where documents received pursuant to a Section 220 inspection demand supported the plaintiffs' pleadings-stage allegations that the board either "utterly failed" to oversee these regulatory safety issues leading to consumer death, or knew that the company was deviating from FDA clinical trial protocol at the risk of serious safety issues. Since the *Marchand* and *Clovis* decisions, the Court of Chancery has dismissed *Caremark* claims applying the traditional *Caremark* framework, such as in *In re LendingClub Corp. Derivative Litigation,* Consol. C.A. No. 12984-VCM (Del. Ch. Oct. 31, 2019) (McCormick, V.C.). There, the active involvement of an independent auditor and board committees in risk management, such as the risk committee and audit committee, was sufficient to distinguish *LendingClub* from the situation in *Marchand*. Given that start-ups and other companies with limited business scopes or product offerings will continue to operate in heavily regulated industries such as pharmaceuticals, the issues raised in *Marchand* and *Clovis* are likely to recur, possibly signaling a new trend in *Caremark* claims. Yet *Caremark's* reputation as the hardest claim to plead and prove likely will hold in other business settings.

What Is A "Heavily Regulated" Industry?: Both *Marchand* and *Clovis* involved monoline companies with serious issues of consumer safety in industries "heavily regulated" by the FDA. It is not entirely clear, however, what other industries Delaware Courts would consider "heavily regulated." For example, *In re LendingClub* involved allegations of SEC violations surrounding the company's online platform facilitating consumer loans. In *AmerisourceBergen* (discussed below), the Court found that a drug distributor operated in a highly regulated industry. At the very least, it appears that industries regulated to protect human health and safety will be viewed as "heavily regulated," but open questions remain.

What Systems Should Boards Implement?: In the wake of *Marchand*, reliance on management to follow procedures required by outside regulatory governing bodies may not be enough to satisfy the level of board oversight required under *Caremark*. However, it is unclear where the demarcation between an "utter failure" of oversight and appropriate procedures lies. In *Clovis*, the Court of Chancery indicated that charging the Nominating and Corporate Governance Committee with oversight of FDA regulation satisfied the aspect of the *Caremark* standard relating to establishing oversight systems. In determining to dismiss *Caremark* claims in *LendingClub,* the Court of Chancery noted that LendingClub had an audit committee, a risk committee, and an independent auditor. These cases suggest that creation of a committee to address oversight issues or delegation of oversight responsibilities likely will satisfy the requirement to establish oversight systems. Importantly, once a board-level system is in place, boards should receive regular reports on safety or other regulatory compliance issues from management. As plaintiffs continue to utilize books and records inspection demands under Section 220 to bolster their *Caremark* claims, companies should document, in board and committee minutes and otherwise, when the board and relevant committees discuss regulatory and compliance issues.

Lebanon County Employees' Retirement Fund v. AmerisourceBergen Corporation
C.A. No. 2019-0527-JTL (Del. Ch. Jan. 13, 2020)
(Laster, V.C.) ("*AmerisourceBergen*")

In *AmerisourceBergen*, the Court of Chancery directed AmerisourceBergen Corporation to make certain books and records available for stockholder inspection in response to a Section 220 demand. The plaintiff stockholders alleged that the directors of AmerisourceBergen, a distributor of healthcare products, including pharmaceuticals, had engaged in potential corporate wrongdoing relating to the company's opioid-distribution practices and adherence to certain FDA regulations. Examining whether plaintiffs had established a proper purpose to seek inspection of corporate books and records under Section 220, the Court emphasized that the existence of several governmental investigations and lawsuits centered on the opioid crisis demonstrated a "credible basis" to suspect possible corporate wrongdoing. In particular, the Court considered whether there was a credible basis for the plaintiffs to investigate whether AmerisourceBergen's directors permitted AmerisourceBergen to violate positive law or consciously failed to monitor "mission critical" risk, which could serve as the basis for *Caremark* claims. The Court rejected arguments from AmerisourceBergen that the plaintiffs should be required to plead not just a proper purpose but also what they intended to do with the fruits of their inspection, and that the plaintiffs had to show actionable wrongdoing. The Court ordered production of formal board materials and, after production of those materials, that AmerisourceBergen make a witness available to testify for a Rule 30(b)(6) deposition regarding what other potentially relevant documents may exist.

Note: As of this writing, the Court of Chancery has certified *AmerisourceBergen* for interlocutory appeal.

Takeaways

Is Purpose Plus An End Needed?: Many previous Court of Chancery decisions have stated that a stockholder making a Section 220 demand must not only show a proper purpose for inspection but also state what it plans to do with the inspection materials once received. *AmerisourceBergen* holds otherwise, stating that any such requirement is inconsistent with Section 220 and Delaware Supreme Court precedent. The Court noted that its decision conflicts with other Court of Chancery decisions that imposed such a requirement. Given this split in the Court of Chancery, the Supreme Court may address this issue. If a stockholder is required, when making a Section 220 demand, to state an end use for the inspection materials, that might in turn have an effect on the scope of inspection. To the extent that a stockholder must state that it is investigating a *Caremark* claim, which is a board-level claim, it is unclear whether there would be a need for anything more than formal board materials in most circumstances. However, other potential purposes may justify a broader scope of inspection.

Section 220 Is The *Caremark* Battlefield: The stockholder-plaintiffs in *Marchand* and *Clovis* both relied on documents obtained through Section 220 demands to plead their *Caremark* claims. Because the *Caremark* standard is stringent and difficult to overcome, even at the pleadings stage, obtaining board-level documents typically will be vital to pleading meritorious claims, as the Court noted in *AmerisourceBergen*. Even if *Caremark* claims might now be easier to plead in certain contexts, such as those involving monoline companies in heavily regulated industries, as cases like *Marchand* and *Clovis* suggest, using Section 220 to investigate before filing a complaint alleging *Caremark* claims likely is to remain of critical importance.

SPECIAL LITIGATION COMMITTEES

In 1981, in the landmark decision *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981), the Delaware Supreme Court laid out a framework for the appointment of Special Litigation Committees ("SLCs") to evaluate and potentially move to dismiss the claims asserted in stockholder derivative suits. In *Zapata*, the Court ruled that an independent committee of an otherwise conflicted board can seek to dismiss derivative claims, but that such dismissal is subject to the approval of the Court. In deciding whether to accept the decision of an SLC to dismiss derivative claims, the Court must inquire regarding the SLC's independence and good faith and the bases for the SLC's conclusion. Moreover, the Court may, at its discretion, apply its own independent business judgment to determine whether to grant dismissal.

Subsequent cases developed other important aspects surrounding the procedures applicable when an SLC has been appointed to evaluate and act on derivative claims. For example, the Court typically will stay a derivative suit during the pendency of an SLC's investigation, and the plaintiff will obtain some discovery of the SLC's materials if the SLC moves to dismiss derivative claims.

The past year saw a number of significant cases arising in the SLC context. The Court of Chancery addressed issues including the use of SLCs by general partnerships and SLCs' relationships with stockholder-plaintiffs who assert derivative claims.

Wenske v. Blue Bell Creameries, Inc.
214 A.3d 958 (Del. Ch. 2019), as corrected (Aug. 30, 2019)
(Slights, V.C.) ("*Wenske*")

In an earlier opinion, *Wenske v. Blue Bell Creameries, Inc.*, C.A. No. 2017-0699-JRS (Del. Ch. July 6, 2018), the Court of Chancery denied a motion to dismiss a derivative count against the general partner of Blue Bell Creameries, L.P., for breach of the limited partnership agreement. As part of that decision, the Court found that the general partner, which was a corporation, was conflicted for purposes of considering a demand. Following that decision, the general partner's board added two new independent directors, appointed them to a special committee, which created an SLC consisting of non-board members. The Court denied the SLC's motion to stay the litigation. The Court relied upon its previous determination that the general partner was conflicted and lost the ability to manage the derivative claims entirely. Therefore, the general partner could not delegate its authority to control derivative litigation to agents, including the SLC. Because the corporate general partner was conflicted, the SLC was not properly constituted, and the Court accordingly refused to stay the litigation.

Note: As of the date of this writing, *Wenske* is on appeal to the Delaware Supreme Court.

Takeaways

Use Of SLCs For Corporations v. Alternative Entities: In *Wenske*, the Court explained that, in the corporate context, it determines whether the board of directors is conflicted by evaluating whether a majority of the board members are conflicted on a director-by-director basis, resulting in disqualifying individual members of the board from the decision at hand. The Court of Chancery contrasted that with its evaluation of conflict for an entity serving as the general partner of a limited partnership, where a court evaluates whether the entity itself is conflicted and does not take a director-by-director approach with respect to the entity general partner's board. Here, the Court considered whether the general partner entity itself is disqualified. The Court explained that this difference in approach permits a conflicted corporate board to transfer control over derivative claims to non-conflicted individual directors, but does not allow a conflicted general partner to do the same (barring adoption of a governance structure for the limited partnership that more closely mimics a corporate structure). The Court specifically noted that the steps the general partner took to create the SLC in *Wenske* likely would have succeeded in the corporate context. Consequently, practitioners considering the creation of an SLC in the alternative entity context should carefully assess the entity's governance structure and be cautious when seeking to invoke corporate precedent or procedures.

Partnership Agreements And SLCs: The *Wenske* Court contrasted its holding with *Katell v. Morgan Stanley Grp., Inc.*, C.A. No. 12343 (Del. Ch. Sept. 27, 1993), in which the Court of Chancery permitted a non-conflicted general partner in a dual-general partner limited partnership to serve as an SLC after an amendment to the partnership agreement permitted it alone to manage litigation assets. Practitioners considering creating an SLC for an alternative entity should carefully examine the governing documents to determine whether, and under what circumstances, creation of an SLC is possible, including any potential changes to governing documents to facilitate SLC creation.

In re Oracle Corporation Derivative Litigation
C.A. No. 2017-0337-SG (Del. Ch. Dec. 4, 2019)
(Glasscock, V.C.) ("*Oracle*")

In 2016, Oracle acquired Netsuite, leading to stockholder derivative litigation. After certain claims survived a motion to dismiss, Oracle formed an SLC. In 2019, the SLC determined that the claims should go forward and turned the prosecution of those claims back over to the lead plaintiff. Lead plaintiff then sought wide-ranging discovery of all materials produced to the SLC or created by the SLC during its investigation, leading to a dispute over what SLC materials the lead plaintiff would be able to obtain.

Neither the Court nor the litigants could identify a previous case in which an SLC determined that a particular derivative plaintiff should prosecute the litigation. Because of that unique context, precedent governing SLC discovery under the more customary *Zapata* scenario did not control. The Court of Chancery held that the litigation was an Oracle asset that the SLC's investigation enhanced. The Court therefore granted lead plaintiff access to the documents the SLC actually reviewed or relied upon, but not all documents provided to the SLC. Additionally, the Court addressed privilege claims from Oracle, individual defendants, and the SLC. The Court of Chancery held that, in light of Oracle's decisions to create an SLC and give the SLC Oracle's privileged documents, lead plaintiff should have access to privileged material that Oracle provided to the SLC. However, the Court held that the SLC, its counsel, and the individual defendants could invoke privilege.

Takeaways

Derivative Claims Are Corporate Assets: In reaching its decision, the Court carefully considered the nature of the derivative claims as assets of Oracle. The Court concluded that the lead plaintiff, a fellow fiduciary of Oracle in its capacity as lead plaintiff, could pursue those claims that constituted assets of the corporation, the value of which had been enhanced by the SLC's investigation. The Court's determination that Oracle could not withhold its privileged material relied in part upon the Court's determination that Oracle's interest in seeing the litigation asset vindicated outweighed any purported harm from disclosure of that privileged material. The Court balanced that interest, however, with the risk that unfettered access for the lead plaintiff could cause parties to withhold privileged information from SLCs in the future, impairing the effective operation of SLCs and their ability to manage litigation assets. *Oracle* shows that the Court will take a comprehensive view of derivative claims as corporate assets, balancing multiple factors. SLCs or parties involved in an SLC process must consider how their actions would affect the value of a derivative claim as a corporate asset and the corporation's ability to best realize the value of that asset.

Company Privilege And SLCs: While the Court limited lead plaintiff's access to SLC materials in part to encourage candor with SLCs, one question *Oracle* raises is whether corporations engaged in an SLC process in the future might seek to limit the privileged material provided to SLCs to prevent the possibility that a derivative plaintiff may later obtain it. Two open issues are particularly relevant to this question. First, *Oracle* does not definitively answer whether there are preventative protective steps corporations can take before producing privileged material to SLCs that would allow corporations to withhold those documents from a derivative plaintiff, such as a clawback agreement. Second, *Oracle* does not address whether corporations can refuse to provide privileged information requested by the SLC. Any corporation considering refusing to produce privileged information to an SLC will need to evaluate case law providing directors with broad access to corporations' privileged material, including *Kalisman v. Friedman*, C.A. No. 8447-VCL (Del. Ch. Apr. 17, 2013), which the Court cited in *Oracle*.

In re Expedia Group Inc. Stockholders Litigation
C.A. No. 2019-0494-JTL (Del. Ch. Jan. 9, 2020) (TRANSCRIPT) (Laster, V.C.) ("*Expedia*")

In July 2019, Expedia and Liberty Expedia Holdings merged. Prior to the merger, Barry Diller held voting control over Expedia due to a proxy over certain shares that Liberty Expedia Holdings owned. While the merger extinguished the proxy, Diller exchanged certain shares of common stock for high-vote stock and maintained voting control over Expedia through certain transactions in connection with the merger. Plaintiffs filed suit alleging that Diller did not have the right to exchange the shares and that he coerced a special committee and Expedia into a transaction that would allow him to maintain voting control. Plaintiffs also alleged that the exchange ratio in the merger was unfair. Expedia formed an SLC in response and moved to stay the litigation pending its investigation. Plaintiffs opposed the stay, contending that their claims were primarily direct because they focused on voting control of a public company. The Court of Chancery granted a six-month stay, holding that, while the claims had direct and derivative elements, the derivative implications were sufficient to justify giving control of the claims to the SLC.

Note: The Court's ruling begins at page 40 of the transcript.

Takeaways

Assets Matter: The Court noted that the distinction between direct and derivative claims is often blurry, posing difficult questions such as when to permit an SLC to manage dual-nature claims and stay litigation. To address that issue, the *Expedia* Court's questioning focused on whether the shares Diller received in the transaction were Expedia's treasury shares, and therefore corporate assets, or whether they came from Liberty Holdings. The Court stated that, if the shares were treasury shares, then plaintiffs' claims were more likely to be derivative. In turn, the Court granted the stay because the Company's interest in the transaction and the corporate stock that would likely be involved in any remedy made it appropriate to give the SLC the first crack at crafting a potential remedy. *Expedia* suggests that, where the alleged wrongs and the potential remedies likely involve corporate assets, even when there are significant stockholder-level effects, the Court is more likely to find a claim is sufficiently derivative to grant a reasonable litigation stay in order to allow the SLC to conduct its investigation.

Remedying Dual-Nature Claims: The *Expedia* Court stated that if the SLC, after completion of its investigation, proposed a remedy that only addressed the derivative claims, then plaintiffs may be able to continue with the direct claims even if the derivative claims were dismissed. When considering dual-nature claims, SLCs and parties negotiating with SLCs should consider whether any proposed settlement adequately addresses both the direct and derivative aspect of the claims. An SLC that pursues a narrow resolution of dual-nature claims may find the Court of Chancery unwilling to dismiss the litigation entirely, subjecting the corporation to the continued burden and distraction of litigation.

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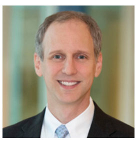

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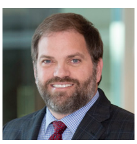

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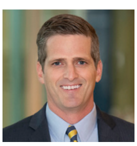

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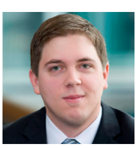

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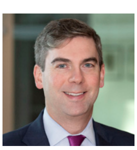

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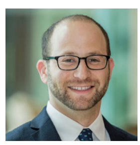

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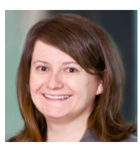

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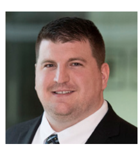

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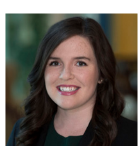

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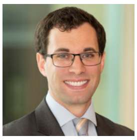

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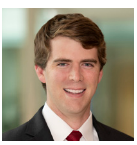

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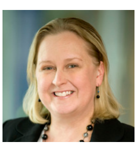

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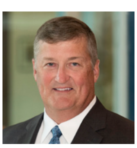

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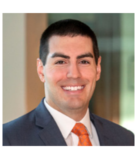

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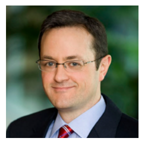

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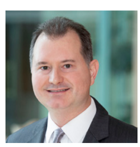

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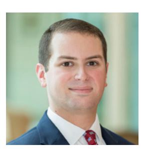

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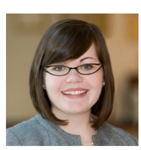

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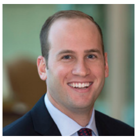

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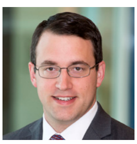

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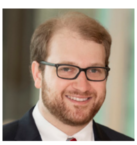

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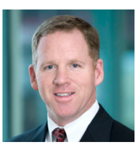

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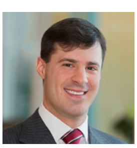

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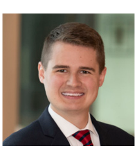

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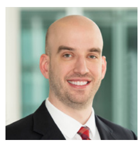

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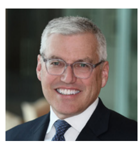

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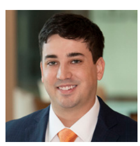

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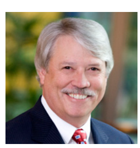

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