Delaware Corporate Law
2020 Year in Review

Potter Anderson Corroon LLP

YOUR DELAWARE ADVANTAGE

2020: DELAWARE CORPORATE JURISPRUDENCE IN REVIEW

"You're on mute." We've all become accustomed to this gentle reminder, as we adapted to the new norms and technologies for practicing law in a pandemic. Thankfully for the corporate bar, the Delaware courts did not stay on mute. In fact, Delaware, with its distinctive responsiveness to the needs of its many stakeholders, rose to the occasion and kept the wheels of justice rolling without a hitch.

As closings began in March, the Delaware legislature promptly considered and revised the Delaware General Corporation Law to address issues brought to the forefront, such as emergency bylaws and powers. In the courts, Chief Justice Collins J. Seitz, Jr., who took over as Chief Justice in 2019, led an extraordinary effort to keep the work of the courts moving while implementing measures to protect court personnel, lawyers, and litigants. These protective measures included limiting in-person proceedings and encouraging the use of Zoom conferences and hearings. The Court of Chancery, in particular, quickly pivoted to the use of Zoom for proceedings that were previously handled in court or chambers. The adaption of virtual hearing and trial protocols was critical not only to permit existing matters to proceed, but also to deal with the influx of new cases brought about by the financial uncertainty surrounding the pandemic. As a firm, we are immensely grateful for the courts and staff who rose to the challenge and allowed us to serve our clients during this challenging year.

As we view 2020 in the rear-view mirror, what is most remarkable is the consistent quantity and quality of the judiciary's work in the face of unprecedented challenges. In addition to its dozens of bench rulings, letter opinions and orders, the Court of Chancery published *more* opinions in 2020 than 2019. As discussed below, those decisions refined the reach and application of such landmark decisions as *Aronson, Caremark, Corwin* and *MFW*. The year also saw the continuing use of books and records demands, resulting in a number of significant cases defining the contours of what a plaintiff may properly inspect. Finally, this was indeed the year of the MAE dispute, resulting from the financial fallout from COVID-19.

Corwin and *MFW*

It would be difficult to overstate the extent to which the Delaware Supreme Court's decisions in *Kahn v. M&F Worldwide Corp.* and *Corwin v. KKR Financial Holdings, LLC* altered the then-prevailing *status quo* for deal litigation. *MFW* permitted the application of business judgment to controller transactions that would otherwise be subject to entire fairness, where the transaction is approved by a fully-empowered, well-functioning special committee and by a vote of a majority of the fully-informed, unaffiliated stockholders. *Corwin* permitted the application of business judgment to transactions, not involving a controller, where the transaction was approved by a fully-informed, uncoerced majority of disinterested stockholders. In the half decade since the Supreme Court decided *MFW* and *Corwin*, the Delaware courts have worked to define and refine the appropriate application of these decisions. That work continued in 2020.

In re USG Corporation Stockholder Litigation
2018-0602-SG (Del. Ch. Aug. 31, 2020)

In 2017, one of USG's stockholders, Knauf, began to explore a strategic acquisition of the company. Knauf, who owned 10% of USG stock, negotiated with both the company and Berkshire Hathaway, a 30% owner. When the board resisted an offer, Knauf waged a successful proxy campaign against four directors. Afterward, Knauf negotiated an acquisition at $44 per share. The company's disclosures repeatedly mentioned that the board held a view on the "intrinsic value" of the company, but the disclosures did not reveal that this figure was $50 per share. A majority of disinterested stockholders approved the transaction.

Responding to defendants' *Corwin* defense, plaintiffs argued that Knauf and Berkshire Hathaway were a control group and the stockholders' approval was coerced and uninformed. The Court concluded the plaintiffs had failed to allege there was a control group or that the stockholder vote was otherwise coerced. However, the Court concluded that *Corwin* could not cleanse the transaction because the approval of the disinterested stockholders was uninformed. A reasonable stockholder would consider the board's undisclosed view of the company's intrinsic value to be material. Nonetheless, the Court dismissed the claims, finding plaintiffs had failed to adequately allege the disclosures were made in bad faith. In doing so, the Court rejected plaintiffs' assertion that the motion to dismiss must be denied, where defendants are unable to invoke *Corwin*.

Takeaways

Plaintiffs do not necessarily state a claim simply by defeating a *Corwin* defense: The Court compared corporate litigation to a steeple chase, where motions to dismiss, summary judgments, and trials are obstacles that plaintiffs must clear. A *Corwin* defense precedes these obstacles by showing there is no agency problem for litigation to address. In other words, if stockholders, in the right transaction, give their fully-informed approval, then the "starting tape" never drops, and the chase is never begun. If, however, the *Corwin* defense is unsuccessful, then the starting tape drops, and the plaintiffs must clear the same course obstacles—such as motions to dismiss—as if the defendants had never asserted a *Corwin* defense. In sum, defeating a *Corwin* defense does not mean that a plaintiff has stated a claim.

A breach of the duty of candor does not necessarily state a non-exculpated claim: The Court found that the plaintiffs successfully pleaded that the board omitted material information from its disclosures. Nonetheless, the Court dismissed under Rule 12(b)(6) for failure to state a claim for a non-exculpated breach of fiduciary duty. As the Court explained, a *Corwin* analysis focuses on the *reader* of the disclosures, and whether those disclosures are fully informed; a duty of loyalty claim focuses on the *drafter* of the disclosures, and whether their intent in omitting material information was motivated by bad faith. Here, despite material deficiencies in the disclosures, the Court found plaintiffs had failed to plead that the board acted in bad faith by making the omissions.

In re HomeFed Corporation Stockholder Litigation
C.A. No. 2019-0592-AGB (Del. Ch. July 13, 2020)

Jefferies, a 70% controlling stockholder of HomeFed, sought to acquire the remaining 30% of the company's stock by exchanging its own stock for the minority shares. Before engaging with the company, Jefferies negotiated directly with a large minority stockholder. When Jefferies approached the HomeFed board, the board formed a special committee to negotiate the transaction. After a time, the negotiations with the special committee ceased, but Jefferies continued to negotiate directly with the large minority stockholder.

After several months had passed, Jefferies issued a press release offering to acquire all the minority shares. The board "reauthorized" the special committee to negotiate the transaction. Jefferies continued to negotiate with the two largest minority stockholders, who together represented 70% of the company's unaffiliated shares. Ultimately, the special committee authorized these two large minority stockholders to negotiate with Jefferies. After the transaction was approved, the plaintiffs sued. The Court found that the deal did not merit business judgment review under the *MFW* framework. Instead, the entire fairness standard of review applied because the transaction was not conditioned on the approval of a fully-empowered special committee before Jefferies engaged in substantive negotiations.

Takeaways

***MFW's* "ab initio" requirement may be violated by substantive discussions with minority stockholders:** Squeeze-out mergers are typically reviewed under the entire fairness standard. Under *MFW*, however, squeeze-out mergers are evaluated under the business judgment standard if the merger "is conditioned ab initio upon both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders." In this case, the Court found the *MFW* defense did not apply because Jefferies engaged in substantive economic negotiations with the large minority stockholders before it committed to the *MFW* framework. Such negotiations disabled the special committee from acting with full empowerment as required for the *MFW* defense to be effective.

A series of negotiations may be a single act: Jefferies' negotiations for the squeeze-out spanned almost two years. During that time, it broke off and then resumed negotiations with the minority stockholders. Similarly, the special committee ceased negotiations with Jefferies before the board "reauthorized" the committee upon Jefferies' renewed tender offer. Rather than viewing these as separate negotiations for the purposes of determining whether an *MFW* defense was applicable, the Court viewed them as a single negotiation that "paused" before resuming. The Court did not permit Jefferies to "reset" the *MFW* framework by breaking off negotiations and then reengaging with the requirements of *MFW* in place.

In re Dell Technologies Inc. Class V Stockholders Litigation
C.A. No. 2018-0816-JTL (Del. Ch. June 11, 2020)

In 2013, Dell's founder, Michael Dell, teamed up with private equity giant Silver Lake to take Dell private. In 2016, Dell acquired EMC Corporation for $67 billion, in part by issuing new Class V common stock. The Class V stock, which represented only 4% of Dell stock, was designed to track the performance of VMware, a valuable company majority-owned by EMC Corporation. While the Class V stock traded publicly on the New York Stock Exchange, it traded at a steep discount to VMware's stock because Dell retained the right to forcibly convert the Class V shares into another class of Dell stock. Following the acquisition of EMC Corporation, Dell sought to consolidate its newly acquired ownership interest in VMware. It could do so by negotiating to acquire VMware, negotiating to redeem the Class V stock, or exercising its forced conversion rights.

The Dell board formed a special committee to negotiate a redemption or any similar transaction, but the company retained its right to a forced conversion of the stock. Negotiations commenced, and the special committee informed the Class V stockholders that if it could not successfully negotiate for a redemption, Dell would unilaterally force a conversion, which would be unfavorable to the Class V minority owners. When the Class V minority owners rejected the terms of the redemption, the special committee permitted them to negotiate directly with the company. The company then directly communicated the possibility of a forced conversion. Ultimately, the Class V stockholders approved the terms of a redemption of their stock with 61% approval. The Court found that the transaction did not merit business judgment review under *MFW* because the special committee was not fully empowered. Instead, the entire fairness standard of review applied.

Takeaways

The threat of an alternative transaction can disable a special committee and coerce minority stockholders: Channeling Greek mythology, the Court found that the forced conversion was like "the sword of Damocles." While the special committee was free to negotiate the terms of a redemption for the minority stockholders, it conducted negotiations beneath the understanding that the company would force an unfavorable conversion if the negotiations were not on terms the company wanted. Thus, the committee was not fully empowered in its negotiations. Similarly, the Court found that the stockholders approved the redemption with the understanding that if they did not approve, the company would forcibly convert their shares on less favorable terms.

Delegating negotiations may disable a special committee: When the minority stockholders rejected the terms of the redemption negotiated by the special committee, the special committee permitted certain of the stockholders to engage directly with the company. The Court found that by doing so, the committee had conceivably not fulfilled its duties to the minority stockholders. According to the Court, when the committee's negotiated terms were rejected, it had a duty to return to the negotiating table rather than to "pass the baton to a handful of stockholder volunteers." The negotiations directly between the company and the minority stockholders potentially disabled the special committee from fulfilling its role of representing all minority stockholders.

Caremark

Perhaps the most notable development in Delaware corporate law in 2019 was the resurgence of claims that directors had breached their duties of oversight under the doctrine the Court established in *In re Caremark Int'l Inc. Derivative Litigation*. In *Marchand v. Barnhill*, the Delaware Supreme Court reversed a Court of Chancery decision dismissing *Caremark* claims. Just months later, the Court of Chancery denied a motion to dismiss *Caremark* claims in *In re Clovis Oncology, Inc. Derivative Litigation*. In both cases, the courts evaluated whether directors had adequately overseen mission critical risks: product safety for an ice cream company in *Marchand* and compliance with FDA regulations and clinical trial standards for a company developing pharmaceuticals in *Clovis*. Although *Caremark* claims had long been described as the most difficult claim to prove in Delaware corporate law, these decisions caused observers to wonder whether that statement remained true. In 2020, the Court of Chancery considered several more *Caremark* cases, and in doing so built on the concepts elucidated in *Marchand* and *Clovis*, while reaffirming the fundamental principles underlying *Caremark*. A summary of some notable *Caremark* decisions from 2020 follows:

Hughes v. Hu
C.A. No. 2019-0112-JTL (Del. Ch. Apr. 27, 2020)

Kandi Technologies Group, Inc. is a Delaware corporation based in China which sells parts for the manufacture of electric vehicles. During yearly audits from 2011 through 2016, Kandi's auditor identified concerns with respect to certain related-party transactions, but it did not investigate those matters further and often failed to report them to Kandi's audit committee. In 2014, Kandi filed its 2013 10-K and stated therein that its "disclosure controls and procedures were not effective as of December 31, 2013, due to a material weakness." The company announced efforts to fix its deficiencies. However, from May 2014 to August 2016, the audit committee met only five times, each time for an hour or less, and only when required by securities law. In March 2017, the company announced that its financial statements from 2014 through the third quarter of 2016 could not be relied upon and would be restated. The company then disclosed in its 10-K that the company lacked expertise regarding matters such as US GAAP and SEC disclosure requirements and the proper disclosure of related-party transactions.

The Court held that the members of Kandi's audit committee and its CEO faced a substantial likelihood of liability with respect to the asserted *Caremark* claims.

The Court found that the allegations gave rise to the reasonable inference that the audit committee was not devoting adequate time to its work and, when it did, was not devoting attention to important issues.

The Court rejected the company's argument that plaintiff could not meet its burden under *Caremark* because it had an audit committee, audit department, code of ethics, and independent auditor and, therefore, plaintiff was pleading only that monitoring systems already in existence should have been more effective. The Court found that plaintiff's allegations supported an inference that the audit committee never implemented its own system for reporting and monitoring, instead choosing to rely upon management for decisions such as replacing its auditor and the appropriate policies for reviewing related-party transactions, even though management had previously shown it did not accurately report related-party transactions. The Court explained that, while an audit committee can rely upon the reports of management, it cannot blindly defer to and totally rely upon management.

In re GoPro, Inc. Stockholder Derivative Litigation
C.A. No. 2018-0784-JRS (Del. Ch. Apr. 28, 2020)

In early 2016, GoPro, Inc. planned to introduce two new products to the market and provided favorable revenue guidance based on projected sales of both products. When the company faced production difficulties in getting the products to market, its revenue guidance did not change. After release of the products in fall 2016, GoPro faced production ramp-up issues, inventory shortages, higher than expected product returns and ultimately a recall of one of the products. GoPro's board of directors eventually caused GoPro's revenue guidance to be adjusted to account for these problems. The year-end results revealed that GoPro generated $1.185 billion in revenue during 2016, below its updated revenue guidance of $1.25 to $1.3 billion. GoPro's stock suffered a 12% decline in response to the revenue miss.

Plaintiffs alleged that GoPro's board breached their fiduciary duties by approving the issuance of the favorable revenue guidance. While plaintiffs claimed that they were not pleading a *Caremark* claim but instead a false disclosure claim, the Court evaluated their claim under *Caremark* because the allegations sounded like a *Caremark* claim. Plaintiffs focused on the board's review of a "Bull and Base Case," a backwards looking presentation, arguing that the board knew that the revenue guidance was impossible in light of that document and other facts about the new products GoPro was offering. The Court, however, found that the board's consideration of past performance in connection with revenue guidance was a sign that the board was appropriately considering business risk and not acting in bad faith.

Teamsters Local 443 Health Services & Insurance Plan v. Chou
C.A. No. 2019-0816-SG (Del. Ch. Aug. 24, 2020)

In *Chou*, the Court found that plaintiffs had pled that demand was excused under Rule 23.1 because they alleged facts that showed that a majority of the board of directors of AmerisourceBergen faced a substantial likelihood of liability for *Caremark* claims related to operations at Medical Initiatives, Inc. d/b/a Oncology Supply Pharmacy Services ("Pharmacy"), a subsidiary whose sole function was to create pre-filled syringes of oncology drugs for sale and distribution to healthcare providers. AmerisourceBergen closed Pharmacy's business in 2014.

As part of the syringe business, Pharmacy created pre-filled syringes by removing FDA-approved drug products from their original glass vials and repackaging them into single-dose syringes. Plaintiffs alleged that Pharmacy systematically extracted the overfill from FDA-compliant vials and combined the contents from multiple vials, which was then allegedly repackaged into new syringes. Thus, by pooling overfill, the syringe business was able to create more doses than it bought from the original drug manufacturers while avoiding FDA registration. Additionally, plaintiffs alleged that Pharmacy did not obtain valid prescriptions, perform checks for harmful potential drug interactions, see or counsel patients, or maintain records of pertinent information for the patients to whom pre-filled syringes were administered. Moreover, plaintiffs alleged that the vials were prepared in an unclean environment and that the vials were not submitted for required sterility testing.

In 2017, a subsidiary of AmerisourceBergen entered a guilty plea in connection with a Department of Justice investigation of Pharmacy. AmerisourceBergen also announced via an SEC filing that the subsidiary had reached an agreement in principle with the United States Attorney's Office for the Eastern District of New York to resolve civil claims under the False Claims Act.

The Court found that because AmerisourceBergen operated in a highly-regulated business and the syringe business involved compliance with FDA regulations governing the health and safety of drugs, management of those risks at Pharmacy was mission critical. Plaintiffs alleged that the defendants ignored four categories of red flags with regards to those risks: 1) a capital expenditure request for a Pharmacy facility; 2) a law firm report regarding operations at Pharmacy; 3) concerns raised by a Pharmacy employee and the employee's subsequent *qui tam* lawsuit; and 4) an FDA search warrant and Department of Justice subpoena relating to Pharmacy operations. The Court found that plaintiffs had adequately pled that the defendants ignored red flags related to risks at Pharmacy for each category except the capital expenditure request and, therefore, had adequately pled that the directors faced a substantial likelihood of liability under the second prong of *Caremark*. While the Court primarily focused on the second prong of *Caremark*, it also found that plaintiffs' allegations were likely sufficient to show that they stated a claim under the first prong of *Caremark* and that there was not an effective reporting system for mission critical risks at Pharmacy.

Takeaways

Foreign businesses remain a source of *Caremark* claims: While *Hu* was the first case to find that a plaintiff stated valid *Caremark* claims after *Marchand* and *Clovis*, it does not signal that those cases represented a major shift in *Caremark* jurisprudence. Instead, *Hu* is perhaps best understood as one of the types of *Caremark* claim that survived a motion to dismiss prior to *Marchand*: lack of directorial oversight in Chinese businesses that have gained access to the United States capital markets through a reverse merger. In both *Rich v. Yu Kwai Chong*, 66 A.3d 963 (Del. Ch. 2013) and *In re China Agritech, Inc. Shareholder Derivative Litigation*, 2013 WL 2181514 (Del. Ch. May 21, 2013), the Court of Chancery found that plaintiffs had stated *Caremark* claims for China-based companies that did not follow proper oversight procedures. *Hu* illustrates the importance of ensuring that directors of foreign businesses that are incorporated in Delaware understand and meet Delaware's expectations concerning oversight responsibilities.

Directors must focus on business risk, not just regulatory and health risks: The *GoPro* decision highlights that the Court is not just focused on risks in situations concerning regulatory compliance or those concerning the safety of their products, like the risks in *Marchand* and *Clovis*, but that it will also scrutinize directorial oversight of business risks. A responsible board must consider both types of risks and overlooking either type creates the risk that a plaintiff will be able to plead a *Caremark* claim that will survive a motion to dismiss.

***Caremark* is not a substitute for federal securities laws:** *GoPro* also suggests that it will be difficult for plaintiffs to use *Caremark* as an alternative to federal securities law for asserting claims related to forward-looking statements. *Caremark* claims and federal securities law claims frequently have similar elements, and plaintiffs may prefer to try their hand in the Court of Chancery, either to avoid the limitations of the PSLRA or because there are already related pending securities laws claims in federal courts. It is not uncommon for alleged transgressions in *Caremark* claims to also underlie federal securities law claims. Indeed, many decisions evaluating *Caremark* discuss whether the director defendants acted with scienter, which is a requirement for establishing liability for misstatements under Rule 10b-5. Decisions like *GoPro* indicate that the Court of Chancery is cautious when finding actions that show bad faith or scienter. Thus, when it comes to forward-looking statements, plaintiffs will face a heavy burden when trying to show that a board of directors breached their *Caremark* duties, and plaintiffs are unlikely to find that, even post-*Marchand* and *Clovis*, that *Caremark* offers a favorable alternative for their potential securities laws claims.

Past financial reporting, not future performance, must be reliable: *Hu* and *GoPro* provide contrasting examples of how the Court treats inaccuracies in past and future financials. In *Hu*, plaintiff's challenge came to the systems surrounding the reporting of past financial performance, not the conclusions directors reached based on that performance. Whereas, in *GoPro*, the Court found consideration of past performance in connection with revenue guidance was appropriate oversight of business risk, even where the guidance turned out to be wrong. *Hu* confirms that ensuring that the system for monitoring accounting and financial functions so that backwards looking financials are accurate is a necessary part of directors' oversight function. Had the *GoPro* plaintiffs been able to plead similar facts that suggested that the board could not reasonably rely on past performance because the system for reporting that performance was flawed due to failures of directorial oversight or blind deference to management, their claims about the future guidance may have survived.

Mission critical risks are not just for monoline businesses: Both *Marchand* and *Clovis* concerned "mission critical" risks in monoline businesses. In *Chou*, the Court considered "mission critical" risks in the context of a larger company with multiple lines of business. The Court rejected defendants' argument that the *Caremark* claims lacked merit because the pharmacies where the syringe business operated were a small part of AmerisourceBergen. *Chou* confirms that mission critical risks may exist even in relatively small departments or subsidiaries of large corporations, and directors need to ensure effective reporting systems throughout their corporations.

Good oversight requires more than just a response to red flags: In *Chou*, the defendants argued that they did not ignore red flags because board minutes showed that, in response to a law firm report about Pharmacy, the board authorized some remedial measures. The Court rejected that argument because those minutes did not show that the referenced oversight addressed the specific mission critical risks that formed the basis for plaintiffs' allegations. The Court similarly discounted AmerisourceBergen's changes to some of Pharmacy's operations in response to another law firm report when there was no evidence the board followed up to determine if the remedial efforts were successful in addressing mission critical risks. *Chou* demonstrates the importance of not only taking remedial efforts in response to a red flag, but also building a record that shows that the remedial efforts addressed the specific mission critical risks raised by red flags. Moreover, *Chou* reinforces that corporate directors should follow up to determine whether the remedial efforts they took were successful in addressing mission critical risks, and directorial oversight is an ongoing responsibility.

Books and Records

Books and records demands, once little-used "tools at hand," now frequently follow the announcement of many significant corporate transactions. This increase appears to be a by-product of *Trulia* tamping down the availability of pre-closing disclosure claims, while *Corwin* has arguably made it more difficult to pursue post-closing damages claims, particularly in the absence of discovery. Whatever the impetus, in 2020, the courts considered numerous books and records cases and addressed both the right to inspect books and records and the scope of any such inspection. Two of the most notable decisions are discussed below.

AmerisourceBergen Corp. v. Lebanon Cnty. Emps. Ret. Fund et al.
243 A.3d 417 (Del. 2020)

In *AmerisourceBergen*, the Delaware Supreme Court affirmed the Court of Chancery's interlocutory post-trial opinion directing AmerisourceBergen to make certain books and records available for stockholder inspection in response to a Section 220 demand. Plaintiff stockholders sought inspection of the company's books and records to investigate potential wrongdoing arising from government investigations and lawsuits relating to AmerisourceBergen's opioid distribution practices, which had been under investigation by several law enforcement and government agencies. Following trial, the Court of Chancery found that plaintiffs' reliance on the pending government investigations and lawsuits was sufficient to establish a credible basis to suspect potential corporate wrongdoing, and ordered the company to produce formal board materials. Further, the Court of Chancery granted plaintiffs leave to take a Rule 30(b)(6) deposition to obtain information regarding the types and custodians of the records maintained by the company.

Thereafter, the Delaware Supreme Court granted the company's interlocutory appeal on three grounds: (1) whether the Court of Chancery erred in holding that there is no purpose-plus-an-end test requiring plaintiffs to disclose what they ultimately intended to do with the books and records they sought; (2) whether it erred by holding that plaintiffs were not required to establish a credible basis to suspect "actionable wrongdoing"; and (3) whether it erred by granting plaintiffs leave to take a post-trial Rule 30(b)(6) deposition to explore what types of books and records exist and who has them.

In affirming the Court of Chancery's opinion on all three grounds, the Supreme Court reasserted the low burden of proof imposed on plaintiff stockholders seeking to obtain books and records under Delaware law.

Takeaways

Stockholders do not need to state the objectives of their investigations into corporate wrongdoing: Several cases decided before the Court of Chancery's decision in *AmerisourceBergen* held that stockholders must state in their demands what they plan to do with the fruits of their intended inspections. While interpreting the stockholders' demand in this case as stating the objectives of plaintiffs' investigation, the Supreme Court affirmed that, as a matter of law, stockholders who intend to investigate corporate wrongdoing are not required to specify the ends to which they might use the books and records.

Stockholders do not need to show actionable wrongdoing to obtain books and records: The Supreme Court affirmed the Court of Chancery's rejection of merits-based defenses in Section 220 proceedings by ruling that stockholders do not need to show the existence of "actionable wrongdoing" to obtain books and records. *AmerisourceBergen* relied on prior decisions to argue that plaintiffs must necessarily lack a proper purpose for their inspection because any subsequent derivative claim against the company's directors would be legally barred by an exculpatory provision in AmerisourceBergen's certificate of incorporation and by the doctrine of laches. But the Supreme Court made clear that a Section 220 proceeding is not the time for a merits-based assessment of potential claims against a corporation's fiduciaries, and it overruled prior decisions to the extent they could be interpreted to suggest otherwise. Nevertheless, the Supreme Court clarified that a books and records demand may still be denied in cases where a stockholder's sole reason for investigating wrongdoing is to pursue eventual litigation and a purely procedural obstacle—such as standing or the statute of limitations—ensures that any anticipated litigation will be "dead on arrival."

Delaware courts may order discovery into the types and custodians of books and records: The Supreme Court affirmed the Court of Chancery's *sua sponte* decision to grant plaintiffs a post-trial Rule 30(b)(6) deposition to explore the types and custodians of the books and records maintained by AmerisourceBergen. Recognizing the fact-specific nature of determining whether a stockholder is entitled to particular categories of books and records, the Supreme Court found that ordering a Rule 30(b)(6) deposition to explore document types and custodians was a sound exercise of the Court of Chancery's discretion.

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

In *Murfey*, the Delaware Supreme Court reinforced the principle that the contract is king in Delaware alternative entity governance disputes. In a 3-2 opinion, the Delaware Supreme Court reversed and remanded the Court of Chancery's decision that denied limited partners access to certain partnership records after applying a corporate law-imported "necessary and essential" test to the limited partners' books and records request. The Supreme Court focused solely on the contractual right of access afforded to the limited partners by the defendant partnerships' operating agreements in finding that the plaintiff limited partners were entitled to the requested records.

Takeaways

Freedom of contract reigns supreme: Delaware's strong freedom of contract policy in the alternative entity context was on full display in *Murfey*, as a majority of the Supreme Court found it unnecessary to look beyond the four corners of the partnerships' operating agreements in reaching its decision. The Court disagreed with the Court of Chancery's analysis that by largely tracking 6 *Del. C.* § 17-305 (the Delaware Revised Uniform Limited Partnership Act's books and records provisions), including its "proper purpose" requirement, the relevant portion of each partnership's operating agreement invited statutory interpretation, along with incorporation of the judicially-created "necessary and essential" test the Court of Chancery applies in books and records cases under 8 *Del. C.* § 220 and analogous alternative entity statutes. The Supreme Court cautioned against implying contractual terms into a contract that could have expressly provided for such terms.

Corporate law's shadow over alternative entities is shortening: In its opinion, a majority of the Supreme Court specifically noted that whether a "necessary and essential" requirement should be imported from 8 *Del. C.* § 220 into 6 *Del. C.* § 17-305(a) was an issue of first impression, and further noted—in sharp contrast with the Court of Chancery—that no Supreme Court case had applied this requirement in the alternative entity context. The majority's decision in *Murfey* may serve as a signal to the Court of Chancery to draw less influence from corporate concepts when engaging in alternative entity contract interpretation.

Other Notable Decisions

AB Stable VIII LLC v. MAPS Hotels and Resorts One LLC

C.A. No. 2020-0310-JTL (Del. Ch. Nov. 30, 2020)

In *AB Stable*, the Court of Chancery found that a buyer could terminate a merger agreement based on a material breach of the ordinary course covenant caused by a seller's conduct in response to the COVID-19 pandemic. In September 2019, Mirae Asset Financial Group entered into a contract with AB Stable to purchase AB Stable's subsidiary, Strategic Hotels & Resorts LLC, which owns luxury hotels. After signing the merger agreement, in response to the COVID-19 pandemic, AB Stable closed two of its hotels, reduced functioning capacity at the rest of its properties and furloughed or laid off thousands of workers. AB Stable took these actions prior to the government's COVID-19 shutdown orders and without Mirae's formal consent. Although the Court concluded that a carve-out in the MAE for "natural disasters or calamities" precluded Mirae from terminating the merger agreement based on an alleged MAE, it held that Mirae could terminate the agreement based on AB Stable's material breach of its ordinary course covenant.

Takeaways

MAE provisions are read broadly to include COVID-19 impacts: The Court's holding in *AB Stable* is consistent with standard commercial practice and the Delaware courts' history of interpreting MAE carve-outs broadly. Despite the absence of an express carve-out for the impacts of a "pandemic," the Court concluded the effects of the COVID-19 pandemic fell within the MAE's carve-out for "natural disasters or calamities." The Court also rejected Mirae's argument that the MAE exception for "general changes" in a specific industry could not apply because the "root cause" of the changes was a pandemic for which there was no specific pandemic exception. The Court held that the "plain language" of the MAE clause excludes the enumerated effects of a pandemic and "does not require a determination of the root cause of the effect."

Ordinary course covenants are enforced narrowly: In reaching its decision, the Court performed a careful reading of the contract's ordinary course covenant and focused on its language requiring the conduct of the business to be "consistent with past practice in all material respects." This language, according to the Court, rendered irrelevant AB Stable's argument that its conduct in response to the pandemic was reasonable and consistent with that of its peers. The Court noted that the covenant required AB Stable to conduct the business based on its own historical patterns rather than to do "what is ordinary during a pandemic."

The Court suggested that if a seller takes actions as a result of government regulation or order, even if the requisite actions are inconsistent with the past practice of the company, a seller could argue that their actions were taken to comply with law and thus those actions are in the "ordinary course." The Court noted, however, that AB Stable took action to address the pandemic before the government's shutdown orders.

United Food & Commercial Workers Union v. Zuckerberg

C.A. No. 2018-0671-JTL (Del. Ch. Oct. 26, 2020)

In this opinion, the Court of Chancery dismissed plaintiff's claim that the board of directors of Facebook, Inc. breached its fiduciary duties in connection with a stock reclassification proposal that would have allowed Facebook founder Mark Zuckerberg to retain voting control of Facebook even after donating a significant portion of his shares to charitable causes. Plaintiff's suit arose from a proposed stock reclassification that would have allowed Zuckerberg to satisfy his "Giving Pledge" of donating nearly all of his wealth during his lifetime without having to give up his voting control of Facebook. Following board and stockholder approval of the reclassification, certain stockholders sought to prevent the reclassification from closing. Before trial in a prior litigation directly challenging the reclassification proposal, Facebook's board, at Zuckerberg's request, agreed to withdraw the reclassification proposal. The legal expenses of pursuing that litigation and subsequent attorneys' fees totaled more than $80 million. Plaintiff then, in this separate derivative action, brought suit claiming that the board of directors of Facebook breached its fiduciary duties in approving the stock reclassification proposal, failing to recover the money expended defending the proposal, and engaging in actions that caused Facebook reputational damage.

Takeaway

The Court attempted to simplify the often discussed but rarely consequential distinction between demand futility tests: Because plaintiff did not make a pre-suit demand, the Court considered whether demand was futile. Before considering which demand futility test would apply, the Court explained at length the shortcomings of the seminal *Aronson v. Lewis* decision, going so far as to question whether "the time has come to move on from" *Aronson's* demand futility test. "Delaware's evolving jurisprudence" had "dismantled the logic of *Aronson*" and that "[v]iewed on its own terms, *Aronson* is no longer a functional test." The Court further explained that, following the Delaware Supreme Court's decision in *In re Cornerstone Therapeutics Inc. Stockholder Litigation*, 115 A.2d 1173 (Del. 2015), *Aronson's* first prong remained viable, "but only because the requirements for satisfying the first prong of *Aronson* also create a pleading-stage inference that exculpation [pursuant to a Section 102(b)(7) provision] will be unavailable to directors comprising a majority of the [b]oard[,]" and *Aronson*'s second prong remained viable "only in the unlikely event that a corporation lacks a Section 102(b)(7) provision, or to the extent that the particularized factual allegations portray a transaction that is so extreme as to suggest bad faith."

Rales v. Blasband did not suffer from the same shortcomings as *Aronson*. The Court concluded that *Rales* was better suited "as the general demand futility test," as it "refocus[ed] on the decision regarding the litigation demand, rather than the decision being challenged." The Court explained that *Rales* was able to account for a number of situations that *Aronson* would not be able to address, such as the potential conflicts faced by a director who had abstained at the time of the voting on the reclassification but remained on the board of directors at the time litigation was filed and by a director who joined the Facebook board of directors following the approval of the reclassification but before the filing of the litigation. In applying *Rales*, the Court considered, for each director subject to the analysis and based on the subject of the demand, whether such director (i) received a "material personal benefit from the alleged misconduct," (ii) faced "a substantial likelihood of liability on any of the claims," and (iii) lacked "independence from someone who received a material personal benefit from the alleged misconduct" or "who would face a substantial likelihood of liability on any of the claims." For purposes of considering "substantial likelihood of liability," the test also considered the "operative standard of review" and "the potential availability of exculpation."

The Court then interpreted plaintiff's framing of the demand futility argument as whether the board of directors of Facebook could have independently and in a disinterested manner determined whether to "embark on litigation over the [r]eclassification." Based on the allegations in the complaint, the Court made "pro-plaintiff assumptions" that three out of the nine directors could not be disinterested and independent with respect to plaintiff's demand due to, in the case of Zuckerberg, the material benefit he could receive in the reclassification, or, in the case of Sheryl Sandberg and Marc Andreessen, their lack of independence from Zuckerberg. The Court then applied the aforementioned test to five out of the six remaining directors. The Court determined that the five directors did not face a "substantial likelihood of liability," would not receive a "material personal benefit from the alleged misconduct" and were independent from those receiving a "material personal benefit" or facing "a substantial likelihood of liability." Therefore, the Court concluded that demand was not excused and dismissed plaintiff's claim.

Salzberg, et al. v. Sciabacucchi
227 A.3d 102 (Del. 2020)

In *Salzberg*, the Delaware Supreme Court upheld the validity of federal forum provisions ("FFPs") in the charters of two defendant Delaware corporations, which required stockholder plaintiffs to assert claims against the corporations under the Securities Act of 1933 (the "Act") only in the federal district courts of the United States. In so holding, the Supreme Court overturned the Court of Chancery's decision that FFPs were facially invalid as a matter of Delaware law.

The Supreme Court's analysis of the validity of FFPs focused on the "broadly enabling" scope of Section 102(b)(1) of the General Corporation Law of the State of Delaware ("DGCL"), which permits a corporation to include in its charter "[a]ny provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders, or any class of the stockholders, . . . if such provisions are not contrary to the laws of this State." In light of this language and plaintiff's facial challenge to the FFPs, the Supreme Court determined that FFPs "easily" fell within Section 102(b)(1) as they "involve[d] a type of securities claim related to the management of litigation arising out of the Board's disclosures to current and prospective stockholders in connection with an IPO or secondary offering." The Supreme Court also dismissed arguments that FFPs "violate[d] policies or laws" of Delaware, noting that the DGCL authorizes corporations to adopt policies for organizing and regulating their business and that the recent enactment of Section 115 of the DGCL did not limit a corporation's ability to direct claims under the Act only to the federal courts in the United States.

The Supreme Court's decision also discussed the universe of stockholder claims against the corporation that may be regulated by forum provisions. It held that Section 102(b)(1) permitted a regulation of claims beyond those related to "internal affairs" matters of a Delaware corporation. In this broader universe of claims, the Supreme Court determined that FFPs' regulated "intra-corporate affairs" were covered by the text of Section 102(b)(1), and thus enforceable under Delaware law.

Takeaways

Scope of forum selection provisions for certain stockholder claims were further defined: The Delaware Supreme Court's decision in *Salzberg* offers further guidance to practitioners in drafting charter and/or bylaw forum selection provisions for potential claims by stockholders. The decision (i) expressly validates the use of FFPs to regulate the forum for claims under the Act, (ii) reviews the applicability of forum selection provisions under Section 115 of the DGCL for “internal corporate claims” involving a Delaware corporation, and (iii) reiterates that a Delaware corporation would not be able to regulate “external affairs” such as tort claims or commercial contract claims by a charter and/or bylaw forum selection provision.

FFPs, while valid under Delaware law, still face some questions regarding enforceability: *Salzberg* involved a facial challenge to the validity of the FFPs, and the Supreme Court’s decision leaves open, in theory, that FFPs may be found unenforceable “as applied” in the future. In addition, the Supreme Court’s opinion hints that Delaware’s sister states may not enforce FFPs. However, a recent decision by the California Superior Court (*Wong v. Restoration Robotics, Inc.*, No. 18CIV02609 (Cal. Super. Ct., Sept. 1, 2020)) has upheld the enforceability of an FFP as enacted by a Delaware corporation for claims brought under the Act and thus has eased concerns, to some degree, regarding enforceability amongst the states.

Further innovation beyond FFPs to limit the forums for stockholder plaintiff claims is likely to meet resistance by the Delaware courts: While not at issue in *Salzberg*, the Delaware Supreme Court took an additional step to address certain concerns regarding the further limitation of forums for stockholder plaintiff claims. In a footnote, the Delaware Supreme Court noted, as *dicta*, that further attempts to limit the forums in which a stockholder plaintiff could assert “internal corporate claims” to arbitration only would likely violate Section 115 of the DGCL, as both the language of, and legislative commentary to, Section 115 of the DGCL preclude an arbitration only forum selection provision.

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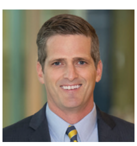

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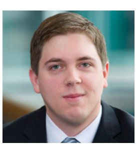

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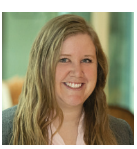

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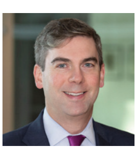

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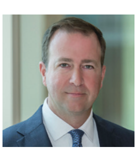

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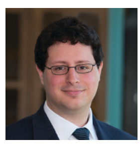

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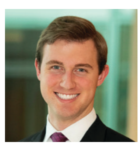

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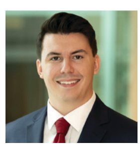

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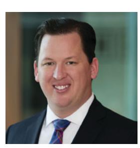

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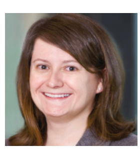

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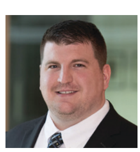

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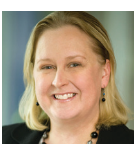

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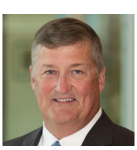

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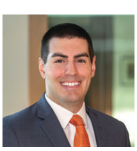

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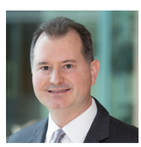

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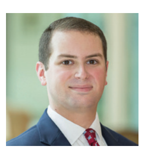

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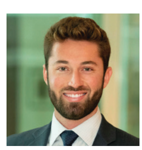

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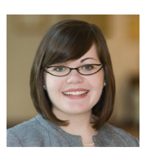

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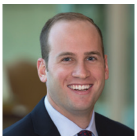

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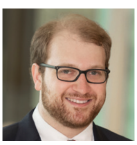

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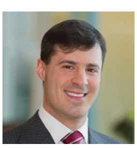

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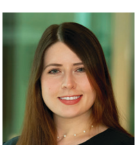

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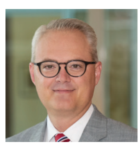

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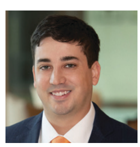

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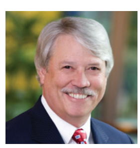

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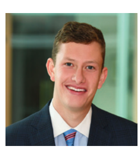

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