Delaware Corporate Law
2022 Year in Review

Potter Anderson Corroon LLP

YOUR DELAWARE ADVANTAGE

2022: DELAWARE CORPORATE JURISPRUDENCE IN REVIEW

2022 was a momentous year for the Court of Chancery. Vice Chancellor Joseph Slights retired after six years in Chancery. The firm thanks Vice Chancellor Slights for his exemplary service as both a Vice Chancellor and as a judge on the Superior Court. Nathan Cook filled the vacancy Vice Chancellor Slights' retirement created. Prior to joining the bench, Vice Chancellor Cook was managing partner of Block & Leviton LLP and represented plaintiffs in many high-profile Chancery matters.

The State also authorized the creation of a third Master in Chancery position, which was filled by Loren Mitchell, previously a Deputy Attorney General at the Delaware Department of Justice. Master Patricia Griffin retired in December, and Bonnie David, previously Counsel at Skadden, Arps, Slate, Meagher, and Flom LLP's Wilmington office, replaced her in January 2023. The ten judicial officers comprise the Court's largest bench ever. The growth of the Court is a welcome development as the Court's caseload increases. In 2022, over 1,200 new actions were filed in the Court of Chancery.

In typical "hands-on" fashion, the Court of Chancery tackled a number of high-profile and cutting-edge cases in 2022. The year began and ended with the attack of the SPACs, with the Court finding that SPACs will be treated like any other Delaware corporation and established standards of review that will apply. The Court also weighed in on hotly contested proxy contests, resolving issues over advance notice bylaws and reaffirming the principle of corporate neutrality for divided boards. Among its many accomplishments was the Court's handling of the Elon Musk-Twitter battle arising from Musk's acquisition of Twitter. Although the case did not proceed to trial, Chancellor McCormick masterfully handled the extraordinary demands placed on the Court by a multiplicity of motions and increased public scrutiny under an expedited time frame. Below we have summarized some of these cases along with the other decisions we view as most notable from 2022 and early 2023.

Looking forward, the Delaware Supreme Court will undergo significant changes, as Governor Carney will need to fill the vacancies resulting from Justice Tamika Montgomery-Reeves appointment to the Third Circuit in December 2022 and Justice James Vaughn, Jr.'s pending retirement in May 2023. The firm thanks both Justice Montgomery-Reeves and Justice Vaughn for their years of dedicated service on both the Supreme Court and the Court of Chancery and Superior Court, respectively.

AmeriSourceBergen Corporation Opioid Cases

On December 30, 2021, plaintiffs filed a derivative complaint against certain directors and officers of AmerisourceBergen Corporation (the "Company") asserting claims related to liabilities the Company incurred relating to the opioid epidemic. Plaintiffs asserted two theories of *Caremark* liability. First, they asserted a claim that defendants had consciously ignored alleged "red flags" regarding non-compliance with anti-diversion laws. Second, they asserted a "*Massey* claim" that defendants allegedly took actions intended to emphasize profitability over legal compliance. In two separate opinions released in December 2022, Vice Chancellor Laster addressed defendants' motion to dismiss arguments. In the first opinion, the Court found that plaintiffs' claims were timely. However, in the second opinion, the Court dismissed plaintiffs' claims in light of a post-trial ruling by the United States District Court for the Southern District of West Virginia, which found that the Company had complied with its drug diversion obligations.

A brief summary of the factual background and the Court's two opinions follow:

Factual Background

The Comprehensive Drug Abuse Prevention and Control Act imposes certain requirements on pharmaceutical distributors regarding controls to prevent the diversion of opioids to disclose suspicious orders. In 2007, the Company worked with the DEA to create industry-wide standards for monitoring orders. As part of this effort, the Company hired outside counsel to evaluate the Company's compliance program. Outside counsel issued a report, reviewed by the Audit Committee in 2010, concluding the Company's compliance program was functioning effectively.

In 2015, the Company implemented a revised order monitoring program (the "Revised OMP"). The Revised OMP created two tiers of order triggers, both of which must fail for an order to be flagged for investigation. Following the implementation of the Revised OMP, the Company's suspicious order reporting levels allegedly decreased. Following lawsuits and government investigations, the Company entered into various settlements, including a $6 billion settlement of multidistrict litigation in 2021.

Lebanon County Employees' Retirement Fund v. Collis

C.A. No. 2021-1118-JTL (Del. Ch. Dec. 15, 2022)
(Vice Chancellor Laster)
(The "Timeliness Opinion")

In this opinion, the Court addressed for the first time the principles of timeliness that apply to red-flags claims and *Massey* claims. In moving to dismiss, defendants had argued, in part, that plaintiffs' *Caremark* claims were untimely under the doctrine of laches. Based on plaintiffs' allegations, the red-flags claim arguably could have extended back to 2012, when investigations and lawsuits first arose. Plaintiffs' *Massey* claims, on the other hand, arguably could have extended back to 2010, when defendants first allegedly adopted an Independent Pharmacy Strategy that, according to plaintiffs, was part of a profits-over-compliance business strategy.

The Court considered three separate approaches to determining when a cause of action accrues for a claim that alleges an ongoing series of decisions and non-decisions, each of which results in a different damages period. First, it considered a "separate accrual" approach that treats them as a "sequence of wrongful acts, each of which gives rise to a separate limitations period." Under that approach, a plaintiff may seek damages for wrongful acts for which the limitations period has not expired. Second, it considered an approach in which the wrongs are treated as a series of discrete acts and the claim accrues as of the date when the series of wrongful acts started. Under that approach, a plaintiff may not be able to obtain any damages if the first wrongful act occurred prior to the relevant limitations period. Third, it considered the "continuing wrong doctrine," in which the cause of action does not accrue until the wrongful acts cease, and the plaintiff can seek damages for the entire period of the alleged wrongdoing.

For the red-flags claim, the Court adopted the separate accrual approach. Though the Court also applied the separate accrual approach to the *Massey* claim, it noted that the continuing wrong doctrine could also apply. However, because the *Massey* claim was timely under either theory, it left this "fundamentally difficult policy question" to a future decisionmaker.

To apply the separate accrual method, the Court looked first to the date the *Caremark* litigation was filed (December 30, 2021) and counted back three years (the analogous limitations period) to December 30, 2018, which would normally be the end of the actionable period. However, because the Court ruled that plaintiffs had diligently pursued a book-and-records demand, the Court held that the date the books-and-records demand was served (May 21, 2019), rather than the date the *Caremark* litigation was filed, could have been used as the relevant date for calculating the statute of limitations period. Notwithstanding this ruling, the Court accepted plaintiffs' proposal to use a later date (October 20, 2019) and established the actionable period as running from October 20, 2016 to December 30, 2022. Using this timeframe, the Court ruled that both claims were timely.

Lebanon County Employees' Retirement Fund v. Collis
C.A. No. 2021-1118-JTL (Del. Ch. Dec. 22, 2022)
(Vice Chancellor Laster)
(The "Dismissal Opinion")

In 2017, nearly 200 opioid-related lawsuits against the Company were consolidated into multidistrict litigation in the United States District Court for the Northern District of Ohio. Among those, a set of cases in West Virginia were remanded to the United States District Court for the Southern District of West Virginia to act as bellwether cases for the lawsuits against distributors. On July 4, 2022, the West Virginia court issued a post-trial decision finding, among other things, that the plaintiffs had not proven that the distributor defendants, including the Company, failed to conduct adequate due diligence regarding suspicious orders or maintain effective anti-diversion controls (the "West Virginia Decision").

The Court found that plaintiffs failed to adequately plead demand excusal for both the red-flags claim and the *Massey* claim. The Court's demand excusal analysis was largely the same for both claims. The Court acknowledged that at the plaintiff-friendly pleadings stage, the allegations supported a reasonable inference that the Company's existing systems were inadequate, and the Company's board (the "Board") consciously decided not to act in response to red flags. However, for purposes of the demand excusal analysis, the Court found persuasive the West Virginia Decision's post-trial findings that the Company's anti-diversion efforts were compliant. The Court explained that, while not preclusive, the findings made it impossible to infer that the Company failed to comply with its regulatory obligations. Thus, the Court could not infer that a majority of the Board knowingly ignored red flags or that its business plan violated the law. For these reasons, the Court found that a majority of the Board did not face substantial likelihood of liability with respect to either the red-flags or *Massey* claims. Therefore, plaintiffs failed to plead demand excusal, and the Court dismissed both claims. As of the time of writing, plaintiffs had filed a notice of appeal in the Delaware Supreme Court and a motion for leave from judgment in the Court of Chancery.

Takeaways:

When Should A *Caremark* Plaintiff File? The two *AmerisourceBergen* opinions create a tension for potential stockholder plaintiffs seeking to assert *Caremark* claims relating to an alleged series of ongoing wrongs. The Court rejected the application of the discrete acts approach to accrual, which would have significantly limited the ability of a *Caremark* plaintiff to assert a claim. By leaving the question of whether the separate accrual or continuing wrongdoing approach applies to *Massey* claims open, plaintiffs asserting *Massey* claims cannot be sure what limitations period applies until the Court provides further guidance. Therefore, a plaintiff may want to file sooner in the event that the Court determines that the less-generous separate accrual approach applies. The application of the separate accrual provision to red-flags claims also may cause a plaintiff to file those claims sooner, as they may not be able to obtain damages for earlier actions that fall outside the limitations period if they wait to file.

The Dismissal Opinion also creates pressure for plaintiffs to file sooner. *Caremark* lawsuits related to corporate trauma are rarely the only lawsuits filed arising from that trauma. If, as the Dismissal Opinion finds, a decision from another lawsuit regarding that same corporate trauma can result in a persuasive finding in the *Caremark* litigation, potential plaintiffs may find themselves wanting to file sooner to reduce the risk of that occurring. However, this can be difficult, as a plaintiff may need a substantial period of time to gather the information necessary to bring a complaint. The plaintiffs in *AmerisourceBergen* did not file derivative litigation until nearly two and a half years after serving their books and records demand. While the Court would have been willing to extend the limitations period due to the plaintiffs' books and records demand, that delay may have impacted the plaintiffs' ability to litigate their claims before the West Virginia litigation. As a result, a stockholder may feel pressure to file suit sooner in order to stay ahead of other litigation, even if they are comfortable that they would survive a laches or statute of limitations defense in accordance with the Timeliness Opinion.

Post-Trial Entire Fairness Opinions

In re Tesla Motors, Inc. Stockholder Litigation
C.A. No. 12711-VCS (Del. Ch. Apr. 27, 2022)
(Vice Chancellor Slights)

In 2016, Tesla Inc., ("Tesla") acquired SolarCity Corporation ("SolarCity") in a $2.6 billion stock-for-stock merger. At that time, Elon Musk owned approximately 22% of Tesla's common stock. Musk was also SolarCity's Chairman of the Board and its largest stockholder. In pursing the acquisition, Tesla's board of directors did not form a special committee to negotiate the transaction, although it conditioned the consummation of any deal on a vote of the majority of Tesla's disinterested stockholders. Tesla and SolarCity executed a merger agreement, and Tesla's stockholders overwhelmingly voted to approve the merger. Shortly thereafter, several Tesla stockholders sued claiming Tesla had overpaid to bail out SolarCity, which they claimed was insolvent, benefiting Musk.

In the post-trial opinion, the Court assumed, for efficiency's sake, that entire fairness would apply, either because Musk was Tesla's controlling stockholder or because a majority of the Tesla board was not disinterested or independent.

Under this framework, the Court first reviewed the evidence regarding the board's deal process. The Court concluded that the negotiation process was "far from perfect," and Musk "was more involved in the process than a conflicted fiduciary should be." For example, Musk had undisclosed communications with SolarCity management about the transaction, participated in the selection of Tesla's deal counsel, and frequently communicated with Tesla's bankers throughout the process. Nonetheless, the Court ruled that the Tesla board implemented a fair process that emulated arm's-length negotiations. In reaching this conclusion, the Court noted that the board selected experienced advisors, used those advisors to extensively and meaningfully vet the acquisition (despite Musk's expressed desire to expedite the acquisition), insisted on a walkaway right in the event that SolarCity breached any debt covenant, used due diligence findings to negotiate for a lower price, only pursued the deal when it was in the interests of Tesla, and also conditioned the approval of the deal on the approval of a majority of Tesla's disinterested stockholders. Therefore, the Court concluded that, despite his conflict of interest and involvement, Musk did not stand in the board's way or impede their work in such a way to "infect" the price it paid.

Regarding price, the Court concluded that the preponderance of the evidence showed that Tesla paid an entirely fair price to purchase SolarCity. The Court found that the discounted cash flow analyses the parties offered were not helpful. Instead, the Court relied on market evidence (including the pre-acquisition SolarCity stock price), Tesla's financial advisor's fairness opinion, projected synergies from the deal, and cashflows from the bonds that SolarCity already issued and would receive over time. The Court also considered the approval by Tesla's stockholders an indication that the deal reflected a fair price. Weighing the evidence, the Court rejected plaintiffs' claim that SolarCity was insolvent (and therefore that any price paid was unfair), and concluded that SolarCity was, at a minimum, worth what Tesla paid for it, and that the acquisition otherwise was highly beneficial to Tesla. Therefore, Musk could not have breached any of his fiduciary duties owed to Tesla or its stockholders. However, the Court did criticize Musk and refused to award him his fees because he could have avoided judicial review by following the principles of good corporate governance for conflict transactions.

Plaintiffs appealed the Court of Chancery's opinion, and argument is currently scheduled for March 29, 2023.

In re BGC Partners, Inc. Derivative Litigation
C.A. No. 2018-0722-LWW (Del. Ch. Aug. 19, 2022)
(Vice Chancellor Will)

In July 2017, BGC Partners, Inc. ("BGC") purchased Berkeley Point Financial, LLC from an affiliate of Cantor Fitzgerald, L.P. ("Cantor") and simultaneously invested $100 million in a Cantor affiliate's mortgage-backed securities business. Plaintiffs filed suit alleging that Howard Lutnick—the controlling stockholder of both BGC and Cantor—and the entities he controlled breached the fiduciary duty of loyalty to BGC's stockholders.

At trial, plaintiffs argued that Lutnick "caused BGC to undertake a deal that benefitted him at the expense of BGC's stockholders" and "that the transaction was a *fait accompli* constructed by Lutnick." Because Lutnick was a conflicted controller, the Court evaluated the claims under the entire fairness standard.

In assessing the fairness of the transaction process, the Court concluded that the process—albeit "imperfect"—was ultimately fair. Lutnick, the conflicted controller, for example, initiated the deal and had incentive to cause BGC to overpay for Berkeley Point given his relative ownership in both entities. Plaintiffs also focused on the effectiveness of the special committee of the board of directors established by BGC's board in connection with the transaction, identifying a number of flaws. The Court found that Lutnick "overstepped" by identifying advisors for the special committee, asking its co-chairs to serve on the committee, and having one-off discussions with committee members. Moreover, the Court noted that "[i]information was slow rolled to the special committee ... [and] [f]inal negotiations unfolded over a compressed time period."

Despite these issues, the Court found that the special committee was independent, effective, and fully empowered, and the process was fair. Lutnick removed himself from the special committee's deliberations, and the timing of the deal did not favor Lutnick or disadvantage BGC's minority stockholders. Moreover, the members of the special committee were each fully engaged and diligent, meeting at least nine times over the three-month negotiation period. The special committee was adequately informed to negotiate the transaction and its advisors were independent. The Court also observed that the special committee meaningfully pushed back on Lutnick when needed and bargained with Cantor, obtaining meaningful concessions. Specifically, the Court found that "[t]he most compelling evidence that the transaction resulted from a fair process [was] the Special Committee's achievement of a deal to acquire 100% of Berkeley Point—the structure it preferred, and the Cantor Defendants disfavored."

As to the fairness of the price, the Court focused on the $875 million initial deal price, rather than the $964.2 million in total value that included pre- and post-closing book value adjustments. The fairness opinion the special committee obtained supported the $875 million deal price and, when also considering expert testimony presented at trial, the Court found the evidence supported a range of fair values for Berkeley Point of $805 million to $1.164 billion. Accordingly, the Court held that the price the special committee agreed to pay for Berkeley Point was in line with what its financial advisor determined to be appropriate and therefore fell within the range of fairness. Applying the unitary standard, the Court found that the transaction satisfied entire fairness.

Plaintiffs appealed the Court of Chancery's opinion, and argument has not yet been scheduled.

Takeaways:

Entire Fairness Is Not A Death Sentence: Entire fairness is the most difficult standard of review for a defendant, but the determination that entire fairness applies is not in all cases outcome determinative. More defendants may be willing to go to trial for claims where they will be subject to entire fairness review in light of the *BGC* and *Tesla* decisions, confident that the Court may reach a similar decision. Controllers may also be willing to forgo procedures that would otherwise result in the application of the business judgment rule under *MFW*. However, parties will still have to weigh the substantial costs in going to trial, as proving entire fairness is fact-intensive and will likely result in significant discovery and expert costs. Failing to follow best practices may also have other consequences, such as the Court's refusal to award Musk fees in *Tesla*.

Process Is Not Fair If It Infects Price: In both *BGC* and *Tesla*, the Court identified process flaws, yet still found entire fairness. This is because the Court was focused on whether the flaws had an impact on the price, not merely whether the process itself was flawed. As the Court said in *Tesla*, Musk "proved that the process did not 'infect' the price." Deal processes rarely are perfect. Counsel for companies and committees should focus on making sure any imperfections do not impact their ability to negotiate the price of the transaction. Litigators representing controllers or director defendants, meanwhile, should focus on showing that any flaws did not impact the ability of the board to negotiate price or the agreed upon price.

Twitter

Few, if any, cases in Delaware have captured the public's attention like the litigation over Elon Musk's purchase of Twitter, Inc. ("Twitter"). In March 2022, Musk began accumulating stock of Twitter, and by April 4, 2022, Musk had acquired over 9% of the outstanding shares of Twitter and agreed to join Twitter's board of directors. Five days later, Musk notified Twitter that he would not be joining the board and would instead be making an offer to take Twitter private. On April 13, he made an offer to acquire the rest of the company for $54.20 per share. Twitter's board initially responded by adopting a poison pill, before negotiating and agreeing to a deal at the offered price. On July 8, 2022, Musk sent a letter to Twitter purporting to terminate the merger agreement. Twitter sued for specific enforcement, seeking to close the deal. During that litigation, Luigi Crispo, a Twitter stockholder, brought a putative class action lawsuit against Musk and the acquisition vehicles he was using to acquire Twitter, alleging that Musk breached the merger agreement. The stockholder also alleged that Musk had breached his purported fiduciary duties owed as a controlling stockholder of Twitter. While the specific performance litigation ultimately was resolved before trial when Musk purchased Twitter, that suit and the related stockholder litigation still produced decisions of interest to corporate practitioners.

Twitter, Inc. v. Musk
C.A. No. 2022-0613-KSJM (Del. Ch. Sept. 13, 2022)
(Chancellor McCormick)

During discovery, Musk asserted attorney-client privilege over communications relating to the transaction that he made on email accounts sponsored by Space Exploration Technology Corp. ("SpaceX") and Tesla, Inc. ("Tesla," together with SpaceX, the "Companies"). In this letter opinion, the Court denied Twitter's motion to compel seeking the production of those communications.

To evaluate whether Musk waived privilege by communicating through these email accounts, the Court considered the four factors set forth in *Asia Global* for determining if use of a third-party email account waives privilege: (i) does the company sponsoring the email account maintain a policy banning personal or other objectionable use, (ii) does the company monitor the use of the employee's computer or e-mail, (iii) do third parties have a right of access to the computer or e-mails, and (iv) did the company notify the employee, or was the employee aware, of the use and monitoring policies.

The Court found the first, and most dominant, factor weighed against production, even though SpaceX and Tesla had policies similar to those favoring production in prior Delaware cases. These policies warned that: (i) employees had no expectation of privacy in their work email accounts; and (ii) the Companies reserved the right to monitor these communications. Here, the Court found this factor weighed against production in light of affidavits Musk submitted, which represented: (i) these policies did not apply to Musk; and (ii) both Companies had adopted "Musk-specific rules," granting Musk "unrestricted" personal use and prohibiting others from accessing his emails without his consent, except "to the extent legally necessary." While acknowledging the self-serving nature of these affidavits, the Court nevertheless found these facts supported the reasonableness of Musk's expectation of privacy, noting the Court had "little doubt that neither SpaceX nor Tesla view [Musk] as on par with other employees."

The Court also found the remaining three factors weighed against production. The Court found the second factor weighed against production because the affidavits represented that neither company had ever monitored, accessed, or reviewed Musk's email except for purposes he had preauthorized or as legally necessary. And, because, in this context, the third factor is considered duplicative of the first two factors, the Court found it also weighed against production. Finally, with respect to the fourth factor, the Court held it also weighed against production because Musk had knowledge of the Companies' policies, including the Musk-specific policies, which "on balance," supported the reasonableness of his expectation of privacy in his work emails.

Takeaways

Courts will consider an individual's position when deciding whether use of a third-party email account waived privilege: Notably, this decision preceded a similar transcript ruling in *In re Madison Square Garden Entertainment Corp. ("MSGE") Stockholders Litigation*, C.A. No. 2021-0504-KSJM (Del. Ch. Nov. 3, 2022) (Transcript), where Chancellor McCormick stated that the *Asia Global* analysis "should take into consideration the email custodians' respective positions within [the companies]" where the custodians at issue were directors and majority owners of the entities sponsoring their work email accounts. In *Twitter*, however, the Court noted that "Musk d[id] not rely on stock ownership or board representation to support his expectation of privacy," suggesting that the Court does not always need to consider the custodian's role in the company to determine that privilege is not waived. If the Court does engage in this analysis, the details of the position are crucial. Serving solely as a senior executive, for example, is not sufficient to avoid waiver. *See In re Info. Mgmt. Servs., Inc. Derivative Litig.*, 81 A.3d 278, 290 (Del. Ch. 2013) (rejecting senior executives' argument that they had "a unique expectation of privacy" and explaining their "expectations of privacy in their work email are no different from any other employee's"); *In re WeWork Litig.*, 2020 WL 7624636, at *3 n.26 (Del. Ch. Dec. 22, 2020) ("[T]his court has rejected the contention that high level employees have a unique expectation of privacy in their corporate email accounts due to the nature of their positions.").

Outside directors should still be wary of using third party email accounts: Many outside directors will use an email account for a third-party entity with which they are affiliated to discuss board matters, including legal matters. While the Court did not find waiver of privilege in *Twitter* and *MSGE*, the unusual circumstances in those cases will not be present for many directors. In *MSGE*, Chancellor McCormick expressed some skepticism that a derivative stockholder suit against a company that did not sponsor the email accounts at issue "[was] a situation in which *Asia Global* should apply," but the law surrounding privilege is still unsettled. The most prudent course for outside directors may be to use a personal account for communications relating to board matters. At minimum, company and committee counsel should advise directors of the risks inherent in using third-party company email accounts, particularly at the outset of major events like M&A processes that are likely to draw litigation.

Crispo v. Musk, et al.
C.A. No. 2022-0666-KSJM (Del Ch. Oct. 11, 2022)
(Chancellor McCormick)

In this decision granting the defendants' motion to dismiss, the Court of Chancery found that the plaintiff stockholder was not a third-party beneficiary to Musk and Twitter's merger agreement for the purpose of seeking specific performance of that agreement. The Court reasoned that because Delaware law imposes pleading hurdles on stockholders who seek to stand in the shoes of a corporation and enforce a corporate contract, deeming stockholders as third-party beneficiaries of corporate contracts risks unsettling the board-centric model by encroaching on the board's authority over litigation assets. The Court recognized that freely granting stockholders third-party beneficiary status under such agreements would result in a "proliferation" of stockholder suits, leading to "inefficiencies both for specific entities and the system as a whole."

Turning to the merger agreement, the Court afforded great weight to the "no third-party beneficiary" provision contained therein, recognizing that it "carve[d]-out" three groups as third-party beneficiaries in certain narrow, inapplicable, circumstances. The Court found that those explicit carveouts suggested that "the parties knew how to confer third-party beneficiary status and deliberately chose not to do so with respect to any unlisted groups." The Court distinguished decisions where (i) the contract granted specific stockholders unique rights, and no other party was in a position to enforce those rights, and (ii) stockholders had independently bargained for the specific provision they sought to enforce.

The Court also rejected plaintiff's other textual arguments for third-party beneficiary standing, in part because the "mechanics provisions" in the agreement were not sufficiently specific as to overcome the "no third-party beneficiaries" provision. However, the Court suggested an "Effect of Termination" clause, which provided that termination would not relieve a party of liability or damages for "the lost stockholder premium," may give plaintiff standing to sue for damages if the merger did not close and invited the parties to submit supplemental briefing on that issue.

The Court rejected plaintiff's argument that Musk, or Musk and others who had signed co-investor letters, controlled Twitter and thus owed fiduciary duties to Twitter's stockholders. Musk individually owned less than 10% of Twitter's stock, did not exercise any contractual rights he had under the merger agreement to veto board action or otherwise assert control, and was only alleged to have a personal relationship with one of eleven members of the Twitter board. Even adding others who had signed co-investor letters, the supposed "group" only had 26.8% of the shares, which by itself was not enough to give rise to an inference of control. Moreover, the Court recognized that Twitter's board had demonstrated its independence by adopting a poison pill, and then sued to specifically enforce the merger agreement. The Court refused "to make multiple logical leaps, as well as ignore the reality [of the parallel litigation] playing out in real time," and dismissed the breach of fiduciary duty claim.

Takeaways

Can stockholders sue for damages under a merger agreement?: While the Court held that Crispo lacked standing to seek specific performance, it did not rule on whether there was standing to seek damages. Instead, the Court outlined the history of provisions providing for liability for lost stockholder premium after *Consolidated Edison, Inc. v. Northeast Utilities*, 426 F.3d 524 (2d Cir. 2005), which found that stockholders did not have standing to sue for lost premium after a failed merger. Because the parties had not had an opportunity to address the issues the Court raised *sua sponte*, and because a damages claim was not ripe, the Court requested supplemental briefing. Ultimately, Musk closed the transaction before the Court could address the issue. Parties to merger agreements that want to avoid giving third-party beneficiary status to stockholders while preserving lost premiums as a form of damages for the target should still consider inclusion of anti-*Consolidated Edison* provisions. However, they should be wary that the Court did not definitively rule on the issue of whether language like that in the Twitter merger agreement would create third-party beneficiary status for stockholders for a damages claim, and it is possible that a future court may find that it does.

Determining controller status is a fact-specific inquiry: Many of plaintiff's arguments that Musk was a controller centered on the dynamics of the merger and merger agreement. For example, plaintiff argued that the Court should consider the total shares owned by investors who signed co-investor letters for the proposed merger, not just Musk's shares. While the Court did not decide whether it should count those shares towards Musk's stake in Twitter, it rejected plaintiff's request as "illogical" that the Court should include the stock that Musk would acquire at the close of the merger for purposes of evaluating if he had control in connection with the close of the merger. The Court also rejected plaintiff's argument that the ordinary course covenants in the merger agreement gave Musk control, because plaintiff could not identify how he used those rights to exercise control over Twitter's board. Instead, the Court found that the hard bargaining leading to the merger agreement, including the adoption of a poison pill, and the contentious litigation after Musk attempted to terminate the merger agreement showed that Musk did not have control over Twitter's board. This ruling further confirms that the Court will reject formalistic assertions that a non-majority stockholder is a controller and instead will take a common-sense approach based on the facts. A plaintiff seeking to assert that someone is a controller in connection with a merger cannot just identify sources of potential control, but it must actually tie those sources to some exercise of control.

Director Independence

Goldstein v. Denner
C.A. No. 2020-1061-JTL (Del. Ch. May 26, 2022)
(Vice Chancellor Laster)

In May 2017, shortly after Bioverativ, Inc. (the "Company") was spun off from Biogen, Inc., Sanofi S.A. ("Sanofi") expressed interest in buying the Company at $90 per share while the stock was trading in the mid-$50s per share. Sanofi approached two Company directors, Alexander Denner and Brian Posner to express its interest. The directors demurred without disclosing the offer to the Company's board of directors (the "Board"). Days later, Denner caused a hedge fund he controls, Sarissa Capital Management L.P. ("Sarissa"), to purchase more than a million shares of Company common stock, in violation of the Company's insider trading policy and without disclosing the same to the Board.

Sanofi approached Denner and Posner again in June and September 2017, but both times Denner and Posner told Sanofi the Company was not for sale, without disclosing Sanofi's interest to the Board. Although Denner stood to profit from a sale of the Company in the range of Sanofi's bid, under the Securities Exchange Act of 1934, Sarissa would have been required to disgorge short-swing profits from a sale taking place within six months of its stock purchase. When Sanofi again approached Denner in October 2017, shortly before the short-swing period closed, Denner invited Sanofi to bid without consulting the rest of the Board. Sanofi's initial offer of $98.50 per share was subsequently raised to $101.50 per share. Thereafter, the Board countered at $105 per share. Notably, at the time of Sanofi's initial offer, the Company's projections from Company management and financial advisors valued the Company at more than $150 per share. Contemporaneous with the negotiations with Sanofi, management created new projections that greatly reduced their valuation of the Company, even though the Company's long-term prospects and business outlook hadn't materially changed.

Plaintiff-stockholders alleged that the Board and certain officers of the Company breached their fiduciary duties during the sale process. The Court first considered whether the claims for breach of fiduciary duty should be dismissed under *Corwin*. Although a majority of the disinterested holders of stock of the Company approved the merger (by tendering their shares in the first-step tender offer), the Court did not apply *Corwin* because plaintiff successfully pleaded that the shareholder approval was not fully informed. In particular, plaintiff adequately alleged misleading disclosures with respect to descriptions of Denner's and Posner's interactions with Sanofi, the failure to disclose Sarissa's purchase of Company stock, and the failure to disclose the Company projections and valuations that valued the Company at a much higher price per share.

Having determined that *Corwin* cleansing was unavailable, the Court then turned to plaintiff's claim for breach of fiduciary duty, applying the enhanced scrutiny standard of review. The Court ultimately determined that it was reasonably conceivable that Denner was conflicted and Denner's conflicts tainted the sale process so that it did not achieve "the best value reasonable available to the stockholders."

The complaint supported a reasonable inference that Denner was self-interested in securing a transaction with Sanofi because he had an interest in a short-term sale and to realize a gain on his insider stock purchases. Denner's past "playbook" of buying stock in a company through Sarissa, using a proxy contest to force his way into the boardroom, recruiting director allies, and pursuing a near-term sale demonstrated a focus on short term investment. This playbook, along with Denner's actions consistent with the playbook, created an inference that Denner acted in furtherance of a short-term strategy to benefit his own hedge fund, rather than the Company and its stockholders. Similarly, Denner's purchase of over a million shares days after Sanofi first approached with an offer supported a reasonable inference that Denner acted to ensure a gain on his stock purchases.

The Court also considered whether the complaint stated non-exculpated claims against other directors and the named officers, including two directors with professional ties to Denner.

While acknowledging that the question of whether the complaint's allegations supported a reasonable inference of non-exculpated claims against Anna Protopapas and Geno Germano presented a "close call," the Court concluded that, at the pleading stage, the complaint adequately stated a claim against both. The Court described its task as determining whether it was reasonably conceivable that the directors in question were independent of Denner or otherwise acted in bad faith to support a transaction that was in the best interests of Denner and Sarissa, rather than in the best interests of the Company and its stockholders. The complaint alleged that Denner had previously nominated Protopapas to serve on the board of directors of another company, which was sold within two years of Protopapas joining the board, netting more than $2 million for her shares and options. Shortly after the sale, Denner caused Protopapas to be appointed to the Company's Board. In addition, the complaint contended that Protopapas was president and CEO of another company in which Sarissa is one of the company's three largest stockholders.

Similarly, in the case of Germano, Denner had secured a director seat for Germano at the Company and, thereafter, at another company, The Medicines Company. Two years after Germano joined the board of The Medicines Company, that company was sold and Germano was paid upwards of $3 million for his shares, options and RSUs. Taken together with allegations in the complaint describing Denner's "practice of rewarding directors with lucrative directorships on other Sarissa-affiliated boards" and the backdrop of a single bidder sale process at a price significantly below the standalone value implied by the original management projections, the Court concluded that the complaint's allegations that the relationships between Denner and Protopapas and Germano caused the directors to fail to act independently were reasonably conceivable.

The complaint also stated claims against officer defendants, John Cox and John Green, for breach of the duty of loyalty related to their role in providing downward revisions to the Company projections while standing to gain personal benefits from the transaction. The complaint likewise stated a claim against Andrea DiFabio for breach of the duty of loyalty for her role in preparing minutes that plaintiff alleged embellished the transaction process.

Takeaways

Past board appointments, and the possibility of future appointments, may call into question a director's independence: While nomination or appointment to a board of directors typically is not sufficient, in and of itself, to challenge a director's independence from the nominating party, it may be possible for plaintiffs to plead facts demonstrating that such appointments are part of a pattern of behavior intended to engender a sense of "owingness." The Court may look at whether the controller has a history of appointing the same individuals to multiple corporate boards. The Court has also adopted this approach in the SPAC context, including in *Multiplan* and *GigAcquisitions3*, where it found that the SPAC's sponsor's history of creating multiple SPACs and selection of repeat directors created a reasonable inference that directors were not independent.

In re Carvana Co. Shareholders Litigation
C.A. No. 2020-0415-KSJM (Del. Ch. June 30, 2022)
(Chancellor McCormick)

As a result of pandemic-related market volatility, the trading price of stock of Carvana Co. ("Carvana" or the "Company") fell from $110 in February 2020 to less than $30 in March 2020. While the trading price of Carvana's stock was depressed, the Company's controlling stockholders— Ernest Garcia II ("Garcia Senior") and his son, Ernest Garcia III ("Garcia Junior" and together with Garcia Senior, the "Garcias")—orchestrated a $600 million direct stock offering, at $45 per share of common stock, to certain handpicked investors, including the Garcias (the "Direct Offering"). Less than two months later, following the announcement of better-than-expected first quarter earnings, Carvana's stock price closed at $97 per share. Shortly thereafter, Garcia Senior entered into a trading plan, enabling him to realize profits from Carvana stock purchased in the Direct Offering.

The stockholder-plaintiffs brought derivative claims alleging that the Garcias breached their fiduciary duties to Carvana in orchestrating the Direct Offering at a price that was below fair value. Garcia Junior and the Company moved to dismiss for failure to plead demand futility and failure to state a claim. The Court of Chancery denied defendants' motions to dismiss for failure to plead demand futility and failure to state a claim, finding that it was reasonably conceivable that the Direct Offering had been orchestrated to take advantage of pandemic-related market volatility to benefit investors hand-selected by Carvana's controlling stockholders. In doing so, the Court provided guidance regarding the types of allegations necessary to establish a director's lack of independence under the recently adopted *Zuckerberg* test.

Focusing on the third prong of the *Zuckerberg* demand futility test, the Court considered whether two allegedly conflicted directors lacked independence from a director who received a material personal benefit from the alleged misconduct that would be a subject of the litigation. The Court concluded that plaintiffs adequately pleaded that the Garcias received material financial benefits from the Direct Offering and that two of Carvana's directors, Sullivan and Platt, lacked independence from the Garcias due to histories of personal and professional ties between each director and the Garcias.

Plaintiffs alleged that Sullivan had a 30-year relationship with Garcia Senior during which he (i) had been employed by Garcia Senior at two different companies, (ii) had been involved in a savings and loan scandal with Garcia Senior that ultimately led to Garcia Senior's felony conviction, (iii) had been censured by the NYSE for actions taken on Garcia Senior's behalf, and (iv) had been involved in a series of business ventures in which Garcia Senior was a co-owner or significant investor. The Court considered whether it was reasonably conceivable that Sullivan "might be incapable of impartially considering a demand to sue the man [Garcia Senior] who allegedly saved his career, helped generate his personal wealth, and financially shores his current livelihood." Taken together, this "constellation of facts" created a reasonable doubt as to Sullivan's ability to objectively consider a demand to pursue litigation against Garcia Senior or, by extension, his son.

Plaintiffs alleged that Platt also had personal and professional ties with the Garcias (although to a degree less significant than Sullivan's) that raised a reasonable doubt as to his independence. Platt had been the relationship banker for the Garcias' companies for decades, during which time the director had served on three of their companies' boards, earning him more than $1 million in compensation in the four years prior to the Direct Offering. Plaintiffs also alleged that Platt made tens of millions of dollars making certain investments in Carvana affiliates that were not available to other directors or the general public and that he employed Garcia Junior following his graduation from college, with Garcia Junior returning the favor by hiring Platt's son as an intern in 2015. Taken together, the Court concluded that plaintiffs had established reasonable doubt that Platt could impartially consider a demand to pursue litigation against the Garcias.

Because Carvana had a six-member board, and that there was no dispute that the Garcias had received personal financial benefits in the Direct Offering, these allegations were sufficient to show demand futility. The Court also refused to dismiss the claim against Garcia Junior, although he abstained from voting on the Direct Offering, because he allegedly "shepherded" the offering from beginning to end "over the course of a few hurried days."

Takeaways

Demand futility is, and remains, a fact-intensive inquiry: The *Carvana* decision does not alter Delaware precedent holding that pleading a director lacks independence requires more than mere allegations of professional relationships, personal friendships, or the potential for some financial benefit. The Court distinguished its holding in *Carvana* from previous decisions, highlighting the "constellation of facts" demonstrating lengthy and close personal and business ties. Demand futility under *Zuckerberg* remains a fact-intensive inquiry.

Plaintiffs may be able to show a lack of independence more easily after potentially career-ending events: Determining whether a director is independent from a controller often focuses on quantifying the materiality of any benefit the director received from the controller. However, other qualitative factors may also influence the analysis. In determining that the complaint adequately pled that Sullivan was not independent from the Garcias, the Court considered that Garcia Senior hired Sullivan to multiple positions after what could have been a "career-ending" censure from the NYSE. Plaintiffs are likely to look for similar instances when evaluating director independence, as it may be easier to plead a sense of owingness when a controller has bestowed a benefit on a director after a potentially career-ending event or equivalent event.

Advance Notice Bylaws and Proxy Contests

Strategic Investment Opportunities LLC v. Lee Enterprises, Inc.

C.A. No. 2021-1089-LWW (Del. Ch. Feb. 14, 2022)
(Vice Chancellor Will)

In November 2021, plaintiff, an affiliate of hedge fund Alden Global Capital ("Alden") and a beneficial owner of stock in Lee Enterprises, Inc. ("Lee"), delivered a notice of director nomination seeking to nominate three individuals for election as directors at Lee's 2022 annual meeting of stockholders. The notice arrived on the last day stockholders could submit director nominations for the then-upcoming meeting, and less than a week after Alden submitted a bid to acquire Lee. Lee's board of directors rejected the nomination notice for failure to comply with Lee's advance notice bylaws. Thereafter, plaintiff filed suit in the Court of Chancery requesting that the Court issue declaratory and injunctive relief permitting its nominees to stand for election at Lee's annual meeting. Following expedited litigation and trial, the Court issued a post-trial decision in favor of Lee.

Lee's advance notice bylaws imposed certain requirements on a stockholder desiring to nominate director candidates for election. Among them were requirements that (1) the nominating stockholder be a stockholder of record at the time a notice of nomination is delivered; and (2) the notice be in proper form, including that such notice include a completed questionnaire in the form provided by the company's secretary within ten days of the request therefor by a stockholder of record.

Four days before the delivery of plaintiff's nomination notice, Alden requested that its broker move 1,000 shares of Lee to book entry form in plaintiff's name, and recognizing that the transfer into record name may not be completed by the advance notice deadline, also requested that its broker arrange for a letter to be executed by Cede & Co. ("Cede") as stockholder of record. The same day, plaintiff – then still only a beneficial owner of Lee common stock – emailed Lee's secretary requesting an electronic copy of the form of questionnaire and written representation and agreement referenced in the bylaws. Lee rejected plaintiff's request for the forms because plaintiff was not a stockholder of record, as required by Lee's advance notice bylaws.

Due to the Thanksgiving holiday, shares were not transferred into the record name of plaintiff before the expiration of the advance notice window. Thus, plaintiff's nomination notice, as submitted, referenced plaintiff as the nominating stockholder, and also included a separate letter from Cede, the record holder of Lee stock, which likewise stated that the nomination was being made by plaintiff, not Cede. The Cede letter referenced a separate letter from plaintiff regarding the nomination, but Cede distanced itself from having any role itself in the nomination. Plaintiff's nomination notice did not include a completed and signed questionnaire from each proposed director nominee in the company's form. At a meeting of Lee's board of directors, the board declared plaintiff's nomination notice invalid and rejected it for failure to comply with the requirements in the company's advance notice bylaws that a nomination notice be submitted by a stockholder of record and that it include the company's form of nominee questionnaire.

Plaintiff advanced claims that the company breached its bylaws and that the board breached its fiduciary duties by rejecting plaintiff's nomination notice. Plaintiff requested that the Court declare that its nominees could stand for election at the 2022 annual meeting and sought a permanent injunction barring Lee from convening and holding the meeting until plaintiff's nominees were included on the ballot. The Court found in favor of the defendants and denied the plaintiff's request for declaratory and injunctive relief.

In rejecting the plaintiff's claim for breach of the bylaws, the Court found that plaintiff failed to comply with the bylaws' clear and unambiguous terms in two ways: (1) plaintiff was not a record holder of Lee stock at the time it delivered the nomination notice, and (2) such notice was not in the proper form because it did not include Lee's nominee questionnaire forms. As to the recordholder requirement, the Court reasoned that Cede, as the record holder, did not make the nomination, as the bylaws require, and the Cede letter did not include the nomination information required by the clear terms of the bylaws. As to the forms requirement, plaintiff conceded that its nominees did not complete a questionnaire on a form provided by the company; the Court rejected plaintiff's excuses for its noncompliance, explaining that the fact that plaintiff requested and did not receive the necessary form for the notice was of no consequence because Lee was only obligated to provide the form upon the written request of a record holder, and plaintiff was not a record holder until six days after the nomination notice was delivered.

Having found that the nomination notice did not comply with the clear and unambiguous requirements of the bylaws, the Court then considered whether the board's rejection of the notice should nevertheless be set aside on equitable grounds. The Court evaluated the board's decision under the enhanced scrutiny standard of judicial review, concluding that the board was justified in rejecting plaintiff's nomination notice. The Court reasoned that plaintiff failed to comply with a validly enacted bylaw that had a legitimate purpose and that "could readily have been satisfied by any stockholder," and the Court found no evidence of manipulative conduct by the board. Noting that the bylaws were validly enacted on a clear day, that the board did not unfairly apply those bylaws or engage in inequitable conduct rendering plaintiff unable to comply therewith, and that plaintiff knew the terms of the bylaws well in advance of the nomination deadline, the Court determined that the board's actions could not constitute a breach of fiduciary duty. The Court further noted that plaintiff's own delay was "what ultimately prevented it from satisfying the Bylaws' record holder (and, by extension, form) requirements."

Accordingly, the Court held that plaintiff did not succeed on the merits of its claims for breach of the bylaws and breach of fiduciary duty, denied its request for declaratory and injunctive relief, and entered judgment in favor of defendants.

Jorgl v. AIM ImmunoTech Inc.
C.A. No. 2022-0669-LWW (Del. Ch. Oct. 28, 2022)
(Vice Chancellor Will)

In *AIM*, the Court of Chancery denied plaintiff's motion for a preliminary mandatory injunction requiring the board of directors (the "Board") of AIM ImmunoTech Inc. ("AIM") to accept plaintiff-stockholder's board nominees and include said nominees on a universal proxy card. The Court concluded that (i) plaintiff's notice of intent to nominate certain board candidates (the "Notice") failed to comply with AIM's bylaws and (ii) plaintiff failed to demonstrate that the Board's rejection of the Notice was inequitable.

Between 2020 and early 2022, several stockholders of AIM engaged in disruptive activities toward AIM, leading to AIM obtaining an injunction from a court in Florida against one of them to prevent interference with AIM's business. In April 2022, one of the stockholders proposed to nominate two Board candidates, including Robert Chioini. The Board rejected the proposal on the grounds that it failed to comply with the Securities Exchange Act, as the SEC subsequently confirmed in a no action letter. Thereafter, the stockholder group recruited plaintiff, requesting that he purchase AIM stock in order to submit a new nomination notice. Two weeks after plaintiff purchased shares of AIM, he submitted the Notice, indicating an intent to nominate two candidates for election at AIM's 2022 annual meeting, one of which candidates was Chioini.

The Board investigated the Notice on suspicion that it was prompted by undisclosed arrangements or understandings given the inclusion of Chioini, the fact that plaintiff had only recently purchased a small number of shares, the fact that neither of the nominees were AIM stockholders, and the Board's knowledge of the recent disruptive activities of certain stockholders. Based on information developed during the investigation, the Board assessed evidence suggesting "that a nameless group was working together 'with the intent o[f] taking control of the company and potentially raiding it or taking other action adverse to the stockholders'" and voted unanimously to reject the Notice after determining that "there was a strong likelihood that the Notice was prompted by undisclosed arrangements or understandings."

The Court first examined whether the Notice complied with AIM's bylaws. The bylaws required, among other things, that a nomination notice include a "description of all arrangements or understandings between such stockholder and each proposed nominee and any other person or persons (including their names) pursuant to which the nomination(s) are to be made." The Court determined that plaintiff's Notice did not satisfy this requirement. Despite plaintiff's argument that "arrangements or understandings" necessarily requires a quid pro quo, the Court determined that AIM's bylaws required plaintiff "to disclose any advance plan, measure taken, or agreement—whether explicit, implicit, or tacit—with any person towards the shared goal of the nomination." The Court observed that plaintiff's Notice was "at least misleading" as a result of the undisclosed involvement of certain persons other than plaintiff and Chioini in certain fee arrangements and the preparation of the Notice.

The Court then considered whether the Board's actions in rejecting the Notice were inequitable. Applying enhanced scrutiny, the Court determined that the corporate objectives served by the advance notice bylaw were not unreasonable. Rather than challenging the Board's intentions in adopting its advance notice bylaw or alleging that the requirements were difficult to comply with, plaintiff questioned the provision's potential breadth and inequity in application if the phrase "arrangements or understandings" is not limited to circumstances where exchanges of promises are made. The Court disagreed noting that the mandate was not unreasonable and that such information would have been material to the stockholders' consideration and ultimate decision on which candidates to support. Likewise, the Court found that the Board's rejection of the Notice may have been a reasonable response in relation to the identified corporate purposes, noting the context in which the Board received the Notice and that the results of the investigation raised questions regarding plaintiff's motives in nominating candidates for election to the Board. Ultimately, the Court stated that the lingering factual questions prevented the Court from granting judgment as a matter of law in plaintiff's favor and denied plaintiff's motion for a preliminary mandatory injunction.

Takeaways

A corporate board should aim to adopt advance notice bylaws on a "clear day" well in advance of any stockholder nomination, rather than in anticipation of or in response to a stockholder nomination: As evidence that Lee's board acted reasonably in enforcing the bylaws and denying plaintiff's nomination notice, the Court of Chancery found persuasive the fact that the bylaws had been adopted long before the board was faced with the imminent threat of Alden's hostile takeover and the accompanying notice from plaintiff. In this context, a board should consider being proactive, rather than reactive. A regular review of the company's bylaws to consider changes as may be necessary or desirable to account for market conditions and takeover trends is advisable.

Clear and unambiguous advance notice bylaws will be enforced by Delaware courts according to their terms – provided that the board does not inequitably manipulate the corporate machinery to impair the rights of stockholders: In both *Lee* and *AIM*, the Court of Chancery noted that any ambiguity in an advance notice bylaw will be resolved in favor of the stockholder's electoral rights. A nominating stockholder must be aware that the plain meaning of words will apply when interpretating a bylaw provision in the absence of a textual definition. Corporate boards should ensure that any advance notice bylaws are written clearly so a stockholder cannot exploit any ambiguities.

However, the Delaware courts' analysis of advance notice bylaws does not stop at whether the nominating stockholder's actions comply with the plain terms of the bylaws. *Schnell* empowers the courts to invalidate a board's decision to reject a nomination (or other proposal) to the extent that the board fails to enforce the bylaw fairly and in furtherance of a legitimate corporate purpose. Notably, such a determination is made under the enhanced scrutiny standard of review, in deference to the inherent conflicts of interest that may arise when an incumbent board of directors rejects dissident nominees.

In re Aerojet Rocketdyne Holdings, Inc.
C.A. No. 2022-0127-LWW (Del. Ch. June 16, 2022)
(Vice Chancellor Will)

In early 2022, the eight-member board of directors of Aerojet Rocketdyne Holdings, Inc. (the "Company") split evenly over the issue of who the Company would put forward as its slate of nominees for the upcoming annual meeting. The split spiraled into a contentious proxy contest that pit three members of the board and the Company's CEO (the "Management Directors") against the remaining four members, one of whom served as the Company's Executive Chairman (the "Chairman Directors"). The Management Directors sought to enlist Company resources and advisors to fight off what they framed as a hostile outside takeover of the Company. In response, the Chairman Directors filed suit in the Court of Chancery, seeking a declaratory judgment regarding corporate neutrality and a temporary restraining order ("TRO") forbidding the Management Directors from using Company resources in the proxy fight. After the Court granted the TRO, the Chairman Directors amended their complaint to seek equitable relief for violations of the TRO by the Management Directors.

In a post-trial opinion, the Court granted the Chairman Directors' request for a declaration that (i) the Management Directors had taken acts unlawfully on behalf of the Company and (ii) the Company must remain neutral in the proxy fight while the board was evenly split because only a majority of the board could authorize or take any action on behalf of the Company. Therefore, when the Management Directors worked with Company management to (i) issue a disparaging press release against the Chairman Directors and (ii) use Company outside counsel to threaten and commence litigation against the Chairman Directors, they acted without board authorization. The Court rejected the Management Directors' arguments that they had been acting in good faith and upon the advice of counsel.

The Court reiterated the principle that a Delaware corporation must remain neutral when a board of directors is evenly split on corporate matters. In this case, neither faction of the board had a valid claim to use the Company's resources – and management could not break the tie. The Court rejected the defendants' arguments that corporate neutrality did not apply to Aerojet due to a threat. There was no unique "threat" to the Company because the Chairman's nomination of a slate of directors was not an attack, but rather corporate democracy in action. Again, the good faith intentions of the Management Directors were irrelevant.

As for the requested equitable relief, the Court granted permanent injunctive relief (effectively making the TRO permanent) and ordered a corrective disclosure by the Company to rescind the unauthorized press release and accompanying SEC filing. The Court additionally voided the retainer payment made to the law firm hired by the Management Directors on behalf of the Company. The Court declined to void any proxies submitted on behalf of the Management Directors in the ongoing proxy fight.

Takeaways

A corporation cannot act if its board is evenly divided: "This case presents a cautionary tale about the perils that can befall a board with an even number of directors." In general, any acts taken on behalf of a corporation must be done with the approval of a majority of its board of directors. Management cannot break the tie of an evenly divided board and actions taken at the behest of less than a majority of the board can be declared invalid, even if taken in good faith. In this circumstance, a Court would likely find attempts by one faction to act on behalf of the company unauthorized and void. No one director, whether the CEO or otherwise, has more say when it comes to board decisions; majority rules unless the charter or bylaws state otherwise.

Corporate neutrality requires a corporation to not act if there is a legitimate question of control: A potential proxy contest is no exception to the rule that a corporation must remain neutral when there is a legitimate question as to who is entitled to act or speak on its behalf. Because half the Aerojet board backed each proxy slate, neither was entitled to the use of company resources, advisors, or employees on their behalf. Consequently, company counsel should be prepared to step aside or stay neutral in the event that a board deadlocks in a proxy contest or finds itself in a similar dispute. Otherwise, counsel risks taking actions that would be unauthorized.

Special Purpose Acquisition Companies

Delman v. GigAcquisitions3, LLC

C.A. No. 2021-0679-LWW (Del. Ch. Jan. 4, 2023)
(Vice Chancellor Will)

In early 2020 GigAcquisitions3, LLC (the "Sponsor") formed GigCapital3, Inc. (the "Company") as a special purpose acquisition company ("SPAC"). Following the Company's IPO, the Sponsor owned approximately 20% of the Company's equity, in the form of founder shares and private placement units. As is typical in a traditional SPAC, the shares held by the Sponsor could not be redeemed, lacked liquidation rights and were subject to a lock-up – unlike the shares held by public holders. Consequently, the Sponsor's shares were virtually worthless unless the Company completed a merger or other business combination within eighteen months of the IPO.

In December 2020, the Company announced a proposed merger with Lightning eMotors Inc. ("Lighting"), an electric vehicle manufacturer. Simultaneously therewith, the Company announced that it had entered into a PIPE subscription agreement and a convertible note subscription agreement, the consummation of which was contingent on the closing of the merger. The terms of the convertible notes were especially creditor-friendly. Ultimately, 29% of public stockholders elected to redeem their shares and 98% of all stockholders voted to approve the merger. Fifteen days after the merger closed, Lightning announced lower than expected revenues and revised its 2021 projections down 12.7%. Notably, the pre-merger proxy included certain projections, prepared by Lighting management, forecasting dramatic revenue growth over the next five years (growing from $9 million in 2020 to over $2 billion in 2025). The stock price tumbled.

Plaintiff sued and alleged that defendants breached their fiduciary duties by issuing a misleading proxy statement, which deprived stockholders of material information necessary to make an informed decision regarding whether to redeem and how to vote, and by prioritizing their own interests in approving an allegedly unfair merger. Building on the Court of Chancery's decision in *In re MultiPlan Corp. S'holders Litig.*, the Court found two independent bases upon which entire fairness review applied: (i) the merger was a conflicted controller transaction because the Sponsor dominated the Company (disproportionate to its 20% stake) and the Sponsor had strong incentives to complete any transaction, even a poor one, that was not shared by the public stockholders, and (ii) a majority of the board was self-interested, due to their interest in the Sponsor, or lacked independence because they had close ties with Avi Katz, a member of the Company's board of directors and the controller and managing member of the Sponsor and/or served serially on other SPACs the Sponsor organized.

Significantly, the Court concluded that *Corwin* cleansing was not available because, among other things, the stockholder vote approving the merger "could not reflect [the Company's] investors' collective economic preferences." The Court observed that the public holders' voting interests were effectively decoupled from their respective economic interests because stockholders could elect to redeem their shares and also vote on the merger. This decoupling of stockholders' voting and economic interests undermines the rationale underlying the Court's normal deference to the stockholders' ratification of a conflicted corporate transaction: the premise that the vote is an expression of stockholders' "collective view" that the merger "serves the corporate goal of stockholder wealth maximization." Because stockholders that have redeemed their shares will not incur economic loss in a value-destroying deal, the vote was afforded no deference under Delaware law.

Lastly, the Court found that the allegations supported an inference that the proxy was materially misleading in two respects: (i) the proxy misstated the net cash per share after accounting for dilution and (ii) the inclusion of Lightning management's rosy projections in the proxy was materially misleading because it was not counterbalanced by impartial information describing realistic expectations for the combined company's growth.

For the reasons set forth above, the Court denied defendants' motion to dismiss.

Takeaways

Traditional elements of SPACs and de-SPACs likely will trigger review under entire fairness: The features of founder shares and the associated incentivization to complete a deal – any deal – together with the influence exercised by sponsors of SPACs likely means that most de-SPAC transactions will be subject to review under the entire fairness standard. Here, the Sponsor's outsized dominance led the Court to conclude that the Sponsor was a controlling stockholder, despite only having a 20% voting interest in the Company. GigAcquisitions3's selection of repeat directors also led the Court to conclude that those directors lacked independence. The Court also concluded that plaintiff adequately pled that the proxy for the de-SPAC merger overstated the net cash to be invested in Lightning after accounting for dilution because of standard costs, including transaction costs and warrants for private placement units and those given to note holders. As a result, the vote was not fully informed.

Decoupling voting and economic interests – inherent in de-SPAC transactions – may nullify application of *Corwin*: The Court concluded that approval of the de-SPAC merger could not cleanse the transaction because stockholders who redeemed their shares were permitted to vote, regardless of the fact that they no longer risked economic loss.

Garfield v. Boxed, Inc.
C.A. No. 2022-0132-MTZ (Del. Ch. Dec. 27, 2022)
(Vice Chancellor Zurn)

The defendant corporation (the "Company") was organized as a SPAC and subsequently merged with Giddy Inc. d/b/a Boxed Inc. Prior to the merger, the defendant was authorized to issue shares of Class A common stock, Class B common stock, and preferred stock. In connection with the merger, the SPAC's stockholders were asked to approve certain amendments to the Company's charter. These amendments, among other things, increased the authorized number of shares of Class A common stock ("Share Increase Amendment") and modified the vote required to increase or decrease the number of authorized shares in the future, as permitted under Section 242(b)(2) of the DGCL (the "Opt-Out Provision Amendment"). The Company's original proxy stated that the approval of the amendments would require "the affirmative vote of the holders of at least a majority of the outstanding [Company] Shares entitled to vote thereon, voting as a single class."

Prior to the vote, plaintiff stockholder sent a pre-suit demand to the Company's board, insisting that the Company's charter and the DGCL required that the proposed charter amendments also be approved by the holders of a majority of the outstanding shares of Class A common stock, voting separately as a class. In response, the Company amended the merger agreement and supplemented the proxy to make the changes plaintiff demanded. The Company's stockholders (including the requisite holders of Class A common stock) subsequently approved both the merger and the proposed charter amendments.

Subsequently, plaintiff filed suit seeking an award of attorney's fees for his work in creating a corporate benefit for the Company and its stockholders. Defendant argued that the claim was not meritorious when filed and that the action did not benefit the Company. In granting summary judgment for plaintiff, the Court rejected both of defendant's arguments.

The Court first evaluated whether plaintiff's demand was meritorious as to the proposed charter amendments. The parties' dispute centered on whether the proposed Share Increase Amendment would have violated Section 242(b)(2) without a class vote of the Class A common stock, the answer to which depended on whether the shares of Class A Common Stock and Class B common stock were separate classes of common stock, or separate series of a single class of common stock. In the Court's analysis, a class vote of the Class A common stock would only be required if Class A and Class B common stock are separate classes of stock, rather than series. In reading the Company's original charter, the Court focused on the provision authorizing the issuance of common stock, which referred to classes of stock, and the absence of language in the charter referring to "Common Stock" as "series." The Court also considered the requirements of Sections 102(a)(4) and 151 of the DGCL and concluded that the plain language of the charter authorized three classes of stock – Class A common, Class B common and preferred, without fixing or authorizing the board to fix any series of common stock. Consequently, the Court held that the Class A common stock was a distinct class, rather than a series, and plaintiff's demand for a class vote of the holders of Class A common stock was meritorious when made.

Next, the Court found that plaintiff's demand had conferred a substantial benefit to the Company and its stockholders. Vindication of the stockholder franchise and ensuring that the Company's charter amendments (and subsequent merger) complied with Delaware law were all material to the Company and its stockholders. The Court observed that by "taking the Company off a path that violated the DGCL and the stockholder franchise, plaintiff conferred a substantial benefit." Plaintiff's preventative action was as beneficial as a corresponding corrective action. The Court therefore awarded $850,000 in attorney's fees and expenses to plaintiff but declined to award a premium.

Takeaways

There is a meaningful difference between the authorization of classes of stock versus series of a class of stock: Drafters of corporate charters should ensure that they are not inadvertently creating separate classes of stock where the intention was to create two or more series of a given class of stock. In turn, practitioners advising corporations with multiple classes of stock should carefully consider whether a particular charter amendment would require a class vote pursuant to Section 242(b)(2). In view of the fact that charters for many SPACs authorize multiple classes of stock, and the fact that most SPAC charters are amended in connection with a de-SPAC transaction, counsel for SPACs should carefully review the SPAC's charter to ensure that the correct votes are sought.

Proactively validating the stockholder franchise provides a substantial benefit to a corporation and its stockholders: A stockholder can seek to invalidate a stockholder vote that violates the DGCL or the corporation's charter. If a stockholder preemptively acts to prevent such a violation, then the Delaware courts likely would find they have conferred a substantial benefit and award fees.

Fiduciary Duty Claims for Ignoring a Demand

Garfield v. Allen, et. al.

C.A. No. 2021-0420-JTL (Del. Ch. May 24, 2022)
(Vice Chancellor Laster)

ODP Corporation ("ODP") adopted, with stockholder approval, an equity incentive plan (the "Plan") in 2019. Under the Plan, certain performance-based equity compensation for top executives would be determined based on the long-term performance of ODP. The total compensation payable under the Plan would not be finally determined until March 2023. However, if ODP's performance would be sufficient to maximize awards, the compensation payable to ODP's CEO would exceed a per-person award limit under the Plan.

In 2021, a stockholder sent a demand letter to ODP's board of directors (the "Board") alleging breaches of the Plan and the Board's fiduciary duty in connection with the issuance of awards and requesting that the Board modify the award to bring it under the Plan cap. The Board refused the demand and declined to make any changes to the Plan itself or any award under the Plan. In response, the stockholder brought claims for breach of contract, unjust enrichment, and breaches of fiduciary duty against the Board and the CEO. Among the claims was a "novel theory" that the Board breached their fiduciary duty by refusing to correct the issue with the Plan award after learning of the award limit issue from the demand letter.

The Court first rejected the Board's and CEO's arguments for dismissal based on ripeness and the business judgment rule because claims for violation of equity limits can be ripe even if the awards have not yet occurred and corporate boards are under an obligation to adhere to the limits of equity award plans. Therefore, the business judgment rule could not apply to a violation of the Plan.

Further, the Court held that an advisory say-on-pay vote did not function as a ratification of the awards.

The Court also allowed the breach of fiduciary duty claim arising from the refusal of the demand letter to survive. However, the Court noted the potential implications of allowing these claims in the future, including attempts to create a new claim to survive a laches defense and "defendant shopping" to bring new board members in as defendants. The Court recognized as a threshold matter that long-standing precedent holds "conscious inaction represents as much of a decision as conscious action." Drawing parallels to *Caremark* claims where plaintiffs allege the board had knowledge of "certain red flags . . . and acted in bad faith by consciously disregarding its duty" to address the potential misconduct and surveying the history of wrongful demand rejection cases under Rule 23.1, the Court found the plaintiff's allegations that the demand letter put the directors on notice of the breach of the Plan and the directors subsequently failed to rectify the breach were sufficient to withstand a 12(b)(6) motion. The Court highlighted that the complaint pled the "likely rare scenario" where all parties to the challenged equity award—namely, the Board and the CEO—had a fiduciary duty to fix the violation, and a different outcome would likely be reached where, for instance, the recipient of the challenged equity awards had no reason to know of the per-person cap.

Takeaways

Equity award caps continue to be a source of "low hanging fruit" in Delaware: Boards should carefully consider the interplay between proposed long-term incentive awards and established limits in equity plans that are adopted at the corporate level. Because these plans and executive compensation are often publicly available, stockholders can readily see when individual or collective awards exceed plan limits. Although a ratification pursuant to Section 204 of the DGCL can retroactively fix many issues, plaintiffs who bring a claim before such a correction can likely move for a mootness fee. Additionally, the overview of recent precedent in *Garfield* makes clear that courts will be skeptical of arrangements to avoid express limits.

Demand refusal may give rise to a standalone cause of action: Although consistently raising concerns about the implications of establishing such a doctrine, the Court in *Garfield* allowed the "novel" theory of demand refusal as a cause of action for breach of fiduciary duty to survive a pleading stage dismissal. Vice Chancellor Laster's stern warnings suggest that these claims will only survive in narrow circumstances, and that the Delaware courts will be skeptical of the use of these claims for some of the more strategic purposes he discussed. However, directors and board advisors should consider the possibility of these claims when evaluating a stockholder demand. If a board is going to reject a demand, it should develop a record sufficient to support that rejection if litigation ensues.

Corporate Officers' Duty Of Oversight

In re McDonald's Corporation Stockholder Derivative Litigation
C.A. No. 2021-0324-JTL (Del. Ch. Jan. 26, 2023)
(Vice Chancellor Laster)

David Fairhurst became McDonald's Corporation's (the "Company") chief human resources officer in 2015 shortly after the Company's promotion of Stephen J. Easterbrook to Chief Executive Officer. Easterbrook, in turn, promoted Fairhurst to Global Chief People Officer, charged with ensuring a safe and respectful workplace. As longtime employees of the Company, Easterbrook and Fairhurst had an existing relationship and allegedly used their new positions to promote and participate in a party atmosphere at the Company's headquarters that emphasized alcohol consumption. Employees complained of inappropriate behavior by male employees—including Easterbrook and Fairhurst—at these events. Human resources ignored these complaints.

Beginning in 2016, the Company faced increased public scrutiny regarding sexual harassment throughout the Company. Dozens of employees filed complaints with the Equal Employment Opportunity Commission ("EEOC") alleging sexual harassment in the Company's restaurants. To bring attention to these complaints, people staged coordinated walkouts in 30 cities across the U.S., resulting in major news coverage.

The public attention to the Company's alleged environment of sexual harassment prompted a December 2018 Senate inquiry. The Company's board of directors concurrently received reports that Fairhurst engaged in sexual harassment at a November 2018 Company event and was accused of other inappropriate behavior in December 2016 that was not officially reported. Despite the Company's zero tolerance policy concerning violations of its code of conduct, the Company entered into a letter agreement with Fairhurst under which any further instances of misconduct would be cause for termination (the "Last Chance Letter").

In 2019, as the Company developed its response to the Senate inquiry, the board received a report outlining the Company's sexual harassment and misconduct issues and its remedial efforts, which Fairhurst participated in developing and implementing. The board fired Easterbrook in October 2019 due to his engagement in a prohibited relationship with an employee. One month later, the board fired Fairhurst for cause. In light of the terms of the Last Chance Letter, the Court found that it was reasonable to infer that Fairhurst's termination was due to further instances of sexual harassment.

In 2022, plaintiffs filed a lawsuit alleging, among other things, that Fairhurst's conduct constituted a breach of his fiduciary duties to the Company. Fairhurst moved to dismiss for failure to state a claim upon which relief can be granted on the grounds that officers do not owe a duty of oversight under Delaware law. As an initial matter, the Court rejected Fairhurst's contention that the plaintiffs' claims alleged only breach of the duty of oversight. The Court clarified that the substance of plaintiffs' allegations also included claims for breach of the duty of loyalty, due to Fairhurst committing sexual harassment.

With respect to the oversight claims, the Court confirmed that corporate officers owe a fiduciary duty of oversight flowing from multiple sources of authority, including (i) the *Caremark* decision's reasoning, which it found logically extended to officers, (ii) the fact that officers share the same duties as directors, (iii) agency principles requiring officers to disclose material information to directors or superior officers, and (iv) the role officers play in corporate oversight structures and the need for accountability to the board. The Court also noted the absence of express authority holding that officers *do not* owe oversight duties. Other than officers with company-wide roles, the Court noted that the scope of officers' oversight duties would generally be limited to such officers' areas of authority (*i.e.,* financial oversight by a chief financial officer, and legal oversight by a chief legal officer). However, the Court clarified that officers would still have a duty to report egregious red flags of which they are aware, even if beyond their area of management.

The Court found that the plaintiffs' oversight allegations against Fairhurst set forth a "red flags claim" under *Caremark* that Fairhurst was aware of sexual harassment issues within the Company, but consciously ignored them. First, the Court explained that plaintiffs had pled facts supporting a reasonable inference that Fairhurst was aware of misconduct at the Company based on, among other things, the number of EEOC complaints filed by employees, the coordinated walkouts, strikes, and ensuing publicity, the fact that Fairhurst himself had engaged in problematic behavior, and the Senate inquiry. Second, the Court found that Fairhurst's own acts of sexual misconduct, which allegedly occurred following each round of EEOC complaints and internal efforts to address the Company's systemic sexual harassment issues, supported an inference that Fairhurst consciously ignored these red flags.

Related, the Court explained that Fairhurst's misconduct and efforts to promote an alcohol-fueled "party atmosphere" bolstered allegations that the human resources department ignored complaints and made employees fear retaliation. Finally, the Court noted the complete lack of any evidence from a prior Section 220 demand on the Company's board to indicate that Fairhurst took any action to report sexual harassment issues to the board before June 2019, by which time the Company was already working on a response to the Senate inquiry. The Court acknowledged that Fairhurst's participation in the Company's 2019 efforts to address sexual harassment may have made it impossible to conclude that Fairhurst ignored red flags beginning in 2019. However, Fairhurst's presumed sexual misconduct in 2019 suggested that Fairhurst continued to turn a blind eye, notwithstanding his participation in the Company's remedial efforts. Ultimately, the Court held that plaintiffs had sufficiently pled a claim against Fairhurst for breach of his duty of oversight.

The Court lastly addressed whether the claim for breach of loyalty based on Fairhurst's own sexual harassment and misconduct could survive the motion to dismiss. The Court held that the claims survive review under Rule 12(b)(6). The Court rejected the contention that a flood of employment-style claims would result from the Court of Chancery hearing sexual harassment claims and explained that the availability of other remedies for sexual harassment does not preclude stockholders from bringing derivative claims based on a fiduciary's sexual misconduct. The Court explained that sexual harassment is bad faith conduct, and bad faith conduct is disloyal conduct, which is actionable under Delaware law. Thus, the Court found that plaintiffs pled sufficient facts regarding Fairhurst's acts of sexual harassment to state a claim for breach of the duty of loyalty.

Takeaways:

Officers owe a duty of oversight: *McDonald's* confirms that corporate officers owe a duty of oversight, although one that is narrower than that which directors owe. Corporate officers should evaluate key risks in their domain and work with their board and corporate advisors to ensure that there is a system for reporting those risks to the board and appropriate board committees. Officers should also note the Court's warnings that they cannot turn a blind eye to egregious risks they become aware of just because they fall within another officer's purview.

Sexual harassment is a risk factor: Corporate boards also should ensure that there are systems for board reporting relating to sexual harassment. While not all instances of sexual harassment may result in harm to the corporation that would justify stockholder claims, boards who turn a blind eye to sexual harassment risks may face *Caremark* claims. Moreover, *McDonald's* suggests that there may be risks in entrusting officers with oversight duties for misconduct when they themselves have been accused of similar misconduct.

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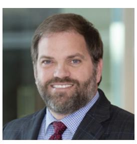

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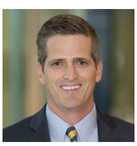

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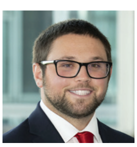

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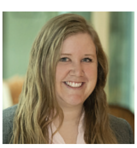

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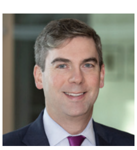

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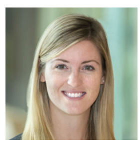

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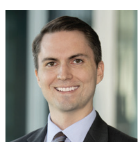

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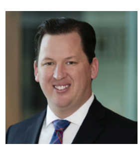

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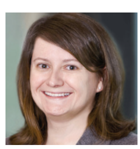

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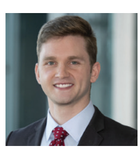

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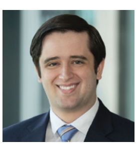

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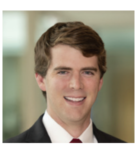

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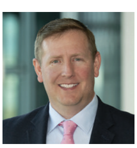

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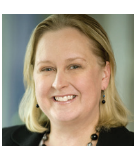

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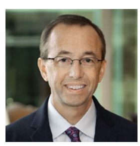

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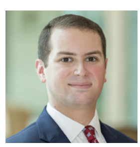

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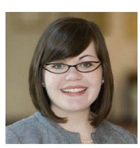

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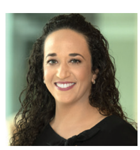

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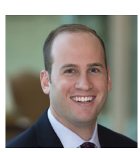

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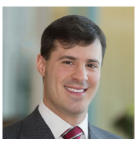

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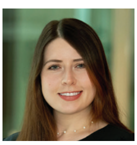

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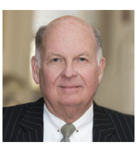

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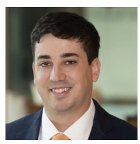

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