Hogan Lovells

2022 securities, shareholder, and M&A litigation outlook

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The outlook for 2022

Despite the ongoing effects of the pandemic, 2021 was an active year for the Delaware courts, which, as described in our quarterly coverage, addressed a number of important issues, at times breaking new ground and making new law. Many of these decisions will continue to shape Delaware law and the courts' docket in 2022. Over the past year, we have observed the following themes in Delaware courts:

- Courts addressed the continued impact of COVID-19, issuing two significant decisions on COVID-19 and M&A transactions;
- Delaware courts continued to address appraisal actions under Section 262, including decisions on "reverse veil piercing" and the viability of a waiver of appraisal rights;
- Delaware courts continued to define the boundaries of *Caremark* claims following the Delaware Supreme Court's decision in *Marchand v. Barnhill* in 2018;
- The Delaware Supreme Court adopted a new universally applicable test for demand futility, while analyzing demand futility in a number of different contexts both before and after the establishment of the new test;
- Delaware courts engaged in many instances of close textual analysis of contracts to resolve matters, weighing in on contract language relating to termination, indemnification, and post-merger dispute resolution; and
- Courts continued to refine key doctrines related to M&A litigation, including dual-natured claims, fraud and fraud carve-out limitations, and the proper standards for assessing conflicted parties and the transactions involving those parties.

Looking to 2022, we expect many of the same trends to continue. For example, we no doubt will see the Delaware courts further explore the new demand futility test, providing insight into the different types of relationships that may affect independence and disinterestedness. *Caremark* claims also likely will continue to be an area of focus, especially as stockholders and regulators continue to focus on ESG-related issues. In addition, 2021 has firmly demonstrated that the Delaware courts are not hesitant to review core doctrines and make necessary changes – or jettison prior cases entirely, such as in the case of dual-natured *Gentile* claims.

We anticipate that 2022 will be no different, and that the courts will continue to look at all of the key doctrines and make adjustments, including in light of the pandemic and other world events as well as shifting priorities of market participants. Finally, the courts in 2022 will face new challenges arising from important developments on the transactional side, such as the implications from the rise in the use of SPACs in M&A transactions and increased regulatory scrutiny of deals from the Federal Trade Commission (FTC) and Department of Justice (DOJ).

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Executive summary

COVID-19 and M&A transactions

In 2020, Delaware courts issued two significant decisions on whether the COVID-19 pandemic constituted a material adverse effect (MAE), one of which was *AB Stable*. In late 2021, the Delaware Supreme Court, sitting *en banc*, affirmed the Court of Chancery's decision in *AB Stable*. The Court held that the seller's obligation to conduct its hotel business "only in the ordinary course of business consistent with past practice in all material respects" meant that the seller had to run the business consistent with its "operational history" irrespective of what other reasonable hotel operators were doing. The Court also held that the agreement's MAE clause did not modify the ordinary course covenant because MAE clauses address valuation risk, not operational changes.

In *Snow Phipps Group v. KCAKE Acquisition*, the Delaware Court of Chancery rejected the buyer's argument that the impact of COVID-19 was reasonably expected to constitute an MAE and instead ordered specific performance because the buyer failed to use reasonable best efforts to obtain appropriate financing.

The Williams Companies Stockholder Litigation addressed a different COVID-19 issue. There, the Delaware Court of Chancery enjoined a publicly traded energy company from implementing a "poison pill" stockholder rights plan adopted at the outset of the COVID-19 pandemic. Applying the *Unocal* standard, the Court found that generalized concerns regarding shareholder activism were inadequate to establish a threat to the corporate enterprise and that the poison pill had features – including its five percent trigger – that were "extreme" and "unprecedented" and which did not bear a reasonable relationship to the threat posed.

The outlook for 2022

We anticipate that courts will continue to deal with COVID-19-related issues into 2022 and beyond.

Appraisal

In 2021, the Delaware courts addressed three key aspects of appraisal actions:

1. whether the right to appraisal can be waived;
2. the preference for a deal-price-minus-synergies approach; and
3. what party is responsible for damages awarded in an appraisal action.

In *Manti Holdings*, the Delaware Supreme Court concluded that both the Delaware General Corporation Law and public policy permitted an *ex ante* waiver of appraisal rights in a stockholder agreement. The Court's analysis presents the possibility, although not a certainty, that appraisal waivers will be upheld in other similar contexts.

In *In re Appraisal of Regal*, the court reiterated its preference for market-based indicators of value over discounted cash flow valuations.

In *Manichaean Capital*, the Court of Chancery ruled as a matter of first impression in Delaware that plaintiffs could pursue "reverse veil piercing" claims against the subsidiaries of a corporate defendant accused of abusing the corporate form to avoid paying an appraisal judgment.

The court left open whether controllers, rather than third parties, could also bring reverse veil piercing claims.

Caremark

The Delaware courts added two significant opinions to the growing line of *Caremark* cases following *Marchand v. Barnhill*.

In *In re The Boeing Company*, the Delaware Court of Chancery denied a motion to dismiss a *Caremark* claim based on safety issues with Boeing's 737 MAX. The court found that the plaintiffs had adequately alleged "the directors' complete failure to establish a reporting system for airplane safety" and "their turning a blind eye to a red flag representing airplane safety problems." In addition, the court found that the directors "face[d] a substantial likelihood of liability for Boeing's losses," and thus held that demand on the board was futile.

Shortly after *Boeing*, the Delaware Court of Chancery reminded litigants that, notwithstanding the recent line of cases beginning with *Marchand*, there remains a "high threshold that a plaintiff must meet to plead a *Caremark* claim." In *Firemen's Retirement System of St. Louis v. Sorenson*, the court dismissed a *Caremark* claim against Marriott executives and directors predicated on a cyberattack that exposed the personal information of Marriott guests. Finding that the board's "flawed effort" to address data security risks in its reservation database was not a deliberate failure to act in the face of red flags or knowledge of positive law violations, the Court of Chancery found that the allegations did not meet the high bar required to state a *Caremark* claim and that demand was not excused.

Demand futility

In late 2022, the Delaware Supreme Court adopted a new, three-part test for determining when a shareholder is required to make a pre-suit demand on a corporation's board before pursuing derivative claims on behalf of a corporation. The test shifted the focus to "the decision regarding the litigation demand, rather than the decision being challenged" and looks on a "director-by-director basis" at:

1. whether the director received a material personal benefit from the alleged misconduct;
2. whether the director would face a substantial likelihood of liability on any of the claims that would be the subject of the litigation demand; and
3. whether the director lacks independence from someone covered by prongs one and two.

The test was quickly put to use in *In re Kraft Heinz*. There, the Delaware Court of Chancery dismissed the complaint on demand futility grounds, finding a majority of the board to be disinterested and independent after a director-by-director analysis. In particular, the court rejected the argument that potentially biasing factors, such as personal relationships and voting agreements between large shareholders, were sufficient to constitute "material personal benefit" or show a lack of independence.

Contract analysis

In 2021, the Delaware courts engaged in several notable analyses of M&A and other contracts. For example, in *Yatra Online v. Ebix*, the court ruled that the defendant was not liable post-termination because the plain language of the agreement stated that "[i]n the event of termination . . . there shall be no liability on the part of any party."

Similarly, in *LDC Parent*, the Delaware Superior Court held that a post-closing purchase price adjustment dispute had to be resolved by an accounting firm rather than a court based on the plain language of the parties' purchase agreement.

In *Blue Cube Spinco v. Dow Chemical*, the court found provisions concerning indemnification were ambiguous and could not be interpreted without discovery because the disclaimer also contained an exception stating it did not apply to the extent it was inconsistent with other provisions.

Finally, in *RSUI Indemnity Co. v. Murdock*, the Delaware Supreme Court upheld on appeal the lower court's decision finding the D&O insurance carrier for Dole Food Company, Inc. liable for the full US$10 million limit of Dole's insurance policy. In doing so, the court rejected the argument that claims settled by Dole, which included allegations of fraud, were not covered by the policy either as a matter of public policy or under the language of the policy.

Refinement of key M&A doctrines

Delaware courts also focused on further refining key M&A doctrines, both by revising guiding principles and by engaging in textual analysis of contracts.

The most significant shift in key M&A doctrines was the Delaware Supreme Court's decision to overturn *Gentile v. Rossette* and eliminate the "*Gentile* carve-out" that permitted certain stockholders claims to be both direct and derivative in nature. The Delaware Supreme Court found that portions of *Gentile* were in conflict with the Court's 2004 decision in *Tooley v. Donaldson, Lufkin & Jenrette* which, properly read, rendered *Gentile* carve-out superfluous.

The Delaware courts also addressed the issue of fraud and fraud carve-out limitations in contracts. In *Express Scripts, Inc. v. Bracket Holdings Corp.*, the Delaware Supreme Court invalidated a US$82 million jury verdict and ordered a retrial on an M&A buyer's claim for fraud by the seller, finding that where a purchase agreement limited fraud claims to "deliberate" fraud, it was error to allow the jury to find liability based on reckless fraud.

In *Online HealthNow*, the Delaware Court of Chancery extended a recent line of cases declining to enforce seller-friendly provisions limiting claims by buyers for fraudulent misrepresentations within the contract. The court found that the "remarkably robust" seller protections in the agreement did not bar claims for fraud within the contract itself because a party "cannot invoke a clause in a contract allegedly procured by fraud to eviscerate a claim that the contract itself is an instrument of fraud."

The Delaware courts also weighed in on important issues relating to the proper review of potentially conflicted mergers. In *In re Pattern Energy Group*, the Delaware Court of Chancery declined to dismiss putative shareholder class claims for breach of fiduciary duty against the officers and directors of Pattern Energy Group Inc. because the bidder selected was not the highest bidder, even though the court acknowledged that the sale process "was run by an undisputedly disinterested and independent special committee that recognized and nominally managed conflicts, proceeded with advice from an unconflicted banker and counsel, and conducted a lengthy process attracting tens of suitors that the special committee pressed for value."

In *Flannery v. Genomic Health*, the Court of Chancery addressed a mixed consideration deal, declining to apply entire fairness review because certain entities were not controlling or conflicted, and found that *Revlon* duties were not triggered because the company "stay[ed] in a large, fluid, changeable and changing public market."

In *Tilray, Inc.*, the court denied the defendants' motions to dismiss for demand futility and for failure to state a claim, finding that the plaintiffs adequately alleged that a control group existed and engaged in a self-dealing transaction, and that the plaintiffs alleged with particularity that demand was excused.

Finally, in *Rosenbaum v. CytoDyn*, the court declined to apply either enhanced scrutiny or the business judgment rule to an incumbent board's rejection of shareholders' proposed board nominees based on noncompliance with an advance notice bylaw, instead choosing to rely on equitable principles.

Outlook for 2022

While Delaware leads the field in the development and analysis of M&A matters, courts around the country weighed in on important M&A issues in 2021, and we anticipate that they will continue to do so in 2022. For example, the Fourth Circuit upheld the Eastern District of Virginia's decision to, for the first time, permit a private antitrust plaintiff to force a defendant to unwind a completed merger. In *Steves and Sons, Inc. v. JELD-WEN, Inc.*, JELD-WEN, a supplier and competitor of plaintiff Steves and Sons, Inc., was ordered to divest the assets it acquired in a 2012 merger, which had resulted in a duopoly of vertically integrated manufacturers that expressed intent to use their market power to put competitors out of business.

COVID-19 and M&A transactions

The Williams Companies Stockholder Litigation: Court rejects 'extreme' and 'unprecedented' poison pill

Why it is important

In *The Williams Companies Stockholder Litigation* (C.A. No. 2020-0707-KSJM (Del. Ch. Feb. 26, 2021)), the Delaware Court of Chancery enjoined a publicly traded energy company from implementing a "poison pill" stockholder rights plan adopted at the outset of the COVID-19 pandemic in response to extreme market volatility and a global oil price war.

Applying the *Unocal* standard, the court found that generalized concerns regarding shareholder activism were inadequate to establish a threat to the corporate enterprise, but assumed, without deciding, that concerns regarding "lightning strike attacks" – where stockholders accumulate large stakes before triggering Schedule 13D filing obligations – could rise to the level of a credible threat. Nonetheless, the court invalidated the poison pill because its features – including its five percent trigger – were "extreme" and "unprecedented" and did not bear a reasonable relationship to the threat posed. Although the ruling does not alter precedent permitting the adoption of more traditional pills in response to specific threats, the ruling illustrates that Delaware courts will view poison pills enacted in response to generalized threats with skepticism, and will strike down pills that are not proportionate to an actual or emerging threat.

Summary

In March of 2020, The Williams Company (Williams), a publicly traded natural gas infrastructure company, adopted a poison pill stockholders rights plan (the Plan) that contained a five percent trigger and a broad "acting in concert" definition that gave the board discretion to aggregate stockholders' shares for purposes of the five percent trigger. Under the Plan, Williams could determine that shareholders were working towards a "common goal" about "changing or influencing" the company without also having to find that the stockholders entered into an "express agreement, arrangement or understanding."

The court struck down the Plan, finding it to be an outlier when compared to other recently adopted poison pills. The court applied the "two-part inquiry" set out in the Delaware Supreme Court's ruling in *Unocal Corp. v. Mesa Petroleum Co.*, "asking first whether the board had reasonable grounds for identifying a threat to the corporate enterprise and second whether the response was reasonable in relation to the threat posed."

The court found Williams' first two justifications for the Plan – preventing stockholder activism during a time of market uncertainty and the apprehension that hypothetical activists might pursue "short-term" agendas or distract management – were insufficient under Delaware law. But the court assumed without deciding that Williams' third justification for the Plan – concerns that activists might stealthily and rapidly accumulate over five percent of Williams stock – might be sufficient under *Unocal*.

Turning to the second prong of *Unocal*, however, the court found that the Plan was not a "reasonable" response to this threat. In particular, the court found that the Plan's five percent trigger was "extreme" and "unprecedented" as compared to the normal 10-15 percent triggers in other poison pills. The court also found that the Plan's "acting in concert" definition was too broad, sweeping in a variety of benign shareholder activities. These features combined to make a poison pill that was more severe than was necessary under the circumstances.

Snow Phipps Group v. KCAKE Acquisition: DE addresses MAE based on COVID-19 impact

Why it is important

In *Snow Phipps Group, LLC v. KCAKE Acquisition, Inc.* (C.A. No. 2020-0282-KSJM), the Delaware Court of Chancery ordered specific performance of a US$550 million acquisition, rejecting the buyer's argument that the impact of COVID-19 was reasonably expected to constitute a materially adverse event (MAE). The court found specific performance appropriate because the plaintiff failed to use reasonable best efforts to obtain appropriate financing, including making unreasonable demands of the potential lenders. Ultimately, the court characterized its decision as a "victory for deal certainty," reaffirming that Delaware courts set a high bar for purchasers seeking to terminate an acquisition agreement on the basis of an MAE. The holding demonstrates that while other deal parties recently were able to demonstrate MAEs, including *AB Stable VIII LLC* and *Akorn*, the burden to do so remains high and requires a "persistent and sustained" failure in an acquisition target's business.

Summary

On March 6, 2020, at the outset of the COVID-19 pandemic in the United States, an affiliate of Kohlberg & Company, LLC (Kohlberg) entered into an agreement with Snow Phipps Group, LLC (Snow Phipps) to acquire DecoPac Holdings Inc. (DecoPac), a company that sells cake-decorating ingredients and products to supermarket bakeries. Within weeks, following widespread government-mandated shutdowns that caused DecoPac's sales to plummet, the buyers "lost their appetite for the deal."

While DecoPac's executives believed that its sales would rebound, Kohlberg did not. Rejecting the projections it requested from DecoPac – and that DecoPac "painstaking[ly]" prepared as "illogically optimistic," Kohlberg prepared its own projections forecasting precipitous declines in DecoPac's performance during the pandemic based on "simplistic assumptions." Kohlberg then shared its own projections, not the DecoPac projections, with lenders and demanded changes to the financing. The lenders rejected the demands. After Kohlberg told Snow Phipps that it would not proceed to closing, Snow Phipps sued for specific performance, and Kohlberg counterclaimed.

After a five-day trial, the court rejected on multiple bases Kohlberg's argument that DecoPac's performance in the early days of the pandemic would reasonably be expected to ripen into an MAE, thereby permitting termination of the share purchase agreement (SPA). First, Kohlberg failed to establish the existence of an MAE, as DecoPac's steep decline in performance in the early days of the pandemic had begun to rebound in the weeks prior to termination, and the company was projected to continue its recovery. Second, the plaintiffs established that the vast majority of the performance decline was causally linked to government shutdown orders. Therefore, the effects of COVID-19 fell within an enumerated carveout of the SPA. Third, Kohlberg did not show that DecoPac suffered a disproportionate impact relative to its industry peers.

After rejecting Kohlberg's MAE claim, the court dismissed an alternative argument by Kohlberg that Snow Phipps had breached its covenant to continue operating the DecoPac business in the ordinary course.

Having rejected Kohlberg's excuses not to close, the court found in favor of Snow Phipps on its counterclaim, concluding that Kohlberg breached its obligation to use reasonable best efforts to obtain financing. The court ordered specific performance of the US$550 million acquisition, as stipulated in the SPA, "[c]halking up a victory for deal certainty."

In its opinion, the court resolved several fact issues even though it ultimately concluded that those fact issues need not be resolved in light of the clear contract language. Of note, however, was the court's rejection of Kohlberg's argument that, because it did not agree to Snow Phipps' proposals that "epidemics" and "pandemic" be added to the definition of MAE, it conclusively allocated to DecoPac potential unknown risks of the pandemic. Instead, the court found based on documents and testimony that Kohlberg did not want to be the "first private equity firm that plays in the middle market space to have that language in the MAE" and that DecoPac "never would have agreed to the transaction if [it] believed that by sticking to the [Kohlberg] MAE definition, Kohlberg was shifting COVID-19 demand risk to [DecoPac]."

AB Stable v. MAPS Hotels: Pandemic changes to hotel operations breach ordinary course covenant

Why it is important

In *AB Stable VIII LLC v. MAPS Hotels and Resorts One LLC* (No. 71, 2021 (Del. Dec. 8, 2021)), the Delaware Supreme Court, sitting en banc, affirmed a Court of Chancery judgment finding that a hotel owner violated its ordinary course covenant in a US$5.8 billion Sale and Purchase Agreement by making "drastic changes to its hotel operations" in response to the COVID-19 pandemic. The court held that the seller's obligation to conduct its hotel business "only in the ordinary course of business consistent with past practice in all material respects" meant that the seller had to run the business consistent with its "operational history" irrespective of what other reasonable hotel operators were doing. The court also held that the agreement's MAE clause did not modify the ordinary course covenant, even if it allocated pandemic risks to the buyer as the seller claimed, because MAE clauses address valuation risk, not operational changes.

Summary

MAPS Hotel and Resorts One LLC (the Buyer) agreed to purchase 15 hotel properties from AB Stable VIII LLC (the Seller) for US$5.8 billion in September 2019 pursuant to a Sale and Purchase Agreement (the SPA). For a number of reasons, closing was delayed and did not occur before the onset of the COVID-19 pandemic and associated lockdowns, which had a significant effect on the hotel industry. The Seller responded to the pandemic by "temporarily closing two hotels (one ahead of its normal seasonal closing), operating other hotels at 16 reduced staffing, and pausing all non-essential capital spending," among other things. The Seller sought the Buyer's consent while maintaining that consent was not required, but did not respond when the Buyer requested additional information in connection with the Seller's request. The Seller sought to compel the Buyer to close after the Buyer refused to do so. At trial, the Court of Chancery ruled that the Seller had breached the ordinary course covenant and that the Buyer could not be compelled to close (previously covered here).

The Delaware Supreme Court, sitting en banc, affirmed. It found that the Seller's actions in response to the COVID-19 pandemic, which it termed "drastic," violated the Seller's covenant to operate the subject business "only in the ordinary course of business, consistent with past practice in all material respects." The court held that it did not matter whether the Seller's response to the pandemic was reasonable, or whether it was consistent with the way other hotel operators were responding to the pandemic, because under the covenant "compliance is measured by its operational history, and not that of the industry in which it operates." The court also noted that the ordinary course covenant did not contain any reasonableness qualifiers, such as language allowing the Seller to operate in the ordinary course where commercially reasonable to do so. The court concluded that although "Seller could have timely sought the Buyer's approval before making drastic changes to its hotel operations, approval which could not be unreasonably withheld. . . [h]aving failed to do so, the Seller breached the Ordinary Course Covenant
and excused the Buyer from closing."

The court also rejected the seller's argument that the ordinary course covenant should be read to permit pandemic-related changes because the SPA's "material adverse effect" (MAE) provision allocated all risks associated with the pandemic to the Buyer. The MAE provision included a carve out for "natural disasters and calamities," which the parties did not dispute covered the pandemic for purposes of the appeal. However, the court held that the SPA "distinguishes between the question of whether the business operated in the ordinary course and whether the business suffered a Material Adverse Effect, and it makes the former irrelevant to the latter." Specifically, the SPA included a requirement that the Seller attest that no MAE had occurred, "whether or not in the ordinary course of business." The court also noted that the ordinary course covenant included a materiality qualifier rather than an MAE qualifier, which the court found "shows that the parties intended the provisions to act independently" because an MAE standard is "much higher" and "analytically distinct" from a materiality standard. Finally, the court held that "an ordinary course covenant and MAE provision serve different purposes."

Ordinary course covenants are "included to reassure the Buyer that the target company has not materially changed its business or business practices during the pendency of the transaction," while an "MAE provision, by contrast, allocates the risk of changes in the target company's valuation."

Finally, the court rejected the Seller's argument that it was not "required to run the business into the ground by continuing to operate in the ordinary course of business," noting that the Seller should have sought the Buyer's consent, which could not be unreasonably withheld under the SPA.

Appraisal

Manti Holdings: Delaware Supreme Court permits advance waiver of appraisal rights

Why it is important

In *Manti Holdings* (No. 354, 2020 (Del. Sept. 13, 2021)), the Delaware Supreme Court affirmed a decision that a corporation can enforce an advance waiver of appraisal rights against its stockholders. In a stockholders agreement, the petitioners agreed to "refrain from the exercise of appraisal rights. . ." The Delaware Supreme Court concluded that both the Delaware General Corporation Law (DGCL) and public policy permitted an ex ante waiver of appraisal rights in a stockholder agreement specifically (as opposed to in a company's charter or bylaws), finding that the DGCL is a "broad enabling act" that "allows immense freedom for businesses to adopt the most appropriate terms for … their enterprise." The court also found that the agreement the petitioners signed did, in fact, waive their appraisal rights, even though the language did not use the word "waive." One justice dissented, concluding that appraisal rights cannot be waived generally and that the specific agreement here was not a valid waiver.

Summary

In 2008, Authentix, Inc. entered into a transaction pursuant to which it became a wholly owned subsidiary of Authentix Company, Inc. As part of that transaction, all stockholders, including the petitioners, entered into a stockholders agreement (the Stockholders Agreement). One provision of the Stockholders Agreement provided that the stockholders would "refrain from the exercise of appraisal rights . . ." (the Refrain Obligation).

In 2017, Authentix merged with a third-party entity (the Merger). In connection with the Merger, the petitioners' stock was cancelled and converted into a right to receive merger consideration pursuant to a waterfall provision. Based on the application of the waterfall provision, however, the petitioners received little to no compensation. As a result, the petitioners sent appraisal demands to Authentix and subsequently filed a petition for appraisal against Authentix (the Petition). The Court of Chancery granted Authentix's partial motion for summary judgment, finding that the petitioners waived their appraisal rights under the Stockholders Agreement. The petitioners sought reargument, which was denied, and the Court of Chancery then issued a final decision to address fee-shifting issues. Both sides subsequently appealed to the Delaware Supreme Court.

On appeal, the Delaware Supreme Court affirmed the lower court's opinion in its entirety. First, the Delaware Supreme Court agreed that the petitioners had waived their appraisal rights. The court rejected the petitioners' arguments that; (1) the Refrain Obligation was not triggered because the petitioners' common stock was being treated differently from certain preferred stock; (2) the termination provision in the Stockholders Agreement extinguished all provisions, including the Refrain Obligation; and (3) Authentix could not enforce the Stockholders Agreement because it was not an intended beneficiary. The court also found that the use of the word "refrain" did not undermine the validity of the waiver because "refrain" made sense in the context of the Stockholders Agreement generally and the Refrain Obligation specifically.

Second, the Delaware Supreme Court found neither the DGCL nor public policy prohibited a corporation's enforcement of a waiver of appraisal rights against its own stockholders. The court considered several arguments. Notably, the court rejected the

petitioners' argument that a waiver of appraisal rights, if any, had to be in the corporation's certificate of incorporation, per DGCL 151(a), because it was a "limitation or restriction" on stock. The court found instead that the Refrain Obligation was not a restriction on stock, but a "personal obligation" to which the petitioners agreed. The court did not address here the additional question of whether an *ex ante* waiver in a charter or bylaws also would operate as a waiver. The Delaware Supreme Court also rejected the argument that Section 262(a)'s use of "shall" prevents appraisal rights from being waived, finding instead that even mandatory rights can be waived by agreement under Delaware law.

Third, the Delaware Supreme Court agreed that the petitioners had an equitable interest in the merger consideration and that Authentix was not entitled to pre-judgment interest on an award of attorneys' fees.

One justice dissented, finding that the Refrain Obligation was ambiguous because it used "refrain" rather than "waive;" that such a waiver should occur in a certificate of incorporation or bylaws, if at all; and that mandatory rights, like appraisal, should not be subject to waiver.

In re Appraisal of Regal: Deal-price-less-synergies valuation method is 'first among equals'

Why it is important

The court's decision in *In re Appraisal of Regal Entertainment Group* (C.A. No. 2018-0266-JTL (Del. Ch. May 13, 2021)) is the most recent in a line of cases confirming that the deal-price-less-synergies valuation method is the current "first among equals." The court doubled down on its preference for market-based indicators over discounted cash flow (DCF) valuations, which it said are inherently subjective where they are developed by partisan experts. It held that the process leading to the acquisition of Regal Entertainment Group (Regal) by Cineworld Group plc (Cineworld) was reliable and arms-length because it involved a third-party buyer, an unconflicted board, robust price negotiations, an active post-signing market check, and no preclusive deal protection measures. The court also showed a growing willingness to rely on non-deal-specific and even non-industry-specific studies for the "imprecise task" of allocating synergies.

Summary

In March 2017, Cineworld, a large European movie theater business, approached Regal about a potential merger. After months of negotiating, Cineworld and Regal reached a deal for US$23 per share, a 46.1 percent premium to the closing price of Regal's stock on November 1, 2017. The deal included a go-shop provision, a two-tiered termination fee provision, and a fiduciary out. News of the negotiation leaked in late November, which caused Regal's stock to increase steadily.

Although Regal's competitor AMC expressed some interest during the go-shop period, it refused to comply with a detailed information request from Regal and did not further engage. None of the other 47 potential buyers expressed interest by the closing of the go-shop period on January 22, 2018. The deal closed on February 28, 2018 for US$23 per share. Meanwhile, the Tax Cuts and Jobs Act (Tax Act) was enacted, cutting the corporate tax rate from 35 percent to 21 percent.

In evaluating the fair price of Regal as a going concern, the court selected the "deal price minus synergies" method adjusted for changes in value between signing and closing because the sale process was reliable and arms-length. The indicia of reliability included a third-party buyer, a unconflicted board, price negotiations, the active post-signing market check, and lack of any preclusive deal protection measures. The court found that the single-bidder process did not affect the deal because the post-signing market check was sufficiently open, Regal had good reasons to avoid pre-signing outreach, and because news of the merger leaked before the deal was signed.
It also rejected the shareholders' argument that t he board delegated the determination of a fair price to the majority shareholder of Regal because the controlling shareholder had (1) interests that aligned with the stockholders and (2) no idiosyncratic reasons to favor a near-term cash deal.

In reaching a valuation, the court rejected the dissenting stockholder's DCF model because DCF modeling is inherently subjective and the model itself relied on overly optimistic projections. The court also rejected using the unaffected trading price of Regal's stock despite the indicia that the trading market for Regal's stock was informationally efficient, because there was a perceived risk of the controlling shareholder obtaining private benefits of control, certain block sales by the controlling shareholder in

2016 created an overhang, and there was evidence that Regal's stock was in a trough after a recent bad film slate.

The court then calculated the synergies from the deal to be US$6.99, comprised of (a) operational synergies of US$4.26 per share from Regal's privatization, eliminating of redundancy, layoffs, and economies of scale on concessions and insurance; and (b) financial savings of US$2.73 per share based on Cineworld's post-Tax Act estimate of financial structuring benefits. Because the deal price was a 46.1 percent premium over Regal's unaffected market price, the court found that some of the synergies were included in the deal price. To determine what percentage of synergies to allocate to the shareholders, it then relied on a 2018 study from Boston Consulting Group that estimated an average synergy allocation of 54 percent to the sellers, 46 percent to the buyers; here, US$3.77 per share of the synergies. The court's calculation resulted in a fair price at the time of signing of US$19.23 per share, or 83 percent of the deal price.

Before reaching a final price, however, the court considered the impact of the Tax Act's cut of the corporate tax rate, which became effective between signing and closing. Finding the Tax Act increased Regal's value, the court relied on Cineworld's disclosures about the financial savings it could achieve before and after the passage of the Tax Act to calculate the figure of US$4.37 per share. Adding this to the US$19.23 deal-price-minus synergies calculation, the court awarded shareholders a price of US$23.60 per share, just over the US$23 deal price. While this represented a modest 2.6 percent increase on the deal price, it was far below the 47 percent increase sought by the petitioners.

Manichaean Capital v. Exela Tech: DE courts rule on 'reverse veil piercing' claims

Why it is important

In *Manichaean Capital, LLC v. Exela Tech., Inc.* (C.A. No. 2020-0601-JRS (Del. Ch. May 25, 2021)), the Court of Chancery ruled as a matter of first impression in Delaware that plaintiffs could pursue "reverse veil piercing" claims against the subsidiaries of a corporate defendant accused of abusing the corporate form to avoid paying an appraisal judgment from the Delaware courts. The court acknowledged that reverse veil piercing claims, which seek to hold subsidiaries liable for conduct by corporate parents, would not be appropriate in all cases, and established a multi-part test for considering whether a case rose to the level required to permit reverse veil piercing claims to proceed. The court did not rule on whether controllers, rather than third parties, could also bring reverse veil piercing claims, leaving that issue for another day.

Summary

Exela Technologies acquired SourceHOV Holdings in a merger in July 2017. Manichaean Capital and other SourceHOV Holdings equity holders (Plaintiffs) exercised their right to a statutory appraisal in September 2017. The court appraised the value of their shares at over US$57 million collectively, which was significantly above the consideration they would have received in the merger, and entered a final judgment in their favor in March 2020, which was affirmed by the Delaware Supreme Court. In July 2020, they obtained a charging order against SourceHOV Holding's membership interest in its subsidiaries. To the extent that Exela, as a parent of SourceHOV Holdings, sought to receive distributions from SourceHOV Holdings subsidiaries, any money that flowed through SourceHOV Holdings had to first be paid to plaintiffs as judgment creditors.

In January 2020, "mere weeks" before the court's decision in the appraisal action, Exela, through its subsidiaries, entered into a US$160 million accounts receivable securitization facility (the A/R Facility). Exela created two entities to facilitate the transaction. Thirteen of the SourceHOV subsidiaries sold their accounts receivable to the first entity, Exela Holdco LLC. Then, Exela Holdco sold those receivables to the second created entity, Exela Receivables I LLC. Exela Receivables I then pledged the receivables as collateral for loans and letters of credit. This A/R Facility permitted value once held by the SourceHOV subsidiaries to instead be held by Exela's indirect subsidiary, diverting the funds around SourceHOV Holdings directly to Exela.

The plaintiffs, confronted with the circumstance where the appraisal judgment debtor could not or would not pay, brought an action in Delaware Court of Chancery to hold Exela and its affiliated entities accountable for the appraisal judgment under three theories.

First, they sought to pierce the corporate veil upwards to reach Exela, SourceHOV Holding's corporate parent.

Second, they sought to pierce the corporate veil downwards via "reverse-veil piercing" to reach SourceHOV Holding's solvent subsidiaries, so plaintiffs could enforce their charging order against these entities.

Third, the plaintiffs argued the court should determine that Exela was unjustly enriched and order it to pay restitution to the plaintiffs. The defendants moved to dismiss under Court of Chancery Rule 12(b)(6).

The court held that under a traditional veil piercing analysis, the complaint sufficiently alleged that Exela engaged in the A/R facility for the purpose of leaving SourceHOV unable to satisfy the appraisal judgement, and declined to dismiss plaintiffs' veil piercing claims against Exela.

Caremark

In re The Boeing Company: Delaware Chancery Court finds Boeing Board oversight allegations satisfy *Caremark* standards

Why it is important

In *In re The Boeing Company* (C.A. No. 2019-0907-MTZ (Del. Ch. Sept. 7, 2021)), the Delaware Court of Chancery held that Boeing stockholders that sued the company over losses relating to safety problems with Boeing's 737 MAX airplane had adequately pleaded that a majority of Boeing's directors "face a substantial likelihood of liability for Boeing's losses." Although it noted that the plaintiffs were pursuing "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment," the court nonetheless found that the plaintiffs had adequately alleged "the directors' complete failure to establish a reporting system for airplane safety" and "their turning a blind eye to a red flag representing airplane safety problems." While duty of oversight claims remain "extremely difficult" to plead, this decision illustrates that they are far from impossible to plead, particularly where, as here, the shareholders obtain substantial discovery through a pre-litigation books and records demand under Section 220.

Summary

On October 29, 2018, a Boeing 737 MAX crashed shortly after takeoff, killing everyone on board. Five months later, a second Boeing 737 MAX crashed after takeoff. Within days of the second crash, regulators around the world grounded all 737 MAX aircraft for a prolonged period. As a result of the grounding, Boeing suffered billions of dollars in losses.

In 2019, a group of Boeing shareholders filed a derivative action against the company alleging that Boeing's directors were liable for losses incurred by the company and its shareholders because they failed to exercise proper oversight over the company's activities. The plaintiffs were the New York State Common Retirement Fund, which is a public pension fund for New York State and local government employees, and the Fire and Police Pension Association of Colorado, which invests pension funds for Colorado firefighters, police officers, and their beneficiaries. The plaintiffs alleged that "Boeing's directors and officers failed them in overseeing mission-critical airplane safety to protect enterprise and stockholder value," as summarized by the court. Boeing moved to dismiss the complaint, arguing among other things that the plaintiffs had not alleged viable duty of oversight claims under *Caremark*.

The court noted that the plaintiffs were pursuing "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment," and that to survive the motion to dismiss, the plaintiffs needed to allege "that a majority of the Company's directors face a substantial likelihood of liability for Boeing's losses." The court found that "[t]his may be based on the directors' complete failure to establish a reporting system for airplane safety, or on their turning a blind eye to a red flag representing airplane safety problems," and concluded that "the stockholders have pled both sources of board liability." The court dismissed only the claim that the board could face liability for not firing its CEO and other executives.

The court cited and quoted from numerous Boeing documents the plaintiffs had obtained from the company pursuant to a Section 220 request and had referenced in their opposition in deciding the motion. Based in part on these documents, the court found that the plaintiffs had alleged that Boeing's board "often met without mentioning or discussing safety at all;" "did not have a means of receiving internal complaints about airplane safety;" and that "[t]he Board publicly lied about if and how it monitored the 737 MAX's safety." Based on these and other allegations, the court found that the plaintiffs alleged facts sufficient to show that "nine of the twelve board members at the time the original complaint was filed face a substantial likelihood of liability for failure to fulfill their oversight duties." The court noted that *Caremark* did not insulate directors who did not make a "a good faith effort—i.e.,try—to put in place a reasonable board-level system of monitoring and reporting." The court further found that the plaintiffs had adequately alleged liability under the second *Caremark* prong by alleging "particularized facts that the board knew of evidence of corporate misconduct—the proverbial red flag—yet acted in bad faith by consciously disregarding its duty to address that misconduct."

The ruling illustrates that while derivative claims remain difficult to plead, they can be viable where extensive evidence is obtained pre-complaint that allows the plaintiff to plead a reasonably conceivable claim that the board's oversight activities failed to meet the requirements set out in *Caremark*.

Firemen's Ret. Sys. of St. Louis v. Sorenson: No *Caremark* liability for data breach

Why it is important

In *Firemen's Ret. Sys. of St. Louis v. Sorenson* (C.A. No. 2019-0965-LWW (Del. Ch. Oct. 5, 2021)), the Delaware Court of Chancery dismissed a derivative lawsuit against Marriott executives and directors for breaches of the duty of loyalty following a cyberattack that exposed the personal information of up to 500 million guests. Finding that the board's "flawed effort" to address data security risks in its reservation database was not a deliberate failure to act in the face of red flags or knowledge of positive law violations, the Court of Chancery found that the allegations did not meet the high bar required to state a *Caremark* claim and that demand was not excused. The court emphasized that, while corporate governance standards must evolve to address the growing risks posed by cybersecurity threats, those threats do not "lower the high threshold that a plaintiff must meet to plead a *Caremark* claim."

Summary

The cyberattack at the core of this case began in 2014 when certain systems of Starwood Hotels and Resorts Worldwide, Inc. (Starwood) were infected with malware. Unbeknownst to Marriott's board of directors, the attack was ongoing in September 2016 when Marriott closed on its acquisition of Starwood. It remained undetected after the acquisition, even as the board and audit committee received routine updates about cybersecurity issues, including in 2017 when the Board was told about deficiencies in Starwood's cybersecurity controls. Marriott discovered the malware on Starwood's system in September 2018. After some initial investigation, Marriott learned in November 2018 that the breach began in 2014 and that the hacker had accessed customers' personal information. Eleven days later, Marriott publicly announced the incident.

The plaintiff brought a derivative claim for breach of the fiduciary duty of loyalty against several Marriott executives and members of the Marriott board of directors. The defendants moved to dismiss, arguing that demand was not futile. The court agreed and dismissed the complaint in its entirety.

In its analysis, the court applied the new test for demand futility established last year in *United Foods & Commercial Works Union v. Zuckerberg*, which requires a plaintiff to show, on a director-by-director basis, that a majority of the directors (1) "received a material personal benefit from the alleged misconduct that is the subject of the litigation demand"; (2) "faces a substantial likelihood of liability on any of the claims that would be the subject of the litigation demand"; and (3) "lacks independence from" a director who is not disinterested under prongs (1) or (2).

The plaintiff argued that four members of the board that considered the demand lacked independence and that all of the directors on the board following the acquisition of Starwood faced a substantial likelihood of personal liability for breach of the duty of loyalty based on three theories; (1) the failure to conduct adequate cybersecurity due diligence before the acquisition; (2) the failure to implement adequate internal controls after the acquisition; and (3) the late disclosure of the incident. The court rejected each theory of liability.

The court rejected the first theory as time-barred. The three-year statute of limitations began to run, at the latest, at the time of the acquisition in September 2016, and the complaint failed to allege any acts of concealment. The court also found that the statute was not tolled by the plaintiff's Section 220 books and records demand, distinguishing a Section 220 demand from a Section 220 lawsuit, which can toll the statute of limitations.

The court rejected the plaintiff's second theory after an analysis under both prongs of Caremark. On the first prong, it found that the board had not utterly failed to implement a system of reporting and controls regarding cybersecurity risks because the board and audit committee were routinely apprised of cybersecurity issues, provided with annual reports on cyber risks, engaged with outside consultants to audit Marriott's cybersecurity practices, and were notified when there were red flags suggesting vulnerabilities.

On the second prong, the court found that the board had not known that Starwood's systems violated any laws or consciously disregarded any red flags. The issues with Starwood's systems were failures to comply with non-binding industry standards, not violations of any positive laws, and, in any event, there were no allegations that the board knew that these violations were occurring. Moreover, even though the board was aware Starwood's cybersecurity systems had some issues, the board was told that management was addressing the issues, and thus the board did not ignore the issues.

The court rejected the plaintiff's third theory premised on late disclosure of the data breach, holding that there was no evidence that the directors were aware of applicable notification laws that the delay allegedly violated. Further, the court noted that the discovery of malware is distinct from the discovery that personal information had been compromised, and the board waited only ten days between learning that guests' personal information had been affected and publicly announcing the attack.

Demand futility

United Food & Com. Workers Union v. Zuckerberg: Exculpatory clause does not render demand futile

Why it is important

In *United Food & Com. Workers Union v. Zuckerberg* (No. 404, 2020 (Del. Sup. Sep. 23, 2021)), the Delaware Supreme Court adopted a new, three-part test for determining when a shareholder is required to make a pre-suit demand on a corporation's board before pursuing derivative claims on behalf of a corporation. The court's new demand futility test, which shifts the focus to "the decision regarding the litigation demand, rather than the decision being challenged," looks on a "director-by-director basis" at (1) whether the director received a material personal benefit from the alleged misconduct; (2) whether the director would face a substantial likelihood of liability on any of the claims that would be the subject of the litigation demand; and (3) whether the director lacks independence from someone covered by prongs one and two.

Summary

In 2015, Facebook, Inc. (Facebook) founder and CEO Mark Zuckerberg took the Giving Pledge – a movement championed by Bill Gates and Warren Buffet that challenges wealthy business leaders to use a majority of their wealth for philanthropy. To effectuate this pledge, Zuckerberg determined to donate roughly US$2-3 billion of Facebook stock a year. Facebook's general counsel warned Zuckerberg that he would lose voting control of Facebook if he sold US$3-4 billion of stock at the current market value. To solve this problem, Zuckerberg, in consultation with Facebook's general counsel, sought to create a class of non-voting stock that Zuckerberg could sell while retaining control of Facebook. Zuckerberg proposed this stock reclassification plan to the board of directors on August 20, 2015, noting that shareholder litigation relating to Google's reclassification of stock resulted in a US$522 million settlement.

The board created a special committee of three purportedly-independent directors to consider the proposal, analyze alternatives, and make a recommendation to the full board. The special committee agreed to nearly all of Zuckerberg's proposals and asked for only minor concessions, many of which appeared not to be based on any legitimate concern (e.g., asking for provisions that would disincentivize Zuckerberg leaving Facebook early, which no one anticipated occurring). Moreover, one of the members of the special committee engaged in what the court called "facially dubious back-channel communications with Zuckerberg" throughout the negotiations over reclassification. On April 13, 2016, the special committee recommended that the full board approve the reclassification plan, which the board did.

On June 20, 2016, holders of a majority of Facebook's stock (Zuckerberg alone would have been sufficient) voted in favor of the reclassification plan; however, more than three-quarters of the minority shareholders voted against the plan.

Several putative class actions were filed shortly after the board's vote in favor of the reclassification plan. Facebook agreed not to proceed with the plan while the lawsuits were pending. About a week before the consolidated class action trial was set to begin in September 2017, Facebook and Zuckerberg announced that they were abandoning the reclassification plan and that Zuckerberg would find another way to fulfill the Giving Pledge.

Following this announcement, one of Facebook's longstanding shareholders, the United Food and Commercial Workers Union and Participating Food Industry Employers Tri-State Pension Fund (Tri-State), filed a derivative lawsuit seeking to recoup the more than US$80 million that Facebook had paid defending the class action lawsuit. Tri-State did not make a pre-suit demand and alleged that such a demand was excused as futile under Delaware Court of Chancery Rule 23.1 because the reclassification vote was not a product of a valid exercise of business judgment, because the directors of Facebook faced a substantial likelihood of liability, and because the directors of Facebook lacked independence.

The Court of Chancery dismissed the case, finding that a pre-suit demand was not excused because (1) the directors were exculpated from breach of care claims and thus did not face a substantial likelihood of liability and (2) Tri-State failed to plausibly allege that the directors were not independent. Tri-State appealed.

The Delaware Supreme Court affirmed the Court of Chancery's decision. In doing so, it made two key holdings.

First, it held that "exculpated breach of care claims no longer pose a threat that neutralizes director discretion," and that if a director is exculpated from duty of care claims, as Delaware statutory law now expressly permits, that director does not face a substantial likelihood of liability for a breach of care claim sufficient to support demand futility.

Second, the court adopted a new test for determining demand futility, which would apply regardless of whether the corporate board at the time a shareholder sought to bring suit was the same or different than the board that made the decision the shareholder sought to challenge. Under the new test, courts are instructed to examine: "(i) whether the director received a material personal benefit from the alleged misconduct that is the subject of the litigation demand; (ii) whether the director would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand; and (iii) whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct that is the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand."

This decision reframes the test for determining whether a litigation demand on a corporate board is necessary or would be futile in light of now well-established changes to Delaware law that permit corporations to exculpate directors for breaches of care.

In re Kraft Heinz Company Derivative Litigation: Plaintiffs fail to plead demand futility

Why it is important

In re Kraft Heinz Company Derivative Litigation (C.A. No. 2019-0587-LWW (Del. Ch. Dec. 15, 2021)) addresses demand futility in a case involving an insider stock sale. 3G Capital, Inc., a 24.2 percent shareholder in Kraft Heinz, sold 7 percent of its stake in August 2018 after the company removed certain stock restrictions. Kraft Heinz reported poor results in the third and fourth quarters of 2018, causing the stock to drop. Shareholders filed derivative suits, alleging that 3G knew of the poor financial results when it traded and that the board of Kraft Heinz breached its fiduciary duties in allowing the trade. The Delaware Court of Chancery dismissed the complaint on demand futility grounds, finding a majority of the board to be disinterested and independent after a director-by-director analysis. This case provides a practical application of the new Zuckerberg demand futility test and insight into how Delaware courts may view potentially biasing factors, such as personal relationships and voting agreements between large shareholders.

Summary

The Kraft Heinz Company (Kraft Heinz) was formed in 2015 when Kraft Food Groups (Kraft) merged with The H.J. Heinz Company (Heinz). Prior to the merger, 3G Capital, Inc. (3G) purchased 50 percent of Heinz. After the closing of the merger to form Kraft Heinz, 3G owned approximately 24.2 percent of the combined company and three of its designees sat on the 11-member board of directors.

On August 2, 2018, the board learned that Kraft Heinz likely would miss its EBITDA target for the first half and full year 2018. On August 7, 2018, 3G sold 7 percent of its stake in Kraft Heinz for over US$1.2 billion after Kraft Heinz agreed to remove certain restrictions on the stock. As anticipated, Kraft Heinz reported poor financial results in November 2018 for its third quarter and February 2019 for its fourth quarter and full year 2018. Kraft Heinz's stock dropped 10 percent in November 2018 and 27.5 percent in February 2019.

Several shareholders filed derivative actions, alleging that the board of directors breached its fiduciary duties in connection with 3G's sale of 7 percent of its stake in August 2018. Specifically, the plaintiffs alleged: (1) breach of fiduciary duty for approving or allowing the 3G sale; (2) contribution and indemnification for causing Kraft Heinz to issue false and misleading statements in violation of the securities laws; and (3) aiding and abetting against 3G-related entities for facilitating the allegedly unlawful sale. The defendants moved to dismiss, arguing that the plaintiffs had not pleaded demand futility. The Delaware Court of Chancery agreed and dismissed the complaint in its entirety.

The court's analysis followed the recently established three-part test from *United Food & Commercial Works Union v. Zuckerberg*, which requires a plaintiff to show, on a director-by-director basis, that a majority of the directors (1) "received a material personal benefit from the alleged misconduct that is the subject of the litigation demand"; (2) "faces a substantial likelihood of liability on any of the claims that would be the subject of the litigation demand"; and (3) "lacks independence from" a director who is not disinterested under prong (1) or (2).

In this case, the court found that the independence of only six directors was at issue because the plaintiffs conceded that two of the 11 board members were independent and disinterested while the defendants conceded that three 3G-affiliated directors were not independent.

Of the six remining directors, the court found that only prong (3) of the Zuckerberg test was relevant because the six directors were non-parties, and thus did not face a substantial likelihood of liability, and were not alleged to have sold stock during the relevant period or otherwise benefitted from 3G's sale. As a result, the analysis "hinge[d] entirely on whether the directors had disabling connections to 3G." The court rejected each of the plaintiffs' arguments.

First, the plaintiffs argued that 3G should be considered to be a "control group" with Berkshire Hathaway, another large shareholder in Heinz and subsequently Kraft Heinz. The court found that even if 3G did control Kraft Heinz with Berkshire, such an allegation, without more, did not overcome the presumption of the directors' independence from a controlling shareholder.

Second, the plaintiffs argued that each of the six directors was not independent from 3G for specific reasons, ranging from a director's private foundation placing 12 percent of its investment portfolio in 3G to close personal relationships between directors to potential opportunities for promotion. The court found all of these allegations insufficient to overcome the presumption of independence. In particular, the court noted that it would not credit a "transitive theory of independence," whereby plaintiffs alleged that two of the directors were beholden to Berkshire Hathaway and Warren Buffett, its CEO, who in turn allegedly were not independent of 3G. The court also found that a shareholders' agreement, which required 3G and Berkshire to vote for one another's director nominees, was not relevant because the two directors the agreement allegedly rendered interested were neither signatories to the agreement nor "Affiliates" under certain provisions.

After conducting a director-by-director analysis for four of the six directors, the court noted that, combined with the two directors the plaintiffs admitted were independent, six of eleven members, and thus a majority, of the board were independent directors. As a result, the court did not reach a conclusion regarding the independence of the final two directors, who the court indicated were most likely to be found not independent under the applicable case law.

Contract analysis

RSUI Indemnity Co. v. Murdock et al.: For fraud allegations, language of insurance policy controls over public policy

Why it is important

In a unanimous decision (Del. Supr., No. 154, 2020 (March 3, 2021) (en banc)), the Delaware Supreme Court upheld on appeal the lower court's decision finding RSUI Indemnity Company, the D&O insurance carrier for Dole Food Company, Inc., liable for the full US$10 million limit of Dole's insurance policy. In doing so, the Delaware Supreme Court rejected the argument that claims settled by Dole, which included allegations of fraud, were not covered by the policy either as a matter of public policy or under the language of the policy. This decision reinforces that insurers generally cannot avoid coverage on public policy grounds. In particular, as a matter of Delaware law, this decision demonstrates that even where there have been findings of fraud, public policy does not vitiate coverage provided by the negotiated language of the policy.

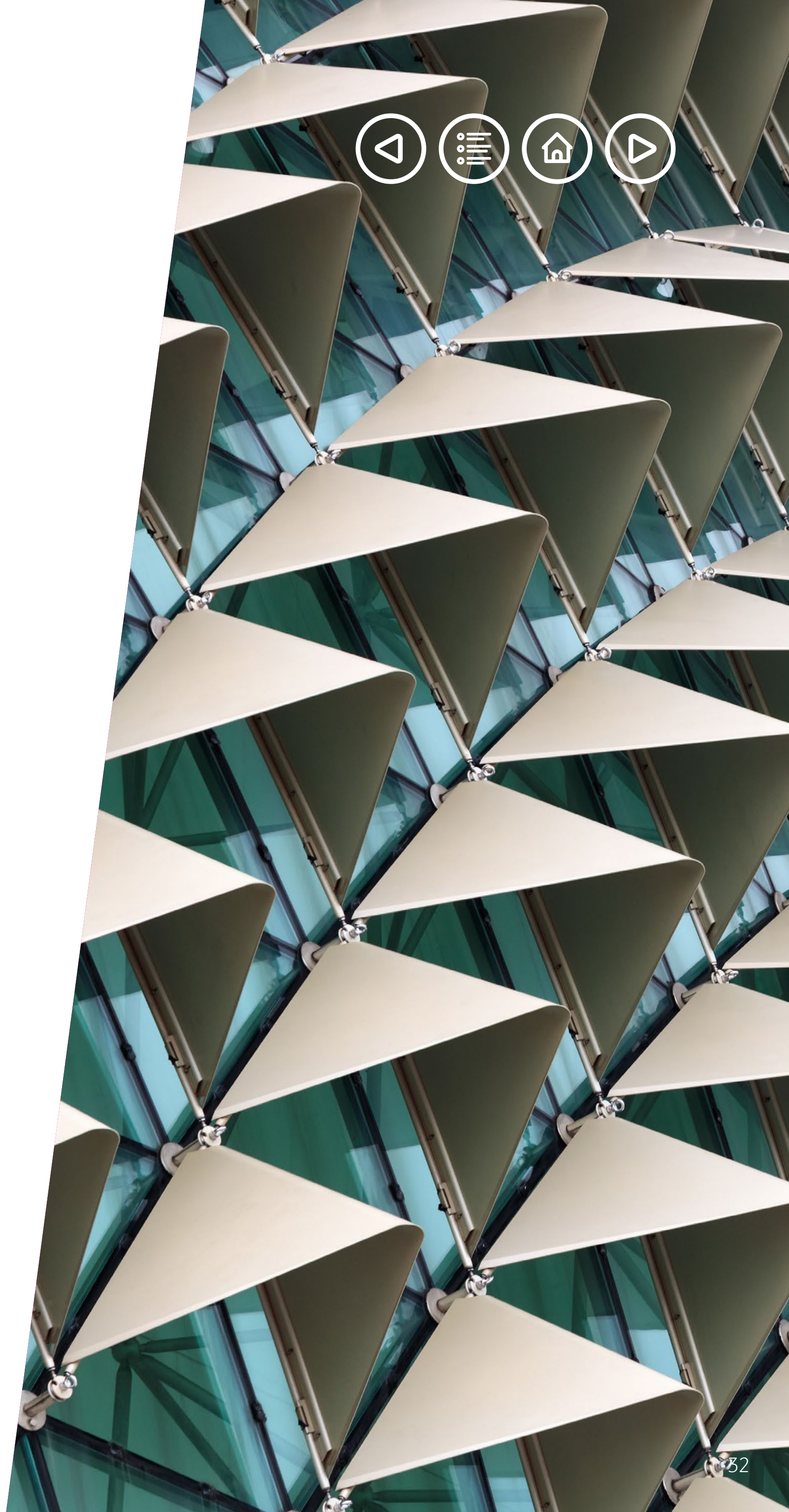
Summary

In November 2013, the CEO of Dole Food Company, Inc. (Dole) took the company private. The transaction sparked several related lawsuits; relevant here is a stockholder class action filed in the Delaware Court of Chancery. Following trial in that matter, the Court of Chancery found the CEO and COO liable for breaches of fiduciary duty, making specific findings that both individuals had "engaged in fraud." The case later settled for the full amount of damages awarded by the Court of Chancery. When Dole tried to recover under its D&O insurance policies, its insurance carriers settled or paid the limits of the applicable policies, with the exception of RSUI Indemnity Company's (RSUI), which sought a declaratory judgment that RSUI was not liable to fund the settlement. Dole counterclaimed, alleging that RSUI breached the implied covenant of good faith and fair dealing. The Superior Court awarded Dole the full US$10 million limit under the insurance policy plus US$2.3 million in prejudgment interest.

On appeal, RSUI asserted four points of error, each of which the Delaware Supreme Court rejected. First, RSUI claimed that the Superior Court incorrectly applied Delaware law instead of California law. Applying the Restatement (Second) of Contracts, the Delaware Supreme Court found that the lower court properly balanced the relevant factors to determine that Delaware had the most significant interest in applying its law. The fact that Dole's headquarters was in California or that Dole's directors and officers lived in and worked in California did not alter its conclusion.

Second, the Delaware Supreme Court rejected RSUI's contention that the Court of Chancery's finding that the directors committed fraud rendered the claim uncoverable as a matter of public policy. The Delaware Supreme Court held that Delaware does not have a public policy against insurability of losses occasioned by fraud so strong as to vitiate the parties' freedom of contract, and that there was a competing public policy interest in that a blanket prohibition against insuring for losses based on director or officer fraud would leave many injured parties with no recovery.

Third, RSUI argued that the parties had specifically excluded fraud from coverage. The policy excluded from coverage "any deliberately criminal or fraudulent act, error or omission by the Insured . . . if established by a final and non-appealable adjudication adverse to such Insured in the underlying action." While RSUI appealed the



Superior Court's holding that the memorandum opinion did not constitute a "final and non-appealable adjudication," the Delaware Supreme Court concluded that it need not reach that issue because the Court of Chancery's decision was not "in the underlying action." The Delaware Supreme Court further concluded that, at worst, the language was ambiguous, in which case the ambiguity would be construed in favor of Dole.

Fourth, RSUI argued that because the damages related to both covered and non-covered entities, it was not responsible for coverage until Dole could allocate the damages attributable directly to the covered entities. The Delaware Supreme Court held that the lower court was correct in applying the "larger settlement rule" under which the responsibility for any portion of a settlement is borne by the insurer unless "the acts of the uninsured party are determined to have increased the settlement." Because there was no evidence that the damages increased because the settlement included the claims against the CEO and COO, the Delaware Supreme Court affirmed.

On Dole's counterclaim, the Delaware Supreme Court found that RSUI had not denied coverage in bad faith and that RSUI had put forward colorable arguments. As a result, the Delaware Supreme Court granted summary judgment in favor of RSUI on Dole's counterclaim for breach of the implied covenant of good faith and fair dealing.

Turning to the plaintiffs' request to hold SourceHOV Holding's subsidiaries liable through reverse veil piercing, the court stated that this appeared to be a question of first impression in Delaware. Looking to decisions of the state courts of Virginia and Colorado, and to the Fourth Circuit's prior interpretation of Delaware law, the court held that outsider reverse veil piercing claims were viable in Delaware in "exceptional circumstances" and established a two part test. First, courts should consider the factors Delaware courts use in a traditional veil-piercing analysis, including whether the company was adequately capitalized and whether corporate formalities were observed. Second, the court asked whether the owner utilized the corporate form to perpetuate a fraud or injustice, and will identify eight factors the courts should analyze.

Applying that test, the court found that the reverse veil piercing claims could proceed, including because of the absence of apparent innocent shareholders or creditors who would be harmed by reverse veil-piercing, and the court's finding there was a reasonable inference that Exela and SourceHOV Holding's subsidiaries had engaged in a scheme to ensure Exela retained the value of the plaintiff's pre-merger SourceHOV Holding equity. Further, there was no other remedy that existed in law or equity against SourceHOV Holdings or its subsidiaries that would remedy the harm. Finally, the court noted that the § 18-703(d), the charging order statute, did not prevent the court from expanding the entities against whom a charging order could be enforced.

Having so held, the court rejected the plaintiffs' alternative claim for unjust enrichment, finding that it was not viable because the charging order statute provided that "a charging order is the exclusive remedy" for a judgment creditor, and that plaintiffs could not bypass the statute by seeking other legal or equitable remedies.

Yatra Online v. Ebix: Clarify post-termination rights to ensure hook for breach of contract claim

Why it is important

The court's decision in *Yatra Online, Inc. v. Ebix, Inc. et al* (C.A. No. 2020-0444-JRS (Del. Ch. May 13, 2021)) underscores the importance of carefully considering the language of a contract's termination provisions when negotiating and terminating a merger agreement. In *Yatra Online*, the plaintiff terminated the merger agreement and sued the defendant for breach of contract and other claims. The court ruled that the defendant was not liable post-termination because the plain language of the agreement stated that "[i]n the event of termination . . . there shall be no liability on the part of any party." The court's decision reminds merger parties to consider what remedies are available in the event of a breach and how the plain language of agreements, including termination clauses, impacts the availability of those remedies.

Summary

In February 2019, Ebix, Inc. approached Yatra regarding a potential merger. In July 2019, Yatra and Ebix finalized the merger agreement. Ebix agreed to create a subsidiary, EbixCash Travels, Inc., that would merge with Yatra, leaving Yatra as the surviving entity and a direct, wholly owned subsidiary of Ebix. As consideration, each Yatra stock would be converted into the right to receive shares of Ebix convertible preferred stock. This right included a put right requiring Ebix to redeem any unconverted shares of convertible preferred stock at a set price.

When the merger agreement was executed, the convertible preferred stock did not exist yet. In the merger agreement, Ebix agreed to use "reasonable best efforts" to file and gain SEC approval of a Form S-4 registration statement. The Form S-4 registration statement, and other closing conditions, had to be completed by April 2020; otherwise, the merger agreement would terminate automatically.

Ebix fell behind in satisfying the closing conditions, and requested that the merger agreement be renegotiated. Ebix and Yatra negotiated several extension agreements, with the final agreement setting a completion date for June 2020. As the COVID-19 pandemic progressed, Ebix's share value fell, inflating the put right's value relative to Ebix's market capitalization. Even as Ebix repeatedly extended its merger deadline with Yatra, Ebix simultaneously negotiated an agreement with its lenders that allegedly would prohibit Ebix from issuing the merger agreement's put right.

When Ebix missed its closing deadline yet again, Yatra terminated the merger agreement and filed suit. Yatra's final complaint alleged the following counts against Ebix: (1) breach of the merger agreement; (2) breach of the extension agreement; (3) breach of the covenant of good faith and fair dealing; and (4) fraud. Additionally, Yatra alleged one count of tortious interference with contract against Ebix's lenders.

The Delaware Court of Chancery dismissed all counts. The court's decision focused primarily on Yatra's choice to terminate the merger agreement.

First, the plain text of the merger agreement stated that "[i]n the event of any termination of this [merger agreement] . . . the obligations of the parties shall terminate and there shall be no liability on the part

of any party with respect thereto," with just a handful of narrow exceptions. The court found that Yatra's interpretation of the language "stretche[d] the words beyond their tolerance" and was not reasonable enough to suggest that the provision was ambiguous. The court also rejected Yatra's argument that Ebix's suggested interpretation conflicted with other portions of the merger agreement, as well as Yatra's argument that it was "absurd" to suggest that the merger agreement could force Yatra to sue for breach of the merger agreement without first terminating the merger agreement. The court noted that a binary choice between terminating and suing for damages or specific performance makes perfect sense, with parties who are concerned that they themselves may have liability choosing to terminate while parties who believe they have clean hands opting to sue. Ultimately, the court enforced the plain language of the merger agreement and concluded that Yatra could not enforce Ebix's various warranties in the merger agreement, including prompt filing of the S-4 related to the put right, post-termination.

Second, the court found that the claim for breach of the extension agreement necessarily failed with the claim under the merger agreement. "[A]s its name suggests," the extension agreement was not a standalone agreement, but an extension of the merger agreement. The parties' rights and obligations under the merger agreement otherwise remained the same. Thus, Yatra's decision to terminate the merger agreement also extinguished any claims it may have had under the extension agreement.

Third, Yatra's claim for breach of the implied covenant of good faith and fair dealing also failed because the alleged conduct was addressed squarely by the merger agreement, leaving no contractual gap for the implied covenant to fill.

Fourth, Yatra's claim of fraud failed because Yatra failed to plead causation. Yatra alleged that but for Ebix's false promises that it was engaged in meaningful negotiations, Yatra would have sued for specific performance of the merger agreement – in particular, the issuance of the put right. However, specific performance of the merger agreement was never a possibility because the SEC had not declared the S-4 effective. Thus, Yatra did not have a right to specific performance, and therefore suffered no injury as a result of its reliance on Ebix's supposed false representations.

Finally, Yatra's claim for tortious interference with contract by the lender defendants was dismissed for failure to allege an injury caused by the tortious interference. Yatra stated that the lenders had caused the loss of the put right. But again, Yatra failed to plead causation – the court noted that even without the lender agreement's execution, Yatra would not have been able to pursue the put right because the S-4 had not been declared effective.

Yatra's breach of contract claims may have survived post-termination had the parties included a provision carving out liability beyond just pre-termination fraud. Yatra reminds parties to keep post-termination scenarios and rights in mind, both while drafting a merger agreement and while considering termination of a merger agreement.

Blue Cube Spinco v. Dow Chemical: Indemnification allegation sufficient for breach of contract claim

Why it is important

In *Blue Cube Spinco LLC v. The Dow Chemical Company* (C.A. No. N21C-01-214 PRW CCLD (Del. Sup. Ct. Sept. 29, 2021)), the Delaware Superior Court found that an M&A buyer had adequately alleged breach of contract claims for a seller's failure to indemnify the buyer for losses relating to a building code violation allegedly caused by pre-closing modifications to a property. The court held that the buyer had alleged potentially covered losses even though the property was being conveyed on an "as is" and "where is" basis. The court found the contractual disclaimer was ambiguous and could not be interpreted without discovery because the disclaimer also contained an exception stating it did not apply to the extent it was inconsistent with other provisions. The court also rejected the seller's argument that some of the buyer's damages claims were barred by a consequential damages exclusion, holding that the claim could proceed so long as there were allegations of at least some covered damages.

Summary

In the spring of 2015, Olin Corporation, through a merger vehicle Blue Cube Spinco (together, the Buyer), purchased certain of Dow Chemical Company's businesses, including their real estate assets, for more than US$5 billion. When the Buyer went to improve one of the assets it acquired under the deal, a manufacturing facility in Germany (the Building), its application for permits was denied by the German government, which took the position that Dow had registered a pre-closing partition that caused the Building to be in violation of zoning law. The Buyer determined that to cure the code violation, the Buyer would need to demolish part of the Building and reconstruct it in another location.

The Buyer sought indemnification from Dow for its past and ongoing consulting and reconstruction costs, relying on provisions in the parties' agreements that the Buyer alleged obligated Dow to indemnify it for "any and all" costs produced by the code violation. Dow offered to pay for certain costs that had been incurred, but refused to pay for future costs that had not yet been incurred. The Buyer rejected Dow's offers and filed suit.

Blue Cube brought two counts against Dow: breach of contract for Dow's failure to indemnify Blue Cube for "any and all" losses caused by the code violation and a declaratory judgement that Dow must pay for any and all future costs required to remedy the code violation. Dow moved to dismiss both counts under Rule 12(b)(6) for failing to state a claim, alleging that Blue Cube had not properly alleged that the code violation was covered by Dow's indemnity, that the agreement's disclaimer barred the Buyer from seeking damages relating to the Building, and that Dow was impermissibly seeking consequential damages that were excluded from indemnity under the parties' agreements. Dow also moved to dismiss Blue Cube's second claim for a declaratory judgment under Rule 12(b)(1), arguing that there was no ripe controversy for the court to adjudicate because Count II related to damages the Buyer had not yet incurred.

The court denied Dow's motion to dismiss as to Count I. The court found that the complaint's allegations supported a reasonable inference that a code violation exists, that the code violation arguably fell within the terms of Dow's agreement to indemnify Blue Cube for losses, and that Blue Cube sufficiently alleged conceivable injuries that could be measured by a fact finder. The court further

found that the contractual disclaimer relied upon by Dow was ambiguous. The disclaimer stated in part that "all transferred assets are being transferred on an 'as is,' 'where is' basis and the parties hereto shall each bear their respective economic and legal risks to the extent resulting from . . . any failure to obtain any necessary consents or approvals of any third parties or governmental authorities and . . . any failure to comply with the requirements of any law." The court held that discovery was needed to determine how the disclaimer was intended to affect indemnifiable losses because it contained an exception for circumstances where it was inconsistent with other provisions, and Blue Cube offered provisions that it reasonably argued would be nullified if the disclaimer swept so broadly.

The court granted Dow's motion to dismiss as to Count II for declaratory judgment. The court found that while the controversy was ripe, Count II was impermissibly duplicative of the Count I breach of contract claim.

LDC Parent v. Essential Utilities: DE court on who should resolve purchase price adjustment dispute

Why it is important

In *LDC Parent, LLC v. Essential Utilities, Inc.* (C.A. No. N20C-08-127-MMJ-CCLD (Del. Super. Apr. 28, 2021)), the Delaware Superior Court held that a post-closing purchase price adjustment dispute had to be resolved by an accounting firm rather than a court under the parties' purchase agreement. The case is an important reminder that Delaware courts may preclude litigation of post-closing disputes where the parties state in their agreement that such disputes are to be resolved by an accountant, even without determining whether the accountant would be acting as an expert or an arbitrator.

Summary

LDC Parent, LLC (LDC or Seller) and Essential Utilities, Inc. (Essential or Buyer) executed a purchase agreement in October 2018 whereby LDC agreed to sell one of its subsidiaries to Essential for a base price of US$4.275 billion. The agreement provided that the purchase price would be adjusted up or down if the acquired company's actual capital expenditures differed from amounts set forth in the agreement. If the parties disagreed on whether an adjustment was needed or its amount, the agreement required that the dispute be submitted to an accounting firm, which was to issue a final and binding decision.

Following the closing, a dispute between Buyer and Seller arose as to whether a purchase price adjustment was required, as well as whether the dispute needed to be resolved by the agreed accounting firm or whether it could be resolved through litigation. LDC argued that the court could resolve the dispute because it concerned a legal issue: contract interpretation. Essential argued, on the other hand, that the issue was factual and reserved for the accounting firm under the parties' agreement. Carefully considering Delaware Court of Chancery precedent, the court agreed that, under the agreement, the dispute had to be resolved by the accountant. The court declined to reach the question of whether the accountant would be acting as an expert or as an arbitrator, finding "it sufficient that the accountant is a third-party decision maker bound by the decision-making parameters set forth in the Purchase Agreement."

Refinements of key M&A doctrines

In re Tilray, Inc. Reorg. Litigation: DE court finds founding members to be control group

Why it is important

In *In re Tilray, Inc. Reorganization Litigation* (C.A. No. 2020-137-KSJM (Del. Ch. June 1, 2021)), the minority shareholders of Tilray, Inc. alleged that the defendants breached their fiduciary duties by entering a self-dealing transaction to gain a tax benefit not available to the minority shareholders. The court denied the defendants' motions to dismiss for demand futility and for failure to state a claim, finding that the plaintiffs adequately alleged that a control group existed and engaged in a self-dealing transaction, and that the plaintiffs alleged with particularity that demand was excused. The court also rejected two defendants' personal jurisdiction challenges, finding that the plaintiffs adequately pleaded conspiracy jurisdiction. This decision highlights the factors that identify a control group and the scope of the application of the entire fairness standard, which the court emphasized applies to self-dealing transactions whenever a controller extracts a unique benefit.

Summary

In 2010, Brendan Kennedy, Christian Groh, and Michael Blue (the Founders) formed Privateer, a private equity firm focused on investing in the cannabis industry. Together, the Founders held 70 percent of Privateer's voting power. In 2013, they formed Tilray as a subsidiary of Privateer to conduct cannabis research, cultivation, process, and distribution, rather than invest in others' established businesses in the industry. Privateer's first investment in Tilray was approximately US$31.7 million for 75 million shares, or approximately US$0.42 per share.

On July 19, 2018, Privateer took Tilray public at US$17 per share, skyrocketing the value of Privateer's 75 million shares to US$1.275 billion. With two classes of stock in place, Privateer held a 75 percent economic interest and 90 percent voting interest in Tilray.

While the Founders had significant wealth tied up in Privateer, they had difficulty accessing that wealth for several reasons, including tax issues and a fear of driving down Tilray's stock price through large block sales. To solve these issues, the Founders contemplated a two-step reorganization (the Reorganization). The first step was to spin off the non-Tilray portfolio companies Privateer held. The second was to conduct a downstream merger, canceling Privateer's Tilray stock and issuing Tilray stock to Privateer's shareholders. This would allow the Founders to retain control over Tilray while enjoying their newfound wealth, tax-free.

The plaintiffs, holders of Tilray Class 2 stock, challenged the Reorganization, alleging (1) a direct breach of fiduciary duty claims against the Founders and Privateer and (2) a derivative breach of fiduciary duty claim against Tilray and Tilray directors. The defendants moved to dismiss both counts, and the court denied the motion in its entirety for several reasons.

First, the court rejected the defendants' argument that the Founders did not constitute a control group and that the Reorganization was not self-dealing. On the issue of a control group, the court applied the "legally significant connection" standard from *Sheldon v. Pinto Technology Ventures, L.P.*, which requires a showing of an agreement to work towards a shared goal.

The court concluded that the plaintiffs adequately alleged a series of historical and transaction-specific ties among the Founders, including: (1) a long-time

friendship; (2) co-founding and running Privateer and other companies; (3) holding each other out as partners and founders; (4) joint retention of advisors; and (5) acting as a voting block of Founders in connection with the Reorganization. The court found these actions were in pursuit of the Founders' shared goal of cashing out on their wealth and avoiding tax consequences, which was a goal unique to the Founders.

On the issue of a self-dealing transaction, the court rejected the defendants' argument that the minority shareholders suffered no detriment because the benefit was neither extracted from, nor available to, the minority shareholders. The defendants extracted a unique or non-ratable benefit. To the extent it was necessary to show a detriment to the minority stockholders, the detriment, the court determined, was the Tilray board's failure to exert leverage over the defendants during the Reorganization negotiations.

Second, the plaintiffs brought a derivative claim against Tilray and Tilray directors Kennedy, Maryscott Greenwood, and Michael Auerbach, alleging they breached their fiduciary duties as directors. Tilray and its directors moved to dismiss the second count according to Court of Chancery Rule 23.1, arguing that pre-suit demand was required and not futile. Applying *Aronson v. Lewis*, the court found that the plaintiffs pleaded with particularity that demand was futile because each of the directors was conflicted: Kennedy was a Founder and part of the Founder control group; Auerbach was a director on the boards of both Privateer and Tilray; and Greenwood was a cannabis lobbyist who previously had lobbied on the Founders' behalf to deregulate cannabis. Given the likelihood that all three directors were interested in the Reorganization, the court found that the plaintiffs had adequately pled demand futility.

The court also found personal jurisdiction over Groh and Blue based on the conspiracy theory of jurisdiction, which treats an individual's co-conspirators as the individual's agents, thereby allowing the agents' forum-directed activities to satisfy Delaware's long-arm statute as applied to the individual. In analyzing the question using the five elements laid out in *Istituto Bancario SpA v. Hunter Engineering Co.*, the court found that the plaintiff adequately alleged that Groh and Blue were part of a control group, which satisfied the first two elements requiring a conspiracy and that the defendants were a member of the conspiracy. For the third element, both Blue and Groh took steps to file and amend Privateer's charter in Delaware, which the court found was "a substantial act . . . in furtherance of the conspiracy." And for the fourth and fifth element, the court found that the complaint adequately pled that Blue and Groh knew the documents were filed in connection with the Reorganization.

Hollywood Firefighters' Pension Fund v. Malone: Award of attorneys' fees as corporate benefit

Why it is important

In *Hollywood Firefighters' Pension Fund v. Malone Inc.* (C.A. No. 2020-0880-SG (Del. Ch. Nov. 18, 2021)), the Delaware Court of Chancery awarded a US$9.35 million mootness fee on the ground that a preliminary injunction stipulation (the PI Stipulation) conferred three distinct corporate benefits. Specifically, the court found that the PI Stipulation cured the disproportionate voting power held by two managers, increased the information disclosed to investors about the proposed merger, and prevented the managers from retaining excessive voting control over the post-merger company. In conducting its analysis, the court chose to base its analysis on past precedent, rather than expert testimony provided by the parties. This case highlights the factors considered in the determination of an award for mootness fees and illustrates the detailed analysis Delaware courts apply when assigning a concrete valuation to corporate benefits.

Summary

In November 2020, a class of investors, led by the Hollywood Firefighters' Pension Fund and Sheet Metal Workers' Local Union No. 80 Pension Trust Fund, sought injunctive relief regarding a corporate merger between GCI Liberty Incorporated and Liberty Broadband Corporation. The investors argued that the merger violated Section 203 of the Delaware General Corporation Law, which prohibits shareholders who own 15 percent or more of a corporation's voting stock from engaging in a business combination with the corporation. At the time of the merger, two GCI managers held 5.7 percent equity ownership in GCI and 5.1 percent equity ownership in Broadband. This ownership, however, translated into approximately 35.3 percent voting control of GCI and 49.9 percent voting control of Broadband. In connection with the litigation, the parties agreed to a preliminary injunction stipulation that, among other things, decreased the "wedge" of disproportionate voting power held by the two GCI managers.

After securing a large settlement of other issues in the litigation and US$22 million in attorneys' fees, the investors sought an additional US$22 million in attorneys' fees for the alleged benefits conferred by the PI Stipulation. The defendants argued that the PI Stipulation provided only "some benefit" warranting a fee of US$1 million to US$2 million.

A court can award attorneys' fees under the corporate benefit doctrine if an applicant shows that the suit was meritorious, that "the action producing benefit to the corporation was taken by the defendants before a judicial resolution was achieved," and the lawsuit caused the benefit. The court determined that the PI Stipulation here met all three elements.

Finding an award of fees to be appropriate, the court next determined the value of the benefits associated with the PI Stipulation based on the five *Sugarland* factors: "(1) the results achieved; (2) the time and effort of counsel; (3) the relative complexities of the litigation; (4) any contingency factor; and (5) the standing and ability of counsel involved." When determining a value for each benefit, the court looked to precedent rather than expert reports provided by the parties seeking to quantify the "wedge" reduction.

The court focused primarily on the first *Sugarland* factor in reaching its valuation. **First**, the court assigned the value of US$800,000 to additional disclosures, citing precedent that found similar disclosures to be worth US$800,000 to US$1 million. The court reasoned the value in this case was on the "low end of the scale" because the investors still viewed the revised disclosures as inadequate.

Second, with respect to the Section 203 issue, the court cited a past case in which the Chancery Court awarded US$3.85 million in fees for the resolution of Section 203 violations. Because that award also included fees for additional disclosures, the court here valued the benefit to the class of investors at US$3.05 million because additional disclosures had already been considered in it's analysis.

Third, when valuing the reduction of the two GCI managers' control, the court referred to a prior case that valued a reduction in voting power between US$5 million and US$10 million. The court concluded the reduction in the GCI managers' voting control was worth US$5.5 million because, although it "prevented de jure control from being established," it still left the two managers "in a position of soft control with respect to the combined company."

Overall, and considering the remaining *Sugarland* factors, the court concluded that an attorneys' fees award in the amount of US$9.35 million was an equitable award falling within the range of precedents.

Online HealthNow, Inc., et al: Anti-fraud provisions can be 'too much dynamite'

Why it is important

The Delaware Court of Chancery in *Online HealthNow, Inc., et al. v. CIP OCL Investments, LLC,* (C.A. No. 2020-0654-JRS (Del. Ch. August 12, 2021)) extended a recent line of cases declining to enforce seller-friendly provisions limiting claims by buyers for fraudulent misrepresentations within the contract. The court likened the "remarkably robust" seller protections in the agreement at issue to "too much dynamite" and found that the provisions were ineffective in barring claims for fraud within the contract itself because a party "cannot invoke a clause in a contract allegedly procured by fraud to eviscerate a claim that the contract itself is an instrument of fraud."

Summary

In the fall of 2018, Online HealthNow, Inc. and Bertelsmann, Inc. (the Buyer) agreed to purchase OCL Holdings (OCL) and its related subsidiaries from CIP OCL Investments, LLP (the Seller). OCL sells continuing education programs to adults, mainly located in the United States. As part of the purchase, the Seller represented that OCL did not have any undisclosed liabilities. However, at the time of the sale, OCL owed an estimated US$8-9 million in unpaid sales and use taxes. According to the Buyer, the Seller knew of this liability and actively hid it from the Buyer, including by making representations in the purchase agreement that the Seller knew were false at the time the agreement was signed.

The Buyer brought suit after learning of the undisclosed tax liability. The Seller moved to dismiss, arguing, among other things, that all representations and warranties under the purchase agreement expired at closing, and further arguing that the agreement limited the parties who could be named in a suit relating to the transaction.

The court denied the motion in its entirety, holding that the Seller could not invoke protections in a contract it was accused of procuring through fraud to block claims asserting that fraud. The court reiterated the importance of *ABRY Partners V, L.P. v. F & W Acquisition LLC*, which held that sellers could not rely on an anti-reliance provision in a purchase agreement to defeat claims alleging fraudulent misrepresentations within that same purchase agreement.

The court also rejected the Seller's argument that the purchase agreement barred fraud claims by causing all contractual representations and warranties to expire at closing. The court called into doubt the Superior Court's decision in *Sterling Network Exchange LLC v. Digital Phoenix Van Buren LLC*, which held that parties could limit the time period in which claims could be asserted so long as the limitations were "reasonable," and found that under the facts alleged, the restrictions at issue were neither reasonable nor enforceable.

The court also found that the contractual provisions prohibiting fraud claims against certain parties were also unenforceable if those parties were complicit in defrauding the Buyer into entering into the agreement that contained those protections.

Flannery v. Genomic Health: Mixed consideration deal with 58 percent stock evades Revlon enhanced scrutiny

Why it is important

In *Flannery v. Genomic Health, Inc., et al.* (C.A. No. 2020-0492-JRS (Del. Ch. Aug. 16, 2021)), the Delaware Chancery Court made three key holdings regarding a merger involving mixed consideration of 58 percent stock and 42 percent cash. First, entire fairness review was not triggered because the Baker Brothers Entities (BBEs), were neither controlling stockholders nor conflicted. Second, the merger did not trigger Revlon duties because the company "stay[ed] in a large, fluid, changeable and changing public market." Third, Exact was not an interested stockholder subject to 8 Del. C. § 203 because there was no voting agreement in place between the BBEs and Exact prior to the Board's vote to approve the merger. This case explores the application of Revlon to mixed consideration deals and illustrates the detailed analysis Delaware courts apply to questions regarding independence and control.

Summary

In November 2019, Exact, a molecular diagnostics company, acquired Genomic, a diagnostic test company, for a mix of cash and stock valued at US$2.8 billion. The merger plan, announced in July, was approved by 84.56 percent of Genomic's outstanding shares, including, pursuant to a voting agreement, four entities controlled by Felix and Julian Baker (the BBEs), which held approximately 25 percent of the outstanding shares.

Prior to the merger, in 2017, Genomic had conducted a robust market check for strategic combinations, contacting 27 potential suitors and signing confidentiality agreements with 16, although no suitor offered a definitive indication of interest. Then, in 2019, Exact contacted Genomic's CEO with an "out of the blue" combination proposal, which led to six weeks of robust negotiations over the deal price and potential terms. During the negotiations, both Genomic's and Exact's stocks were trading at all-time highs, so the discussions included bartering over the mix of consideration and whether to include a collar on the stock portion of the deal. Exact was initially against the collar, but conceded on that point in order to quickly finalize the deal, which was approved by Genomic's board on July 28.

During negotiations, Exact also reached out to the BBEs to demand a voting agreement and to discuss agreeable terms. The BBEs, on July 26, indicated that they would not agree to trading restrictions while the merger was pending but that they would still agree to vote in favor of the proposed transaction. Exact and the BBEs entered a voting agreement two days later, on July 28, after the Genomic Board approved the merger agreement.

For the plaintiff's breach of fiduciary duty claims, the court found that the defendants' arguments that the plaintiff's claims were "after-the-fact quibbles with the exercise of business judgment by corporate fiduciaries that should not be subjected to judicial second guessing" carried the day. The court refused to apply entire fairness review based on the allegation that the BBEs controlled Genomic because those entities owned only 25 percent of the outstanding shares, held only two of eight board seats, and "d[id] not meddle in the day-to-day operations of

the Company." The fact that the BBEs' Felix and Julian Baker were friends and business partners with the majority of the board and had investments in companies where the board members worked or sat on other boards was not enough to rebut the presumed independence of those board members. Even if the BBEs were controllers, there was no indication that they had a conflict of interest in the merger because there was nothing resembling a fire sale, substantial liquidity crisis, or other divergent interest.

Enhanced scrutiny under *Revlon* also was not justified because there were no allegations that the merger resulted in a change of control. The merger consideration was 58 percent stock and 42 percent cash and there was no allegation that Exact had a controlling shareholder. Under those facts, "it cannot be said that Genomic abandoned its long-term strategy," and its shareholders were not prevented from obtaining a control premium for their shares in a future transaction. Even if *Revlon* did apply, the exculpatory clause in Genomic's charter meant that the plaintiff had to allege bad faith or disloyal conduct, which she failed to do. The transaction was arms-length, the process leading to the merger was robust, it was preceded by an extensive market check in 2017, and the ultimate agreement to a 5 percent premium over Genomic's then-current trading price was not beyond the bounds of reasonable judgment.

In reviewing the plaintiff's claim under 8 Del. C. § 203, which prohibits an owner of 15 percent or more of a corporation's voting stock from engaging in a business combination with the corporation within three years after acquiring such ownership, the court rejected the argument that Exact became an "interested shareholder" before the merger agreement was signed by having "an agreement, arrangement or understanding for the purpose of acquiring" the BBEs' 25 percent stake in Genomic on July 26. The court said that there must be a meeting of the minds to form an agreement, and that there was not even an informal meeting of the minds on July 26 because the BBEs' communication rejected the proposed voting agreement and conditioned their intent to vote their shares in favor of the transaction on a voting agreement that did not contain trading restrictions. The later voting agreement, executed after the merger agreement, did not change the analysis, because that agreement was evidence of only "the commonplace scenario where a large stockholder agrees to vote its shares in favor of a transaction approved and authorized by the board of the target company." The court also noted that Genomic's board implicitly approved the voting agreement by negotiating with the understanding that Exact would require a voting agreement. Overall, the court said, the conduct at issue was nothing like the kind of abusive takeover practices that § 203 was enacted to prevent.

In re Pattern Energy Group Inc.: Risks to directors and officers in not maximizing stockholder value

Why it is important

In a 200+ page decision, the Court of Chancery in *In re Pattern Energy Group Inc. Stockholders Litigation* (C.A. No. 2020-0357-MTZ (Del. Ch. May 6, 2021)), declined to dismiss putative shareholder class claims for breach of fiduciary duty against the officers and directors of Pattern Energy Group Inc. stemming from the US$6.1 billion sale of the company, even though the sale process "was run by an undisputedly disinterested and independent special committee that recognized and nominally managed conflicts, proceeded with advice from an unconflicted banker and counsel, and conducted a lengthy process attracting tens of suitors that the special committee pressed for value." The case stands as a reminder of the risks to directors and officers where they consider goals other than the maximization of stockholder value, particularly where a bidder is selected that offers less than other bidders.

Summary

Riverstone is a private equity fund that owned and controlled Pattern Energy Group Inc. (the Company) and Pattern Energy Group LP (the LP). The LP had a substantial stake in the Company, and because the LP was mostly owned by Riverstone, Riverstone was the Company's majority shareholder.

In 2018, the Company's board began exploring a potential sale. The board formed a disinterested and independent special committee, which followed many standard procedures, including identifying conflicts, obtaining advice from an unconflicted banker and counsel, and conducting a lengthy process that attracted tens of suitors that the special committee pressed for value. Ultimately, however, the special committee selected a lower bid made by Canada Pension Plan Investment Board (the Buyer), despite a competing bid from Brookfield that offered shareholders greater value.

The plaintiff alleged that the process the committee followed suffered from numerous deficiencies, including allowing a conflicted director and officer to engage with potential bidders. The plaintiff alleged that the Company's board of directors had breached their duty of loyalty, and that the Company's officers, Riverstone, and the LP formed a "controlling group" that owed and breached their fiduciary duties to shareholders. The court found that the plaintiff had adequately alleged bad faith by the defendants and rejected the defendants' arguments that they were protected by the company's exculpatory charter provision or that any deficiencies in the sale process were "cleansed" by an informed stockholder vote under *Corwin*. The court noted in rejecting these defenses that, among other things, the buyer's inferior bid allegedly was preferred and shaped with the directors' and officers' involvement by a private equity investor in the seller.

The court first considered what standard of review would apply to the transaction. The court found that because shareholders were cashed out, the transaction was subject to enhanced scrutiny under *Revlon*. The plaintiff argued that the standard of review should be even higher – the court should consider the transaction under the entire fairness standard. The court declined to apply the "entire fairness" standard of review at the motion to dismiss stage, but did not rule out the possibility that the

transaction could be examined later under the entire fairness standard in the event it were determined based on a fuller record that a control group stood on both sides of the transaction.

On the question of whether the directors breached their duty of loyalty, the court found that the special committee had taken "reasonable actions" to fulfil their duties, and was disinterested and independent. The special committee also hired independent advisors, and engaged with several bidders, providing many of them with the opportunity to conduct due diligence. Furthermore, the special committee refused to grant exclusivity to any particular buyer and also attempted to keep Brookfield at the table.

The court found, however, that all of these reasonable steps were colored by the directors placing the interests of Riverstone, the LP, and the officers above maximization of shareholder value. The court found that the plaintiff had sufficiently alleged that the defendants may have acted in bad faith. That bad faith was evidenced by certain interested directors involvement in the special committee's meetings and discussions with potential buyers; the preference for the Buyer throughout the process, despite Brookfield's superior offers; and misuse of Riverstone's consent right over changes of control. The court held that these issues outweighed whatever reasonable steps that the directors took. Thus, the court found it reasonably conceivable that the Board failed to comply with its duty to maximize shareholder value.

Although the court noted that *Revlon* claims "do not admit of easy categorization as duties of care or loyalty[,]" the court held that the plaintiff's allegations made it reasonably conceivable that the director defendants acted in bad faith by (1) placing others' interests above their duty to maximize stockholder value and (2) abdicating their duty of disclosure. As a result, the court held that the exculpation provision in the Company's charter did not support dismissal of the claims against the directors at the pleading stage. The court also held that the plaintiffs pleaded claims against certain officers (who are not protected by an exculpatory charter provision) based on their alleged conflicts.

The court further concluded that the defendants could not invoke *Corwin's* protections because, among other things, a majority of the vote was cast by a stockholder that was contractually obligated to vote its preferred shares in accordance with the board's recommendation and otherwise was interested in the transactions because it stood to receive non-ratable benefits.

Express Scripts, Inc. et al. v. Bracket Holdings Corp.: Plain language of fraud carve-out for “deliberate” fraud does not include “reckless” fraud

Why it is important

In *Express Scripts, Inc. et al. v. Bracket Holdings Corp.* (No. 62, 2020 (Del. Feb. 23, 2021)), the Delaware Supreme Court invalidated a US$82 million jury verdict and ordered a retrial on an M&A buyer’s claim for fraud by the seller, finding that where a purchase agreement limited fraud claims to “deliberate” fraud, it was error to allow the jury to find liability based on reckless fraud. The decision establishes that Delaware courts will enforce contractual limitations on liability for reckless, grossly negligent or negligent fraud, provided the liability limitations are drafted with clear and unambiguous language and do not limit liability for intentional fraud. The decision also illustrates Delaware courts’ willingness to enforce transaction structures limiting a buyer to a representations and warranties insurance policy, absent evidence of intentional fraudulent acts by the seller.

Summary

Express Scripts, Inc. (ESI) is a pharmaceuticals management and support services company that acquired United BioSource LLC (BioSource) as a subsidiary in 2012. In 2013, Bracket Holding Corp. (Bracket) acquired the BioSource business from ESI for US$187 million. Other than for “deliberate fraud” or breaches of fundamental representations, the purchase agreement provided that Bracket’s exclusive remedy was to bring claims under a representations and warranties insurance policy.

After closing, Bracket alleged that ESI and BioSource had fraudulently inflated the business’s revenue and working capital by millions of dollars. Bracket filed an arbitration to collect under its insurance policy in 2014 and was awarded US$13 million; ESI and BioSource were not involved in this arbitration proceeding. Bracket then sued ESI, BioSource, and BioSource’s former Vice President of Finance in the Delaware Superior Court for fraudulent inducement. BioSource counterclaimed for Bracket’s failure to pay under a separate Transition Services Agreement post-closing. One point of contention, both before and after the trial, was the state of mind required for fraud: Bracket argued that the defendants should be liable for both deliberate fraud and reckless conduct amounting to fraud, while the defendants argued that the agreement limited liability to the former. The Superior Court ruled that because “deliberate” was not otherwise defined in the purchase agreement, the common law standard for fraud applied, which includes recklessness. The Superior Court found that including the phrase “deliberate fraud” in the purchase agreement without defining the term “deliberate” did not constitute an express agreement to alter the common law standard for fraud, and that accordingly the parties had not modified that standard.

After a 10-day trial, the Superior Court issued a jury instruction on the common law definition of fraud that included recklessness. The jury found that BioSource committed fraud aided and abetted by ESI and awarded Bracket US$82.1 million in damages. The jury separately found that Bracket breached the Transition Services Agreement and awarded BioSource US$2.2 million in damages.

On appeal, the Delaware Supreme Court reversed, finding that where an exculpatory clause limited the seller’s liability to deliberate fraud, the seller could not be held liable for reckless fraud. The court found that the phrase “deliberate fraud” was clear and unambiguous, rejecting the argument that the term “deliberate fraud” needed to be defined, or that “deliberate fraud” includes reckless fraud. The court further found that the trial court’s erroneous jury instruction was not a harmless error because it allowed for liability to be established upon a lesser mental state, and that a retrial was necessary.

Steves and Sons, Inc. v. JELD-WEN, Inc.: Private antitrust plaintiff forces unwind of merger

Why it is important

For the first time, a private antitrust plaintiff has successfully forced a defendant to unwind a completed merger. The Fourth Circuit upheld the Eastern District of Virginia's decision requiring JELD-WEN, a supplier and competitor of plaintiff Steves and Sons, Inc. (Steves), to divest the assets it acquired in a 2012 merger. In doing so, the court called the case the "poster child for divestiture" because the merger resulted in a duopoly of vertically integrated manufacturers that expressed intent to use their market power to put competitors out of business. The court also rejected JELD-WEN's laches defense and found that it was not relevant that the Department of Justice reviewed the merger twice and decided not to take any action. This decision (No. 19-1397 (4th Cir. Feb. 18, 2021)) enhances the antitrust risks associated with merger transactions by recognizing that a competitor may seek dissolution.

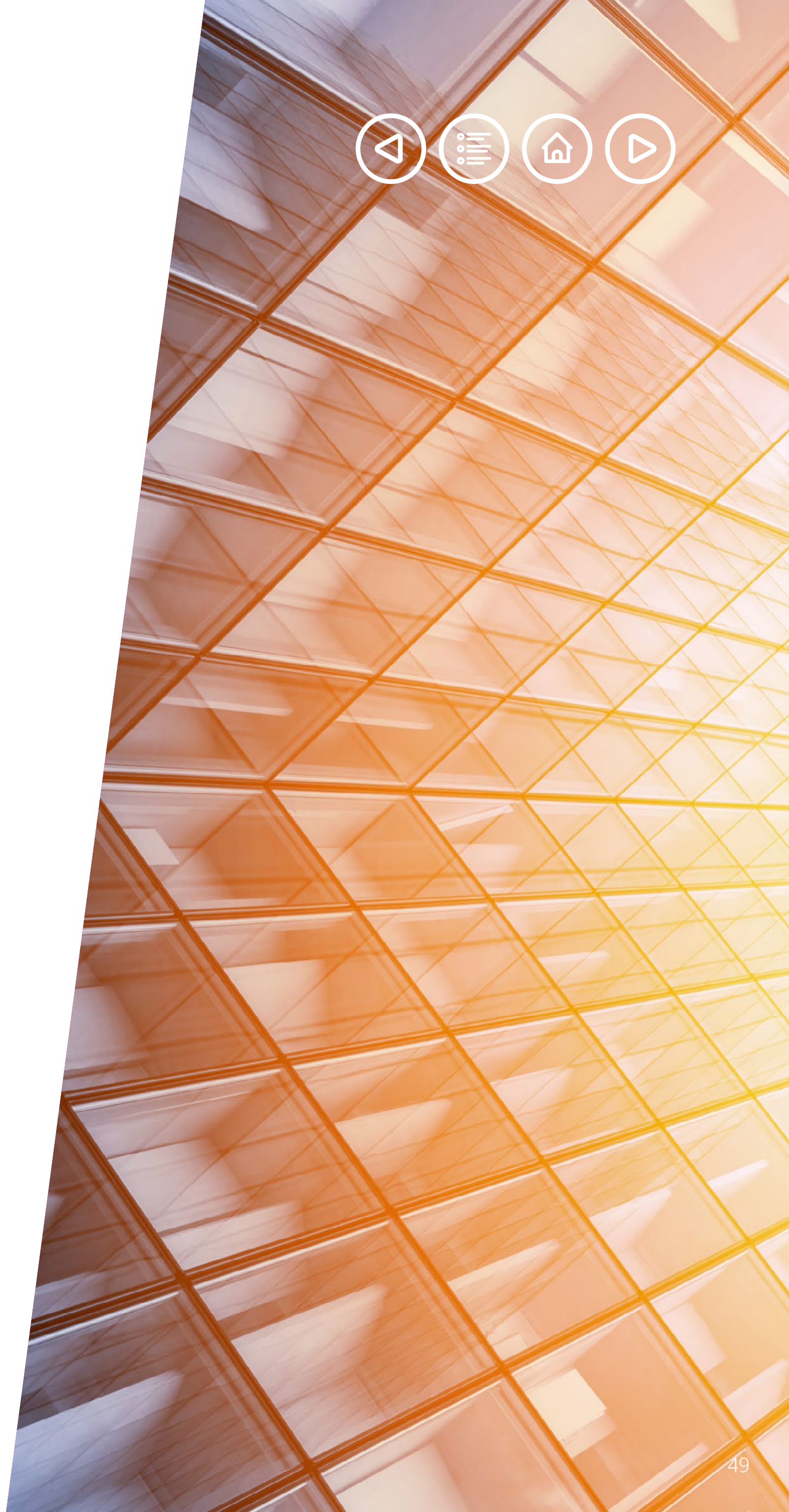
Summary

Both Plaintiff Steves and Defendant JELD-WEN make molded doors by attaching two molded "doorskins" to either side of a wood frame. JELD-WEN manufactures doorskins to use in its own doors and to sell to independent doormakers like Steves. Before 2012, there were three doorskin manufacturers in the United States, JELD-WEN, Masonite, and CMI, each of which made their own doors and sold doorskins to independent doormakers. In October of 2012, JELD-WEN acquired CMI, reducing that number to two. The Department of Justice investigated this acquisition but closed its investigation without taking action.

From 2010 to 2012, Steves bought doorskins from CMI and Masonite. In May of 2012, Steves signed a long-term supply contract with JELD-WEN. Shortly after signing the agreement, Steves began noticing quality issues in the doorskins. JELD-WEN also increased the prices it charged Steves every year despite its costs decreasing.

In 2014, Masonite announced that it would stop selling doorskins to all independent doormakers. Shortly after that, JELD-WEN gave Steves notice of termination of the supply contract, which would be effective in seven years. This left Steves facing the prospect of having no ability to purchase doorskins starting in September 2021, and, consequently, going out of business. So, in 2015, Steves began the dispute resolution process established by the supply contract and asked the Department of Justice to reexamine the CMI acquisition. Steves did not get any relief from the contractual dispute resolution process and the Department of Justice closed its investigation without acting, so Steves filed suit in June 2016 for breach of contract and under Section 7 of the Clayton Act.

After a trial, the jury found that JELD-WEN had breached the supply contract by overcharging for doorskins, that JELD-WEN's merger with CMI had the effect of substantially lessening competition, that Steves had suffered an antitrust injury, and that Steves had proved past and future damages resulting from the antitrust injury. The district court then held a bench trial on Steves' claims for equitable relief, including divestiture. Rejecting JELD-WEN's laches defense, the district court granted the request for divestiture. Using the two-step process established in *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962), the district court held that JELD-WEN could first appeal the divestiture order, and then, if it was affirmed, a special master would run an auction of the divested assets. JELD-WEN appealed.



On appeal, the Fourth Circuit rejected JELD-WEN's argument that Steves failed to prove an antitrust injury by considering whether Steves would have suffered an identical loss if JELD-WEN had breached the contract without having merged with CMI. It found that the merger weakened the competitive pressures on JELD-WEN to provide good customer service and high-quality products, enabled it to raise prices without fear of being undercut by another supplier, and foreclosed Steves' ability to mitigate its damages by buying from other doorskin manufacturers.

The Fourth Circuit also rejected JELD-WEN's attacks on the divestiture order for two main reasons. First, it found that the district court properly rejected JELD-WEN's laches defense because, despite filing suit nearly four years after the merger, Steves did not unreasonably delay filing suit. Steves did not discover its injury until 2014, when JELD-WEN terminated the supply contract and Masonite announced that it would no longer sell to independents, and then diligently exhausted its alternative remedies through 2016, when it filed suit.

Second, the Fourth Circuit affirmed the district court's grant of equitable relief. The potential of Steves, a family-owned business for over 150 years, going out of business was a significant threat of irreparable harm that could not be repaired with money damages. The balance of the hardships tipped in favor of divestiture because Steves' potential collapse was a greater hardship than the significant cost to JELD-WEN of divesting the doorskin plant it acquired in the CMI merger. And divestiture served the public interest because it was likely to result in a third doorskin supplier entering the market, which would end the duopoly of JELD-WEN and Masonite and increase competition.

In re Columbia Pipeline Group, Inc. Merger Litigation: Prior appraisal and securities litigation does not bar breach of fiduciary duty action

Why it is important

In *In re Columbia Pipeline Group, Inc. Merger Litigation* (C.A. No. 2018-0484-JTL (Del. Ch. Mar. 1, 2021)), the plaintiffs alleged that the defendants, the officers and directors of Columbia, Inc., breached their fiduciary duties and that the purchaser, TransCanada, aided and abetted those breaches. The defendants moved to dismiss, arguing that two prior litigations arising from the same merger were preclusive and that the plaintiff failed to state a claim. The Delaware Court of Chancery found that shareholders who were not plaintiffs in the prior litigations – here, an appraisal action and a federal securities action – were not barred from bringing suit. The Court of Chancery also did not defer to the decisions in the prior litigations, finding that the plaintiffs had sufficiently alleged that the officers breached their duties of disclosure and loyalty, and had sufficiently alleged an aiding and abetting claim against TransCanada.

Although a case with extreme facts, this decision highlights that even if challenges to a merger transaction have been rejected in one forum, a defendant may have to relitigate issues arising from the transaction in another forum when facing a differently situated plaintiff – and may face different result. The decision also is notable because it sustained an aiding and abetting claim against an acquiror.

Summary

In December 2014, NiSource spun off Columbia Pipeline Group, Inc. (Columbia), with Robert Skaggs, Jr. serving as CEO and chairman of the board, and Steven Smith serving as CFO. The plaintiffs alleged that Skaggs and Smith, even before the spin-off, planned to sell Columbia for their own financial benefit. From July 2015 to November 2015, several companies proposed acquiring Columbia. Columbia executed NDAs with all of these companies, with standstill and "don't ask, don't waive" (DADW) provisions.

Plaintiffs alleged that Skaggs and Smith showed favoritism to TransCanada as a bidder for Columbia. In December 2015, a TransCanada officer contacted Columbia in violation of the standstill provision in the NDA. Nevertheless, Smith allegedly provided TransCanada with 190 pages of confidential information, including notes from Columbia's financial advisor discussing how to convince Columbia's board to agree to a merger, without exposing TransCanada to a competitive auction for Columbia. Smith told TransCanada that Columbia had eliminated other possible acquirers. The board of directors was not aware of communication between TransCanada and Columbia, and Skaggs and Smith allegedly did not engage with any other acquirers, even when instructed to do so by the board.

On March 9, 2016, TransCanada sent a proposal to Columbia. After another bidder emerged, TransCanada is alleged to have demanded a "moral commitment" that Columbia would only respond to other bids, if that bid was fully financed and subject only to confirmatory diligence. Skaggs agreed. Thereafter, TransCanada lowered its offered share price and included additional restrictions on Columbia's ability to consider other bids. Nevertheless, the board approved the merger, which closed on July 1, 2016; Skaggs and Smith retired shortly afterwards.

After the merger was complete, shareholders filed both appraisal litigation in the Delaware Court of Chancery and a securities class action in the United States District Court for the Southern District of New York. The Chancery Court found that the plaintiffs had received fair value for their shares, despite material omissions. The Southern District of New York dismissed the class action without certifying a class. Later, the plaintiffs in this case sued in the Court of Chancery, alleging breach of fiduciary duty by Skaggs and Smith, and aiding and abetting breaching of fiduciary duty by TransCanada. The plaintiffs were not parties in any of the prior proceedings.

The defendants moved to dismiss, making two procedural arguments (that the plaintiffs were barred by issue preclusion or stare decisis) and arguing substantively that the plaintiffs had failed to state a claim for relief. Vice Chancellor Laster rejected the procedural arguments, finding that aligned interests or prior adequate litigation efforts alone do not bar a non-party from bringing suit. Instead, the plaintiff must have been a party to the prior litigation to be bound. Regarding the stare decisis argument, the court noted that no prior court had decided whether there was a breach of fiduciary duty under Delaware law, so the court had to consider the case before it under Delaware's pleading standard.

The court then considered whether the complaint's allegations pleaded a claim for breach of fiduciary duty. The court applied enhanced scrutiny because the complaint alleged conflicts of interest rather than the business judgment rule. In doing so, the court rejected the defendants' argument that the business judgment rule should apply under the *Corwin* doctrine. Specifically, the court concluded that *Corwin* cleansing did not apply because the proxy statement made three material omissions, and thus the shareholder vote was not fully informed.

The court next examined whether the decision-making process behind the transaction and the directors' actions were reasonable in light of the circumstances at the time. The court found that the plaintiffs had alleged sufficient details to overcome a motion to dismiss, relying on the allegations that the defendants provided confidential information to TransCanada and failed to keep the Columbia board fully informed. Furthermore, the court found that the plaintiffs had pleaded a sufficient claim against TransCanada for aiding and abetting Skaggs' and Smith's breaches because TransCanada allegedly breached its DADW standstill, became aware of Skaggs' and Smith's fiduciary duty breaches, and failed to disclose these breaches in its proxy statement.

Brookfield Asset Management Inc. v. Rosson: Gentile overturned, eliminating dual-natured claims

Why it is important

In *Brookfield Asset Management Inc. v. Rosson* (No. 406, 2020 (Del. Sept. 20, 2021)), the Delaware Supreme Court unanimously overturned its 2006 decision in *Gentile v. Rossette*, thereby eliminating the dual nature "*Gentile* carve-out" that allowed for both direct and derivative claims for alleged breaches of fiduciary duty premised on dilutive transactions for the benefit of controlling stockholders. The Delaware Supreme Court agreed with Brookfield's argument that *Gentile* deviated from and was doctrinally inconsistent with the "simple analysis" previously adopted by the Delaware Supreme Court in 2004 in *Tooley v. Donaldson, Lufkin & Jenrette*. Specifically, the Delaware Supreme Court held that certain aspects of Gentile are in tension with *Tooley*, most importantly the test determining whether claims are direct or derivative, and that the *Gentile* carve-out was superfluous.

Summary

In October 2017, Brookfield Asset Management (Brookfield) became the controlling stockholder of Terraform Power (TerraForm). Several months later, in early 2018, Brookfield encouraged TerraForm to acquire Saeta Yield, S.A. (Saeta), a Spanish power company. TerraForm determined that it could effectuate the acquisition with US$800 million in available liquidity and a US$400 million equity offering. In connection with the equity offering, TerraForm entered into a support agreement pursuant to which Brookfield would backstop up to 100 percent of the US$400 million equity offering. Following the commencement of the tender offer, the TerraForm board opted to raise US$650 million, rather than US$400 million, and Brookfield agreed to continue to backstop 100 percent of the equity offering.

After additional discussions, in June 2018, the TerraForm board changed plans again, and decided to sell the US$650 million proposed offering directly to Brookfield in a private placement at US$10.66 per share. The private placement increased Brookfield's holdings in TerraForm to 65.3 percent. Following the acquisition of Saeta, TerraForm's stock price increased to US$11.77, or 10.4 percent above the private placement price.

Following the private placement, several minority shareholders brought a derivative and class action suit alleging that TerraForm and Brookfield breached their fiduciary duties by issuing stock for inadequate value, thereby diluting the financial and voting interests of the minority stockholders. After the case was filed, Brookfield acquired all of TerraForm's remaining stock.

In its motion to dismiss, Brookfield argued that the dilution claims were exclusively derivative because all harm would flow to TerraForm, and the plaintiffs no longer had standing after the merger. The Court of Chancery denied the motion to dismiss, agreeing that the claims were exclusively derivative under *Tooley*, but holding that both the direct and derivative claims could still be brought because the facts of the case fit the *Gentile* carve-out, which held that some claims of corporate dilution are "dual-natured," permitting both direct litigation on behalf of shareholders and derivative litigation on behalf of the company.

The Delaware Supreme Court accepted Brookfield's interlocutory appeal to consider the *Gentile* carve-out to the test the Court previously established in *Tooley v. Donaldson, Lufkin & Jenrette* for determining whether claims are direct or derivative. Under *Tooley*, the determination of whether a claim is direct or derivative "must turn *solely* on the following questions: (1) who suffered the alleged harm (the corporation or the stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?" In *Gentile*, the Delaware Supreme Court found that some claims could be both direct and derivative in nature if "(1) a stockholder having a majority or effective control causes the corporation to issue 'excessive' shares of its stock in exchange for assets of the controlling stockholder that have a lesser value; and (2) the exchange causes an increase in the percentage of the outstanding shares owned by the controlling shareholder, and a corresponding decrease in the share percentage owned by the public (minority) shareholders."

Brookfield argued that *Gentile* should be overturned. The Supreme Court unanimously agreed, concluding that the difficulties Delaware courts had in applying *Gentile* after 15 years constituted more than mere "growing pains." The Supreme Court held that *Gentile* was in conflict with *Tooley*, leading to a carve out that was both contradictory and unnecessarily complicated. The Court also explained its decision to overturn given the weight of precedent, noting that it had ruled unanimously, and that 15 years had shown that the practical and analytical difficulties of *Gentile* rendered it fundamentally unworkable. The court also acknowledged that reliance on the Gentile carve-out was muted by the court's previous decision in *El Paso Corporation*, in which the Delaware Supreme Court declined to "expand the universe of claims that can be asserted 'dually'. . . ," making clear that *Gentile* had to be read narrowly because "any other interpretation would swallow the general rule that equity dilution claims are solely derivative and cast doubt on the *Tooley* framework."

Brookfield is expected to engender greater clarity and predictability in whether a stockholder's corporate dilution claims are determined to be direct or derivative. Defendants are also now more likely to defeat merger claims at the pleading stage of litigation, especially when stockholders' standing to bring derivative claims has been extinguished under Delaware law.

Rosenbaum v. CytoDyn: Noncompliance with advance notice bylaw can block shareholders' board nominees

Why it is important

In *Rosenbaum v. CytoDyn Inc.* (C.A. No. 2021-0728-JRS (Del. Ch. Oct. 13, 2021)), the Delaware Court of Chancery declined to apply the Blasius enhanced scrutiny standard to an incumbent board's rejection of shareholders' proposed board nominees based on noncompliance with an advance notice bylaw. The court also refused to apply the business judgment rule, instead applying equitable principles to evaluate whether the advance notice bylaw, as applied, afforded the shareholders a fair opportunity to nominate director candidates. Applying these principles, the court upheld the board's decision, finding no inequitable conduct where the board had reasonably rejected shareholders' nomination notice.

Summary

On the eve of the submission deadline prescribed by the bylaws, a group of dissident stockholders of pharmaceutical firm CytoDyn filed an advance notice of intent to nominate rival candidates to replace the incumbent board at the company's next annual meeting. Nearly a month later, the board sent a deficiency letter identifying several omissions in the notice. Although the stockholder group filed a supplemental notice with the missing information, the board rejected the notice. The dissident stockholders sought an injunction compelling CytoDyn to allow the nominees to stand for election and argued that the heightened scrutiny of *Blasius Industries, Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988) should apply because the board acted "for the primary purpose of preventing the effectiveness of a shareholder vote," and that the court should impose a presumption that the conduct was invalid unless the board could provide a compelling justification. The board, on the other hand, argued that the advance notice bylaws were a matter of pure contract law that should be evaluated under the business judgment rule.

Vice Chancellor Slights rejected the application of both standards, finding instead that equitable principles articulated in *Schnell v. Chris-Craft Indus., Inc.* applied. The court found no basis to apply the exacting *Blasius* standard because there was no evidence that the board's denial of the shareholder nominees was the product of "manipulative conduct." But the deferential business judgment rule was also inappropriate given the structural conflicts that confront any incumbent board when enforcing an advance notice bylaw to reject a proposed rival slate for election to the board. Drawing from the equitable principles in *Schnell*, the court found that it is the plaintiffs' burden to prove that there are "compelling circumstances" that justify a finding of inequitable conduct.

Applying this standard, the court found in favor of the board. Even though the board waited nearly a month before sending out its deficiency letter, the plaintiffs waited until the last minute to file their nomination notice knowing the bylaws contained no method to cure, and thus ran the risk of filing a noncompliant notice subject to rejection by the incumbent board. Indeed, the court found that the notice was deficient

in two key respects – it did not disclose who supported the nominations and it did not disclose that one of the nominees may seek to facilitate an insider transaction – and thus, the board rejected the notice on reasonable grounds.

The ruling illustrates that Delaware courts will enforce reasonable advance notice bylaws to reject rival board nominees in the absence of inequitable conduct by the incumbent board. However, the *Rosenbaum* opinion also highlights two scenarios that may have resulted in a different outcome. In *Rosenbaum*, the court emphasized that CytoDyn's advance notice bylaws were put in place on "a clear day" years before the controversy. The court also observed that the board's nearly month-long delay in responding to the shareholders' nomination notice may have been viewed differently if the plaintiffs' notice was submitted well in advance of the deadline. Thus, the outcome may be different in instances where an advance notice bylaw was not adopted on a clear day, or where the board remained silent in responding to a nomination notice submitted well in advance of the deadline such that deficiencies could have been timely cured.

Securities, Shareholder, and M&A Litigation practice overview

Securities, Shareholder, and M&A Litigation practice overview

At Hogan Lovells, we guide companies – and their officers and directors – through all types of disputes that arise with their investors, shareholders, and transactional partners. You must engage seasoned litigators who will work with you through the full lifecycle of the dispute to protect your interests. We are the team to have on your side, whether to obtain favorable outcomes at the earliest possible stage or to defend your interests all the way to verdict through appeal, when necessary.

We have a unique approach to defending our clients in securities, shareholder, and M&A litigation. First and foremost, we work with you to identify and prioritize your business objectives. We also help you develop the factual and legal framework to drive the proper narrative. We put together the right team to handle your matter, including lawyers across different practices, geographies, and industry experience. We are able to do this in a cost effective way through use of our advanced technology platforms, such as machine learning and other types of AI, to review documents, prepare litigation outcome assessments, help surface new insights, and realize other efficiencies and enhance service quality.

We bring extensive experience spanning all industries, focusing on the following areas:

1. Corporate governance litigation
2. Private company M&A disputes
3. Public company M&A litigation
4. Federal securities litigation
5. Investment fund disputes and litigation

Corporate governance litigation

Shareholders frequently challenge decisions made by the boards of directors at both public and private companies; our role is to advise, and when necessary defend, companies and their directors against these challenges. We have successfully done so in a wide array of contexts, including M&A transactions, dissolutions, recapitalization plans, compensation awards, bylaw amendments, and voting rights agreements.

We also are frequently involved early in corporate transactions to help clients navigate the conflicts of interest – and other potential pitfalls – that often later give rise to shareholder litigation. We represent special committees of the board in investigating shareholders' allegations of misconduct. And when shareholders make books and records demands on a company under Section 220 of the Delaware General Corporations Law, or similar state laws, prior to making a litigation demand, we have significant experience in successfully limiting or opposing inappropriate demands.

Private company M&A disputes

Disputes between the buyer and the seller in private company M&A transactions arise in several predictable areas:

1. Purchase price disputes in which one party (usually the buyer) seeks to re-negotiate the deal price through the use of a post-closing price adjustment provision;
2. Earn-out disputes in which the parties disagree about whether deferred portions of the purchase price are payable based on the target's post-closing performance; and
3. Indemnification disputes where one party (usually the buyer) seeks indemnification for breach of representations and warranties in the purchase agreement.

Working with our Corporate M&A colleagues, we review transaction documents to craft the most favorable terms for your company, and if a dispute later arises – whether in arbitration or in court, we have substantial experience litigating the complex accounting and contract issues involved.

Public company M&A litigation

Recent data reflects that, in more than 90 percent of public company M&A transactions, lawsuits are filed by shareholders that purport to challenge the transactions; in transactions in excess of US$100 million that number is over 95 percent. Working together with our M&A group, we advise directors on relevant litigation issues prior to the M&A announcement and aggressively defend the predictable suit when filed, aiming to prevent plaintiffs and their lawyers from disrupting transactions that the board has found to be in the best interest of the company and its stockholders. We also have experience representing companies when faced with tender offers or proxy battles that can arise in conjunction with announced M&A transactions.

Federal securities litigation

We have deep experience representing public companies and their officers and directors in all types of securities litigation in courts across the United States. We have successfully defended clients in cases involving initial and secondary offerings alleging violations of Sections 11 and 12 of the '33 Act and fraud claims under Section 10(b) of the '34 Act. We defend companies in proxy litigation and short-swing trading cases. Underwriters and auditors also rely on us to defend them, and our attorneys have won victories for all of the major accounting firms and the leading investment banks.

Investment fund disputes and litigation

We have represented funds of all types – private equity, venture capital, distressed debt, REITs, and investment management companies – in disputes at the portfolio company and fund level. These disputes have run the gamut, involving any of the following:

- investor complaints by limited partners and shareholders;
- board disputes and/or contests for board control;
- corporate governance rights or creditor rights, both in and out of bankruptcy;
- allegations of alter ego and veil piercing;
- minority shareholder rights when the funds are not in a control position; and
- damages claims when an investment suffers loss or when a portfolio company or fund is threatened with such claims.

Private equity funds are repeat players in private M&A and corporate governance disputes, and so are we, having developed significant experience representing fund sponsors in these disputes. The sponsors also can have unique disputes with their own minority partners or investors, whether over capital calls, investor rights, or management decisions under the terms of the fund documents, and we advise and represent funds in these disputes.

Notable cases and victories

Notable cases and victories

We are a team of experienced trial attorneys focused on helping our clients achieve their key business objectives. We continued our rich history of success on behalf of our clients in 2021. Notably, our team:

- Enabled a biotech client to close an extraordinarily difficult deal on a transaction that was heavily litigated and included a remarkable four motions for TROs being filed by a director/minority shareholder to block the transaction, all of which were denied. Added pressure arose when we were confronted with a last-minute whistleblower, and we were under constant pressure from an aggressive buyer who threatened to walk on the deal.
- Defeated an injunction that sought to prevent an international M&A transaction from closing.
- Secured the full dismissal of a defamation complaint on behalf of a private equity fund in New York Supreme Court on the grounds that it lacked personal jurisdiction over our European clients based on the special jurisdictional standards applicable to defamation claims under NY law.
- Recovered US$15 million in cash as restitution owed to a publicly traded Fortune 1000 company from a former executive who defrauded the company and served a five-year prison sentence for his securities crimes.
- Won a second complete victory for Papa John's International Inc. in a securities class action filed in the SDNY.
- Won a motion to dismiss an action with prejudice for personal jurisdiction, which removes a potential impediment to our energy client's broader efforts to seek a substantial recovery from the defendants in litigation in Texas.
- Represented a Chinese travel industry conglomerate in a Delaware law breach of fiduciary duty action arising from a failed joint venture in the U.S. online travel agency industry – ICDR arbitration panel rejected nearly all of the stockholders' claims seeking US$93 million in alleged damages.
- Secured a complete victory after a five-day arbitration hearing that found that numerous investor claims seeking substantial payments were subject to extensive forbearance under a binding term sheet.
- Acting as lead trial counsel for a former CEO in the defense of claims alleging breaches of fiduciary duty based on alleged acts of self-dealing during his tenure as CEO, including being granted an order of advancement under the New York Business and Corporation Law, which states that the plaintiff must pay our client's attorneys' fees and costs to defend the case.
- We have extensive experience litigating federal securities class actions. In addition, we are regularly called upon to act as amicus curiae counsel, weighing in for our clients in some of the key securities law cases pending before the Supreme Court and other state appellate courts. Over the last 12 months, our team has:
- Represented Kevin Plank, the founder of Under Armour, in securities class actions and derivative suits in Maryland federal and state courts.
- Acted as amicus curiae in support of a leading securities industry trade organization in an important U.S. Supreme Court case that will define the conduct of state court class actions under the Securities Act of 1933.
- Represented an emerging markets investment management firm that commenced a federal action on behalf of its fund investors against the controlling stockholder of an international agricultural conglomerate, his Wyoming-based business associates, and affiliates arising from the covert transfer of more than US$1 billion in company assets into U.S. and foreign shell companies and other tortious conduct that targeted the firm's client as the company's largest noteholder.
- Represented a life sciences company in a '34 Act class action alleging misrepresentations and omissions concerning sales growth in China – motion to dismiss granted by the United States District Court for the Northern District of California, currently on appeal to the Ninth Circuit.

Our team litigated a number of cases in Delaware, and beyond, in 2021, securing important victories for our clients. We:

- Won a unanimous ruling from the Delaware Supreme Court, which affirmed that, as a matter of equity, the "affirmative deception" by the founder/director of a tech company voided his attempted "coup d'etat" to take control of the company from our client: the board of directors.
- Won a favorable settlement for our REIT client stemming from a US$4.6 billion merger that resulted in multiple shareholder lawsuits in Maryland state court dealing with key issues related to their D&O coverage.
- Advised a liquefied natural gas company on a long-running dispute with a former officer and director, and several affiliated shareholders, who filed a lawsuit against our client challenging a number of corporate actions, including significant stock offerings as invalid under t he company's corporate documents and Delaware law.
- Advised a financial services company in a coordinated effort across three separate proceedings: a lawsuit filed in Delaware

Chancery Court against a former director and officer alleging breaches of an employment agreement and duties to the company that our client invested in; a lawsuit filed in Louisiana state court by the former director seeking to invalidate his employment agreement; and an arbitration against a former officer who is alleged to have engaged in improper conduct with the former director.

- Secured a favorable settlement in a significant bet-the-company litigation in Delaware federal court that included allegations of various breaches of fiduciary duty, breaches of contract, and misappropriation of trade secrets in connection with the formation of a company that competes in the same investment market as the principals' prior employer.
- Won a motion to dismiss on behalf of our energy client in the New York Supreme Court Commercial Division in a putative class action brought by a minority shareholder alleging that our client's directors violated their fiduciary duties.
- Represented our client in Florida state court against allegations of a range of business torts, where we convinced the court to enforce a forum selection clause and secured a dismissal of amended claims with prejudice due to improper venue.

In public M&A litigation matters, we handled numerous cases in connection with hundred million-dollar deals.

- Nine separate lawsuits in four different federal jurisdictions (the U.S. District Courts for the Southern District of New York, the Eastern District of New York, the Northern District of New York, and the District of Delaware) that alleged violations of § 14(a) of the Securities Exchange Act of 1934 by making false and misleading statements to investors concerning a US-based company's US$10 billion acquisition of a tech company.
- Claims against a software company and its board of directors in federal and state court litigation arising from its US$792 million sale to an education tech company.
- Claims against a special committee of the board of directors in numerous federal and state suits challenging a "go private" merger transaction.
- Claims against a semiconductor manufacturer in a series of individual and investor class actions arising from its US$500 million acquisition of a technology company.
- Claims against a biopharmaceutical company in more than 10 suits, in a combination of federal and state courts, challenging its US550 million acquisition of a medical technology manufacturer.

In addition, we are actively litigating a number of large cases across a broad array of industries. We are currently:

- Representing a South American state-controlled oil company on a litigation over international investments of over US$200 million in a failed offshore drilling company that planned to explore oil and gas deposits off the coast of Brazil, with allegations of fraudulent inducement to invest with compensatory damages, punitive damages, and prejudgment interest of more than US$700 million.
- Representing the co-creator of a social networking site after the site owner's successful IPO didn't acknowledge her contributions to the company's early strategy development and her insights into desired features for the targeted audience.
- Representing a member of the C-suite at an entertainment company whose conduct has come under scrutiny, leading to potential shareholder suits.
- Representing a computer technology company in shareholder claims stemming from its acquisition of a digital information systems company.
- Representing a digital learning and talent management company in both state and federal courts in shareholder suits, following its acquisition of a business management consulting organization.

These examples represent just a sample of our team's experience and successes in 2021. We are poised and eager to help our clients tackle new challenges in 2022 – and beyond.

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