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2021 Delaware Year-End Review: M&A and Shareholder Litigation

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Despite the ongoing impact of the COVID-19 pandemic, it was another busy year for the Delaware courts. The Delaware Supreme Court issued several major opinions, including adopting a new unified standard for pleading demand futility in derivative suits and clarifying that stockholder claims may no longer be classified as both derivative and direct.

Meanwhile, in the Delaware Court of Chancery, another opinion joined the small but growing list of cases where a plaintiff was found to have adequately pleaded a *Caremark* derivative claim. Most of the pandemic-related broken deal litigation analyzing material adverse effects has now been resolved, and the first opinion analyzing SPAC-related litigation was issued in the first few days of 2022. The Court also continued to refine the scope of books and records demands under Section 220 of the Delaware General Corporation Law ("DGCL"), and ordered fee shifting in a case where it found a company had been overly aggressive in opposing such demands. The Court also continued to clarify what it means to be a "controlling stockholder," when the *MFW* standard of review will apply to transactions with a controller, and when *Revlon* enhanced scrutiny will apply. In other noteworthy opinions, the Court addressed the validity of an "extreme" poison pill, how a change in value between signing and closing affects fair value in an appraisal claim, and how to plead the "knowing participation" required for an aiding and abetting claim.

Finally, there have been a number of personnel changes on the Court of Chancery. Chancellor Bouchard stepped down and Kathaleen McCormick was elevated to be the first woman Chancellor in May 2021. In addition, Lori Will was sworn in as the newest Vice Chancellor, and Vice Chancellor Joseph Slights III announced his retirement shortly after the new year, so there will be at least one new jurist on the bench in 2022 as well.

Broken Deal Litigation and MAE Provisions

As we wrote about last year, there was a wave of broken deal litigation as a result of the COVID-19 pandemic, where buyers attempted to invoke material adverse effect ("MAE") and other provisions to exit their merger agreements. With a few notable exceptions, most of those cases ended in settlement. Where the Delaware courts did issue opinions, they carefully analyzed the particular language in each agreement and were generally unwilling to let the parties out of a deal through an MAE.

For example, in ***Snow Phipps Group, LLC v. KCAKE Acquisition, Inc.***, a private equity sponsored acquisition entity agreed to acquire DecoPac Holdings, Inc., the parent of a supplier of cake decorations and products to supermarket bakeries in March 2020.[1] To secure financing for the acquisition, the parties also entered into a debt commitment letter, within which they agreed to use their reasonable best efforts to work towards a definitive credit agreement. Shortly after signing, government entities around the country issued stay-at-home orders and DecoPac's weekly sales precipitously declined. In an effort to terminate the deal, the buyer was alleged to have provided potential lenders with a "draconian reforecast of DecoPac's projected sales" and demanded more favorable debt financing terms. When the lenders refused, the buyer relied on the unavailability of debt financing as a basis to not consummate the transaction. It also asserted that DecoPac had experienced an MAE due to the sales decline and had failed to operate in the ordinary course by drawing on a revolving credit facility and implementing cost-cutting measures. After a five-day trial, then-Vice Chancellor McCormick found that (1) DecoPac had not experienced an MAE, given the short duration of the sales decline; (2) even if it was reasonable to expect that COVID-19-related sales declines would give rise to an MAE, the seller-friendly exception in the contract for events "related to" government orders applied; and (3) DecoPac had not suffered disproportionately to comparable companies. The Court also found that DecoPac had not violated the ordinary course covenant because drawing on a credit line and cutting costs were consistent with its past practices. Instead, the Court found that the buyer had breached its obligation to use reasonable best efforts in connection with the debt financing, and ordered that the parties consummate the transaction.

In another closely-watched case, ***Level 4 Yoga, LLC v. CorePower Yoga, LLC***, franchisors of the CorePower branded yoga studios were given a call option on 34 CorePower studios owned and operated by Level 4 Yoga, LLC. In early 2019, the franchisors expressed an interest in exercising that option, but sought to delay the closing date. The parties eventually came to an agreement whereby closing would be pushed to April 1, 2020 in exchange for no closing conditions and the buyers assuming any market or industry-wide risk associated with the delayed closing. When April 1, 2020 rolled around, however, CorePower sought to terminate the acquisition, claiming that Level 4's closure of studios in response to COVID-19-related orders from government entities resulted in an MAE. Level 4 sued, seeking a declaratory judgment, specific

[1] C.A. No. 2020-0282-KSJM, 2021 WL 1714202 (Del. Ch. Apr. 30, 2021).

performance. and damages for CorePower's refusal to close. The trial in this matter took place in August 2021 and post-trial briefing concluded in November 2021, but as of this writing, the Court has not yet issued a ruling.[2]

There was also broken deal litigation in 2021 unrelated to the COVID-19 pandemic. ***Bardy Diagnostics, Inc. v. Hill-Rom, Inc.*** concerned a transaction in which Hill-Rom, Inc. had agreed to acquire Bardy Diagnostics, Inc., a medical device startup.[3] However, after Medicare announced that the reimbursement rates it would pay for Bardy's only medical device would be reduced by approximately 86%, Hill-Rom informed Bardy that it would not close on the deal because the decreased rates constituted an MAE between signing and closing. Bardy sued, and Hill-Rom countersued. Vice Chancellor Slights determined that there was no MAE because Hill-Rom failed to prove that the rate drop would have a durationally significant material effect on Bardy. Although the Court could have ended its analysis there, it further held that even if Hill-Rom had proven such an effect, a change in the Medicare rates was carved out from the MAE definition, and Hill-Rom failed to prove that the disproportionate-effect exception to that carve out applied. Addressing Hill-Rom's fallback common law frustration argument, the Court also held that the purpose of the merger had not been frustrated because, among other things, the parties had allocated the risk of a rate drop onto Bardy through the merger agreement's earn-out provision, thereby helping to offset any short-term losses Hill-Rom may suffer due to the rate drop. The Court ordered Hill-Rom to close the transaction, and also awarded prejudgment interest running from the time the merger would have closed (this relief was not contested by the parties). The Court did not, however, award Bardy compensatory damages, finding that the award of prejudgment interest would adequately address any harm flowing from the delayed closing.

SPAC Litigation Heats Up

As the pace of broken deal litigation has wound down in 2021, litigation involving special purpose acquisition companies ("SPACs") has picked up.

In a highly anticipated decision issued a few days into 2022, Vice Chancellor Will denied a motion to dismiss in ***In re MultiPlan Corp. Stockholders Litigation***.[4] The claims in that case centered around the disclosures contained in the proxy statement issued by Churchill Capital Corp. III, the SPAC seeking stockholder approval of the de-SPAC transaction. Specifically, the plaintiffs claimed that the proxy statement disclosed that MultiPlan was heavily dependent on a single customer who was responsible for 35% of its revenues, but did not disclose that the customer was planning to move those accounts in-house. According to the plaintiffs, the alleged omissions "robbed" them of their right to make a fully informed decision about whether to redeem their shares prior to consummation of the transaction.

In denying the motions to dismiss filed by the sponsor and the directors, the Court made two threshold rulings. First, the Court applied *Tooley* and determined that the shareholders' claims are direct rather than derivative, because they

2 C.A. No. 2020-0249 (Del. Ch. Apr. 3, 2020).

3 C.A. No. 2021-0175-JRS, 2021 WL 2886188 (Del. Ch. July 9, 2021).

4 --- A.3d ---, C.A. No. 2021-0300-LWW, 2022 WL 24060 (Del. Ch. Jan. 3, 2022).

involved the redemption right, not a right that belonged to the SPAC, and impacted the stockholders' right to redeem. Second, the Court held that the claims are subject to the entire fairness standard of review, because it was a conflicted transaction and a majority of Churchill's board was interested or lacked independence from the sponsor. Thus, the Court found that the complaint sufficiently alleged non-exculpated claims for breach of fiduciary duty against Churchill's directors. But, acknowledging that many of the features of the transaction and process identified in the complaint were common to SPACs generally, the Court emphasized that:

"[P]laintiffs' claims are viable not simply because of the nature of the transaction or resulting conflicts. They are reasonably conceivable because the Complaint alleges that the director defendants failed, disloyally, to disclose information necessary for the plaintiffs to knowledgably exercise their redemption rights. This conclusion does not address the validity of a hypothetical claim where the disclosure is adequate and the allegations rest solely on the premise that fiduciaries were necessarily interested given the SPAC's structure. The core, direct harm presented in this case concerns the impairment of stockholder redemption rights. If public stockholders, in possession of all material information about the target, had chosen to invest rather than redeem, one can imagine a different outcome."

Several other lawsuits have been filed in Delaware regarding SPACs, so *MultiPlan* is likely the first opinion of many to address these issues. SPAC sponsors, their advisors and investors will no doubt be closely watching those cases to see how this area of law develops over the next year.

"Extreme" Poison Pill Enjoined

In ***The Williams Companies Stockholder Litigation***, then-Vice Chancellor (now Chancellor) McCormick enjoined a poison pill stockholder rights plan adopted by The Williams Companies, a publicly traded natural gas company.[5] In early 2020, after COVID-19 was declared a public health emergency and oil prices dropped due to a dispute between Saudi Arabia and Russia, the company's stock price fell precipitously. To prevent the company from becoming a potential target for activists, the board decided to adopt a poison pill in March 2020. The pill had what the Court of Chancery later described as "a more extreme combination of features than any pill previously evaluated." First, the pill had an unusually low 5% trigger threshold. Second, the pill had a broad "acting in concert" (or "wolfpack") provision, which aggregated the beneficial ownership of not only investors who had expressly agreed to act in concert, but also extended to investors knowingly acting in parallel toward a goal related to changing or influencing the control of the company. Third, the pill had a broad definition of "beneficial ownership" that included synthetic equity interests such as those in options or derivatives. Fourth, the pill had a limited exemption for "passive" investors that would only apply to "truly passive investors" who do not seek to "direct or cause the direction of the management and policies" of the company. Together, these provisions were designed to, and in effect did, function as a one-year moratorium on any shareholder activism.

5 C.A. No. 2020-0707-KSJM, 2021 WL 754593 (Del. Ch. Feb. 26, 2021).

Shareholders filed suit seeking to enjoin the poison pill and alleging breach of fiduciary duty against the board, and the Court of Chancery conducted a three-day trial in January 2021. The Court analyzed the validity of the pill under the familiar two-part test in *Unocal*, which looks to (1) whether the board had reasonable grounds to conclude that a threat to the corporate enterprise existed, and (2) whether the defensive measures in the pill were reasonable in relation to the threat posed.[6] The Court determined that the threats identified by the board were "hypothetical" and "abstract," given that there was no specific activist threat, and held that "generalized concern about stockholder activism" does not constitute a "cognizable threat" under *Unocal*. The Court further concluded that the pill was a disproportionate response to the threat posed, and expressed concern that the "unprecedented collection of features" would "chill a wide range of anodyne stockholder communications." Thus, the Court enjoined the pill. On appeal, the Delaware Supreme Court upheld the Chancery Court's decision in a brief ruling without elaboration.[7]

In light of the extreme provisions included in this particular pill, this case does not suggest that the Court is likely to invalidate pills that contain more measured, litigation-tested features that are tailored to a specific, legitimate threat. However, notwithstanding its unique facts, the case serves as a good reminder of the importance of adequately documenting the threat the board is concerned about, the justifications for the features of the pill, and the board's deliberations about those issues.

New Rules Governing Pleading In Derivative Suits

For nearly three decades, the question of whether a formal demand on a company's board of directors was required before a stockholder could pursue derivative litigation was governed by two tests under Delaware law. Under the test set forth in *Aronson v. Lewis*, which applied where the stockholder sought to challenge an affirmative decision by the same board that would consider the demand, the complaint had to plead facts creating a "reasonable doubt" that (1) the directors are disinterested and independent or (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.[8] In all other circumstances, the test articulated in *Rales v. Blasband* would apply, which required a complaint to plead facts creating a "reasonable doubt" that, at the time the complaint was filed, the board "could have properly exercised its independent and disinterested business judgment in responding to a demand."[9] The question of which test applied was often hotly contested in derivative litigation.

6 *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

7 *The Williams Cos., Inc. v. Wolosky*, No. 139, 2021, 2021 WL 5112495 (Del. Nov. 3, 2021).

8 473 A.2d 805 (Del. 1984), *overruled on other grounds*, 746 A.2d 244 (Del. 2000).

9 634 A.2d 927 (Del. 1993).

In ***United Food & Commercial Workers Union v. Zuckerberg***, the Delaware Supreme Court affirmed and adopted the approach taken by the Court of Chancery last year that unified the two tests into a single three-pronged test that refocused the inquiry "on the decision regarding the litigation demand, rather than the decision being challenged."[10]

In *Zuckerberg*, stockholders claimed that Facebook's board breached its fiduciary duties by approving a reclassification of Facebook's shares that would have enabled founder Mark Zuckerberg to retain voting control of the company despite donating a significant portion of his shares to charity. Immediately challenged, the reclassification was withdrawn and never went into effect, but the stockholders pursued damages for the money spent defending and settling the challenge to the reclassification.[11] Vice Chancellor Laster noted that he could apply the *Aronson* test because the challenged decision was an affirmative board action, but he nevertheless declined to do so, citing intervening developments in Delaware law and the practical difficulties of applying *Aronson* in cases where directors abstained or joined the board after the challenged decision. Instead, the Court of Chancery introduced a unified three-part test (discussed below), and concluded that the plaintiff did not establish that demand would be futile because six of the nine Facebook directors were able to exercise independent and disinterested business judgment to consider a demand.

The Delaware Supreme Court affirmed the Court of Chancery's decision in its entirety and expressly adopted the Court of Chancery's new, three-part test for demand futility. Going forward, courts and litigants must assess the following three questions with respect to each director who was on the board at the time the complaint was filed: (1) whether the director received a material personal benefit from the alleged misconduct that would be the subject of the litigation demand; (2) whether the director faces 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 who falls into the first two categories. "If the answer to any of the questions is 'yes' for at least half" of the members of the board, "then demand is excused as futile." Although declining to overrule *Aronson* and noting that "cases properly construing *Aronson*, *Rales*, and their progeny remain good law," the Delaware Supreme Court emphasized that it is "no longer necessary to determine whether the *Aronson* test or the *Rales* test" applies.

By adopting a streamlined, unified test, *Zuckerberg* will simplify litigation over the threshold question of demand futility in derivative lawsuits filed against Delaware corporations. *Zuckerberg* may be most impactful in cases formerly governed by the *Aronson* test and may foreclose arguments previously available to plaintiffs seeking to meet the rigorous pleading standards for establishing demand futility. In particular, *Zuckerberg* clarifies the rule that demand will not automatically be deemed futile if the challenged transaction is subject to a heightened standard of review. Overall, however, the Delaware Supreme Court's decision re-affirms the core principles considered by Delaware courts in assessing demand futility, as

[10] 262 A.3d 1034 (Del. 2021).

[11] *United Food & Commercial Workers Union v. Zuckerberg*, 250 A.3d 862 (Del. Ch. 2020).

well as the significant hurdles a stockholder must overcome at the pleadings stage to establish that demand on the board of directors of a Delaware corporation should be excused as futile.

In 2021, the Delaware Supreme Court also revisited the often-debated question of when a stockholder's claim could be both direct and derivative. Under the test set forth in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, the determination of whether a stockholder's claim is direct or derivative turns on whether the stockholders or the corporation suffered the alleged harm and whether the stockholders or the corporation would receive any recovery or relief from the action.[12] However, *Gentile v. Rossette* created a carve-out for claims that involved corporate overpayment for assets of a controlling stockholder as well as the dilution of minority stockholders, and classified such "dual-natured" claims as both direct and derivative.[13] Unfortunately, *Gentile* proved difficult to apply, sometimes leading to confusing results, and case law at the trial court level began to question whether *Gentile* continued to be viable. In ***Brookfield Asset Management, Inc. v. Rosson***, the Delaware Supreme Court clarified this area of law, explicitly overruled *Gentile*, and held that stockholder claims may no longer be classified as both derivative and direct in nature.[14]

The complaint in Rosson alleged that Brookfield Asset Management, as controlling stockholder of TerraForm Power, Inc., caused TerraForm to issue stock to Brookfield through a private placement to finance the purchase of Saeta Yield, S.A. Plaintiffs brought breach of fiduciary duty claims against Brookfield, Brookfield's affiliates, and directors of TerraForm, alleging that TerraForm overpaid its controlling stockholder Brookfield in the private placement and that the private placement unfairly diluted the financial and voting interest of TerraForm's minority stockholders. During the course of the litigation, Brookfield affiliates purchased TerraForm, thereby extinguishing plaintiffs' standing to pursue derivative claims. Brookfield then moved to dismiss plaintiffs' direct claims on the basis that they were actually derivative. The Court of Chancery reluctantly denied the motion to dismiss, reasoning that, though the claims were better characterized as derivative in nature, the pleaded harms were analogous to the facts of *Gentile* and therefore precedent required it to characterize the claims as both direct and derivative.[15] Interlocutory review was granted.

On appeal, after tracing the evolution of Delaware law before and after *Gentile*, the Delaware Supreme Court concluded that *Gentile* should be overruled. The Delaware Supreme Court explained that *Gentile* had created doctrinal confusion, and further noted the practical concern that *Gentile* could arguably lead to improper double recovery by both the corporation and its stockholders. Then, because *Gentile* ceased to be controlling authority, the Delaware Supreme Court reversed the Court of Chancery's denial of the motion to dismiss. The decision gives clarity and certainty to the applicable

[12] 845 A.2d 1031 (Del. 2004).

[13] 906 A.2d 91 (Del. 2006).

[14] 261 A.3d 1251 (Del. 2021).

[15] *In re TerraForm Power, Inc. S'holders Litig.*, C.A. No. 2019-0757-SG, 2020 WL 6375859 (Del. Ch. Oct. 30, 2020).

pleading standard when stockholders bring a dilution claim, which, as the Delaware Supreme Court noted, may be "outcome-determinative" in situations where a stockholder loses standing to assert a derivative claim post-merger.

Continued Emergence Of *Caremark* Claims

Historically, stockholder derivative claims based on a board's failure to discharge its duty of oversight, known as *Caremark* claims,[16] have been one of the most difficult theories upon which a plaintiff can hope to prevail, and such cases were commonly dismissed at the pleadings stage. However, in recent years, a number of complaints asserting *Caremark* claims based on specific allegations of board misconduct or inaction have survived motions to dismiss.[17] To plead a *Caremark* claim, a plaintiff must allege particularized facts showing either that (1) "the directors utterly failed to implement any reporting or information system or controls," or (2) "having implemented such a system or controls, [the directors] consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[18] The allegations must support a reasonable inference that the directors acted with scienter, because "a showing of bad faith is a necessary condition to director oversight liability."[19]

In ***In re The Boeing Company Derivative Litigation***, Vice Chancellor Zurn determined that plaintiffs had successfully pleaded a *Caremark* claim against the board for failure to oversee "mission-critical airplane safety."[20] The case arose out of the deadly crashes of Boeing 747 Max jetliners in late 2018 and early 2019. Under the first prong of *Caremark*, plaintiffs alleged that (1) the board had no committee charged with direct responsibility to monitor airplane safety; (2) the board did not monitor, discuss, or address airplane safety on a regular basis until after the second crash; (3) the board had no regular process requiring management to apprise the board of airplane safety; and (4) management saw red or yellow flags, but never informed the board. The Court also found that the allegations supported plaintiffs' claim that the board not only "act[ed] inconsistently with their fiduciary duties, but they also knew of their shortcomings." Under the second prong of *Caremark*, plaintiffs alleged that the board had ignored the first crash and other red flags about airplane safety before the second crash, including by failing to request information from management, deciding to delay an internal investigation, and making the first board call devoted to the first crash "optional." As a result, the Court denied the motion to dismiss the

16 *See In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

17 *See, e.g.*, *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019) (claims related to listeria outbreak at Blue Bell); *Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou*, C.A. No. 2019-0816-SG, 2020 WL 5028065 (Del. Ch. Aug. 24, 2020) (claims related to illegal repackaging and sale of chemotherapy drugs); *In re Clovis Oncology, Inc. Deriv. Litig.*, C.A. No. 2017-0222-JRS, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019) (claims related to efficacy of key cancer drug).

18 *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

19 *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 123(Del. Ch. 2009).

20 C.A. No. 2019-0907-MTZ, 2021 WL 4059934 (Del. Ch. Sept. 7, 2021).

Caremark claims, although it did dismiss two other claims against the board. The case later settled for $237.5 million, one of the largest settlements ever in a derivative case.

Nonetheless, other Delaware decisions in 2021 show that it remains difficult for a stockholder to plead a *Caremark* claim in the absence of factual allegations showing bad faith conduct by directors. For example, Vice Chancellor Will dismissed claims against the board of Marriott related to a data security breach, because the record showed that the directors had tried in good faith to put a reasonable compliance and reporting system in place, were routinely apprised of cybersecurity risks, and engaged outside consultants to audit corporate cybersecurity practices.[21] These decisions underscore the importance of directors being proactive about monitoring "mission-critical" risks, ensuring that reporting systems and protocols allow them to do so regularly and effectively, and documenting their efforts in the corporation's books and records.

Books and Records Actions Under DGCL § 220

An important reason for the increasing viability of *Caremark* claims at the pleadings stage of derivative litigation has been the proliferation of books and records demands under Section 220 of the DGCL, which permits a stockholder to inspect corporate books and records for a "proper purpose" that is reasonably related to their interests as a stockholder.[22] The Delaware courts have encouraged plaintiffs to use books and records demands to investigate potential fiduciary misconduct before filing derivative actions and other suits in order to present more particularized allegations, and as a result, such pre-litigation demands have become routine. For example, in *Boeing* (discussed above), plaintiffs obtained nearly 45,000 documents pursuant to a Section 220 demand before filing suit, and used these documents to support allegations about what the board did and did not do. Indeed, the Court in Boeing even stated that "[i]t is reasonable to infer that exculpatory information not reflected in the [Section 220] document production does not exist."[23] In 2021, the Delaware Courts continued to provide guidance regarding the scope of stockholder access rights under Section 220.

In ***Gross v. Biogen***, beginning in 2016, stockholder Melvin Gross sent three demands for books and records relating to a government investigation for an alleged kickback scheme involving Biogen.[24] Biogen denied those demands, claiming that Gross did not have the requisite proper purpose. In 2019, Gross sent a fourth demand, stating that he sought to investigate possible breaches of fiduciary duty and to evaluate the independence of the directors. When that demand was also rejected, Gross filed suit. Biogen raised several defenses, including that Gross (1) did not have his own purpose for the demand, but had merely lent his name to a lawyer-driven effort, (2) had not shown a credible basis to suspect wrongdoing, and (3) had not established that he would be able to bring a lawsuit based on the wrongdoing he sought to investigate. Vice Chancellor Fioravanti rejected these arguments, finding that Gross was entitled to rely on counsel, the

21 *Firemen's Ret. Sys. of St. Louis v. Sorenson*, C.A. No. 2019-0965-LWW, 2021 WL 4593777 (Del. Ch. Oct. 5, 2021).

22 8 *Del. C.* § 220.

23 *Boeing*, 2021 WL 4059934, at *1 n.1.

24 C.A. No. 2020-0096-PAF, 2021 WL 1399282 (Del. Ch. Apr. 14, 2021).

governmental investigation was sufficient to satisfy the very low burden to meet the credible basis standard, and Gross did not have to demonstrate the existence of an actionable litigation claim because he had not limited the purpose of the demand solely to litigation. However, the Court did not require Biogen to produce all of the demanded documents, and limited the scope of production to “formal board materials,” including minutes, reports and presentations related to the investigation, compliance policies, and director independence questionnaires. The Court denied Gross’s request for “informal” board materials, such as directors’ emails and notes, concluding that Gross had not shown those documents would be “necessary and essential” to accomplishing his stated purpose, or that the formal board materials would be insufficient.

The *Biogen* decision continues to reflect the Court of Chancery’s close scrutiny of the reasonableness of a corporation’s response to Section 220 demands. As we noted last year, Delaware courts have become increasingly focused on conduct they perceive to be “obstructing the exercise of [p]laintiffs’ statutory rights,” and appear to be seeking ways to “recalibrate[e] the risks of Section 220 litigation.”[25] The Court has also made clear that there can be consequences for such behavior: in ***Pettry v. Gilead Sciences, Inc.***, Chancellor McCormick awarded $1.76 million in attorneys’ fees to the stockholders after ruling in their favor in a hotly-contested books and records dispute.[26] Taken together, these cases suggest that companies should respond promptly to reasonable demands for books and records, and show that the Court may be willing to order fee shifting in certain circumstances.

Transactions With Controlling Stockholders

Challenges to transactions involving controlling stockholders continued to be a focus of litigation in 2021, and we continued to see similar themes. The Court of Chancery further refined the contours of when the *MFW* framework can apply to such transactions.[27] The Court also addressed circumstances under which minority stockholders are deemed to be “controllers.”

The Scope of MFW’s Application to Controller Transactions

In ***Berteau v. Glazek***, Vice Chancellor Fioravanti held on a motion to dismiss that, under *MFW*, the application of the deferential business judgment rule in a transaction with a controller requires the approval of a majority-of-the-minority, even if the underlying transaction does not require stockholder approval.[28] The case arose out of Turning Point Brands’s (“TPB”) buyout of SDI, a publicly traded holding company that held the majority of TPB’s stock and was, in turn, controlled

[25] *Pettry v. Gilead Sciences, Inc.*, C.A. No. 2020-0132-KSJM, 2020 WL 6870461, *30 (Del. Ch. Nov. 24, 2020).

[26] C.A. No. 2020-0132-KSJM, 2021 WL 3087027 (Del. Ch. July 22, 2021).

[27] *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635, 644 (Del. 2014) (holding that the business judgment rule applies in a controlling stockholder merger “where the merger is conditioned *ab initio* upon both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care, and the uncoerced, informed vote of a majority of the minority stockholders”).

[28] *Berteau v. Glazek*, C.A. No. 2020-0873-PAF, 2021 WL 2711678 (Del. Ch. June 30, 2021).

by Standard General, L.P. Several directors on the board of TPB also served on the board of SDI. TPB's board had established a two-person Special Committee, but the Court found that it was reasonably inferable that Standard General had exercised control over the transaction process on multiple occasions for the benefit of SDI and Standard General, with respect to deal price and other substantive terms. After the transaction closed, stockholders sued, alleging that the buyout of SDI was not entirely fair to TPB's shareholders. On the motion to dismiss, the Special Committee defendants argued that the standard of review should be the business judgment rule, because *MFW* should not require a majority-of-the-minority vote for the business judgment rule to apply to parent-subsidiary mergers that do not statutorily require a stockholder vote. The Court rejected this argument and applied the entire fairness standard of review, making clear that *MFW*'s dual protections must be put in place to qualify a transaction with a controller for business judgement review, even where a stockholder vote is not statutorily required to effectuate the transaction.

The timing of adoption of the *MFW* framework also continued to be an obstacle for defendants who were found to have engaged in substantive merger-related activity prior to adopting *MFW*'s dual protections. ***In re Pivotal Software Inc. Stockholders Litigation*** serves as another reminder that *MFW*'s dual protections must be put in place before any substantive economic negotiations take place.[29] Pivotal was owned by VMware and EMC and was alleged to be controlled by Dell Technologies through its interests in EMC and VMware. In December 2018, Michael Dell, the founder of Dell Technologies, raised the possibility of a transaction between VMware and Pivotal to VMware's CEO. By March 2019, both VMware and Pivotal had created Special Committees to evaluate the potential merger. VMware made an offer conditioned on *MFW* protections on August 4, 2019, and Pivotal's Special Committee approved the merger 18 days later. After the deal closed, Pivotal's stockholders sued, alleging breach of fiduciary duty claims against Pivotal's controlling stockholders—Dell Technologies, Michael Dell, and VMware—and certain officers and directors of Pivotal. Defendants moved to dismiss, and argued that the business judgment rule should apply, because both of the *MFW* protections had been in place at the time of the offer. Chancellor McCormick disagreed, finding that *MFW*'s protections were not in place early enough in the process, because substantive economic negotiations had already occurred. The Court noted that before the *MFW* protections were put in place, the parties had already engaged both legal and financial advisors, participated in numerous due diligence meetings, shared certain nonpublic information, and determined that the due diligence process was substantially completed. Additionally, one of Pivotal's directors had met with VMware's CEO to discuss integration and go-forward strategies. Thus, the defendants would not receive the benefit of *MFW*'s safe harbor, and the entire fairness standard of review would apply.

The Definition of "Control"

The Court of Chancery revisited the recurring question of when a less than 50% stockholder should be deemed a controller, and therefore become subject to fiduciary duties and the more rigorous judicial scrutiny that comes along with

[29] C.A. No. 2020-0440 (Del. Ch. June 29, 2021) (TRANSCRIPT).

such status. In ***In re GGP, Inc. Stockholder Litigation***,[30] Vice Chancellor Slights dismissed a challenge to the acquisition of GGP, Inc. by Brookfield Property Partners L.P. and its affiliates, which had owned 35.3% of GGP's shares before the transaction. Stockholder plaintiffs alleged that Brookfield should be treated as GGP's controlling stockholder and also alleged that GGP's directors, including GGP's CEO, had negotiated an agreement with Brookfield for post-closing employment with substantial benefits and compensation days before the merger agreement was signed. In its analysis, the Court noted that after Brookfield made its proposal to acquire GGP, Brookfield's three director designees recused themselves from all meetings regarding the proposal, and GGP's board had formed a five-member special committee that was empowered to reject the proposal. As a result, the Court found that Brookfield did not control GGP with respect to the transaction, emphasizing that Brookfield did not participate in the special committee's decision-making process and the special committee was not dominated by Brookfield. The Court also found that Brookfield did not actually control GGP generally. The Court further held that the stockholder approval of the transaction was fully informed and uncoerced, rejecting a "laundry list" of "kitchen sink" disclosure claims, and therefore dismissed the action under *Corwin*[31] and the business judgment rule. This case has been appealed and is scheduled for oral argument in March 2022.[32]

The Court of Chancery also issued an opinion discussing the factors that determine when a control group is formed. In ***In re Tilray, Inc. Reorganization Litigation***, stockholders challenged a two-step reorganization of Tilray, Inc., a cannabis distributor, alleging that it was a self-dealing transaction to achieve a tax benefit for a group of founding investors (the "Founders") that was not available to the minority stockholders.[33] As alleged in the complaint, the reorganization would allow the Founders to retain control of Tilray, extract their gains, and avoid huge tax consequences. The Founders argued that they were not a control group, but Chancellor McCormick disagreed. The Court applied the "legally significant connection" standard from *Sheldon v. Pinto Technology Ventures, L.P.*,[34] which requires a showing of an agreement to work towards a shared goal. The Court concluded that it was "reasonably conceivable that the desire to avoid massive tax liabilities through the Reorganization was more than merely a concurrent interest, but rather, a shared goal that the Founders agreed or arranged to work toward." The Court noted that the Founders had several historical and transaction-specific ties, including that they had been classmates and long-time friends, jointly ran businesses (including the entity through which they allegedly controlled Tilray), shared office space, jointly retained tax advisors, and referred to themselves as a voting block while negotiating the reorganization. As such, the entire fairness standard of review would apply. The Court also found that plaintiffs had adequately pleaded that demand was futile because Tilray's board was conflicted and therefore not able to impartially consider a demand to independently investigate the claims.

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30 C.A. No. 2018-0267-JRS, 2021 WL 2102326 (Del. Ch. May 25, 2021).

31 *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015).

32 No. 202, 2021 (Del. June 23, 2021).

33 C.A. No. 2020-0137-KSJM, 2021 WL 2199123 (Del. Ch. June 1, 2021).

34 220 A.3d 245, 251-52 (Del. 2019).

On the topic of control, we note that post-trial arguments in ***In re Tesla Motors, Inc. Stockholders Litigation***, concerning Tesla's 2016 merger with SolarCity Corporation, were held on January 18, 2022. The Court previously held, at the motion to dismiss stage, that plaintiffs had sufficiently alleged that Elon Musk, who owned 22% of Tesla, was a controlling stockholder. Last year, following completion of discovery, defendants argued that plaintiffs had not produced any evidence showing Musk "actually coerced" the stockholder vote. However, the Court of Chancery denied summary judgment, concluding that for the purpose of the controlling shareholder inquiry, a plaintiff need not show actual control, only the ability to control given Delaware law's longstanding "recognition that a controller's influence is 'inherently coercive.'"[35] The Court decided that the case should proceed to trial because there remained genuine issues of material fact as to Musk's status as the controlling stockholder of Tesla. Closing arguments in the trial took place in January 2022 and a decision is expected in the Spring.

***Revlon* Claims**

Post-closing damages actions under *Revlon*[36] brought by stockholders seeking to challenge a non-controller acquisition continued to face significant hurdles at the pleadings stage given the potent protection afforded to directors by exculpatory charter provisions.

For example, in ***Flannery v. Genomic Health, Inc.***, Vice Chancellor Slights dismissed all stockholder claims brought in connection with Genomic's cash and stock sale to Exact Sciences.[37] First, the Court held that Exact did not become an interested stockholder before the merger, and therefore was not subject to Section 203 of the DGCL.[38] Section 203 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 unless certain stockholder approvals are obtained. Plaintiffs claimed that Exact became an interested stockholder two days before the merger, when the 25% stockholder group agreed to vote in favor of the transaction. The Court rejected this argument on the facts, because the stockholder group had not accepted the voting agreement at that time and demanded different terms, so there was no meeting of the minds and therefore no agreement. Second, the Court determined that the transaction was not subject to entire fairness review, because a 25% stockholder group was not a controller and there was no conflict. The Court found that the stockholder group only had two of the eight board seats, "d[id] not meddle in the day-to-day operations of the Company" or make any attempt to exercise control over the transaction, and the friendships between the directors for the stockholder group and the rest of the board were not enough to rebut any director's presumed independence. The Court further held that even if the stockholder group was a controller, there was no indication that they had any divergent interest from the rest of the stockholders. Finally, the Court determined that *Revlon* enhanced scrutiny did not apply to the transaction, because there

[35] C.A. No. 12711-VCS, 2020 WL 553902 (Del. Ch. Feb. 4, 2020).

[36] *Revlon v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

[37] C.A. No. 2020-0492-JRS, 2021 WL 3615540 (Del. Ch. Aug. 16, 2021).

[38] 8 *Del. C.* § 203.

was no change of control: the merger consideration was 58% stock and 42% cash, and the company remained in "a large, fluid, changeable and changing public market." The Court also held that even if *Revlon* did apply, the complaint had not sufficiently pleaded that the board acted in bad faith.

The Court also dismissed nearly all claims in ***Teamsters Local 237 Additional Security Benefit Fund v. Caruso***, a case arising from the acquisition of Zayo Group Holdings, Inc. by a consortium of equity co-investors.[39] First, plaintiffs claimed that the transaction should be subject to entire fairness review, because Dan Caruso, Zayo's Chairman and CEO, was conflicted and his conflicts had "corrupt[ed] the sale process" because a majority of Zayo's board was not independent from him. Vice Chancellor Fioravanti found that the complaint adequately pleaded that Caruso had a conflict, because Caruso knew that the acquiror wanted to retain him as CEO after the merger. But the Court held that plaintiffs had not adequately alleged that a majority of the board was beholden to Caruso or that the board had not acted in a manner reasonably designed to manage the conflict. In the alternative, plaintiffs alleged that the transaction should be subject to *Revlon* enhanced scrutiny. The Court disagreed, rejecting allegations that Caruso concealed any critical information from the board, or that the board inadequately supervised Caruso's conduct. However, the Court refused to dismiss a claim for breach of the duty of care against Caruso, in his non-exculpated capacity as an officer, for failure to disclose in the proxy statement information regarding a discussion between Caruso and the acquiror regarding sale price.

But some *Revlon* claims managed to survive a motion to dismiss. For example, in ***In re Pattern Energy Group Inc. Stockholders Litigation***, Vice Chancellor Zurn denied a motion to dismiss a stockholder action arising from the take-private acquisition of Pattern by the Canada Pension Plan Investment Board.[40] Although the sale process was managed by a special committee of five independent and disinterested directors, the Court determined that plaintiffs sufficiently alleged that the special committee had delegated much of its responsibility to Pattern's CEO, who was alleged to be conflicted because of his overlapping relationships with Pattern's primary supplier and the supplier's controller, Riverstone; failed to manage the CEO's conflicts; and prioritized Riverstone's goals over stockholder value in bad faith. Thus, the Court held that the transaction at a minimum warranted enhanced scrutiny, noting that the complaint offered a "theory of director breach that tracks the paradigmatic *Revlon* narrative of an overweening CEO and supine board." Interestingly, the Court noted that it was possible that entire fairness could apply, and that Riverstone, the supplier, and certain Pattern officers could constitute a control group—even though Riverstone and the supplier were not stockholders—due to their "soft power" over the company, but it declined to make that finding at the pleadings stage. The Court also rejected the argument that the narrow approval of the transaction by a majority of the minority stockholders cleansed the transaction under *Corwin*. The Court held that the allegations were sufficient to find that the stockholder vote was coerced, because CBRE, who had 10% of the vote and was necessary to achieve a majority, was contractually

[39] C.A. No. 2020-0620-PAF, 2021 WL 3883932 (Del. Ch. Aug. 31, 2021).

[40] C.A. No. 2020-0357-MTZ, 2021 WL 1812674 (Del. Ch. May 6, 2021).

obligated to vote in favor of the transaction. Even if CBRE had not been coerced, the Court further found that the vote was not fully informed, due to material misstatements and omissions in the proxy statement.

In ***Firefighters' Pension Sys. of City of Kansas City, Missouri Tr. v. Presidio, Inc.***,[41] Vice Chancellor Laster discussed a variety of issues related to *Revlon* claims. In May 2019, Presidio's controlling stockholder, Apollo, began exploring a potential sale of Presidio. As part of that exploration, Apollo and the company's banker (LionTree) met with two private equity firms. Plaintiffs alleged that Presidio's CEO, assisted by Lion Tree, favored one of those two firms because it was a "purely a financial buyer" and therefore was likely to retain the CEO to run the post-transaction company. Plaintiffs further allege that during the post-signing go-shop, LionTree tipped off the allegedly favored bidder about the details a competing bid thereby allowing it to make a topping bid that was ultimately accepted by the board. As a threshold matter, the Court determined that *Corwin* cleansing did not apply, because even though Apollo was not conflicted and received the same consideration as other stockholders, the stockholder vote was not fully informed because it did not disclose the material facts concerning LionTree's price tip to the buyer.[42] The Court next determined that the claims supported a reasonable inference that the sale process fell outside the range of reasonableness required under *Revlon*, because both LionTree and the CEO allegedly had self-interested reasons to prefer one bidder over the other and the board did not provide sufficient oversight of the sale process. In reaching that decision, the Court focused on the alleged tip, describing it as the "principal defect in the sale process" and noting that without it, "the sale process as a whole would fall within a range of reasonableness." Having found only a breach of the duty of care, which was exculpated under Presidio's charter, Vice Chancellor Laster granted the motion to dismiss with respect to the members of the board other than the CEO. The Court also dismissed claims against Apollo as insufficiently pleaded. However, the motion was denied with respect to the CEO, because the plaintiffs had sufficiently alleged a breach of his duty of loyalty in his capacity as a director as well as a breach of his duty of care in his capacity as an officer, neither of which are exculpated. The Court also denied the motion to dismiss aiding and abetting claims against LionTree and BCP. Interestingly, the Court noted that even if there was not an underlying breach for the aiding and abetting claims, the pleaded facts "would support a claim for primary liability under a theory of fraud on the board." Financial advisors should be aware that plaintiffs will likely continue to pursue such claims under multiple theories.

And in ***In re Columbia Pipeline Group, Inc. Merger Litigation***, Vice Chancellor Laster denied a motion to dismiss an action arising from the sale of Columbia to TransCanada Corporation.[43] In that case, stockholders alleged that Columbia's Chairman/CEO and CFO breached their fiduciary duties by secretly communicating and sharing confidential information

[41] 251 A.3d 212 (Del. Ch. 2021).

[42] The Court also rejected the application of the *Synthes* "safe harbor," determining that it conflicted with other rulings and effectively had been displaced by *Corwin*, and teeing that issue up for review by the Delaware Supreme Court. *See In re Synthes S'holder Litig.*, 50 A.3d 1022 (Del. Ch. 2012) (holding that a sale of a controlled company to an unaffiliated third party where the controller is not conflicted and received the same consideration as other stockholders would be evaluated under the business judgment rule).

[43] C.A. No. 2019-0484-JTL, 2021 WL 772562 (Del. Ch. Mar. 1, 2021).

with TransCanada about a potential deal and later favoring TransCanada over other potential bidders, and that TransCanada had aided and abetted those breaches. The Court held that the plaintiffs had adequately alleged that the merger and the process leading up to it fell outside the range of reasonableness under *Revlon* because the CEO and CFO had improperly favored TransCanada for personal reasons concerning their compensation and benefits. The Court also held that *Corwin* cleansing was not available, in light of material misstatements and omissions in the proxy regarding the standstill provisions in the NDAs with other potential bidders, the CEO and CFO's plans to retire, and the meetings with TransCanada. In addition, the Court declined to dismiss an aiding and abetting claim against TransCanada, because the complaint adequately pleaded that TransCanada had knowledge of the breaches. The case is particularly interesting because Vice Chancellor Laster had previously determined that the $25.50 per share deal price was fair value in an appraisal action.[44] But the Court said that "[t]he appraisal decision did not examine whether the sale process resulted in 'the best value reasonably available for the stockholders,'" and "did not consider whether the officers breached their duties in a manner that undercut the Board's negotiating leverage and resulted in TransCanada paying less" than it may have if "loyal negotiators" had actually tried to bargain for more. Thus, the case leaves open the possibility that fair price in the fiduciary duty action may be higher than fair value in the appraisal action.

Appraisal Actions

Speaking of appraisal, since the Delaware Supreme Court's recent guidance on appraisal actions,[45] the Court of Chancery has repeatedly held that deal price minus synergies represents the most reliable indicator of fair value, so long as the sale process reflects objective indicia of reliability. In light of these decisions, which effectively treated deal price as a cap on fair value, the volume of appraisal litigation has declined substantially. But one noteworthy case in 2021 explored an issue that had not previously been addressed in prior precedent.

Under the appraisal statute, the Court is instructed to determine the value of the company on the date the transaction closes, not when it is signed.[46] Thus, there is the potential for there to be a change in value between signing and closing, which was precisely the issue in ***In re Appraisal of Regal Entertainment Group***.[47] Cineworld Group agreed to acquire Regal for $23.00 per share in cash, but between signing and closing Congress passed the 2017 Tax Cut and Jobs Act, which reduced Regal's tax rate from 35% to 21%. The parties disagreed whether the favorable impact to Regal of the new tax law should be taken into account for purposes of determining fair value. Cineworld argued that any adjustment on account of the tax change should be minimal because no other bidder emerged to bid for Regal during the post-signing "go-shop" period and because the expectation of a lower corporate tax rate was already included in the deal price. Vice

44 *In re Appraisal of Columbia Pipeline Gp., Inc.*, 2019 WL 3778370 (Del. Ch. Aug. 12, 2019).

45 *See, e.g.*, *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, 210 A.3d 128 (Del. 2019); *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, 177 A.3d 1 (Del. 2017); *DFC Global Corp. v. Muirfield Value Partners, L.P.*, 172 A.3d 346 (Del. 2017).

46 8 *Del. C.* § 262.

47 C.A. No. 2018-0266-JTL, 2021 WL 1916364 (Del. Ch. May 13, 2021).

Chancellor Laster rejected both arguments finding that the universe of buyers who could realistically bid for Regal was limited and that the company failed to provide persuasive evidence showing that the deal price already incorporated value from a lower tax rate. In reaching its final decision, the Court first concluded that deal price minus synergies was the most reliable indicator of fair value and it resulted in a value of $19.23 per share. However, based largely on the quantification of the savings in presentations Cineworld made to its lenders, the Court then added the value of the reduced tax rate, which increased the value by $4.37 per share and yielded a total value of $23.60 per share, or an amount about 2.6% higher than the deal price. Although the facts of this case, and in particular the timing of the changes in tax law, were somewhat unique, the Court's reasoning could lead to more appraisal petitioners looking to offset deductions for synergies by arguing that fair value should be increased as a result of favorable changes in the target's financial condition between signing and closing.

Additionally, we previously wrote about ***Manti Holdings, LLC v. Authentix Acquisition Company***, where the Court of Chancery held that sophisticated stockholders could contractually limit or waive their appraisal rights as long as the waiver was clear and unambiguous, and the stockholders were fully informed and represented by counsel at the time they signed the agreement.[48] That opinion was affirmed by the Delaware Supreme Court, with Justice Valihura dissenting. The Delaware Supreme Court held that the appraisal statute "does not prohibit sophisticated and informed stockholders, who were represented by counsel and had bargaining power, from voluntarily agreeing to waive their appraisal rights in exchange for valuable consideration."[49] The Court further explained that as a matter of public policy, there are certain fundamental features of a corporation that are essential to that entity's identity and cannot be waived; but it determined that the individual right of a stockholder to seek a judicial appraisal is not one of them. Thus, contractual waivers of appraisal rights will be enforced.

Shareholder Activism And Bylaw Enforcement

In ***Rosenbaum v. CytoDyn Inc.***, after a trial on a paper record, Vice Chancellor Slights strictly enforced the terms of an advance notice bylaw and denied a stockholder activist group's request for a mandatory injunction to compel CytoDyn to allow their nominees to be included on the ballot at the annual meeting.[50] The activist group had submitted their nomination notice one day before the deadline set in the bylaws, but the board rejected it after determining that it was deficient because it omitted necessary information that was required under the bylaws, including information about who was supporting the proxy contest or potential conflicts of interest. The Court declined to apply enhanced review under *Blasius*,[51] which would require a "compelling justification" for the board's actions, because the evidence did not show that the board engaged in "manipulative conduct." But the Court also declined to apply the deferential business judgment rule,

[48] C.A. No. 2017-0887-SG, 2019 WL 3814453 (Del. Ch. Aug. 14, 2019).

[49] *Manti Holdings, LLC v. Authentix Acquisition Co., Inc.*, 261 A.3d 1199, 1204 (Del. 2021).

[50] C.A. No. 2021-0728-JRS, 2021 WL 4775140, at *1 (Del. Ch. Oct. 13, 2021).

[51] *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 661 (Del. Ch. 1988).

noting that under *Schnell*,[52] it was required to determine whether the bylaws had been applied inequitably. Nonetheless, the Court reviewed the contractual language of the bylaws and determined that the board was not “nitpicking” when it identified the issues with the notice, describing it as “fatally incomplete” and “woefully deficient.” Thus, the Court concluded that, “[w]here plaintiffs ultimately went wrong here is by playing fast and loose in their responses to key inquiries embedded in the advance notice bylaw, and then submitting their nomination notice on the eve of the deadline, leaving no time to fix the deficient disclosures when the incumbent board exposed the problem.” The case is a good reminder for both companies and activists that bylaws will be enforced to the letter and that there are limits to the *Schnell* doctrine.

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52 *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439 (Del. 1971) (holding that “inequitable action does not become permissible simply because it is legally possible”).