SPRING 2019

Richards, Layton & Finger | Recent Developments in Delaware Law

Front cover: *Fireworks over Legislative Hall,* Brian Wood, Seven One Photography.

Delaware Legislative Hall, the state capital building in Dover, houses the chambers and offices of the Delaware General Assembly. The General Assembly has a distinguished history: established in 1704, it announced Delaware's independence from Great Britain several weeks before the enactment of the Declaration of Independence in 1776; in 1787, Delaware became the first state to ratify the U.S. Constitution, earning it the distinction of "The First State." Delaware's capital was moved from New Castle to Dover in 1777, where Legislative Hall was built in 1933.

UNIQUELY SKILLED AT HELPING SOPHISTICATED CLIENTS NAVIGATE THE INTRICACIES OF DELAWARE CORPORATE LAW

This publication, which highlights recent corporate and alternative entity cases and statutory developments in Delaware, continues our long tradition of providing insight into the development of Delaware law. Our corporate and alternative entities teams, the largest and most recognized in the state, play a crucial role in Delaware. For decades we have contributed to the development of key statutes, litigated influential decisions, and provided counsel on complex transactions—making us uniquely skilled at helping sophisticated clients navigate the intricacies of Delaware corporate law.

Richards Layton has been intimately involved with many of the cases highlighted in this publication, and we have handled, as Delaware counsel, the most M&A transactions valued at or above $100 million for more than 20 years running, as reported in *The Deal* and *Corporate Control Alert.* We welcome the opportunity to discuss the practical implications of the recent developments in Delaware law with you, and we look forward to helping you whenever a need may arise.

—Richards, Layton & Finger

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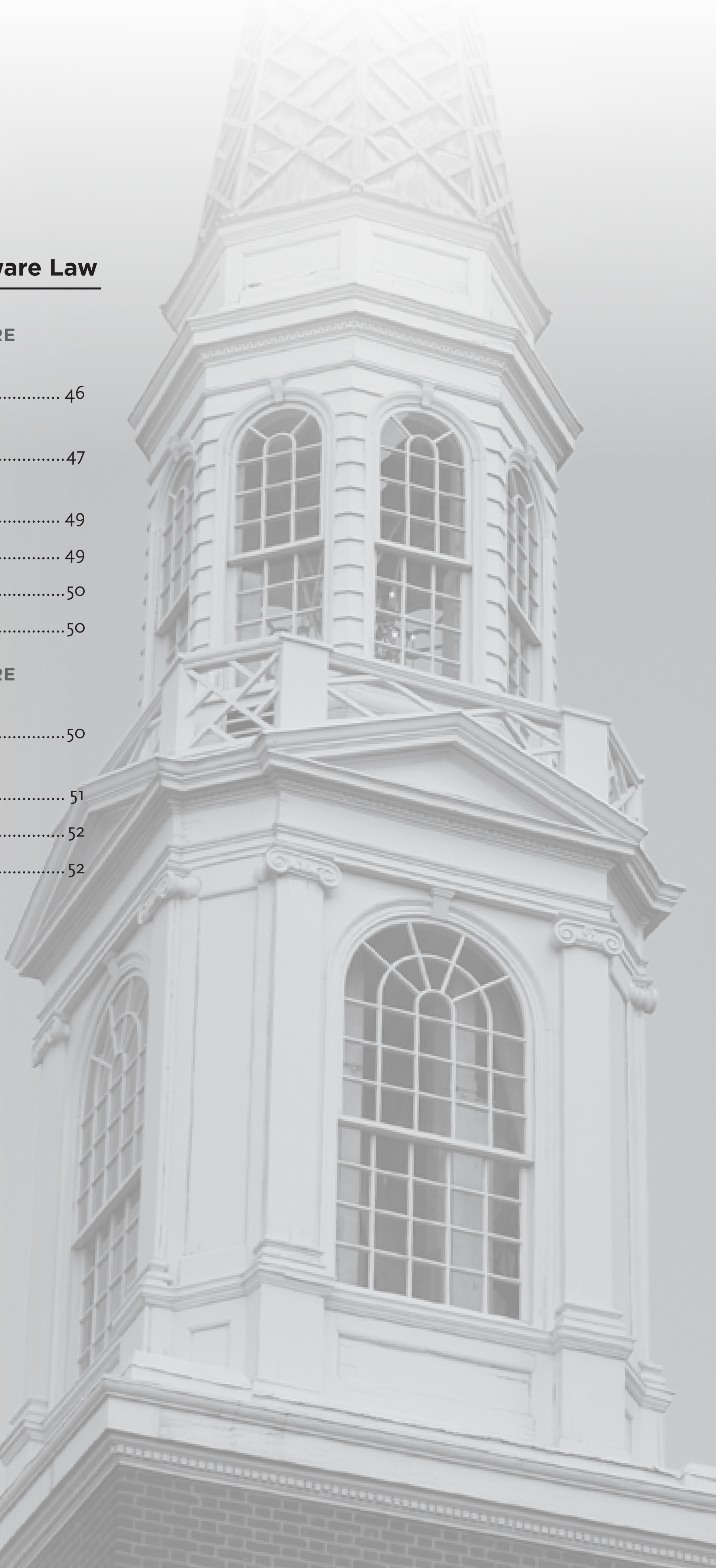

Recent Decisions of Delaware Courts

BUSINESS COMBINATIONS

Breach of Fiduciary Duty

Morrison v. Berry: Delaware Supreme Court Holds *Corwin* Inapplicable When Disclosures Contained Materially Incomplete and Misleading Information Regarding Founder's Preference during Merger Negotiations

In *Morrison v. Berry,* 191 A.3d 268 (Del. 2018), the Delaware Supreme Court reversed a ruling by the Court of Chancery that had dismissed a suit challenging the acquisition of The Fresh Market by an entity controlled by Apollo Global Management LLC. The Court held that disclosure deficiencies related to, among other things, Fresh Market's founder's potential unwillingness to partner with other potential acquirers during the auction process prevented Fresh Market's stockholder vote from being fully informed and that, as a result, the prerequisites for business judgment rule review under *Corwin v. KKR Fin. Holdings LLC,* 125 A.3d 304, 312 (Del. 2015), were not met.

In March 2016, Fresh Market publicly filed a Solicitation/Recommendation Statement on Schedule 14D-9 (as amended, the "14D-9") in relation to Fresh Market's going-private tender offer transaction, in which Apollo offered to acquire the shares of Fresh Market for $28.50 in cash per share. The 14D-9 disclosed details regarding the proposed tender offer and an equity rollover whereby Fresh Market's founder, Ray Berry, and his son would hold an approximately 20% stake in Fresh Market after the closing.

While the tender offer was pending, Elizabeth Morrison, a Fresh Market stockholder, demanded certain Fresh Market books and records pursuant to Section 220 of the General Corporation Law of the State of Delaware for the purpose of investigating potential breaches of fiduciary duty during the sale process. Fresh Market denied Ms. Morrison's demand, and the tender offer closed with 68.2% of the outstanding shares validly tendered.

Litigation over Ms. Morrison's Section 220 demand ensued, in which Ms. Morrison ultimately obtained, among other things, Fresh Market's board minutes and a November email from Mr. Berry's counsel to Fresh Market's lawyers. The November email included (i) reference to an agreement that Mr. Berry had with Apollo in October, despite his earlier representations to Fresh Market's board that no such agreement existed, and (ii) statements suggesting that Mr. Berry preferred a transaction with Apollo and was reluctant to consider bids from other prospective purchasers. The 14D-9 mentioned neither of these matters. Additionally, minutes from the October 15, 2015 board meeting revealed that Fresh Market had received stockholder pressure to form a strategic transaction committee to oversee the sale process. Despite this *existing* stockholder pressure, the 14D-9 stated that the board created such committee because of the possibility it *could* become the subject of stockholder pressure. Ms. Morrison filed an action in the Court of Chancery, alleging that Fresh Market's directors, including Mr. Berry, breached their fiduciary duties in connection with the Apollo acquisition.

"'Partial and elliptical disclosures' cannot facilitate the protection of the business judgment rule under the *Corwin* doctrine."

The Court of Chancery found that the facts regarding Mr. Berry's involvement with Apollo had been adequately disclosed in the 14D-9 and held that the business judgment rule standard of review applied to the transaction under *Corwin*. Accordingly, the Court of Chancery dismissed Ms. Morrison's complaint, stating that this matter "presents an exemplary case of the utility of th[e] ratification doctrine, as set forth in *Corwin."*

The Delaware Supreme Court disagreed with the Court of Chancery's conclusion regarding the adequacy of the disclosures in the 14D-9 and reversed the judgment of the Court of Chancery. While recognizing the potential cleansing effect of *Corwin,* the Court noted that "stockholders cannot possibly protect themselves when left to vote on an existential question in the life of a corporation based on materially incomplete or misleading information." The Court identified and discussed four specific disclosure deficiencies in the 14D-9, including the 14D-9's: (i) failure to disclose Mr. Berry's agreement with Apollo, as revealed in the November email; (ii) failure to disclose Mr. Berry's statements expressing a preference for a rollover transaction involving Apollo and reluctance to engage in such a transaction if another buyer were to prevail, as contained in the November email; (iii) failure to disclose Mr. Berry's threat contained in the November email, in which Mr. Berry indicated that he would sell his shares if the board did not undertake a sale process; and (iv) misrepresentations regarding the board's reasons for forming its strategic transaction committee to oversee the sale process.

As a result of these inadequate and misleading disclosures, the Court concluded that the business judgement rule standard of review did not apply because the defendants had not shown, as required by *Corwin,* that the stockholder vote was fully informed. The Supreme Court remanded the case for further proceedings, noting that this case offers a cautionary reminder to directors: "'partial and elliptical disclosures' cannot facilitate the protection of the business judgment rule under the *Corwin* doctrine."

In re Tangoe, Inc. S'Holders Litig.: *Corwin* Found Inapplicable Where Company Did Not Disclose Proper Financial Statements Prior to the Stockholder Vote on Merger

In *In re Tangoe, Inc. S'Holders Litig.,* 2018 WL 6074435 (Del. Ch. Nov. 20, 2018), the Court of Chancery denied the defendants' motion to dismiss the plaintiff's breach of fiduciary duty claim relating to the acquisition of Tangoe, Inc. by TAMS, Inc., Asentinel, LLC, and Marlin Equity Partners (collectively, "Marlin"). The Court of Chancery held that business judgment rule review under *Corwin v. KKR Fin. Holdings LLC,* 125 A.3d 304, 312 (Del. 2015), was inapplicable because the board failed to disclose to the stockholders of Tangoe audited financial statements and details on the status of restated financial statements.

In March 2016, Tangoe announced that the SEC had detected false statements in its publicly filed financial statements and that the SEC required Tangoe to restate its financials for 2013, 2014, and the first three quarters of 2015 (the "Restatement"). By November 10, 2016, Tangoe had further failed to file multiple 2016 quarterly reports with the SEC. On this same date, the board of Tangoe disclosed that the Restatement was "substantially complete" and confirmed that it was working with its independent accounting firm as it audited the restated year-end financial statements. However, the board ultimately shifted its focus away from completing the Restatement to selling Tangoe.

On December 27, 2016, Marlin provided an indication of interest in acquiring Tangoe, conditioned upon, among other things, Marlin's receipt of a quality earnings report. On December 28, 2016, Tangoe hired Alvarez & Marshal, LLC ("A&M") to prepare such a quality earnings report for Marlin. While Tangoe and Marlin negotiated an acquisition, Tangoe failed to complete the Restatement by the SEC's deadline, and on March 10, 2017, NASDAQ delisted Tangoe's stock and the SEC threatened deregistration of Tangoe's stock. Also, by this date, Tangoe had not held an annual stockholders' meeting in nearly two years.

Ultimately, on April 28, 2017, Tangoe and Marlin announced an acquisition, which involved a tender offer at $6.50 per share of Tangoe (a 28% negative premium) followed by a second-step merger pursuant to Section 251(h) of the General Corporation Law of the State of Delaware (the "Transaction"). On May 12, 2017, Tangoe filed a Schedule 14D-9 and accompanying Form 8-K recommending the Transaction to stockholders. As of this date, Tangoe still had not provided its stockholders or the SEC with any audited financial statements, nor had it updated the stockholders on the status of the Restatement.

On June 5, 2017, the SEC sent a letter to Tangoe's then-CEO stating that it had "significant concerns as to whether investors have access to the financial information necessary to make a decision" regarding the Transaction. On June 15, 2017, "[f]aced with the

When navigating the company through a so-called "storm," the directors must "demonstrate that they carefully and thoroughly explained all material aspects of the storm to stockholders."

'Hobson's choice' of holding potentially illiquid stock or accepting an all-cash transaction," 78.2% of Tangoe's stockholders tendered their shares.

After the Transaction had closed, a stockholder plaintiff filed an action alleging that Tangoe's directors breached their fiduciary duties by failing to disclose all information material to the stockholders' decision on whether to tender their shares and agree to the Transaction. Specifically, the plaintiff alleged four subject areas where Tangoe's disclosures regarding the Transaction omitted material facts, two of which were: (i) the failure to provide Tangoe stockholders with audited financial statements, and (ii) the failure to disclose whether (or when) the Restatement would be completed.

The Court of Chancery noted that the *Corwin* doctrine only applies to fully informed, uncoerced stockholder votes, and the Court's inquiry turned on whether the plaintiff had pled facts from which the Court might reasonably conceive that the approval was not fully informed or was coerced. The Court then found that the alleged financial statement omissions had been well pled; therefore, *Corwin* did not apply and the business judgment rule was not available to the director defendants at the pleading stage.

Concerning Tangoe's failure to provide audited financial statements to the stockholders, the Court noted that under the circumstances, a reasonable stockholder would have deemed audited financial statements important when deciding to tender their shares in the Transaction. The Court noted that the financial information the board provided to stockholders was "sporadic and heavily qualified" due to the uncertainties surrounding the Restatement. Additionally, the Court noted that the board engaged A&M to prepare a quality of earnings report, but elected not to disclose that report to the public stockholders. Ultimately, the Court stated that this "information vacuum, compounded by the fact that [Tangoe] had failed to file multiple 2016 quarterly reports and had not held an annual stockholders meeting for nearly three years, supports a reasonable inference that stockholder approval of the Transaction was not fully informed in the absence of adequate financial information about [Tangoe] and its value."

The Court further noted that the Restatement "stakes were high" because NASDAQ had delisted Tangoe's stock and the SEC was threatening deregistration. The Court stated that under these circumstances, the "stockholders' need for information regarding the Restatement was *ne plus ultra"* when considering whether to tender into the Transaction, "[a]nd yet, when deciding whether to tender their shares, Tangoe stockholders did not know whether [Tangoe] would ever complete the Restatement, let alone when." In other words, Tangoe "deprived [its stockholders] of the opportunity to consider whether to stay the course and allow the Restatement to proceed or whether to sell as the consequences of the unfinished Restatement were still unfolding."

The Court denied the defendants' motion to dismiss, noting that "to earn pleading-stage business judgment deference by invoking stockholder approval of a challenged transaction," even when navigating the company through a so-called "storm," as was the case here, the directors must "demonstrate that they carefully and thoroughly explained all material aspects of the storm to stockholders—how the company sailed into the storm, how the company has been affected by the storm, what alternative courses the company can take to sail out of the storm and the bases for the board's recommendation that the sale of the company is the best course."

In re Xura S'Holder Litig.: *Corwin* Found Inapplicable When Target Failed to Disclose that Its CEO Engaged in Side Negotiations with Acquirer Throughout Sale Process

In *In re Xura S'Holder Litig.*, 2018 WL 6498677 (Del. Ch. Dec. 10, 2018), the Court of Chancery denied the defendants' motion to dismiss the plaintiff's breach of fiduciary duty claim regarding the acquisition of Xura, Inc. by an affiliate of Siris Capital Group, LLC. The Court of Chancery held that business judgment rule review under *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 312 (Del. 2015), was inapplicable because Xura failed to disclose that its then-CEO and member of the board of directors, Philippe Tartavull ("Tartavull"), engaged in side negotiations with Siris throughout the sale process and steered the transaction in favor of Siris in an effort to remain employed with Xura post-closing.

Business judgment rule review under *Corwin* was inapplicable because Xura failed to disclose that its then-CEO and member of the board of directors engaged in side negotiations with Siris throughout the sale process and steered the transaction in favor of Siris in an effort to remain employed with Xura post-closing.

In 2012, Tartavull met the co-founder of Siris, and the two discussed a potential acquisition of Xura. Nothing came of these discussions; however, in late 2014, Siris and Tartavull met again to discuss a potential acquisition of Xura. On January 7, 2015, Siris submitted a letter of interest to Xura regarding an acquisition, but the board of Xura later rejected this offer. On October 19, 2015, Siris contacted Tartavull directly with another offer to acquire Xura. Tartavull communicated this offer to the board, and negotiations followed. Xura retained Goldman Sachs & Co. to assist it in the sale process.

On December 3, 2015, the board created a strategic committee consisting of Tartavull and two other directors to review, evaluate, and negotiate the terms of a potential transaction with Siris; however, the strategic committee never took any formal action. Additionally, Hank Nothhaft, one of the strategic committee members, did not realize that the strategic committee existed or that he was a member thereof until litigation ensued. All the while, despite Goldman Sachs's request that all communications go through them, Tartavull communicated directly with Siris on a regular basis without keeping Goldman informed.

In February 2016, Siris and Tartavull had a lunch meeting to discuss the potential Xura transaction. At this meeting, Tartavull negotiated an offer price with Siris of $28 per share. Tartavull did not inform anyone at Xura or Goldman Sachs about this meeting. The next day, Siris submitted its formal offer to Xura, which reflected the offer price of $28 per share that Tartavull had negotiated in private. On March 24, 2016, Siris revised its offer to $24 per share, and the board decided the correct response would be to go "radio silent"; however, Tartavull disagreed and contacted Siris directly to discuss the next steps. Additionally, while Tartavull engaged in private negotiations with Siris, he was informed that he may lose his job at Xura if Xura was not acquired.

On April 9, 2016, Siris offered $24.75 per share after speaking with Tartavull. The board discussed this revised offer, and later Xura and Siris agreed to $25 per share. On April 15, 2016, Xura publicly announced a potential transaction in which it would be acquired for $25 per share. Immediately thereafter, Francisco Partners contacted Tartavull to let him know that it would like to bid on Xura, but Francisco Partners never made a bid because it somehow learned that Siris was the potential buyer. Instead, Francisco Partners contacted Siris about a potential co-investment on the buy-side of the transaction with Xura.

On May 23, 2016, Xura and Siris executed a merger agreement whereby Siris would acquire all outstanding shares of Xura for $25 per share (the "Transaction"). Two days later, Siris executed an NDA with Neuberger Berman, which at the time held over 5% of Xura's stock. By the end of June, Neuberger Berman had sold nearly all of its Xura stock and was co-investing its equity with Siris. Thus, by the time of the Transaction's closing, both Neuberger and Francisco Partners had joined Siris on the buy-side.

On August 16, 2016, a majority of Xura's stockholder voted in favor of the Transaction. On March 30, 2018, a plaintiff stockholder filed an action in the Court of Chancery alleging that Tartavull had breached his fiduciary duties to Xura stockholders in the sale process leading up to the Transaction.

The defendants argued that *Corwin* required application of the business judgment standard of review; the Court of Chancery disagreed. The Court of Chancery noted that Xura's stockholders "could not have cleansed conduct about which they did not know" and found that the plaintiff had adequately pled seven disclosure violations that prevented "*Corwin* cleansing" at the pleading stage. Specifically, the Court of Chancery found that from the public disclosures provided to Xura stockholders, it was reasonably conceivable that stockholders lacked the following material information when voting to approve the Transaction: (i) Tartavull and Siris regularly communicated in private about the Transaction without the knowledge or approval of the board or Goldman Sachs; (ii) Tartavull and Siris executives negotiated price terms without board approval; (iii) in all of its offer letters to Xura, Siris had made clear its intention to work with management (including Tartavull) after consummation of the Transaction; (iv) certain disclosures mischaracterized the strategic committee's role in negotiating the Transaction; (v) Francisco Partners initially expressed interest in submitting a bid to acquire Xura, but somehow learned Siris was the competing bidder and then moved its support to Siris on the buy-side of the Transaction; (vi) Siris offered Neuberger Berman a "side deal" by inviting it to co-invest on the buy-side; and (vii) during negotiations with Siris, Tartavull was told that his job at Xura was in jeopardy if Xura was not sold. As a result, the Court of Chancery denied the defendants' motion to dismiss, holding that the defendants were not entitled to business judgment deference under *Corwin* at the pleading stage of the proceedings.

Merger Agreement Construction

Akorn, Inc. v. Fresenius Kabi AG: Court of Chancery Finds Occurrence of a Material Adverse Effect

In *Akorn, Inc. v. Fresenius Kabi AG*, 2018 WL 4719347 (Del. Ch. Oct. 1, 2018), *aff'd*, 2018 WL 6427137 (Del. Dec. 7, 2018), the Court of Chancery issued what is believed to be the first decision of a Delaware court allowing a buyer to terminate a merger agreement due to the occurrence of a material adverse effect.

The dispute arose from Fresenius Kabi AG's agreement to acquire Akorn, Inc. in April 2017. Soon after the agreement was reached, "Akorn's business performance fell off a cliff" due largely to increased market competition that affected Akorn significantly more than its competitors. Additionally, Fresenius received a series of letters from anonymous whistleblowers calling into question Akorn's compliance with FDA data integrity regulations. Fresenius informed Akorn of the letters and, after conducting an independent investigation revealing serious FDA compliance issues, questioned the appropriateness of Akorn's response and remediation efforts. In April 2018, Fresenius terminated the merger agreement with Akorn.

The Court upheld the validity of Fresenius's termination of the merger agreement on several bases. First, the Court found that Akorn had breached its representations relating to regulatory compliance. As a result, the Court found that Akorn was unable to satisfy the closing condition requiring that all of its representations be true and correct as of the closing date except where the failure "would not, individually

or in the aggregate, reasonably be expected to have a Material Adverse Effect." In so holding, the Court determined that the regulatory compliance issues—expected to take at least three to four years to remedy—were durationally significant and gave rise to estimated remediation costs of approximately 20% of Akorn's standalone value. The Court accordingly found that the issues resulted in a material adverse effect under the merger agreement. Second, the Court found that Akorn, in failing to take appropriate action in response to these regulatory compliance issues, failed to satisfy its interim covenant to use "commercially reasonable efforts to carry on its business in all material respects in the ordinary course of business," thereby giving Fresenius additional grounds to terminate the merger agreement. Finally, the Court held that the significant drop-off in Akorn's performance, which included a 55% drop in annual EBITDA in 2017 after Akorn's annual EBITDA had grown consistently over the preceding years, constituted a general material adverse effect. Although the merger agreement did not provide Fresenius with a separate right to terminate the agreement upon a general material adverse effect, it did entitle Fresenius to refuse to close the merger on that basis.

In addition to its findings relating to the occurrence of a material adverse effect, the Court's 247-page opinion provides insight into a number of issues relevant to M&A negotiations.

Material Adverse Effect Provisions

While the *Akorn* Court was careful to caution against the inference that it was making any per se rule, and warned readers not to "fixate on a particular percentage as establishing a bright-line test" or to construe its "decision as suggesting that there is one set of percentages for revenue and profitability metrics and another for liabilities," its opinion indicates that events giving rise to a 20% decrease in a target's value, when considered with other factors, could constitute a material adverse effect.

The Court indicated that, in most cases, a seller will not be able to overcome the finding that a material adverse effect had occurred on the basis that the buyer should have known about the risks. The Court further indicated that parties may allocate these risks by contract. The Court noted, for example, that the material adverse effect definition at issue could have excluded (but did not exclude) specific matters that the seller believed would, or were likely to, occur during the interim period, or matters disclosed during due diligence, or risks identified in public filings. The Court also suggested that the parties could have defined (but did not define) the term to include only unforeseeable effects, changes, events, or occurrences.

The Court highlighted the distinction between actions or factors causing a material adverse effect, on the one hand, and actions or factors that could "reasonably be expected to" cause a material adverse effect, on the other. The latter formulation is not satisfied through the "mere risk" of a material adverse effect, but it does allow for "future occurrences [to] qualify as a material adverse effect" such that a material adverse effect "can have occurred without the effect on the target's business being felt yet."

Although the material adverse effect provision at issue included a carve-out for general industry risks, the carve-out contained an exception that applied to the extent that Akorn was disproportionately affected by those risks. In this case, the increased market competition giving rise to the general material adverse effect on Akorn did not similarly affect its competitors.

Representations and Warranties

Despite finding a representation with a material adverse effect qualifier to have been breached, the Court observed that representations couched with a material adverse effect qualifier are more forgiving than those requiring that the representation be true in "all material respects." The Court indicated that a representation subject to a material adverse effect qualifier will not be breached unless it gives rise to material and durationally significant qualitative and quantitative damage to the target. By contrast, the Court found that an "all material respects" qualifier operates in a manner similar to the test used to determine materiality under disclosure law and looks to whether a reasonable buyer would have viewed the representation's inaccuracy to "significantly alter the 'total mix' of information."

Without directly addressing the issue, the Court articulated a number of policy arguments that could be read to support the position that Delaware law is "pro-sandbagging." The Court of Chancery's statements should be viewed, however, in light of the Delaware Supreme Court's recent decision in *Eagle Force Holdings, LLC v. Stanley,* in which it declined to affirmatively decide the issue, but questioned the view that Delaware was pro-sandbagging. 187 A.3d 1209, 1236 n.185 (Del. 2018); *id.* at 1247 (Strine, C.J. & Vaughn, J., concurring in part and dissenting in part).

In *Akorn*, the Court of Chancery issued what is believed to be the first decision of a Delaware court allowing a buyer to terminate a merger agreement due to the occurrence of a material adverse effect.

Interim Covenants

Citing the Supreme Court's holding in *Williams Cos. v. Energy Transfer Equity, L.P.,* 159 A.3d 264 (Del. 2017), the *Akorn* Court found that covenants to use "commercially reasonable efforts" and "reasonable best efforts" effectively impose identical requirements to "take all reasonable steps."

The Court found that Fresenius had breached the merger agreement's "hell-or-high-water" covenant (albeit immaterially) in seeking antitrust approval of the merger, but its analysis on this issue was colored by the fact that the merger agreement vested Fresenius with the right to control the strategy for obtaining antitrust approval. To avoid potential dilution to the strength of a hell-or-high-water provision, sellers negotiating for such provisions should seek to obtain some level of input on antitrust strategy or limit the buyers' discretion to formulate antitrust strategy in a way that could delay antitrust approval.

As the regulatory issues underlying Fresenius's termination rights were largely uncovered through its own independent investigation, the *Akorn* opinion underscores the importance of the buyer's contractual information rights. Buyers should strive to secure the type of information rights secured by Fresenius, which gave Fresenius reasonable access to Akorn's "officers, employees, agents, properties, books, [c]ontracts, and records."

Termination

The merger agreement at issue in *Akorn* did not allow Fresenius to exercise either of the termination rights it ultimately relied upon if it was in material breach of any of its own obligations under the merger agreement. It is not uncommon for a merger agreement to only limit a party's termination right to the extent that such party's breach was the cause of the conditions giving rise to the termination right. If Fresenius's unrelated breach of the merger agreement had been found to be material, the merger agreement's use of the former approach could have been significant.

Confidentiality Agreements

The Court found that outside counsel engaged by Fresenius to investigate Akorn's alleged regulatory violations was entitled to use the information originally furnished to Fresenius in connection with its due diligence. Although the confidentiality agreement between the two parties provided that such information "could be used 'solely for the purpose of evaluating, negotiating, and executing' a transaction," the Court determined that the outside counsel's investigation formed part of the process of executing the transaction. As a result, in confidentiality agreements with prospective buyers, sellers should consider further limiting the permissible uses of confidential information provided during the course of due diligence and including express prohibitions on the use of such information in connection with any litigation brought against or investigations of the seller.

On December 7, 2018, the Delaware Supreme Court issued a three-page order affirming the Court of Chancery's opinion on the following two bases: (i) Akorn had suffered a general material adverse effect excusing Fresenius from its obligation to close the merger, and (ii) Fresenius properly terminated the merger agreement due to Akorn's breach of regulatory representations and warranties, giving rise to a material adverse effect, and Fresenius had not itself engaged in a prior, material breach of a covenant preventing it from exercising the termination right. The Delaware Supreme Court expressly did not comment on or address whether Akorn's conduct also constituted a breach of the ordinary course covenant. ◆

Appraisal Actions and Proceedings

Manti Holdings, LLC v. Authentix Acquisition Co.: Court of Chancery Enforces Contractual Waiver of Appraisal Rights in Appraisal Action

In *Manti Holdings, LLC v. Authentix Acquisition Co.*, 2018 WL 4698255 (Del. Ch. Oct. 1, 2018), the Delaware Court of Chancery held that investors in Authentix Acquisition Co. who had initiated an appraisal proceeding following Authentix's acquisition by a third party were contractually bound by the terms of a waiver of appraisal rights contained in a stockholders' agreement that they had entered into with Authentix prior to the acquisition.

Following the Authentix merger, former Authentix stockholders petitioned the Delaware Court of Chancery for appraisal of their shares. Authentix argued that the stockholders were not entitled to demand appraisal because they were all a party to a stockholders' agreement pursuant to which they had agreed that in the context of a company sale, they would "refrain" from the exercise of appraisal rights.

At the outset, the Court stated that two principles guided its decision: "1) [a]ssuming that Section 3(e)(iv) is both enforceable and unambiguously applicable under these facts, the Company is entitled to Summary Judgement; and 2) if ambiguities lurk in the [stockholders' agreement] such that I cannot find it applicable on its face, the [stockholders' agreement] cannot be construed to bar the Petitioners' right to appraisal."

First, the petitioners argued that because the stockholders' agreement terminated at the time of the sale, their duty to refrain from petitioning for appraisal was extinguished. The petitioners further asserted that the stockholders' agreement was ambiguous because "refrain" implies live rights from which to refrain, and therefore cannot refer to irrevocably waived rights. The Court rejected this argument, finding that the language was unambiguous and that no reasonable contracting party would consider itself free to exercise appraisal rights in the context of an approved company sale.

Second, the petitioners argued that their duty to refrain from appraisal, and other related duties, was conditioned on the acquisition of their shares being on the same "terms and conditions" as the shares held by the majority stockholder in connection with the transaction. The petitioners contended that because the preferred and common stock did not receive the same value in the transaction, and because the stockholders' mix of preferred and common shares differed, they were not receiving the same "price" terms as the majority stockholder. The Court found this argument "doubtful" but found it inapplicable because under the stockholders' agreement, a sale by merger did not impose the same terms and conditions provision. Therefore, the Court rejected the petitioners' second argument as well.

Investors who had initiated an appraisal proceeding following an acquisition by a third party were contractually bound by the terms of a waiver of appraisal rights contained in a stockholders' agreement that they had entered into prior to the acquisition.

Third, the petitioners argued that even if the stockholders' agreement was an enforceable waiver of appraisal rights, it was not enforceable by Authentix. Specifically, they argued that Authentix was precluded from enforcing the petitioners' rights under the stockholders' agreement because of public policy under Section 151(a) of the General Corporation Law of the State of Delaware. Petitioners argued that Section 151(a) requires limitations on classes of stock to be set out in, or derived from, the corporate charter. Therefore, enforcement would impermissibly allow the Authentix directors to impose a limitation on classes of stock by contract, in contravention to the statute. The Court disagreed, finding that the stockholders' agreement required the petitioners to take on contractual responsibilities in return for consideration, including the obligation to refrain from appraisal. The Court concluded that the petitioners agreed not to exercise appraisal rights and that agreement was enforceable in accordance with its terms. Accordingly, the Court determined that the petitioners were not entitled to an appraisal of their shares.

Blueblade Capital Opportunities LLC v. Norcraft Cos., Inc.; In re Appraisal of Solera Holdings, Inc.: 2018 Developments in Delaware Statutory Appraisal Law

Following the Delaware Supreme Court's guidance regarding the importance of deal price as an indicator of fair value in *DFC Global Corp. v. Muirfield Value Partners, L.P.*, 172 A.3d 346 (Del. 2017), and *Dell Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, 2017 WL 6375829 (Del. Dec. 14, 2017), in two appraisal actions in July 2018, the Court of Chancery came to different conclusions regarding its ability to rely on transaction price given the quality of the underlying sales processes. In B*lueblade Capital Opportunities LLC v. Norcraft Companies, Inc.*, 2018 WL 3602940 (Del. Ch. July 27, 2018), the Court of Chancery used its own discounted cash flow analysis to reach a fair value calculation $0.66 per share above deal price after declining to place any weight on a transaction price generated through a sales process with "significant flaws." Conversely, three days later in *In re Appraisal of Solera Holdings, Inc.*, 2018 WL 3625644 (Del. Ch. July 30, 2018), the Court of Chancery placed sole weight on deal price adjusted for synergies to determine a fair value $1.90 per share less than the merger consideration, after finding the sales process was "open" and "characterized by many objective indicia of reliability."

In *Norcraft,* mindful of the Supreme Court's "embrace" of deal price as a strong indicator of fair value in *DFC* and *Dell,* the Court of Chancery emphasized that the Supreme Court had declined to adopt a rule that deal price presumptively reflects fair value. Based on the record before it, the Court concluded that the deal price did not reflect Norcraft's fair value because there were significant issues undermining the reliability of the sales process, including (i) the lack of a pre-signing market check, (ii) that Norcraft's board did not consider other potential merger partners, (iii) deal protection measures that rendered a post-signing go-shop ineffective as a price discovery tool, and (iv) that Norcraft's CEO, who led the merger discussions, "was at least as focused on securing benefits for himself as he was on securing the best price available for Norcraft." The Court also gave no weight to Norcraft's unaffected market price because Norcraft was "fresh off" an initial public offering, its stock was "thinly traded" and "thinly covered by analysts," and the parties did not introduce significant evidence regarding market efficiency. Consequentially, the Court relied solely on its own discounted cash flow ("DCF") valuation, calculated by borrowing the "most credible components" of each parties' expert's analyses, to conclude that a valuation of $26.16 per share, or 2.59% more than the $25.50 per share deal price, represented fair value as of the merger date. The Court then conducted a "reality check" by comparing its own DCF valuation to the market price, and determined that it was "satisfied" that the identified deal process flaws "resulted in the Board leaving $0.66 per share on the bargaining table."

Days later, in *Solera,* the Delaware Court of Chancery concluded that a sale process, while not perfect, "was characterized by many objective indicia of reliability." Specifically, the Court commended several features of the sale process, including: (i) two months of outreach to large private equity firms, (ii) a subsequent six-week auction process conducted by an independent and fully empowered special committee of the board, which contacted eleven financial and seven strategic firms, (iii) public disclosures during the sale process that made clear the company was for sale, and (iv) a 28-day go-shop period that allowed a key strategic competitor of Solera to continue to bid for the company after the merger agreement was signed. The Court also found that "the sales process was conducted against the backdrop of an efficient and well-functioning market for Solera's stock," highlighting Solera's "deep base of public stockholders," that its shares were actively traded on the New York Stock Exchange and covered by numerous analysts, and its debt was "closely monitored by the ratings agencies." Accordingly, the Court found that the sale process "delivered for Solera stockholders the value obtainable in a bona fide arm's-length transaction and provides the most reliable evidence of fair value," and gave the deal price adjusted for synergies "sole and dispositive weight" in determining the fair value of Solera's shares as of the date of the merger. In adjusting the deal price for synergies, the Court indicated that synergies are not limited to the strategic buyer context, and that Solera's financial buyer had "significant 'touch points' with Solera from which synergies could be realized." Observing that the petitioners "made no effort to rebut" the company's expert's evidence regarding synergies, the Court concluded that it was "convincing" and accordingly subtracted $1.90 from the merger price of $55.85 per share to arrive at a fair value of $53.95 per share.

In two appraisal actions in July 2018, the Court of Chancery came to different conclusions regarding its ability to rely on transaction price given the quality of the underlying sales processes.

The Court also considered, but did not rely on, the parties' "dueling DCF analyses." The Court noted that the company's DCF result was "in the same ballpark" as the Court's deal-price-less-synergies result, but found the petitioners' DCF valuation, which was almost 52% above the merger price, "facially unbelievable." The Court also declined to value Solera based on its unaffected market price, as had been done in *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.,* 2018 WL 922139 (Del. Ch. Feb. 15, 2018), because the company made this argument for the first time in post-trial supplemental briefing (giving the petitioners no opportunity to respond and reflecting a "facially incredible" change in the company's position, having previously argued that merger price adjusted for synergies was the best evidence of fair value). Finally, the Court declined to exclude the value attributable to the elimination of agency costs (i.e., the cost benefits to a company of consolidating ownership in a single buyer as opposed to having diffuse ownership) from its fair value determination, reasoning that the Delaware Supreme Court's decisions in *Dell* and *DFC* did not change existing precedent in the Court of Chancery holding that agency costs (and other elements of a "control premium") are properly part of a company's going-concern value.

Dell Inc. v. Magnetar Global Event Driven Master Fund Ltd.; DFC Global Corp. v. Muirfield Value Partners, L.P.; ACP Master, Ltd. v. Sprint Corp; In re Appraisal of SWS Group, Inc.; In re Appraisal of PetSmart, Inc.; In re Appraisal of AOL Inc.; Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.: 2017 Developments in Delaware Statutory Appraisal Law

The Delaware courts have decided a number of statutory appraisal cases recently. Most prominently, the Delaware Supreme Court reversed two post-trial appraisal decisions of the Court of Chancery, in *DFC Global Corp. v. Muirfield Value Partners, L.P.*, 172 A.3d 346 (Del. Aug. 1, 2017), and *Dell Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, 177 A.3d 1 (Del. Dec. 14, 2017). The Court of Chancery in *In re Appraisal of PetSmart, Inc.*, 2017 WL 2303599 (Del. Ch. May 26, 2017), determined that a transaction price generated through an arm's-length auction process was reliable evidence of fair value and declined to place any weight on the parties' competing discounted cash flow analyses. And in four recent decisions, *In re Appraisal of SWS Group, Inc.*, 2017 WL 2334852 (Del. Ch. May 30, 2017); *ACP Master, Ltd. v. Sprint Corp.*, 2017 WL 3421142 (Del. Ch. July 21, 2017); *In re Appraisal of AOL Inc.*, 2018 WL 1037450 (Del. Ch. Feb. 23, 2018); and *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, 2018 WL 922139 (Del. Ch. Feb. 15, 2018), the Court of Chancery declined to rely on transaction price, but used a discounted cash flow analysis in three cases and pre-announcement market trading price in the last to reach valuation conclusions below the transaction price.

In *DFC Global,* the Court of Chancery had opined that, while the transaction was arm's length and subject to a robust pre-signing market check, significant regulatory uncertainty undermined the reliability of the corporation's cash flow forecasts (and hence of a valuation based on discounting those forecast cash flows), but also undermined the reliability of the transaction price and of a multiples-based valuation as indicators of fair value. The trial court had therefore placed equal weighting on transaction price, a discounted cash flow valuation that was above the deal price, and a comparable companies valuation that was below the deal price. *See In re Appraisal of DFC Global Corp.*, 2016 WL 3753123 (Del. Ch. July 8, 2016).

On appeal, the Delaware Supreme Court reversed. Although the Supreme Court declined to establish a presumption in favor of the transaction price, it rejected the premise that the future uncertainty that rendered the cash flow forecasts unreliable also vitiated the transaction price and the multiples analysis as indicators of fair value. The Supreme Court also rejected the thesis, referenced in the trial court's opinion, that the transaction price may have been unreliable because the buyer, a private equity firm, determined the price it was willing to pay by reference to achieving an internal rate of return and reaching a deal within its financing constraints; the Supreme Court held that a buyer's focus on its internal rate of return has "no rational connection to whether the price it pays as a result of a competitive process is a fair one." The Supreme Court concluded that the trial court had not adequately explained, in light of the record and the economic literature, the basis for its decision to assign equal weight to the three measures of value, and remanded for further proceedings.

Similarly, in *Dell,* the trial court had declined to place mathematical weight on the transaction price in a management-led buyout in which a special committee had elected to conduct a limited pre-signing market check followed by a post-signing go-shop process. *See In re Appraisal of Dell Inc.*, 2016 WL 3186538 (Del. Ch. May 31, 2016). The trial court determined that the process included "sufficient pricing anomalies and dis-incentives to bid ... to create the possibility that the sale process permitted an undervaluation of several dollars per share." The trial court therefore placed exclusive weight on a discounted cash flow valuation that resulted in an appraisal value approximately 28% above the deal price. The trial court also focused on the fact that the private equity group that had participated in the buyout along with the company's founder, Michael Dell, had determined its bid based in part on a leveraged buyout model, and that, at the value returned by the Court's discounted cash flow valuation model, the internal rate of return under the LBO model would have been unacceptably low, and the corporation would not have been able to support the necessary levels of leverage.

On appeal, the Delaware Supreme Court reversed, holding that "the reasoning behind the trial court's decision to give no weight to any market-based measure of fair value runs counter to its own factual findings." The Supreme Court rejected the thesis that the corporation was obliged to show that the sale process is "the most reliable evidence of its going concern value in order for the resulting deal price to be granted any weight." Rather, the Supreme Court wrote, the fact that the corporation attracted no bidders at the price determined by the trial court "is not a sign that the asset is stronger than believed—it is a sign that it is weaker." The Supreme Court identified numerous factors suggesting that the transaction process was well designed to capture the highest available price for the company, and stated that those factors "suggest strong reliance upon the deal price and far less weight, if any, on the DCF analysis." The Supreme Court remanded with the instruction that the trial court was at liberty to enter judgment at the deal price with no further proceedings or to follow another route, potentially including a weighing of multiple factors with an explanation "based on reasoning that is consistent with the record and with relevant, accepted financial principles."

The Court of Chancery's *PetSmart* decision, released several months before the Supreme Court's decisions in *DFC Global* and *Dell,* sounded many of the same themes. In that case, the Court concluded that the petitioners had not carried "their burden of persuasion that a DCF analysis provides a reliable measure of fair value" on the facts of the case, due in large part to the speculative nature of the projections involved. Rather, the Court determined that the corporation had established that the merger "was the result of a proper transactional process comprised of a robust pre-signing auction in which adequately informed bidders were given every incentive to make their best offer in the midst of a well-functioning market." In reaching that conclusion, the Court rejected the argument, also raised in *DFC Global* and *Dell,* that a buyer's use of the leveraged buyout model to determine its offer price implied that the offer price would "rarely if ever produce fair value because the model is built to allow the funds to realize a certain rate of return that will always leave some portion of the company's going concern value unrealized." The Court finally noted that the petitioners' valuation contention, based on a discounted cash flow model that valued the company at a 55% premium to deal price, "would be tantamount to declaring that a massive market failure occurred here that caused PetSmart to leave nearly $4.5 billion on the table." Concluding that the transaction price was a reliable indicator of fair value under the circumstances of the case, the Court entered judgment at the $83 per share deal price, which judgment was not appealed by the petitioners.

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The Court of Chancery also has ruled, in three cases decided since mid-2017, that a discounted cash flow analysis yielded a valuation below the transaction price. Two of those cases, *SWS Group* and *Sprint,* involved purchasers with significant degrees of control over the sale process; SWS was sold to a substantial creditor that possessed a contractual right to block competing bids, and the target company in the *Sprint* case, Clearwire Corporation, was sold to its majority stockholder. Hence, neither case involved a claim that the Court should determine that the transaction price was the fair value for appraisal purposes. Both transactions included significant synergistic elements. Both *SWS* and *Sprint* have been affirmed on appeal in summary orders.

The latest discounted cash flow case, *AOL,* involved an arm's-length acquisition of AOL by Verizon. AOL's board had decided to approach potential buyers on a selective basis (rather than conduct a broad pre-signing market check), and several potential buyers had signed non-disclosure agreements and received access to due diligence materials. The Court did not criticize that decision about the structure of the sale process, but noted that once the merger agreement had been signed, AOL's CEO (who was to be employed in the post-merger entity) made public statements expressing his commitment to the Verizon transaction. The Court also noted that the Verizon transaction was protected by a no-shop and unlimited three-day match rights, and that the time between signing and closing was relatively short. The Court therefore concluded that it could rely on the transaction price only as a check on the discounted cash flow analysis that it undertook. The result of the discounted cash flow analysis was $48.70 per share, a 2.6% discount to the $50.00 per share deal price.

Finally, in *Aruba,* the Court of Chancery observed that the Delaware Supreme Court's rulings in *Dell* and *DFC* endorsed the efficient capital markets hypothesis, which suggests that prices produced by an efficient market are generally reliable indicators of value. Although the parties had not focused on market efficiency during trial, the Court concluded that the market for Aruba's stock possessed the attributes consistent with an efficient market found in *Dell* and *DFC*. On that basis, the Court concluded that the market for Aruba's stock was efficient and the unaffected trading price provided reliable evidence of fair value. The Court also considered the deal price less synergies approach for determining the fair value. The Court concluded that the HP-Aruba merger "looks like a run-of-the-mill, third-party deal," and that the deal price likely included value attributable to expected synergies. The Court noted, however, that it was not possible based on the record to determine with confidence the amount of synergistic value included in the deal price. Thus, while the Court estimated the deal price less synergies to be $18.20, it found the unaffected trading price to be a more straightforward and reliable method for valuing Aruba. Finally, the Court rejected the petitioners' discounted cash flow analysis because its significant divergence from market value indicators raised doubts as to its reliability, and rejected the respondent's discounted cash flow analysis based on various methodological flaws. Accordingly, the Court found that the unaffected trading price ($17.13 per share), which was more than 30% below the deal price ($24.67 per share), was the best indicator of the fair value of Aruba's stock. The Court of Chancery's decision in *Aruba* has been appealed to the Delaware Supreme Court.

Section 205 Actions

Almond v. Glenhill Advisors LLC: Court of Chancery Validates Corporate Acts Preceding Acquisition Merger under Section 205

In *Almond v. Glenhill Advisors LLC,* 2018 WL 3954733 (Del. Ch. Aug. 17, 2018), the Court of Chancery offered guidance regarding the circumstances under which it would use its equitable powers under Section 205 of the Delaware General Corporation Law ("DGCL") to validate acts that, due to technical failures in authorization, would be void or voidable. Additionally, the Court offered guidance on the circumstances where a corporate overpayment claim will be considered purely derivative in nature and therefore eliminate a plaintiff's derivative standing.

This dispute arose following Herman Miller, Inc.'s acquisition of Design Within Reach, Inc. ("DWR") in 2014, but involved two financing transactions and other corporate actions that occurred years prior to the merger. In 2009, funds affiliated with Glenhill invested $15 million in DWR, receiving 92.8% of the outstanding equity in exchange for the investment. Glenhill's equity interests included both common stock and the Series A Preferred, with the Series A Preferred being convertible into shares of common stock in certain specified circumstances based on a conversion formula. The Series A Preferred certificate of designation provided for adjustments to such conversion formula in the event of a reverse split of the common stock, but not in the event of a reverse split of the Series A Preferred. In the midst of a downturn in the company's business, DWR's board of directors decided to implement a 50-1 reverse stock split of both the common stock and the Series A Preferred in 2010 to relieve the company from its reporting obligations as a public company. The board recommended, and Glenhill as the majority stockholder approved, the reverse stock split and related transactions, including amending the certificate of incorporation.

Following the reverse stock split, Glenhill converted Series A Preferred into common stock in 2013. In the years following Glenhill's investment, DWR's business started to turn around, and the company eventually negotiated a $170 million acquisition by Herman Miller in 2014. Following the acquisition, the plaintiffs did not seek statutory appraisal or challenge the fairness of the merger, but did initiate a post-closing lawsuit against Glenhill and the board related to the merger and their conduct in the years leading up to the merger.

During the pendency of the lawsuit, the plaintiffs discovered certain technical issues with the certificate of amendment approving the 50-to-1 stock split and other actions taken by DWR prior to the merger. Under the terms of DWR's certificate of incorporation, the reverse stock split of the common stock triggered an adjustment to the conversion ratio of the Series A Preferred stock, resulting in an automatic reduction in the number of shares of common stock into which the Series A Preferred stock would be convertible. As a result of this adjustment provision, the simultaneous reverse stock split of the Series A Preferred stock and common stock resulted in a massive (albeit unintended) reduction in the number of shares of common stock into which the holders of Series A Preferred could convert. That defect was not uncovered either in 2013, when the Series A Preferred stock was converted, or in 2014, when the merger became effective. After discovering this defect, the plaintiffs amended their complaint to add Herman Miller as a defendant and allege that the merger was void as a result.

The Court stated that the ratification was "clearly the equitable outcome," noting that the defendants were seeking to restore the company and its stockholders to the positions they believed they occupied at all relevant times.

In addition to their claims challenging the validity of the merger, the plaintiffs challenged several pre-merger transactions pursuant to which members of DWR's board and their affiliates had received equity in DWR. Herman Miller responded to the plaintiffs' amended complaint by taking action under Section 204 of the DGCL to ratify seven defective corporate acts relating to the reverse stock split and conversion of the Series A Preferred Stock. Herman Miller, along with DWR as an intervenor, also filed a counterclaim under Section 205 to ratify those acts. The plaintiffs ultimately only challenged two of the defective acts, including preserving their claim to a larger portion of the merger consideration through the invalidation of a massive number of shares of common stock issued upon the conversion of the Series A Preferred stock.

As to the Section 205 claims, the Court first determined that the defective acts the plaintiffs were challenging—specifically, the amendment to the certificate of incorporation to render inoperative the adjustment to the conversion price of the Series A Preferred stock, and the validation of an issuance in 2013 of 5,351,439 shares of common stock, at a time when there were only 1,600,000 shares of common stock authorized for issuance due to the fact that an amendment to DWR's certificate of incorporation increasing the shares of common stock to 7,500,000 was not approved until one week after the purported issuance—were corporate acts that were capable of being ratified. In doing so, the Court rejected the plaintiffs' arguments that the Court did not have the power under Section 205 to validate the defective acts.

Next, the Court found that the factors outlined in Section 205 weighed heavily in favor of the validation of the acts ratified under Section 204. The Court stated that the ratification was "clearly the equitable outcome," noting that the defendants were seeking to restore the company and its stockholders to the positions they believed they occupied at all relevant times.

The Court also evaluated the plaintiffs' breach of fiduciary duty claims regarding overpayment in connection with the authorization of equity issuance transactions that allegedly unfairly benefitted some or all of the directors of the DWR board or their affiliates. The Court proceeded from the premise that under the Delaware Supreme Court's opinion in *Lewis v. Anderson,* a plaintiff's standing to maintain a derivative suit is generally extinguished upon a merger, given that a derivative claim is a right owned by the nominal corporate defendant that vests in the acquiring entity in the merger. The plaintiffs did not attempt to argue that the overpayment claims fit into one of the two exceptions to the general rule that a merger extinguishes a derivative claim, but instead advanced a theory of standing on the basis of the "transactional paradigm" set forth in the Delaware Supreme Court's opinion in *Gentile v. Rosette*.

Before turning to the plaintiffs' specific arguments, the Court discussed the Delaware Supreme Court's opinion in *El Paso Pipeline GP Co., L.L.C. v. Brinckerhoff,* in which the Supreme Court questioned the continued viability of *Gentile*'s holding. The *Glenhill* Court stated that in the wake of *El Paso,* the Court of Chancery "has exercised caution in applying the *Gentile* framework." Nevertheless, the Court of Chancery reviewed each of the allegations under the requirements of *Gentile,* ultimately finding that the plaintiffs failed to satisfy them. *Gentile* has been narrowly interpreted and only applies where (i) there is a controlling stockholder or control group, and (ii) the challenged transaction results in an improper transfer of both economic value and voting power from the minority stockholders to the controller.

In this case, however, the Court noted that Glenhill was already a controlling stockholder at the time of the transactions and did not agree to limit its ability to act in its own self-interest as a controller in some material way. Accordingly, the Court found that Glenhill still had control of DWR, and because it did not receive any additional percentage of economic and voting power beyond what Glenhill had already held in the company immediately before the challenged framework, *Gentile* did not apply and the plaintiffs' standing to bring derivative claims for overpayment was extinguished in the merger.

Multi-Forum Litigation

California State Teachers' Retirement System v. Alvarez: Delaware Supreme Court Finds Dismissal of Derivative Action for Failure to Plead Demand Futility Has Preclusive Effect on Other Derivative Plaintiffs

In *California State Teachers' Retirement System v. Alvarez,* 2018 WL 547768 (Del. Jan. 25, 2018), the Delaware Supreme Court declined to adopt a proposed rule from the Court of Chancery that, as a matter of due process, a judgment in a derivative action cannot bind a corporation or other stockholders until the suit has survived a motion to dismiss for failure to plead demand futility. In doing so, the Supreme Court confirmed that, generally, the dismissal of a shareholder derivative action for failure to plead demand futility precludes other derivative actions brought in other jurisdictions as long as the plaintiff in the dismissed case adequately represented the corporation's interests.

In April 2012, *The New York Times* reported on an alleged bribery scheme and subsequent cover-up by executives of a Wal-Mart subsidiary. Derivative lawsuits asserting claims for breach of fiduciary duty against Wal-Mart's officers and directors were filed in Arkansas federal court and in the Delaware Court of Chancery. The Delaware plaintiffs made a books and records demand pursuant to Section 220 of the DGCL, while the plaintiffs in the Arkansas litigation did not make a similar demand, relying solely on publicly available information, including internal Wal-Mart corporate memos referenced in a news article.

A subsequent derivative plaintiff's due process rights were protected, and dismissal based on issue preclusion was appropriate where the plaintiff's "interests were aligned with and were adequately represented by the prior plaintiffs."

While litigation relating to the Delaware plaintiffs' Section 220 demand was pending, Wal-Mart moved to dismiss the Arkansas action under Federal Rule of Civil Procedure 23.1, arguing that the Arkansas plaintiffs had failed to plead sufficiently that demand on Wal-Mart's board of directors would have been futile. The Arkansas court granted the motion to dismiss, and Wal-Mart moved to dismiss in Delaware on the grounds that the decision by the Arkansas court had a preclusive effect on the issue of demand futility. The Delaware Court of Chancery agreed, applying Arkansas preclusion principles and dismissing the Delaware action.

Following the Court of Chancery's original decision, the Delaware plaintiffs appealed to the Delaware Supreme Court. The Supreme Court issued an order in January 2017 in which it did not disagree with the Court of Chancery's dismissal, but expressed concern over the due process implications. The Supreme Court remanded the action to the Court of Chancery to determine whether "the subsequent stockholders' Due Process rights [had] been violated" by the dismissal of the Arkansas action on demand futility grounds. *See Cal. State Teachers' Ret. Sys. v. Alvarez,* 2017 WL 6421389 (Del. Jan. 18, 2017) (TABLE).

On remand, the Court of Chancery recommended that the Supreme Court adopt a rule that derivative litigation does not have a preclusive effect against stockholders in another derivative action "until the [first] action has survived a Rule 23.1 motion to dismiss, or the board of directors has given the plaintiff authority to proceed by declining to oppose the suit." *See In re Wal-Mart Stores, Inc. Del. Deriv. Litig.,* 167 A.3d 513 (Del. Ch. 2017).

The Supreme Court declined to adopt the Court of Chancery's recommendation, and instead affirmed the Court of Chancery's original dismissal of the Delaware action on preclusion grounds. The Supreme Court observed that three federal Courts of Appeals had arrived at the same conclusion—a subsequent derivative plaintiff's due process rights were protected, and dismissal based on issue preclusion was appropriate where the plaintiff's "interests were aligned with and were adequately represented by the prior plaintiffs."

Applying that test, the Supreme Court found that, under the Arkansas privity test—which is satisfied "when two parties are so identified with one another that they represent the same legal right"—the Arkansas and the Delaware plaintiffs stood in privity. The Supreme Court reasoned that even where there are multiple pending derivative actions, the derivative plaintiffs "seek to control the corporation's cause of action" and therefore stand in privity to one another. The Supreme Court rejected the plaintiffs' argument that the dual-phase nature of a derivative action, as first a suit seeking authority to pursue the corporation's claim and then a suit to recover on behalf of the corporation, transformed the first step of a derivative action into an individual claim by the shareholder, which (plaintiffs argued) caused a stockholder-plaintiff who fails to reach the second phase not to be in privity with other stockholders seeking to assert the same claim.

Turning to the due process analysis, the Supreme Court applied the test outlined in Restatement (Second) of Judgments, under which a prior representation would be considered inadequate only where (i) the prior litigation was conducted in a "grossly deficient" manner, or (ii) the first-filed plaintiffs had a conflict of interest that caused them to pursue the litigation at the expense of later-filed plaintiffs. The Supreme Court found that neither prong of that test was present. First, while the Supreme Court recognized that the Arkansas plaintiffs may have made a "tactical error" by not pursuing a books and records demand prior to filing a derivative action, such a decision was considered and one upon which "[r]easonable litigants can differ" in the context of this litigation. Second, the Delaware plaintiffs made no showing that the Arkansas plaintiffs' interests were adverse to those of Wal-Mart, and therefore the Supreme Court found no conflict of interest that would render the Arkansas representation inadequate.

Controlling Stockholder Issues

Flood v. Synutra Int'l, Inc.: Delaware Supreme Court Clarifies the *Ab Initio* Requirement Articulated in *MFW*

In *Flood v. Synutra Int'l, Inc.,* 195 A.3d 754 (Del. 2018), the Delaware Supreme Court, sitting *en banc,* affirmed the Delaware Court of Chancery's decision, which held that the business judgment rule applies where a controlling stockholder conditions its bid on approval by a special committee and by a majority of the minority stockholders before any substantive economic negotiations have occurred.

Liang Zhang and entities related to him (collectively, "Zhang") controlled 63.5% of Synutra International Inc.'s capital stock. Zhang delivered an initial letter proposing to take Synutra private at $5.91 per share; however, the initial offer letter did not condition the transaction on approval by a special committee or the disinterested minority stockholders of Synutra. Two weeks after the initial offer and one week after Synutra formed a special committee to consider the proposal, Zhang sent a second letter including both conditions. The second letter was delivered to Synutra before the committee had met to consider Zhang's proposal and before any economic negotiations between Zhang and Synutra had occurred. The special committee did not engage an investment bank or counsel until after the second offer letter containing the two conditions. In fact, the committee did not begin price negotiations until seven months after receiving Zhang's offer containing the dual requirements.

In *Kahn v. M & F Worldwide Corp. ("MFW"),* 88 A.3d 635 (Del. 2014), the Delaware Supreme Court held that the business judgment rule would apply to a controlling stockholder transaction where the dual protections of a special committee and majority of the minority stockholder approval were agreed to by the controller *ab initio*. The plaintiff in *Flood* argued for a bright-line rule to interpret *MFW*'s *ab initio* requirement, whereby a transaction would not be entitled to business judgment rule review if the controller's *first* expression of interest was not conditioned on satisfaction of *MFW*'s dual requirements. The Delaware Supreme Court rejected the plaintiff's argument and instead focused on the fact that the dual requirements were included in the offer before the special committee and the controller engaged in any economic negotiations. Critically, the committee knew that the dual requirements were in place at the commencement of substantive deliberations with the controlling stockholder; therefore, the controller was unable to proffer the dual requirements as a bargaining chip to obtain a better price later in the process. The Court further rejected the plaintiff's argument by interpreting the meaning of *"ab initio,"* or when translated from Latin, "from the beginning," as used in everyday speech. The Court found that the plaintiff's interpretation did not comport with an ordinary person's understanding of "from the beginning" because the beginning of an event necessarily includes a time period beyond the first moment that the event occurs, such as how the beginning of a book includes not just the first word but the first few chapters.

The Delaware Supreme Court also grounded its holding on an earlier case, *Swomley v. Schlecht,* in which it affirmed the Court of Chancery's holding that *"MFW*'s *'ab initio'* requirement was satisfied even though 'the controller's initial proposal hedged on whether the majority-of-the-minority condition would be waivable or not' because the controller conditioned the merger on both of *MFW*'s dual requirements 'before any negotiations took place.'" *See Swomley v. Schlecht,* 2014 WL 4470947, at *17-18 (Del. Ch. 2014), *aff'd*

128 A.3d 992 (Del. 2015) (TABLE). Consistent with *Swomley,* the Court in *Flood* reasoned that conditioning an offer upon *MFW*'s dual requirements prior to the initiation of economic negotiations corresponded with *MFW*'s purpose: preventing a controller's use of the dual requirements, particularly the majority-of-the-minority vote, as leverage in negotiations with a special committee to dampen the special committee's ability to negotiate a better deal for the minority stockholders. The Court also found significant the fact that the dual conditions were in place before the special committee had even selected its advisors.

Ultimately, the Delaware Supreme Court agreed with the Court of Chancery's finding that Zhang's prompt follow-up letter prevented use of the dual requirements as bargaining chips. The Court concluded that because Zhang self-disabled before economic negotiations took place, the *ab initio* requirement of *MFW* had been satisfied, and therefore the transaction was subject to review under the business judgment rule standard.

Basho Technologies Holdco B, LLC v. Georgetown Basho Investors, LLC: Finding of Effective Control Gives Rise to Fiduciary Duties for Minority Stockholder

In *Basho Technologies Holdco B, LLC v. Georgetown Basho Investors, LLC,* 2018 WL 3326693 (Del. Ch. July 6, 2018), the Delaware Court of Chancery reviewed the plaintiffs' fiduciary claims under the entire fairness standard and found post-trial that the defendants breached their fiduciary duties by exercising their control over Basho Technology, Inc. to limit Basho's access to capital.

In 2011, Basho was an early-stage technology start-up in need of funding. The company solicited an investment from Chester Davenport, who agreed to have his private equity fund, Georgetown Basho Investor, LLC ("Georgetown"), lead a Series D round of funding and to join Basho's board of directors. Davenport believed an investment in the company could be profitable if the company could be sold in short order. Over the next year, Davenport and Georgetown participated in another round of Series E funding.

In 2012, Davenport announced that he would lead a round of Series F financing and proposed an investment that would give Georgetown majority control. The board rejected Davenport's proposal. However, the company found another investor who, together with Georgetown, participated in a modified Series F round of funding. As a result, Georgetown invested $5 million, with an option to invest another $5 million, in exchange for a majority of Series F preferred shares and another board seat. Importantly for Georgetown, the Series F preferred shares came with blocking rights, which effectively allowed Georgetown to unilaterally veto subsequent investments by withholding its consent. Davenport intended to use Georgetown's blocking rights to prevent additional outside investment, such that Georgetown would be "the sole life line of the Company for money." Georgetown would then seize control of the company and force a sale.

Throughout 2012, Georgetown used its blocking rights to rebuff overtures from third-party investors, and effectively positioned itself as Basho's only option for capital. In December 2012, Basho was left with no option but to enter into a loan agreement with Georgetown, on terms less favorable than outside investment offers Georgetown had rejected. Georgetown also used its growing influence over Basho to reshuffle the company's management in its favor. Shortly thereafter, in the beginning of 2013, the company engaged Cowen & Co.—an investment bank with which Georgetown had a relationship—to initiate a sale process.

The Cowen-led sale process was unsuccessful, and beginning in April 2013, Davenport intentionally delayed funding under the loan agreement to force Basho to cooperate further with Georgetown. Davenport also instructed Cowen to initiate a Series G round of fundraising.

From the beginning, Davenport and other Georgetown representatives sought to control the company's fundraising efforts, including by misleading the company's board and management. However, the initial phase of Series G fundraising yielded only one expression of interest. With limited options, Cowen reached out to Southeast Venture Partners, which Basho had previously identified as a potential investor. Southeast showed interest in investing.

On November 4, 2013, Georgetown submitted a term sheet for the Series G round, which included a modest investment of new money and a conversion of amounts due under the loan agreement. In exchange, Georgetown demanded a liquidation preference, significant dividends, the ability to convert its preferred stock to super-voting common stock, and the right to designate five of seven directors. Georgetown

In finding Georgetown to be a minority controller, the Court pointed to Georgetown's use of its contractual blocking rights, efforts by Georgetown affiliates to spread misinformation, interference with management, and insistence on Series G financing.

demanded that Basho act on its term sheet within 72 hours. The board formed a committee to consider Georgetown's offer. The committee then decided that the term sheet was too one-sided and should be rejected. In response, Davenport threatened to withhold payments under the loan agreements. The board then capitulated and resolved to negotiate definitive transaction documents with Georgetown.

But Basho's CEO forwarded Georgetown's offer to Southeast, which responded with an offer of its own, on terms superior to Georgetown's. Davenport then threatened to sue the CEO and Basho's founder if the company did not accept Georgetown's offer. Over the next two months, Davenport and other Georgetown affiliates sought to delay any deal with Southeast, and engaged in a campaign of misinformation. At times Georgetown pretended to support a deal with Southeast, but would then refuse to negotiate with Southeast. Eventually, Southeast provided a revised term sheet, which the board approved (with Davenport and the other Georgetown designee abstaining). However, Southeast was unable to secure funding for its investment and was ultimately unable to close. After the Southeast investment fell through, Basho's CEO resigned.

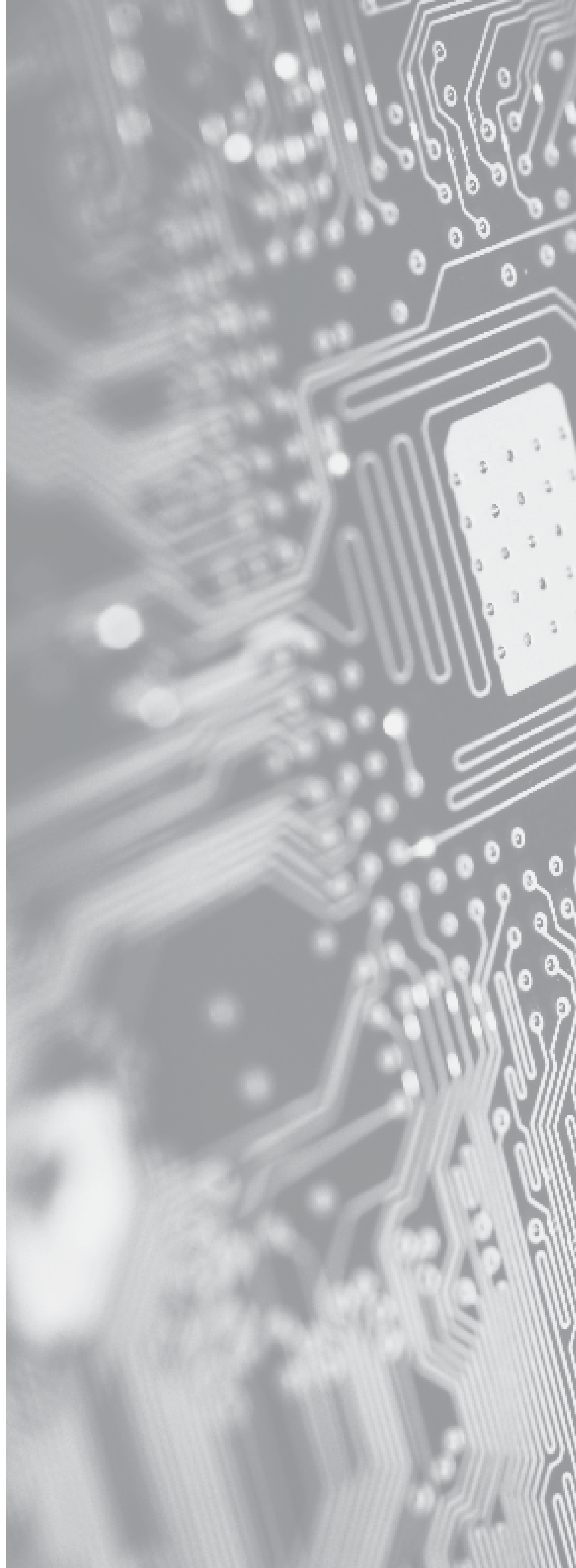
Georgetown—which by then was the company's only option—submitted a revised offer for Series G funding and gave the company less than 20 hours to deliberate. The terms of Georgetown's offer were onerous and would give Georgetown majority control at both the board and stockholder levels. On January 18, 2014, the board accepted Georgetown's offer. Then, with hard control of the company, Georgetown further consolidated power by appointing Davenport as executive chairman, inserting an ally as CEO, and creating an executive committee of the board, comprised of Davenport and two other Georgetown affiliates, which was empowered to act with the full authority of the board. From then on, the full board rarely met. Unchecked, Georgetown caused Basho to engage in a series of interested transactions, including accepting loans from Georgetown and affiliates and entering into consulting agreements with Georgetown affiliates.

However, Georgetown was unable to successfully run the company and failed to complete the Series G funding. Despite Basho's serious need for capital, Georgetown allowed the company to accept only those investments it deemed favorable to Georgetown and blocked all others. With no alternative access to capital, the company ceased operations in May 2017.

The plaintiffs then brought fiduciary claims against defendants Georgetown, Davenport, and other Davenport/Georgetown affiliates in the Court of Chancery. The plaintiffs' claims covered two time periods. First, the plaintiffs alleged that the defendants breached their fiduciary duties by forcing Basho to accept Georgetown's Series G funding. Second, the plaintiffs claimed that the defendants further breached their fiduciary duties by their disloyal management of the company post-Series G funding.

The Court considered the plaintiffs' claims in turn. In addressing the first claim, the Court determined the defendants owed fiduciary duties to Basho because they effectively controlled the company. Although Georgetown did not then have mathematical control at either the board or stockholder level, the Court found, after considering "the totality of the facts and circumstances, considered in the aggregate," that Georgetown controlled the company in connection with the Series G round of funding. In so finding, the Court pointed to Georgetown's use of its contractual blocking rights to limit Basho's options and access to capital, efforts by Davenport and other Georgetown affiliates to spread misinformation about the Series G round, interference with management, influence over Cowen, and insistence on Series G financing. The Court was careful to note that a stockholder's exercise of contractual blocking or veto rights will not result in the stockholder being deemed a controller in all circumstances, and that "a finding of control requires a fact-specific analysis of multiple factors." The Court went on to state that "[i]f Georgetown only had exercised its consent right, that fact alone would not have supported a finding of control. The plaintiffs proved that Georgetown and Davenport did far more." The Court then reviewed the plaintiffs' claim under the entire fairness standard, and found that the Series G funding was not fair as to process or price. The Court then awarded damages equaling the decrease in value of the plaintiff's stock, by comparing its immediate pre-Series G value to its immediate post-Series G value.

The Court then addressed the plaintiffs' second claim. After the Series G round, Georgetown had mathematical control at both the board and stockholder levels, so it controlled the company as a matter of settled Delaware law. Applying an entire fairness review, the Court found that Georgetown's consolidation of control in the executive committee and rampant self-dealing were unfair to Basho. The Court also found that the defendants' actions following the Series G funding "led directly and ineluctably to the demise of the Company." The Court then awarded rescissory damages equal to the difference between the value of the plaintiff's equity in the company after the Series G round and its current value of $0. ◆



Section 220 Demands and Director Information Rights

KT4 Partners LLC v. Palantir Techs. Inc.: Delaware Supreme Court Permits Access to Emails in Books and Records Demand

In *KT4 Partners LLC v. Palantir Techs. Inc.*, 2019 WL 347934 (Del. 2019), a books and records case pursuant to 8 *Del. C.* § 220 ("Section 220"), the Delaware Supreme Court reversed two elements of the trial court's decision: First, the Court found that the plaintiff was entitled to the production of certain emails, as more formal board-level documents on the topics at issue did not exist. Second, the Court found that the plaintiff should be permitted to use the Section 220 production materials to bring suit in the Delaware Superior Court or, under certain circumstances, another jurisdiction, rather than being restricted to using the materials only in the Delaware Court of Chancery.

The plaintiff, KT4 Partners LLC, was a long-time stockholder of Palantir Technologies Inc., a privately held company. Palantir was a party to investor rights agreements that gave certain major investors the right to be notified and given the opportunity to buy stock when the company made future stock offerings. The investor rights agreements also gave the major investors the right to inspect the company's books and records, as well as inspect the company's properties and discuss the company's business with its officers. The company and certain investors, including KT4, also entered into a first refusal agreement, which, among other things, gave the company the right to buy any or all shares of stock that a stockholder proposed to sell to another party.

The relationship between Palantir and KT4's principal soured after Palantir's CEO accused the principal of stealing the company's intellectual property. Thereafter, KT4 attempted to sell its stock in the company but was unable to do so, ultimately spurring litigation in multiple forums.

KT4 initially sent the company an information request pursuant to the investor rights agreements, but the company amended the agreements, effectively eliminating the plaintiff's contractual inspection rights. KT4 then sent a demand letter pursuant to Section 220, seeking books and records for the purpose of investigating wrongdoing with respect to, among other things, KT4's rights under the investor rights agreements and the first refusal agreement. KT4 did not specify valuation as a purpose for the inspection, although it did request financial documents.

After trial, the Court of Chancery found that KT4 had stated a proper purpose to investigate three areas: (i) the company's failure to hold stockholder meetings, (ii) the amendment of the investor rights agreements to eliminate KT4's information rights, and (iii) the company's potential failure to comply with the investor rights and first refusal agreement by failing to give stockholders notice and the opportunity to purchase stock.

The parties were tasked with drafting a proposed final order, but could not agree on certain terms and so submitted competing orders to the Court. KT4's proposed final order included language that specifically required the production of emails, while the company's proposed final order did not. Palantir also included a jurisdictional use restriction that would require that any action using the Section 220 materials be brought in the Delaware Court of Chancery, unless the Court of Chancery declined to exercise jurisdiction, in which case the action could be brought in any other Delaware court. KT4's proposed order would have allowed it to bring a non-derivative suit in any jurisdiction where the defendant director, officer, or agent of the company was subject to personal jurisdiction, so long as that individual had not consented to jurisdiction in Delaware.

The Court of Chancery adopted the company's proposed form of order. KT4 moved for reargument, which was denied. In the decision denying reargument, the Court of Chancery explained that it

CORPORATE GOVERNANCE ISSUES

had rejected the language including emails because the demand letter's request for "hardcopy and electronic documents and information" could not "reasonably be viewed as a targeted request for electronic mail." The Court of Chancery also found that emails were not essential to fulfilling KT4's stated purposes.

"If a respondent in a § 220 action conducts formal corporate business without documenting its actions in minutes and board resolutions or other formal means, but maintains its records of the key communications only in emails, the respondent has no one to blame but itself for making the production of those emails necessary."

On appeal, the Delaware Supreme Court first clarified the standard of review for a determination concerning the meaning of a Section 220 demand letter. The Supreme Court will review such a determination *de novo* unless the demand letter is ambiguous and the trial court relied on factual determinations to resolve that ambiguity. With respect to the scope of relief to which a Section 220 plaintiff is entitled, the Court stated that the appropriate standard of review is abuse of discretion.

The Delaware Supreme Court determined that the demand letter indeed requested emails, explaining that "books and records" "has long been understood to cover both official corporate records and less formal written communications." It also pointed to the fact that the demand had specifically requested "electronic documents." The Delaware Supreme Court then determined that the trial court had abused its discretion in ruling that emails were not necessary for KT4 to carry out its proper purposes. The Supreme Court explained that the question of what documents are necessary is fact specific, and that Section 220 actions are not the equivalent of full discovery. With respect to the production of emails, the Supreme Court stated that "the Court of Chancery should not order emails to be produced when other materials (e.g., traditional board-level materials, such as minutes) would accomplish the petitioner's proper purpose, but if non-email books and records are insufficient, then the court should order emails to be produced."

The Supreme Court's opinion noted that Section 220 "must be interpreted in light of companies' actual and evolving record-keeping and communication practices." The Delaware Supreme Court also noted that the company in a Section 220 action is in a better position to know about its record-keeping process and consequently what books and records are necessary for the plaintiff to accomplish his purpose, and should exercise good faith in determining what documents are to be produced.

In this case, the Supreme Court noted that Palantir had appeared to concede during oral argument on appeal that it did not have any formal corporate documents (such as board resolutions or minutes of board meetings) on the topic of the amendments to the investor rights agreements, and that the emails of the company's officers and directors were the only documents that the company had with respect to the subject matter of the inspection. The Supreme Court stated that, even without the benefit this concession, had the Court of Chancery doubted that the production of emails was necessary for KT4's proper purposes, the trial court could have ordered emails to be produced "only if Palantir could not in good faith produce other documents sufficient to fairly address the proper subjects of the inspection."

The Supreme Court further stated:

> If a respondent in a § 220 action conducts formal corporate business without documenting its actions in minutes and board resolutions or other formal means, but maintains its records of the key communications only in emails, the respondent has no one to blame but itself for making the production of those emails necessary.

With regard to the jurisdictional restriction, the Delaware Supreme Court contrasted the facts at issue in *Palantir* with those at issue in *United Techs. Corp. v. Treppel,* 109 A.3d 553, 558 (Del. 2014), an earlier Supreme Court decision that established that the Court of Chancery did have the authority to impose a jurisdictional limitation on the use of Section 220 material. In *Treppel,* the company's governing documents contained forum provisions consistent with the jurisdiction restriction at issue. Furthermore, in *Treppel,* the company had already been sued in Delaware over the same underlying conduct. In contrast, Palantir did not have a forum selection provision in its governing documents, and the parties were already engaged in litigation in California and in the Delaware Superior Court. For these reasons, the Supreme Court found that the efficiency rationale that permitted the use of a jurisdiction restriction in *Treppel* was absent in *Palantir*. Additionally, the Supreme Court found it significant that two key individuals and potential defendants resided outside of Delaware, which raised the possibility that personal jurisdiction over those defendants might be lacking in Delaware.

Schnatter v. Papa John's International, Inc., 2019 WL 194634 (Del. Ch. Jan. 15, 2019): Court of Chancery Holds that Director Is Entitled to Emails and Text Messages in Books and Records Case

In *Schnatter v. Papa John's International, Inc.,* 2019 WL 194634 (Del. Ch. Jan. 15, 2019), the Court of Chancery found that the company had not met its burden of proving that plaintiff John Schnatter, a former CEO and current director, lacked a proper purpose for a books and records demand made upon the company pursuant to 8 *Del. C.* § 220 ("Section 220"). Notably, the Court of Chancery explained that even though Schnatter might also be motivated by a desire to clear his name from widespread criticism in the media, the company had not established by a preponderance of the evidence that the ousted CEO was not also motivated by a desire to investigate mismanagement in his capacity as a director. The Court of Chancery explained that Schnatter's personal reputation was intertwined with the company's fortunes because he had been the long-serving public face of the company and its namesake.

Schnatter claimed that the board and the company had not done enough to defend his reputation when he attracted criticism because of controversial racial comments. The controvery began when Schnatter made certain comments during an earnings call regarding the protests of the national anthem during National Football League games. The company was an official sponsor of the NFL, and after the comments generated controversy, Schnatter resigned as Papa John's CEO and the NFL terminated Papa John's sponsorship. During a subsequent internal training exercise, Schnatter used a racial slur, which also provoked negative media coverage and prompted some sports teams and organizations to end their relationship with Papa John's. Although Schnatter claimed that his words had been taken out of context, he resigned as chairman but declined to resign as a director.

The board formed a special committee with exclusive power to review and make determinations about the relationship between Schnatter and the company. The board met for approximately three hours. Counsel for the company then sent Schnatter notices that it was terminating a services agreement and a sublease agreement for the use of office space at the company's headquarters.

Schnatter made a demand pursuant to Section 220 in his capacity as a director, seeking seventeen categories of documents for the purpose of investigating whether the other directors had breached their fiduciary duties in their handling of the situation. By the time the Court of Chancery wrote its opinion, only four categories of documents remained contested.

The Court of Chancery explained that, unlike when a stockholder makes a demand, when a director uses Section 220 to obtain books and records, he need only show that he is a director, he has demanded inspection, and the demand has been refused. The burden then shifts to the company, which must show that it is more likely than not that the director lacks a proper purpose for the demand. In this case, the company argued that Schnatter lacked a proper purpose because he sought documents relating to his individual status and reputation, and because he had already filed a breach of fiduciary duty action against the directors serving on the special committee. The Court of Chancery, however, ruled that the company had not met its burden. The Court found Schnatter's testimony credible regarding his concerns about the actions of the other board members relating to the controversies involving Schnatter and their decision to quickly begin to cut ties between him and the company. The Court of Chancery explained:

> Given his unique role as the Company's longstanding public spokesman, Schnatter's concerns that the Company made no effort to defend him in response to the controversies ... and that the Company instead appeared intent on abruptly severing ties with him, [were] relevant concerns that any director, including Schnatter, would have about the Company's management and oversight.

In other words, although "there is a personal element to the concerns Schnatter testified about because they also pertain to his reputation as an individual ... that fact does not negate that these concerns are legitimate corporate concerns, particularly given that Schnatter's image and standing has been inextricably intertwined with the Company's public persona for decades."

The Court of Chancery likewise rejected the company's argument that the filing of a plenary action by Schnatter indicated that he lacked a proper purpose. This is because, unlike a stockholder who seeks to investigate mismanagement, a director is not limited to those documents that are necessary to carry out his proper purpose, but has "unfettered access to the books and records of the corporation" unless the company can prove that the purpose itself is improper and not "reasonably related to the director's position as a director." Additionally, a director does not have standing to bring a breach of fiduciary duty case in his capacity as director. Schnatter was therefore limited to using the Section 220 documents internally at the company and forbidden from using them to pursue an individual derivative action.

The Court declined to condition the production of the books and records on the entry of a confidentiality order, reasoning that as a fiduciary, Schnatter was already obligated to maintain the confidentiality of sensitive documents. The Court also declined to forbid the plaintiff's counsel, who also represented him in the plenary action and who also represented two individuals suing the company for sexual harassment, from seeing the Section 220 materials. The Court of Chancery explained that it would rely on the plaintiff law firms to uphold their professional responsibilities and refrain from using the material in other actions.

Finally, the Court of Chancery noted that in practice, many individuals use email and text communications to communicate about board-level affairs, and that the decision to order the production of emails and text messages in a Section 220 action should be made on a "case-by-case" basis. The Court of Chancery reasoned that the purpose and utility of Section 220 as a means of investigating mismanagement would be undermined if a court categorically were to rule out the need to produce emails and text messages. However, the Court of Chancery did narrow the scope of the four requests still at issue to communications that "reflect any consideration of changing Schnatter's relationship

The Court of Chancery noted that in practice, many individuals use email and text communications to communicate about board-level affairs, and that the decision to order the production of emails and text messages in a Section 220 action should be made on a "case-by-case" basis.

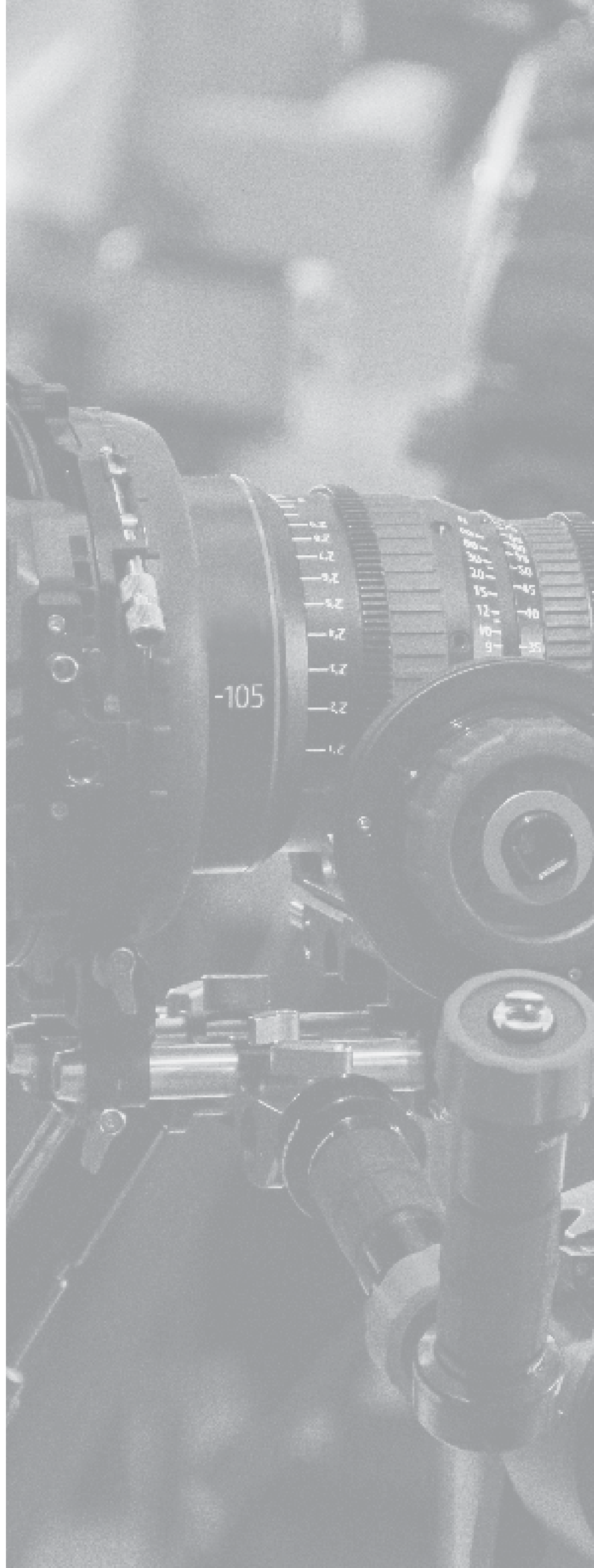
with the Company, which would include assessments of his behavior or performance in his various roles at the Company," reasoning that such limitations would properly limit the scope of the requests to documents that would constitute the books and records of the company.

In re CBS Corp. Litig.: Court of Chancery Finds Controller-Affiliated Directors Not Entitled to Certain Privileged Documents

In *In re CBS Corporation Litigation,* 2018 WL 3414163 (Del. Ch. July 13, 2018), the Court of Chancery granted in part and denied in part a motion to compel the production of certain documents that were withheld on privilege grounds. CBS Corporation split from Viacom Inc. in 2005. National Amusements, Inc. ("NAI"), Sumner M. Redstone, Shari Redstone, and NAI Entertainment Holdings LLC (collectively, the "NAI Parties") own approximately 10.3% of the economic stake in CBS and control 79.7% of the voting power. Three NAI affiliated directors are members of the CBS board of directors.

In September 2016, NAI contacted Wachtell, Lipton, Rosen & Katz, outside counsel to CBS, requesting that CBS consider a potential transaction with Viacom. Two days later, the CBS board adopted resolutions authorizing the formation of a special committee of independent directors to consider, negotiate, and oversee the potential transaction. The board resolutions establishing the special committee and the special committee's charter provided a broad delegation of authority to the special committee and required that all CBS directors, officers, employees, and agents fully cooperate with the special committee. By December 2016, discussions regarding the potential transaction were called off and the work of the special committee ended.

A potential transaction was again proposed in early January 2018. In response, the board adopted resolutions forming a special committee to consider, negotiate, and oversee the potential transaction. The board resolutions forming the special committee and the special committee's charter once again required



that CBS directors, officers, employees, and agents fully cooperate with the special committee.

In May 2018, the special committee determined that the potential transaction was not in the best interests of CBS stockholders and recommended that the board issue a dividend that would reduce NAI's voting power without diluting the economic ownership interests of any CBS stockholder, including NAI. Prior to the board meeting, NAI executed a written consent to amend the bylaws to change the approval requirements for the issuance of a dividend. Notwithstanding the written consent, on May 17, the board voted to approve the dividend—the NAI affiliated directors being the only dissenting votes.

Litigation contesting the validity of the dividend and the bylaw amendment commenced on May 14, 2018. Through this motion, the NAI Parties sought to compel CBS and the non-NAI affiliated board members (collectively, the "CBS Parties") to produce two categories of information: (i) communications with and between "CBS Counsel" (meaning CBS in-house counsel and Wachtell Lipton) and any officer or director of CBS, and (ii) communications between (a) the members of the special committees or committee counsel, on the one hand, and (b) CBS Counsel, on the other hand. The NAI Parties argued the NAI affiliated directors were entitled to the documents because, as directors, they are entitled to "unfettered access to any legal advice rendered to CBS or other members of its Board as joint clients of CBS Counsel."

The CBS Parties argued that the NAI Parties had no right to: (i) privileged documents concerning the potential transactions, regardless of their origination, from September 2016 forward, because their "adversity on that subject was obvious from the moment in 2016" when NAI first proposed a potential transaction; and (ii) communications between the special committees and CBS Counsel and between CBS management and CBS Counsel in aid of the special committee because such communications were protected by the special committees' privilege. They further argued that even if the NAI affiliated directors were entitled to the privileged documents, the remaining NAI Parties were not because they lacked "the contractual designation rights required to access such information."

Citing *Kalisman v. Friedman,* 2013 WL 1668205 (Del. Ch. Apr. 17, 2013), the Court emphasized that a director's right to information, which "is essentially unfettered in nature," extends to privileged material. The Court explained, however, that a board may withhold privileged communications in certain circumstances, such as when sufficient adversity exists between the director and the corporation such that a director could no longer have a reasonable expectation that he was a client of the board's counsel. The Court noted that prior decisions mandate that "appropriate governance procedures" be employed, such that the adversity is openly known and not concealed from the director involved. The Court emphasized that the burden is on the corporation to establish when sufficient adversity existed.

To begin its analysis, the Court held that the NAI Parties were not entitled to the second category of information sought. In so doing, the Court found that when NAI asked CBS to consider the potential transaction in 2016, the NAI Parties created sufficient adversity such that the NAI affiliated directors could not have reasonably expected they were a client of

A director's right to information "is essentially unfettered in nature" and extends to privileged material, but a board may withhold privileged communications in certain circumstances, such as when sufficient adversity exists between the director and the corporation such that a director could no longer have a reasonable expectation that he was a client of the board's counsel.

CBS Counsel or the special committees' counsel with respect to the matters delegated to the special committees. The Court further found that, by forming the special committees, "CBS employed appropriate governance procedures that openly put NAI Affiliated Directors on notice that they would be segregated from the CBS side of the deliberations, including privileged information relating thereto." The Court found both that it is "logical" that the special committees might need to confer with CBS Counsel to discharge their duties and that the board resolutions and charters required CBS employees and agents—which includes CBS Counsel—to fully cooperate with the special committees. Accordingly, "given the adversity of interests that prompted the creation of the special committees and given the mandate they were provided as part of a transparent process, the NAI Affiliated Directors could not have had a reasonable expectation that they were clients of CBS Counsel insofar as CBS Counsel was acting in aid of the process undertaken by either of the Special Committees."

With respect to the first category of information sought, the Court held the NAI Parties were not entitled to communications undertaken "in aid of the process of either of the Special Committees." However, the NAI Parties were entitled, the Court found, to communications that did not fall within that category.

Finally, with respect to the information that the Court ordered be produced, the Court found that the NAI affiliated directors were entitled to share the privileged communications with the remaining NAI Parties and their counsel. In so holding, the Court noted that the NAI Parties and their counsel were "bound by the confidentiality order governing the use of discovery material in this action."

Federal Forum Selection Provisions

Sciabacucchi v. Salzberg: Court of Chancery Invalidates Federal Forum Selection Bylaw

The Delaware Court of Chancery, in *Sciabacucchi v. Salzberg*, 2018 WL 6719718 (Del. Ch. Dec. 19, 2018), has declared "ineffective and invalid" provisions in three corporations' certificates of incorporation that purported "to require any claim under the Securities Act of 1933 to be brought in federal court" (the "Federal Forum Provisions").

Ruling on cross-motions for summary judgment, the Court, by Vice Chancellor Laster, ruled that "[t]he constitutive documents of a Delaware corporation cannot bind a plaintiff to a particular forum when the claim does not involve rights or relationships that were established by or under Delaware's corporate law. In this case, the Federal Forum Provisions attempt to accomplish that feat. They are therefore ineffective and invalid."

The Court recognized that the impetus for these provisions "came from an epidemic of stockholder litigation, in which competing plaintiffs filed a bevy of lawsuits, often in different multiple jurisdictions, before settling for non-monetary relief and an award of attorneys' fees." The Court recognized the detrimental effects of this process on corporations and the courts, but explained that forum selection provisions in a corporation's constitutive documents can govern only intra-entity disputes.

The Court's analysis relied heavily on its interpretation of then-Chancellor Strine's decision in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. June 25, 2013), in which the Court upheld the validity of corporate bylaws requiring (i) derivative actions, (ii) fiduciary duty actions, (iii) actions arising under the Delaware General Corporation Law, and (iv) actions asserting claims governed by the internal affairs doctrine, to be brought exclusively in the Court of Chancery. The Court in *Boilermakers* contrasted the provisions at issue in that case against a hypothetical provision addressing suits over external matters, such as "a tort claim against the company based on a personal injury [plaintiff] suffered that occurred on the company's premises or a contract claim based on a commercial contract with the corporation," suggesting that forum selection bylaws governing external claims might not be valid.

The Court in *Sciabacucchi* held, consistent with the dicta in *Boilermakers,* that the certificate of incorporation and bylaws could not regulate the forum of suits over external matters, including claims arising under the '33 Act. The Court reached this conclusion based in part on the language in *Boilermakers* and in part on the Delaware General Assembly's adoption, in 2015, of Section 115 of the General Corporation Law, which codified the result of *Boilermakers,* and of revisions to Sections 102 and 109, which prohibited fee-shifting provisions in the certificate of incorporation or bylaws. The Court determined that the 2015 revisions to the General Corporation Law manifested an implicit understanding by the legislature that a corporation's internal governance documents could reach only the internal affairs of the corporation.

"Under existing Delaware authority, a Delaware corporation does not have the power to adopt in its charter or bylaws a forum-selection provision that governs external claims."

The Court concluded that the rationale advanced in *Boilermakers* (which dealt with the validity of bylaws) applied equally to provisions in the certificate of incorporation, such as the Federal Forum Provisions. Because the Federal Forum Provisions did not address "the rights and powers of the plaintiff-stockholder *as a stockholder,"* but rather addressed what the Court determined to be external claims, those provisions exceeded the permissible scope of provisions of the certificate of incorporation under Section 102.

The Court rejected the defendants' argument that "issuing securities and defending against securities lawsuits involve the business and affairs of the corporation." The Court noted that, while that assertion was true, "it does not follow that these matters involve the *internal affairs* of the corporation. Many aspects of the corporation's business and affairs involve external relationships. The certificate of incorporation and Delaware law cannot regulate those external relationships." Thus, the Court concluded:

> Under existing Delaware authority, a Delaware corporation does not have the power to adopt in its charter or bylaws a forum-selection provision that governs external claims. The Federal Forum Provisions purport to regulate the forum in which parties external to the corporation (purchasers of securities) can sue under a body of law external to the corporate contract (the 1933 Act). They cannot accomplish that feat, rendering the provisions ineffective. ◆

LIMITED LIABILITY COMPANIES AND PARTNERSHIPS

Dieckman v. Regency GP LP: Delaware Supreme Court Invokes Implied Covenant of Good Faith and Fair Dealing to Reverse Court of Chancery's Dismissal of Lawsuit Challenging MLP Conflict of Interest Transaction

The Delaware Supreme Court confirmed in *Dieckman v. Regency GP LP,* 155 A.3d 358 (Del. 2017), that although Delaware courts will enforce clear, express, and unambiguous language modifying or eliminating default fiduciary duties, a conflict of interest transaction may still run afoul of implied contractual standards.

In *Dieckman,* the transaction at issue involved a merger of Regency Energy Partners LP, a publicly traded Delaware limited partnership (the "MLP"), with an affiliated entity. To reconcile this inherent conflict of interest, the general partner of the MLP attempted to satisfy two safe harbor mechanisms enumerated in the partnership agreement, either of which could be used to insulate the transaction from legal challenge—"Special Approval" by the independent conflicts committee and "Unaffiliated Unitholder Approval." The plaintiff, a common unitholder of the MLP, alleged that (i) the general partner failed to satisfy the Special Approval safe harbor because there was a conflicted member on the conflicts committee, and (ii) the general partner failed to satisfy the Unaffiliated Unitholder Approval safe harbor because the general partner made false and misleading statements in a proxy statement to secure such approval. The Court of Chancery, while not reaching the defendants' Special Approval defense, found that the Unaffiliated Unitholder Approval safe harbor had been satisfied because (i) the partnership agreement had eliminated all fiduciary duties, including the duty of disclosure, and (ii) the disclosures expressly required by the partnership agreement had been made. The Court of Chancery therefore granted the defendants' motion to dismiss.

On appeal, the Delaware Supreme Court noted that even when a partnership agreement waives fiduciary duties, investors of publicly traded partnerships still have protections afforded to them through principles of *contra proferentem* (ambiguities are construed against the drafter to give effect to the reasonable expectations of the investors) and the implied covenant of good faith and fair dealing. The Supreme Court focused on the safe harbor process in its entirety and found that the language in the partnership agreement's conflict resolution provision implicitly required the general partner to act in a manner that would not undermine the protections afforded to the unitholders in connection with the safe harbor process.

Although contractual flexibility afforded to Delaware limited partnerships provides general partners with significant protections, general partners must still comply with implied contractual responsibilities in the partnership agreement.

In analyzing the Unaffiliated Unitholder Approval defense, the Supreme Court noted that the general partner had issued a comprehensive proxy statement, which went far beyond the minimal disclosures required by the express terms of the partnership agreement, to induce the unitholders to approve the merger transaction. The Supreme Court held that once the general partner determined to go beyond the minimal disclosure requirements under the partnership agreement, then—pursuant to the implied covenant of good faith and fair dealing—the general partner had an obligation not to mislead investors. The Supreme Court found that the plaintiff pled facts raising sufficient doubt concerning whether the proxy statement misled investors by creating the false appearance that the conflicts committee, which had approved the transaction, was composed solely of unaffiliated and independent persons.

In analyzing the Special Approval defense, the Supreme Court found the general partner had an obligation to form a conflicts committee as set forth in the partnership agreement, which required committee members to be independent from and unaffiliated with the general partner. The plaintiff alleged the general partner created a two-member committee that included an individual who began reviewing the merger transaction while still a member of an affiliate board, which is not consistent with the independent status of the conflicts committee members as required by the partnership agreement. The Supreme Court concluded that the plaintiff had raised sufficient doubt as to whether the conflicts committee was properly constituted, which would call into question whether the general partner could utilize the safe harbor provisions under the partnership agreement to preclude judicial review of the merger transaction.

The *Dieckman* decision is a reminder that although contractual flexibility afforded to Delaware limited partnerships can be used to provide general partners with significant protections, general partners must still comply with implied contractual responsibilities in the partnership agreement.

Miller v. HCP & Co.: Court of Chancery Dismisses Claim for Breach of the Implied Covenant

In *Miller v. HCP & Co.*, 2018 WL 656378 (Del. Ch. Feb. 1, 2018), the Delaware Court of Chancery dismissed a claim for breach of the implied covenant of good faith and fair dealing on the ground that there was no gap in the parties' agreement to which the implied covenant may apply. HCP & Company and its affiliates (the "HCP Entities") held a majority of the membership units in Trumpet Search, LLC, holding 80% of Class E units and 90% of Class D units, collectively. Trumpet's limited liability company agreement (the "Trumpet Agreement") provided that upon a sale of Trumpet, Class E unitholders were entitled to a "first in line" payment of 200% of their investment in Class E units, after which Class D unitholders were entitled to receive 200% of their investment in Class D units. As such, upon a sale of Trumpet, the HCP Entities were entitled to the first $30 million, 200% of their investment in Trumpet, before any sales proceeds would be available to holders of other classes of membership units. The board of managers of Trumpet, in a privately negotiated sale process, approved the sale of Trumpet to an unaffiliated third party for $43 million.

Under the Trumpet Agreement, the HCP Entities were entitled to appoint four of the seven managers on the Trumpet board, which had sole discretion as to the manner of any sale of Trumpet, conditioned only on the sale being to an unaffiliated party. The Trumpet Agreement did not require the Trumpet board to conduct an open-market process in the sale of Trumpet and provided that where the Trumpet board approved a sale of Trumpet, every member was obligated to consent to the sale. The members explicitly agreed to waive all fiduciary duties to one another and from the managers to the members under the Trumpet Agreement.

Plaintiffs Christopher Miller, a co-founder, member, and manager of Trumpet, and his affiliate, which also held membership units in Trumpet, alleged that the HCP Entities and members of the Trumpet board who were appointed by the HCP Entities breached the implied covenant of good faith and fair dealing by refusing to pursue a sale process designed to achieve the highest value reasonably available for all of Trumpet's members. The plaintiffs contended that the Trumpet board's discretion to determine the "manner" of a sale under the Trumpet Agreement was limited to the structure of the transaction and that there was a gap in the Trumpet Agreement as to the type of sales process the Trumpet board could conduct. The plaintiffs also argued that even if the board had discretion, the implied covenant required discretion to be exercised reasonably and in good faith.

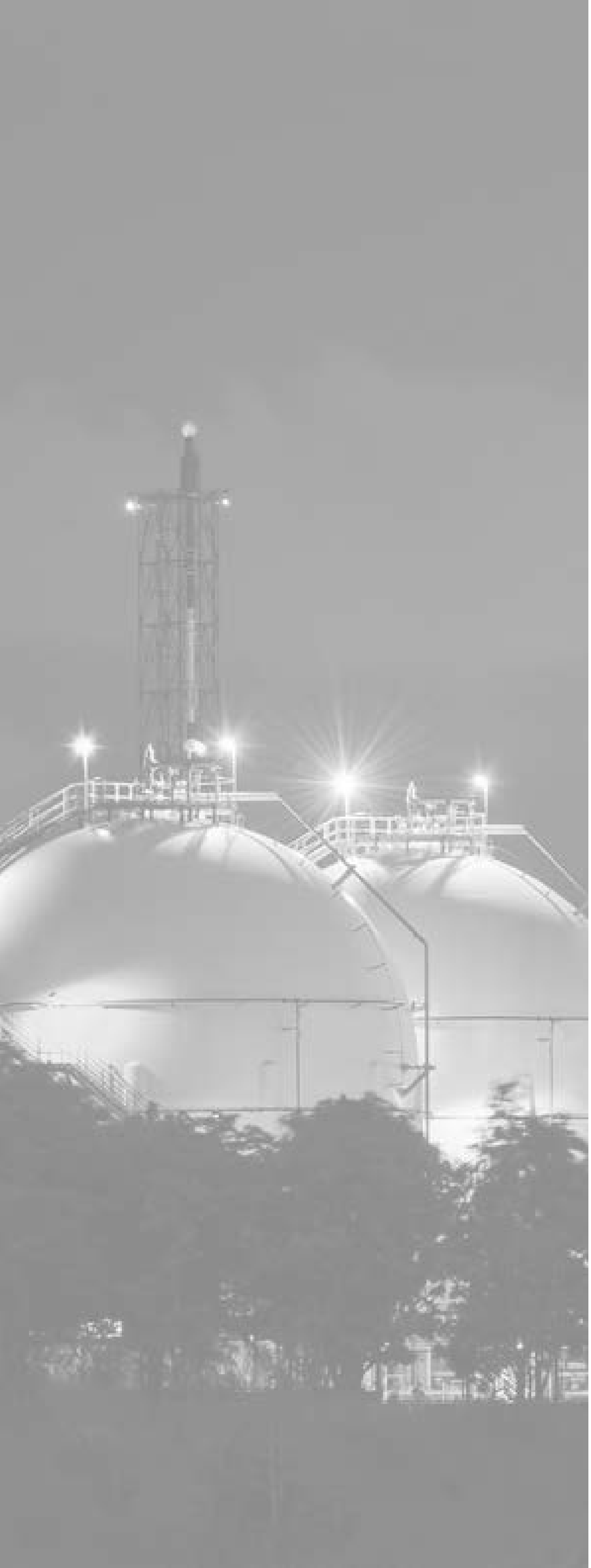
The Court held that the Trumpet Agreement did not contain a gap as to how Trumpet could be marketed and sold because it explicitly vested the Trumpet board with sole discretion as to the manner in which a sale is conducted, subject to the limitation that the company is ultimately sold to an unaffiliated third-party buyer. The Court recognized that when a contract confers discretion on one party, the implied covenant requires that the discretion be used reasonably and in good faith. However, the Court added, if the scope of discretion is specified, as it was in the Trumpet Agreement, with the requirement that any sales transaction be with an unaffiliated third party, there is no room for the implied covenant to operate. The Court, concluding that the parties to the Trumpet Agreement recognized the potential for self-dealing inherent in sole-discretion clauses and filled the gap by providing that the Trumpet board does not retain sole discretion to sell the company to insiders, dismissed the complaint for failure to state a claim.

The implied covenant was insufficient to require the defendants to run an open market process in the sale of Trumpet.

On appeal, the Delaware Supreme Court disagreed with the Court of Chancery's analysis that the sole discretion provision displaced the implied covenant altogether, but it ultimately affirmed the decision below on the basis that the implied covenant was insufficient to require the defendants to run an open market process in the sale of Trumpet.

In re Oxbow Carbon LLC Unitholder Litig.: The Court of Chancery Invokes the Implied Covenant; on Appeal, the Delaware Supreme Court Reverses

In *In re Oxbow Carbon LLC Unitholder Litig.,* C.A. No. 12447-VCL (Del. Ch. Feb. 12, 2018), the Court of Chancery invoked the implied covenant of good faith and fair dealing as a matter of compelling fairness to imply a term in a limited liability company agreement relating to the terms by which additional members were admitted to a limited liability company. William I. Koch ("Koch") controls Oxbow Carbon LLC, a Delaware limited liability company ("Oxbow"), through Oxbow Carbon & Mineral Holdings, Inc. ("Oxbow Holdings"). Crestview Partners, L.P. and Load Line Capital LLC are minority members (together, the "C&L Members") of Oxbow.



In 2007, the parties began negotiating Oxbow's limited liability company agreement (the "Oxbow Agreement"), which ultimately contained a provision for an exit sale that became the focus of the dispute. The Oxbow Agreement defined an exit sale as "a Transfer of all, but not less than all, of the then-outstanding Equity Securities of [Oxbow] and/or all of the assets of [Oxbow]." *Id*. at *1. The Oxbow Agreement also contained a related provision that stated that the party exercising its exit sale right "may not require any other Member to engage in such [e]xit [s]ale unless the resulting proceeds to such Member (when combined with all prior distributions to such Member) equal at least 1.5 times such Member's aggregate Capital Contributions through such date." *Id*. The Court referred to this as the "1.5x Clause." The Oxbow Agreement also contained various provisions (the "Equal Treatment Requirements") that provided that in an exit sale each member must be offered "the same terms and conditions" and the proceeds of the sale must be allocated "by assuming that the aggregate purchase price was distributed" *pro rata* to all unitholders. *Id*. at *2.

The Supreme Court emphasized that the implied covenant cannot be used to rebalance economic interests due to an unanticipated development.

By 2011, the C&L Members and Oxbox Holdings had received over 1.5 times their respective aggregate capital contributions. In late 2011 and early 2012, two Koch-affiliated entities (the "Small Holders") were issued units, which collectively accounted for approximately 1.4% of Oxbow's total issued units, as members of Oxbow. But Oxbow's board failed to follow proper formalities for admitting the Small Holders and failed to specify the Small Holders' rights under the Oxbow Agreement.

Over the next few years, the relationship between the C&L Members and Koch deteriorated. In 2016, the C&L Members attempted an exit sale. At this point, the Small Holders had not received distributions equal to at least 1.5 times their capital contributions. In an attempt to block the sale, Koch orchestrated the filing of two related lawsuits against the C&L Members. In response, the C&L Members argued that under the Oxbow Agreement, even if the 1.5x Clause was not satisfied with respect to the Small Holders, it simply prohibited the C&L Members from requiring the Small Holders to sell their units in Oxbow. Under this reading of the Oxbow Agreement, the C&L Members could sell their units without the Small Holders selling theirs (the "Leave Behind Option"). In the alternative, the C&L Members argued that they could provide additional consideration to the Small Holders to satisfy the 1.5x Clause (the "Seller Top Off Option"), and then force the Small Holders to participate in the exit sale. Koch argued that the Equal Treatment Requirements required all members to receive the same consideration and therefore all members must receive the highest price per unit necessary to satisfy the 1.5x Clause for any member (the "Highest Amount Option"). The Court held that the plain language of the Oxbow Agreement, read as a whole, implemented the Highest Amount Option.

The C&L Members sought a declaratory judgment regarding the effect of the implied covenant of good faith and fair dealing. As an initial matter in determining whether to apply the implied covenant of good faith and fair dealing, the Court had to first determine if a gap existed in the Oxbow Agreement. Here, the Court found that the admission of the Small Holders created a gap in the Oxbow Agreement regarding the operation of the 1.5x Clause with respect to the rights of the Small Holders.

Under the Oxbow Agreement, the rights of subsequently admitted members were left open to determination by the board of Oxbow at the time of such admission. The provision governing admission of new members states that

> upon the approval of the Directors, additional Persons may be admitted to [Oxbow] as Members and Units may be created and issued to such Persons as determined by the Directors on such terms and conditions as the Directors may determine at the time of admission. The terms of admission may provide for the creation of different classes or series of Units having different rights, powers and duties.

In connection with the admission of the Small Holders, the board passed general resolutions authorizing the issuance of units; however, the resolutions failed to specify the rights of the Small Holders. The Court found that the failure of the board to specify the rights and obligations of the Small Holders, in addition to the failure of Oxbow to follow proper formalities for admitting the Small Holders, such as having the Small Holders execute a signature page to the Oxbow Agreement, left open a gap regarding the operation of the 1.5x Clause.

After finding that the gap remained open, the Court turned to determining the appropriate implied provision to fill the gap. The Court analyzed "what the parties would have agreed to themselves had they considered the issue" during the time when they were contracting. *Id*. The Court found that since the gap concerned the terms by which Oxbow admitted the Small Holders, the Court should look to what the parties would have bargained for when the issue of admitting the Small Holders first arose in 2011.

The Court found that the C&L Members would have never consented to admitting the Small Holders if they understood that they were resetting the 1.5x Clause for the new members. The Court also found that no parties would have argued for the Highest Amount Option at the time of contracting since none of the parties identified the Highest Amount Option until 2016. In addition, the Court found that the parties would not have agreed to a Leave Behind Option since Koch from the beginning had been adamantly opposed to any provision that would leave any member behind. In analyzing each of the parties' positions in 2011, the Court found that the most likely outcome is that the parties would have agreed to a Seller Top Off Option as the commercially reasonable term.

Finally, the Court found that issues of compelling fairness called for deploying the implied covenant to permit a Seller Top Off Option. The Court found that applying the plain language of the Oxbow Agreement would deprive the C&L Members of a bargained-for right while permitting Oxbow Holdings to insist on a right to receive 1.5 times somebody else's capital contributions. Koch and the Small Holders argued that their position was not unfair because Crestview had maintained a right to exit by selling its stake. However, the Court found that Crestview's right to exit was no substitute for the exit sale since it contemplated a minority transaction that would carry a minority discount. Ultimately, the Court held that the unforeseen confluence of the poorly documented admission of the Small Holders and the resulting transformation of the 1.5x Clause into a near-absolute transactional barrier called for deploying the implied covenant.

On appeal, in *Oxbow Carbon & Mineral Holdings, Inc. et al. v. Crestview-Oxbow Acquisition, LLC, et al.*, 2019 WL 237360 (Del. S. Ct. Jan. 17, 2019), the Delaware Supreme Court affirmed in part and reversed in part the Delaware Court of Chancery's decision. The Supreme Court agreed with the Court of Chancery that the 1.5x Clause must be applied to the Small Holders as members, regardless of their improper admission as members (failure to procure the board's supermajority vote), because the doctrine of laches barred any claim that the Small Holders were not members. Among other facts, but most tellingly, the minority members' board representatives never challenged the Small Holders' member status until six years after the Small Holders were admitted.

The Supreme Court further agreed that the Oxbow Agreement's plain meaning mandates that the exit sale proceeds must meet the 1.5x Clause for each member based upon *pro rata* distribution, and that all members must participate and receive the same consideration, because the very definition of exit sale states: "[A] Transfer of all, but not less than all ... Securities of the Company."

The Supreme Court reversed the Chancery Court's finding that a contractual gap existed with regard to the Small Holders' contractual rights as members. Specifically, the Supreme Court said that a plain reading of the "New Member Provision" opted to leave the terms of new Members' admission to Board discretion: "Units may be ... issued to such [new Members] as determined by the [Board] on such terms and conditions as the [Board] may determine...." Thus, there was no contractual gap to fill, and the covenant of good faith and fair dealing should not be implied to institute a "Top-Off" so that the Minority Holders could come up with greater consideration for the Small Holders in order to satisfy the 1.5x Clause. The Supreme Court went on to emphasize that the implied covenant cannot be used to rebalance economic interests due to an unanticipated development.

The Supreme Court also vacated the Court of Chancery's remedies decision, in which it was held that Oxbow did not use reasonable efforts to effectuate the exit sale, because there was no exit sale available (the 1.5x Clause was not satisfied).

In re Energy Transfer Equity L.P. Unitholder Litig.: Court of Chancery Rules Following Trial that Issuance of Convertible Units Did Not Constitute a Distribution

In *In re Energy Transfer Equity L.P. Unitholder Litig.*, 2017 WL 782495 (Del. Ch. Feb. 28, 2017), the Delaware Court of Chancery considered whether an issuance of convertible units by Energy Transfer Equity, L.P. ("ETE"), a Delaware limited partnership, constituted an impermissible non *pro rata* distribution under the terms of the ETE partnership agreement (the "ETE Agreement"). The general partner of ETE authorized the issuance of convertible units to some, but not all, unitholders of ETE, in return for which the unitholders gave up common units of ETE. The plaintiffs were common unitholders of ETE who were not offered the opportunity to acquire any of the convertible units that were issued. The plaintiffs challenged the purported issuance on the basis that it constituted a distribution and, as such, was made in violation of the requirement in the ETE Agreement that "distributions" be provided *pro rata* to all unitholders.

In authorizing the issuance, ETE relied on Section 5.8(a) of the ETE Agreement, which permitted

ETE to "issue additional Partnership Securities and options, rights, warrants and appreciation rights relating to the Partnership Securities for any Partnership purpose at any time and from time to time to such Persons for such consideration and on such terms and conditions as the General Partner shall determine, all without the approval of any Limited Partners." The ETE Agreement provided an overarching "good faith" requirement whereby the board, or the party acting, must "believe that the determination or other action is in the best interests of the Partnership."

The plaintiffs argued that the issuance was a distribution of value to favored unitholders and thus amounted to an improper distribution of ETE's assets. ETE argued that the issuance was an exchange for value, in connection with which ETE issued units. ETE further argued that an issuance of units, even if conflicted, was permitted under the ETE Agreement, so long as it was "fair and reasonable" to ETE. The plaintiffs defined a "distribution" as any transfer "to partners in their capacity as partners," and asserted that there was no requirement that the transfer occur without consideration. The plaintiffs further argued that a distribution "occurs when cash, Partnership Securities or other property of the Partnership is allocated among the Partners." Additionally, the plaintiffs argued that to the extent there was any ambiguity in the ETE Agreement, it should be construed against ETE.

ETE contended that "a 'distribution' is a disbursement of the partnership's assets to the partners by virtue of their status as equity holders." ETE asserted that a distribution is "akin to a corporate dividend" and "occurs when a partnership, without receiving anything in return, gives its assets or earnings to its partners by virtue of their status as equity holders." ETE argued that Section 7.6(f) of the ETE Agreement conflicts with the plaintiffs' definition of distribution. Such section provides that in the context of conflicted transactions, when assets are contributed "in exchange for Partnership Securities, the Conflicts Committee, in determining whether the appropriate number of Partnership Securities are being *issued,* may take into account" various factors.

In considering the defendant's motion to dismiss, the Court noted that no provision of the ETE Agreement defined issuance or distribution and that the Delaware Revised Uniform Limited Partnership Act also does not define the term "distribution." The Court therefore looked to the contextual use of the term "distribution" in the ETE Agreement and to everyday usage to supply a meaning. It noted that *Black's Law Dictionary* defines partnership distribution as "[a] partnership's payment of cash or property to a partner out of earnings or as an advance against future earnings, or a payment of the partners' capital in partial or complete liquidation of the partner's interest." The Court held that usage of the term "distribution" within the ETE Agreement appeared consistent with this dictionary definition. However, the Court ultimately declined to find as a matter of law on the record before it what "distribution" means in the context of the issuance of convertible units in return for common units. The Court held that the record was incomplete, or in dispute, on issues helpful to the analysis, including whether the issuance was a true exchange for value or simply a way to benefit favored unitholders.

Following a trial in the matter, the Court in *In re Energy Transfer Equity, L.P. Unitholder Litig.,* 2018 WL 2254706 (Del. Ch. May 17, 2018), ruled that the issuance of convertible units did not constitute a distribution under the ETE Agreement.

The plaintiffs sought cancellation of the convertible units to avoid an alleged windfall for the subscribers at the expense of ETE and its non-subscribing unitholders. Under the ETE Agreement, distributions were required to be *pro rata*. The plaintiffs argued that the issuance via the private offering was a non-*pro-rata* distribution of partnership securities and thus a breach of the ETE Agreement. The Court concluded that the term "distribution," which was used but not defined in the ETE Agreement, unambiguously referred to something transferred to the unitholders, not something offered to the unitholders for value that they may accept or reject. This definition, the Court noted, also conformed with the ordinary dictionary meaning of "distribution." The Court noted further that to accept the plaintiffs' definition would make nonsense of provisions of the ETE Agreement allowing

ETE to issue partnership securities by providing that the failure of even a single partner to subscribe would result in a prohibited non-*pro-rata* distribution. Further, to the plaintiffs' argument that consideration given by the subscribers was illusory, thus making the issuance a one-way distribution, the Court noted that the millions of dollars in foregone distributions were useful to ETE and represented an opportunity cost and risk of some amount to the subscribers. Therefore, the private offering did not represent a distribution but rather an issuance for value.

Under the ETE Agreement, issuances of partnership securities were required to be "fair and reasonable" to ETE and its unitholders. The plaintiffs argued that the issuance at the increased accrual rate gave the subscribers thereof some upside risk (but no downside risk) at potential cost to ETE. The Court determined that "entire fairness" was the standard under which the issuance ought to be scrutinized and agreed that, due to the problematic downside hedge as well as a lack of proper scrutiny by a disinterested conflicts committee, the defendants failed to meet their burden to show that the issuance had a fair process and fair price. The Court noted that, because the private offering was not "fair and reasonable," the Court would have canceled the securities if their conversion would have damaged ETE or worked an unfair benefit on the defendants. Given a post-issuance boom in the energy market, however, the unfair downside hedge did neither. Therefore, the Court found that equity did not require, and even prohibited, cancellation of the securities.

CompoSecure, L.L.C. v. CardUX, LLC: Court of Chancery Considers Agency Principles and the Distinction Between Void and Voidable Acts

In *CompoSecure, L.L.C. v. CardUX, LLC* 2018 WL 660178 (Del. Ch. Feb. 1, 2018), the Court of Chancery considered agency principles in evaluating the distinction between void and voidable acts taken by a Delaware limited liability company. CompoSecure, L.L.C., a Delaware limited liability company that manufactures metal credit cards, was governed by an LLC agreement that provided for class A and class B units, established a board management structure, and set forth a broad purpose and related powers. CompoSecure's broad powers were limited by a provision (the "CS Related Party Provision") requiring that certain transactions between CompoSecure and its members and/or board members, including any affiliates thereof, be formally approved by the board and a majority of both class A and class B unitholders. A majority of the class A units were held by Michelle

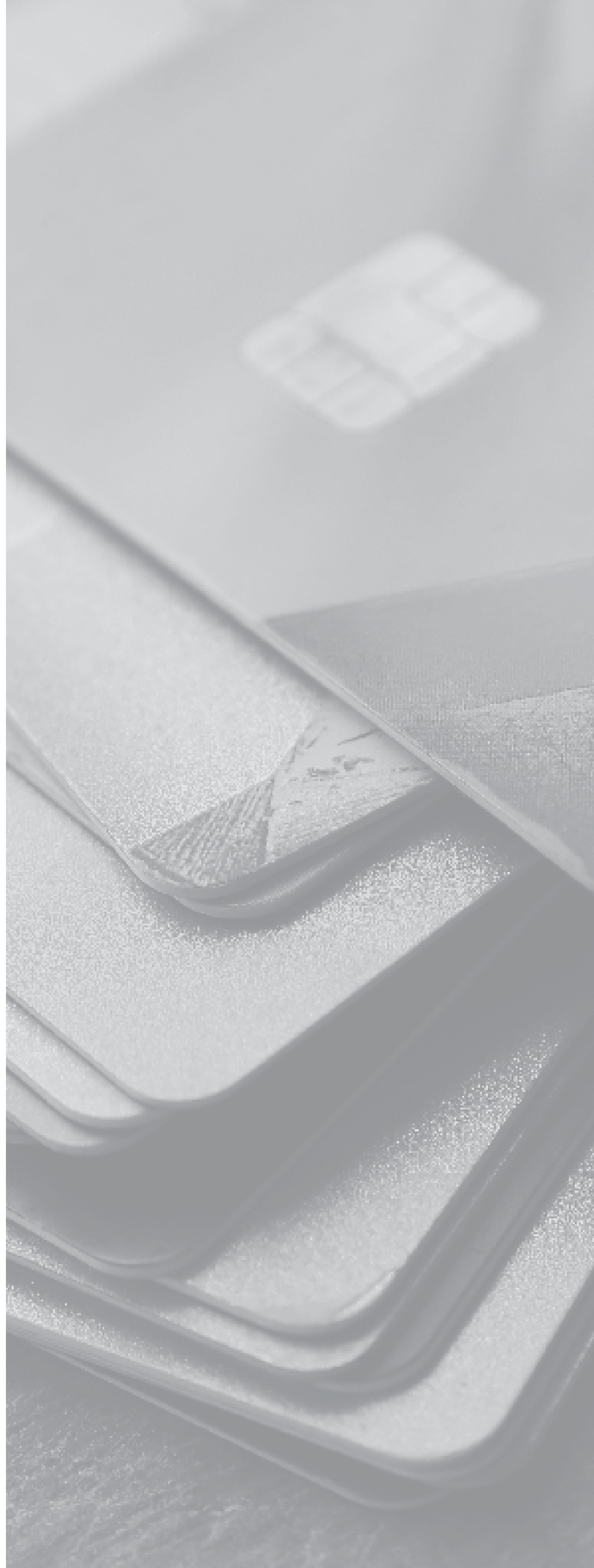
"Voidable acts can be validated by equitable defenses, such as ratification and acquiescence."

Logan, a co-founder and the CEO of CompoSecure, whereas a majority of the class B units were held by outside investors including Kevin Kleinschmidt, who served on the board of CompoSecure. Mr. Kleinschmidt also held equity interests in and was a controller of CardUX, LLC ("CardUX"), with which CompoSecure had an interest in doing business.

In November 2015, CompoSecure entered into a heavily negotiated sales agreement with CardUX, pursuant to which CardUX would promote CompoSecure's metal credit cards to industry contacts in exchange for a commission on certain sales. Ms. Logan signed the CardUX sales agreement as CEO on behalf of CompoSecure. Given Mr. Kleinschmidt's multiple roles, the CardUX sales agreement triggered the CS Related Party Provision. None of the formal approvals required by the CS Related Party Provision were obtained, however, in connection with the CardUX sales agreement. Nor did Ms. Logan otherwise receive any formal authorization by the board of CompoSecure to sign the CardUX sales agreement. Nonetheless, after CompoSecure and CardUX signed the CardUX sales agreement, both parties initially treated it as valid and performed in accordance with its terms. After receiving a large order for its cards, however, CompoSecure objected to paying a commission to CardUX in accordance with the CardUX sales agreement. CompoSecure brought suit seeking a declaration that the sales agreement was invalid, alleging that the CardUX sales agreement had not received the formal approvals required by the CS Related Party Provision.

Although the CardUX sales agreement was governed by New Jersey law, the Court of Chancery considered the question of Ms. Logan's actual authority to bind CompoSecure under Delaware law because it involved CompoSecure's internal affairs and interpretation of the CompoSecure LLC agreement. Finding that the necessary consents under the CS Related Party Provision had not been obtained and that Ms. Logan had not otherwise been authorized by the CompoSecure board to execute the CardUX sales agreement, the Court held that Ms. Logan lacked actual authority under Delaware law to bind CompoSecure when she executed the CardUX sales agreement. Under Delaware agency law, if CardUX had knowledge of Ms. Logan's limited authority as an agent, Ms. Logan could not bind CompoSecure (as the principal) beyond its scope of authority. Because Mr. Kleinschmidt was a party to the CompoSecure LLC agreement as a direct signatory as well as a member and manager of CompoSecure, he was found to have knowledge of Ms. Logan's limited authority to bind CompoSecure as well as the formal approval requirements imposed by the CS Related Party Provision. As an agent of CardUX, Mr. Kleinschmidt's knowledge was imputed to CardUX as well.

After establishing that Ms. Logan lacked actual authority to sign the CardUX sales agreement, rendering it an improperly authorized contract, the Court of Chancery distinguished between void and voidable acts. While void acts are those "that [an] entity lacks the power or capacity to effectuate," voidable acts are "within the power or capacity of an entity, but were not properly authorized or effectuated by the representatives of the entity." *Id.* at *26. Given the broad purpose set forth in the CompoSecure limited liability company agreement and related authority that included the power to enter into contracts, and because the CS Related Party Provision recognized the power of CompoSecure to enter into contracts subject to the satisfaction of certain procedural requirements, the Court held that CompoSecure had the authority to enter into the CardUX sales agreement and similar



agreements. Hence, the fact that the CS Related Party Provision requirements had not been satisfied rendered the CardUX sales agreement voidable rather than void. The Court then noted that "voidable acts can be validated by equitable defenses, such as ratification and acquiescence." *Id.* Although "a claim of formal ratification would implicate the internal affairs doctrine and be governed by Delaware law," CardUX's argument that the CardUX sales agreement arose under the "agency-based doctrine of implied ratification, or ratification by acquiescence," was interpreted under New Jersey law. *Id.* at *27. Because CompoSecure recognized the existence of the CardUX sales agreement, treated it as valid and binding, and accepted the benefits of CardUX's performance under the agreement, the Court found that its conduct ratified the CardUX sales agreement under New Jersey law.

On appeal, the Delaware Supreme Court agreed with the Chancery Court's interpretation of the CS Related Party Provision. However, the Supreme Court reversed and remanded the decision because a separate provison of the LLC agreement, if applicable, would have required a finding that the CardUX sales agreement was void and not capable of ratification under common law.

Brinckerhoff v. Enbridge Energy Co.: Delaware Supreme Court Holds Specific Requirements for Conflict of Interest Transactions Control over General Good Faith Standard in Related-Party Transaction

In *Brinckerhoff v. Enbridge Energy Co.,* 159 A.3d 242 (Del. 2017, revised Mar. 28, 2017), the Delaware Supreme Court reversed in part a decision of the Delaware Court of Chancery granting a motion to dismiss the complaint and remanded the case for further proceedings. In 2009, Enbridge Energy Partners, L.P. ("EEP"), a master limited partnership, owned 100% of a proposed pipeline construction project. EEP subsequently entered into a joint venture agreement with its parent entity, Enbridge, Inc., pursuant to which EEP sold a two-thirds interest in the project to Enbridge for $800 million. In 2015, EEP repurchased the same exact interest in the project back from Enbridge for $1 billion. In connection with the repurchase, EEP's general partner ("EEP GP") also amended EEP's partnership agreement (the "EEP LPA") to effect a "special tax allocation" whereby the public investors in EEP were allocated items of gross income that would otherwise have been allocated to EEP GP, allowing EEP GP to avoid a large taxable gain on the transaction.

The plaintiff, a limited partner of EEP, filed suit challenging the repurchase transaction in the Court of Chancery, alleging, *inter alia,* breach of contract claims under the EEP LPA against EEP GP. The plaintiff claimed that (i) the terms of the repurchase were not "fair and reasonable" to EEP, as required by Section 6.6(e) of the EEP LPA, and (ii) the amendment to the EEP LPA implementing the special tax allocation violated prohibitions in the EEP LPA on effecting amendments that materially adversely affected EEP's limited partners or enlarged their obligations without their consent. The Court of Chancery, interpreting the EEP LPA to contain an overarching "good faith" standard applicable to EEP GP's actions under the EEP LPA, regardless of whether EEP GP had breached any specific provision of the agreement, held that the plaintiff had failed to adequately allege that EEP GP acted in bad faith in approving the transaction and dismissed the complaint.

On appeal, the Delaware Supreme Court held that the Court of Chancery had erred in determining that the general provision of the EEP LPA imposing a "good faith" standard of conduct on EEP GP modified the specific "fair and reasonable" standard applicable to affiliated transactions such as the transaction at issue here. The Court found that the plaintiff had stated a claim that EEP GP had breached its affirmative obligation to satisfy the "fair and reasonable" standard in connection with the repurchase transaction. This conclusion was based in large part on (i) the language in the EEP LPA providing that whether a transaction meets the "fair and reasonable" standard is to be considered in the context of "all similar or related transactions," (ii) the allegations that EEP paid $200 million more to repurchase the same exact assets it had sold a few years earlier at a lower price, (iii) the fact that this higher price for the same assets was paid despite declining earnings for the underlying assets and the declining state of oil prices in the interim, and (iv) the negative effects of the special tax allocations on the public investors.

The Court found for the defendants, however, in holding that the special tax allocation did not breach the EEP LPA. In reaching this conclusion, the Court considered whether the special tax allocation, which increased the public investors' tax liability, could be considered to have "enlarged the obligations" of the affected limited partners. Noting that the article of the EEP LPA entitled "Tax Matters" did not use the term "obligations," the Court reviewed the ways in which the term was used in other provisions of the agreement and determined that the amendment restriction applied only to obligations of EEP's limited partners to the partnership under the EEP LPA and did not extend to obligations of the limited partners to others, including the amount of their tax liability to the government.

The Court next turned to potential remedies available to the plaintiff given that the EEP LPA exculpated EEP GP from monetary damages to EEP and its limited partners if it acted in good faith. In addressing this issue of good faith and bad faith, the Court noted that in one of its earlier opinions in the dispute, the Court had characterized the pleading standard for asserting bad faith to be similar to waste—namely, that the action or decision was so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith. Here, however, the Supreme Court walked back from the standard it had adopted in its earlier decision and instead used a more commonly used definition of bad faith. In applying this "new" standard, the Supreme Court determined that, to survive a motion to dismiss, the plaintiff had to allege facts to support the inference that the transaction was not fair and reasonable to the partnership. This conclusion, the Court held, was more faithful to the contractual language. The EEP LPA provided that a transaction would be deemed fair and reasonable if no less favorable to EEP than an arm's-length transaction. Because EEP paid approximately $200 million more for the same assets only several years after the initial transaction, and in an environment with declining earnings and slumping oil prices, the Court determined that the plaintiff had carried his burden to plead bad faith.

Finally, the Court addressed the question of whether, notwithstanding the foregoing, EEP GP was nonetheless entitled to a conclusive presumption of good faith by virtue of its reliance on the fairness opinion of EEP's financial advisor, as such presumption was set forth in a provision of the EEP LPA. The Court answered this question in the negative, holding that, since EEP's financial advisor had not been involved in valuing the interests being repurchased throughout the course of negotiations with respect to the transaction and instead had "appeared on the scene" to render its fairness opinion after the financial terms of the transaction had been determined, EEP GP had not "relied" upon the financial advisor in the manner contemplated by the provision in the EEP LPA setting forth the presumption of good faith. For all these reasons, the Supreme Court reversed and remanded to the Court of Chancery for further proceedings. ◆

Because EEP paid more for the same assets only several years after the initial transaction, and in an environment with declining earnings and slumping oil prices, the Court determined that the plaintiff had carried his burden to plead bad faith.

Recent Developments in Delaware Law

2018 Amendments to the Delaware General Corporation Law

Legislation amending the DGCL has been approved by the Delaware General Assembly and was signed by Delaware Governor John Carney on July 23, 2018. The amendments, among other things, (i) amend Section 262 to apply the "market out" exception to the availability of statutory appraisal rights in connection with an exchange offer followed by a back-end merger consummated without a vote of stockholders pursuant to Section 251(h); (ii) clarify and confirm the circumstances in which corporations may use Section 204 to ratify defective corporate acts; (iii) allow nonstock corporations to take advantage of Sections 204 and 205, including for the ratification or validation of defective corporate acts; (iv) revise Section 102(a)(1) to provide that a corporation's name must be distinguishable from the name of (or name reserved for) a registered series of a limited liability company; and (v) make other technical changes.

The amendments to Section 262 (relating to statutory appraisal rights) are effective only with respect to a merger or consolidation consummated pursuant to an agreement entered into on or after August 1, 2018; the amendments to Section 204 (relating to defective corporate acts) are effective only with respect to defective corporate acts ratified or to be ratified pursuant to resolutions adopted by a board of directors on or after August 1, 2018; the amendments to Section 102(a)(1) (relating to the requirements of the corporation's name) are effective August 1, 2019; and all other amendments are effective August 1, 2018.

Appraisal Rights

Application of the "Market Out" Exception to Intermediate-Form Mergers

The amendments amend Section 262(b) of the General Corporation Law to provide that the "market out" exception to the availability of statutory appraisal rights applies in connection with an exchange offer followed by a back-end merger consummated without a vote of stockholders pursuant to Section 251(h). As previously drafted, Section 262(b)(3) provided that appraisal rights were available for any "intermediate-form" merger effected pursuant to Section 251(h) unless the offeror owns all of the stock of the target immediately prior to the merger. Practically speaking, under prior Section 262(b)(3), holders of shares of stock of a target corporation that were listed on a national securities exchange were entitled to appraisal rights in an "intermediate-form" stock-for-stock merger in which they received only stock listed on a national securities exchange even if they would not be entitled to appraisal rights in a comparable "long-form" merger as a result of the "market out" exception set forth in subsections (b)(1) and (b)(2) of Section 262. To address the incongruity between long-form and intermediate-form mergers with respect to the availability of appraisal rights in stock-for-stock mergers, the amendments to Section 262(b)(3) provide that, in the case of a merger pursuant to Section 251(h), appraisal rights will not be available for the shares of any class or series of stock of the target corporation that were listed on a national securities exchange or held of record by more than 2,000 holders as of immediately prior to the execution of the merger agreement, so long as such holders are not required to accept for their shares anything except (i) stock of the surviving corporation (or depository receipts in respect thereof), (ii) stock of any other corporation (or depository receipts in respect thereof) that at the effective time of the merger will be listed on a national securities exchange or held of record by more than 2,000 holders, (iii) cash in lieu of fractional shares or fractional depository receipts in respect of the foregoing, or (iv) any combination of the foregoing shares of stock, depository receipts and cash in lieu of fractional shares or fractional depository receipts. Accordingly, exchange offers followed by a merger under Section 251(h) will now receive the same basic treatment as long-form mergers requiring a vote of stockholders with respect to the availability of appraisal rights.

Appraisal Statement

The amendments effect a technical change to Section 262(e) to clarify what information must be included in the statement required to be furnished by the surviving corporation under that subsection in cases where the merger was effected without a vote of stockholders pursuant to Section 251(h). Section 262(e) previously required the surviving corporation to provide, upon request and subject to specified conditions, a statement to dissenting stockholders setting forth the aggregate number of shares that were not voted in favor of the merger or consolidation and as to which demands for appraisal have been received, and the aggregate number of holders of such shares. Given that no shares are "voted" for the adoption of an agreement of merger in a transaction under Section 251(h), the amendments to Section 262(e) clarify that where the statement is given in the context of an intermediate-form merger, it must set forth the relevant shares not purchased in the tender or exchange offer for which appraisal rights were demanded, rather than the shares not voted for the merger for which appraisal rights were demanded.

Ratification and Validation of Defective Corporate Acts

The amendments effect several changes to Section 204 of the General Corporation Law, which deals with the ratification of defective corporate acts, primarily to confirm the circumstances in which it is available for use.

First, the amendments to Section 204(c)(2) confirm that Section 204 may be used in circumstances in which there is no valid stock outstanding, even if the ratification of the underlying defective corporate act would otherwise require stockholder approval under Section 204(c). As originally drafted, and as further clarified in amendments that became effective in 2015, Section 204 specifies that whenever a vote of stockholders is required to ratify a defective corporate act, only the valid stock (which is generally defined as stock that has been issued in accordance with the General Corporation Law) is entitled to vote on the ratification of a defective corporate act. The 2018 changes are intended to confirm that where there are no shares of valid stock outstanding, either because no shares (valid or putative) have been issued or because all of the shares are putative stock, a corporation may take advantage of Section 204, even if a vote of stockholders otherwise would be required to approve the ratification.

The amendments to Section 204(d) specify the holders to whom notice of a ratification of a defective corporate act must be given. Previously, under Section 204(d), where a vote of stockholders was required to approve the ratification of a defective corporate act, notice of the meeting at which the proposed ratification will be considered must be given to the holders of valid stock and putative stock, whether voting or non-voting, as of the record date for notice of the meeting as well as the holders of valid stock and putative stock, whether voting or non-voting, as of the time of the defective corporate act. The corporation need not provide such notice to holders of valid stock or putative stock at the time of the defective corporate act if their identities or addresses cannot be determined from the records of the corporation. In many cases, the time of the defective corporate act differs from the original record date that was fixed for purposes of determining the stockholders entitled to vote or provide consent on the authorization of the original act, or the record date fixed for another purpose in relation to the defective corporate act. For example, where a reverse stock split is the defective corporate act to be ratified, the time of the defective corporate act would be the date on which the reclassification of the outstanding shares pursuant to a certificate of amendment to the certificate of incorporation becomes effective. The stockholders' authorization of such amendment, however, in many cases will have been given at a meeting held weeks in advance of such effective time by stockholders of record as of a date preceding the date of the meeting.

Experience has shown that many corporations, particularly public corporations, are far more likely to have a list of stockholders as of a particular record date than they are to have a list of stockholders as of the time of a defective corporate act where such act did not occur on the record date for determining stockholders entitled to vote on the authorization of the defective corporate act. Accordingly, the changes to Section 204(d) provide that in cases where a vote of stockholders is being sought for the ratification of a defective corporate act at a meeting of stockholders, the notice that is required to be given to holders of valid stock and putative stock as of the time of the defective corporate act may be given, in circumstances where the defective corporate act required the establishment of a record date for voting, consent or for another purpose, to the holders of valid stock and putative stock as of the record date established for determining stockholders entitled to vote on or provide consent with respect to the authorization of the defective corporate act or the stockholders as of the record date fixed for such other purpose. Section 204(g) was also amended to provide that public companies may give such notice through disclosure in a document publicly filed with the Securities and Exchange Commission pursuant to Sections 13, 14 or 15(d) of the Securities Exchange Act of 1933.

Third, the amendments to Section 204(h)(1) clarify and confirm that any act or transaction within a corporation's power under subchapter II of the General Corporation Law may be subject to ratification under Section 204. Subchapter II of the General Corporation Law is broadly enabling, empowering Delaware corporations to engage in all categories and classes of activities, with very few exceptions. As originally drafted, Section 204 was designed to enable Delaware corporations to ratify any act or transaction taken by or on behalf of the corporation so long as the act was one involving a power not specifically denied to corporations generally under the General Corporation Law, such as engaging in a banking business or conferring honorary degrees.

In *Nguyen v. View, Inc.*, 2017 WL 2439074 (Del. Ch. June 6, 2017), the Court of Chancery arguably adopted a different reading of the statute. Specifically, the Court indicated that because an arbitrator had ruled that a stockholder whose vote was required to approve an amendment to the certificate of incorporation had specifically revoked his prior consent, the subsequent ratification of the amendment had to "be viewed in light of that operative reality." The Court held that the corporation, in proceeding with a financing transaction that relied for its effectiveness on the stockholders' approval of the amendment, "did so notwithstanding that the majority common stockholder had deliberately withheld his consent for the transaction—consent that was required for the transaction to be valid as a matter of law." Therefore, the Court found, "at the time the defective corporate acts here were taken ... the [corporation at issue] did not have the power to take these acts...."

The amendments to Section 204(h)(1) overturn any implication from the *View* opinion that an act or transaction may not be within the power of a corporation solely on the basis that it was not approved in accordance with the provisions of the General Corporation Law or the corporation's certificate of incorporation or bylaws. Indeed, defective corporate acts require ratification because they were not originally so approved. The amendments attempt to clarify that the failure to approve an act in accordance with the General Corporation Law or the certificate of incorporation or bylaws may not, of itself, serve as a basis for excluding the act from the scope of the statute. The amendments to Section 204(h)(1), however, do not disturb the Court's power to decline to validate a defective corporate act under Section 205 on the basis that the failure of authorization that rendered such act void or voidable involved a deliberate withholding of any consent or approval required under the General Corporation Law, the certificate of incorporation or bylaws. Notably, Section 205 of the General Corporation Law provides the Court broad power, upon application of various parties, to validate or decline to validate (or grant other relief) in respect of acts that have been ratified in accordance with Section 204 as well as acts that have not been ratified. In resolving matters brought under Section 205, the Court is expressly directed to consider, among other things, "[w]hether the defective corporate act was originally approved or effectuated with the belief that the approval or effectuation was in compliance with the provisions of [the General Corporation Law], the certificate of incorporation or the bylaws of the corporation."

Finally, the amendments to Section 204(h)(2) clarify that the failure of an act or transaction to be approved in compliance with the disclosure set forth in any proxy or consent solicitation statement may constitute a failure of authorization. The amendment to Section 204(h)(2) confirms that any act that is alleged to be defective due to deficiencies in the disclosure documents pursuant to which the vote or consent of stockholders was sought may be cured through ratification pursuant to Section 204. By way of example, the amendments make clear that a corporation may use Section 204 to ratify an amendment to the certificate of incorporation that is alleged to be defective due to a misstatement in the proxy statement regarding the vote required for its adoption.

Application of Sections 204 and 205 to Nonstock Corporations

The amendments also revise Section 114 of the General Corporation Law to enable nonstock corporations to take advantage of Sections 204 and 205. In 2010, Section 114 was added to the General Corporation Law to apply (or preclude the application of) other sections of the General Corporation Law to nonstock corporations by translation. In 2014, Sections 204 and 205 were added to the General Corporation Law. Those sections were originally designed primarily to cure defects in capital stock. As a result, and because nonstock corporations are inherently more structurally flexible than their stock corporation counterparts (thus allowing greater opportunity for "self-help" fixes to defective acts), Section 114 initially excluded the application of Sections 204 and 205 to nonstock corporations. Experience has shown, however, that Sections 204 and 205 have wide-ranging applications and could offer nonstock corporations a means of fixing otherwise intractable problems. Although Section 114 will not operate to translate every term in Sections 204 and 205 with literal precision, consistent with ordinary principles of statutory construction, the as-translated statutes should be construed in such a way as to give effect to the underlying intent of enabling nonstock corporations to take advantage of the procedures for ratifying or validating defective corporate acts.

Corporate Name

The amendments also revise Section 102(a)(1) to provide that a corporation's name, as included in its certificate of incorporation, must be such as to distinguish it upon the records of the Division of Corporations in the Delaware Department of State from any name reserved for or name of any registered series of a limited liability company. Previously, Section 102(a)(1) required a corporation to include its name in its certificate of incorporation and, with limited exceptions, specified that the name must be such as to distinguish it upon the records of the office of the Division from the names that are reserved on such records and from the names on such records of each other corporation, partnership, limited partnership, limited liability company, or statutory trust organized or registered as a domestic or foreign corporation, partnership, limited partnership, limited liability company, or statutory trust under Delaware law. The revisions to Section 102(a)(1) adding registered series of limited liability companies to the list of entities from which a corporation's name must be distinguished were made in connection with the amendments to the Delaware Limited Liability Company Act providing for the establishment of registered series of a Delaware limited liability company, which series are formed through the filing of a certificate of registered series with the Delaware Secretary of State.

Forfeiture of Charter

The amendments clarify that the Attorney General of the State of Delaware has the exclusive authority to seek the revocation of a charter pursuant to Section 284 of the General Corporation Law, and that the Court of Chancery may appoint a trustee to wind up the affairs of a corporation whose charter has been revoked. The amendments thereby clarify the procedures applicable in situations in which a corporation's charter is revoked due to a clear abuse of its privileges and franchises, such as grievous criminal violations perpetrated by or in the name of the corporation.

Exempt Corporations

Finally, the amendments effect a technical change to Section 313(b) of the General Corporation Law to reflect the Delaware Secretary of State's current practice regarding the filing of certificates of revival for exempt corporations. Corresponding amendments were made to Section 502 of Title 8 of the Delaware Code to reflect the Secretary of State's practice regarding exempt corporations' filing of annual reports.

2018 Amendments to the Delaware LLC and Partnership Acts

Legislation amending the Delaware Limited Liability Company Act (LLC Act) and the Delaware Revised Uniform Limited Partnership Act (LP Act) (jointly, the LLC and LP Acts) was approved by the Delaware General Assembly and signed into law by the Governor of Delaware. The following is a brief summary of some of the more significant amendments that affect Delaware limited liability companies (Delaware LLCs) and Delaware limited partnerships (Delaware LPs), including amendments (i) enabling a Delaware LLC to divide into two or more Delaware LLCs as a new permitted form of Delaware LLC reorganization, (ii) providing for the formation of statutory public benefit Delaware LLCs (Statutory Public Benefit LLCs), (iii) authorizing the creation of a new type of Delaware LLC series known as a "registered series," and (iv) providing specific statutory authority for the use of networks of electronic databases (including blockchain and distributed ledgers) by Delaware LLCs and Delaware LPs. All of the amendments became effective on August 1, 2018, except that the amendments relating to Delaware LLC series will not become effective until August 1, 2019.

Division of a Limited Liability Company

Under a new Section 18-217 of the LLC Act, a single Delaware LLC can divide into two or more Delaware LLCs. The original dividing Delaware LLC can continue its existence or terminate as part of the division as provided in a plan of division. In connection with a division, a dividing Delaware LLC must adopt a plan of division setting forth the terms and conditions of the division, including the allocation of assets, property, rights, series, debts, liabilities and duties of such dividing Delaware LLC among the division Delaware LLCs, the name of each resulting Delaware LLC and, if the original dividing Delaware LLC will survive the division, the name of the surviving Delaware LLC. The surviving Delaware LLC, if applicable, or any resulting Delaware LLC must then file a certificate of division and a certificate of formation for each resulting Delaware LLC with the Delaware Secretary of State.

Following a division, each division Delaware LLC will be liable for the debts, liabilities and duties of the original dividing Delaware LLC as are allocated to it pursuant to the plan of division, and no other division Delaware LLC will be liable for such obligations unless the plan of division constitutes a fraudulent transfer under applicable law. If any allocation of assets or liabilities is determined by a court of competent jurisdiction to constitute a fraudulent transfer, each division Delaware LLC will be jointly and severally liable on account of such fraudulent transfer. Debts and liabilities of the original dividing Delaware LLC that are not allocated by the plan of division will be the joint and several debts and liabilities of all division Delaware LLCs.

The amendments relating to division of a Delaware LLC became effective August 1, 2018. Because of the novelty of this type of reorganization that may have not otherwise been specifically contemplated in existing contractual arrangements, the amendments provide that any terms of a written contract, indenture or other agreement that restrict, condition or prohibit a Delaware LLC from consummating a merger or consolidation or transferring assets will apply with equal force to a division if (i) the Delaware LLC was formed prior to August 1, 2018, and (ii) the Delaware LLC entered into such written contract, indenture or other agreement prior to August 1, 2018.

Statutory Public Benefit Limited Liability Companies

In a development that may be of significant interest to social entrepreneurs, the LLC Act has been amended to add a new subchapter XII for purposes of enabling Delaware LLCs to elect to be formed as Statutory Public Benefit LLCs. Such Statutory Public Benefit LLCs would remain subject to all other applicable provisions of the LLC Act, except as modified or supplanted by the new subchapter XII of the LLC Act governing Statutory Public Benefit LLCs.

In general, a Statutory Public Benefit LLC is a for-profit limited liability company that is intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner. To that end, a Statutory Public Benefit LLC is required to be operated in a way that balances the pecuniary interests of the members of such Statutory Public Benefit LLC, the best interests of those materially affected by such Statutory Public Benefit LLC's conduct, and the public benefit or public benefits as set forth in such Statutory Public Benefit LLC's certificate of formation.

Each Statutory Public Benefit LLC is required, in its certificate of formation, to identify itself as a Statutory Public Benefit LLC and to state one or more specific public benefits to be promoted by the Statutory Public Benefit LLC. "Public benefit" is defined as "a positive effect (or reduction of negative effects) on one or more categories of persons, entities, communities or interests (other than members in their capacities as members) including, but not limited to, effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature."

New subchapter XII of the LLC Act also (i) sets forth specific duties of members, managers and other persons with authority to manage or direct the business and affairs of a Statutory Public Benefit LLC; (ii) imposes special notice requirements on Statutory Public Benefit LLCs, mandating periodic statements to members regarding the LLC's promotion of its public benefits and as to the best interests of those materially affected by the LLC's conduct; (iii) contains limitations on the power of Statutory Public Benefit LLCs to (a) adopt amendments to their certificates of formation or effect mergers, consolidations or divisions if the effect would be to abandon their public benefit, or (b) cease to be a Statutory Public Benefit LLC; (iv) establishes a means of enforcing the promotion of the public benefits of a Statutory Public Benefit LLC by granting certain derivative rights; (v) provides that the requirements imposed on Statutory Public Benefit LLCs may not be altered in a limited liability company agreement; and (vi) provides that such new subchapter XII is not to be construed to limit the accomplishment by any other means permitted by law of the formation or operation of a Delaware LLC that is formed or operated for a public benefit (including a Delaware LLC that is designated as a public benefit limited liability company) that is not a Statutory Public Benefit LLC.

Limited Liability Company Series

The amendments amend the LLC Act to create a new type of Delaware LLC series known as a "registered series." The registered series is governed by a new Section 18-218 of the LLC Act. A registered series will qualify as a registered organization under the Uniform Commercial Code that will facilitate the use of Delaware LLC series in secured financing transactions. To form a registered series, the certificate of formation of the Delaware LLC must contain a notice of the limitation on liabilities of a registered series, and a certificate of registered series must be filed with the Delaware Secretary of State. The name of a registered series must begin with the name of the Delaware LLC and be distinguishable upon the records of the Delaware Secretary of State from any entity or other registered series formed or qualified to do business in Delaware. Registered series will be able to merge or consolidate with or into one or more other registered series of the same Delaware LLC.

Series created under Section 18-215(b) of the LLC Act, both before and after the effective date of these amendments, will be known as "protected series." These amendments will not alter the features of protected series. An existing protected series will be able to convert to a registered series in accordance with the new Section 18-219 of the LLC Act.

The Delaware Secretary of State will be able to issue certificates of good standing and certificates of existence with respect to a registered series. Each registered series will be required to pay an annual franchise tax of $75.

The amendments regarding series of Delaware LLCs will not be effective until August 1, 2019, to provide the Delaware Secretary of State's office with the time necessary to prepare for the new filings to be made with, and certificates to be issued by, such office in connection with registered series.

Blockchain and Distributed Ledgers

Several sections of the LLC and LP Acts have been amended to provide express statutory authority for Delaware LLCs and Delaware LPs to use networks of electronic databases (including blockchain and distributed ledgers) for the creation and maintenance of records of Delaware LLCs and Delaware LPs and for certain electronic transmissions. These amendments are expected to facilitate and accommodate the myriad of uses for these burgeoning technologies in the governance and activities of Delaware LLCs and Delaware LPs.

The amendments reflect Delaware's continuing commitment to maintaining statutes governing Delaware LLCs and Delaware LPs that effectively serve the business needs of the national and international business communities. The amendments to the LLC Act and the LP Act are contained in Senate Bill Nos. 183 and 182, respectively. ◆

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