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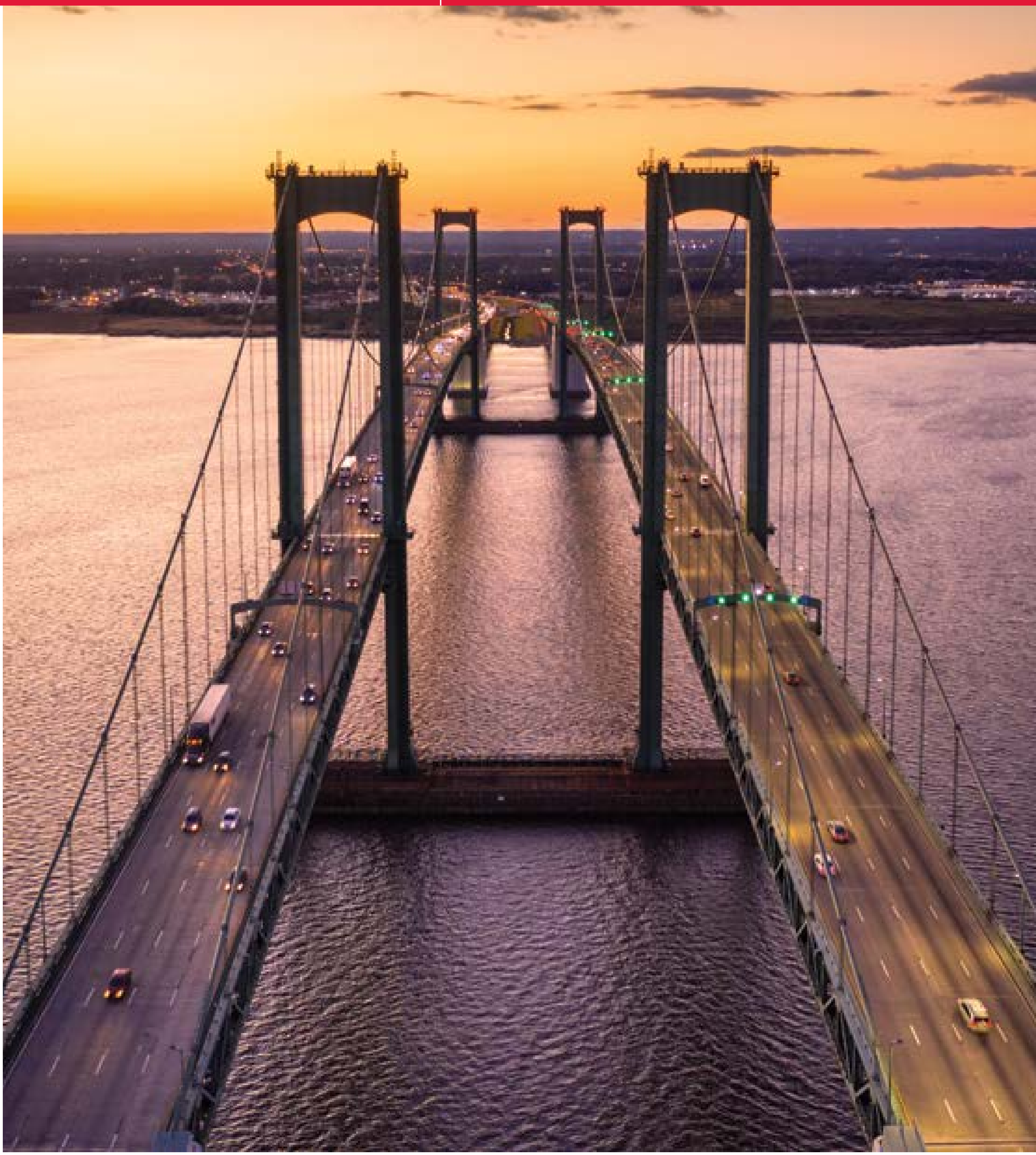
Richards, Layton & Finger | Recent Developments in Delaware Law



The Delaware Memorial Bridge, with its massive suspension cables that link Delaware to New Jersey across the Delaware River, is the eighth-longest suspension bridge in the U.S. Robert H. Richards Jr., a partner at Richards, Layton & Finger and son of one of the firm's founders, was instrumental in naming the bridge in honor of World War II veterans from Delaware and New Jersey. Opened in 1951, the Delaware Memorial Bridge became a major link in the nation's new interstate highway system, and remains a testament to the sacrifices of those who have lost their lives serving our country.

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 evolution 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.

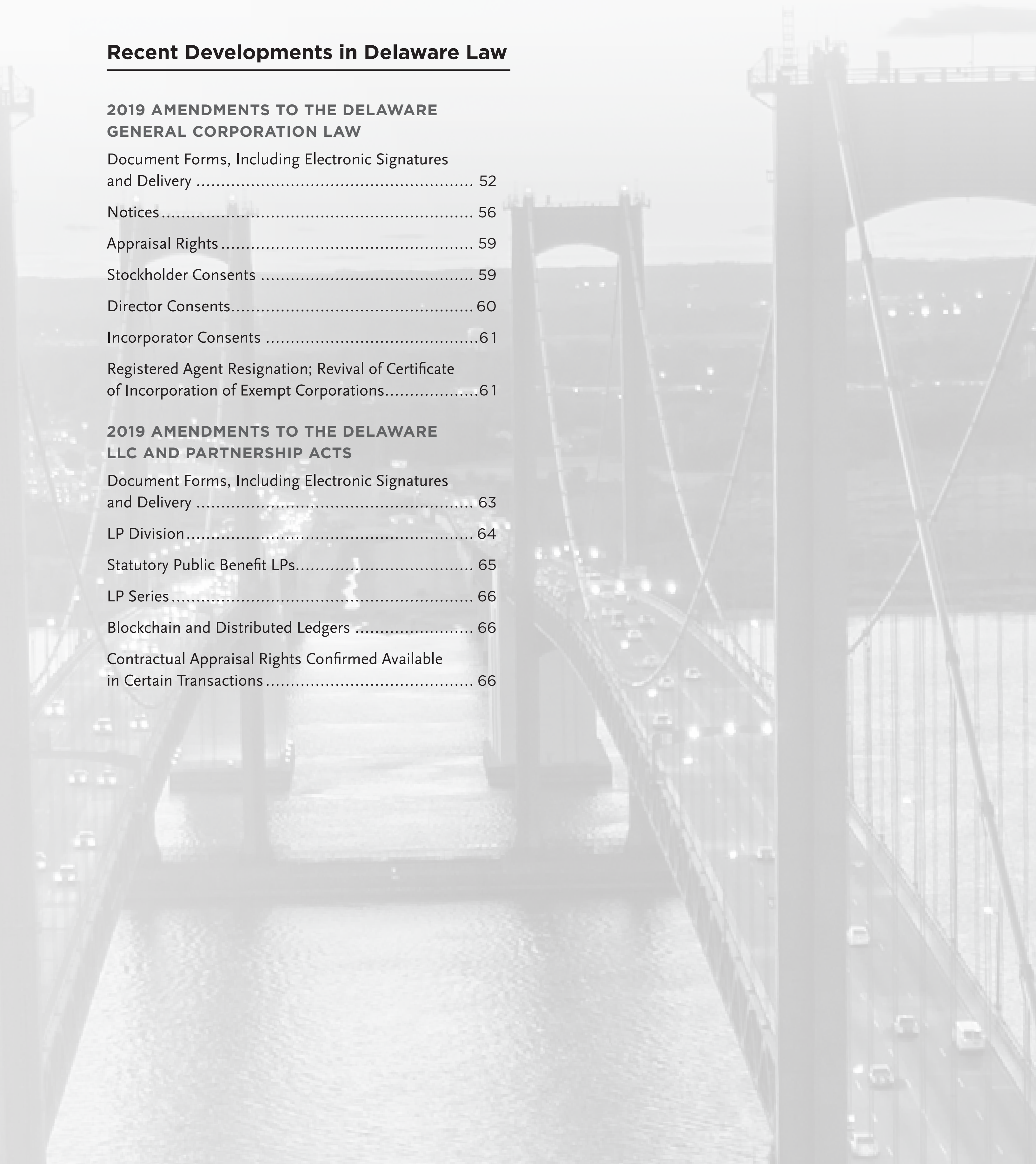
Richards Layton has been involved with many of the cases highlighted in this publication, and we have handled, as Delaware counsel, the most M&A transactions valued at or above $100 million for more than 25 years running, as reported in *Corporate Control Alert.* We welcome the opportunity to discuss 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

TABLE OF CONTENTS

Recent Decisions of Delaware Courts

Recent Developments in Delaware Law



Recent Decisions of Delaware Courts

BUSINESS COMBINATIONS

Breach of Fiduciary Duty

Marchand v. Barnhill: Delaware Supreme Court Reverses Court of Chancery Dismissal of *Caremark* Claims Where Plaintiff Alleged No Board-Level Oversight

In *Marchand v. Barnhill,* 212 A.3d 805 (Del. 2019), the Delaware Supreme Court reversed the Court of Chancery's dismissal of *Caremark* claims arising out of a deadly listeria outbreak that resulted from Blue Bell Creamery's sale of contaminated ice cream. While *Marchand* offers guidance on what sort of soft, interpersonal relations suffice to disqualify a director from dispassionately evaluating a litigation demand under the familiar *Rales* independence rubric, it is most notable because it presents a rare example of a *Caremark* claim—a species of fiduciary liability considered "the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment" *(Stone v. Ritter,* 911 A.2d 362 (Del. 2006))—surviving a motion to dismiss.

Blue Bell Creamery is a single-product company that sells ice cream. For approximately 100 years preceding this lawsuit, the company had been managed by three generations of men in the Kruse family: first Ed Kruse, then his sons Ed Kruse and Howard Kruse, and finally his grandson Paul Kruse. Paul Kruse served as CEO and chairman during the events at issue—namely, a series of food safety violations beginning in 2009 and culminating in 2015 with a listeria outbreak, the deaths of three customers, and a nationwide recall of all Blue Bell ice cream. The listeria recall was so damaging to Blue Bell that the company suffered a liquidity crisis. It ultimately resorted to a $125 million equity capital infusion entitling the purchaser to warrants to acquire 42% of the company and substantial governance rights, including the right to appoint one board designee who would control one-third of the board's voting power.

A stockholder plaintiff asserted two derivative claims premised on the defendants' failure to manage food safety risks: one against management for failure to respond adequately to repeated food safety violations, and a second against the board for violating its *Caremark* duty to implement proper safety monitoring systems. The Court of Chancery dismissed both counts for failure to satisfy Rule 23.1's demand requirement. The Court dismissed the management-based claim on grounds that a majority of directors were disinterested and independent for purposes of *Rales,* and dismissed the board-based claim because the plaintiff had failed to plead particularized facts of board misconduct that would give rise to a substantial likelihood that directors considering the demand faced *Caremark* liability.

The Delaware Supreme Court, sitting *en banc,* reversed both holdings.

First, the high court held that the Court of Chancery erred in concluding that one director—W.J. Rankin—was independent under *Rales*, meaning that the directors holding a majority of the voting power on the Blue Bell board were not independent for demand futility purposes. Relying on Delaware courts' recognition "that deep and longstanding friendships are meaningful to human beings and that any realistic consideration of the question of independence must give weight to these important relationships," the Court reasoned that Rankin's close personal ties to the Kruse family rendered Rankin unable to objectively consider whether to sue Paul Kruse on behalf of the company.

The Supreme Court inferred that Rankin's ties were significant enough to be disqualifying based on several facts. Rankin owed his successful career as a businessman to the Kruse family. He began his 28-year career at Blue Bell as Ed Kruse's administrative assistant before rising to CFO and a directorship, a path that depended on the Kruse family's mentorship. In addition, the Kruse family had spearheaded charitable efforts culminating in a $450,000 donation to a local college that subsequently named an agricultural facility after Rankin.

Although Rankin had voted to decouple the CEO and chairman positions, which had both belonged to Paul Kruse, the Court was not persuaded by this apparent signal of independence, finding that the decision to sue Paul Kruse was "materially different and more important" than the decision to curtail his authority. *Id*. at 819.

Second, the Supreme Court reversed the Court of Chancery's holding that directors did not face a substantial likelihood of liability under *Caremark*. Here, the Court reasoned that the plaintiff had sufficiently pled facts "support[ing] an inference that no system of board-level compliance monitoring and reporting existed at Blue Bell." In particular, the plaintiff had well pled that (i) the board had no food safety committee; (ii) the company had no process or protocols requiring management to apprise the board of safety issues; (iii) the board had no schedule requiring regular board consideration of food safety; (iv) the board was not given information about past food safety violations; and (v) the board's minutes reflected no evidence that food safety issues had been disclosed to the board or discussed by the board on a regular basis.

The board had "undertaken no efforts to make sure it is informed of a compliance issue intrinsically critical to the company's business operation," which created a substantial likelihood of *Caremark* liability.

Accordingly, the Court inferred that the board had "undertaken no efforts to make sure it is informed of a compliance issue intrinsically critical to the company's business operation," which created a substantial likelihood of *Caremark* liability.

The Supreme Court rejected the defendants' argument that monitoring systems existed in the form of (i) company-provided food safety manuals for employees, (ii) reports to management on the results of FDA and state government health inspections of Blue Bell facilities, and (iii) management's regular reports to the board on "operational issues." None of these practices, reasoned the Court, qualified as a *Caremark* monitoring system because none were implemented and monitored by the board.

In re Clovis Oncology, Inc. Deriv. Litig.: Court of Chancery Denies Dismissal of *Caremark* Claims Where Board Allegedly Failed to Monitor Oversight System

In *In re Clovis Oncology, Inc. Derivative Litigation*, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019), the Delaware Court of Chancery addressed a *Caremark* claim that the directors of Clovis Oncology, Inc. breached their fiduciary duties by failing to monitor the clinical trials of the company's most promising drug. In reaching its decision, the Court relied heavily on *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019), a June 2019 decision by the Delaware Supreme Court reversing the Court of Chancery's dismissal of a *Caremark* claim. Examining the parallels with *Marchand*, the Court concluded that the *Clovis* plaintiffs had stated *Caremark* claims by bringing factual allegations strikingly similar to those alleged by the *Marchand* plaintiffs—namely, that the board of a company in a highly regulated industry failed to monitor its single product and thereby failed to avert compliance failures.

Clovis is an early-stage pharmaceutical company whose business model is to make and sell drugs. During the events in question, Clovis had three drugs in production but none on the market. Thus, Clovis's future hinged on successfully shepherding one or more of these drugs through the regulatory approval process and into the marketplace. Clovis's most promising drug was a lung cancer therapeutic called Rociletinib ("Roci"). Time was of the essence in producing Roci, since a competitor was intent on beating Clovis to the market with a similar drug.

To secure regulatory approvals for Roci, Clovis used an established clinical trial protocol called "RECIST," which relied on an objective response rate ("ORR") metric to demonstrate Roci's success in shrinking cancerous tumors. Importantly, only "confirmed" responses (i.e., responses confirmed by a subsequent scan or observation) complied with RECIST protocols; "unconfirmed" responses were neither RECIST-compliant nor relevant to the FDA's consideration of whether to approve Roci for sale.

Central to the *Clovis* suit was the allegation that Roci failed to secure FDA approval because Roci's ORR, calculated using only confirmed responses, was too low (28-34%). Further, Clovis had allegedly misinformed the market that Roci's ORR was much

The director defendants failed to properly monitor the regulatory approval process by "consciously ignor[ing] red flags" with respect to the company's testing procedures.

higher than 28-34% (citing numbers as high as 60% that improperly included unconfirmed responses).

The stockholder plaintiffs brought three claims: (i) a *Caremark* claim against Clovis's directors for breach of the duty of oversight, (ii) an unjust enrichment claim against directors in connection with alleged benefits received in connection with their oversight failures, and (iii) a *Brophy* claim against certain insiders who sold stock prior to the publication of Roci's downward-adjusted ORR. The defendants moved to dismiss all counts under Rule 23.1 for failure to make demand on the board and Rule 12(b)(6) for failure to state a claim. The Court granted the motion with respect to the unjust enrichment and *Brophy* claims, but upheld the plaintiffs' *Caremark* claim.

First, the Court held that the plaintiffs successfully alleged particularized facts creating a reasonable doubt that a majority of directors would be unable to impartially consider the demand because they faced a substantial likelihood of personal liability under *Caremark*. The Court outlined the contours of the

Caremark inquiry, guided by the Supreme Court's recent opinion:

> As *Marchand* makes clear, when a company operates in an environment where externally imposed regulations govern its "mission critical" operations, the board's oversight function must be more rigorously exercised. Key to the Supreme Court's analysis was the fact that food safety was the "most central safety and legal compliance issue facing the company."

As the Court noted, *Marchand* emphasized that mistreating "a compliance issue intrinsically critical" to a business with a single product in a highly regulated industry supports an inference of bad faith. In *Marchand*, the Supreme Court found that the board allegedly utterly failed to establish a board-level system of oversight, but also noted that a *Caremark* claim could be sustained where a board consciously failed to properly monitor an existing system.

Turning to the facts, the Court held that, although the company's nominating and corporate governance committee was charged with providing "general compliance oversight," as well as regular reviews of Roci's testing progress conducted at every board meeting, the director defendants failed to properly monitor the regulatory approval process by "consciously ignor[ing] red flags" with respect to the company's testing procedures. The Court held that the plaintiffs had well pled that the board took no remedial measures despite knowing that (i) management was reporting "unconfirmed" response rates, (ii) this practice violated both the RECIST protocol and FDA standards, and (iii) Roci was Clovis's mission-critical product. These facts, the Court concluded, stated a claim under *Caremark*'s second prong (i.e., for failure to monitor existing systems in bad faith).

The Court also held that the plaintiffs failed to state a *Brophy* claim because the trades, although made while the disappointing results of Roci's clinical trials were unfolding, occurred at routine

trading intervals and represented a fraction of the defendants' total holdings. The Court declined to infer from timing alone that the defendants acted with *scienter* or knowledge of wrongdoing, a necessary element under *Brophy*.

Finally, the Court dismissed the plaintiffs' unjust enrichment claim because the plaintiffs failed to allege any connection between the purported enrichment—the defendants' employment compensation—and the trades at issue.

In re LendingClub Corp. Derivative Litigation: Court of Chancery Dismisses *Caremark* Claims Where Board Implemented and Monitored Oversight System

In *In re LendingClub Corp. Derivative Litigation,* 2019 WL 5678578 (Del. Ch. Oct. 31, 2019), the Court of Chancery dismissed *Caremark* allegations that the board of directors of LendingClub Corporation, a company that operates an online platform that facilitates loans, breached its fiduciary duties by failing to implement an internal monitoring system or failing to monitor such a system.

In March and April 2016, LendingClub sold over $22 million in near-prime loans to an institutional investor that did not meet the investor's instructions concerning loan characteristics. Whistleblowers alerted the board to these sales in April 2016, and promptly thereafter, the audit committee of the board created a subcommittee to investigate the sales. The audit committee retained independent legal counsel and a forensic auditor to assist in the investigation. LendingClub then repurchased the loans at par value and resold them at par to another investor; as a result, LendingClub was unable to recognize approximately $150,000 in revenue. In addition, LendingClub gave three senior managers involved the choice to resign or be terminated.

The subcommittee's investigation uncovered additional problems. The board learned that Renauld Laplanche, LendingClub's CEO and chairman of the board, and John Mack, a member of the board, were heavily invested in Cirrix Capital. Yet prior to LendingClub's $10 million investment in Cirrix Capital, neither Laplanche nor Mack had disclosed his personal investments. After learning of the omissions, the board asked Laplanche to resign. The subcommittee's investigation also revealed that LC Advisors LLC, a wholly owned subsidiary of LendingClub, made certain valuation adjustments that were inconsistent with generally accepted accounting principles. LendingClub had an established supervisory committee to monitor LC Advisors, the investment policy committee. Upon discovery of these events, the board abolished the investment policy committee and established a governing board to supervise LC Advisors. The board of directors took further remedial actions with respect to the limited partners and funds adversely impacted by the improper adjustments and promptly reported the misconduct to the SEC.

The plaintiffs brought suit, alleging four *Caremark* claims, but failed to make demand on the board, arguing demand was excused. The Court rejected all four claims, holding that the plaintiffs failed to plead facts sufficient to show that a majority of the board of directors was unable to objectively consider a demand because they faced a substantial likelihood of liability in connection with these claims.

First, the plaintiffs alleged that the board failed to implement internal controls to prevent the issuance of false and misleading statements. Noting that the plaintiffs alleged "a complete failure to maintain adequate internal controls," the Court found no substantial likelihood of liability regarding the first claim. The Court observed that the board had an audit committee that met monthly and that the complaint was devoid of facts concerning LendingClub's internal controls that could support a finding that the board utterly failed to implement them.

Second, the plaintiffs alleged that the board breached its fiduciary duties by investing in a company in which LendingClub's CEO-chairman of the board and a member of the board were heavily invested. To show a substantial likelihood of liability, the Court noted, the plaintiffs were required to show that the board knew that it was not doing its job and deliberately ignored red flags. In rejecting this claim, the Court found that the board had a risk committee, in addition to an audit committee, and that the risk committee actively discussed and evaluated the investment in question. Moreover, the Court found that the plaintiffs provided no facts suggesting that the board knew or should have known about Laplanche's or Mack's investments, neither of which was disclosed to the board nor listed on their respective director questionnaires. The Court emphasized that upon discovery, the audit committee resolved that all LendingClub-Cirrix transactions be disclosed as related-party transactions in LendingClub's quarterly financial statements, and the board subsequently ratified the LendingClub-Cirrix and the Mack-Cirrix investments.

Third, the plaintiffs alleged that the board breached its fiduciary duties by permitting LendingClub to sell nonconforming near-prime loans to an institutional investor. The Court found that LendingClub "maintained an effective information security program" with established policies and procedures to safeguard borrower and investor information. The program involved incident response reports and continuous monitoring and review, and deficiencies in this program did not equate to an utter failure of oversight. The Court further noted that the board took prompt remedial steps after discovering the sale, which included, among other things, securing the resignation of senior managers involved, including CEO and chairman of the board Laplanche, and bifurcating the roles of CEO and chairman of the board. The board did not face a substantial likelihood of liability on this claim.

Fourth, the plaintiffs alleged that the board breached its fiduciary duties by failing to monitor LC Advisors' risk management and compliance with federal laws. Noting that this claim requires a showing that the board "failed to implement any mechanism by which it could oversee LC Advisors," the Court rejected the claim, finding that LendingClub had established the investment policy committee specifically to oversee LC Advisors' operations. The Court emphasized that the board dismantled the committee once it learned of the problems at LC Advisors and established a new governing board comprised of a majority of independent members to supervise LC Advisors' exercise of its fiduciary duties. The Court additionally noted that since then, the new governing board "regularly makes reports" to the board. Again, the board did not face a substantial likelihood of liability on this claim.

The Court noted that *LendingClub* was "readily distinguishable" from *Marchand*. Critically, the Court emphasized that the complaint conceded the existence of the risk and audit committees, as well as the former existence of the investment policy committee.

Notably, the Delaware Supreme Court rendered its decision in *Marchand v. Barnhill,* 212 A.3d 805 (Del. 2019), approximately one month before oral argument in *LendingClub*—after the parties in *LendingClub* had completed briefing on the motion to dismiss. Though the parties did not propose supplemental briefing to address *Marchand* nor mention *Marchand* at oral argument, the Court noted that *LendingClub* was "readily distinguishable" from *Marchand.* Critically, the Court emphasized that the complaint conceded the existence of the risk and audit committees, as well as the former existence of the investment policy committee. The Court stressed the following observation of the Delaware Supreme Court in *Marchand*: "In decisions dismissing *Caremark* claims, the plaintiffs usually lose because they must concede the existence of board-level systems of monitoring and oversight such as a relevant committee, a regular protocol

requiring board-level reports about the relevant risks, or the board's use of third-party monitors, auditors, or consultants." The Court found that this was the case in *LendingClub*.

Morrison v. Berry: On Remand, Court of Chancery Dismisses Director Disloyalty Claims but Holds Plaintiff Sufficiently Alleged Chairman and Officers Breached Fiduciary Duties

In *Morrison v. Berry,* 2019 WL 7369431 (Del. Ch. Dec. 31, 2019), the Delaware Court of Chancery addressed motions to dismiss claims for breach of fiduciary duty by officers and directors of a specialty grocery-store chain, The Fresh Market, Inc., in connection with the go-private sale of the chain to a private equity firm, Apollo Global Management LLC. The Court granted the motions of the director defendants, finding that the stockholder plaintiff failed to plead that the directors were self-interested, lacked independence, or acted in bad faith in approving the sale of the company. The Court, however, denied motions to dismiss by the company's chairman, general counsel, and CEO, holding that the plaintiff had sufficiently alleged that the chairman acted in bad faith and the officers violated their duty of care in connection with the company's disclosures related to the sale.

In January 2015, Fresh Market suffered a sharp decline in stock price, triggering pressure from stockholders and outside acquisition interest in the company. An activist stockholder, Neuberger Berman, urged the company to end the downward drift in August 2015, and the company hired a new CEO, Richard Anicetti, on September 1. Shortly thereafter, Neuberger pushed the company to analyze its strategic alternatives, and the company separately received indications of interest from two financial buyers.

Unbeknownst to the board of directors, the company's chairman, Ray Berry, had been speaking with Apollo about a potential acquisition since July 2015. Berry and his son together owned 9.4% of the company's stock. In September, Apollo orally agreed to roll the Berrys' equity into a 28.3% stake post-merger if Apollo were to acquire the company. Berry finally disclosed Apollo's acquisition proposal to general counsel Scott Duggan on September 25, yet Berry insisted he had no commitment to or agreement with Apollo. On October 1, Apollo submitted a preliminary offer to purchase the company, which included an equity rollover with the Berrys. On October 15, however, Berry told the board that he would not be comfortable partnering with any other private equity buyer, contrary to his previous representations. From that point forward, he recused himself from all board meetings relating to the merger. The board then formed a strategic transaction committee.

On October 18, the board announced the commencement of a strategic review process. The company's financial advisor, JPMorgan, contacted 32 potential bidders, but Apollo was the only company that submitted a bid. In March 2016, upon recommendation by the committee, the board approved an agreement to merge with and into an Apollo subsidiary for $28.50 per share.

The Schedule 14D-9, in which the company recommended that its stockholders tender their stock in furtherance of the merger, failed to disclose that (i) Berry lied to the board about his September rollover agreement with Apollo; (ii) Berry had a clear preference for Apollo and was unwilling to consider partnering with other firms; (iii) Berry had indicated he might sell his stock if the company did not conduct a sale; and (iv) the company faced significant pressure from activist stockholders to sell the company. A majority of the company's disinterested stockholders approved the merger.

Following a books-and-records demand under Section 220 of the Delaware General Corporation Law, a stockholder brought direct claims challenging the merger. The director defendants and officers moved to dismiss for failure to state a claim under Rule 12(b)(6). On September 28, 2017, the Court of Chancery dismissed all claims on the ground that the merger was approved by a majority of Fresh Market's disinterested stockholders and therefore subject to business judgment review under *Corwin v. KKR Fin. Holdings LLC,* 125 A.3d 304 (Del. 2015). On appeal, the Delaware Supreme Court reversed the Court of Chancery, holding that Fresh Market's Schedule 14D-9 contained material omissions, the Fresh Market stockholder vote to approve the merger therefore was uninformed, and the board's approval of the merger therefore was not subject to business judgment deference under *Corwin*. On remand, the Court of Chancery revisited the motions to dismiss that were not addressed in the prior ruling. In particular, the Court addressed whether the plaintiff adequately alleged non-exculpated breaches of fiduciary duty by the company's board of directors, chairman, general counsel, and CEO. The Court did not address the plaintiff's further claims for aiding and abetting against Apollo, JPMorgan, and the committee's legal advisor.

First, the Court dismissed breach of fiduciary duty claims against the board. Because the company had a Section 102(b)(7) exculpation provision, the Court noted that only breaches of the duty of loyalty—self-dealing or bad faith—could survive a motion to dismiss. Regarding self-dealing, the Court held that it was unreasonable to infer that directors would breach their fiduciary duties to protect their reputations based on the mere possibility an activist could conduct a proxy fight. The Court further dismissed allegations of bad faith because the plaintiff failed to allege an intentional dereliction of duty. In particular, the Court held that (i) the directors' decision to initiate an auction, as opposed to dealing exclusively with Apollo, was not knowingly contrary to the interests of the company and its stockholders; (ii) the directors' decision not to let Berry discuss an equity rollover with other bidders was rational given his allegiance to Apollo and likelihood he would dissuade other bidders; (iii) the directors' failure to investigate whether JPMorgan was concurrently providing Apollo services in connection with the Fresh Market acquisition was perhaps negligent but not intentional; and (iv) the directors' approval of the Schedule 14D-9 disclosures did not indicate an intent to mislead because elsewhere in the schedule the directors disclosed Berry's contacts with Apollo and the activist pressure the company faced.

Although Berry appropriately recused himself from board deliberations due to his allegiance to Apollo, this measure was too little, too late; he had been dishonest with the board for several months prior to his recusal.

Second, the Court held that the plaintiff stated a claim for breach of the duty of loyalty against Berry in his capacity as chairman of the board. The Court reasoned that although Berry appropriately recused himself from board deliberations due to his allegiance to Apollo, this measure was too little, too late; he had been dishonest with the board for several months prior to his recusal. Berry did not disclose his correspondence with Apollo (which had begun in July) until late September, which was in violation of company policy requiring disclosure of acquisition proposals; he intentionally obscured the extent of his involvement with Apollo to management; and he only corrected prior misleading statements when prompted. From these facts, the Court inferred that Berry acted in his own self-interest and to the company's detriment.

Third, the Court held that the plaintiff stated a claim for breach of the duty of care, but not the duty of loyalty, against Duggan in his capacity as general counsel. The Court rejected the plaintiff's theories that Duggan was interested by virtue of a change-in-control benefit of up to $2.3 million or the possibility of acquiring a position with the company post-merger. The Court held, however, that Duggan had acted with gross negligence in drafting materially misleading Schedule 14D-9 disclosures. The Court reasoned that, because Duggan drafted the disclosures, he could have known that they were materially deficient, especially given Duggan's knowledge of Berry's misconduct with the board and allegiance to Apollo.

Finally, the Court held that the plaintiff stated a claim for breach of the duty of care, but not the duty of loyalty, against Anicetti in his capacity as CEO. The plaintiff argued that Anicetti supported a "sham sale" to benefit from post-merger compensation because Apollo based its compensation on multiples of invested capital; a low buyout price, the plaintiff alleged, would make hitting high multiples post-merger easier. The Court rejected this theory, however, because a low purchase price would damage Anicetti as a stockholder. Yet the Court held that Anicetti may have breached his duty of care by participating in the preparation of the Schedule 14D-9, which Anicetti may have known, by virtue of his role as director and CEO, was materially deficient.

Disclosures

Chester County Employees' Retirement Fund v. KCG Holdings, Inc.: Court of Chancery Denies Dismissal under *Corwin*, Finding Stockholder Vote Uninformed

In *Chester County Employees' Retirement Fund v. KCG Holdings, Inc.*, 2019 WL 2564093 (Del. Ch. June 21, 2019), the Delaware Court of Chancery denied the defendants' motion to dismiss claims relating to the acquisition of KCG Holdings, Inc. by Virtu Financial, Inc. The Court's denial relied, in part, on finding that the stockholder plaintiff's allegations of disclosure deficiencies precluded business judgment review of the transaction under *Corwin v. KKR Financial Holdings LLC,* 125 A.3d 304 (Del. 2015).

In December 2016, Jefferies LLC, KCG's largest stockholder and long-time financial advisor, engaged with Virtu in discussions about Virtu's potential acquisition of KCG. Before informing KCG's board of Virtu's interest, Jefferies and Virtu discussed KCG's standalone bond-trading platform, BondPoint, and the potential for a sale of BondPoint to increase KCG's book value. In February 2017, Jefferies informed KCG that Virtu was likely to make a formal offer to acquire KCG, but did not disclose that Jefferies had been negotiating with Virtu over the previous two months. The next day, Virtu presented KCG with an offer to acquire KCG at between $18.50 and $20 per share.

In April 2017, Virtu made a final offer of $20 per share. All of KCG's directors except for its CEO, Daniel Coleman, approved a counteroffer of $20.21 per share. Coleman told the board that $20.21 was "too low" and that execution of KCG's pending restructuring plan offered the company greater value and less risk. Coleman agreed to support the deal, however, if KCG received guarantees concerning certain "closing risks," including post-closing retention and compensation for himself and his management team. The next day, Coleman presented the $20.21 counteroffer to Virtu.

Virtu rejected the counteroffer, but agreed with Coleman on a post-closing compensation pool benefitting Coleman and the rest of the management team. KCG's board then approved the merger at $20 per share, subject to a fairness opinion. That evening, Coleman and other members of the management team revised KCG's projections downward. Based on the revised projections, Goldman Sachs, KCG's financial advisor, determined that $20 per share was a fair price. Following a procedural challenge to an initial proxy statement, KCG issued a second proxy in June 2017 to inform stockholders about the deal before a stockholder vote. In July 2017, an affirmative vote of the majority of uninterested stockholders approved the transaction at a price of $20 per share. The merger closed the next day.

The plaintiff then filed a complaint alleging that KCG's directors breached their fiduciary duties, that Virtu and Jefferies aided and abetted those breaches, and that Virtu and Jefferies engaged in a civil conspiracy.

In their motion to dismiss, the defendants argued that, under *Corwin,* the merger was subject to the deferential business judgment standard of review because a majority of KCG's stockholders approved it in a fully informed, uncoerced vote. However, the Court found that the stockholder vote was not fully informed. Instead, the proxy omitted information that could have been material to a stockholder evaluating the deal. In particular, the Court criticized the proxy's failure to disclose: (i) Virtu's discussions with Jefferies about the divestiture of BondPoint, (ii) Coleman's belief that $20.21 per share was "too low" before securing the post-closing compensation guarantees, and (iii) the downward adjustment to KCG's financial projections before the fairness opinion was issued. As a result, the Court reviewed the plaintiff's claims under the more stringent *Revlon* standard, enhanced scrutiny. The Court found that the complaint adequately pled facts supporting a reasonable inference that KCG's directors had breached non-exculpated fiduciary duties by placing Coleman in a position to extract compensation for himself and management at the expense of stockholders, and by approving hurried revisions to the company's projections to make the deal price appear more reasonable.

The Court also denied dismissal of the plaintiff's aiding and abetting and conspiracy claims against Jefferies and Virtu. Jefferies's failure to inform KCG's board about the full extent of its discussions with Virtu had created an "informational vacuum" that could support a finding of aiding and abetting the directors' breach of fiduciary duty. Further, the Court determined that Virtu accepted confidential company information from Jefferies, exploited Coleman's conflict during negotiations, and used Jefferies to pressure the KCG board into accepting the merger. Finally, the Court determined that the

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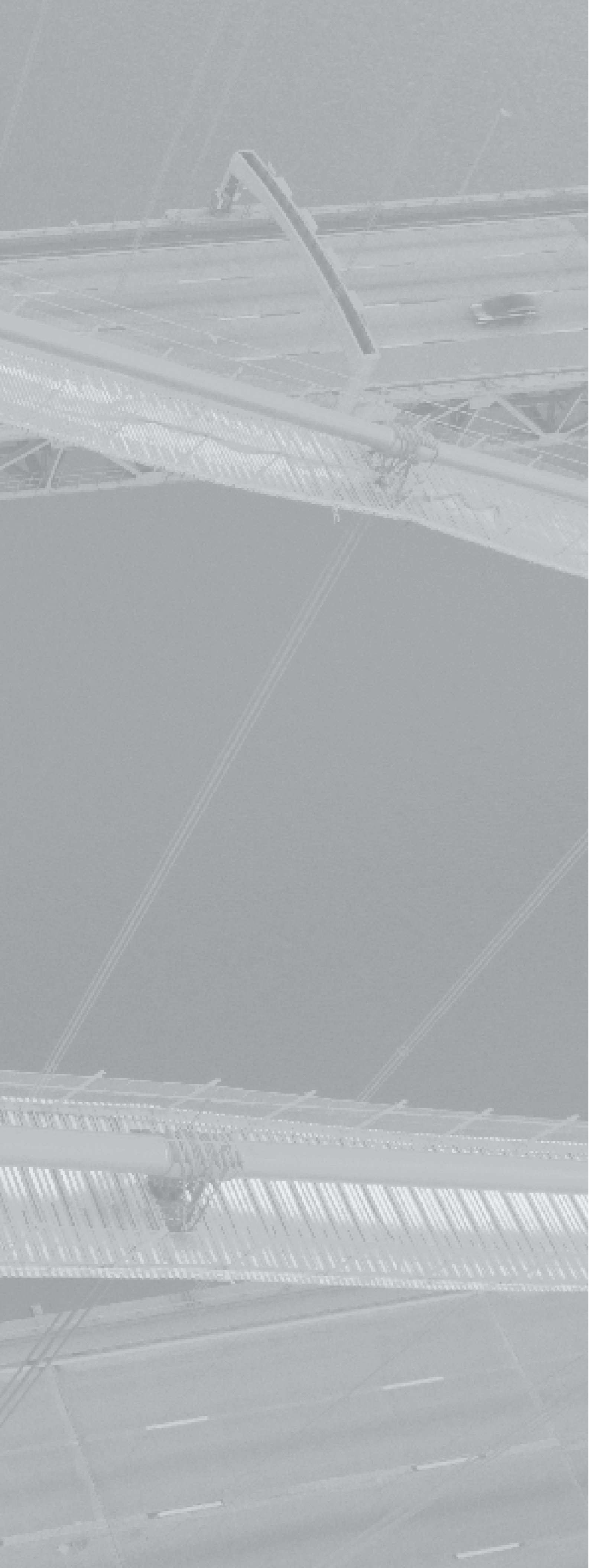

plaintiff adequately alleged that Jefferies and Virtu had conspired on a merger price and agreed to a post-merger sale of BondPoint. Accordingly, the Court denied the defendants' motion to dismiss in its entirety.

Clark v. Davenport: Court of Chancery Denies Dismissal of Fraud Claims Where Financial Condition and Future of Company Were Misrepresented

In *Clark v. Davenport,* 2019 WL 3230928 (Del. Ch. July 18, 2019), the Delaware Court of Chancery addressed a motion to dismiss claims that directors of a Delaware corporation fraudulently induced the plaintiff to invest in the company by misrepresenting its financial condition and prospects. The Court denied the motion in part, upholding certain claims for fraud and aiding and abetting fraud.

Chester Davenport controlled Basho Technologies, Inc., a privately held Delaware corporation specializing in distributed-systems database software. Following an initial investment in Basho that included blocking rights, Chester foreclosed other third-party financing options and forced Basho to issue preferred stock (the "Series G shares"), which was designed to raise $25 million. Exercising his control, Chester appointed Adam Wray as Basho's CEO. Chester, through Georgetown Basho Investors, LLC, purchased $10 million of the Series G shares. The remaining $15 million was to come from outside investors.

Chester and his Georgetown colleagues were unable to find investors to fill out the remaining $15 million of the Series G financing. By mid-March 2014, Georgetown had raised less than $100,000 from outside investors. To keep Basho afloat, Georgetown exercised warrants it received in the Series G financing and paid $1.8 million for additional Series G shares. Basho continued to struggle to raise capital and lost a number of its strategic relationships.

In October 2014, Chester contacted his friend Kenneth Clark about investing in Basho. Chester provided Clark with an executive summary, which Clark later alleged contained false and misleading statements about the qualifications of Wray, Basho's CEO. Chester also sent Clark an email that allegedly made further false and misleading statements, and omitted negative information about the company. Chester then put Clark in contact with Wray, who corroborated the allegedly misleading and false information Chester had provided. Based on the conversations with Chester and Wray, Clark purchased $2 million in Series G shares (the "October 2014 Investment").

In December 2014, Chester and Wray approached Clark again, urging him to further invest in Basho. Wray claimed that (i) in deference to Clark, Chester was holding at bay at least three investors wishing to purchase Series G shares, (ii) other New York investors were considering the shares, (iii) aggressive ramp-up of Basho's booking was expected in 2015, (iv) Basho was close to claiming the dominant place in the market, and (v) Basho was about to enter a beneficial partnership with IBM. Wray also represented that the company anticipated announcing a partnership with IBM at an upcoming IBM conference. Wray and Chester did not mention any of Basho's financial problems. Relying on Chester and Wray's representations, Clark purchased another $500,000 in Series G shares (the "December 2014 Investment").

In 2016, Chester and Wray approached Clark to participate in Basho's latest round of financing ("Series H"). Clark agreed to invest an additional $6 million, relying on a letter of intent sent to Basho, which was countersigned by Wray on behalf of Basho. The letter indicated an enterprise value of $45 million for Basho, based on an analysis prepared by Basho directors, including Chester's son, Corey Davenport. Wray and Corey represented to Clark that Basho had a path to achieving sustained cash-flow positive results within 12 months of the Series H financing. Clark joined the board after the Series H round closed.

Shortly after joining the board, Clark learned that Basho was in dire financial straits and near insolvency. Basho was placed into receivership in July 2017 and thereafter liquidated. Clark brought suit against Georgetown and various directors of Basho. Only claims against Corey and Wray were addressed in the motion to dismiss.

Clark asserted four claims: (i) breach of fiduciary duty against Wray in connection with the December 2014 and Series H Investments, (ii) common law fraud against Wray and Corey in connection with the three investments, (iii) negligent misrepresentation against Wray and Corey in connection with the three investments, and (iv) aiding and abetting against Wray and Corey. Wray and Corey moved to dismiss pursuant to Rule 12(b)(6).

The parties agreed that Count I, the breach of fiduciary duty claim, was governed by the framework provided for in *Malone v. Brincat,* 722 A.2d 5 (Del. 1998), which applies "when a corporate fiduciary speaks outside of the context of soliciting or recommending stockholder action … or public filings required by the federal securities laws." In this context, "directors owe a duty to stockholders to not speak falsely … [and] 'directors who knowingly disseminate false information that results in corporate injury or damage to an individual stockholder violate their fiduciary duty[.]'" The Court treated the breach of fiduciary duty claim, brought against Wray, as "rising or falling with the claims for common law fraud in Count II."

Regarding the October 2014 Investment, the complaint did not mention Corey and only alleged that Wray "corroborated everything Chester had said, and reinforced the message that Basho was postured for imminent success." The Court held that these allegations were conclusory and dismissed the fraud claim based on the October 2014 Investment.

The allegations concerning the December 2014 Investment, again, failed to mention Corey. Yet, the Court held that Clark stated a fraud claim against Wray. The Court distinguished between fraudulent statements of fact, such as Basho's purported negotiations with IBM and an existing plan to announce a partnership, which were actionable, and mere puffery, such as claims about Basho's unique positioning in the market, which were not. Further, the Court distinguished between good faith statements regarding Basho's future performance and projections about the future that were intended to deceive. The Court found that it was reasonable to infer that Wray, whose sole source of income was Basho, had a motive to misrepresent the financial condition and prospects of the company and, in fact, did so.

For similar reasons, the Court found that the plaintiff stated a fraud claim against Wray but not against Corey in connection with the Series H investment.

The Court further held that the negligent representation claims were precluded by the fiduciary duty claim to the extent it addressed the December 2014 and Series H Investments. The Malone framework for a breach of fiduciary duty claim displaced any claim for negligent misrepresentation. Further, in connection with the October 2014 Investment, Clark's friendship with Chester, and indirectly Wray, was not sufficient to create the type of "special relationship" required for a negligent misrepresentation claim.

The Court distinguished between fraudulent statements of fact, such as Basho's purported negotiations with IBM and an existing plan to announce a partnership, which were actionable, and mere puffery, such as claims about Basho's unique positioning in the market, which were not.

Finally, the Court held that the complaint stated a claim that Wray aided and abetted Chester's fraud in connection with all three investments. The complaint also supported a reasonable inference that Corey aided and abetted the fraud in connection with the Series H Investment. The plaintiff alleged that Corey "knowingly gave substantial assistance to Chester and Wray by preparing the financial statements and projections that [unreasonably] supported an enterprise value for Basho of $45 million."

Merger Agreement Construction

Akorn, Inc. v. Fresenius Kabi AG: Court of Chancery Finds Occurrence of 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.

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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 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).

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.

Vintage Rodeo Parent, LLC v. Rent-A-Center, Inc.: Court of Chancery Holds Merger Validly Terminated Where Party Failed to Issue Notice to Extend End Date

In *Vintage Rodeo Parent, LLC v. Rent-A-Center, Inc.*, 2019 WL 1223026 (Del. Ch. Mar. 14, 2019), the Delaware Court of Chancery held that Rent-A-Center, Inc. was permitted to terminate a merger agreement with Vintage Capital Management, LLC because Vintage failed to submit a notice to extend the closing date. The Court strictly interpreted the express language of the merger agreement and permitted Rent-A-Center to deliver a termination notice only hours after the deadline to extend had passed.

Vintage agreed to purchase Rent-A-Center for approximately $1.365 billion pursuant to a merger agreement that provided that either party could terminate the agreement if the merger was not consummated by 11:59 p.m. on December 17, 2018 (the "End Date"). If antitrust clearance had not been obtained by that time, each party to the merger agreement had a unilateral right to extend the End Date to March 17, 2019 by delivering written notice to the other party at or prior to the End Date. Further, Vintage agreed to pay a termination fee of $126,500,000, or 15.75% of the equity value of the transaction, to Rent-A-Center if the agreement was terminated because of failure to receive antitrust approval or by written notice by either party.

Because both parties were key players in the "rent-to-own" market, the parties were required to obtain antitrust clearance from the Federal Trade Commission (FTC) for the merger. The merger agreement required that the parties use "commercially reasonable efforts" to obtain FTC approval. After lengthy discussion between the parties and the FTC, the parties agreed to a joint timing agreement with the FTC to provide the FTC

The Court categorized Vintage's arguments as "after-the-fact rationalizations as to why failure to give written notice of election to extend is excused" in an instance where Vintage "simply forgot to give such notice."

a 45-day waiting period to take action on the merger, which would be triggered once the parties filed a certification of compliance with the FTC. Both parties anticipated that the certification would not be filed until December 2018, which would push closing past the End Date to sometime in January 2019.

In early December 2018, Rent-A-Center's board of directors met and determined that if Vintage failed to properly extend the End Date, it would terminate the merger agreement and seek the termination fee. Anticipating that Vintage would exercise its right to extend the End Date, and in compliance with its obligation under the merger agreement, Rent-A-Center continued using commercially reasonable efforts to obtain regulatory approval and consummate the merger. Rent-A-Center, however, did not receive written notice to extend the End Date by the end of the day on December 17. In the early morning of December 18, a few hours after the deadline had passed, Rent-A-Center delivered a notice to Vintage to exercise its right to terminate the merger agreement and sought payment of the termination fee. Thereafter, Vintage brought suit in the Delaware Court of Chancery to prevent Rent-A-Center from terminating the agreement. The Court held a two-day trial.

Vintage advanced two main arguments as to why Rent-A-Center's termination was improper: (i) Rent-A-Center's conduct toward Vintage or the FTC either fulfilled the notice requirement, waived the notice requirement, or estopped Rent-A-Center from terminating the merger agreement; and (ii) Rent-A-Center fraudulently concealed its intent to terminate the merger agreement, which Vintage characterized as a failure to employ commercially reasonable efforts toward the closing. For these reasons, Vintage asserted that Rent-A-Center was in breach of the merger agreement and could not properly terminate it.

The Court noted with regard to Vintage's first argument that literal compliance with a notice provision may be unnecessary where substantial compliance has been shown. Yet, the Court noted that substantial compliance typically is only sufficient when the notice was deficient in the *manner* it was provided, not in its *substance*. Here, Vintage was unable to produce any evidence of any notice sent to Rent-A-Center that explicitly mentioned the term "End Date," the section of the merger agreement referencing the term "End Date," or March 17, 2019 (the date to which Vintage was entitled to extend the End Date). Although Vintage pointed to the joint timing agreement and other discussions between the parties as implicit agreement by Rent-A-Center that the merger would not be consummated by the End Date, the Court held that these actions could not constitute substantial compliance because both the manner and the substance of the notice were deficient.

Further, the Court observed that the purpose of the joint timing agreement and other discussions surrounding antitrust approval was to "encourage a favorable outcome from the FTC" and evidenced the parties making an effort to obtain FTC approval, but did not evidence any intent by the parties to be bound by the merger agreement after the End Date. The Court held that the merger agreement required a written notice that evinced an intent to extend the End Date, which was not present here. Nor did Vintage reasonably rely on or change its position on the basis of Rent-A-Center's actions following the Rent-A-Center board meeting, as would be required to show equitable estoppel; Vintage was constructively aware of its right to extend and could have exercised it, but simply forgot about the End Date provision.

The Court rejected Vintage's second argument by stating that "parties are assumed to have knowledge of their own contractual rights" and that "[c]ommercially reasonable efforts do not require that sophisticated parties remind one another of their contractual rights." Further, the Court noted that Rent-A-Center had valid reasons for not sharing the board's decision to terminate the agreement with Vintage or key personnel at Rent-A-Center, such as wanting to avoid upsetting Vintage and ensuring that Rent-A-Center personnel continued using commercially reasonable efforts to consummate the merger while Rent-A-Center was still bound to the merger agreement. Vintage's second argument was also rejected because Rent-A-Center had no "duty to warn" Vintage of the impending End Date and the contractual rights associated with the End Date; the failure to warn Vintage did not constitute a failure to use commercially reasonable efforts.

In sum, the Court categorized Vintage's arguments as "after-the-fact rationalizations as to why failure to give written notice of election to extend is excused" in an instance where Vintage "simply forgot to give such notice." Because the End Date was not properly extended, Rent-A-Center was within its rights to terminate the contract.

Finally, the Court asked the parties for supplemental briefing as to whether the implied covenant of good faith and fair dealing prevents Rent-A-Center from receiving the termination fee. Although the Court did not definitively address this issue, it noted that it was "dubious whether the parties meant for a reverse breakup fee to apply in this situation," where the party terminating the agreement was the same party seeking the termination fee. ■

Director and Officer Compensation

Stein v. Blankfein: Court of Chancery Denies Business Judgment Review of Stockholder-Approved Director Compensation Plan Where Awards Involve Discretion

In *Stein v. Blankfein,* 2019 WL 2323790 (Del. Ch. May 31, 2019), the Delaware Court of Chancery addressed the defendants' motion to dismiss claims that non-employee directors at the Goldman Sachs Group violated their fiduciary duties by granting themselves excessive compensation pursuant to stockholder-approved stock incentive plans ("SIPs"). Relying on the Delaware Supreme Court's guidance in *In re Investors Bancorp Stockholder Litigation,* 177 A.3d 1208 (Del. 2017), the Court held that the non-employee director compensation plans were subject to entire fairness review. Although the director defendants sought and received approval by Goldman's stockholders for the SIPs, the Court held that, under *Investors Bancorp,* stockholder approval will only trigger business judgment review if the specific compensation is approved or if the approved plans are self-executing (i.e., if the board has no discretion in the amount of the awards granted under the plan).

The plaintiff alleged that the non-employee directors, who received an annual grant of restricted stock units valued at $500,000 and total annual compensation in excess of $600,000, violated their duty of loyalty by issuing themselves excessive compensation. The plaintiff also alleged that the defendants violated their duty of disclosure when seeking stockholder approval in connection with the SIPs from 2013 and 2015. These disclosure violations, the plaintiff argued, rendered the SIPs void *ab initio*.

That Court noted that "[i]f the awards at issue had been specifically placed before the stockholders for a vote, stockholder approval would cleanse any actionable breach of duty, based solely on overpayment." In approving the SIPs at issue, however, the stockholders did not ratify specific awards; the SIPs provided the non-employee directors discretion in setting their own compensation.

Nevertheless, the defendants argued that because the stockholders approved the SIPs and the SIPs included an exculpatory provision, entire fairness did not apply. The provision purported to exculpate the board from "any liability to any person ... for any action taken or omitted to be taken or any determination made in good faith with respect to the [SIPs] or any Award." At bottom, the defendants contended that, in the words of the Court, "Goldman's stockholders waived the right to entire fairness review in cases of self-dealing transactions, absent bad faith."

In approving the SIPs at issue, however, the stockholders did not ratify specific awards; the SIPs provided the non-employee directors discretion in setting their own compensation.

The Court disagreed, holding that the language of the provision was insufficient to constitute a knowing waiver by the stockholders of their ability to challenge future unfair and self-dealing transactions and that entire fairness remained the standard of review. The Court indicated that to demonstrate a sufficiently knowing waiver, Goldman would, at a minimum, have needed to expressly inform stockholders at the time the SIPs were approved that a vote in favor of the SIPs would constitute such a waiver, although the Court suggested that it was "dubious" that such a waiver would even be viable under Delaware law.

The defendants also sought dismissal on the ground that the complaint did not contain sufficient allegations to support an excessive compensation claim. Although the complaint did not contain any allegations of unfair process, the Court found that the plaintiff had carried her burden by pleading "some facts implying lack of entire fairness." In particular, the plaintiff alleged that: (i) the average annual compensation for Goldman's non-employee directors was almost double that of the peer companies identified in the company's proxy statements, (ii) the company's directors attended fewer meetings than the peer companies' directors, and (iii) those peer companies were approximately the same size and performed either as well as or better than Goldman. Although the Court stated that the fiduciary duty claim was "not ... particularly strong," the Court found the allegations sufficient at the preliminary stage of the proceedings to deny the motion to dismiss.

The Court did, however, dismiss two disclosure claims and a direct claim related to the approval of the SIPs. The plaintiff alleged that the SIPs, approved by the Goldman stockholders in 2013 and 2015, were void *ab initio* because the related disclosures failed to include material information required by a Treasury Department regulation. The Court held that the plaintiff, who was not alleged to be a stockholder at the time the 2013 SIP was approved, lacked standing to challenge that plan.

Moreover, the plaintiff was barred from challenging either plan under the doctrine of laches, even though the challenge to the 2015 vote was brought within the analogous three-year limitations period. The Court noted that the 2015 proxy statement referenced the relevant Treasury regulation, and therefore any deficiency was not hidden and would have been obvious on the face of the proxies. Yet the stockholder plaintiff had continued to accept the benefits of Goldman's management for two years prior to bringing suit. Because the disclosure claims relating to the SIPs were dismissed, the plaintiff's direct claims that the SIPs were void *ab initio* due to disclosure deficiencies were also dismissed.

Finally, the Court dismissed a separate disclosure claim. The plaintiff had alleged that proxy statements from 2015, 2016, and 2017 were deficient because they failed to disclose whether certain cash-based incentive awards for company executives would be tax deductible. The Court held that the proxies, which expressly stated that the company "may decide to pay non-deductible variable compensation," were neither materially false nor misleading.

Tornetta v. Musk: Court of Chancery Holds Dual Protections of *MFW* Necessary for Business Judgment Review of Controlling Stockholder Compensation

In *Tornetta v. Musk,* 2019 WL 4566943 (Del. Ch. Sept. 20, 2019), the Delaware Court of Chancery, addressing "issues of first impression in Delaware," held that the entire fairness standard of review applies to a board's executive compensation decisions for an officer who is also a controlling stockholder, absent compliance with the dual procedural protections provided for in *Kahn v. M&F Worldwide Corp.,* 88 A.3d 635 (Del. 2014). Although the *MFW* protections—conditioning the transaction *ab initio* on the approval of both independent board members and a majority of the minority stockholders—were developed and originally applied in the context of a controlling stockholder buyout, the Court held that, due to the specter of structural coercion inherent in any conflicted controller setting, compliance with the *MFW* conditions "is key to allaying the Court's suspicions" in a manner sufficient to restore the presumption of the business judgment rule.

In *Tornetta,* the stockholder plaintiff brought direct claims on behalf of a class of stockholders as well as derivative claims on behalf of Tesla, Inc. challenging the board's approval in 2018 of a compensation package for Elon Musk, the company's chief executive officer and chief product architect. For purposes of a motion of dismiss in an unrelated action concerning Tesla's 2016 acquisition of SolarCity, the Court of Chancery in March 2018 held that Musk was the controlling stockholder of Tesla despite holding just over 20% of its outstanding stock. "[O]ut of deference" to this decision, the defendants chose not to challenge Musk's alleged status as a controller at this stage of the proceedings.

Musk's first compensation package, fixed in December 2009, included time-vested options as well as options contingent on operational milestones, nearly all of which had been reached by 2012. In that year, Tesla's compensation committee revisited Musk's pay package and approved an almost entirely performance-based package providing for annual option awards over a 10-year period, with awards in each period being made subject to the achievement of operational milestones. Within five years of the 2012 award, the milestones had largely been reached. By 2018, the compensation committee recognized that it would need to provide Musk with a new pay package. Because Musk, in addition to serving in his roles at Tesla, was also serving as the chairman, chief executive officer, and chief technology officer of Space Exploration Technologies Corporation—"one of the world's most valuable private companies"—the compensation committee was keenly concerned with "how to keep [him] focused on Tesla."

Using its 2012 award as a guide, the compensation committee again proposed a 10-year package providing for the grant of options vesting in multiple tranches, with each contingent upon market capitalization and operational milestones. If all the milestones were reached, Tesla would likely be one of the most valuable public companies in the world, and Musk's options would vest with a value of more than $55 billion. Due to the milestones and other features of the 2018 award, including the likelihood of all the milestones being achieved, however, Tesla's preliminary estimate of the fair value of the award was roughly $2.6 billion. On the recommendation of the compensation committee, the board approved the 2018 award, but made its implementation subject to approval by the holders of a majority of the shares present in person or by proxy at a meeting of stockholders to vote on the proposal. At a special meeting, the stockholders ratified the 2018 award, with the holders of 64% of Tesla's outstanding disinterested shares entitled to vote present in person or by proxy at the meeting and the holders of 73% of the disinterested shares present (equating to 47% of the total outstanding disinterested shares) voting for the proposal.

The plaintiff alleged that the board breached its fiduciary duties in granting the 2018 award because it was unfair to Tesla. Because the grant of the 2018 award constituted a transaction between Tesla and its controller, the plaintiff argued, the transaction should be subject to entire fairness review. The defendants moved to dismiss, arguing the 2018 award, having been ratified by a disinterested stockholder vote, should be reviewed under the deferential business judgment standard.

As an initial matter, the plaintiff argued that the stockholder vote approving the 2018 award did not produce a ratifying effect because it was only approved by a majority of the disinterested shares *present at the meeting* and not by a *majority of the total disinterested shares outstanding*. The Court rejected this argument because the vote of a majority of the outstanding shares was not statutorily required (and Tesla did not voluntarily subject the 2018 award to the heightened statutory voting standard), and the vote actually obtained by Tesla satisfied the minimum statutory quorum and voting threshold requirements under Section 216 of the General Corporation Law of the State of Delaware, even when considering only the disinterested shares.

With regard to Tesla's failure to use a special committee to negotiate Musk's compensation, the defendants argued that the dual procedural protections contemplated by *MFW* to restore the presumption of the business judgment rule were only required in situations involving "transformational" transactions where the Delaware General Corporation Law requires a stockholder vote—not when a voluntary vote of stockholders is sought.

Stating that Delaware law "recognizes the relationship between a controlling stockholder and minority stockholders is fertile ground for potent coercion," the Court rejected the defendants' argument that a disinterested stockholder ratification vote alone was sufficient to restore the presumption of the business judgment rule to an executive compensation decision involving an officer-controller. Declining the defendants' invitation to limit the need to obtain both of *MFW*'s procedural protections to only "transformational" transactions—and to apply instead a more lenient framework for other transactions involving controllers—the Court stated that it could "discern no reason to think minority stockholders would feel any less coerced when voting against the controlling CEO's compensation plan than they would when voting to oppose a transformational transaction involving the controller." The Court noted that the risk "that those who pass upon the propriety of the transaction might perceive that disapproval may result in retaliation" from the controller applies with equal force in the compensation setting, where the controller would remain in a position to retaliate.

The risk "that those who pass upon the propriety of the transaction might perceive that disapproval may result in retaliation" from the controller applies with equal force in the compensation setting, where the controller would remain in a position to retaliate.

The Court agreed with the defendants that nothing in the *MFW* opinion itself suggested that it was intended to be applied outside the context of a controlling-stockholder buyout. Yet the Court reasoned that, nevertheless, the dual protections would provide "useful safeguards" in the context of setting the controller's compensation in his capacity as an officer. According to the Court, had the *MFW* protections been utilized by Tesla from the outset, it would have helped minimize the effects of structural coercion to a degree that would allow the Court to apply the deferential business judgment standard. However, since a special committee had not been used, the entire fairness standard applied.

Applying the entire fairness standard, the Court held that the plaintiff "just barely" stated a claim against the board. The plaintiff alleged that Musk's compensation award was "orders of magnitude higher than what other highly paid CEOs earn[,] ... dwarfing the compensation of 'the world's most successful technology executives.'" These alleged facts, on the "very outer margins of adequacy," were sufficient to defeat a motion to dismiss.

Finally, because alternative pleading is permitted under Delaware law, the Court upheld an essentially duplicative claim against Musk for unjust enrichment. The Court, however, dismissed a parallel claim against the board for waste, emphasizing "that stockholders would be unlikely to approve a transaction that is wasteful."

Dividends

JPMorgan Chase Bank, N.A. v. Ballard: Court of Chancery Dismisses Unlawful Dividend Claims, Holding Section 174 Is a Statute of Repose

In *JPMorgan Chase Bank, N.A. v. Ballard*, 2019 WL 3022338 (Del. Ch. July 11, 2019), the Delaware Court of Chancery dismissed JPMorgan Chase Bank, N.A.'s claims to recover against directors for dividends that were allegedly unlawfully paid because JPMorgan failed to file these claims within six years of the date the dividends were paid. The Court, however, declined to dismiss JPMorgan's related claims to recoup the dividend payments and certain other payments to insiders under the Delaware Uniform Fraudulent Transfer Act (DUFTA).

In its decision, the Court addressed three issues of first impression concerning Delaware law: (i) whether a plaintiff must be a "judgment creditor" at the time of the allegedly unlawful dividend to have standing to maintain a claim under Section 174 of the General Corporation Law of the State of Delaware; (ii) whether the six-year limitations period in Section 174 is a statute of repose, to which tolling principles do not apply, or a statute of limitation, to which tolling principles do apply; and (iii) whether the one-year discovery period in DUFTA begins when a plaintiff discovers or reasonably could have discovered the *fraudulent nature* of the transfer or the *mere existence* of the transfer.

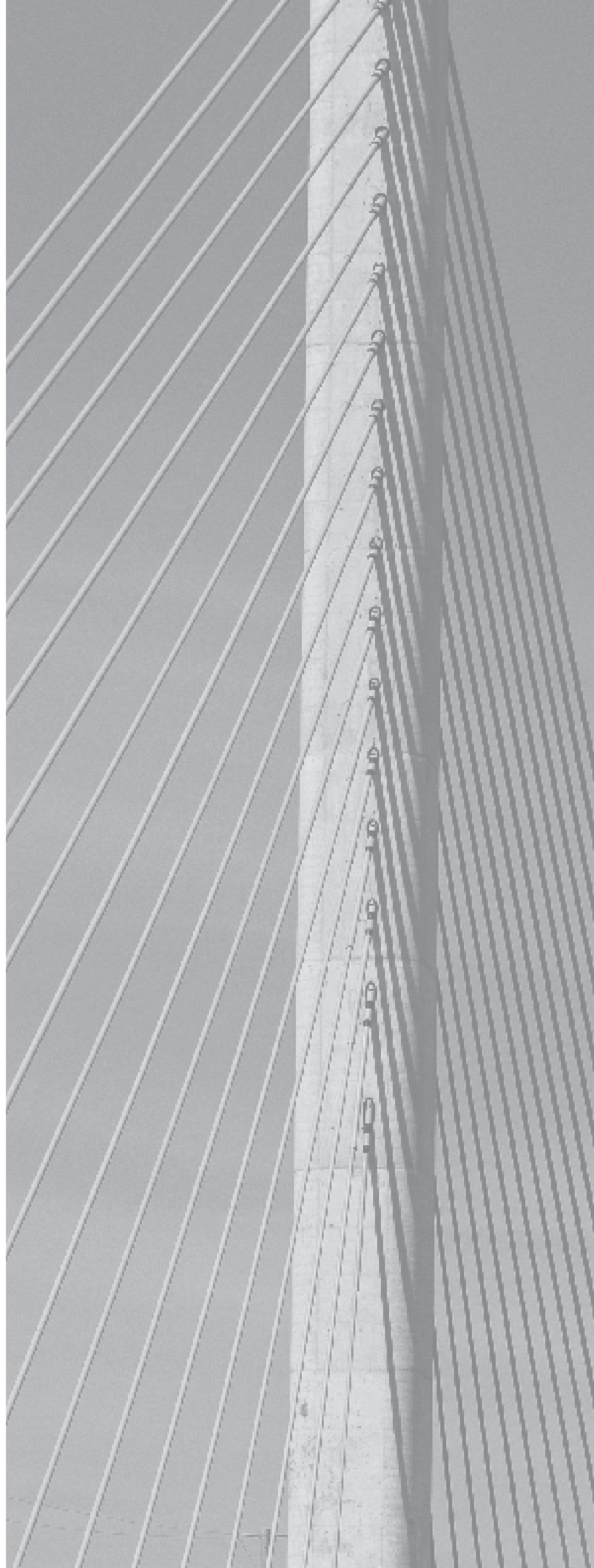
Data Treasury Corporation ("DTC") entered into an agreement with JPMorgan to license two patents that DTC owned related to check imaging. The licensing agreement contained a most-favored license provision that required DTC to notify JPMorgan if it licensed its patents to other entities and to provide a monetary benefit to JPMorgan if these licensing agreements contained more favorable terms. From 2006 through 2013, DTC entered into a number of licensing agreements with other entities that contained more favorable terms than its licensing agreement with JPMorgan. Additionally, from 2006 to 2010, DTC issued $117 million in dividends to its stockholders (the "Challenged Dividends") and transferred an additional $13.7 million to insiders (the "Challenged Transfers").

In 2015, JPMorgan sued DTC in the United States District Court for the Eastern District of Texas for violating the most-favored license provision and obtained a $69 million judgment. During post-judgment discovery in 2018, JPMorgan learned of the Challenged Dividends and the Challenged Transfers. Shortly thereafter, JPMorgan filed claims in the Delaware Court of Chancery under Section 174, which provides that directors who negligently or willfully declare an unlawful dividend may be jointly and severally liable to "creditors" of the company at any time within six years after the payment of the unlawful dividend, and under DUFTA against DTC's directors and the directors' affiliates seeking to recover the proceeds of the Challenged Dividends and the Challenged Transfers to satisfy the judgment in the Texas action.

The defendants argued that JPMorgan was not a "creditor" of the company prior to the judgment in the Texas action and therefore did not have standing to bring suit under Section 174 regarding dividends issued prior to the judgment. The Court disagreed. The Court concluded that it was not necessary for a plaintiff to have a claim reduced to a judgment (i.e., that the plaintiff be a "judgment creditor") for the plaintiff to recover under Section 174 for an improperly declared dividend. Instead, a plaintiff need only have a claim or a right to payment at the time the dividend was declared to qualify as a creditor. Here, JPMorgan had a claim after DTC licensed its patents to another entity on more favorable terms in 2006, which was before the first of the Challenged Dividends had occurred; therefore, JPMorgan had standing as a creditor under Section 174.

The six-year period provided for in Section 174 was a statute of repose to which tolling principles do not apply (and not a statute of limitation to which tolling principles would apply).

Despite holding that JPMorgan had standing under Section 174 as a creditor, the Court dismissed JPMorgan's claims under Section 174, finding JPMorgan failed to file its claims within the statute's period of repose. The Court held that the six-year period provided for in Section 174 was a statute of repose to which tolling principles do not apply (and not a statute of limitation to which tolling principles would apply). As a result, DTC's directors could not be liable under Section 174 for unlawful dividends because JPMorgan filed suit more than six years after the payment of the last of the Challenged Dividends. The Court relied upon the legislative history of the statute and the plain language of Section 174 in reaching its conclusion. The Court observed that statutes of limitation generally connect



a time period to the accrual of a cause of action, whereas statutes of repose generally connect a time period to a specific event. Section 174 anchors its time period to a specific event, providing for liability "at any time within 6 years *after paying such unlawful dividend*" (emphasis added).

Although it dismissed JPMorgan's claims for unlawful dividends under Section 174, the Court upheld claims relating to the Challenged Transfers and the Challenged Dividends for fraudulent transfer under DUFTA. DUFTA requires that a fraudulent transfer claim be brought "within 4 years after the transfer was made or the obligation was incurred or, if later, within 1 year after the transfer or obligation was or could have reasonably been discovered by the claimant." While JPMorgan brought its claims more than four years after the Challenged Transfers and the Challenged Dividends occurred, the Court held that the claims were brought within one year after the Challenged Transfers and the Challenged Dividends were or could have been reasonably discovered by JPMorgan. In so holding, the Court held that the proper measure of the one-year period was when JPMorgan "discovered or reasonably could have discovered the fraudulent nature of the transfers for which it seeks relief," not when JPMorgan discovered or reasonably could have discovered the mere existence of the transfers. The Court held that JPMorgan had otherwise pled facts sufficient to state a claim with respect to both the Challenged Dividends and the Challenged Transfers under DUFTA.

Proxy Contests

Bay Capital Finance, LLC v. Barnes & Noble Education, Inc.: Court of Chancery Denies Injunction Where Plaintiff Failed to Meet Advance Notice Bylaw Deadline

In *Bay Capital Finance, LLC v. Barnes & Noble Education, Inc.*, C.A. No. 2019-0539-KSJM (Del. Ch. Aug. 14, 2019) (TRANSCRIPT), the Delaware Court of Chancery interpreted and analyzed the effect of stockholder noncompliance with the express requirements of an advance notice bylaw. Barnes & Noble Education, Inc. had an advance notice bylaw that required any stockholder submitting a director nomination to be a "holder of record" as of the date its nomination was submitted to the company. Under the company's bylaws, stockholders were required to submit their nominations "not less than 90 days nor more than 120 days prior to the first anniversary of the date of the immediately preceding annual meeting." The company held its 2018 annual meeting on September 25, 2018, which meant that stockholders were required to submit their nominations for the 2019 annual meeting to the company by June 27, 2019.

> "Not even Delaware's strong public policy favoring the stockholder franchise will save Bay Capital from its dilatory conduct. Bay Capital blew the deadline. It then made up excuses for doing so."

On June 27, 2019, one of the company's stockholders, Bay Capital LLC, noticed the nomination of a slate of director candidates for election at the company's 2019 annual meeting; however, as of June 27, 2019, Bay Capital was merely a beneficial owner of company stock, not a record holder. Bay Capital became a record holder on June 28, 2019, one day after the nomination deadline. Because Bay Capital did not meet the record holder requirement on June 27, 2019, the company rejected Bay Capital's nominations.

Bay Capital brought suit for injunctive relief, seeking either to force the company to include Bay Capital's nominees on the ballot at the 2019 annual meeting or to enjoin that meeting until a final adjudication of the merits of Bay Capital's complaint.

In denying Bay Capital's motion, the Court observed that the record reflected that Bay Capital and its principal, Sunil Suri, were fully aware of the company's advance notice bylaw and Bay Capital was advised timely and repeatedly by its own advisor that it must become a record holder by June 27, 2019 to notice its nomination. Additionally, the bylaws, which set forth the relevant nomination procedures and methods for calculating nomination deadlines, were publicly available. The Court noted that despite knowing of the record holder requirement under the advance notice bylaw, Bay Capital and Mr. Suri waited until June 24, 2019 to initiate the process to become a record holder. Because that process can take a few days to be completed, Bay Capital did not actually become a record holder until June 28, 2019.

The Court succinctly summarized the reasoning behind its holding:

> [N]ot even Delaware's strong public policy favoring the stockholder franchise will save Bay Capital from its dilatory conduct. Bay Capital blew the deadline. It then made up excuses for doing so. No record evidence suggests that the company is in any way at fault for that mistake. If this Court required the company to accept the nomination in these circumstances, advance notice requirements would have little meaning under Delaware law.

Bay Capital also argued that the company should not have been permitted to enforce the record holder requirement because the company's disclosures regarding its advance notice bylaw in its 2018 proxy statement conflicted with the actual requirements of the company's bylaws. Specifically, the 2018 proxy statement and the bylaws pegged the nomination window to two separate events. Under the 2018 proxy statement, stockholders were to submit their nominations not less than 90 days nor more than 120 days prior *to the 2019 annual meeting*. Under the company's bylaws, stockholders were required to submit their nominations "not less than 90 days nor more than 120 days prior *to the first anniversary of the date of the immediately preceding annual meeting.*" Additionally, the 2018 proxy statement stated that any "stockholder" may submit a nomination, while the bylaws stated that any "stockholder who is a holder of record" may submit a nomination. The Court, however, found that the record showed that Bay Capital did not actually rely on the 2018 proxy statement when making its nominations, and that Bay Capital's alleged reliance on the 2018 proxy statement was "not totally accurate" and "slightly misleading."

Although it denied Bay Capital's motion for a preliminary injunction, the Court cautioned that the company should not view the Court's ruling as an endorsement of the conflicting disclosure regarding the advance notice bylaw in the 2018 proxy statement.

BlackRock Credit Allocation Income Trust v. Saba Capital Master Fund, Ltd.: Delaware Supreme Court Holds Dissident Nominee Slate Properly Rejected for Failure to Comply with Advance Notice Bylaw

In *BlackRock Credit Allocation Income Trust v. Saba Capital Master Fund, Ltd.*, 2020 WL 131370 (Del. 2020), the Delaware Supreme Court reversed the Delaware Court of Chancery, holding that the defendant boards of trustees had properly rejected the plaintiff's nomination of a dissident slate of board nominees for failing to comply with the defendants' advance notice bylaws. The dissident plaintiff failed to strictly comply with the trusts' advance notice bylaws because it did not return supplemental information requested by the trusts within the five-day deadline in the provision.

Saba Capital Master Fund, Ltd., a shareholder in two BlackRock trusts, submitted to each of the trusts a written notice of nomination, in which Saba sought to nominate a dissident slate of trustees for each trust's board of trustees in accordance with each of the trust's advance notice bylaw provisions. Each of the trust's bylaws had identical advance notice provisions that laid out certain procedural requirements for shareholders seeking to nominate trustees to a board. Among other requirements, the advance notice bylaws stated that a nomination notice must include "information to establish to the satisfaction of the Board of Directors that

the Proposed Nominee satisfies the director qualifications" as set forth in the bylaws. The advance notice bylaws further provided that the board could request updates and supplements to a nomination notice "if necessary" to determine if "the Proposed Nominee has met the director qualifications." Any such update or supplement was required to be completed and returned by the shareholder "no later than five (5) business days after the request by the Board of Directors for subsequent information."

On March 30, 2019, Saba timely delivered its nomination notice and, at a "high level and without much context or explanation," addressed each of the director qualifications set forth in the bylaws. On April 22, 2019, the trusts' counsel requested additional information regarding the nominees and sent Saba a 47-page questionnaire with nearly 100 questions about each of the proposed nominees listed in the nomination notice. Saba did not complete and return the questionnaire within five days, as prescribed by the advance notice bylaws, and on May 1, 2019, the trusts informed Saba that the nomination notice was invalid because the questionnaire was not returned within the required timeframe. Saba submitted the completed questionnaires to the trusts later that same day. The next several weeks saw a "flurry of SEC filings and fight letters that accompany a challenge to an incumbent board," and each of the boards announced that Saba's nominations were invalid.

Saba then filed an action against the trusts seeking a preliminary injunction, alleging that the boards breached the bylaws and their fiduciary duties in sending the onerous questionnaire and invalidating Saba's nominations. Saba argued that the questionnaires exceeded the scope of the advance notice bylaws and that Saba could not reasonably be held to the five-day response deadline given the voluminous questionnaire. The Court of Chancery noted that the bylaws imposed three restrictions on the board's right to request updates and supplements to the nomination notices: the desired information must be (i) for the purpose of determining whether Saba's nominees met the director qualifications in the bylaws, (ii) "reasonably requested" with that scope in mind, and (iii) "necessary" for the boards' determinations. The Court of Chancery found that the questionnaire included a substantial number of questions that were not tied to whether the nominees met the director qualifications.

Saba's choice to "stay silent, do nothing, and let the deadline pass" undercut Saba's various challenges to the questionnaires, which the Supreme Court characterized as "after-the-fact excuses."

After noting that the boards "were entitled to ask for supplemental information and updates ... to determine that the nominees 'met the director qualifications,'" the Court of Chancery found that the trusts' 47-page questionnaires "went too far." The Court of Chancery stated that "[b]y including in the Questionnaire a substantial number of questions unrelated to ... director qualifications, and nonetheless enforcing the strict five-day deadline to invalidate Saba's nominations, Defendants overstepped their authority ... while demanding strict compliance from Saba." Accordingly, the Court of Chancery found that the questionnaire "as a whole" was not "reasonably requested" or "necessary" to determine whether Saba's nominees met the director qualifications. Having found that the questionnaire exceeded the bylaws' scope, the Court of Chancery held that the trusts were not permitted to rely on the five-day deadline for Saba's compliance with its questionnaire request and enjoined the trusts from relying on the advance notice bylaws to invalidate Saba's nominations.

Saba also argued that the directors violated their fiduciary duties because their "primary purpose" in barring Saba's nominations was "to interfere with the ability of shareholders to nominate and vote for trustees other than the incumbents." In response, the Court of Chancery noted that "[a]dvance notice bylaws are often construed and frequently upheld as valid by Delaware courts." Yet the Court of Chancery also warned that "when advance notice bylaws unduly restrict the stockholder franchise or are applied inequitably, they will be struck down." Nevertheless, the Court of Chancery denied the mandatory injunction on this theory of relief because the bylaws were adopted "on a 'clear day' before the proxy contest," and proof of inequitable conduct on the part of the defendants "requires more than merely laying out the timeline of Defendants' conduct and speculating about bad intent or purpose."

On appeal, the Delaware Supreme Court reversed the Court of Chancery's grant of injunctive relief. Although it agreed with the Court of Chancery's interpretation of the bylaws, the Supreme Court disagreed with that court's decision to excuse Saba's noncompliance with its "clear and unambiguous" obligation to respond to the questionnaire request before the expiration of the five-day deadline. The Supreme Court noted that it was undisputed that at least one-third of the questions included in the questionnaire were directly relevant to whether the nominees satisfied the director qualifications under the bylaws, and that the dissidents had offered no valid reason as to why they were precluded from responding to those questions by the deadline. Specifically, the Supreme Court found that Saba should have raised its questionnaire-related concerns with the trusts prior to the expiration of the deadline. The Supreme Court found that Saba's choice to "stay silent, do nothing, and let the deadline pass" undercut Saba's various challenges to the questionnaires, which the Supreme Court characterized as "after-the-fact excuses." The Supreme Court stated that "[a] rule that would permit election-contest participants to ignore a clear deadline and then, without having raised any objection, proffer after-the-fact reasons for their noncompliance with it, would create uncertainty in the electoral setting" and "could potentially frustrate the purpose of advance notice bylaws." Accordingly, the Supreme Court held that Saba's nominees were ineligible under the advance notice bylaws for failure to timely respond to the questionnaire.

Controlling Stockholder Issues

FrontFour Capital Group LLC v. Taube: Court of Chancery Enjoins Stockholder Vote Based on Inadequate Disclosures

In *FrontFour Capital Group LLC v. Taube,* 2019 WL 1313408 (Del. Ch. Mar. 11, 2019), the Delaware Court of Chancery enjoined a stockholder vote pending corrective disclosures for a proposed merger in which Sierra Income Corporation was to acquire Medley Management, Inc. and Medley Capital Corporation after determining that brothers Brook and Seth Taube were controlling stockholders and the other defendant directors of Medley Capital breached their fiduciary duties.

The Taube brothers proposed the transaction between Sierra, Medley Management, and Medley Capital in late June 2018, with a timeline to complete the transaction by August 2018. Medley Management is an asset management firm founded and majority-owned by the Taube brothers. Medley Capital and Sierra are affiliated business development corporations advised by Medley Management. The Court found that, when the transaction was proposed, Medley Management was "under enormous pressure financially" after multiple failed attempts to engage in a sale of itself. In these attempts, Medley Management secured standstill agreements from nearly 30 bidders, preventing them from proposing transactions with Medley Capital. Sierra, Medley Management, and Medley Capital each empowered separate special committees to negotiate and, if appropriate, recommend the transaction.

Medley Capital's special committee retained a financial advisor on July 11, 2018, which, in the Court's view, left Medley Capital only a few weeks to negotiate under the Taube brothers' proposed timeline. In that timeframe, Medley Capital's special committee negotiated a slightly improved deal while also securing board positions on the combined entity's board for two of the four committee members. The Medley Capital special committee was not apprised of two inbound expressions of interest for Medley Management that occurred in 2018. The Medley Capital special committee also did not run a pre-signing market check or consider any alternative transactions.

The finalized transaction, announced in early August, was structured so that Medley Management stockholders would receive cash and stock representing a 100% premium to Medley Management's trading price, while Medley Capital stockholders would receive only shares of Sierra stock providing no premium against Medley Capital's net asset value. The Medley Management senior executives would receive employment contracts, and directors of Medley Capital's board would receive both compensation for their interests in Medley Management and compensation packages.

In December 2018, Medley Capital issued a proxy statement that allegedly failed to disclose Medley Management's financial condition, the bids made for Medley Management, or the existence of the standstill agreements. After issuing the proxy statement, multiple third parties expressed interest in alternative transactions with Medley Capital. Although Medley Capital's special committee considered each bid, the Court concluded that Medley Capital's special committee did not engage with any of the third-party bidders.

In February 2019, FrontFour Capital Group LLC and FrontFour Master Fund, Ltd (together, "FrontFour"), stockholders of Medley Capital, filed expedited pre-closing litigation challenging the proposed merger as a breach of Medley Capital's directors' fiduciary duties and alleging Sierra aided and abetted those fiduciary duty breaches.

Despite owning less than 15% of Medley Capital, the Court determined that the Taube brothers exercised *de facto* control over a majority of the members of the Medley Capital special committee with respect to the proposed transaction. The Court's finding that the special committee lacked independence hinged on the following: (i) the directors received fees totaling several hundred thousand dollars and sought to remain on the board after the transaction; (ii) the directors "willfully deferred" to the Taube brothers by agreeing to the merger after only a one-month negotiating period and agreeing to deal protection measures such as a "no-shop"; and (iii) the directors allowed the Taube brothers to set the deal structure, control the flow of information, withhold information, withhold details about Medley Management's own value and the existence of offers from third parties, lock out "interlopers" through standstill agreements, impose certain restrictive deal protection provisions and an aggressive timeline, and rush the special committee's decision. The Court also observed that the board and special committee meeting minutes were not finalized until after FrontFour commenced the litigation. As a result, the Court concluded that the meeting minutes were not contemporaneous evidence of what transpired during the process and did not give the minutes any presumptive weight.

Concluding that the Taube brothers were controlling stockholders, the Court applied the entire fairness standard to the proposed transaction. With respect to the fair process prong, the Court emphasized that Medley Capital's board and special committee agreed to a deal timeline desired by Medley Management, declined to inquire meaningfully as to the value of Medley Management, failed to conduct a pre-signing market check, declined to consider alternative transactions, and were unaware of standstill agreements prohibiting third parties from proposing an alternative transaction with Medley Capital. With respect to fair price, the Court found that the deeply flawed process obscured the value of Medley Capital.

The Court also determined that the disclosures made in conjunction with the proposed transaction were deficient because they failed to disclose the process flaws identified above. The Court ultimately ruled that Medley Capital's stockholders were entitled to corrective disclosures and enjoined the stockholder vote pending issuance of such disclosures. The Court ordered that the corrective disclosures must include information about the special committee's lack of independence and the third-party expressions of interest previously undisclosed to stockholders. The Court also noted that the timing of the special committee's knowledge of the transaction's process flaws was a critical fact, as the committee was only aware of the process flaws after execution of the merger agreement.

Medley Capital's board and special committee agreed to a deal timeline desired by Medley Management, declined to inquire meaningfully as to the value of Medley Management, failed to conduct a pre-signing market check, declined to consider alternative transactions, and were unaware of standstill agreements prohibiting third parties from proposing an alternative transaction with Medley Capital.

FrontFour also sought an order imposing a "go shop" free from deal protections as a remedy for the breach of fiduciary duties. The Court held, however, that the Delaware Supreme Court's decision in *C & J Energy Services, Inc. v. City of Miami Gen. Employees. & Sanitation Employees Retirement Trust*, 107 A.3d 1049 (Del. 2014), prevented the issuance of such relief because FrontFour failed to sufficiently plead that Sierra aided and abetted the breaches of fiduciary duty. The Court could not issue an injunction that would "strip an innocent third party [i.e., Sierra] of its contractual rights" under the proposed merger agreement, and therefore Sierra was still entitled to its contractual rights, including the no-shop. The Court stated that although the most equitable relief for the stockholders would be a curative shopping process, ordering this relief would require the Court to blue-pencil Sierra's merger agreement, an action prevented under these circumstances by *C & J Energy*.

In re Pilgrim's Pride Corporation Derivative Litigation: Court of Chancery Holds Controller Implicitly Consented to Jurisdiction Where Controlled Board Adopted Forum Selection Provision

In *In re Pilgrim's Pride Corporation Derivative Litigation,* 2019 WL 1224556 (Del. Ch. Mar. 15, 2019), the Delaware Court of Chancery held that JBS S.A., the controlling stockholder of Pilgrim's Pride Corporation, implicitly consented to personal jurisdiction in Delaware when the board of directors of Pilgrim's Pride adopted a forum-selection bylaw. In addition, the Court upheld claims that directors of Pilgrim's Pride breached their fiduciary duties in connection with the acquisition of Moy Park, Ltd., another company controlled by JBS.

In June 2017, JBS, an entity organized under Brazilian law and the controlling stockholder of Pilgrim's Pride, announced that it was selling Moy Park, a wholly owned subsidiary. JBS CEO Wesley Mendonça Batista, whose family had recently pled guilty to bribery and owed a fine of approximately $3.2 billion to the Brazilian government, indicated that JBS would be interested in selling Moy Park to Pilgrim's Pride, and the parties entered into negotiations. The Pilgrim's Pride board—the majority of which were executive officers of JBS or a subsidiary of JBS—delegated complete authority to negotiate, review, evaluate, and approve an acquisition of Moy Park or any alternative thereto to a special committee of purportedly independent directors. The board also resolved not to approve or recommend any transaction unless it was first approved by the special committee.

JBS agreed to acquire Moy Park for $1.3 billion (the "Acquisition"). On September 6, 2017, the Pilgrim's Pride board approved the Acquisition solely to satisfy a requirement in a bond indenture provision that required board approval for any transaction with an affiliate in excess of $100 million. Two days later, the special committee approved the Acquisition. Notably, on the same day the special committee approved the Acquisition, the board adopted a bylaw selecting the Delaware Court of Chancery as "the sole and exclusive forum" for disputes related to the internal affairs of Pilgrim's Pride.

The plaintiffs, minority stockholders of Pilgrim's Pride, filed a derivative action against JBS challenging the fairness of the Acquisition. JBS moved to dismiss the complaint for lack of personal jurisdiction, arguing that the plaintiffs failed to allege that JBS had any ties to the state of Delaware other than its status as the controller of Pilgrim's Pride, a Delaware corporation.

JBS had implicitly consented to personal jurisdiction in Delaware because its representatives on the board adopted the forum-selection bylaw.

The Court disagreed. While acknowledging that a forum-selection bylaw will not always confer jurisdiction, the Court held that, on the facts alleged, JBS had implicitly consented to personal jurisdiction in Delaware because its representatives on the board adopted the forum-selection bylaw.

The Court based its conclusion on the following key facts. First, the Court emphasized the extent of JBS's control. At the time of the transaction and the adoption of the forum-selection bylaw, JBS controlled 78% of Pilgrim's Pride's voting power. Additionally, under the company's certificate of incorporation, JBS had the right to designate six of Pilgrim's Pride's nine directors, and JBS had filled five of these seats with executive officers of JBS or its subsidiaries.

Second, the Court found it significant that the Pilgrim's Pride board adopted the forum-selection bylaw on the same day the company approved the transaction. The Court found it reasonable to infer that the board intended the forum-selection bylaw to apply to any derivative action challenging the Acquisition. Moreover, the forum-selection bylaw selected the Delaware Court of Chancery as the sole and exclusive forum for "any action asserting a claim for breach of fiduciary duty owed by any … stockholder of the Corporation to the Corporation or the Corporation's stockholders." The Court found that JBS, as the controlling stockholder and a counterparty in the Acquisition, was "the obvious stockholder defendant" in any fiduciary duty action.

Third, the Court noted that the forum-selection bylaw did not contain any language conditioning its coverage on the existence of personal jurisdiction. Such a condition, had it been included in the forum-selection bylaw, would have been a factor counseling against implicit consent.

The Court also upheld claims that the JBS-affiliated directors breached their fiduciary duties in connection with the Acquisition. Relying on *In re Tri-Star Pictures, Inc. Litigation,* 1995 WL 106520 (Del. Ch. Mar. 1995), and its progeny, which held that a director who plays no legally significant role in the negotiation or approval of a challenged transaction may avoid liability, the JBS-affiliated directors argued that they had engaged in no actionable conduct. Acknowledging that the JBS-affiliated directors delegated complete authority to negotiate and approve the transaction to the special committee, the Court nevertheless found that the mere approval of the Acquisition to satisfy the indenture provision, which may have facilitated the Acquisition, was sufficient to implicate the JBS-affiliated directors.

The Court also considered, but did not decide, a question of first impression under Delaware law: Could approval of a controlling stockholder transaction by "enhanced-independence directors" influence the standard of review? The Court noted that the special committee directors, who could not be removed by JBS and were elected by the minority stockholders, would qualify as enhanced-independence directors, as defined by Lucian Bebchuk and Assaf Hamdani in *Independent Directors and Controlling Shareholders,* 165 U. Pa. L. Rev. 1271 (2017). Under existing law, parties can shift the burden of proving entire fairness in a controller transaction by conditioning it on the approval of a committee of independent

directors, but that approval does not change the standard of review. To obtain business judgment review under *Kahn v. M & F Worldwide Corp.,* 88 A.3d 635 (Del. 2014), a transaction must also be conditioned on the approval of a majority of the minority stockholders. But what if the transaction is approved by enhanced-independence directors, who have less reason to fear retribution by a controller? Should the standard of review become enhanced scrutiny? The Court did not answer those questions, concluding that "the current record does not provide an adequate basis for assessing the many questions of first impression raised by the enhanced-independence approach."

Olenik v. Lodzinski: Delaware Supreme Court Holds *MFW* Protections Were Too Late in Reversing Chancery Court Dismissal of Challenge to Controller Transaction

In *Olenik v. Lodzinski,* 208 A.3d 704 (Del. 2019), the Delaware Supreme Court, relying on its prior decision in *Flood v. Synutra International, Inc.,* 195 A.3d 754 (Del. 2018), held that the plaintiff pled facts supporting a reasonable inference that the conditions set forth in *Kahn v. M & F Worldwide Corp.,* 88 A.3d 635 (Del. 2014) ("*MFW*"), were not in place before substantive economic negotiations transpired in a controller-led business combination. Because *MFW*'s dual protections—a sufficiently empowered and independent special committee and a majority-of-the-minority-vote requirement—were not in place early enough in the process, the Supreme Court reversed the Court of Chancery's dismissal of the complaint.

The transaction at issue was a stock-for-stock deal between Earthstone Energy, Inc., an upstream oil and gas company that develops domestic oil and gas reserves, and Bold Energy III LLC, a private equity and venture capital firm that focuses on domestic oil and gas ventures. The Supreme Court found that both companies were controlled by EnCap Investments L.P. EnCap directly controlled Bold and indirectly controlled Earthstone through another controlled entity, Oak Valley Resources, LLC.

The concept of an Earthstone-Bold transaction first surfaced in late 2015. Frank Lodzinski, who founded Oak Valley, served as president and chief executive officer of Oak Valley and Earthstone. He saw an opportunity to combine Earthstone's cash-generating assets with Bold's undeveloped resources, so he initiated discussions with EnCap about a possible Earthstone-Bold transaction.

From November 2015 to January 2016, Lodzinski and Earthstone engaged in discussions with EnCap. EnCap provided Earthstone with Bold's marketing pitchbook and had a conference call with Earthstone to discuss a potential deal. Earthstone management also spoke with Bold's investment banker, who provided a technical overview of Bold's assets to Earthstone and EnCap, and met with three separate investment banks regarding a potential Earthstone-Bold combination.

Discussions were briefly put on hold but were restarted in April 2016, after Lodzinski provided Earthstone's board with a letter describing the transaction with Bold as a "Current Deal" and noting that Lodzinski intended to make an offer. Over the months that followed, Lodzinski led substantive financial discussions relating to the transaction between Earthstone and Bold, including discussions between Earthstone and EnCap regarding Bold's value. Earthstone also granted EnCap access to its data room, which included a combined corporate model of Earthstone and Bold and a model of Earthstone's net asset valuation.

Over a month after these valuation discussions occurred, Earthstone's two independent directors decided that the board should form a special committee to oversee the transaction and took steps in furtherance of the formation of a special committee in early July 2016, including interviewing legal and financial advisors. In the weeks that followed, before Earthstone's board formally established the special committee, substantive discussions continued regarding the transaction. And while the special committee was formally established at the end of July 2016, there was no requirement at that time that the transaction be approved by a majority of the minority stockholders.

On August 19, 2016, the special committee met to discuss the transaction and authorized Lodzinski to send an offer letter to Bold with a $325 million purchase price. That same day, Lodzinski sent a written proposal to Bold's president to acquire Bold through a private stock transaction with a face value of $325 million funded through the issuance of Earthstone common stock (the "August 19 Letter"). The August 19 Letter conditioned the transaction on approval by the special committee and a majority of the minority stockholders of Earthstone common stock. Following additional negotiations between Earthstone and Bold, the parties reached a final agreement on November 7, 2016, which reflected an equity valuation for Bold of approximately $333 million.

Nicholas Olenik, a stockholder of Earthstone, filed class and derivative claims against, among others, the Earthstone directors, EnCap, Oak Valley, and Lodzinski for breach of fiduciary duties. The complaint alleged that EnCap controlled Earthstone and Bold, and caused Earthstone stockholders to approve an unfair transaction based on a misleading proxy statement. The Court of Chancery dismissed the complaint for failing to state a claim, determining that the August 19 Letter included the dual protections required by *MFW*—approval by an independent special committee and a majority of the minority stockholders—and that the allegations were insufficient to overcome the business judgment rule.

On appeal, Olenik argued that Lodzinski and EnCap had engaged in substantive economic negotiations prior to agreeing to the *MFW* dual protections in the August 19 Letter. The defendants argued that the interactions preceding the August 19 Letter did not involve substantive economic negotiations because neither side changed its position on any issue before the August 19 Letter.

Although noting that "preliminary discussions ... do not pass the point of no return for invoking *MFW*'s protections," the Supreme Court found that the facts pled supported a reasonable inference that the preliminary discussions between the parties shifted to substantive economic negotiations before the transaction was conditioned on *MFW*'s dual protections.

First, the Court emphasized that in April 2016, months before the August 19 Letter containing the *MFW* dual protections, Lodzinski updated an analysis of Bold and intended to make an offer. Additionally, the Court noted that in his August 1, 2016 letter to the Earthstone board, Lodzinski stated that "he was 'negotiating' with Bold while the special committee and its advisors were still 'getting up to speed.'"

Second, although the Court recognized that "some of the early interactions between Earthstone and EnCap could be fairly described as preliminary discussions outside of *MFW*'s 'from the beginning' requirement," it found that the facts pled supported a reasonable inference that "the preliminary discussions transitioned to substantive economic negotiations when the parties engaged in a joint exercise to value Earthstone and Bold." In May 2016, for example, "there were multiple substantive economic communications between Earthstone and EnCap," including a presentation from Earthstone management to EnCap about the proposed deal indicating an equity valuation for Bold of approximately $305 million and a subsequent

Although noting that "preliminary discussions do not pass the point of no return for invoking *MFW*'s protections," the Supreme Court found that the preliminary discussions between the parties shifted to substantive economic negotiations before the transaction was conditioned on *MFW*'s dual protections.

presentation valuing Bold at approximately $335 million. The Court determined that, based on the facts, "it is reasonable to infer that these valuations set the field for the economic negotiations to come by fixing the range in which offers and counteroffers might be made." The Court therefore held that the complaint should not have been dismissed on *MFW* grounds.

In addition to reversing the Court of Chancery's dismissal on *MFW* grounds, the Court rejected the defendants' alternative argument that EnCap was not a controlling stockholder and therefore was not subject to entire fairness. The Court found that at the time of the substantive negotiations, EnCap owned a majority of Oak Valley's units, which in turn owned a majority of Earthstone stock. Finally, the Court affirmed the dismissal of the plaintiff's disclosure claims, explaining that the proxy did not contain any material omissions and was not required to adopt the plaintiff's characterization of the facts. The Court remanded the case for further proceedings to adjudicate the plaintiff's claim that the Earthstone-Bold combination was not entirely fair.

In re BGC Partners, Inc. Derivative Litigation: Court of Chancery Holds Longstanding Friendships, Extensive Business Connections, and Material Compensation Call Director Independence into Question

In *In re BGC Partners, Inc.*, 2019 WL 4745121 (Del. Ch. Sept. 30, 2019), the Delaware Court of Chancery declined to dismiss derivative claims challenging the fairness of a controller transaction—the acquisition of Berkeley Point Financial LLC, a private company controlled by Howard Lutnick, by BGC Partners, Inc., a public company controlled by Lutnick, for $875 million. The plaintiffs alleged that Lutnick was highly motivated to—and did—have BGC overpay for Berkeley Point because his economic interest in Berkeley Point (60%) far exceeded his economic interest in BGC (13.8%). The plaintiffs further alleged that BGC's outside directors acted in bad faith in approving the acquisition.

The plaintiffs brought three derivative claims for breach of fiduciary duty against: (i) Lutnick as a director, controlling stockholder, and officer of BGC; (ii) two entities through which Lutnick controlled BGC and Berkeley Point; and (iii) BGC's four outside directors. The defendants countered with two separate grounds for dismissal: (i) failure to make demand or plead demand futility under Chancery Court Rule 23.1, and (ii) failure to state a claim for relief against the company's outside directors who served on a special committee evaluating the proposed merger, pursuant to *In re Cornerstone Therapeutics Inc., Stockholder Litigation*.

The Court concluded that both of the grounds for dismissal failed for essentially the same reason: the complaint sufficiently alleged that the outside directors lacked independence from controller Lutnick.

In its demand futility analysis, the Court analyzed whether the complaint alleged sufficient particularized facts to create a reasonable doubt that a majority of the board in place at the time the complaint was filed were disinterested and independent. The Court determined that the demand board consisted of five directors, including Lutnick. The defendants conceded that Lutnick was interested, and the plaintiffs declined to challenge the interest or independence of one other director. Thus, the Court considered whether the plaintiffs raised a reasonable doubt as to the independence of two of the three remaining directors. The Court determined that the particularized allegations of the complaint created a reasonable doubt as to the independence of each of those three individuals.

First, the Court held that the plaintiffs had sufficiently pled that director William Moran was beholden to Lutnick. The plaintiffs alleged that the two shared a 20-year professional relationship, serving together on the boards of four Lutnick-controlled companies. Moran and Lutnick were also alleged to have deep personal connections: Moran and his wife attended public events with Lutnick, Moran's wife honored Lutnick's sister at a gala event, and Lutnick offered to arrange a private tour of London for Moran's wife and granddaughters. In

The Court emphasized the importance of a "holistic" approach in assessing director independence and was persuaded that the complaint sufficiently pled a "constellation of facts" casting reasonable doubt on the independence of each director.

addition, Moran collectively garnered $931,986 for his past five years of board service.

Second, the Court reached the same conclusion regarding director Linda Bell. The plaintiffs alleged that Bell served with Lutnick on the boards of two affiliated companies. Bell, who previously served as provost of Haverford College, and Lutnick were members of the Haverford donor society. While Bell was provost, Lutnick donated to Haverford, which, the plaintiffs alleged, benefited Bell professionally and deepened her personal relationship with Lutnick. Further, the plaintiffs alleged that Bell's board compensation—$1,206,956 over the past four years—represented over 30% of her income while she later worked at Barnard College.

Finally, the Court held that the plaintiffs sufficiently alleged that director Stephen Curwood could not objectively consider whether to sue Lutnick. The plaintiffs alleged that Curwood served with Lutnick on affiliated boards for 10 years. Curwood and Lutnick also served together on the Haverford College board of managers and the Haverford College Corporation. In addition, the Court concluded that Curwood's BGC compensation—more than $1.3 million, including $938,000 over the past five years—was material to him.

The Court emphasized the importance of a "holistic" approach in assessing director independence and was persuaded that the complaint sufficiently pled a "constellation of facts" casting reasonable doubt on the independence of each director as it pertained to the decision to bring suit against Lutnick.

The outside directors—Moran, Bell, Curwood, and John Dalton—were protected by the exculpatory provision in BGC's certificate of incorporation. Thus, under the rule articulated in *In re Cornerstone Therapeutics Inc. Stockholder Litigation,* plaintiffs bringing claims for breach of fiduciary duty against outside directors could only survive a motion to dismiss if they alleged facts supporting a rational inference that the directors harbored self-interest adverse to the stockholders' interests, acted to advance the self-interest of an interested party from whom they could not be presumed to act independently, or acted in bad faith.

Drawing on the allegations discussed above, the Court determined that the plaintiffs had pled facts supporting a rational inference that, by voting to approve the transaction, Bell, Curwood, and Moran acted to advance the self-interest of an interested party (Lutnick) from whom they could not be presumed to act independently.

The Court also held that the plaintiffs had stated a claim against Dalton. Dalton was alleged to have enjoyed a personal relationship with Lutnick spanning 20 years, including service on three affiliated boards. Further, the plaintiffs claimed that Dalton received more than $2 million for board service at BGC and affiliated companies, accounting for 40-50% of his income. These facts were sufficient to meet the pleading standard of Rule 12(b)(6). The Court noted, however, that under the heightened pleading requirements of Chancery Court Rule 23.1, these allegations would not have overcome the presumption of innocence accorded to directors of Delaware corporations under the law. (Dalton was not on the board at the time the complaint was filed, so the demand futility analysis did not require an assessment of his independence.) ■

LIMITED LIABILITY COMPANIES AND PARTNERSHIPS

Wenske v. Blue Bell Creameries, Inc.: Court of Chancery Considers Oversight Claims and Permissibility of Special Litigation Committee Where General Partner Is Deemed Conflicted, Denying Stay

In *Wenske v. Blue Bell Creameries, Inc.*, 2018 WL 3337531 (Del. Ch. July 6, 2018), the Delaware Court of Chancery denied in part and granted in part a motion to dismiss a derivative complaint brought by the plaintiffs, limited partners of Blue Bell Creameries, L.P. ("Blue Bell"), a manufacturer of ice cream products distributed throughout the southern United States. Blue Bell was managed by its general partner, Blue Bell Creameries, Inc. ("Blue Bell GP"), a wholly owned subsidiary of Blue Bell Creameries USA, Inc. ("Blue Bell USA").

As alleged in the plaintiffs' complaint, in January 2015, South Carolina state health inspectors discovered listeria bacteria in certain Blue Bell ice cream products. Shortly thereafter, the FDA and Texas and Kansas state health agencies also discovered listeria in Blue Bell products. The contamination led to at least ten people contracting listeriosis, three of whom died. Blue Bell soon shut down all of its production operations, instituted product recalls, and ceased paying distributions to its limited partners. The plaintiffs further alleged that Blue Bell failed to comply with multiple statutory, regulatory, and dairy industry standards, and failed to take any effective action to mitigate or eradicate the listeria threat.

The plaintiffs brought a derivative action on behalf of Blue Bell against Blue Bell GP, Blue Bell USA, and various directors and officers of Blue Bell GP and Blue Bell USA (the "Blue Bell Directors") alleging, among other things, that (i) Blue Bell GP breached the Blue Bell partnership agreement, (ii) Blue Bell USA and the Blue Bell Directors aided and abetted Blue Bell GP in breaching its contractual fiduciary duties under the partnership agreement, and (iii) Blue Bell USA and the Blue Bell Directors breached their common law fiduciary duties owed to Blue Bell.

The Blue Bell partnership agreement contained a provision that disclaimed Blue Bell GP's common law fiduciary duties to Blue Bell and its limited partners. It also had a separate provision requiring Blue Bell GP to use its "best efforts" to conduct Blue Bell's business "in accordance with sound business practices in the industry." The Blue Bell defendants argued, among other things, that the standard imposed by the latter provision was too indefinite to enforce in the manner sought by the plaintiffs because the partnership agreement did not provide sufficient guidance as to the meaning of the terms "best efforts," "sound business practices," and "industry." The Blue Bell defendants also argued that a contractual good faith standard of care in the partnership agreement supplanted not only common law fiduciary duties but also the supposed "best efforts" obligation in the Blue Bell partnership agreement.

The Court rejected both arguments and noted that in interpreting undefined terms in a contract, the Court may consult a dictionary when determining such terms' plain meanings. The Court concluded that "sound business practices in the industry" could be reasonably understood to encompass food safety practices prescribed by statutes, regulations, agency guidelines, and industry guidelines applicable to dairy product manufacturers. Citing precedent, the Court also noted that when provisions in a partnership agreement unconditionally eliminate all common law standards of care and fiduciary duties, they are replaced with a "contractual good faith standard of care" only where the partnership agreement does not otherwise have express standards. Here, the Blue Bell partnership agreement provided an express obligation that Blue Bell GP shall use its best efforts to conduct Blue Bell's business in accordance with sound business practices in the dairy industry. The Court concluded that the complaint sufficiently pled that Blue Bell GP breached this obligation under the partnership agreement.

The Court dismissed the aiding and abetting claim against Blue Bell USA and the Blue Bell Directors. It reiterated that Blue Bell GP's "best efforts" obligation under the partnership agreement was a purely contractual duty. The Court concluded that there could be no aiding and abetting claim because Delaware law does not recognize a claim for aiding and abetting a breach of contract.

The Court also dismissed the breach of fiduciary duty claim against Blue Bell USA and the Blue Bell Directors. The Court explained that because the partnership agreement eliminated all common law fiduciary duties owed by Blue Bell GP, neither Blue Bell USA nor the Blue Bell Directors owed fiduciary duties to Blue Bell or its limited partners. The Court further stated that there would be no such duties even if Blue Bell USA and the Blue Bell Directors exercised control over Blue Bell's property. The Court distinguished the case at bar from precedent that held that where a partnership agreement had not eliminated a general partner's fiduciary duties, the general partner's controllers could owe fiduciary duties to the limited partnership if they controlled the limited partnership's property.

In a separate decision, *Wenske v. Blue Bell Creameries, Inc.,* 214 A.3d 958 (Del. Ch. Aug. 28, 2019), the Delaware Court of Chancery considered a motion to stay this derivative action. Following the earlier decision denying in part the defendants' motion to dismiss, Blue Bell GP created a committee of its board of directors that then formed a special litigation committee (the "SLC") to manage and control Blue Bell's claims against Blue Bell GP. The SLC subsequently moved to stay the derivative action to allow it to conduct its investigation and make its determination regarding whether to pursue the derivative claims.

The Court stated that, under certain circumstances, the special litigation committee framework can serve its intended purpose in the partnership context. The Court further noted that the organizational documents of the typical limited partnership will vest the general partners with broad authority to manage and control the business and affairs of the partnership under the Delaware Revised Uniform Limited Partnership Act (DRULPA) and such authority can include the right to determine whether to prosecute derivative actions. While Section 17-403(c) of DRULPA provides that, unless otherwise restricted in the partnership agreement, the general partner can delegate management rights, the Court stated that the special litigation committee of the general partner of a limited partnership must be independent "if it is to perform its mandate properly and with binding effect."

Blue Bell GP was disabled by conflict from considering what to do with the derivative claims. As a result, the Court found Blue Bell GP's delegation of decision-making authority to the SLC unavailing because Blue Bell GP, the principal, possessed a right to control the SLC, the agent.

The Court noted that in the limited partnership context, it "does not draw a distinction between a general partner and the members of its board of directors when assessing conflicts." The "conflict analysis focuses on the general partner as an entity, rather than the individual members of its decision-making apparatus," unless the limited partnership has agreed to include features of a corporation's governance structure (e.g., if a board was elected by the limited partners and the board's members owed fiduciary duties to the limited partners).

Accordingly, the Court identified the question at issue to be whether, as a matter of law, the SLC can be deemed independent from Blue Bell GP such that it can exercise independent business judgment. Citing corporate precedent, the Court noted that this determination depends on whether the limited partnership agreement allows the entity to create a special litigation committee. The Court observed that the Blue Bell partnership agreement vested Blue Bell GP with the "exclusive right and authority to manage, conduct, control and operate [Blue Bell]'s business." The partnership agreement further authorized the general partner to appoint an agent to act as if it were the general partner.

The Court determined that Blue Bell GP was disabled by conflict from considering what to do with the derivative claims. As a result, the Court found Blue Bell GP's delegation of decision-making authority to the SLC unavailing because Blue Bell GP, the principal, possessed a right to control the SLC, the agent. The Court noted that "[a] defining feature of the principal-agent relationship is the principal's inherent control over the agent's conduct" and that "it is the existence of the right to control, not its exercise, which is decisive." The Court further reasoned that "[f]or a special litigation committee, it is precisely the lack of control by the conflicted principal over the non-conflicted principal that legitimizes the committee's creation, investigation and ultimate decision of whether *vel non* to pursue the derivative claim." The Court concluded that Blue Bell GP, as an entity, is conflicted and as a result, "[t]hat some members of its board ... might be independent is irrelevant" and that "there is no non-conflicted principal decision maker who can properly delegate management authority." As a result, the Court denied the SLC's motion to stay.

Mesirov v. Enbridge Company, Inc.: On Remand, Court of Chancery Rules Breach of Contract Claims Could Be Asserted Against Non-Party "Indemnitees"

In *Mesirov v. Enbridge Company, Inc.*, 2018 WL 4182204 (Del. Ch. Aug. 29, 2018), the latest of a long string of Delaware decisions involving Enbridge Energy, the Delaware Court of Chancery granted in part and denied in part the defendants' motion to dismiss. The Court granted, among other things, the defendants' motion seeking to dismiss the plaintiffs' fiduciary duty claims on the basis that the contractual duties set forth in the partnership agreement of Enbridge Energy Partners, L.P. ("EEP") supplanted any common law residual fiduciary duties. The Court denied, among other things, the

The Court of Chancery had dismissed the breach of contract claims against affiliates of EEP GP on the basis that these persons and entities were not parties to the EEP agreement. The Chancery Court here held that, based on guidance from the Delaware Supreme Court, this earlier decision was wrong.

defendants' motion seeking to dismiss the plaintiffs' claims for breach of contract against various affiliates of EEP's general partner ("EEP GP"), including the parent entity Enbridge, Inc. and the individual directors of EEP GP.

In an earlier stage of this litigation, the Court of Chancery had dismissed the breach of contract claims against affiliates of EEP GP on the basis that these persons and entities were not parties to the EEP agreement. The Chancery Court here held that, based on guidance from the Delaware Supreme Court, this earlier decision was wrong. The Court noted that, pursuant to the terms of the EEP partnership agreement, affiliates of EEP GP qualified as "indemnitees" under the EEP partnership agreement and that indemnitees were protected against liability if they acted in good faith. Here, given that the plaintiffs set forth well-pled allegations that the affiliates of EEP GP acted in bad faith in connection with the challenged transaction, the Court held that the plaintiffs could amend their complaint to reassert breach of contract claims against Enbridge, the directors of EEP GP, and other affiliates of EEP GP.

Oxbow Carbon & Minerals Holdings, Inc. v. Crestview-Oxbow Acquisition, LLC: Court of Chancery Invokes Implied Covenant; on Appeal, Delaware Supreme Court Reverses

In *In re Oxbow Carbon LLC Unitholder Litigation,* 2018 WL 818760 (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 controls Oxbow Carbon LLC, a Delaware limited liability company ("Oxbow"), through Oxbow Carbon & Minerals 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, which ultimately contained a provision for an exit sale that became the focus of the dispute. The Oxbow LLC 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 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." Oxbow's LLC 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.

By 2011, the C&L Members and Oxbow 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 Oxbow's LLC 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 LLC 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 LLC 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 LLC 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 LLC agreement. Here, the Court found that the admission of the Small Holders created a gap in the agreement regarding the operation of the 1.5x Clause with respect to the rights of the Small Holders.

Under the LLC 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 stated 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 LLC 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.

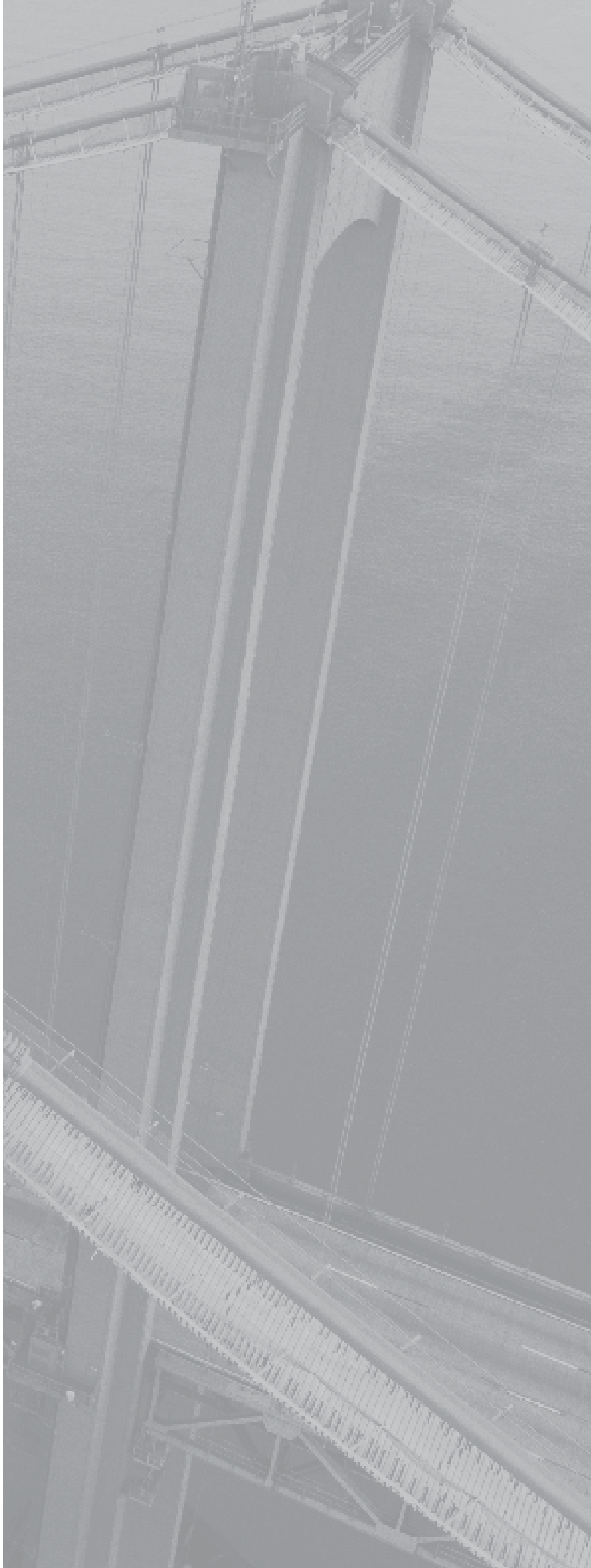
The Court found that the C&L Members would have never consented to admitting the Small Holders if they understood that they were resetting the 1.5x Clause for the new members. The Court also found that no parties would have argued for the Highest Amount Option at the time of contracting since none of 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 LLC 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 & Minerals Holdings, Inc. v. Crestview-Oxbow Acquisition, LLC,* 2019 WL 237360 (Del. Jan. 17, 2019), the Delaware Supreme Court affirmed in part and reversed in part the decision below. Most notably, the Delaware Supreme Court held that the implied covenant was inapplicable and could not be used to alter the plain reading of the Oxbow LLC agreement.

The Supreme Court agreed with the Court of Chancery that the 1.5x Clause must be applied in any exit sale to the Small Holders as members of Oxbow, 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. The Supreme Court further agreed that the LLC 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. The Supreme Court held, however, that the Court of Chancery had erred in employing the implied covenant to imply the Seller Top Off Option.

The Supreme Court noted that the Court of Chancery had repeatedly emphasized that the



Highest Amount Option was the only reading that gives meaning to the LLC agreement as a whole. The Supreme Court also found that the LLC agreement delegates responsibility to the Oxbow board to set the terms of admission of members and that the record shows that the Oxbow board admitted the Small Holders without imposing a different set of rights. Thus, it is clear that the Small Holders have the same rights as the other members. The Supreme Court stated:

> "Whatever mistake the parties subjectively made about the implications of admitting new Members does not operate to create a contractual gap."

> The crucial problem with the Court of Chancery's reasoning [for employing the implied covenant] is that it posits that a gap was created in the parties' contract because they did not give adequate attention to the effect that the admission of new Members at a higher entry price would have on the Exit Sale Right provisions of the agreement. The Court of Chancery's analysis hinged on the assumed negotiation that would have taken place between Koch and Crestview if Crestview had focused on the effect of the Small Holders' entrance on the Exit Sale Right's hurdle rate and concluded that it would have impaired Crestview's ability to force an Exit Sale.... Based on its own detailed findings, the Court of Chancery held that the parties agreed and expected that the Small Holders would be admitted as Members. As such, whatever mistake the parties subjectively made about the implications of admitting new Members does not operate to create a contractual gap.

Id. at *18.

The Supreme Court declined to apply the implied covenant here because no gap exists concerning the admission of the Small Holders, and because the admission of new members and their impact on the exit sale process could have been anticipated. *Id.* at *19. Ultimately, the Supreme Court agreed with the Court of Chancery that the Highest Amount Option is the only reading that gives effect to the Oxbow LLC agreement as a whole.

Perry v. Neupert: Court Considers Retroactive Effect of Amendment to LLC Act

In *Perry v. Neupert,* 2019 WL 719000 (Del. Ch. Feb. 15, 2019), the Delaware Court of Chancery considered the effects of an assignment of LLC interests in connection with a dispute in which the plaintiff alleged that the defendants, The BGO Foundation and Dieter Walter Neupert, had engaged in a conspiracy to seize the equity interests in Côte D'Azur Estate Corporation (formerly known as Côte D'Azur Estate LLC), a Delaware entity, which owns a villa in the south of France.

Côte D'Azur was originally formed as a member-managed Delaware limited liability company in 2001, with Israel Igo Perry as its sole member. On May 21, 2013, Israel, still the sole member of Côte D'Azur, executed a deed of assignment that stated his intention to assign all of his limited liability company interest in Côte D'Azur to The BGO Foundation. While the Court held that this assignment did not effectuate an immediate transfer of Israel's limited liability company interests in Côte D'Azur to BGO, the Court discussed, *in dicta,* how it would analyze the issue if the Côte D'Azur assignment had validly effectuated such a transfer.

The Court relied on the LLC Act as it existed on May 21, 2013, the date on which the Côte D'Azur assignment was executed, to reason that BGO would not have been validly admitted to Côte D'Azur as a member thereof even if the Côte D'Azur assignment had validly transferred the limited liability company interests in Côte D'Azur to BGO at that time. Because Côte D'Azur would have had no members as a result of such an assignment, it would have subsequently dissolved. The Court declined to retroactively apply

Section 18-704(a)(3) of the LLC Act, which was added to the LLC Act pursuant to an amendment effective August 1, 2016, to this analysis.

Section 18-704(a)(3) provides a safe harbor for situations where a sole member of a limited liability company voluntarily assigns all of its limited liability company interests to a single assignee by providing for the automatic admission of such assignee and permitting the limited liability company to continue without dissolution. The Court reasoned that while amendments to the LLC Act apply to a limited liability company regardless of whether such limited liability company is formed before or after the enactment of an amendment, amendments to the statute do not retroactively apply to alter the effects of past acts. The Court reasoned that the execution by Israel of the Côte D'Azur assignment was a past act, and the new Section 18-704(a)(3) would not retroactively apply to its effects because such effects occurred under the LLC Act as it was in effect as of the execution of the Côte D'Azur assignment. In so reasoning, the Court stated that there is no indication that Section 18-704(a)(3) of the LLC Act would apply retroactively.

While amendments to the LLC Act apply to a limited liability company regardless of whether such limited liability company is formed before or after the enactment of an amendment, amendments to the statute do not retroactively apply to alter the effects of past acts.

The Court made no mention of Section 18-1106 of the LLC Act, which contains the following language added pursuant to an amendment effective August 1, 1999: "all amendments of [the LLC Act] shall apply to limited liability companies and members and managers whether or not existing as such at the time of the enactment of any such amendment," unless otherwise stated in the LLC Act. The Delaware Senate bill enacting the LLC Act amendments effective August 1, 1999 notes that Section 18-1106 of the LLC Act was amended "to confirm the intended retroactive effect of amendments of the [LLC] Act heretofore, now and hereafter enacted."

Timothy Li v. loanDepot.com, LLC: Court Holds Statutory Protective Right Preserving Ability to Bring a Claim in Delaware Only Applies to Non-Managing Members of LLC

In *Timothy Li v. loanDepot.com, LLC,* C.A. No. 2019 WL 17926307 (Del. Ch. April 24, 2019), the Delaware Court of Chancery determined whether a mandatory forum selection clause in the limited liability company agreement of loanDepot.com, LLC was enforceable against Timothy Li, a former member and employee of loanDepot.com. Initially, loanDepot.com sued Li and then commenced arbitration proceedings against him. Li, pursuant to a provision in the loanDepot.com LLC agreement granting employees and agents of loanDepot.com a right to mandatory indemnification, brought suit against loanDepot.com seeking to enforce such rights. The company moved to dismiss the case on the grounds that the LLC agreement's forum selection clause required Li's claim to be brought in a state or federal court located in Los Angeles, California. Li, citing to Section 18-109(d) of the LLC Act, argued that he was not bound by the forum selection clause because he was a non-managing member of loanDepot.com.

The at-issue portion of Section 18-109(d) of the LLC Act provides that, with the exception of an agreement to arbitrate in a specified jurisdiction or in Delaware, a non-managing member of an LLC may not waive its right to bring or maintain a suit in Delaware with respect to matters relating to the organization or internal affairs of an LLC. Li asserted that the second sentence of Section 18-109(d) of the LLC Act protected his right to bring his claim in Delaware because he was a member of loanDepot.com at the time of the conduct giving rise to his claim. The Court held that the second sentence of Section 18-109(d) of the LLC Act, by

its terms, only extends to non-managing members of an LLC. The Court determined that Li's claim arose in his capacity as an employee or agent of loanDepot.com because Li committed the actions that gave rise to loanDepot.com's claims against Li in those capacities. Therefore, the Court found that the protections afforded in the second sentence of Section 18-109(d) preserving the rights of non-managing members to bring a claim in Delaware were not applicable here.

While not advanced by Li, the Court observed whether a policy-based argument could support preserving a Delaware forum for those with an even more attenuated relationship to the LLC agreement than non-managing members, such as employees and agents of an LLC. The Court noted that such argument would need to address the text of Section 18-109(d) of the LLC Act, which only preserves a Delaware forum for non-managing members, and case law holding that non-parties seeking rights under an agreement are required to accept the agreement as a whole, including forum selection provisions.

Freeman Family LLC v. Park Avenue Landing LLC: Court Considers Corporate Principles by Analogy in Reviewing Entitlement to Advancement Pursuant to LLC Agreement

In *Freeman Family LLC v. Park Avenue Landing LLC*, 2019 WL 1966808 (Del. Ch. Apr. 30, 2019), the Delaware Court of Chancery held that Freeman Family LLC, a non-managing member of Park Avenue Landing LLC, a Delaware limited liability company, was entitled under Park Avenue's limited liability company agreement to advancement of legal fees incurred by Freeman Family in defending a lawsuit brought against it by Hugo Neu, the managing member of Park Avenue, in New Jersey (the "New Jersey Proceeding"). The Court, analogizing to recent precedent, found that the language used in the Park Avenue LLC agreement mirrored, and thus evidenced the Park Avenue members' intent to borrow from, the provisions of the Delaware General Corporation Law providing indemnification and advancement rights to directors and officers of Delaware corporations. The Court then employed principles derived from analogous case law in the corporate context to hold that Freeman Family was entitled to advancement, which required the Court to determine that Freeman Family was acting in its "official capacity" as a member of Park Avenue in connection with the actions that formed the basis for the New Jersey Proceeding.

In conducting its analysis, the Court first examined the language of the indemnification and advancement provisions contained in Park Avenue's LLC agreement, which applied to any person involved in or made a party to any action or proceeding "by reason of" such person's status as a managing member, member, or officer of Park Avenue. Noting the similarities between the language used in the Park Avenue LLC agreement and the Delaware General Corporation Law, including the use of the "by reason of" standard, the Court dismissed Freeman Family's argument that the Court should look to the plain language of the LLC agreement in determining whether Freeman Family had demonstrated an entitlement to advancement, reasoning that the case law cited to by Freeman Family in support of its position did not preclude the Court from applying corporate principles by analogy where the Court could infer from the language of the contract that such an analogy was appropriate.

Having found that corporate principles should be employed in its analysis, the Court applied the "by reason of," or "official capacity," standard in determining whether Freeman Family qualified for advancement. This required the Court to first determine which actions comprised Freeman Family's "official capacity" with respect to Park Avenue and then to decide whether Freeman Family had acted in such capacity in committing the alleged misconduct that formed the basis for the New Jersey Proceeding. Because Freeman Family had undertaken to carry out certain responsibilities in connection with its admission as a member of Park Avenue, including seeking to acquire and develop real property on behalf of Park Avenue, the Court held that Park Avenue's desire that these matters be accomplished formed the basis for Freeman Family's admission and that actions in furtherance thereof were taken by Freeman Family in its "official capacity." The Court then found that the requisite nexus between Freeman Family's actions and the New Jersey Proceeding established where the central dispute in the New Jersey Proceeding related to the validity of Neu's exercise of a call right under the Park Avenue LLC agreement to acquire Freeman Family's interest, which right was premised upon the failure of Freeman Family to carry out the responsibilities it had undertaken in connection with its admission as a member of Park Avenue. As a result, the Court held that Freeman Family was entitled to advancement.

Leaf Invenergy Co. v. Invenergy Renewables LLC: Delaware Supreme Court Reverses Order for Nominal Expectation Damages, Awarding Contractually Stipulated Payment

In *Leaf Invenergy Company v. Invenergy Renewables LLC,* 210 A.3d 688 (Del. 2019), the Delaware Supreme Court reversed a Court of Chancery decision that awarded the plaintiff nominal damages of one dollar for the breach of a limited liability company agreement, finding that the concept of efficient breach did not insulate the defendant from a contractual damage award for its breach.

Invenergy Wind LLC, a wind energy developer, sought investors for its Series B convertible notes in 2008. Leaf Clean Energy Company, an investment fund, purchased $30 million of these notes in 2008 and 2009 through a vehicle called Leaf Invenergy Company. Under the notes agreement, upon conversion of its debt into equity, Leaf would become a signatory to the Invenergy Renewables LLC operating agreement and a member of that LLC. Under the LLC agreement, Invenergy could not undertake a significant sale of assets (a "Material Partial Sale") unless it (i) obtained the consent of Leaf, or (ii) paid Leaf a premium, calculated as a multiple of Leaf's original investment (a "Target

Multiple") at the close of such a sale. The applicable provision of the LLC agreement ("Section 8.04") read:

> Without the prior consent of ... [Leaf], [Invenergy] shall not: ... (b) participate in or permit a Material Partial Sale, unless the transaction giving rise to the Material Partial Sale yields cash proceeds equal to or greater than the amount that would provide [Leaf], as of the closing of such Material Partial Sale, with cash proceeds equal to or more than their applicable Target Multiple with such Target Multiple to be paid upon closing of the Material Partial Sale.

In 2014, Invenergy determined that the value of wind assets was rising and the time was right for an asset sale. In June 2015, Invenergy entered into exclusive negotiations with TerraForm Power, Inc. When Leaf learned of the potential asset sale, it converted its notes into equity and became a member of the LLC. In December 2015, Invenergy closed its deal with TerraForm without seeking or receiving Leaf's consent, and without paying Leaf the Target Multiple.

Leaf brought suit against Invenergy for breach of the LLC agreement in the Delaware Court of Chancery, alleging Invenergy had conducted a Material Partial Sale without receiving Leaf's consent or paying Leaf the Target Multiple. Leaf then moved for partial summary judgment, seeking payment of the Target Multiple.

The Court of Chancery found that Invenergy had breached the LLC agreement by failing to obtain Leaf's consent before entering into the transaction with TerraForm and failing to pay Leaf the Target Multiple. However, the Court of Chancery determined that a trial was necessary to determine damages.

After trial, the Court of Chancery concluded that Section 8.04 provided Invenergy with three—not two—options when considering a Material Partial Sale: (i) obtain the consent of Leaf, (ii) do not obtain the consent of Leaf but pay the Target Multiple, or (iii) do not obtain the consent of Leaf and pay expectation damages—not the Target Multiple—for failure to obtain that consent. The Court of Chancery characterized the third option as an application of the doctrine of "efficient breach," viz., that economic efficiency may be increased where a party can break a contract "if, but only if, he gains enough from the breach that he can compensate the injured party for his losses and still retain some of the benefits from the breach." The Court of Chancery held that Invenergy took the third option, and therefore "Leaf must demonstrate actual damages by showing either that it suffered harm as a result of the TerraForm Transaction or that it would have secured additional consideration given the opportunity to negotiate for its consent." In other words, the Court of Chancery read the Target Multiple provision of Section 8.04 merely as an exception to the consent provision, not as a measure of damages if consent were not obtained, and then held that Invenergy could breach Section 8.04 if it was willing to pay the damages Leaf suffered from its inability to consent to the transaction.

Efficient breach theory, the Court noted, allows a party "to refuse to perform a contract if he will still have a net gain *after he has fully compensated the injured party for the resulting loss."*

Applying its interpretation of Section 8.04 and the doctrine of efficient breach, the Court of Chancery held that Leaf failed to prove that it had suffered cognizable harm from the failure to obtain Leaf's consent because Leaf, as an investor in Invenergy, actually benefited from the asset sale, which was made at an attractive price. Indeed, the Court held that Leaf should not have withheld its consent to the value-producing transaction, an additional reason Leaf suffered no harm in having its consent right violated. Accordingly, the Court of Chancery awarded Leaf one dollar in nominal damages for the breach of the LLC agreement.

On appeal, the Delaware Supreme Court reversed the Court of Chancery's decision, finding that "all parties had contemporaneous understandings that [Section 8.04 of the LLC agreement] would require Invenergy to pay the Target Multiple to Leaf if Invenergy chose to conduct a Material Partial Sale without Leaf's consent." The Court determined that the consent provisions unambiguously required Invenergy to pay Leaf the Target Multiple if it conducted a Material Partial Sale without Leaf's consent.

The Supreme Court rejected the Court of Chancery's application of the doctrine of efficient breach to the calculation of damages. Efficient breach theory, the Court noted, allows a party "to refuse to perform a contract if he will still have a net gain *after he has fully compensated the injured party for the resulting loss."* The Court explained that the theory does not allow a breaching party to bypass a contractually stipulated determination of damages. The Court emphasized that "[c]ourts award contract damages corresponding to the degree of the injury suffered and do not increase or decrease those damages because of 'efficiency' or lack thereof."

In addition, the Court observed that a contract can specify damages outside of express liquidated damages provisions; for example, "in a sales contract in which the seller fully performs and the buyer does not pay at all, the seller is entitled to the sales price specified in the contract." The Court awarded Leaf expectation damages in the amount of the Target Multiple, a total of $126 million. ■

Recent Developments in Delaware Law

2019 Amendments to the Delaware General Corporation Law

Legislation amending the General Corporation Law of the State of Delaware (the "General Corporation Law") has been approved by the Delaware General Assembly and was signed by Delaware Governor John Carney on June 19, 2019. The 2019 amendments to the General Corporation Law, among other things, (i) add new provisions relating to the documentation of transactions and the execution and delivery of documents, including by electronic means, and make conforming changes to existing provisions; (ii) significantly revise the default provisions applicable to notices to stockholders under the General Corporation Law, the certificate of incorporation, or the bylaws, including by providing that notices may be delivered by electronic mail, except to stockholders who expressly "opt out" of receiving notice by electronic mail; (iii) consistent with the foregoing, update the provisions governing notices of appraisal rights and demands for appraisal; (iv) update the procedures applicable to stockholder consents delivered by means of electronic transmission; (v) clarify the time at which a unanimous consent of directors in lieu of a meeting becomes effective; and (vi) make various other technical changes, including with respect to incorporator consents and the resignation of registered agents.

The 2019 amendments (other than the amendments to Section 262 (appraisal rights)) became effective on August 1, 2019, and the amendments to Section 262 are effective with respect to a merger or consolidation consummated pursuant to an agreement of merger or consolidation entered into on or after August 1, 2019.

Document Forms, Including Electronic Signatures and Delivery

Although the General Corporation Law has for years included provisions relating to the execution and delivery of consents, notices, and other instruments by means of electronic transmission, it does not currently address in a comprehensive manner the form and effect of electronic signatures, or delivery by electronic means. Instead, key provisions of the General Corporation Law governing notices and consents contain individual provisions governing the form and effect of "electronic transmissions," with Delaware's version of the Uniform Electronic Transactions Act expressly providing that it does not apply to a transaction to the extent it is governed by the General Corporation Law.

General Application: The "Safe Harbor" Provision

The 2019 amendments change numerous sections of the General Corporation Law to address comprehensively the documentation of acts or transactions through electronic means, as well as the execution and delivery of documents through the use of electronic signatures and by electronic transmission. The linchpin of these changes is new Section 116. Section 116(a) provides that, except as otherwise expressly provided in Section 116(b), any act or transaction contemplated or governed by the General Corporation Law or the certificate of incorporation or bylaws may be provided for in a "document," and an electronic transmission will be deemed the equivalent of a written document. The term "document" is defined in Section 116(a) to mean any tangible medium on which information is inscribed, and includes handwritten, typed, printed, or similar instruments, and copies of those instruments, and an electronic transmission. The term "electronic transmission," which is defined in Section 232 of the General Corporation Law, continues to mean any form of communication, not directly involving the physical transmission of paper, including the use of, or participation in, one or more electronic networks or databases, including one or more distributed electronic networks or databases, that creates a record that may be retained, retrieved, and reviewed by a recipient thereof, and that may be directly reproduced in paper form by such a recipient through an automated process.

Section 116(a) provides that whenever the General Corporation Law or the certificate of incorporation or bylaws requires or permits a signature, the signature may be a manual, facsimile, conformed, or "electronic signature," which is defined to mean an electronic symbol or process that is attached to, or logically associated with, a document and executed or adopted by a person with an intent to authenticate or adopt the document. Thus, a wide variety of corporate documents, including merger agreements, voting agreements, and other documents contemplated by the General Corporation Law, may be executed by means of electronic signatures, such as DocuSign®.

Section 116(a) further provides that, unless otherwise agreed between the sender and recipient, an electronic transmission will be deemed delivered to a person for purposes of the General Corporation Law and the certificate of incorporation and bylaws at the time it enters an information-processing system that the person has designated for the purpose of receiving electronic transmissions of the type delivered, so long as the electronic transmission is in a form capable of being processed by that system and the person is able to retrieve the electronic transmission. Section 116(a) provides guidance on the issue of whether a person has so designated such a system, stating that the question will be governed by the certificate of incorporation or bylaws or from the context and surrounding circumstances, including the parties' conduct. Thus, the prior use of electronic mail between or among specified parties may supply evidence that the parties have made the designation required by Section 116(a).

Section 116(a) sets forth nonexclusive means of reducing specified acts or transactions to a written or electronic document, as well as means of executing and delivering documents manually or electronically. It states that the General Corporation Law shall not prohibit one or more persons from conducting a transaction in accordance with Delaware's Uniform Electronic Transactions Act so long as the part or parts of the transaction that are governed by the General Corporation Law are documented, signed, and delivered in accordance with Section 116(a) or the other relevant provisions of the General Corporation Law. Thus, to the extent Delaware's Uniform Electronic Transactions Act does not apply to a transaction because the transaction is governed by the General Corporation Law, the parties to the transaction can satisfy the requirements of the General Corporation Law by complying with Section 116(a).

The "safe harbor" provisions in Section 116(a) apply solely for purposes of determining whether an act or transaction has been documented, and whether a document has been signed and delivered, in accordance with the General Corporation Law and the corporation's certificate of incorporation and bylaws. As its application is limited to the General Corporation Law and the corporation's certificate of incorporation and bylaws, Section 116(a) does not preempt any applicable statute of frauds, nor does it override any other applicable law requiring actions to be documented, or signed and delivered, in a specified manner.

Specific Exclusions from the "Safe Harbor"

Section 116(b) sets forth the actions and documents to which Section 116(a) will not apply. The items excluded from the scope of Section 116(a) consist primarily of those that are governed by other provisions of the General Corporation Law that already address electronic signature or transmission. Thus, Section 116(b) provides that Section 116(a) does not apply to the following:

- Documents filed with or submitted to the Delaware Secretary of State, which continue to be governed by Section 103(h), which will continue to provide that any signature on an instrument authorized to be filed with the Delaware Secretary of State under the General Corporation Law may be a facsimile, a conformed signature, or an electronically transmitted signature;
- Documents filed with or submitted to the Register in Chancery, or a court or other judicial or governmental body—all of which must be filed or submitted under the rules or procedures adopted by such courts or other judicial or governmental bodies;
- A document comprising part of the stock ledger;
- Any certificate representing a security;
- Any document expressly referenced as a notice by the General Corporation Law, the certificate of incorporation, or the bylaws, which matters are governed by other provisions of the General Corporation Law, including, in the case of notices to stockholders, Section 232, and the certificate of incorporation and bylaws;
- Any document expressly referenced as a waiver of notice by the General Corporation Law, Section 229 of which already permits directors and stockholders to give waivers by electronic transmission;
- Consents by directors in lieu of a meeting, which are governed by Section 141(f), which already provides for consents delivered by electronic transmission;
- Consents of stockholders, which are governed by Section 228, which currently provides for the delivery of consents by electronic transmission and is the subject of amendments summarized below;
- Consents of incorporators, which are governed by Section 108, which is also the subject of amendments summarized below;
- Ballots to vote on actions at a meeting of stockholders;
- Acts effected pursuant to Section 280 of the General Corporation Law, which sets forth the procedures for giving notice to claimants and other matters in connection with a so-called "long-form" dissolution;
- Any acts or transactions effected pursuant to subchapter III of the General Corporation Law, which contains the provisions addressing the requirement to maintain a registered office in the State of Delaware and includes the principal provisions governing registered agents as well as notices between the corporation and its registered agent;
- Any acts or transactions effected pursuant to subchapter XIII of the General Corporation Law, which deals with suits against corporations, directors, officers, or stockholders, including the means of serving process on corporations; and
- Any acts or transactions effected pursuant to subchapter XVI of the General Corporation Law, which deals with foreign corporations, including

the requirements of foreign corporations to qualify to do business in the State of Delaware.

Although Section 116(b) excludes the foregoing matters from the automatic operation of Section 116(a), the statute expressly states that the exclusion shall not create any presumption regarding the lawful means of documenting a matter governed by Section 116(b) or the lawful means of signing or delivering a document addressed by Section 116(b). Accordingly, the mere inclusion of any item in Section 116(b)'s "excluded items list" should not, in and of itself, be deemed to create a negative implication that the item may not otherwise be validly executed, delivered, or authenticated through electronic means, including DocuSign®. Indeed, many of the instruments in the "excluded items list" are currently executed and delivered, and will continue to be permitted to be executed and delivered, through electronic means.

Section 116(b) also states that no provision of the certificate of incorporation or bylaws shall limit the application of Section 116(a), unless the provision expressly restricts one or more of the means of documenting an act or transaction, or of signing or delivering a document, permitted by that subsection. Thus, a corporation may, through the adoption of an express provision in its certificate of incorporation or bylaws, restrict the application and use of Section 116(a). Any such provision, however, must clearly and expressly restrict the use of electronic signatures and electronic transmissions for documenting an act or transaction or signing and delivering any document. Thus, provisions in certificates of incorporation or bylaws stating that a particular act or transaction must be "signed" or "in writing," as well as provisions stating that documents must be manually delivered, sent, or given, will not, in and of themselves, be sufficient to limit the application of Section 116(a). Unless a corporation desires to limit the application of Section 116(a), it will not in most cases be required to amend its certificate of incorporation or bylaws to allow for the documentation by electronic means of acts or transactions covered by that subsection, nor for the signing or delivery of documents falling within its scope.

Interplay with the Federal E-Sign Act

Finally, Section 116(c) addresses the interaction between the provisions of the General Corporation Law and the U.S. federal Electronic Signatures in Global and National Commerce Act (the "E-Sign Act"). In general, the E-Sign Act provides that, with respect to a transaction in or affecting interstate or foreign commerce (and subject to specified exceptions and limitations), a signature, contract, or other record relating to the transaction may not be denied legal effect, validity, or enforceability solely because it is in electronic form, and a contract relating to such transaction may not be denied legal effect, validity, or enforceability solely because an electronic signature or electronic record was used in its formation. Section 116(c) states that if any provision of the General Corporation Law is deemed to modify, limit, or supersede the E-Sign Act, the provisions of the General Corporation Law will control to the fullest extent permitted by Section 7002(a)(2) thereof. Section 7002(a)(2) of the E-Sign Act provides:

> A State statute, regulation, or other rule of law may modify, limit, or supersede the provisions of section 7001 of [the E-sign Act] with respect to State law only if such statute, regulation, or rule of law ... specifies the alternative procedures or requirements for the use or acceptance (or both) of electronic records or electronic signatures to establish the legal effect, validity, or enforceability of contracts or other records, if (A) (i) such alternative procedures or requirements are consistent with [subchapters I and II of the E-Sign Act]; and (ii) such alternative procedures or requirements do not require, or accord greater legal status or effect to, the implementation or application of a specific technology or technical specification for performing the functions of creating, storing, generating, receiving, communicating, or authenticating electronic records or electronic signatures; and (B) if enacted or adopted after June 30, 2000, makes specific reference to [the E-Sign Act].

Thus, Section 116(c) provides express evidence of the intent to allow the General Corporation

Law to govern the documentation of actions, and the signature and delivery of documents, to the fullest extent the General Corporation Law is not preempted by the E-Sign Act.

Ancillary Amendments

The 2019 amendments also effect changes to Section 212(c) (which deals with the manner in which a stockholder may authorize another person to act as its proxy) and Section 212(d) (which generally provides that copies of proxies may be substituted for an original) to conform to Section 116(a). Specifically, Section 212(c)(1), which provided that a stockholder may execute a "writing" authorizing another person or persons to act for such stockholder as proxy and provides that execution of the proxy may be accomplished by the stockholder (or authorized officer, director, employee, or agent "signing such writing or causing such person's signature to be affixed to such writing by any reasonable means, including, but not limited to, by facsimile signature"), was amended to provide simply that a stockholder may execute a "document" granting such authorization, thus confirming that a proxy may be documented, executed, and delivered in accordance with Section 116(a). Section 212(c)(2) was also amended to eliminate references to the transmission of proxy by "telegram" or "cablegram," opting instead for "electronic transmission," a broader term that would include telegrams and cablegrams in the unlikely event those means of proxy transmission are deployed. Similarly, Section 212(d) was amended to replace the reference to copies or reproductions of the "writing" granting a proxy with a reference to the "document" and to eliminate the specific references to telegrams and cablegrams, opting again to use the broader concept of "electronic transmission."

In addition, Sections 251(b) (merger or consolidation of Delaware stock corporations) and 255(b) (merger or consolidation of Delaware nonstock corporations) were amended to permit any authorized person to execute an agreement of merger or consolidation, except that any agreement filed with the Secretary of State must be executed by a person, and in the manner, authorized by Section 103. The changes are unlikely to have significant practical effect, given that certificates of merger or consolidation (as opposed to agreements of merger or consolidation) are frequently filed.

Notices

Along with the amendments dealing with the documentation of transactions and execution and delivery of documents (including through the use of electronic signatures and electronic transmissions), the 2019 amendments include significant revisions to the provisions of the General Corporation Law dealing with the form and manner of notices to stockholders.

Default Delivery of Notices

Section 232, which addresses notice by electronic transmission, was substantially revised to set forth the statutory defaults for notices to stockholders. Section 232(a), as amended, provides that, without limiting the manner in which they may otherwise be effectively given, notices to stockholders may be given by (i) U.S. mail, postage prepaid, (ii) courier service, or (iii) electronic mail. Section 232(a) further specifies the time at which notices are given, providing that, if mailed, a notice is given when deposited in the U.S. mail, postage prepaid (thus preserving the concept that appeared in Section 222(b) prior to the 2019 amendments, which was amended to eliminate that provision, as it would have been redundant); if delivered by courier service, the notice is given at the earlier of the time it is received or left at the stockholder's address; and if given by electronic mail, the notice is given at the time it is directed to the stockholder's electronic mail address.

Additional Provisions Applicable to Notices by Electronic Mail

Since 2000, Section 232(a) has permitted notices to stockholders to be given by means of "electronic transmission," defined broadly to include electronic mail. Section 232(b), however, has since that time provided that notice given by electronic mail will be deemed given only when directed to an electronic mail address at which the stockholder has consented to receive notice. As the initial set of amendments allowing for notices by electronic transmission were adopted in 2000, at a time when electronic mail was not nearly as ubiquitous, the consent requirement was intended as a means of protecting stockholders. The requirement to obtain such consent from stockholders has in many cases limited the usefulness of notice by electronic mail, with corporations effectively being forced to give notices by traditional means, even in cases where they have valid electronic mail addresses for their entire stockholder base. As revised by the 2019 amendments, Section 232(a) reverses the statutory default as it relates to notices to stockholders by electronic mail.

Despite the change in the statutory default, revised Section 232 contains several provisions governing the validity of notice by electronic mail. First, while notices to stockholders by electronic mail generally will become effective when directed to the stockholder's electronic mail address, they will not be effective as to any stockholder that has notified the corporation in writing or by electronic transmission of an objection to receiving notice by electronic mail. Second, any notice given by electronic mail must include a prominent legend that the communication is an important notice regarding the corporation. Third, Section 232(a) will not affect, limit, eliminate, or override the application of any other law, rule, or regulation applicable to a corporation or by which such corporation or its securities may be bound. Thus, for example, public companies will remain subject to the obligations under Regulation 14A or Regulation 14C promulgated under the Securities Exchange Act of 1934 and will accordingly be unable to send notices thereunder by electronic mail.

Revised Section 232 expressly defines the terms "electronic mail" and "electronic mail address" based on similar terms defined in the Controlling the Assault of Non-Solicited Pornography and Marketing (CAN-SPAM) Act of 2003. As so defined, the term "electronic mail" means an electronic transmission directed to a unique electronic mail address, and is deemed to include any files attached to it as well as any information hyperlinked to a website, but only if the electronic mail itself includes the

contact information of an officer or agent of the corporation who is available to assist with accessing the files and information. Given that many notices to stockholders are likely to include attachments—for example, a consent solicitation statement, form of written consent, or notice of merger and appraisal—corporations will need to ensure that they provide, in the body of the electronic mail, the contact information for the corporate secretary or other officer or agent of the corporation who can assist stockholders with accessing the files. The term "electronic mail address" is defined to mean a destination, commonly expressed as a string of characters, consisting of a unique user name or mailbox and a reference to an internet domain, to which electronic mail can be sent or delivered. Finally, revised Section 232 provides that a notice may not be given by an electronic transmission (including any electronic mail) from and after the time that the corporation is unable to deliver by such electronic transmission two consecutive notices and the inability becomes known to the secretary, assistant secretary, transfer agent, or other person responsible for giving the notice (although the inadvertent failure to discover the inability will not invalidate any meeting or other action).

Section 232(a), as amended, sets forth the statutorily recognized means of providing notice to stockholders; it applies not only to meetings of stockholders, but to any notice required to be given to stockholders under the General Corporation Law or the corporation's certificate of incorporation or bylaws. Thus, under revised Section 232(a), a corporation will be able to give all types of notices required under the General Corporation Law or its certificate of incorporation and bylaws, including notices of meetings, notices of actions by written consent of stockholders in lieu of a meeting, and notices of appraisal rights, by electronic mail. As noted in the synopsis to the legislation containing the 2019 amendments, "Section 232(a) applies to any notice that is required to be given under [the General Corporation Law] or under the certificate of incorporation or bylaws" and accordingly, "no provision of the certificate of incorporation or bylaws (including any provision requiring notice to be in writing or mailed) may prohibit the corporation from giving notice in the form, or delivering notice in the manner, permitted by Section 232(a)." Thus, while it is often advisable for corporations to review their certificates of incorporation and bylaws periodically to ensure they are current, they will not be precluded from taking advantage of the means of giving notice set forth in Section 232(a). Thus, existing provisions of a corporation's certificate of incorporation or bylaws that require, for example, that notices to stockholders be given in writing or delivered by U.S. mail will not override the statutory provisions allowing for notice to be given by courier or electronic mail in accordance with Section 232.

Other Changes

New Section 232(c) (which substantially incorporates the provisions that were formerly set forth in Section 232(b)) provides the three other means of giving notice by electronic transmission: facsimile telecommunication, posting on an electronic network (with separate notice of the posting), and other forms of electronic transmission. In the case of a facsimile notice, the notice is deemed given when directed to a number at which the stockholder has consented to receive notice; in the case of a posting on an electronic network, the notice is given upon the later of the posting and the giving of the separate notice to the stockholder of the posting; and if given by other means of electronic transmission, the notice is deemed given when directed to the stockholder.

Lastly, new Section 232(f) of the General Corporation Law includes provisions (similar to the provisions formerly in Section 222(b) and Section 232(b)) for transmittal affidavits that serve as prima facie evidence that notice has been given to stockholders. Section 232(g) (formerly designated as Section 232(e)) identifies certain types of notices that must continue to be given in the manner specified by those provisions addressed in Section 232(g).

Ancillary Provisions

Section 160(d), which formerly generally provided that shares called for redemption will not be deemed outstanding for purposes of quorum and voting after "written" notice has been sent to stockholders and a sum sufficient to pay the redemption price has been irrevocably deposited or set aside, was amended to eliminate the requirement of a "written" notice, thus clarifying that such notice may be given in the form and manner provided in revised Section 232. Section 163, which formerly generally required notices to be given with respect to partly paid shares, was similarly amended to clarify that such notices may be given in the manner and form provided in revised Section 232.

The 2019 amendments also amend Section 230 of the General Corporation Law, which sets forth the exceptions to the requirement to provide notice. In general, Section 230(b)(1) of the General Corporation Law eliminates the requirement to give notice to any stockholder to whom notice of two consecutive annual meetings, and all notices of meetings or of the taking of action by written consent without a meeting to such stockholder during the period between such two consecutive meetings, have been returned as undeliverable. Section 230(c) previously rendered Section 230(b)(1)'s exception to the requirement to give notice inapplicable to any notice if the notice was given by electronic transmission. The 2019 amendments add a new sentence to Section 230(c) to provide that Section 230(b)(1)'s exception shall not be applicable to any stockholder whose electronic mail address appears on the records of the corporation and to whom notice is not prohibited by Section 232. Thus, if a corporation has an electronic mail address for a stockholder and notice to such stockholder by electronic mail is not prohibited under Section 232, then the corporation will not be relieved of the obligation to send that stockholder notices pursuant to the "returned mail exception" in Section 230(b)(1).

The 2019 amendments also amend Sections 251 (merger or consolidation of Delaware stock corporations), 253 (short-form merger of corporations), 255 (merger or consolidation of Delaware nonstock corporations), 266 (conversion of Delaware corporations to other entities), 275 (dissolution), and 390 (transfer, domestication, or continuance of Delaware corporations) to provide that the notices required thereunder may be "given," rather than mailed, thereby clarifying that such notices may be provided in the form, and delivered in the manner, permitted by Section 232, as revised.

Appraisal Rights

The 2019 amendments make several technical changes to Section 262(d), which sets forth the provisions for notices to stockholders in circumstances where they are entitled to appraisal rights, to clarify such notice provisions and conform them to amended Section 232(a). The amendments to Section 262(d) permit a corporation to deliver a notice of appraisal rights by courier or electronic mail (in addition to by U.S. mail). In addition, Section 262(d) was amended to permit stockholders to deliver demands for appraisal by electronic transmission. The corporation, however, is only required to receive such demands if it has expressly designated, in the notice of appraisal rights, an information-processing system for receipt of electronic delivery of demands. Thus, a corporation that desires to receive appraisal demands by, for example, electronic mail would need to provide expressly in the appraisal notice that such demands may be delivered to a specified electronic mail address. Similarly, Section 262(e), which requires the provision of specified information regarding the statement of the number of shares and holders entitled to appraisal, was amended to clarify that the information may be given in any manner permitted by Section 232(a). As indicated above, the foregoing amendments to Section 262 are effective with respect to a merger or consolidation consummated pursuant to an agreement of merger or consolidation entered into on or after August 1, 2019.

Stockholder Consents

As part of the overall update to the provisions of the General Corporation Law dealing with electronic signatures and electronic transmissions, the 2019 amendments effect several changes to Section 228(d), which governs the manner and circumstances under which stockholder consents may be delivered through electronic means. In 2000, Section 228(d) was amended to provide that a “telegram, cablegram or other electronic transmission consenting to an action to be taken and transmitted” by a stockholder or proxy holders (or authorized agent) “shall be deemed to be written, signed and dated” for purposes of Section 228, provided that the telegram, cablegram, or other electronic transmission sets forth or is delivered with information from which the corporation can determine (x) that it was transmitted by the stockholder, proxyholder, or authorized agent, and (y) the date on which the stockholder, proxyholder, or agent transmitted it. Nevertheless, while the amendments to Section 228 adopted in 2000 essentially allowed for electronic transmissions to be used in connection with consent solicitations, subject to certain procedural requirements, they also specified that, unless the board of directors otherwise provides, consents delivered by electronic transmission may not be given directly to the corporation or its registered agent. Thus, Section 228(d)(1), as enacted in 2000 and in effect prior to the 2019 amendments, required that, unless the board otherwise provided, stockholder consents delivered by electronic transmission must first be reduced to paper form and delivered in such paper form to the corporation’s registered office in Delaware, to its principal place of business, or to an officer having custody of its books. Thus, former Section 228(d)(1), by default, contemplated a consent solicitation in which stockholders provide consents by electronic transmission to an agent, which agent then reduces the consents to paper form and delivers them to the corporation as required by the statute, with the statutorily specified information.

The 2019 amendments overhaul the basic regime governing stockholder consents delivered by electronic transmission. First, as with other provisions of the General Corporation Law, the 2019 amendments eliminate references to consents given by telegram and cablegram, using instead only the term “electronic transmission.” Next, the 2019 amendments replace the provisions of Section 228(d)(1) requiring that, unless otherwise provided by the board, consents given by electronic means be reduced to paper form and delivered through traditional means with provisions that expressly allow for the delivery of consents by electronic transmission. Specifically, the 2019 amendments amend Section 228(d)(1) to provide that a consent given by electronic transmission is delivered upon the earliest of (i) the time the consent enters an information-processing system designated by the corporation for receiving consents (so long as the transmission is capable of being processed by the system and the corporation is able to retrieve it); (ii) the time at which a paper reproduction of the consent is delivered to the corporation’s principal place of business or the appropriate officer or agent; (iii) the time at which a paper reproduction is delivered, by hand or certified or registered mail, to the corporation’s registered agent in Delaware; or (iv) the time at which it is delivered in any other manner authorized by the board.

As with Section 116, for purposes of determining whether the corporation has “designated” an information-processing system for the receipt of consents, revised Section 228(d)(1) looks to the certificate of incorporation, the bylaws, or the context and surrounding circumstances, including the corporation’s conduct. In addition, revised Section 228(d)(1) expressly provides that a consent is delivered even if no person is aware of its receipt. Thus, for example, no party will be able to disclaim the validity of a consent validly transmitted to the corporation’s information-processing system by electronic transmission on the grounds that the corporation had failed to open the electronic mail or other transmission. Moreover, the receipt of an electronic acknowledgment from an information-processing system will establish that a consent was received, although it would not, in and of itself, establish that the content corresponds to the content received.

Director Consents

The 2019 amendments revise Section 141(f) of the General Corporation Law, which deals with director action by consent in lieu of a meeting, to clarify that the filing of the consent (whether in writing or by electronic transmission) to action by the board or any committee is not a condition precedent to the effectiveness of the action. Section 141(f) formerly provided that, unless restricted by the certificate of incorporation or bylaws, any action required or permitted to be taken at a meeting of the board or any committee may be taken without a meeting if all members of the board or committee consent thereto in writing, or by electronic transmission, and the writing(s) or electronic transmissions are filed with the minutes of the proceedings of the board or committee. In practice, consents may be obtained from directors—and delivered to the corporation's secretary or outside counsel—and the action may be considered duly authorized before the consents are physically placed with the minute book. To avoid the implication that an action taken by unanimous consent of directors in lieu of a meeting does not become effective until such time as the relevant instruments are so placed with the minute book, the 2019 amendments remove from the first sentence of Section 141(f) the requirement that the consents or electronic transmissions be filed with the minutes of the proceedings of the board or committee. The 2019 amendments add to the end of Section 141(f) a requirement that "[a]fter an action is taken, the consent or consents relating thereto shall be filed with the minutes of the proceedings of the board of directors, or the committee thereof, in the same paper or electronic form as the minutes are maintained." As the amendments to Section 141(f) are clarifying in nature, they should not, by negative implication or otherwise, give rise to questions regarding the timing of the effectiveness of actions taken by unanimous consent of directors before their adoption.

Incorporator Consents

Section 108(b) of the General Corporation Law, which deals with the principal matters within the power of incorporators (generally, the power to elect the initial board of directors and adopt the initial bylaws), was amended to clarify that notice of an initial organization meeting may be given in writing or by electronic transmission. The 2019 amendments also eliminate from Section 108(b) the express requirement that a waiver of that notice be signed. Instead, any such waiver may be given in the manner provided by Section 229, which permits waivers in writing and by electronic transmission.

Finally, consistent with the 2014 amendments to Section 141(f) allowing for director consents to become effective at a future date, Section 108(c) was amended to clarify that a consent of incorporator may become effective in the future in the same manner that a consent of directors may become effective.

Registered Agent Resignation; Revival of Certificate of Incorporation of Exempt Corporations

The 2019 amendments amend Section 136(a) to permit the registered agent of a Delaware corporation, including a corporation that has become void pursuant to Section 510 of Title 8 of the Delaware Code, to resign by filing a certificate of resignation. The amendments to Section 136(a) also require the certificate to include the last known information for a communications contact provided to the resigning registered agent. The communications contact information will not be deemed public, and falls within the exception set forth in Section 10002(l)(6) of Title 29 of the Delaware Code to the definition of "public record" for purposes of the Freedom of Information Act.

In addition, the 2019 amendments revise Section 313(a) of the General Corporation Law, which deals with the revival of exempt corporations, to provide that Section 313 applies to an exempt corporation whose certificate of incorporation or charter has become forfeited pursuant to Section 136(b) for failure to obtain a registered agent. ■

2019 Amendments to the Delaware LLC and Partnership Acts

Legislation amending the Delaware Limited Liability Company Act (LLC Act), the Delaware Revised Uniform Limited Partnership Act (LP Act), and the Delaware Revised Uniform Partnership Act (GP Act) (collectively, the LLC and Partnership 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), Delaware limited partnerships (Delaware LPs), and Delaware general partnerships (Delaware GPs), including amendments (i) relating to document forms, including electronic signatures and delivery, (ii) enabling a Delaware LP to divide into two or more Delaware LPs as a new permitted form of Delaware LP reorganization (LP Division), (iii) providing for the formation of statutory public benefit Delaware LPs (Statutory Public Benefit LPs), (iv) authorizing the creation of a new type of Delaware LP series known as a "registered series" (LP Series), (v) providing specific statutory authority for the use of networks of electronic databases (including blockchain and distributed ledgers) by Delaware GPs, and (vi) confirming the availability of contractual appraisal rights in connection with certain transactions involving Delaware LLCs and Delaware LPs. All of the amendments became effective on August 1, 2019.

The amendments to the LP Act described herein relating to LP Division, Statutory Public Benefit LPs, and LP Series are substantially similar to the legislation enacted in 2018 that amended the LLC Act to (i) enable a Delaware LLC to divide into two or more Delaware LLCs as a new permitted form of Delaware LLC reorganization, (ii) provide for the formation of statutory public benefit Delaware LLCs, and (iii) authorize the creation of a new type of Delaware LLC series known as a "registered series."

Further, the amendments to the GP Act related to providing specific statutory authority for the use by Delaware GPs of networks of electronic databases (including blockchain and distributed ledgers) are substantially similar to the amendments enacted in 2018 with respect to Delaware LLCs and Delaware LPs that provide specific statutory authority for the use of such networks and databases by Delaware LLCs and Delaware LPs.

Document Forms, Including Electronic Signatures and Delivery

The amendments to the LLC and Partnership Acts include the addition of provisions relating to the execution of documents by electronic signature and delivery of documents by electronic transmission. These electronic signature and delivery provisions explicitly state that any act or transaction contemplated or governed by the LLC and Partnership Acts or a limited liability company or partnership agreement may be provided for in a document, and an electronic transmission will be deemed the equivalent of a written document. The term "document" is defined to mean "(i) any tangible medium on which information is inscribed, and includes handwritten, typed, printed or similar instruments, and copies of such instruments and (ii) an electronic transmission." The term "electronic transmission" is defined as "any form of communication not directly involving the physical transmission of paper, including the use of, or participation in, 1 or more electronic networks or databases (including 1 or more distributed electronic networks or databases), that creates a record that may be retained, retrieved and reviewed by a recipient thereof and that may be directly reproduced in paper form by such a recipient through an automated process."

Whenever the LLC and Partnership Acts or a limited liability company or partnership agreement require or permit a signature, an electronic signature will be a permissible mode of executing a document. An electronic signature is defined as an "electronic symbol or process that is attached to, or logically associated with, a document and executed or adopted by a person with an intent to authenticate or adopt the document."

The new electronic signature and delivery provisions further provide that, unless otherwise provided in a limited liability company or partnership agreement or agreed to between the sender and recipient, an electronic transmission is delivered to a person at the time it enters an information-processing system that the person has designated for the purpose of receiving electronic transmissions of the type delivered, so long as the electronic transmission is in a form capable of being processed by that system and the person is able to retrieve it.

The electronic signature and delivery provisions establish nonexclusive safe harbor methods of reducing specified acts or transactions to a written or electronic document and executing and delivering a document manually or electronically. The electronic signature and delivery provisions do not prohibit one or more persons from conducting a transaction in accordance with Delaware's Uniform Electronic Transactions Act, so long as the part or parts of the transaction that are governed by the LLC and Partnership Acts are documented, signed, and delivered in accordance with the applicable electronic signature and delivery provisions or other relevant provisions of the LLC and Partnership Acts. Further, the safe harbor methods provided for in the electronic signature and delivery provisions apply solely for purposes of determining whether an act or transaction has been documented, and whether the document has been signed and delivered, in accordance with the LLC and Partnership Acts and a limited liability company or partnership agreement. As application of the electronic signature and delivery provisions is limited specifically to the LLC and Partnership Acts and a limited liability company or partnership agreement, the provisions do not preempt any statute of frauds or other applicable law that might require that actions be documented or documents be signed and delivered in a specified manner.

The electronic signature and delivery provisions set forth certain documents and actions that are not governed thereby, including (i) a document filed with or submitted to the Delaware Secretary of State, the Register in Chancery, or a court or other judicial or governmental body of the State of Delaware, (ii) a certificate of limited liability company interest or partnership interest, and (iii) an act or transaction effected pursuant to the respective provisions of the LLC and Partnership Acts relating to the requirement to maintain a registered office and registered agent in the State of Delaware, service of process, foreign entities, or derivative actions. The electronic signature and delivery provisions expressly state that the foregoing shall not create any presumption regarding the lawful means to document a matter, or sign or deliver a document, addressed by these excluded items. Further, the electronic signature and delivery provisions state that no provision of a limited liability company or partnership agreement shall limit the application of the electronic signature and delivery provisions, unless such provision expressly restricts one or more of the means of documenting an act or transaction, or of signing or delivering a document, permitted by the electronic signature and delivery provisions.

Finally, the electronic signature and delivery provisions address the interaction between the LLC and Partnership Acts and the U.S. federal Electronic Signatures in Global and National Commerce Act (E-Sign Act). In general, the E-Sign Act provides that, with respect to a transaction in or affecting interstate or foreign commerce (and subject to specified exceptions and limitations), a signature, contract, or other record relating to the transaction may not be denied legal effect, validity, or enforceability solely because it is in electronic form, and a contract relating to such transaction may not be denied legal effect, validity or enforceability solely because an electronic signature or electronic record was used in its formation. The electronic signature and delivery provisions state that if any provision of the LLC and Partnership Acts is deemed to modify, limit, or supersede the E-Sign Act, the provisions of the LLC and Partnership Acts will control to the fullest extent permitted by Section 7002(a)(2) thereof. Section 7002(a)(2) of the E-Sign Act provides:

A State statute, regulation, or other rule of law may modify, limit, or supersede the provisions of section 7001 of [the E-Sign Act] with respect to State law only if such statute, regulation, or rule of law ... (A) specifies the alternative procedures or requirements for the use or acceptance (or both) of electronic records or electronic signatures to establish the legal effect, validity, or enforceability of contracts or other records, if (i) such alternative procedures or requirements are consistent with [subchapters I and II of the E-Sign Act]; and (ii) such alternative procedures or requirements do not require, or accord greater legal status or effect to, the implementation or application of a specific technology or technical specification for performing the functions of creating, storing, generating, receiving, communicating, or authenticating electronic records or electronic signatures; and (B) if enacted or adopted after June 30, 2000, makes specific reference to [the E-Sign Act].

Thus, the electronic signature and delivery provisions expressly confirm an intent to allow the LLC and Partnership Acts to govern the documentation of actions, and the signature and delivery of documents, to the fullest extent the LLC and Partnership Acts are not preempted by the E-Sign Act.

LP Division

Under a new Section 17-220 of the LP Act, a single Delaware LP can now divide into two or more Delaware LPs. The original dividing Delaware LP 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 LP 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 LP among the division Delaware LPs, the name of each resulting Delaware LP, and, if the original dividing Delaware LP will survive the division, the name of the surviving Delaware LP. The dividing Delaware LP must then file a certificate of division and a certificate of limited partnership for each resulting Delaware LP with the Delaware Secretary of State.

Following a division, each division Delaware LP will be liable for the debts, liabilities, and duties of the original dividing Delaware LP as are allocated to it pursuant to the plan of division, and no other division Delaware LP 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 LP will be jointly and severally liable on account of such fraudulent transfer. Debts and liabilities of the original dividing Delaware LP that are not allocated by the plan of division will be the joint and several debts and liabilities of all division Delaware LPs.

The amendments relating to division of a Delaware LP became effective August 1, 2019. 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 LP from consummating a merger or consolidation or transferring assets will apply with equal force to a division if (i) the Delaware LP was formed prior to August 1, 2019, and (ii) the Delaware LP entered into such written contract, indenture, or other agreement prior to August 1, 2019. References to "division Delaware LPs" above refer to (i) the original dividing Delaware LP effecting a division in the manner provided in new Section 17-220 of the LP Act if it survives the division, and (ii) each resulting Delaware LP formed as a consequence of the division.

Statutory Public Benefit LPs

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

In general, a Statutory Public Benefit LP is a for-profit limited partnership 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 LP is required to be operated in a way that balances the pecuniary interests of the partners of such Statutory Public Benefit LP, the best interests of those materially affected by such Statutory Public Benefit LP's conduct, and the public benefit or public benefits as set forth in such Statutory Public Benefit LP's certificate of limited partnership.

Each Statutory Public Benefit LP is required, in its certificate of limited partnership, to identify itself as a Statutory Public Benefit LP and to set forth one or more specific public benefits to be promoted by the Statutory Public Benefit LP. "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 partners in their capacities as partners) 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 LP Act also (i) sets forth specific duties of general partners and other persons with authority to manage or direct the business and affairs of a Statutory Public Benefit LP; (ii) imposes special notice requirements on Statutory Public Benefit LPs, mandating periodic statements to limited partners regarding the Delaware LP's promotion of its public benefits and as to the best interests of those materially affected by the Delaware LP's conduct; (iii) contains limitations on the power of Statutory Public Benefit LPs to (a) adopt amendments to their certificates of limited partnership 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 LP; (iv) establishes a means of enforcing the promotion of the public benefits of a Statutory Public Benefit LP by granting certain derivative rights; (v) provides that the requirements imposed on Statutory Public Benefit LPs may not be altered in a partnership 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 LP that is formed or operated for a public benefit (including a Delaware LP that is designated as a public benefit limited partnership) that is not a Statutory Public Benefit LP.

LP Series

The LP Act was amended to create a new type of Delaware LP series known as a "registered series." Registered series are governed by a new Section 17-221 of the LP Act. A registered series will qualify as a registered organization under the Uniform Commercial Code, which will facilitate the use of Delaware LP series in secured financing transactions. To form a registered series, the certificate of limited partnership of the Delaware LP 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 LP 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 are able to merge or consolidate with or into one or more other registered series of the same Delaware LP.

Series created under Section 17-218(b) of the LP Act, both before and after the effective date of the amendments, will be known as "protected series." The amendments do not alter the features of protected series. An existing protected series can convert to a registered series in accordance with the new Section 17-222 of the LP Act, and a registered series can in turn convert to a protected series in accordance with the new Section 17-223 of the LP Act.

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

Blockchain and Distributed Ledgers

The GP Act was amended to provide express statutory authority for Delaware GPs to use networks of electronic databases (including blockchain and distributed ledgers) for the creation and maintenance of records of Delaware GPs 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 GPs.

Contractual Appraisal Rights Confirmed Available in Certain Transactions

Prior to the recently enacted amendments, the LLC Act and the LP Act each contemplated that contractual appraisal rights may be provided with respect to a limited liability company interest, partnership interest, or another interest in a Delaware LLC or Delaware LP in connection with any amendment of a limited liability company or partnership agreement, any merger or consolidation in which a Delaware LLC or Delaware LP is a constituent party, any conversion of a Delaware LLC or Delaware LP to another business form, any transfer to or domestication or continuance in any jurisdiction by a Delaware LLC or Delaware LP, or the sale of all or substantially all of a Delaware LLC's or Delaware LP's assets. The amendments to the LLC Act and the LP Act include provisions that confirm that contractual appraisal rights may also be made available in connection with (i) a merger or consolidation in which a registered series is a constituent party, (ii) any division, (iii) any conversion of a protected series to a registered series, and (iv) any conversion of a registered series to a protected series.

The amendments reflect Delaware's continuing commitment to maintaining statutes governing Delaware LLCs, Delaware LPs, and Delaware GPs that effectively serve the business needs of the national and international business communities. ■

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