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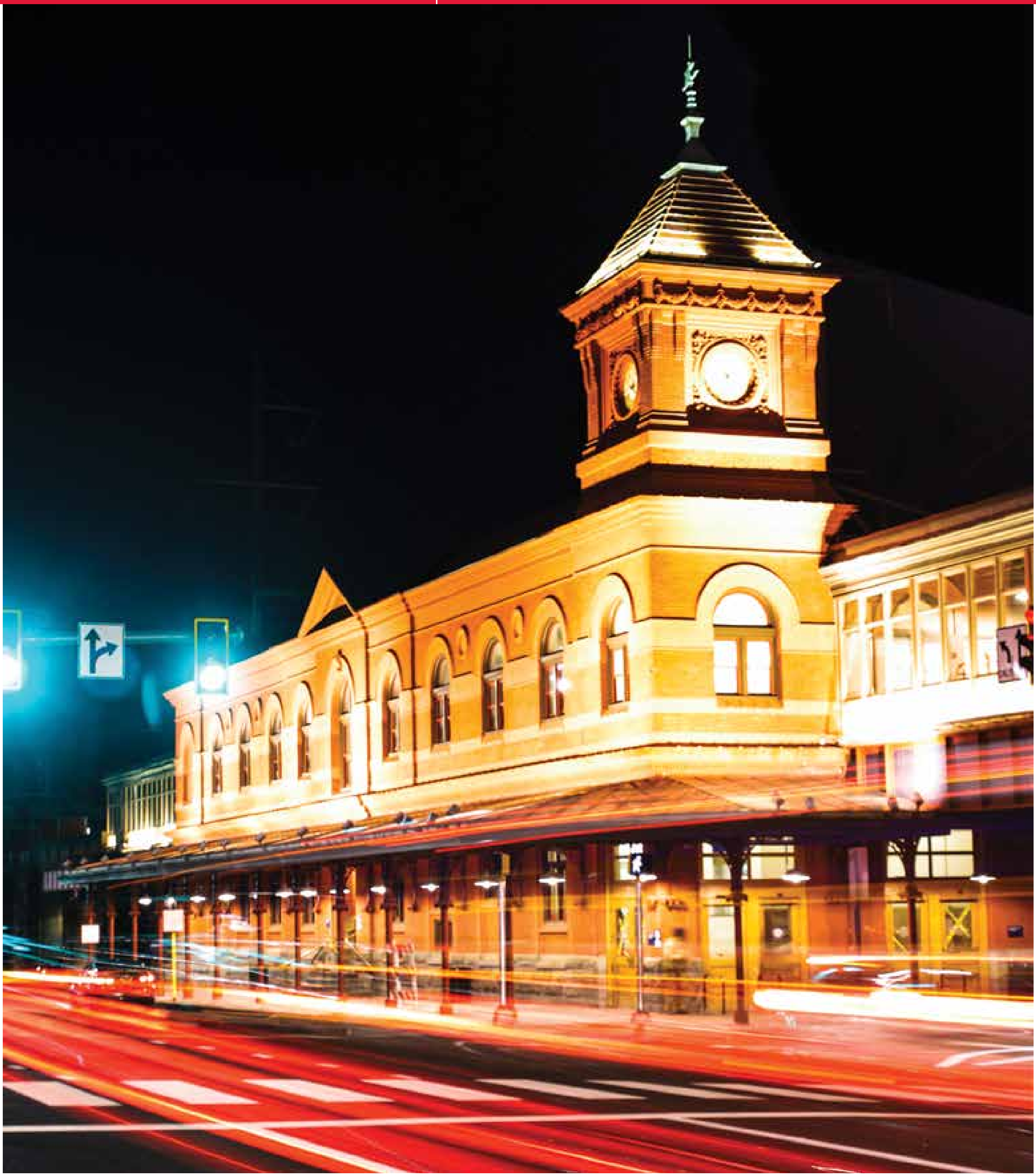
Richards, Layton & Finger | Recent Developments in Delaware Law



Front cover: Ted Sammons Photography

The Joseph R. Biden, Jr., Railroad Station, also known as Wilmington Station, is one of the busiest stops along the Northeast Corridor and is walking distance to downtown Wilmington, Delaware and its courts. Designed by Frank Furness and Allen Evans, the station showcases the renowned architects' signature use of powerful architectural statements, featuring exposed steel beams studded with rivets and trains traveling right through the second floor of the station.

Listed on the National Register of Historic Places in 1976, the station's name was changed in 2011 to Joseph R. Biden, Jr., Railroad Station in honor of then-Vice President (now President) Joe Biden, a long-time advocate for passenger rail who took more than 7,000 round trips from the station to Washington, D.C. during his long career in the U.S. Senate.

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 nearly 30 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

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AB Stable VIII LLC v. MAPS Hotels and Resorts One LLC: Delaware Supreme Court Affirms Finding of Breach of Ordinary Course Covenant in Response to COVID-19

In *AB Stable VIII LLC v. MAPS Hotels & Resorts One LLC,* --- A.3d ----, 2021 WL 5832875 (Del. Ch. Dec. 8, 2021), the Delaware Supreme Court affirmed the Court of Chancery's decision that actions taken by the seller, AB Stable VII LLC, owner of 15 luxury hotels, in response to the COVID-19 pandemic breached the ordinary course covenant in a sale and purchase agreement and excused the buyer, MAPS Hotels and Resorts One LLC, of its obligation to consummate the acquisition of the hotels.

In September 2019, the parties entered into the purchase agreement, which provided for MAPS's acquisition of the hotels for $5.8 billion. As the parties were negotiating the agreement, AB Stable became aware of fraudulent deeds linked to six of the hotels. In order to provide enough time to quiet title to the hotels and to allow MAPS to obtain financing for the transaction, the agreement provided for a delayed closing upon the satisfaction of certain conditions. One such condition to MAPS's obligation to close was AB Stable having "performed in material respects all obligations and agreements and complied in all material respects with all covenants and conditions required by th[e] Agreement to be performed or complied with by it prior to or at the Closing." This included, among other things, AB Stable's compliance with its obligations under a traditional ordinary course covenant requiring that, unless MAPS otherwise provided its prior written consent (which consent could not be unreasonably withheld, conditioned, or delayed), the business of AB Stable's subsidiaries "be conducted only in the ordinary course of business consistent with past practice in all material respects." A separate condition to MAPS's obligation to close was AB Stable obtaining documentation enabling MAPS to obtain title insurance that either had no exception for the fraudulent deeds or affirmatively provided coverage for any such exception through an endorsement.

As a result of issues relating to the fraudulent deeds and financing, the expected closing date was delayed until April 17, 2020. By that point, the COVID-19 pandemic had emerged, preventing the parties from obtaining the financing required for the transaction. The operation of the hotels was also significantly impacted by the COVID-19 pandemic. The hotels' response to the pandemic included, among other things, closing two of the hotels entirely, severely limiting the operations of thirteen others, laying off or furloughing over 5,200 employees, and reducing spending. On April 17, 2020, MAPS informed AB Stable that its closing conditions had not been satisfied as a result of, among other things, AB Stable's failure to comply with its obligations under the agreement (including the ordinary course covenant) in all material respects. On April 27, 2020, AB Stable filed suit seeking an order of specific performance to compel MAPS to close the acquisition. Then, on May 3, 2020, MAPS gave notice of termination of the agreement on the grounds that AB Stable had failed to cure its breaches of the agreement.

Following trial, the Court of Chancery held that MAPS validly terminated the agreement as a result of AB Stable's failure to cure its breach of the ordinary course covenant caused by the hotels' responses to the COVID-19 pandemic. In addition, the Court of Chancery concluded that MAPS had a separate basis to validly terminate the agreement upon the occurrence of the outside date under the agreement because AB Stable failed to obtain the requisite title insurance as of such date.

On appeal, the Delaware Supreme Court affirmed the Court of Chancery's decision on the basis that AB Stable's breach of the ordinary course covenant excused MAPS of its obligation to close. Despite AB Stable's assertions that it was justified in taking reasonable and industry-standard steps to preserve its business in light of the pandemic, the Supreme Court explained that, under the language of the ordinary course covenant agreed to by the parties, AB Stable's actions were to be measured against its operational history and not the actions of other industry participants. The Supreme Court further explained that the ordinary course covenant was absolute and not subject to any type of reasonableness qualifier, rendering the reasonableness of AB Stable's actions as compared to other industry participants irrelevant.

While AB Stable argued that this interpretation of the ordinary course covenant could not be reconciled with the agreement's material adverse effect provision that generally allocated pandemic risk to MAPS, the Supreme Court distinguished between the purpose and terms of these provisions in rejecting this argument. On the one hand, an ordinary course covenant serves the purpose of reassuring an acquiror that the target company will not materially change its business or business practices between signing and closing. On the other hand, a material adverse effect provision allocates the risk of changes in the target company's valuation. Moreover, the agreement's material adverse effect provision was based on a more onerous "material adverse effect" standard that included carve-outs for "calamities" and shifted the risk of events like pandemics to MAPS, while the ordinary course covenant used a lesser "in all material respects" standard and contained no such carve-outs. As a result, the Supreme Court held that the two provisions acted independently of one another.

The Supreme Court explained that the ordinary course covenant was absolute and not subject to any type of reasonableness qualifier, rendering the reasonableness of AB Stable's actions as compared to other industry participants irrelevant.

Finally, the Supreme Court rejected AB Stable's argument that its breaches of the ordinary course covenant were immaterial. As AB Stable requested that MAPS consent to changes in the hotels' operations two weeks after it began to implement these changes, AB Stable argued that there was only a two-week delay before MAPS unreasonably withheld its consent to the changes. In response to AB Stable's request, however, MAPS requested additional information about the hotels. Because AB Stable did not respond to that request, the Supreme Court held that it was not unreasonable for MAPS to withhold its consent.

Accordingly, the Supreme Court ruled that MAPS was not obligated to close the acquisition due to AB Stable's breach of the ordinary course covenant. In light of its ruling, the Supreme Court found it unnecessary to address the Court of Chancery's separate holding that MAPS was relieved of its obligation to close as a result of the failure to satisfy the title insurance condition.

Bardy Diagnostics, Inc. v. Hill-Rom, Inc.: Material Adverse Effect Claim Rejected as Excuse for Failure to Close Merger

Bardy Diagnostics, Inc. v. Hill-Rom, Inc., 2021 WL 2886188 (Del. Ch. July 9, 2021), is a post-trial opinion in which the Delaware Court of Chancery determined that a material adverse effect ("MAE") provision found in a merger agreement whereby Hill-Rom, Inc. ("Hillrom") agreed to acquire Bardy Diagnostics, Inc. had not been triggered.

In January 2020, Hillrom expressed interest in acquiring Bardy, a startup medical device company. Bardy offered a single product: a long-term ambulatory electrocardiogram device called the Carnation Ambulatory Monitor ("CAM") patch.

Bardy monetized the CAM patch in a few ways, with the largest revenue model tied to servicing Medicare patients. Medicare sets its rates for reimbursement through use of Current Procedural Technology ("CPT") codes. While the Centers for Medicare & Medicaid ("CMS") was tasked with overseeing the adoption and pricing of CPT codes, occasionally CMS would delegate its authority to local Medicare Administrative Contractors ("MACs") that would set pricing for certain CPT codes. Novitas Solutions, Inc., a MAC, had historically determined the temporary CPT code for the CAM patch (consistently pricing the CAM patch at around $365 per patch).

While Hillrom and Bardy negotiated the terms of the acquisition, both parties understood that CMS was expected to set a permanent national rate for the CAM patch's CPT codes. Moreover, both parties expected the permanent national rate to be higher than the Novitas rate. To the surprise of both Hillrom and Bardy, however, CMS decided not to set a reimbursement rate and instead elected to delegate that authority to the MACs. Nonetheless, Hillrom and Bardy both expected that, at a minimum, Novitas would set the reimbursement rate for the CAM patch at the historic level (i.e., $365 per patch).

In early January 2021, before Novitas determined the reimbursement rate, Hillrom signed the merger agreement to acquire Bardy. In an effort to apportion the risk associated with a potentially lower reimbursement rate, the agreement contemplated an earnout regime (tethered to Bardy's revenue) and an MAE clause providing (in relevant part) as follows:

> "Company Material Adverse Effect" means any fact, event, circumstance, change, effect or condition that, individually or in the aggregate, has had, or would reasonably be expected to have a material adverse effect on ... the Business of the Acquired Companies, taken as a whole; *provided, however,* that ... none of the following, alone or in combination, will constitute, or will be considered in determining whether there has occurred, and no event, circumstance, change, effect or condition resulting from or arising out of any of the following, alone or in combination, will constitute, a Company Material Adverse Effect: ...
>
> (ii) any condition or change in economic conditions generally affecting the economy or the industries or markets in which the Acquired Companies operate (including increases in the cost of products, supplies, materials or other goods purchased from third party suppliers); ...

> (v) any change in any Law (including any COVID-19 Measures and any Health Care Law) or GAAP or any interpretation thereof;
>
> provided, that, with respect to a matter described in any of the foregoing clauses (ii)-(vii), any such fact, event, circumstance, change, effect or condition may be taken into account in determining whether or not there has been a Company Material Adverse Effect to the extent such matter has a materially disproportionate impact on the Acquired Companies as compared to other similarly situated companies operating in the same industries or locations, as applicable, as the Business.

On January 29, Novitas announced a new rate for the CPT codes governing the CAM patch: $42.68 for Texas and $49.70 for New Jersey (two states where Bardy operates its facilities) (the "January Rate"). Stunned by the drastic rate decrease, Bardy (with Hillrom's support) and other industry leaders took action to educate Novitas. On February 21, three days before the deal was to close, Hillrom informed Bardy that Hillrom was not obligated to close, as it believed that the January rate was an MAE under the merger agreement. In response, Bardy filed a complaint a week later seeking specific performance and money damages. Despite Novitas later increasing the rate to approximately $133 in April 2021 (the "April Rate"), Hillrom continued to maintain that the decreased reimbursement rate was an MAE. As an alternative, Hillrom also argued that its obligation to close was excused under the frustration of purpose doctrine. The parties conducted a trial on these disputed issues, which the Court of Chancery resolved by written opinion.

The court opened its analysis by clarifying that *Akorn, Inc. v. Fresenius Kabi AG,* 2018 WL 4719347, at *60 (Del. Ch. Oct. 1, 2018), *aff'd,* 198 A.3d 724 (Del. 2018), does *not* stand for the general principle that the parties' high-level risk allocation regime is irrelevant in interpreting MAE clauses. Rather, the court continued, MAE clauses must be interpreted pursuant to both their specific terms and the

agreement as a whole. The court highlighted the Delaware Supreme Court's pronouncement in *Chicago Bridge & Iron Co. N.V. v. Westinghouse Electric Co.,* 166 A.3d 912 (Del. 2017), that "[i]n giving sensible life to a real-world contract, courts must read the specific provisions of the contract in light of the entire contract," which "is true in all commercial contexts, but especially so when the contract at issue involves a definitive acquisition agreement addressing

The court opened its analysis by clarifying that *Akorn* ... does *not* stand for the general principle that the parties' high-level risk allocation regime is irrelevant in interpreting MAE clauses.

the sale of an entire business." Thus, the court concluded that while "any resolution of the MAE dispute ultimately must be grounded in the language of the contract itself," evidence of risk allocation is not irrelevant under *Akorn* or otherwise.

The court next turned to whether Bardy suffered an MAE, an analysis that comprised four parts. First, the court addressed whether the April Rate change was an "event" that affected Bardy's "Business." Bardy made two arguments in support that it was not: (i) that an "event" can only be an *unanticipated* event; and (ii) that "Business" only encompasses Bardy's operations, and not its financial condition. The court rejected both arguments, reasoning that: (i) the parties did not include "unknown" in front of "events" and instead opted for a broadly worded general MAE; and (ii) the term "Business" included "commercialization activities," which included amounts Bardy could charge for its products, which in turn included the rate change.

Second, the court addressed whether the rate decrease was an MAE under the merger agreement. The court summarized the applicable legal standard as reducing to the following two elements: whether, at the time Hillrom invoked the MAE clause, the April Rate (i) could reasonably be expected to constitute an MAE, and (ii) would reasonably be expected to endure for a "durationally significant" period. Hillrom had the burden to prove each element.

After assuming for the sake of argument that the first prong was satisfied, the court turned to the second. The court noted that to satisfy the durational significance element, Hillrom had to prove that Bardy suffered an MAE for a "commercially reasonable period," as judged from the perspective of a "reasonable acquirer." The court determined that Bardy could conservatively operate under the April Rate for two years without suffering an MAE because Hillrom itself—the court's "proxy for a reasonable acquiror"—acknowledged that five or more years is "durationally significant" and was prepared, per its own internal analyses, to own and operate Bardy for three years without returns. Consequently, the issue reduced to whether Hillrom proved that the April Rate would endure for two years and, if the April Rate was revisited, that it would not be restored to historic levels (i.e., $365 per share).

In addressing the first question, the court evaluated the credibility of each party's expert witness and considered the context surrounding how the April Rate was affixed. The court found Hillrom's expert witness "not persuasive on several fronts," and ultimately concluded that Hillrom failed to present sufficient evidence showing that the April Rate would not be revisited within two years. On the other hand, the court found the testimony of Bardy's expert witness—that regulators will revisit within two years to correct the CAM patch's reimbursement rate—credible and reasonable.

The court next considered whether Hillrom proved that regulators would not revise the April Rate meaningfully upward such that an MAE would reasonably be expected to have occurred. Pre-signing, Hillrom believed the case for a $400+ CAM reimbursement rate was strong, but at trial offered no evidence as to why its view had changed post-signing. Hillrom relied principally on the April Rate, which the court deemed a "mistaken outcome[]" that would not "meaningfully affect CMS's independent review of the relevant CPT codes." Accordingly, the court was not persuaded given Hillrom's newfound "cynicism" and concluded that Hillrom failed to carry its burden to prove that the April Rate constituted an MAE.

Third, the court held that the rate change was a "Health Care Law" carved out of the definition of an MAE. The court explained that this carve-out included any "regulation" issued by any governmental body, then reasoned that rate-setting is a regulatory function of CMS, a federal agency within the Department of Health and Human Services, which had delegated its executive rate-setting authority to Novitas in this instance. Accordingly, although Novitas was not itself a governmental body, its rate change qualified as a "regulation" because it was promulgated with the force of a CMS ruling.

Fourth, the court held that the rate change did not have a disproportionate impact on Bardy such that it could trigger the MAE provision despite falling within a carve-out. The court reasoned that the only similarly situated company Hillrom identified—which was comparable to Bardy by virtue of its revenue, "developmental maturity, and, most importantly, product portfolio"—suffered to a similar extent "by any measure." To wit, each impact metric the court considered (revenue decrease, gross margin, and discounted-cash-flow valuation) displayed comparable relative losses for both companies. Notably, in the course of its analysis, the court rejected Bardy's construction of the word "impact" to mean only revenue lost *per unit* (which would mean that every company suffered the same amount by definition) because this would render the MAE carve-out for market-wide effects nugatory.

Next, the court rejected Hillrom's argument that the rate change excused its obligation to close by frustrating the purpose of the merger agreement. Here, the court reasoned that the transaction's purpose was not frustrated because "Hillrom sought to acquire a growth company with clinically superior technology to expand its cardiology offering; Bardy remains exactly that." While the April Rate lowered Bardy's short-term profitability, the court continued, Hillrom failed to present evidence that the April Rate would remain the status quo in the long term.

Accordingly, the court entered a verdict in favor of Bardy on its claim for specific performance and prejudgment interest on the deal price. The court rejected Bardy's request for compensatory damages under the merger agreement's provision obliging Hillrom to indemnify "Equityholders" because Bardy did not fall within the definition of "Equityholder."

Snow Phipps Group, LLC v. KCAKE Acquisition, Inc.: Court of Chancery Orders Buyer to Close $550 Million Merger

In *Snow Phipps Group, LLC v. KCAKE Acquisition, Inc.*, 2021 WL 1714202 (Del. Ch. Apr. 30, 2021), the Delaware Court of Chancery held that acquirer Kohlberg was required to specifically perform its obligations under a stock purchase agreement and complete its agreed-to acquisition of target DecoPac, rejecting each of Kohlberg's arguments that it was entitled to terminate the deal.

The trial court established the following facts. In December 2019, Snow Phipps Group, LLC, a private equity firm, decided to sell DecoPac Holdings Inc., a supplier and marketer of cake-decorating products. In January 2020, Kohlberg & Company, LLC was approached to purchase DecoPac. After some back and forth negotiations between the parties, DecoPac accepted Kohlberg's acquisition offer. Although other parties had expressed interest in acquiring DecoPac, DecoPac determined to move forward with Kohlberg because Kohlberg was "uniquely positioned to complete the Transaction with speed and certainty" and had offered the highest price. During subsequent negotiations over the terms of the purchase agreement, COVID-19 began to be front-page news and concerns about its ultimate impacts were growing.

While the threat of COVID-19 was growing, the parties signed transaction documents in March 2020, which included a stock purchase agreement ("SPA") and a debt commitment letter ("DCL"). The SPA included a typical seller representation that no change had occurred, or would be reasonably expected to occur, that would have a material adverse effect ("MAE") on DecoPac. Further, Kohlberg also agreed in the SPA to "use its reasonable best efforts" to obtain financing under the terms of the DCL or find alternative financing on terms no less favorable to Kohlberg than under the DCL.

Immediately after signing the documents, DecoPac's sales plunged as the COVID-19 pandemic and government-ordered lockdowns hit businesses and produced a sharp decline in demand for DecoPac's cake-decorating products. Though DecoPac informed Kohlberg that sales were expected to recover, Kohlberg created pessimistic financial models and began contemplating ways to avoid closing. DecoPac created detailed financial forecasts to account for COVID-19's impact on the company and provided sales data upon Kohlberg's requests, but Kohlberg rejected this information, instead favoring its own simplistic model that rested on unsubstantiated assumptions about COVID-19's impact on DecoPac's business. DecoPac's sales updates showed promise that sales were rebounding and would continue to do so, but Kohlberg did not update its models nor inform lenders of the uptick in sales. Instead, using its own model, Kohlberg demanded changes to the DCL from its lenders, who rejected most of the demands but remained committed to proceed under the previously agreed-upon terms of the DCL. Despite the lenders' commitments and willingness to proceed under the terms of the DCL, Kohlberg told DecoPac that debt financing was no longer available and that its attempts to find favorable alternative financing arrangements had been fruitless. At the same time, Kohlberg told DecoPac that it believed an MAE had occurred and that Kohlberg was also considering whether there had been a violation of the ordinary course provision in the SPA. DecoPac insisted it was ready to move towards closing and that the company would meet its closing conditions, but Kohlberg responded that "[t]here was not going to be a closing."

Following Kohlberg's refusal to close the deal, Snow Phipps and DecoPac sued in the Delaware Court of Chancery, seeking specific performance of the SPA. A week later, Kohlberg terminated the SPA, arguing that it no longer had contractual obligations to close the deal because (i) despite Kohlberg's efforts, financing was not available; and (ii) DecoPac had breached certain representations in the SPA, including the MAE representation, a representation about the company's top customers, and the ordinary course covenant.

At trial, Kohlberg argued that it properly terminated the agreement on three grounds: (i) inaccuracy of DecoPac's MAE representation, (ii) inaccuracy of the top-customers representation, and (iii) DecoPac's failure to comply with the ordinary course covenant. The court rejected all three arguments.

With respect to Kohlberg's MAE argument, the court explained that in order for a drop in sales to constitute an MAE, the decline would need to be consequential to the company's "long-term earnings power over a commercially reasonable period." The court held that Kohlberg did not show that the COVID-19 pandemic had sufficient materiality or duration to constitute an MAE. While DecoPac's sales did initially plummet, the company's more reliable and thorough projections, based on regularly updated real sales data, correctly predicted a recovery. Because DecoPac's projections forecasted that 2020 revenue would be down 11% under budgeted projections and EBITDA would be down 22% from projections, and the court found the company's projections to be reliable, the court held that DecoPac was not "projected to face a 'sustained drop' in business performance." Second, the MAE provision in the SPA included a typical exception for effects "'arising from or related to ... changes in any Laws, rules, regulations, orders, enforcement policies or other binding directives issued by any Governmental Entity.'" As a result, the court noted that even if there was an MAE, such an MAE was carved out from the company's representation because the MAE arose out of government lockdown orders that were directly linked to the decline in the company's sales. Third, the MAE provision included a typical exception for events "'to the extent that such matter has a materially disproportionate effect on [DecoPac] ... relative to other comparable entities operating in the industry in which [DecoPac] operate[d].'" As such, the court concluded that even if there was an MAE, it was carved out of the company's representations because DecoPac did not face a disproportionate sales impact relative to its peers.

Second, the court concluded that the top-customers representation did not excuse Kohlberg from closing because projections showed that sales to DecoPac's top costumers would rebound by 2021. In short,

Under the prevention doctrine, Kohlberg was barred from using the lack of financing as a basis to avoid performance, and the plaintiffs were entitled to specific performance of the SPA.

Kohlberg failed to provide sufficient evidence to "suggest that the decrease in sales to top customers was reasonably expected to be durationally significant and material to a reasonable acquirer."

Third, the court held that the plaintiffs did not breach the ordinary course covenant. Kohlberg challenged DecoPac's draw of a revolving credit line and budget cuts as inconsistent with DecoPac's past business practices. The court found that the revolver was not a material departure from the ordinary course of business because, among other things, DecoPac had made several similar draws on the line of credit in recent years. With respect to DecoPac's cost-cutting actions, the court held that DecoPac had employed similar cost-cutting measures in the past in response to decreased production and Kohlberg failed to convince the court otherwise.

Next, the court held that Kohlberg breached its SPA obligations to use its reasonable best efforts to obtain financing. Under the SPA, Kohlberg had to either obtain financing under the terms of the DCL or find alternative financing no less favorable to Kohlberg than the DCL, and it could not modify the terms of the DCL in a manner that would jeopardize financing or closing. The court held that rather than use reasonable best efforts to work towards a definitive credit agreement, Kohlberg sought a way out of the deal, reforecast DecoPac's projected sales based on "uninformed (and largely unexplained) assumptions that were inconsistent with real-time sales data," and then used such reforecast to demand better financing terms. When the lenders rejected Kohlberg's demands, Kohlberg used the lenders' stance to justify its position that debt financing was no longer available. Then Kohlberg "conducted a perfunctory and unsuccessful four-day search for alternative debt financing." As a result, the court held that Kohlberg failed to use its "reasonable best efforts" to obtain debt financing, breaching the SPA.

Finally, the court held that the plaintiffs were entitled to specific performance and that Kohlberg was required to close on the SPA. The parties agreed to specific performance in the SPA, but only if Kohlberg had received the funding under the DCL. Though Kohlberg did not receive the funding, the court noted that the lenders were committed to fund the deal under the terms of the DCL such that Kohlberg's failure to receive funding stemmed from its own breach and refusal to accept funding on the agreed-upon terms. Therefore, under the prevention doctrine, Kohlberg was barred from using the lack of financing as a basis to avoid performance, and the plaintiffs were entitled to specific performance of the SPA.

SPAC and Business Combination Litigation

In re Multiplan Corp. Stockholders Litigation: Traditional Fiduciary Duty Principles Applied in de-SPAC Transaction

In *In re MultiPlan Corp. Stockholders Litigation,* --- A.3d ----, 2022 WL 24060 (Del. Ch. Jan. 3, 2022), the Court of Chancery addressed whether a SPAC's directors and controlling stockholder breached their fiduciary duties by withholding material information that allegedly impaired the stockholders' right to divest their shares before a business combination occurred.

Defendant Churchill Capital Corp III was formed in October 2019 to serve as a special purpose acquisition company ("SPAC"). A SPAC is a publicly traded company that raises capital through an initial public offering with the goal of merging with a private company and taking it public. SPACs are generally formed and controlled by a management group, known as a "sponsor." Here, defendant Michael Klein incorporated Churchill through Churchill Sponsor II, LLC (the "Sponsor"). The Sponsor's managing member was M. Klein Associates, Inc., whose sole stockholder was Klein. Consequently, Klein, through his control of the Sponsor, had the exclusive power to appoint Churchill's board of directors.

Churchill went public in a $1.1 billion initial public offering in February 2020, selling 110,000,000 units at $10 per unit. Each unit consisted of one share of company Class A common stock and a quarter of a warrant with an exercise price of $11.50. Churchill also issued Class B Founder Shares, which were purchased by the Sponsor for an upfront nominal contribution. If Churchill succeeded in consummating an initial business combination, the Founder Shares would convert into Class A shares at a one-to-one ratio. The Sponsor was also compensated through an option to purchase warrants in the SPAC (the "Private Placement Warrants"), which had an exercise price of $11.50.

As was standard in the SPAC market, Churchill had a "completion window" for a business combination that ended 24 months after its initial public offering. If no transaction was completed within that window, the proceeds of the initial public offering (plus interest) would be returned to the Class A stockholders, while the Founder Shares and Private Placement Warrants would expire worthless. Furthermore, the SPAC's charter provided the Class A stockholders with the option to redeem their shares for $10 plus accumulated interest after a potential merger was disclosed but before the stockholder vote.

Churchill chose the parent company of MultiPlan, Inc. as its target company for the business combination. As contemplated by the proposed de-SPAC merger, MultiPlan would become a wholly owned subsidiary of Churchill and Churchill would rename itself MultiPlan Corporation. The board approved the de-SPAC merger and issued its definitive proxy statement. The proxy disclosed that MultiPlan was dependent on a single customer, but it did not disclose the name of the customer, UnitedHealth Group Inc. ("UHC"), or that UHC intended to create an in-house platform, Naviguard, that would allegedly cause UHC "to move all of its key accounts from MultiPlan to Naviguard by the end of 2022."

Following board approval, stockholders overwhelming voted in favor of the proposed merger, with fewer than 10% of the Class A stockholders opting to exercise their redemption right. After the merger closed, however, a report was published detailing UHC's formation of Naviguard. The following day, MultiPlan's stock price fell to a low of $6.27.

The plaintiffs, Class A stockholders, filed direct claims for breach of fiduciary duty against Churchill's directors, officers, and controlling stockholder. The plaintiffs alleged that the defendants issued a false and misleading proxy that impaired the ability of the Class A stockholders to exercise their redemption rights in a fully informed manner. In response, the defendants moved to dismiss the complaint under Court of Chancery Rule 23.1 for failure to plead demand futility and under Court of Chancery Rule 12(b)(6) for failure to state a claim upon which relief can be granted.

Under the plaintiff-friendly 12(b)(6) standard, the court first addressed the threshold issue of whether the claim was direct or derivative. In making its determination, the court applied the test established by the Delaware Supreme Court in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004). Under *Tooley,* the court analyzed two issues to determine whether the claim was direct or derivative: (i) who suffered the alleged harm, and (ii) who would receive the benefit of any recovery. In addressing the first question, the court distinguished this case from the typical overpayment/dilution case, which is "normally viewed as 'exclusively derivative' under the *Tooley* analysis." Here, the court reasoned, the alleged harm—that the board impaired the stockholders' informed exercise of their redemption right—could not run to Churchill since Churchill had no redemption right and no right to the funds until the stockholders chose not to redeem. In addressing the second question under *Tooley,* the court again contrasted this case with the typical overpayment case in which the recovery (i.e., restoration of improperly reduced value) flows to the corporation. Here, the

court concluded, the damages for impairment of the redemption right flowed to the stockholders: “Class A stockholders ... personally lost the opportunity to recover $10.04 before the merger closed and any reduction in enterprise value occurred.” Therefore, since the stockholders suffered the alleged harm and would receive the benefit of any recovery, the claim was considered direct.

The court next turned to the question of whether the claim was governed by contract and thus must be dismissed. In holding that the claim was not governed by contract, the court reasoned that the plaintiffs were not disputing whether they had the contractual right to redeem, but rather were claiming that the defendants disloyally impaired the stockholders’ redemption right by breaching their fiduciary duty to disclose all material information about the merger.

The court concluded that a majority of the board was either self-interested in the merger or controlled by Klein [because the] board members were compensated with membership interests in the Sponsor.

Finally, the court addressed the question of whether the claims were holder claims—i.e., “a cause of action by persons wrongfully induced to *hold* stock instead of selling it.” In holding that the plaintiffs had not advanced a holder claim, the court reasoned that the stockholders were faced with two choices: to exercise the redemption right or approve the merger. The choice to exercise the redemption right, the court reasoned, was a call for stockholder action in the form of an “investment decision.” As the court concluded, this was “an active and affirmative choice around which the SPAC structure revolved.”

With the threshold questions out of the way, the court next determined the applicable standard of review, holding that the entire fairness standard was appropriate since (i) the de-SPAC merger was a conflicted controller transaction, and (ii) the majority of the board was conflicted.

Regarding the conflicted controller ruling, the court noted how Klein and the public stockholders had different incentives, and that a bad deal versus no deal affected the parties differently. More specifically, if the deal was not completed, both the Class B shares and the Private Placement Warrants held by the Sponsor would be worthless; whereas, on the other hand, the public stockholders would still have received $10.04 per share. Therefore, given the non-value of Klein's stock and warrants absent a business combination, the merger was valuable to him well below $10.04 per share. Moreover, in support of its conclusion, the court noted that Churchill retained a financial advisor that was owned by Klein in connection with the merger.

Regarding the conflicted board ruling, the court concluded that a majority of the board was either self-interested in the merger or controlled by Klein. The board members were compensated with membership interests in the Sponsor, indirectly receiving economic interests in the Founder Shares and Private Placement Warrants. As such, and for reasons similar to those discussed above, the directors benefited from virtually any merger, even one that was value diminishing for Class A stockholders. Moreover, the court noted how the majority of the director defendants were controlled by Klein: (i) Klein had the unilateral power to remove them; (ii) a few of the directors were on the board of other SPACs affiliated with Klein; and (iii) one director was Klein's brother. In short, "the directors each had a personal or employment relationship with or received lucrative business opportunities from Klein."

The court next applied the entire fairness standard to the fiduciary duty claims. Under the entire fairness standard, the defendants had the burden of showing that the transaction was entirely fair to Churchill and the stockholders, which requires a showing of fair price and fair dealing (which incorporates the duty of disclosure). According to the court, because this is necessarily a fact-intensive inquiry, it is rare that a court will dismiss a fiduciary duty claim under Rule 12(b)(6) when entire fairness is the appropriate standard of review. With that in mind, the court held that the plaintiffs had pled viable, non-exculpated claims: "Based on the plaintiffs' allegations, it is reasonably conceivable that a Class A stockholder would have been substantially likely to find [the undisclosed] information important when deciding whether to redeem her ... shares."

For the foregoing reasons, the court denied the defendants' motion to dismiss the breach of fiduciary duty claims against Churchill's directors and its controlling stockholder.

In re Pattern Energy Group Inc. Stockholders Litigation: Court of Chancery Refuses to Dismiss Allegations of Control Group

In *In re Pattern Energy Group Inc. Stockholders Litigation,* 2021 WL 1812674 (Del. Ch. May 6, 2021), stockholder-plaintiffs brought claims for breach of fiduciary duty, aiding and abetting, and others against Pattern Energy Group Inc.'s ("Pattern Energy") directors, officers, and alleged controlling stockholder in connection with the multibillion-dollar go-private cash sale of the company to Canada Pension Plan Investment Board ("Canada Pension").

In 2012, the private equity firm Riverstone Pattern Energy Holdings, L.P. ("Riverstone") formed Pattern Energy to run renewable energy facilities built by another Riverstone affiliate, Pattern Energy Group Holdings 2, LP ("Developer 2"). The plaintiffs alleged that Riverstone controlled Pattern Energy through Developer 2 and Riverstone affiliates who served as Pattern Energy directors (comprising two of the company's seven directors) and officers (Pattern Energy's CEO, CFO, and president). The plaintiffs further alleged that Riverstone (through Developer 2) had a consent right over Pattern Energy's transfer or sale of Pattern Energy's interest in Developer 2. This consent right only restricted Pattern Energy from selling its interest "via merger or consolidation," but not through all transactions with third parties.

In 2018, the board formed a special committee of the five disinterested directors to explore a potential merger transaction. The plaintiffs alleged that the special committee delegated responsibility to solicit bids to Pattern Energy's allegedly conflicted CEO, Michael Garland, and permitted the other conflicted director to attend committee meetings. During the process, the committee engaged in negotiations with Brookfield Management Asset Inc., which did not condition its first offer on acquiring Developer 2. Canada Pension, by contrast, had indicated it would acquire Developer 2.

The court held that a third party with no stock can be a controller under Delaware law (an issue the court characterized as "an open question") and that the plaintiffs had well pled legally significant contacts sufficient to infer a control group existed.

At a high level, the plaintiffs alleged that Riverstone steered the process towards a transaction with Canada Pension due to Canada Pension's willingness to acquire Developer 2 and that Pattern Energy's fiduciaries improperly permitted this to occur. For example, the plaintiffs alleged that Pattern Energy's conflicted CEO met in secret with Riverstone and Canada Pension and that Riverstone affiliates and associates encouraged the special committee to pursue Canada Pension throughout the process because Canada Pension was interested in acquiring Developer 2, all despite the fact that selling Developer 2 would allegedly divert merger consideration from Pattern Energy stockholders to Riverstone. Brookfield Management eventually withdrew from the process upon discerning it would not be able to secure Riverstone's support, leaving Canada Pension the last bidder standing.

Pattern Energy's board ultimately approved the transaction with Canada Pension and delegated to the company's officers authority to draft, review, and publish the merger proxy. The merger was approved by a vote of 52% of Pattern Energy's stockholders, 10.4% of which derived from CBRE Caledon Capital Management, Inc., which had been contractually obligated to vote for any future merger recommended by the Pattern Energy board. The plaintiffs challenged the transaction post-closing by filing a complaint in the Court of Chancery, which defendants moved to dismiss for failure to state a claim under Court of Chancery Rule 12(b)(6).

The court first determined the applicable standard of review. The court held that intermediate scrutiny applied under *Revlon* because Pattern Energy stockholders received all cash for their shares. The court further held that the entire fairness standard might apply due to the influence of an alleged conflicted controlling stockholder (Riverstone), but declined to definitively hold as much pending further discovery. Notably, the court held that a third party with no stock can be a controller under Delaware law (an issue the court characterized as "an open question") and that the plaintiffs had well pled legally significant contacts sufficient to infer a control group existed, but declined to undertake the fact-intensive inquiry of whether that group exercised control on a pleading-stage record. Finally, the court considered and rejected the plaintiffs' contention that entire fairness applied under the plaintiffs' theory that Garland committed a "fraud on the board"—that is, materially deceived the board into pursuing Garland/Riverstone's preferred transaction by meeting in secret with Canada Pension. Although the court accepted the legal premise that fraud on the board can elevate the standard of review to entire fairness, it declined to apply it under the facts pled because the plaintiffs failed to plead that Garland's acts affected the special committee's decision.

Next, the court applied intermediate scrutiny to the facts at bar. The court held that the plaintiffs had alleged non-exculpated breaches of fiduciary duty by Pattern Energy's directors, who had acted in bad faith by prioritizing Riverstone's interests over those of the stockholders. The court reasoned that although the special committee members were independent, the manner in which the committee operated was not: it failed to follow conflict management guidelines it had established, delegated authority to conflicted officers during both the sales process and proxy drafting process, and hired a conflicted financial advisor that owned a significant stake in

Riverstone. These problems were exacerbated by the committee's insistence on deal terms that were favorable to Riverstone, particularly with regard to the treatment of Developer 2. Taken together, the plaintiffs' allegations made it reasonably conceivable that the committee had prioritized Riverstone's favored transaction and in so doing had failed to reasonably maximize stockholder value under *Revlon*. Further, because actions in bad faith are loyalty breaches, Pattern Energy's Section 102(b)(7) exculpation provision, which only absolved due care breaches, did not apply.

The court found that the plaintiffs adequately pled a second bad faith act—that is, that directors had abdicated their fiduciary duties by delegating to conflicted officers sole authority to draft and file the proxy despite knowing such officers were conflicted. In so holding, the court relied on the fact that the resolutions authorizing officers to file the proxy did not reserve the board's authority to review the proxy before publication, as well as the lack of minutes or other evidence showing directors had reviewed the proxy before it was disseminated. Accordingly, the court concluded that the defendant's choice of agents and scope of delegation amounted to actionable bad faith.

Next, the court held that the 52% stockholder vote did not have the effect of reinstating the business judgment rule as the applicable standard of review under *Corwin v. KKR Financial Holdings, LLC,* 125 A.3d 304 (Del. 2015), because the merger did not garner the requisite vote of a majority of disinterested shares voting on a fully informed and uncoerced basis. That was so, the court reasoned, because CBRE had been contractually required to vote its shares per the board's recommendation when CBRE bought them, making those shares neither fully informed with respect to the Canada Pension transaction (because CBRE had no knowledge of the transaction when it entered into the voting commitment) nor disinterested (because CBRE faced breach of contract liability if it did not vote in favor). Accordingly, *Corwin* did not apply because removing CBRE's stake brought the disinterested share vote below the necessary threshold.

Relatedly, the court held that the complaint stated a claim that Garland, in his capacity as CEO, breached his fiduciary duties by disseminating a proxy that was materially misleading for failure to adequately disclose (i) the financial advisor's compensation and connections to Riverstone, (ii) the consent right's importance in negotiations, (iii) that Brookfield Management's offer had been $6 above any other bidder's and the committee deemed it "superior" to all other bids (notably, disclosure that the bid reflected a 20% premium was deemed insufficient), and (iv) that the special committee believed Brookfield's offer was more valuable than Canada Pension's. Further, the court held that "only Garland" was responsible for disseminating the proxy, as evidenced by Garland being an "integral figure" during negotiations and, "most significantly," by Garland signing the proxy.

Finally, the court declined to dismiss the plaintiffs' claims against Riverstone for aiding and abetting, civil conspiracy, and tortious interference. The court reasoned that the plaintiffs had well pled the elements of aiding and abetting (including scienter), which substantially resemble those of civil conspiracy. The court further explained that Riverstone's exercise of influence through the consent right, combined with allegations making it reasonable to infer those actions proximately caused Brookfield to withdraw its bid, were sufficient to plead tortious interference.

Appraisal Rights Waivers

Manti Holdings, LLC v. Authentix Acquisition Comp., Inc.: Advance Waiver of Appraisal Rights Upheld

In *Manti Holdings, LLC v. Authentix Acquisition Comp., Inc.,* 261 A.3d 1199 (Del. 2021), the Delaware Supreme Court affirmed the Court of Chancery's prior decision, holding that the petitioners and other common stockholders agreed in the stockholders agreement to "refrain" from exercising their appraisal rights following a sale of Authentix Acquisition Company, Inc.

The arguments on appeal largely centered on whether Section 262 of the DGCL prohibits a Delaware corporation from enforcing an advance waiver of appraisal rights in a stockholders agreement against its own stockholders. The court ultimately ruled that "sophisticated and informed" investors represented by counsel can waive their appraisal rights in exchange for consideration and that statutory appraisal rights are not an essential component of the corporate form.

In *Manti,* the petitioners signed the stockholders agreement in 2008, which required stockholders to "refrain" from exercising their appraisal rights in the event that Authentix engaged in an M&A transaction under specific conditions. On September 12, 2017, the Authentix board authorized and recommended to its stockholders such a transaction—a merger with a third-party entity—which was then approved by its majority stockholder. Shortly after the merger closed, Authentix provided the minority stockholders with written notice of the merger as well as notice of their appraisal rights. Notably, the minority stockholders were informed that if they had signed the stockholders agreement, they had waived their appraisal rights under Section 262 of the DGCL. Nevertheless, the minority stockholders sought appraisal in the Court of Chancery.

The Supreme Court, affirming the Court of Chancery's decision, found that the minority stockholders effectively waived their right to appraisal in the so-called "Refrain Obligation," which provided:

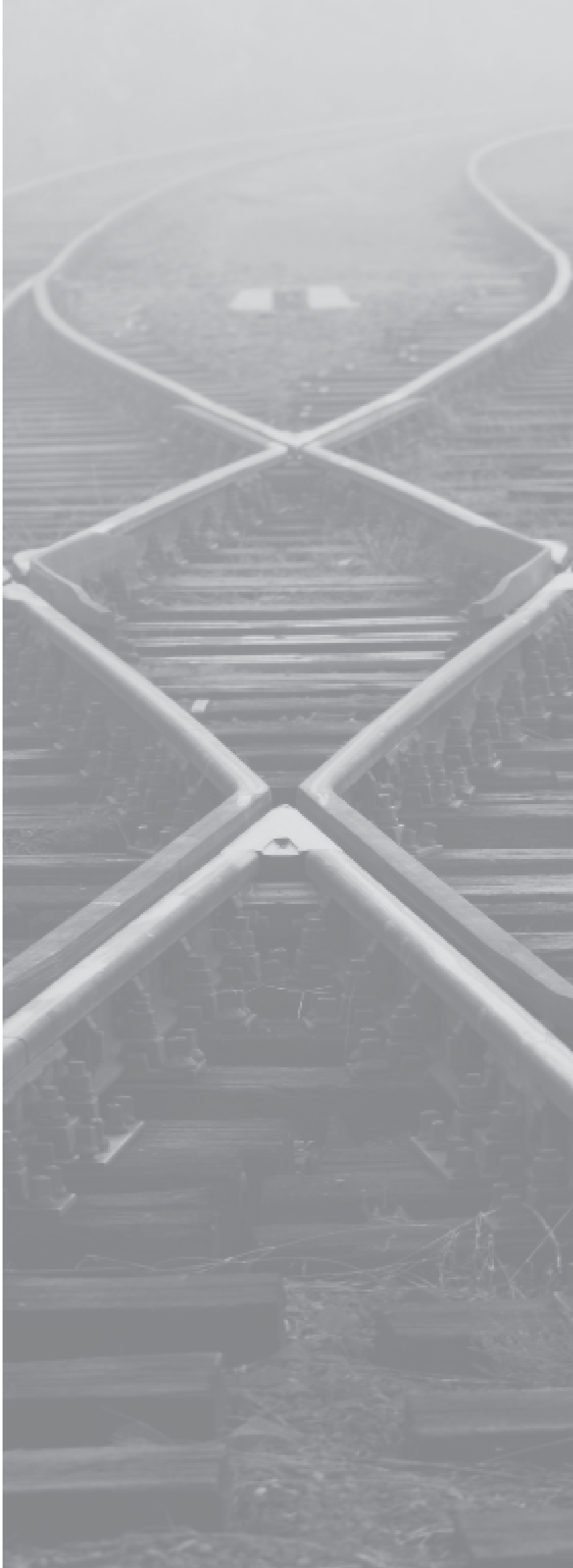
> [I]n the event that ... a Company Sale is approved by the Board and ... the Carlyle Majority, each Other Holder shall consent to and raise no objections against such transaction ... and ... [shall] refrain from the exercise of appraisal rights with respect to such transaction.

From a contractual interpretation perspective, the court found that the Refrain Obligation was enforceable and effective. The petitioners argued that the use of the word "refrain" rather than "'waive' cement[ed] that they did not agree to permanently relinquish their appraisal rights." The court disagreed and instead found that the Refrain Obligation only barred the petitioners from exercising their appraisal rights if certain conditions, which were fulfilled in this instance, were satisfied. Thus, the word "refrain" was (i) appropriate for the petitioners to agree to a contingent waiver of appraisal rights, and (ii) effective to waive appraisal rights.

The court held that "sophisticated and informed stockholders can voluntarily agree to waive their appraisal rights in exchange for valuable consideration."

Additionally, the petitioners argued that the Refrain Obligation did not apply after the 2017 merger closed because the Refrain Obligation in the stockholders agreement terminated upon consummation of the merger and appraisal rights are necessarily exercised post-merger. However, the court reasoned that "Delaware courts read contracts as a whole, and interpretations that are commercially unreasonable ... must be rejected." The court noted that if the petitioners' argument was accepted, the Refrain Obligation would never ripen to be exercised, which would result in what the court called a "commercially unreasonable" interpretation of the Refrain Obligation. Instead, the court held that the "clear purpose of the Refrain Obligation was to assure that ... minority stockholders would not be able to obtain a judicial appraisal *after* a Company Sale had closed."

The court further held that "sophisticated and informed stockholders can voluntarily agree to waive their appraisal rights in exchange for valuable consideration." Section 262(a) of the DGCL provides that any stockholder who meets certain requirements "shall be entitled to an appraisal by the Court of Chancery of the fair value of the stockholder's shares of stock" in connection with certain transactions. The petitioners argued that the General Assembly's use of the word "shall" in "shall be entitled to appraisal" in Section 262(a) meant that appraisal rights were mandatory and could not be waived. The court again disagreed. First, the court noted that the DGCL is a broad enabling statute that allows "immense freedom for private ordering." Second, the court concluded that the "plain language of Section 262 does not prohibit stockholders from agreeing to waive their appraisal rights" because, unlike other provisions in the DGCL that explicitly prohibit the waiver of certain rights, Section 262 includes no such prohibition. Third, the court relied on *In re Appraisal of Ford Holdings, Inc. Preferred Stock,* 698 A.2d 973 (Del. Ch. 1997), for its precedential principle that under certain circumstances preferred stockholders could waive appraisal rights *ex ante*. The court held that Section 262 made no distinction between preferred stockholders and common stockholders and that, in its view, there was no reason to treat common stockholders and preferred stockholders differently with respect to the ability to waive appraisal rights. Lastly, the court held that from a public policy perspective, there was no reason to excuse the petitioners from the bargain they struck, emphasizing that in this case the stockholders were "sophisticated and informed investors, represented by counsel that used their bargaining power to negotiate for funding from Carlyle in exchange for waiving their appraisal rights." ■



Corporate Litigation Issues

United Food and Commercial Workers Union v. Zuckerberg: Delaware Supreme Court Announces Universal Demand Futility Standard

In *United Food and Commercial Workers Union v. Zuckerberg,* 262 A.3d 1034 (Del. 2021), the Delaware Supreme Court (i) affirmed the Court of Chancery's dismissal of the complaint for failure to make a demand on the board after holding that exculpated duty of care claims do not excuse demand under *Aronson*'s second prong, and (ii) adopted a new three-part demand futility test to replace the *Aronson* and *Rales* tests.

In 2010, Mark Zuckerberg, controller, chairman, and CEO of Facebook, Inc., took a pledge to donate most of his wealth to philanthropic causes (the "Giving Pledge"). In 2015, Zuckerberg began working on a plan to complete the Giving Pledge without losing control of Facebook. Facebook's legal team suggested that Facebook could issue a new class of non-voting stock that Zuckerberg could sell without diminishing his voting power (the "Reclassification"). At the suggestion of the legal team, the board of directors of Facebook established a special committee composed of three purportedly independent directors. The special committee was charged with evaluating the Reclassification and making a recommendation to the board. Throughout the negotiation process, "the Special Committee largely agreed to give Zuckerberg the terms that he wanted and did not consider alternatives or demand meaningful concessions." In April 2016, the special committee recommended that the board approve the Reclassification, and the next day the board voted in favor of the Reclassification, with Zuckerberg and Sheryl Sandberg, Facebook's COO, abstaining.

On April 27, 2016, following board approval, Facebook announced the Reclassification to the public. Two days later, the first class action challenging the Reclassification was filed in the Court of Chancery. Several similar complaints were thereafter filed, and in May 2016 the Court of Chancery consolidated 13 cases into a single class action. In June 2016, at Facebook's annual meeting of stockholders, the stockholders approved the Reclassification. Zuckerberg voted all of his stock in favor of the Reclassification, and more than three-quarters of the minority stockholders voted against the Reclassification.

Approximately one week before the class action trial, the board abandoned the Reclassification at Zuckerberg's request and mooted the class action. The defense of the class action and payment of the plaintiffs' attorneys fees cost Facebook more than $88 million.

Thereafter, the United Food and Commercial Workers Union and Participating Food Industry Employers Tri-State Pension Fund ("Tri-State"), another Facebook stockholder, filed a derivative complaint in the Court of Chancery, seeking to recover the money Facebook spent in connection with the class action. Tri-State did not make a litigation demand on Facebook's board, but instead pled that demand was excused for two reasons: because "the Reclassification was not the product of a valid exercise of business judgment" and because "a majority of the Board face[d] a substantial likelihood of liability[ ] and/or lacke[d] independence." In 2020, the Court of Chancery dismissed Tri-State's complaint under Rule 23.1, holding that "exculpated care claims do not excuse demand under *Aronson*'s second prong because they do not expose directors to a substantial likelihood of liability." The Court of Chancery also held that "the complaint failed to raise a reasonable doubt that a majority of the Board lacked independence from Zuckerberg." In reaching these conclusions, the Court of Chancery applied a three-part test for demand futility that blended the *Aronson* and *Rales* demand futility tests. Tri-State appealed the Court of Chancery's judgment.

The Delaware Supreme Court affirmed the Court of Chancery's ruling, (i) holding that exculpated care claims do not excuse demand under *Aronson*'s second prong, and (ii) adopting the Court of

Chancery's three-part test "as the universal test for demand futility." First, the Supreme Court addressed whether allegations of exculpated care violations can establish that demand is excused under *Aronson*'s second prong. Tri-State contended that under *Aronson*'s second prong, demand is excused whenever the complaint raises a reasonable doubt that the challenged transaction was a valid exercise of business judgment. In reaching its decision, the court looked at precedent and found that, "[a]lthough not unanimous, the weight of Delaware authority since the enactment of Section 102(b)(7) supports holding that exculpated care violations do not excuse demand under Aronson's second prong." The court explained that, following *In re Cornerstone Therapeutics, Inc. Stockholder Litigation,* a valid Section 102(b)(7) provision removes the threat of liability and protracted litigation for breach of care claims.

The Supreme Court adopted the Court of Chancery's three-part test "as the universal test for assessing whether demand should be excused as futile." The refined test blends the *Aronson* test with the *Rales* test and "refocuses the inquiry on the decision regarding the litigation demand, rather than the decision being challenged."

"As such, *Cornerstone* eliminated 'any continuing vitality from *Aronson*'s use of the standard of review for the challenged transaction as a proxy for whether directors face a substantial likelihood of liability sufficient to render demand futile.'"

The Supreme Court then adopted the Court of Chancery's three-part test "as the universal test for assessing whether demand should be excused as futile." The refined test blends the *Aronson* test with the *Rales* test and "refocuses the inquiry on the decision regarding the litigation demand, rather than the decision being challenged." Under the new *Zuckerberg* test, courts should ask the following three questions on a director-by-director basis:

> (i) whether the director received a material personal benefit from the alleged misconduct that is the subject of the litigation demand;
>
> (ii) whether the director faces a substantial likelihood of liability on any of the claims that would be the subject of the litigation demand; and
>
> (iii) whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct that would be the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand.

"If the answer to any of the questions is 'yes' for at least half of the members of the demand board, then demand is excused as futile. It is no longer necessary to determine whether the *Aronson* test or the *Rales* test governs a complaint's demand-futility allegations."

In making this decision, the Supreme Court reasoned that "[t]he purpose of the demand-futility analysis is to assess whether the board should be deprived of its decision-making authority because there is reason to doubt that the directors would be able to bring their impartial business judgment to bear on a litigation demand." The court emphasized that "because the three-part test is consistent with and enhances *Aronson, Rales,* and their progeny, the Court need not overrule *Aronson* to adopt this refined test, and cases properly construing *Aronson, Rales,* and their progeny remain good law."

Finally, the Supreme Court applied the new three-part test to the facts of the complaint, holding that the complaint did not plead with particularity facts establishing that demand would be futile. The analysis focused on four of the nine directors, as Tri-State conceded on appeal that two directors could have impartially considered a litigation demand and Facebook did not argue that three directors, including Zuckerberg and Sandberg, could have impartially considered such demand. Tri-State had further conceded on appeal that none of the four directors in question had a personal interest in the Reclassification and there was no dispute that Facebook had a broad Section 102(b)(7) provision. Accordingly, demand could not be excused under the first or second prong of the new test. The Supreme Court's analysis therefore focused on the third prong, and the court found that the complaint failed to plead with particularity facts establishing that two of the four directors at issue lacked independence from Zuckerberg. Consequently, the judgment of the Court of Chancery was affirmed.

Brookfield Asset Management, Inc. v. Rosson: "Dual nature" Claims Eliminated by Overturning *Gentile v. Rossette*

In *Brookfield Asset Management, Inc. v. Rosson,* 261 A.3d 1251 (Del. 2021), the Delaware Supreme Court overruled prior precedent under *Gentile v. Rossette,* 906 A.2d 91 (Del. 2006), which had held that rather than claims being either direct or derivative, certain claims could be both. In overruling *Gentile,* the Supreme Court re-established that the test for determining whether a claim is direct or derivative is governed, without exception, by the two-part test set forth in *Tooley v. Donaldson, Lufkin & Jennette, Inc.,* 845 A.2d 1031 (Del. 2004). That two-part test asks (i) who suffered the alleged harm, and (ii) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders individually).

In June 2018, Brookfield Asset Management, Inc. acquired $650 million worth of shares of TerraForm Power, Inc. in a private placement, increasing its interest in TerraForm from 51% to 65.3%. The TerraForm stockholders sued, alleging that Brookfield—as the majority stockholder—caused TerraForm to dilute the minority stockholders' economic and voting interests by issuing stock for inadequate value in the private placement. The stockholder plaintiffs' complaint alleged both direct and derivative claims, but in July 2020, Brookfield acquired the remaining stock of TerraForm, eliminating the minority stockholders' interests in TerraForm. Therefore, the stockholder plaintiffs no longer had standing to sue derivatively, and only direct claims remained. Brookfield moved to dismiss the direct claims, which the Court of Chancery denied. The court reasoned that although the stockholder plaintiffs did not have standing under *Tooley,* they had standing under the exception to the direct-versus-derivative test articulated in *Gentile.*

On appeal, Brookfield advanced two arguments in favor of its motion to dismiss: first, the plaintiff's claims were exclusively derivative under *Tooley,* and second, because *Gentile* was "doctrinally inconsistent" with *Tooley,* a "complic[ation] to real world commercial transactions," and "superfluous given existing legal remedies," it should be overruled. The Supreme Court agreed and unanimously overruled *Gentile.*

Under *Tooley,* the Supreme Court created a "simple test of straightforward application to distinguish direct claims from derivative claims." The determination turned on the following questions: (i) who suffered the alleged harm, and (ii) who would receive the benefit of any recovery or other remedy. Under *Tooley,* a claim that a majority stockholder diluted the economic and voting interests of minority stockholders fit "neatly" as a derivative claim. However, *Gentile* carved out an exception to *Tooley,* allowing derivative dilution claims involving majority stockholders to be brought as dual claims—both direct and derivative. In *Brookfield,* the Supreme Court explained that at the time *Gentile* was decided, the court believed that its holding "fit[] comfortably within the analytical framework mandated by *Tooley.*" In this case, however, the Supreme Court concluded that the "fit" was not so "comfortable" and identified three sources of tension between *Gentile* and *Tooley,* justifying the Supreme Court's decision to overrule *Gentile.*

First, *Gentile* concluded that economic and voting dilution was an injury to stockholders independent of any injury to the corporation. Second, *Gentile* arguably relied on a special injury concept, which *Tooley* had criticized and sought to supplant. Third, rather than following *Tooley, Gentile* focused on the alleged wrongdoer and created an exception to the general framework set forth in *Tooley.*

As to the first source of tension between *Gentile* and *Tooley,* the Supreme Court recalled that under *Tooley,* a stockholder's alleged direct injury was required

to be *"independent* of any alleged injury to the corporation." Nonetheless, *Gentile* side-stepped this rule by holding that economic and voting dilution via a stock issuance to a controlling stockholder was a direct harm to minority stockholders. Having the opportunity to review this type of claim again squarely in *Brookfield,* the Supreme Court held that the allegation that stock issued in the private placement was issued for an unfairly low price did not allege a harm to the stockholders that was independent of the harm to the company. Rather, the injury "flowed indirectly to [stockholders] in proportion to, and via their shares"—a quintessentially derivative claim under *Tooley.*

As to the second source of tension, the Supreme Court noted that *Gentile* arguably relied on the special injury concept, which focused on whether one group of shareholders was impacted differently from another group, in reaching its conclusion that a claim could be both derivative and direct. *Tooley,* however, had specifically supplanted the "special injury test" and replaced it with a test centered on who suffered the alleged harm and who the remedy should flow to, creating tension between the two opinions.

The Supreme Court overruled *Gentile* and, in so doing, clarified that *Tooley* supplied the appropriate test for determining whether a claim is direct or derivative.

As to the third source of tension, *Gentile* focused on the controlling stockholder's role, which led to "doctrinal confusion" in the law. The Supreme Court reasoned that "the presence of a controller, absent more, should not alter the fact that such equity overpayment/dilution claims are normally exclusively derivative because the *Tooley* test does not turn on the identity of the alleged wrongdoer."

In addition to the Supreme Court's finding that *Gentile* was in tension with *Tooley,* the court also found that its holding was superfluous because under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.,* 506 A.2d 173 (Del. 1995), stockholders already had a basis for bringing direct claims to address fiduciary duty violations in the change of control context.

As a result, the Supreme Court overruled *Gentile* and, in so doing, clarified that *Tooley* supplied the appropriate test for determining whether a claim is direct or derivative. Because the Chancery Court had applied *Gentile* in refusing to dismiss the former Terraform stockholders' claims, the Supreme Court reversed the Chancery Court's denial of the defendant's motion to dismiss for lack of standing.

Caremark Claims

Firemen's Retirement System of St. Louis v. Arne M. Sorenson, et al. (Marriott International, Inc.): Court of Chancery Dismisses *Caremark* Claims Related to Starwood Data Breach

In *Firemen's Retirement System of St. Louis v. Arne M. Sorenson, et al. (Marriott International, Inc.)*, 2021 WL 4593777 (Del. Ch. Oct. 5, 2021), the stockholder-plaintiff's derivative lawsuit, which alleged that Marriott International Inc.'s board of directors breached its fiduciary duties in connection with a cybersecurity breach, was dismissed by the Delaware Court of Chancery under Rule 23.1 for failure to plead demand futility.

In 2015, Marriott International entered into an agreement (the "Acquisition") to acquire Starwood Hotels and Resorts Worldwide, Inc., which Acquisition closed in September 2016. Both prior to and following closing, cybersecurity was a "top level risk" for Marriott, though the pre-Acquisition board of directors of Marriott did not order any specific due diligence in connection with the Acquisition. Five days after Marriott and Starwood signed the merger agreement, Starwood disclosed that the point-of-sale systems at 54 of its hotels in North America had been infected by malware, and several months later, an internal Marriott report noted that Starwood's systems lacked certain protections. Marriot's board was not made aware of this information prior to closing. Post-closing, the board and the audit committee were "routinely apprised of cybersecurity issues," and at a February 2017 meeting, the board was "allegedly apprised for the first time about deficiencies in Starwood's security controls." Throughout 2017 and 2018, the board and audit committee received updates regarding cybersecurity, which addressed, among other things, the security concerns relating to Starwood's systems. The board received presentations from management and outside firms regarding these cybersecurity risks and the various mitigating procedures and/or measures Marriott had undertaken or planned to undertake in response thereto.

On September 7, 2018, Marriott discovered that Starwood's guest reservations systems had been breached. Ten days later, outside investigators engaged by Marriott uncovered malware on such system, and the next day, the board was notified of the breach. On October 29, 2018, after company investigators found evidence of other malware in Starwood's database, Marriott notified the FBI. "The Company's investigation continued into November 2018, with the Board and Audit Committee receiving regular updates from management and privileged briefings from Marriott's General Counsel." On November 30, 2018, Marriott publicly announced that "there had been unauthorized access to the Starwood network since 2014 that exposed the personal information of approximately 500 million guests." It was considered "one of the biggest data breaches in history," and Marriott's stock price plummeted following the announcement. Using documents obtained through a demand made pursuant to Section 220 of the General Corporation Law of the State of Delaware (the "DGCL"), the plaintiff brought a derivative claim against the board.

The plaintiff's claim was based on allegations that the defendants breached their fiduciary duties in three parts, by: (i) failing to conduct pre-Acquisition due diligence specific to cybersecurity, (ii) failing to implement adequate internal controls after the Acquisition, and (iii) concealing the data breach until November 30, 2018. The defendants moved to dismiss the claim pursuant to Court of Chancery Rule 23.1 for failure to make a demand on the board. Highlighting the new three-part demand futility test established in *United Foods & Commercial Workers Union v. Zuckerberg,* the court found that the second part of the test—whether a majority of the board would face a substantial likelihood of liability—applied to the facts of the case. The court held that demand was not excused and dismissed the complaint in its entirety.

First, the court held that the plaintiff's pre-Acquisition due diligence claim was barred by Delaware's three-year statute of limitations ("SOL"). The court found unpersuasive the plaintiff's argument that: (i) the defendants waived their untimeliness argument by not raising it in their opening brief; (ii) the SOL was tolled pursuant to fraudulent concealment and equitable tolling; and (iii) the SOL was tolled while the plaintiff pursued a books and records inspection pursuant to Section 220 of the DGCL.

As the court reasoned, for both prongs of *Caremark*, a showing of "bad faith conduct" is still required to establish oversight liability.

Next, the court held that the post-Acquisition board did not face "a substantial likelihood of liability for a sustained, bad faith failure of oversight" under either prong of *Caremark*. The court acknowledged that cybersecurity "is an area of consequential risk" that requires that "companies have appropriate oversight systems in place." The court emphasized, however, that such consequential risk does not lower the high threshold that a plaintiff must meet to plead a *Caremark* claim. As the court reasoned, for both prongs of *Caremark,* a showing of "bad faith conduct" is still required to establish oversight liability.

With respect to *Caremark* prong one, the court found that the board had systems in place to assess cybersecurity risks. The board and audit committee were "routinely apprised" of cybersecurity risks and mitigation, provided with annual risk assessment reports that specifically evaluated cybersecurity risks, engaged with outside firms to help improve corporate cybersecurity practices, and received information from management regarding "red flags" related to cybersecurity vulnerabilities. In short, the plaintiff failed to show that the board "made no good faith effort to ensure the company had in place any system of controls."

With respect to *Caremark* prong two, the plaintiff alleged that the board both knew of violations of law and consciously disregarded red flags. The court found that the board did not knowingly permit Marriott to violate positive law. "Pleading non-compliance with non-binding industry standards ... is not the same as pleading that directors knowingly permitted a company to violate positive law." The fact that Starwood's "[b]rand standards did not mandate PCI compliance, tokenization, or point-to-point encryption" was immaterial, as they were not mandated by law. The court found equally unpersuasive the plaintiff's argument that the board's failure to improve Starwood's deficient systems violated various other laws, which the plaintiff had simply listed "'in vague, broad terms' without alleging what law was violated and how." As the court noted, a *Caremark* claim requires that the plaintiff demonstrate scienter. In so holding, the court distinguished the facts of this case with the facts of *Massey* (involving violations of mining safety laws), *Westmoreland* (involving violations of FDA regulations), and *Abbott Labs* (involving violations of FDA regulations), noting that, unlike in those cases, the plaintiff in this case had not pled particularized facts that the board knowingly permitted Marriott to violate the law.

The court similarly held that the board did not consciously disregard "red flags," which were updates to the board regarding Starwood's cybersecurity measures that needed improvement. The plaintiff argued that, despite these red flags, the board waited a year before re-implementing Starwood's information protection systems. The court found that, "[e]ven if the gaps in Starwood's data security evidenced the sort of compliance failure that could support a viable claim under the second prong of *Caremark,* the Complaint lacks particularized allegations that the Board consciously overlooked or failed to address them." In other words, "[t]he[]

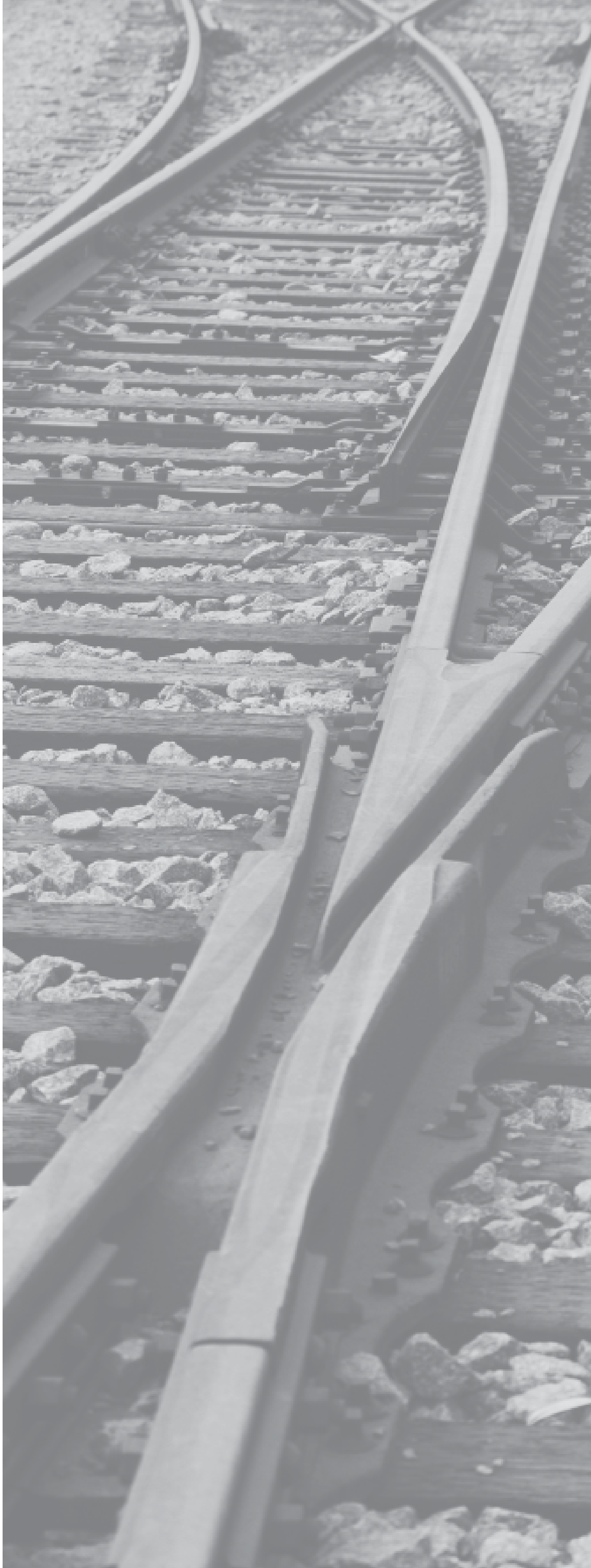
facts are not reflective of a board that has decided to turn a blind eye to potential corporate wrongdoing." The plaintiff also alleged that the board was exposed to *Caremark* liability for failing to immediately discontinue Starwood's system after learning that it was infected with malware (which, allegedly, led to the breach). The court found this argument equally unpersuasive, reasoning that the board had no reason to believe an immediate shutdown of Starwood's system was necessary. Finally, the court ruled that the timing of disclosure was not an obvious violation of notification laws that would suggest bad faith on the part of the board.

The court held that the plaintiff failed to allege particularized facts that could support a finding that any member of the board faced a substantial likelihood of liability on a non-exculpated claim. Therefore, a demand made on the board would not have been futile, and the defendants' motion to dismiss was granted.

In re Boeing Co. Derivative Litigation: *Caremark* Claims Survive Motion to Dismiss in Boeing 737 MAX Litigation

In *In re Boeing Co. Derivative Litigation,* 2021 WL 4059934 (Del. Ch. Sept. 7, 2021), the Court of Chancery denied a motion to dismiss derivative *Caremark* claims against directors of The Boeing Company, holding that, with one exception, the stockholder-plaintiffs had adequately pled with particularity that demand is futile. However, the court granted a motion to dismiss similar derivative claims against Boeing's officers, holding that the plaintiffs had not pled with the requisite particularity that demand is futile.

In October 2018, a Boeing 737 MAX airplane crashed, killing everyone on board. In March 2019, a second Boeing 737 MAX airplane crashed, with the same fatal result. Following numerous investigations and proceedings into the cause of the crashes, it was discovered "that the 737 MAX tended to pitch up due to its engine placement; that a new software program designed to adjust the plane downward depended on a single faulty sensor and therefore activated



too readily; and that the software program was insufficiently explained to pilots and regulators. In both crashes, the software directed the plane down."

The crashes resulted in the grounding of Boeing's entire 737 MAX fleet and caused significant financial and reputational harm to Boeing. In light of this, the plaintiffs brought derivative claims against the defendants, alleging that the defendants breached their duty of oversight. The defendants moved to dismiss all claims against them pursuant to Court of Chancery Rule 23.1 for failure to plead that the demand was futile.

The court first noted that to survive a Rule 23.1 motion to dismiss—where, as here, the plaintiffs forgo a demand on the board—the plaintiffs must plead particularized facts creating a reasonable doubt concerning the defendants' ability to consider the demand. Utilizing the demand futility test outlined in *Rales v. Blasband,* the court focused its analysis on whether the plaintiffs had alleged with particularity that a majority of the director defendants faced a substantial likelihood of liability for failing to fulfill their oversight duties.

In tackling this question, the court first noted that "the *[Caremark]* claim that corporate fiduciaries have breached their duties to stockholders by failing to monitor corporate affairs is 'possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.'" To clear this high hurdle, the plaintiffs must plead particularized facts that allow a reasonable inference that either "(1) 'the directors utterly failed to implement any reporting or information system or controls'; or (2) 'having implemented such a system or controls, [the directors] consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.'" The plaintiffs must also plead particularized facts that allow a reasonable inference that the defendants acted with scienter. While the plaintiffs asserted claims under both *Caremark* prongs, the court focused its analysis on this first prong.

In addressing the first *Caremark* prong, the court first highlighted the similarities with its recent decision in *Marchand*. Similar to *Marchand,* where food safety and regulatory compliance was "essential and mission critical," the court here reasoned that airplane safety—which was also alleged to have been externally regulated—"was essential and mission critical" to Boeing's business. The court explained that *Marchand* mandates that boards rigorously exercise their oversight function with respect to mission critical aspects of their company's business, and deficiencies in this area give rise to the reasonable inference that a board faces a substantial likelihood of liability under *Caremark* prong one. Analyzing the plaintiffs' prong one claim, the court focused on several alleged oversight deficiencies by Boeing's board of directors.

First, the complaint alleged that the board had no committee charged with direct responsibility to monitor airplane safety. While there was an audit committee charged with "risk oversight," it was alleged that its function was primarily geared toward monitoring Boeing's financial risks. It was further alleged that Boeing lacked an internal reporting system by which whistleblowers and employees could bring their safety concerns to the board's attention.

The board cannot leave compliance with "mission-critical safety" mandates to management's discretion rather than implementing and overseeing a more structured compliance system.

Second, the complaint alleged that the board did not monitor, discuss, or address airplane safety on a regular basis. As alleged, the board did not regularly allocate meeting time or devote discussion to airplane safety following the Ethiopian Airlines crash. The court noted that, under *Marchand,* "minimal regulatory compliance and oversight do not equate to a *per se* indicator of a reasonable reporting system: The fact that Boeing nominally complied with FAA regulations does not imply that the board implemented a system to monitor airplane safety at the board level."

Third, the complaint alleged that the board had no regular process or protocols requiring management to apprise the board of airplane safety; instead, the board allegedly only received *ad hoc* management reports that conveyed only favorable or strategic information. As the court reasoned, the board cannot leave compliance with "mission-critical safety" mandates to management's discretion rather than implementing and overseeing a more structured compliance system.

Fourth, the complaint alleged that management saw red, or at least yellow, flags, but that information never reached the board. As alleged, among other things, prior to the Lion Air crash, management received formal complaints from employees questioning the safety of the 737 Max airplane. However, there was no evidence that the board was apprised of these safety concerns. The court found that this supported the inference that the board failed to establish a reporting system.

The court further found that the plaintiffs sufficiently pled facts allowing a reasonable inference of scienter. Accordingly, the court held that the plaintiffs carried their burden under Rule 23.1 for their *Caremark* prong one claim, and the defendants' Rule 23.1 motion to dismiss was denied with respect to such claim. As a result of its finding with respect to the prong one claim, the court did not find it necessary to expressly decide the plaintiffs' claims with respect to prong two of their *Caremark* claim.

The court then turned to the plaintiffs' claim that the defendants breached their fiduciary duties by allowing Dennis Muilenburg, Boeing's former chairman and CEO, to receive unvested equity-based compensation in his retirement following the crashes. The court held that the plaintiffs had not pled particularized facts demonstrating that the defendants faced a substantial likelihood of liability for such claim and dismissed the claim. The court also granted the motion to dismiss as to the plaintiffs' similar derivative claim against Boeing's officers, noting that the plaintiffs had not pled such claim with the requisite particularity.

On February 23, 2022, the court approved a $237.5 million settlement of the derivative claims against the board.

Dissolution

In re Altaba, Inc.: Court of Chancery Clarifies Standard for Setting Dissolution Reserves

In *In re Altaba, Inc.,* --- A.3d ----, 2021 WL 4705176 (Del. Ch. Oct. 8, 2021), the Delaware Court of Chancery ruled that Altaba, Inc. must set aside $400 million to cover potential indemnification liability it could face following its dissolution.

In 2016, Altaba sold its operating company, Yahoo, Inc., to Verizon Communications Inc. Following the sale, Altaba disclosed massive data breaches that impacted up to three billion users. Litigation ensued in state, federal, and foreign courts. A number of the federal class actions were consolidated and transferred to the United States District Court for the Northern District of California, where a settlement was reached and approved. The settlement was appealed and, at the time the Court of Chancery's opinion was issued, was pending before the United States Court of Appeals for the Ninth Circuit.

In 2019, Altaba dissolved and undertook the long-form dissolution process under Sections 280 and 281(a) of the General Corporation Law of the State of Delaware (the "DGCL") that contemplates a court-supervised notice of claims process and calculation of a reserve sufficient to satisfy prospective claims. Notably, this long-form process obliged Altaba to offer the holders of contingent, conditional, or unmatured contractual claims an "amount and form of security that will be sufficient to satisfy the claim[s] if [they] mature[]." Verizon asserted a contingent contractual claim to indemnification from Altaba for "50% of the liabilities associated with the [class actions]." Verizon rejected Altaba's proposed security, prompting Altaba to petition the Court of Chancery to approve the security's amount and form.

Altaba argued that it only needed to provide a security that was "reasonably likely to be sufficient to provide compensation" for Verizon's claim (which it argued was $0 given the settlement), while Verizon argued that Altaba needed to provide a security that was "sufficient to provide compensation to the claimant if

the claim matures" (a "Sufficiency Standard"). The court held in Verizon's favor on this point, reasoning that Section 280(c)(2)'s plain terms so require and that applying a Sufficiency Standard to contract claims harmonizes the dissolution process with Delaware's historic solicitude for contract rights. Accordingly, the court concluded that Altaba must reserve an amount that would be sufficient to pay Verizon's full claim should it mature with no discount for its probability of success.

The court next determined what amount would be sufficient to satisfy Verizon's claim if it matured. The court first explained that this approach did not require the court to accept a "worst case result," but rather a reasonable assessment of "the range of possibilities that could exist if the claim matures." The court supposed a number of reasonable outcomes could manifest, but only considered outcomes in which Verizon's claims matured (and thereby ruled out, for example, a universe in which the Ninth Circuit affirmed the settlement, which would render Verizon's claim worthless). Thus, although the "undoubtedly ... odds-on result" was that the court of appeals would affirm the settlement, the court looked only to possibilities in which the Verizon claim would mature, among them the possibility of a massive class action judgment rendered against Yahoo in which indemnifiable damages could exceed $1 billion. However, because Verizon had only requested a reserve of $400 million, the court affixed that number as the necessary holdback upon concluding it took into account known risks, "[fell] within a range of reasonableness," and was supported by Delaware public policy in favor of creditors' rights and principles of comity, and against the duplicative litigation that occurs in instances in which two full trials must be held on the same issue.

The court concluded that Altaba must reserve an amount that would be sufficient to pay Verizon's full claim should it mature with no discount for its probability of success.

Dividends

In re Chemours Co. Derivative Litigation: Lawsuit Alleging Wrongful Dividends Dismissed

In *In re Chemours Co. Derivative Litigation,* 2021 WL 5050285 (Del. Ch. Nov. 1, 2021), the Delaware Court of Chancery dismissed derivative claims against directors and officers of The Chemours Company brought by Chemours stockholders challenging dividends paid and stock repurchases made by Chemours after it was spun off from E. I. DuPont de Nemours and Company in 2015. Based on allegations that the Chemours board relied on GAAP and consulted with management and outside financial advisors in determining that Chemours had sufficient lawfully available funds for the challenged dividends and stock repurchases, the court found that the complaint did not plead "willful or negligent" violations of Section 160, 170, or 173 of the Delaware General Corporation Law (the "DGCL") and established that the directors were "fully protected" under Section 172 of the DGCL for their good faith reliance on Chemours's records, officers, and financial advisors. Accordingly, the court found that none of the director defendants faced a substantial likelihood of liability and dismissed the claims under Court of Chancery Rule 23.1.

In connection with its spin-off of Chemours, DuPont transferred certain contingent environmental liabilities to Chemours. In 2019, Chemours sued DuPont, asserting that if a contract between them was interpreted as transferring all of these environmental liabilities to Chemours, the spin-off was illegal and rendered Chemours insolvent *ab initio*. Between 2015 and 2020, including during the pendency of the DuPont litigation, the challenged dividends were declared and paid, and Chemours repurchased approximately $1.07 billion in shares of its common stock.

Based on Chemours's own allegations in its litigation with DuPont, the plaintiffs asserted that Chemours was aware that it lacked surplus as a result of the disputed contingent environmental liabilities. The plaintiffs further alleged that the Chemours board determined that Chemours had sufficient surplus for the dividends and stock repurchased using GAAP principles, as explained to them by Chemours's officers and outside advisors. As the plaintiffs contended that GAAP did not require accounting for these contingent environmental liabilities, the plaintiffs asserted that the board's reliance on GAAP constituted willful wrongdoing or negligence.

As an initial matter, the Court of Chancery found that the complaint conceded that most of the challenged dividends were declared and paid in accordance with Section 170 of the DGCL, which allows dividends to be paid out of a corporation's surplus or, in case there is no such surplus, out of the corporation's "net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year." The court explained that Chemours's annual net profits from 2014 through 2020 included in the complaint were sufficient to support the payment of nearly all of the challenged dividends regardless of whether Chemours had sufficient surplus available.

The court then found that the directors did not face a substantial likelihood of liability with respect to the remaining challenged dividends and stock repurchases. The court explained that Section 154 of the DGCL "does not require any particular method of calculating surplus, but simply prescribes factors that any such calculation must include." The court further explained that, under Delaware law, courts "defer to the Board's surplus calculation 'so long as [the directors] evaluate assets and liabilities in good faith, on the basis of acceptable data, by methods that they reasonably believe reflect present values, and arrive at a determination of the surplus that is not so far off the mark as to constitute actual or constructive fraud.'" Applying this standard, the court rejected the plaintiffs' argument that the board's reliance on GAAP was improper. Despite the plaintiffs' assertions that GAAP failed to recognize all of the contingent environmental liabilities and only included those that were both "probable" and "reasonably estimable," the court found that the complaint failed to provide any specific reason why the board was required to depart from GAAP's "generally accepted" approach here. In addition, the court ruled that, even if any excluded contingent environmental liabilities were included, the complaint failed to plead that their inclusion would have prevented Chemours from having sufficient surplus. Notably, the court held that it was proper to discount contingent liabilities to present value for purposes of calculating surplus, reasoning that under Delaware precedent, "Sections 160 and 170 only require a valuation that 'reasonably reflect[s] present values'" and "[s]uch a valuation would necessarily include a probability component." For these reasons, the court found that none of the directors faced a substantial likelihood of liability under Section 174 of the DGCL.

Separately, the court found that the defendants were "fully protected" from liability under Section 172 of the DGCL, which generally protects directors for their good faith reliance on corporate records, officers, employees, board committees, and professional advisors in determining the existence of surplus and lawfully available funds to declare and pay dividends or repurchase or redeem stock. The court held that Section 172 is available as a pleading-stage defense if it is clear from the allegations in a complaint. As the plaintiffs' complaint recited the presentations provided to the board by, and the board's discussions with, Chemours's financial advisors and management in connection with the board's determinations regarding surplus and related matters, the court found that the directors were "fully protected" under Section 172 in making these determinations and did not face a substantial likelihood of liability.

Despite the plaintiffs' assertions that GAAP failed to recognize all the contingent environmental liabilities and only included those that were "probable" and "reasonably estimable," the court found that the complaint failed to provide any specific reason why the board was required to depart from GAAP's "generally accepted" approach.

In light of the foregoing, the court found that the directors also did not face a substantial likelihood of liability with respect to the plaintiffs' related breach of fiduciary duty claims or other claims challenging stock sales made by Chemours officers while Chemours was allegedly insolvent. Accordingly, the court found that demand was not excused for any of the plaintiffs' claims and dismissed the complaint in its entirety under Court of Chancery Rule 23.1.

Advance Notice Bylaws

Rosenbaum v. CytoDyn Inc.: Director Nominations Properly Excluded for Failure to Comply with Advance Notice Bylaw

Rosenbaum v. CytoDyn Inc., 2021 WL 4775140 (Del. Ch. Oct. 13, 2021), is a post-trial opinion in which the Delaware Court of Chancery held that because dissident stockholders' director nominations violated the corporation's concededly valid advance notice bylaw, such stockholders' request for a mandatory injunction requiring the corporation to allow their nominees to stand for election was denied.

The plaintiffs, three significant stockholders of CytoDyn Inc., purported to nominate an opposing slate of directors for election at CytoDyn's annual stockholder meeting. A few of the plaintiffs' nominees had ties to another company, IncellDx, Inc., which had a "complicated history" with CytoDyn—including a failed acquisition of IncellDx by CytoDyn and a patent dispute between the two companies—that presaged a proxy contest that the plaintiffs began planning in March 2021.

In preparation for the proxy contest, Rosenbaum began communicating with a group of dissident stockholders. The group discussed, among other things, the advance notice provision in CytoDyn's bylaws: an advance notice bylaw that required any stockholder seeking to nominate any persons for election to the board at an annual meeting of stockholders to disclose, during a specified period in advance of the meeting, information regarding the person making the nomination, the proposed nominees, and the agreements, arrangements, and understandings among the proponents and other persons with respect to the nominations. In response, CytoDyn's board of directors expanded to elect a new independent director and employed a consultant to monitor the dissident group.

On June 30, 2021, the plaintiffs sent their director nomination notice to CytoDyn, which was received by the company one day before the deadline set by the advance notice bylaw. On July 30, almost a month after receiving the nomination notice, CytoDyn sent a letter to the plaintiffs identifying several deficiencies in their nomination notice, including the plaintiffs' failure to disclose information with respect to IncellDx's previous proposal to be acquired by CytoDyn, potential future transactions between CytoDyn and IncellDx that the plaintiffs were considering, and the role of a company that the plaintiffs had formed to fund the proxy contest.

On August 11, the plaintiffs responded to the letter by disputing CytoDyn's application of the advance notice bylaw and attaching a supplemental notice. CytoDyn replied that the supplemental notice had not cured the deficiencies and that the plaintiffs had no right to nominate directors at the upcoming 2021 annual meeting.

The plaintiffs thereafter filed their definitive proxy statement with the SEC and initiated an action in the Court of Chancery to have the rejection of the nomination notice declared invalid and to allow the director nominations to proceed. The matter was deemed fully submitted on a post-trial, paper record on October 8, and the court rendered a decision on October 13.

The court entered a final judgment in favor of defendants. To begin its analysis, the court determined the applicable standard review, and ultimately held that the issue would turn on principles of contract interpretation and the equitable overlay of *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437 (Del. 1971).

In so holding, the court rejected the plaintiffs' argument that the board's rejection of the nomination

notice should be reviewed under the standard established in *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988), which provides that "director conduct intended to interfere with or frustrate shareholder voting rights is presumptively inequitable and will be invalidated, unless the directors are able to rebut that presumption by showing a compelling justification for their actions." The court so held on grounds that the plaintiffs' theory "extend[ed] *Blasius* beyond its intended limits"; that is, because the *Blasius* standard is reserved for instances where "self-interested or faithless

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The plaintiffs "went wrong ... by playing fast and loose in their responses to key inquiries embedded in the advance notice bylaw" and then submitting their nomination at the last minute.

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fiduciaries act to deprive stockholders of a full and fair opportunity to participate in the matter" and the "challenged action had to be taken for the sole or primary purpose of thwarting a shareholder vote," it should not be applied to all instances of board interference with a stockholder vote. Applying this general limitation to the facts at bar, the court concluded that because the plaintiffs failed to either challenge the bylaw's adoption or allege that the board engaged in manipulative conduct, *Blasius* did not apply. Rather, because the board had rejected the plaintiffs' nominees on the basis of CytoDyn's advance notice bylaw, the court determined to apply general principles of contract interpretation that, under Delaware law, govern alleged breaches of corporate bylaws. The court further reasoned that general principles of equity espoused in *Schnell,* which established that directors may not undertake inequitable action simply because such action is legally possible, would also apply.

Applying principles of contract interpretation, the court sided with CytoDyn and the incumbent board. CytoDyn's advance notice bylaw required all director nomination submissions to provide information pertaining to the interests and intentions of the nominees and their proponents by a date certain, which the plaintiffs plainly failed to do. Further, the court highlighted that the plaintiffs had read and understood the bylaw's content and timing requirements, yet inexplicably submitted a deficient notice on the eve of the deadline. Accordingly, the court held that the board had appropriately applied the advance notice bylaw in rejecting the plaintiffs' notice.

Finally, the court held that *Schnell*'s equitable overlay did not require a contrary result, and in particular that the board's month-long delay in identifying the plaintiffs' deficiencies was of no moment. The court reasoned that the advance notice bylaw had been in place for years, and "had Plaintiffs submitted their Nomination Notice well in advance of the deadline, they might have a stronger case that the Board's prolonged silence upon receipt of the notice was evidence of manipulative conduct." Instead, the court continued, the plaintiffs "went wrong ... by playing fast and loose in their responses to key inquiries embedded in the advance notice bylaw" and then submitting their nomination at the last minute, "leaving no time to fix the deficient disclosures when the incumbent Board exposed the problem." This course of action did not permit equitable principles to override the board's straightforward application of CytoDyn's advance notice bylaw.

Initial Public Offerings

In re SmileDirectClub, Inc. Derivative Litigation: Post-IPO Stockholders Lack Standing to Challenge Pre-IPO Board Decisions

In *In re SmileDirectClub, Inc. Derivative Litigation,* 2021 WL 2182827 (Del. Ch. May 28, 2021), the Court of Chancery dismissed a derivative suit challenging transactions with alleged insiders for lack of standing because the plaintiffs purchased their stock after the challenged transactions and the terms thereof had been authorized and disclosed, notwithstanding that the transactions were completed after the plaintiffs became stockholders.

In connection with its IPO, SmileDirectClub, Inc. ("SDC") implemented an "UP-C" structure under which public stockholders held shares of SDC's Class A common stock, SDC and certain pre-IPO investors held units in a limited liability company through which SDC conducted its business (the "LLC Units"), and each such pre-IPO investor also held a number of shares of SDC's Class B common stock equal to the number of LLC Units held by such investor. As part of the IPO, SDC filed its Form S-1 Registration Statement, which stated that SDC intended to use the IPO's proceeds to purchase LLC Units and shares of Class A common stock held by pre-IPO holders, including members of SDC's board of directors and their affiliates, at the IPO price (less underwriting discount). The registration statement further disclosed and detailed at length how SDC would finance these transactions, the exact number of LLC Units and Class A shares that SDC would purchase from the pre-IPO investors upon the IPO's closing, and the price at which such LLC Units and Class A shares would be purchased. The IPO raised sufficient funds, and immediately thereafter SDC consummated these transactions in the manner that had been disclosed in the registration statement.

Plaintiffs who purchased shares of SDC's Class A common stock on the initial day of trading brought multiple lawsuits in the Delaware Court of Chancery contesting these transactions, asserting a derivative claim for breach of fiduciary duty against SDC's directors and related derivative claims for aiding and abetting and unjust enrichment. Pointing to the fact that the trading price of SDC's Class A common stock had declined between the beginning of trading and the consummation of the challenged repurchases, the plaintiffs alleged that the directors breached their fiduciary duties by "deciding to pay an excessively high price for the Units and Common Stock acquired ... from corporate insiders at ... a grossly inflated price." Thereafter, the defendants moved to dismiss these claims, contending that the plaintiffs were not stockholders at the time of the challenged conduct and lacked standing to pursue their derivative claims under the contemporaneous ownership requirement set forth in Section 327 of the Delaware General Corporation Law (the "DGCL").

Ruling on the motion to dismiss, the court found that the plaintiffs lacked standing to pursue the claims and dismissed the complaint in its entirety. The court explained that owning stock at the time of the challenged conduct is a prerequisite to maintaining

"Where the plaintiff complains of the transaction's terms, rather than the technicalities of its actual consummation, the 'time of the challenged transaction' is the time when the transaction's terms were established."

a derivative action under Section 327 of the DGCL and, in this connection, longstanding Delaware Supreme Court precedent has held that "[w]here the plaintiff complains of the transaction's terms, rather than the technicalities of its actual consummation, the 'time of the challenged transaction' is the time when the transaction's terms were established." Because the terms of the challenged transactions were fixed in advance and the challenged transactions were executed exactly as disclosed in the registration statement, the court held that the plaintiffs were barred from challenging the transactions on the terms that were fixed and disclosed before the plaintiffs purchased their stock. ■

LIMITED LIABILITY COMPANIES AND PARTNERSHIPS

Dlayal Holdings, Inc. v. Marwan Al-Bawardi: Court of Chancery Draws Distinction Between Overseeing Day-to-Day Operations and Managing a Limited Liability Company

In *Dlayal Holdings, Inc. v. Marwan Al-Bawardi,* 2021 WL 6121724 (Del. Ch. Dec. 27, 2021), the Delaware Court of Chancery granted a motion to dismiss an action brought against three Kansas residents, Rodger Gracey, Betty Gracey, and Marnie Gracey, due to a lack of personal jurisdiction. In a memorandum opinion, the court held that the Graceys' oversight of the day-to-day operations of two properties in Kansas was not equivalent to managing the Delaware limited liability company that owned those properties, and thus jurisdiction was improper.

The dispute concerns a Delaware limited liability company, Oasis Direct Seven LLC, which is wholly owned by its sole member, plaintiff Dlayal Holdings, Inc. Oasis was formed for the purposes of managing real property in several states, including two properties in Kansas managed by the Graceys. Between 2000 and 2019, managers of Oasis signed several powers of attorney granting Rodger Gracey continued authority to manage the first property, including by performing duties related to "running, maintaining, or administering the affairs" of the property and "sign[ing] any contract ... required for the purposes of administering and managing" the property. In 2015, Oasis formed a Kansas limited liability company for the purpose of purchasing a second adjacent property and appointed Rodger Gracey as its manager. Marnie Gracey assisted with the purchase of the second property. Betty Gracey acted as an accountant and bookkeeper for both properties. In 2019, upon reviewing the books and records of the first property, Dlayal discovered accounting irregularities and alleged that the Graceys misappropriated company funds, made unauthorized purchases, and incurred substantial debt in Oasis's name without authorization. In 2020, Dlayal filed a complaint against a former manager of Oasis, Marwan Albawardi, for breach of fiduciary duty. Albawardi then filed a third-party complaint against the Graceys seeking indemnification. The Graceys moved to dismiss the third-party complaint for lack of personal jurisdiction.

In a two-step analysis used by Delaware courts to resolve questions of jurisdiction, the court must first determine that service of process on a defendant is authorized by statute. Dlayal and Albawardi identified Section 18-109(a) of the LLC Act as the statutory basis for exercising personal jurisdiction over the Graceys, which authorizes service of process on the "managers" of Delaware limited liability companies. The key question was whether the Graceys were "managers" of Oasis for purposes of the statute. As the court explained, the term "manager" is defined in the statute to include both "formal managers" and "acting managers." A formal manager is designated as a manager in the entity's governing documents, and Dlayal and Albawardi conceded that none of the Graceys were formal managers. They instead contended that the Graceys were "acting managers" due to their participation in the management of the properties.

The court, however, rejected the argument that the Graceys were "acting managers" by analyzing the plain meaning of the term "acting manager." Under the applicable statute, an "acting manager" is defined as someone who "participates materially in the management of the limited liability company." The court held that the phrase "participated materially" requires meaningful participation, rather than minor participation, and thus an "individual must take a significant role in management of a limited liability company in order to qualify as an acting manager." The court discussed Delaware cases in which defendants were found to have participated materially in the management of a company for purposes of the statute. One defendant was named as "a Principle and key man" and conceded that he "participated materially in the management" of the companies." In two other separate cases, each defendant served as the president of the company, controlled the day-to-day affairs, and made key decisions for the company. Another defendant directed a company's filing of an action seeking dissolution, while that company had no employees at the time of the filing.

By contrast, the court noted, Rodger Gracey did not serve as an officer of Oasis, oversee Oasis's operations, hold decision-making authority, or participate in the management of the Oasis investment portfolio. He was not even consulted when Oasis decided to sell the properties. The court held that Rodger Gracey's mere management of the day-to-day operations of the two properties was not equivalent to materially participating in the management of Oasis itself because Oasis "did not exist solely to manage" the properties and instead was "formed ... to own and manage real property in various states."

The key question was whether the Graceys were "managers" of Oasis for purposes of the statute. As the court explained, the term "manager" is defined in the statute to include both "formal managers" and "acting managers."

The court compared the facts to another case in which no material participation was found where a defendant "negotiated a distribution agreement on behalf of the subsidiary, arranged bridge financing for the subsidiary and marketed the subsidiary's products." The court also rejected the argument that the powers of attorney that granted Rodger Gracey the authority to administer the first property provided a basis to deem him a manager of Oasis. Under Section 18-407 of the LLC Act, a manager may delegate any of his powers to manage the business of the company, and such delegation "shall not cause the person to whom any such rights, power and duties have been delegated to be ... a manager" of the company.

Lastly, the court found the arguments regarding jurisdiction over Betty Gracey and Marnie Gracey to be "even more strained" since "the limited responsibilities they allegedly had ... cannot support an inference" that they participated in the management of Oasis. Given that no other basis for jurisdiction over the Graceys was asserted, the court granted their motion to dismiss.

In re Cadira Group Holdings, LLC Litigation: Court of Chancery Finds that LLC Agreement Replaced Fiduciary Duties with Identical Contractual Duties

In *In re Cadira Group Holdings, LLC Litigation,* 2021 WL 2912479 (Del. Ch. July 12, 2021), the Delaware Court of Chancery considered competing motions to dismiss and ultimately denied both motions. Cadira Group Holdings, LLC was formed as a Delaware limited liability company and is the joint venture of Knights Genesis Healthcare, LLC ("KGH") and Perseverance Med, LLC for the purpose of targeting investments in the healthcare field. Beau Gertz is the sole manager of Cadira and is also the controller of Perseverance.

KGH claimed, *inter alia,* that Gertz had breached the fiduciary duties that he owed under the Cadira LLC agreement with respect to KGH itself and derivatively on behalf of Cadira. In particular, KGH asserted that Gertz wrote checks, withdrew funds, incurred debt, entered into transactions, and hired and fired management personnel in violation of the Cadira LLC agreement and his fiduciary duties to KGH and Cadira by not obtaining unanimous member approval in connection with such actions. The Cadira LLC agreement required Gertz, in his capacity as manager of Cadira, to obtain unanimous approval from all Cadira's members in order to write checks, withdraw funds from Cadira's bank accounts, incur debt, enter into or effect any one of a number of transactions, appoint or remove Cadira's officers and management, or enter into, amend, waive, or terminate any related-party agreement.

The court noted that under the LLC Act, the fiduciary duties of a manager may be expanded, restricted, or eliminated by the provisions in a limited liability company agreement. Absent such modifications, traditional fiduciary duties applicable to Delaware corporations apply. In order to eliminate traditional fiduciary duties, the drafters of a limited liability company agreement must make their intent to eliminate traditional fiduciary duties plain and unambiguous. The Cadira LLC agreement contained an exculpation provision purporting to restrict the liability of Cadira's managers to acts or omissions of such manager constituting fraud, gross negligence, willful misconduct, or a material breach of the Cadira LLC agreement or acts or omissions made in knowing violation of the Cadira LLC agreement. The Cadira LLC agreement also contained a provision purporting to restrict the liability and fiduciary duties of Cadira's managers and members to the maximum extent permitted by applicable law. Such provision similarly restricted the liability of a manager to acts or omissions involving bad faith, gross negligence, willful misconduct, or actual fraud.

The court, in considering KGH's breach of fiduciary duty claims, noted that "[w]here an LLC agreement purports to replace traditional fiduciary duties with duties not to engage in bad faith, willful misconduct, or gross negligence, that agreement essentially 'replaces' traditional fiduciary duties with identical contractual duties." The court expounded on this, stating that "a contractual duty to refrain from 'willful misconduct' or 'bad faith' corresponds with the traditional duty of loyalty, and a contractual duty to refrain from 'gross negligence' corresponds with the traditional duty of care." The court noted that while the Cadira LLC agreement purported to restrict the liability and fiduciary duties owed by Cadira's members and managers, it also authorized claims against a manager arising from such manager's bad faith, gross negligence, willful misconduct, or actual fraud. As a result, the court noted that it cannot be said that the drafters of the Cadira LLC agreement evinced a plain and unambiguous intent to fully displace traditional fiduciary duties and declined to dismiss KGH's claims for breach of fiduciary duty against Gertz.

The court expounded on this, stating that "a contractual duty to refrain from 'willful misconduct' or 'bad faith' corresponds with the traditional duty of loyalty, and a contractual duty to refrain from 'gross negligence' corresponds with the traditional duty of care."

Murfey v. WHC Ventures, LLC: Delaware Supreme Court Decision Prompts Amendment to Delaware LP Act Providing that Limited Partners' Inspection Rights Are Limited to "Necessary and Essential" Information

In *Murfey v. WHC Ventures, LLC,* 236 A.3d 337 (Del. 2020), the Delaware Supreme Court, in a three-to-two split decision, reversed a judgment of the Court of Chancery and held that limited partners seeking books and records under a contractual provision of a partnership agreement do not need to make the "necessary and essential" showing when the partnership agreement does not "expressly condition" such an inspection right upon satisfying the "necessary and essential" standard.

Defendant/appellee WHC Ventures, LLC ("WHC GP") is the general partner of several Delaware limited partnerships, including defendants/appellees WHC Venture 2009-1, L.P., WHC Ventures 2013, L.P., and WHC Ventures 2016, L.P. (collectively, the "WHC Partnerships"). In 2011, WHC GP presented the limited partners of the WHC Partnerships with two opportunities to increase their ownership interests in WHC Venture 2009-1, L.P. ("WHC 2009"). Plaintiffs/appellants Trust for the Benefit of Spencer L. Murfey, III and Trust for the Benefit of Cynthia H. Murfey (collectively, the "Murfeys") are limited partners of the WHC Partnerships. The Murfeys participated in only one of the opportunities to increase their ownership interests in WHC 2009. As a result of the Murfeys participating in only one of the investment opportunities and WHC 2009 admitting new limited partners, the Murfeys' ownership percentages in the WHC Partnerships decreased.

In 2018, the Murfeys made a books and records demand on the WHC Partnerships under Section 17-305 of the LP Act and the WHC Partnerships' respective partnership agreements. The Murfeys sought to inspect the books and records of the WHC Partnerships in order to value their interests in the WHC Partnerships and to investigate wrongdoing and mismanagement related to the reduction of their ownership interests. The demand included a request

for “copies of each Partnership’s federal, state and local income tax or information returns and reports, if any, for the six most recent taxable years.” Although the WHC Partnerships responded to the demand by pointing out that the Murfeys lacked proper purpose and sought information not related to the alleged purposes, the WHC Partnerships produced all the requested documents except copies of the Schedule K-1s sent to other limited partners.

The Court of Chancery, applying case law from corporate precedents, found that for a party to succeed in making a demand under Section 17-305, the party needs to not only prove a “proper purpose” but also must prove that the requested documents are “necessary and essential” to accomplish that purpose. Although the Court of Chancery found that the Murfeys demonstrated a “proper purpose” by seeking to value their interests in the WHC Partnerships (but found no credible basis for the suspicion of wrongdoing), it held that the Murfeys failed to prove that the Schedule K-1s were “necessary and essential” in accomplishing that purpose. Thus, the Court of Chancery held that the Murfeys were not entitled to the Schedule K-1s.

On appeal, the Murfeys argued that they had the right to copies of the Schedule K-1s under Section 17-305 as well as under the WHC partnership agreements (which contained books and records provisions substantially similar to the language of Section 17-305). The Delaware Supreme Court declined to address the Murfeys’ argument under Section 17-305. The Supreme Court did note that although there were instances in which the Court of Chancery had looked to the analogous corporate statute and related corporate precedents to interpret Section 17-305, the issue of whether a “necessary and essential” scope requirement from corporate precedents was applicable for purposes of Section 17-305 had never been specifically addressed by the Delaware Supreme Court.

Rather than addressing this admittedly interesting issue, the majority opinion focused on the contractual inspection rights and held that under the plain terms of the WHC partnership agreements, the Murfeys were entitled to obtain copies of the Schedule K-1s upon stating a proper purpose, subject to reasonable standards the WHC GP may establish. Although it agreed with the Court of Chancery's proper-purpose analysis, the Supreme Court declined to import a "necessary and proper" requirement into the WHC partnership agreements, emphasizing the freedom of contract in the alternative entity context. The Supreme Court stated that the WHC Partnerships should not be able to determine which information from the tax returns they deem to be "necessary and essential" to the Murfeys' valuation purpose when they have not set forth in the partnership agreement any standards or restrictions that pertain to inspection rights. Furthermore, the Supreme Court stated that although partnership agreements and limited liability company agreements may adopt concepts from the laws of other entities, any similarity in language used in those agreements to the corresponding statutory scheme does not mean that courts should import new terms and conditions into the agreement that simply do not exist within the four corners of the agreement, particularly where the parties could have easily drafted such terms and conditions.

The Supreme Court declined to import a "necessary and proper" requirement into the WHC partnership agreements, emphasizing the freedom of contract in the alternative entity context.

After the *Murfey* decision, language was added to Section 17-305(f) of the LP Act to clarify that when a limited partner is entitled to obtain information for a proper purpose or other stated purpose (whether pursuant to a statutory right under Section 17-305 or a contractual right under a partnership agreement), the limited partner's right is limited to information that is "necessary and essential" to achieve such purpose, unless that right has been expanded or restricted in the partnership agreement. This amendment is intended to (i) change the law set forth in *Murfey* (holding that the "necessary and essential" test does not apply by default to a limited partner's contractual right to obtain information for a stated purpose), and (ii) clarify that the "necessary and essential" test also applies to a limited partner's statutory right to obtain information under Section 17-305 for a proper purpose.

Dohmen v. Goodman: Delaware Supreme Court Finds No Disclosure Obligations in Context of Individual Capital Contribution Transaction

In *Dohmen v. Goodman,* 234 A.3d 1161 (Del. 2020), the Delaware Supreme Court answered a question certified to it by the United States Court of Appeals for the Ninth Circuit concerning (i) whether a general partner's request to a limited partner for a one-time capital contribution constituted a request for limited partner action such that the general partner has a duty of disclosure; and (ii) if the general partner fails to disclose material information in connection with the request, may the limited partner prevail on a breach of fiduciary duty claim and recover compensatory damages without proving reliance and causation. The court found in the negative with respect to both queries.

In *Dohmen,* Bert Dohmen formed Croesus Fund, L.P. as a Delaware limited partnership and Macro Wave Management, LLC to serve as Croesus's general partner. Dohmen was the sole member and manager of Macro Wave. Albert Goodman was an investor and limited partner in Croesus. Goodman specifically inquired about other investors in Croesus, once after an initial investment and again in connection with a second investment. Both times Dohmen indicated that friends of his had expressed an interest in participating in Croesus. In fact, none had committed to investing and the only investors in Croesus were Dohmen and Goodman.

Goodman sued Dohmen, alleging common law fraud by misrepresentation, securities fraud, and breach of fiduciary duty. The district court found against Goodman on the claims of common law fraud and securities law fraud because Goodman could not satisfy the requirement of loss causation required for such claims. The district court found in Goodman's favor with respect to his claim for breach of fiduciary duty. The court held that Dohmen had misrepresented the number of investors in connection with Goodman's second investment and characterized the misrepresentation as one made "when seeking [limited] partner action." The court further held that Goodman did not need to prove reliance or causation to support his breach of fiduciary duty claim and awarded him compensatory damages.

The Supreme Court held that an affirmative fiduciary duty of disclosure does not apply to individual transactions.

On appeal, the Ninth Circuit rejected all of Dohmen's arguments except whether the district court should have required Goodman to prove loss causation because Dohmen did not make the material misrepresentation in connection with a request for limited partner action. The Ninth Circuit certified the question to the Delaware Supreme Court.

The Supreme Court found that absent modification, a general partner's duties to a limited partnership and its limited partners parallel those of a director of a Delaware corporation. Most relevant, a director's fiduciary duties of care and loyalty apply when directors communicate with stockholders.

The Supreme Court noted that a director's specific disclosure obligations are defined by the context in which a director communicates information and distinguished between two contexts: (i) communication associated with a request for stockholder action (such as approving corporate transactions (mergers, sale of assets, etc.) and making investment decisions (purchasing and tendering stock or making an appraisal election)), and (ii) communication not associated with a request for stockholder action (such as when directors make periodic financial disclosures). When directors request stockholder action, they must disclose fully and fairly all material facts within their control bearing on the request. They breach this duty of disclosure when the alleged omission or misrepresentation is material. When directors seek stockholder action and breach their fiduciary duty of disclosure, a stockholder can seek equitable relief or damages. A fiduciary's damages are characterized as "per se"; that is, when directors seek stockholder action and fail to disclose material facts bearing on that decision, a beneficiary does not need to demonstrate proof of reliance, causation, or damages. The per se damages rule, however, presumes only nominal damages. Reviewing precedent, the court noted that the per se damages rule is limited to nominal damages and only applies if there is impairment of economic or voting rights.

The duty of disclosure does not apply to communications not associated with a request for stockholder action, but the directors must still deal honestly with stockholders. To state a claim for a breach of fiduciary duty in this context, the directors must have knowingly disclosed false information.

The Supreme Court held that an affirmative fiduciary duty of disclosure does not apply to individual transactions, such as when a corporation asks a stockholder as an individual to enter into a purchase or sale. Under the facts of the case, Dohmen did not have a fiduciary duty of disclosure. However, even if he did, the court found that Goodman would still have to prove reliance and causation to recover the compensatory damages sought in his case.

Borealis Power Holdings Inc. and BPC Health Corp. v. Hunt Strategic Util. Inv., L.L.C.: Delaware Supreme Court Reverses Ruling Regarding Applicability of Right of First Refusal in the Context of an Indirect Transfer

In *Borealis Power Holdings Inc. and BPC Health Corp. v. Hunt Strategic Util. Inv., L.L.C.*, 233 A.3d 1 (Del. 2020), the Delaware Supreme Court interpreted the language of various agreements to determine whether an indirect transfer of interests in a Delaware LLC triggered certain restrictions. Ultimately, the Supreme Court reversed a judgment of the Court of Chancery and remanded the case to the Court of Chancery to enter a judgment in favor of Borealis Power Holdings Inc. and BPC Health Corporation (jointly, "Borealis"). In so doing, the Delaware Supreme Court held that a right of first refusal in an investor rights agreement of Oncor

Electric Delivery Company LLC (the "Oncor IRA") did not apply to an indirect equity holder of Oncor.

Oncor is owned by two sets of parties. Hunt Strategic Utility Investment, L.L.C. owns 1% of Texas Transmission Holdings Corporation ("TTHC") (the "Hunt Interest"). Borealis and Cheyne Walk Investment PTE LTD ("Cheyne Walk" and together with Borealis and Hunt, the "Borealis Parties") each owns 49.5% of TTHC. TTHC wholly owns Texas Transmission Finco LLC ("TTFinco"), which wholly owns Texas Transmission Investment LLC ("TTI"). TTI owns 19.75% of Oncor. Sempra Texas Holdings Corp. ("STH") and Sempra Texas Intermediate Holding Company, LLC (together with STH, "Sempra") own the remaining 80.25% of Oncor through Oncor Electric Delivery Holdings Company LLC ("Oncor Holdings").

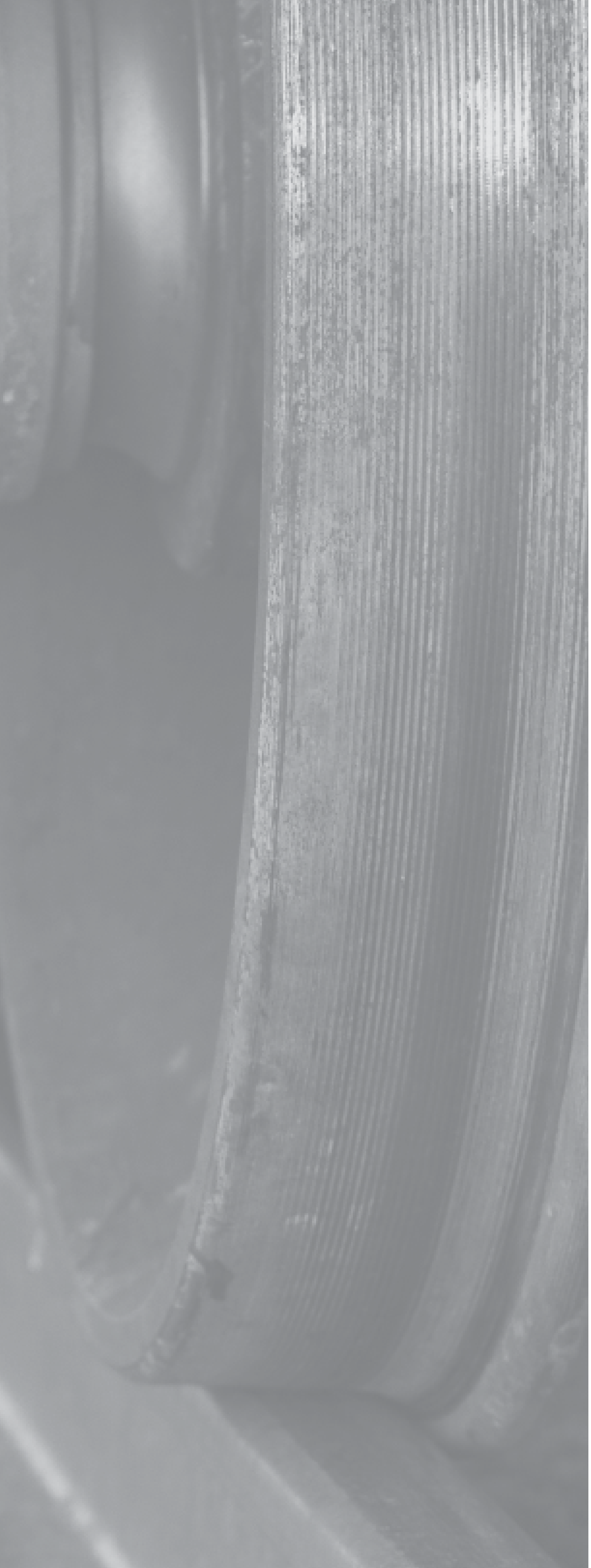
The Borealis Parties, as TTHC shareholders, entered into a shareholders agreement (the "TTHC SA"), which provided a right of first offer for non-selling TTHC shareholders. Contemporaneously with the execution of the TTHC SA, Oncor, Oncor Holdings, TTI, and STH entered into the Oncor IRA, which included a right of first refusal in favor of Sempra (the "Sempra ROFR") if there is a transfer of limited liability company interests in Oncor ("Oncor LLC Interests").

Thereafter, Hunt and Sempra executed a share purchase agreement (the "Sempra SPA") for the Hunt Interest. Hunt sent a letter alleged to be a first offer notice to Borealis and Cheyne Walk with the Sempra SPA attached as an exhibit thereto. Borealis responded that it planned to exercise its right of first offer under the TTHC SA and purchase the Hunt Interest. Sempra also planned to exercise the Sempra ROFR under the Oncor IRA. Borealis then filed a complaint with the Court of Chancery asserting that Hunt breached the TTHC SA and sought a temporary restraining order enjoining the sale of the Hunt Interest to Sempra. The Court of Chancery determined that while the right of first offer and the Sempra ROFR were both triggered, the sale of the Hunt Interest was a "transfer" of Oncor LLC Interests under the Oncor IRA and Sempra had a superior right to exercise the Sempra ROFR.

The Supreme Court rejected Sempra's arguments to parse the expansive scope of the defined term "Transfer" to determine whether it applied to Hunt, on the basis that the language in the Oncor IRA is clear.

On appeal, the Delaware Supreme Court conducted a *de novo* review of the language of the TTHC SA and the Oncor IRA. The Supreme Court noted that the Oncor IRA provides that "[TTI] and its Permitted Transferees may only Transfer [Oncor LLC Interests]" under certain conditions. The definition of "Transfer" in the Oncor IRA includes "any direct or indirect transfer" of Oncor LLC Interests and provides that an event where a member "ceases to be controlled by the Person controlling such Member" is also a "Transfer." Sempra argued that the sale of the Hunt Interest was an indirect "Transfer" of Oncor LLC Interests and that the parties to the Oncor IRA intended to restrict TTI's indirect equity holders from making such transfers. Alternatively, Sempra argued that the sale of the Hunt Interest was a "Transfer" because such sale to Borealis or Cheyne Walk would change the control of TTHC.

The Supreme Court found that while the definition of "Transfer" in the Oncor IRA applies to direct or indirect transfers of Oncor LLC Interests and changes of control of TTHC, the Oncor IRA does not restrict the sale of the Hunt Interest because the Sempra ROFR only restricts Oncor's minority member, TTI, and TTI's permitted transferees with respect to "Transfers" of Oncor LLC Interests under certain conditions. Hunt was undisputedly neither TTI nor a permitted transferee of TTI. Therefore, the restriction in the Oncor IRA did not apply to Hunt. The Supreme Court rejected Sempra's arguments to parse the expansive scope of the defined term "Transfer" to determine whether it applied to Hunt, on the basis that the language in the Oncor IRA is clear that the subject to which the transfer restrictions applied are TTI and permitted transferees of TTI. As a result, the Supreme Court determined that the sale of the Hunt Interest (i) did not trigger the Sempra ROFR, and (ii) may not occur until first satisfying Borealis's right of first offer.



In re CVR Refining, L.P. Unitholder Litigation: Court of Chancery Considers General Partner's Duties in Connection with Exchange Offer and Call Right Transactions

In *In re CVR Refining, L.P. Unitholder Litigation,* 2020 WL 506680 (Del. Ch. Jan. 31, 2020), the Delaware Court of Chancery considered a motion to dismiss an action brought by common unitholders of CVR Refining, LP, a publicly traded Delaware master limited partnership ("CVR Partnership"), against, *inter alia,* CVR Partnership, its general partner CVR Refining GP, LLC ("CVR GP"), and certain of their respective parent entities, directors, and officers for (i) breach of the CVR Partnership partnership agreement, and (ii) breach of the implied covenant of good faith and fair dealing.

Under the CVR partnership agreement, CVR GP has the right to purchase the common units of CVR Partnership held by unaffiliated limited partners (the "CVR call right") at a contractually determined price based on the market value of the units when CVR GP and its affiliates hold more than 80% of total limited partner interests in CVR Partnership as a whole. The CVR partnership agreement also eliminates fiduciary duties of CVR GP, but CVR GP is subject to a contractual duty of subjective good faith when acting as the general partner of CVR Partnership.

Before the transactions that are the subject of the litigation, CVR GP and its affiliates owned less than 70% of the outstanding limited partner interests in CVR Partnership. Per the allegations in the complaint, an affiliate of CVR GP initiated an exchange offer for common units in CVR Partnership. The CVR exchange offer was conditioned on sufficient units being tendered such that CVR GP and its affiliates would own more than 80% of the limited partner interests of CVR Partnership. Nevertheless, the CVR exchange offer stated that CVR GP and its affiliates had no current intent to exercise the CVR call right. The board of directors of CVR GP took no position with respect to the CVR exchange offer and indicated that each limited partner needed to make its own investment decision as to whether to tender units. The CVR exchange offer was successful and resulted in CVR GP and its affiliates owning more than 80% of the limited partner interests, thus enabling CVR GP to trigger the CVR call right in the future. Over the next few months following the consummation of the CVR exchange offer, the market price of CVR limited partner interests declined in value. The parent entity of CVR GP publicly disclosed that it was now considering whether to exercise the CVR call right. The CVR limited partner interests continued to decline in value. Ultimately, an affiliate of CVR GP exercised the CVR call right and thereby acquired all the publicly held CVR limited partner interests at a price per unit that was less than half of the price that was offered in the CVR exchange offer, which had been consummated approximately six months earlier.

The Court of Chancery reasoned that CVR GP was acting in its capacity as general partner of CVR Partnership when it took the steps of responding to the CVR exchange offer, and that as a result such actions were subject to the contractual subjective good faith standard under the CVR partnership agreement.

The complaint alleged, *inter alia,* that CVR GP breached its contractual duty of subjective good faith under the CVR partnership agreement by (i) failing to provide adequate disclosures or negotiate adequate protections for the limited partners in connection with the CVR exchange offer, and (ii) manipulating the price of units in CVR Partnership by publicly announcing its intention to exercise the CVR call right in advance of actually exercising the CVR call right. The complaint alleged that by taking actions in furtherance of the foregoing, CVR GP and certain of its respective parent entities also breached the implied covenant of good faith and fair dealing embedded in the CVR partnership agreement.

In considering the defendants' motion to dismiss, the Court of Chancery reasoned that CVR GP was acting in its capacity as general partner of CVR Partnership when it took the steps of responding to the CVR exchange offer, and that as a result such actions were subject to the contractual subjective good faith standard under the CVR partnership agreement. The court held that it was reasonably conceivable, assuming the allegations of the complaint were true, that such actions violated CVR GP's contractual duty to act in subjective good faith because (i) the CVR exchange offer was detrimental to the CVR common unitholders and CVR Partnership because it triggered speculation that CVR Partnership would be privatized and thereby lowered the market price of common units, which in turn increased CVR Partnership's cost of equity and its cost of capital; and (ii) the board of directors of CVR GP were sophisticated actors within the energy master limited partnership sector and were aware or should have been aware of the potential effects of such actions.

The Court of Chancery also held that under the implied covenant of good faith and fair dealing, the CVR call right provision in the CVR partnership agreement has an implied term that CVR GP may not interfere or undermine the pricing protections afforded to the CVR common unitholders by the CVR call right. The court reasoned that CVR GP's announcement that it was considering exercising the CVR call right conceivably undermined the protections afforded to the CVR common unitholders by the market-price floor in the CVR call right and thereby breached the implied covenant of good faith and fair dealing. For these reasons, the court denied the motion to dismiss the breach of contract claim and the breach of implied covenant claims against CVR GP.

Wenske v. Blue Bell Creameries, Inc.: Court of Chancery Decision Prompts Amendment to Delaware LP Act Providing that a Delegatee of a Conflicted General Partner Is Not Automatically Deemed to Have a Conflict of Interest

In *Wenske v. Blue Bell Creameries, Inc.,* 214 A.3d 958 (Del. Ch. 2019), the Delaware Court of Chancery denied a motion to stay a derivative action brought by a limited partner of Blue Bell Creameries, L.P. ("BBLP") alleging failures by Blue Bell Creameries, Inc. ("BBGP"), the sole general partner, to operate BBLP in compliance with BBLP's partnership agreement. The lawsuit alleged that BBGP's failures contributed to hundreds of millions of dollars of lost profits arising from alleged contamination at Blue Bell's ice cream production facilities.

The court previously had denied a motion to dismiss based on the finding that the plaintiff had adequately pled demand futility with respect to BBGP because BBGP, as an entity, faced a substantial likelihood of liability for breach of BBLP's partnership agreement. Following the earlier ruling, BBGP created a special litigation committee to manage and control the derivative claims asserted in the lawsuit. The BBGP special litigation committee moved to stay the derivative action pending its investigation and determination regarding whether to pursue the derivative claims.

The court found BBGP's delegation of decision-making authority to the BBGP special committee unavailing because BBGP possessed a right to control the BBGP special committee.

The court stated that, under certain circumstances, the special litigation committee framework can serve its intended purpose in the limited partnership context. The court further noted that the constitutive documents of the typical limited partnership will vest the general partners with broad authority to manage and control the business and affairs of the limited partnership and that under Sections 17-1001 through 17-1003 of the LP Act, such authority can include the right to determine whether to prosecute derivative actions. While Section 17-403(c) of the LP Act 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."

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 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 BBGP special litigation committee can be deemed independent from BBGP such that it can exercise independent business judgment. Citing corporate precedent, the court noted that this determination depends on whether the partnership agreement allows the entity to create a special litigation committee. The court observed that the BBLP partnership agreement vested BBGP with the "exclusive right and authority to manage, conduct, control and operate [BBLP]'s business." The BBLP partnership agreement further authorized the general partner to appoint an agent to act as if it were the general partner.

The court determined, however, that BBGP was disabled by conflict from considering what to do with the derivative claims. As a result, the court found BBGP's delegation of decision-making authority to the BBGP special litigation committee unavailing because BBGP, the principal, possessed a right to control the BBGP special litigation committee, 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 BBGP, 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 BBGP special litigation committee's motion to stay.

In August 2021, in reaction to the *Wenske* decision, Section 17-403(c) of the LP Act was amended again to further clarify its intent. The amendment is intended to create a different rule than the rule applied in cases such as *Wenske* (holding that a conflicted principal is disabled from delegating authority to an independent committee over the subject matter as to which such principal is conflicted). Amended Section 17-403(c) expressly provides that a general partner's delegation may be made irrespective of whether the general partner has a conflict of interest with respect to the matter being delegated. And significantly, it further expressly provides that a delegatee is not deemed to be conflicted solely by reason of the general partner's conflict of interest. Finally, amended Section 17-403(c) adds to the enumerated examples of permitted delegatees a committee of one or more persons.

The analysis that a court uses in the future to address the delegation of rights, powers, and duties by a general partner will need to consider the effects of the revisions that have been made over time to Section 17-403(c) of the LP Act. ■

Recent Developments in Delaware Law

2020 Amendments to the Delaware General Corporation Law

Legislation amending the General Corporation Law of the State of Delaware has been approved by the Delaware General Assembly and was signed by Delaware Governor John Carney on July 16, 2020. The 2020 amendments to the General Corporation Law make several important changes to the General Corporation Law, including clarifying the circumstances under which emergency bylaws may be invoked, providing safe harbors for specified corporate actions taken during the pendency of an emergency condition, reducing the statutory hurdles for a conventional corporation to become a public benefit corporation (and vice versa), eliminating some of the existing governance restrictions imposed on operating companies resulting from a statutory holding company reorganization, providing further definition around statutory-based mandatory indemnification for officers, clarifying the application of the safe harbor provisions for documents executed by electronic means, and effecting other technical changes. Except as specifically noted below, the 2020 amendments became effective on July 16, 2020.

Emergency Bylaws

The COVID-19 pandemic precipitated a renewed focus on Section 110 of the General Corporation Law, which authorizes the adoption of bylaws that become operative during any emergency resulting from an attack on the United States or on a locality in which the corporation conducts its business or holds meetings, or during any nuclear or atomic disaster, or during the existence of any catastrophe, or other similar emergency condition, that prevents a quorum of the board from convening, and provides for the exercise of other emergency powers. Section 110 was adopted in 1962, in the wake of the Cuban Missile Crisis, which likely accounts for the specific references to nuclear and atomic disasters. The language of Section 110, however, is not expressly limited to such disasters, and emergency bylaws may become operative while other catastrophic or emergency conditions persist.

The amendments clarify the application, and expand the scope, of Section 110 in several key respects. First, the amendments clarify that “an epidemic or pandemic, and a declaration of a national emergency by the United States government,” are among the catastrophes that may result in emergency bylaws becoming operative and allow for the exercise of emergency powers under Section 110. Second, the amendments dispense with the requirement that the specific catastrophe or emergency be one that prevents a quorum of the board from convening a meeting. Third, the amendments provide that emergency bylaws may be adopted by the board of directors or, if a quorum cannot be readily convened for a meeting, by a majority of the directors present.

The amendments make two significant changes to Section 110—one dealing with meetings of stockholders and the other dealing with dividends—that are directly attributable to fallout from the COVID-19 pandemic. As a result of government-ordered lockdowns and in view of public health and safety, many corporations determined it was necessary or advisable to switch from holding an annual meeting of stockholders at a physical location to a virtual meeting format, or to adjourn or postpone a previously called meeting. In many cases, the decision to change the format of the annual meeting, or to adjourn or postpone the meeting, gave rise to questions regarding whether the corporation would be required to mail a new notice of the meeting. On April 6, 2020, the Governor of the State of Delaware issued the Tenth Modification of the Declaration of a State of Emergency for the State of Delaware Due to a Public Health Threat that sought to relax some of the notice requirements for public corporations that, before the date of this order, had called a physical meeting and were seeking to switch to a virtual meeting format. The order, however, was limited in scope and included a so-called “savings clause” that called into question its enforceability, and it did not address the multitude of issues that corporations were facing as they navigated calling and convening an annual meeting in the midst of a public health crisis. Separately, many corporations that had declared dividends in the pre-pandemic era were seeking to conserve cash once it became clear that the pandemic was likely to have a severe economic toll on various industries and sectors. Those corporations, however, were forced to contend with case law indicating that the declaration of a dividend creates a debtor-creditor relationship between the corporation and the stockholders entitled to receive it. New Section 110(i) of the General Corporation Law addresses both of these issues and provides safe harbor protection for specified actions taken under emergency conditions.

First, new Section 110(i) provides that, during any emergency condition, the board (or, if a quorum cannot be readily convened, a majority of the directors present) may take any action that it determines to be practical and necessary to address the circumstances of the emergency as it relates to a meeting of stockholders, regardless of any contrary provisions of the General Corporation Law, the certificate of incorporation, or bylaws, including postponing any such meeting to a later time or date (with the record date for determining the stockholders entitled to notice of, and to vote at, such meeting applying to the postponed meeting) and, in the case of a public corporation, giving notice to stockholders of any postponement or change of the place of the meeting (or a change to hold the meeting solely by means of remote communication) solely by a document publicly filed by the corporation with the Securities and Exchange Commission pursuant to Sections 13, 14 or 15(d) of the Securities Exchange Act of 1934, as amended, and the rules and regulations thereunder (the “Exchange Act”). In addition to providing safe harbor protection with respect to notices, adjournments, and postponements of stockholders’ meetings, new Section 110(i) provides that no person shall be liable for, and no meeting of stockholders shall be postponed or voided due to, the corporation’s failure to make a stocklist available pursuant to Section 219 of the General Corporation Law if it was not practicable to allow inspection during any such emergency condition.

Second, Section 110(i) provides that, during any emergency condition, the board (or, if a quorum cannot be readily convened, a majority of the directors present) may change the record date and payment date of any dividend that has been declared, but whose record date has not yet occurred, to a later date or dates. In delaying the record date and payment date, the board (or majority of the directors) must ensure, consistent with Section 213(c), that the new payment date is within 60 days of the new record date. In all cases, the corporation must give notice of any change to the record date or payment date of a dividend to stockholders as promptly as practicable thereafter (and in any event before the applicable record date). In the case of a public corporation, the notice may be given solely by a document publicly filed under Sections 13, 14, or 15(d) of the Exchange Act.

It is important to recognize that Section 110(i) operates as a safe harbor provision for purposes of Delaware corporate law. Indeed, the synopsis to House Bill 341 (the bill proposing the 2020 amendments) makes clear that the amendments to Section 110 are "not intended, by implication or otherwise, to limit or eliminate the availability of any powers or emergency actions that are not specifically enumerated with respect to stockholders' meetings, dividends, or other matters that are practical and necessary in connection with the particular emergency, or to affect the validity of any action taken in an emergency situation but not authorized by the amendments or taken in a non-emergency situation." To this point, it should be noted that Section 110(i) does not address other issues that might arise as a result of a previously declared dividend, including the potential consequences that might arise if a board seeks to delay a record date or payment date after the shares have begun trading "ex-dividend." In addition, Section 110(i) does not alter or change any existing law that would preclude the payment of dividends under specified circumstances, including situations in which the corporation does not have sufficient "surplus" to make the payment.

In recognition of the disruption to ordinary corporate processes wrought by the COVID-19 pandemic, the amendments to Section 110 became effective retroactively as of January 1, 2020 with respect to any emergency condition occurring on or after that date and with respect to any action contemplated by those provisions and taken on or after that date by or on behalf of the corporation with respect to a meeting of stockholders held or a dividend as to which the record date or payment date is anticipated to occur during the pendency of such condition.

Public Benefit Corporations

The amendments make several significant changes to the statutory regime governing public benefit corporations. A public benefit corporation is a for-profit corporation that is intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner. In furtherance of that purpose, public benefit corporations are to be managed in a manner that balances the stockholders' pecuniary interests, the best interests of those materially affected by the corporation's conduct, and the public benefit or benefits identified in the corporation's certificate of incorporation. When the concept of the public benefit corporation was first introduced to the General Corporation Law, significant hurdles, largely in the form of super-majority stockholder votes and appraisal rights, were placed on any conventional corporation seeking to convert to a public benefit corporation and vice-versa. These statutory hurdles were considered to be important protections to stockholders due in large part to the differences between conventional corporations, the directors of which are charged with a duty to maximize value for the benefit of stockholders, and public benefit corporations, the directors of which are obligated to engage in a balancing of interests. After a few years of experience with public benefit corporations, and with interest in sustainability and corporate environmental and social responsibility on the rise, questions arose as to the need for those statutory hurdles, particularly given that the General Corporation Law is a flexible, enabling statute that is designed to allow corporations to implement the governance regime that best suits their particular needs. To that end, the 2015 amendments to the General Corporation Law reduced the vote required to convert a conventional corporation to a public benefit corporation (and vice versa) and limited the circumstances in which appraisal rights would be available upon conversion to or from a public benefit corporation. The 2020 amendments continue this trend, further relaxing some of the barriers to converting to or from a public benefit corporation.

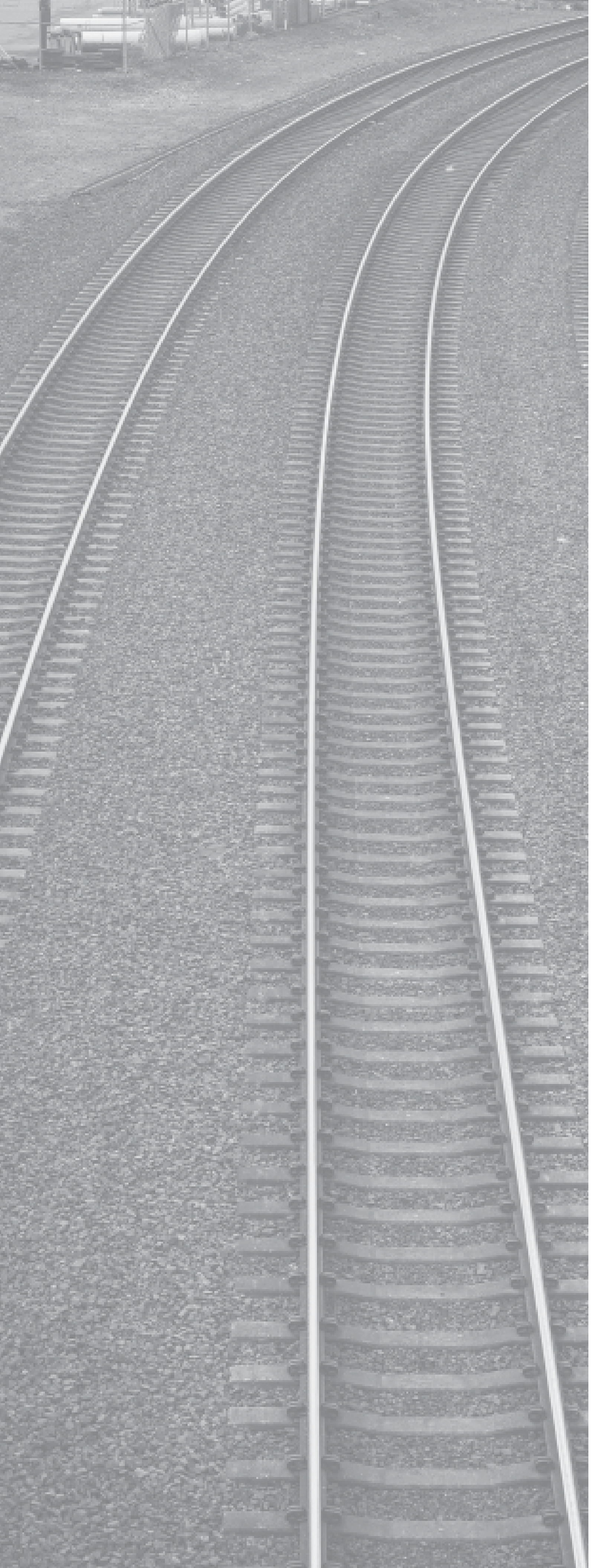
ELIMINATION OF SUPER-MAJORITY VOTING RIGHTS

Section 363(a) of the General Corporation Law previously provided that a corporation that is not a public benefit corporation may not, without the approval of two-thirds of the outstanding stock entitled to vote thereon, (i) amend its certificate of incorporation to include provisions resulting in its becoming a public benefit corporation, or (ii) merge or consolidate with or into another entity if, as a result of the merger or consolidation, the shares of the corporation would become (or would be converted into or exchanged for the right to receive) shares or equity interests in a domestic or foreign public benefit corporation or similar entity. In addition, Section 363(c) of the General Corporation Law previously provided that a public benefit corporation may not, without the approval of two-thirds of its outstanding stock entitled to vote thereon, amend its certificate of incorporation to delete the provisions relating to its status as a public benefit corporation or merge or consolidate with another entity if, as a result, the shares of the public benefit corporation would become, or be converted into or exchanged for the right to receive, shares or other equity interests in an entity that is not a public benefit entity.

The amendments eliminate current Sections 363(a) and 363(c). As a result, the vote of stockholders required to amend the certificate of incorporation of a conventional corporation to become a public benefit corporation, as well as the vote required to amend the certificate of incorporation of a public benefit corporation to become a conventional corporation, is now the default vote required under Section 242(b) of the General Corporation Law—that is, a majority of the outstanding stock entitled to vote thereon (along with any greater or additional vote of stockholders required under the certificate of incorporation). Likewise, the vote of stockholders required to approve a merger in which shares of capital stock of a conventional corporation are converted into shares of a public benefit corporation, as well as the vote required to approve a merger in which shares of a public benefit corporation are converted into shares of a conventional corporation, is now the default vote required under Section 251 or other applicable provision governing mergers—that is, a majority of the outstanding stock entitled to vote thereon (along with any greater or additional vote of stockholders required under the certificate of incorporation).

APPRAISAL RIGHTS

Section 363(b) of the General Corporation Law previously provided that any stockholder of a conventional corporation that holds shares of stock of the corporation immediately prior to the effective time of (i) an amendment to the corporation's certificate of incorporation that causes it to become a public benefit corporation, or (ii) a merger or consolidation that would result in the conversion of the corporation's stock into or exchange of the corporation's stock for the right to receive shares in a public benefit corporation and who has not voted for such amendment or merger will be entitled to appraisal rights, subject to the "market out" exception. (The "market out" exception generally provides that appraisal rights are not available for holders of shares listed on a national securities exchange or held of record by more than 2,000 holders, unless, in the case of a merger, the holders are required to accept anything other than shares listed on a national securities exchange or held of record by more than 2,000 holders.) In the case of private corporations, the previous provisions of Section 363(b) had the practical effect of severely restricting conversions to a public benefit corporation model, as few private corporations were willing to risk being subject to a liquidity event requiring an outlay of cash. The amendments eliminate Section 363(b) in its entirety. (The amendments make conforming changes to Section 262, which governs the procedures for demanding and perfecting appraisal rights.) Following the amendment to Section 363(b), appraisal rights are no longer automatically provided by statute as a result of an amendment of a certificate of incorporation that effectively converts a conventional corporation to a public benefit corporation. Nevertheless, the determination as to whether appraisal rights will be available in connection with a merger in which a public benefit corporation is a constituent corporation will still be determined in accordance



with Section 262 of the General Corporation Law; in many cases, appraisal rights will be triggered in such mergers.

DIRECTOR INTEREST

The amendments make several changes in respect of the governance of public benefit corporations. To explicate these changes, it is important to recite the existing statutory framework. Section 365(a) of the General Corporation Law sets forth the duties of directors of a public benefit corporation, providing that the board shall manage or direct the business and affairs of the public benefit corporation in a manner that balances the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct, and the specific public benefit or public benefits identified in its certificate of incorporation. Section 365(b) then provides that, for any decision implicating the "balancing requirement," a director will be deemed to have satisfied such director's fiduciary duties if such director's decision is informed and disinterested and not such that no person of ordinary, sound judgment would approve. Section 365(c), in turn, authorizes the certificate of incorporation of a public benefit corporation to include a provision that any disinterested failure to satisfy the provisions of Section 365 shall not, for purposes of Section 102(b)(7) of the General Corporation Law (which generally exculpates directors against liability for monetary damages for breaches of the duty of care) or Section 145 (which governs rights to indemnification, subject, in specified cases, to the indemnitee having met specified standards of conduct), constitute an act or omission not in good faith or a breach of the duty of loyalty.

The amendments revise Section 365(c) in two key respects. First, the amendment clarifies that a director's ownership of or other interest in the stock of the public benefit corporation will not, of itself, create a conflict of interest on the part of the director with respect to any decision implicating the director's balancing requirements, except to the extent such ownership or other interest would create a conflict of interest if the corporation were a conventional corporation. Put differently, a stockholder generally will not be able to attack a director's balancing decision solely on the basis that the director owned stock in the public benefit corporation (and therefore presumably could be alleged to favor the pecuniary side of the balancing test). Second, the amendment revises Section 365(c) to provide that, absent a conflict of interest, no failure to satisfy the balancing requirement shall, for purposes of Section 102(b)(7) or Section 145 of the DGCL, constitute an act or omission not in good faith, or a breach of the duty of loyalty, *unless* the certificate of incorporation so provides. In other words, this latter revision to Section 365(c) provides, by statutory default, the protection available to directors of public benefit corporations that could previously be obtained only through a provision of the certificate of incorporation. Following the amendments, public benefit corporations seeking to divest directors of the protection afforded to their satisfaction of the balancing requirement must do so through the certificate of incorporation.

SUITS TO ENFORCE THE BALANCING REQUIREMENT

Section 367 governs the rights of stockholders to maintain derivative suits to enforce the statutory balancing requirements, setting forth minimum stock ownership thresholds for the plaintiffs, individually or collectively (previously fixed at 2% of the outstanding stock or, in the case of certain listed corporations, the lesser of 2% of such shares or shares with a market value of $2,000,000). The amendments revise Section 367 to clarify that any action to enforce the balancing requirement (including any individual, derivative, or other type of action) to which a public benefit corporation is subject must be brought by one or more plaintiffs owning individually or collectively at least 2% of the corporation's outstanding shares or, in the case of certain listed corporations, the lesser of 2% of the corporation's shares or shares with a value of at least $2,000,000.

EFFECTIVE TIME OF AMENDMENTS

The amendments effecting the repeal of Section 363(b)(2), and the corresponding amendments to Section 262 described above, are effective only with respect to a merger or consolidation consummated pursuant to an agreement entered into, or, with respect to a merger consummated pursuant to Section 253, resolutions of the board of directors adopted, on or after July 16, 2020. Because Section 262 of the General Corporation Law requires that a current copy of that section be included with a notice of appraisal rights, corporations and practitioners preparing disclosure documents for a merger or consolidation are reminded to ensure that they include in such notices the correct version of Section 262.

Holding Company Reorganization Mergers

Section 251(g) of the General Corporation Law allows a corporation to effect a so-called "holding company reorganization merger" without the need to obtain a vote of its stockholders, subject to compliance with specified conditions and procedures. In general, to effect a holding company reorganization under Section 251(g), an existing operating corporation first establishes a wholly owned subsidiary corporation, which will eventually become the new holding company. That first subsidiary corporation then establishes a wholly owned merger subsidiary, which may either be a Delaware corporation or Delaware limited liability company. The merger subsidiary is then merged with or into the original operating corporation. In the merger, all of the shares or equity interests in the merger subsidiary outstanding prior to the merger are converted into all of the shares or equity interests of the surviving entity, and all of the shares of the original operating corporation outstanding prior to the merger are converted into shares of the new holding company. The end result is that the stockholders of the original operating company become stockholders of the new holding company, which owns all of the equity of the operating company.

Section 251(g) previously provided that the provisions of the organizational documents of the surviving entity in a merger under that subsection must be identical to the provisions of the certificate of incorporation of the original operating corporation immediately prior to the merger, subject to limited exceptions. In many cases, the provisions of the certificate of incorporation of the original operating corporation, which is often a public corporation with widely held stock, make little sense in the context of corporation that will be managed as a wholly owned subsidiary in a holding company structure. Moreover, in cases where the operating company that emerges from the reorganization is to be a limited liability company, it is often difficult to recreate the provisions of the original operating corporation's certificate of incorporation in the form of a limited liability company agreement. The amendments to Section 251(g) eliminate the requirement that the provisions of the organizational documents of the surviving entity in a reorganization merger under that subsection be identical to those of the original operating company as of immediately prior to the merger. The amendments to Section 251(g), however, do not disturb the requirement that the organizational documents of the surviving entity contain provisions requiring approval of the holding company's stockholders for any act or transaction by the surviving entity that, if taken by the original operating company immediately prior to the merger, would have required stockholder approval. In addition, Section 251(g) continues to provide that the business and affairs of a surviving entity in a holding company reorganization merger that is not a corporation must be managed by or under the direction of a board of directors, board of managers, or other governing body consisting of individuals who are subject to the same fiduciary duties applicable to, and who are liable for breach of such duties to the same extent as, directors of a Delaware corporation.

The amendments to Section 251(g) became effective with respect to agreements of merger consummated pursuant to an agreement entered into on or after July 16, 2020.

Indemnification

The amendments make certain changes to the provisions of the General Corporation Law governing rights to indemnification.

MANDATORY INDEMNIFICATION BY STATUTE

Section 145(a) of the General Corporation Law generally provides that a corporation may indemnify its directors, officers, employees, agents, and other persons against expenses, judgments, fines, and amounts paid in settlement arising out of specified actions, suits, or proceedings (other than those brought by or in the right of the corporation). Section 145(b) generally permits a corporation to indemnify those parties against expenses they incur in connection with actions brought by or in the right of the corporation. Those permissive rights to indemnification under subsections (a) and (b) of Section 145 may be made mandatory by a provision of the certificate of incorporation, the bylaws, agreement, or through other means. In either case, however, a person asserting a claim to indemnification under subsection (a) or (b) of Section 145 generally must establish that such person has met the so-called "standard of conduct"—that he or she acted in good faith and in a manner in or not opposed to the best interests of the corporation and, with respect to any criminal action or proceeding, had no reason to believe that his or her conduct was unlawful. Section 145(d) then specifies the manner in which such standard of conduct determination must be made with respect to persons who are directors or officers of the corporation at the time of the determination.

Section 145(c) of the General Corporation Law, however, previously required the corporation to indemnify its present and former directors and officers against expenses they incur in connection with any action, suit, or proceeding if they are successful (on the merits or otherwise) in defending any action, suit, or proceeding for which the corporation may indemnify them under subsections (a) or (b) of Section 145, regardless of whether such rights have been granted under the certificate of incorporation, bylaws, any agreement, or through other means, and without any need for a determination as to whether the officer or director has met the standard of conduct. Previously, Section 145(c) did not define the "officers" to whom such mandatory rights to indemnification must be provided. The amendments revise Section 145(c) to add a new clause (1), which preserves the existing text of Section 145(c) and adds a new sentence providing that, for indemnification with respect to any act or omission occurring after December 31, 2020, references to "officer" for purposes of Section 145(c) shall mean only a person who at the time of such act or omission is deemed to have consented to service by the delivery of process to the registered agent of the corporation pursuant to Section 3114(b) of title 10 of the Delaware Code. (Although Section 3114(b) does not apply to residents of Delaware, given that they are already subject to personal jurisdiction, new Section 145(c)(1), as amended, treats Delaware residents as if they were non-residents to ensure that persons who hold the officer positions identified in Section 3114(b) are entitled to indemnification, whether or not they are Delaware residents.) Thus, by reference to Section 3114(b), the "officers" entitled by statutory default to mandatory indemnification under Section 145(c) are (i) the corporation's president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer, or chief accounting officer; (ii) an individual identified in public filings as one of the most highly compensated officers of the corporation; or (iii) an individual who, by written agreement with the corporation, has consented to be identified as an officer for purposes of Section 3114(b) (all such officers, "3114 Officers"). The amendments then add a new clause (2) to Section 145(c), which provides that the corporation may indemnify any other person who is not a present or former director or officer against expenses (including attorneys' fees) actually and reasonably incurred by such person to the extent he or she has been successful on the merits or otherwise in defense of any action, suit, or proceeding identified in subsections (a) or (b) of Section 145. Following the effectiveness of the amendments to Section 145(c), if a corporation has officers that, although appointed pursuant to the bylaws, do not qualify as 3114 Officers ("Non-3114 Officers"), those Non-3114 Officers will not be entitled, by statutory default, to mandatory indemnification under Section 145(c) with respect to acts or omissions occurring after December 31, 2020. (The Non-3114 Officers should, however, remain entitled to the statutory protection under Section 145(c) with respect to acts or omissions occurring before December 31, 2020.) Although new Section 145(c)(1) narrows the scope of covered persons, new Section 145(c)(2) makes clear that corporations may provide Non-3114 Officers (along with other indemnifiable persons) the same basic protection that is granted to directors and 3114 Officers under new Section 145(c)(1).

In light of these changes, corporations should review the provisions of their certificates of incorporation and bylaws dealing with indemnification and advancement to ensure that they meet the corporation's objectives. In this regard, it is important to consider the amendments to Section 145(c) in light of the opinion of the Court of Chancery in *Zaman v. Amedeo Holdings,* 2008 WL 2168397 (Del. Ch. May 23, 2008). In *Zaman,* the court was called upon to construe a bylaw providing that the corporation "shall indemnify and hold harmless, to the fullest extent permitted by applicable law ... any person who was or is made or is threatened to be made a party or is otherwise involved in any threatened, pending, or completed action, suit, or proceeding ... by reason of the fact that he, or a person for whom he is the legal representative, is or was a director or officer of the corporation or is or was serving at the request of the corporation as a director, officer, employee, or agent of another corporation or of a partnership ... against all liability and loss suffered and expenses (including attorneys' fees) reasonably incurred by such indemnitee," to determine whether agents serving at the corporation's request were entitled to mandatory indemnification under Section 145(c) by virtue of that bylaw. The court stated:

> Under Section 145(c), mandatory indemnification for success is not required as to an agent, only as to "a present or former director or officer of a corporation." But, Section 6.1 [of the bylaws] contractually obligates the defendants to indemnify an agent serving at their request at another corporation to the full extent permitted by Delaware law. Therefore, as a contractual matter, if the [agent-indemnitees] acted in an indemnifiable capacity, the defendants must indemnify if Section 145(c) would authorize them to do so if the [agent-indemnitees] were directors or officers. The reason why is simple: if Delaware law mandates indemnity for success by a director or officer, a corporation is not prohibited by Delaware law from providing indemnity to an agent who was successful. Having promised to indemnify persons they ask to serve as agents of other corporations to the fullest extent permitted by Delaware law, the defendants are bound if a person is sued in an indemnifiable capacity and is successful.

Thus, in cases where the corporation has bound itself, through its certificate of incorporation or bylaws, to provide mandatory indemnification, to the fullest extent permitted by law, to its "officers," without further qualification or conditions, the corporation likely would be required to extend such protection to all those persons who serve as officers pursuant to its bylaws, including any Non-3114 Officers. The changes to Section 145(c), however, would be expected to affect the protections of Non-3114 Officers not party to separate indemnification contracts in cases where: (i) the corporation's certificate of incorporation and bylaws contain no provisions extending rights to indemnification (or contain provisions that are entirely permissive), (ii) the corporation's certificate of incorporation or bylaws contain provisions that extend mandatory rights to indemnification to "officers" but clearly subject to the officers' entitlement to indemnification to a standard of conduct determination, or (iii) the corporation's certificate of incorporation or bylaws narrowly define the class of officers entitled to mandatory indemnification such that it includes only 3114 Officers.

The language in new Section 145(c)(1) does not define who qualifies as an "officer" for purposes of the provisions outside of subsection (c), and new subsection 145(c)(2) allows for the extension of mandatory indemnification of expenses under Section 145(c) to persons other than "officers" (as that term is used and defined in Section 141(c)(1) (i.e., 3114 Officers)). Thus, corporations that want to specify the universe of "officers" to whom they wish to provide mandatory rights to advancement of expenses or to provide mandatory rights to indemnification under subsections (a) or (b) of Section 145 may wish to consider adopting express provisions clarifying which parties constitute officers for those purposes. In considering these matters, corporations may also want to consider whether to make clear that employees bearing officer-like titles (e.g., Vice President) but who are not "officers" appointed pursuant to the bylaws should be expressly excluded from any structural mandatory indemnification and advancement rights provided to "officers."

CONTINUED APPLICATION OF INDEMNIFICATION AND ADVANCEMENT PROVISIONS

Section 145(f) prohibits the elimination or impairment of a right to indemnification or to advancement by an *amendment* to the certificate of incorporation or the bylaws after the occurrence of the act or omission that is the subject of the civil, criminal, administrative or investigative action, suit or proceeding for which indemnification is sought, unless the provision in effect at the time of the act or omission expressly authorizes such elimination or impairment after such act or omission has occurred. The amendments clarify that the prohibition against divesting such rights applies to an amendment to or repeal or elimination of the certificate of incorporation and bylaws.

Exculpatory Clauses

Section 102(b)(7) of the General Corporation Law provides that a corporation may, through the adoption of a provision of its certificate of incorporation, limit or eliminate the liability of a director for monetary damages to the corporation or its stockholders for breach of fiduciary duty, other than liability stemming from any breach of the duty of loyalty, acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law, illegal dividends or share repurchases or redemptions, and any transaction from which the director receives an improper personal benefit. In many cases, corporations that adopt so-called "102(b)(7) provisions" expressly state in their certificate of incorporation that, if the provision is later modified or amended to reduce or eliminate the protection afformed to directors, the modification or amendment will not apply to acts or omissions that occurred prior to that modification or amendment. The amendments codify this not uncommon practice, unless the corporation elects otherwise in its 102(b)(7) provision. The amendments to Section 102(b)(7) thus clarify that an exculpatory provision has the effect of eliminating or limiting a director's liability for monetary damages with respect to any acts or omissions occurring while the exculpatory provision is in effect. Unless the corporation's 102(b)(7) provision provides otherwise, at the time of such act or omission, any future amendment, repeal, or elimination of the 102(b)(7) provision will not revoke the elimination or limitation of liability with respect to acts or omissions occurring while it is in effect.

Electronic Transmissions and Notices

ELECTRONIC SIGNATURES, ETC.

In 2019, Section 116 was added to the General Corporation Law to provide, among other things, a non-exclusive safe harbor for the execution and delivery of documents contemplated by the General Corporation Law. In general, Section 116(a) broadly enabled the use of electronic signatures and electronic transmissions for the execution and delivery of documents, while Section 116(b) carved out various classes and categories of documents and instruments that would not be covered by the safe harbor provisions of Section 116(a). In some cases, specific classes of documents and instruments, such as board and stockholder consents, were carved out of the safe harbor provision of Section 116(a) on the basis that separate statutes (e.g., Section 141(f), in the case of board consents, and Section 228, in the case of stockholder consents) already addressed the manner in which those documents and instruments could be executed and delivered through electronic means. Nevertheless, to provide additional clarity, the amendments revise Section 116 in a few technical respects to confirm the validity of the use of electronic signatures and transmissions for the execution and delivery of various documents and instruments.

First, the amendments to Section 116(a)(2) clarify that a person may "execute" a document (such as agreements of merger and other documents that require execution under the General Corporation Law) by using any type of signature contemplated by Section 116(a)(2), which includes both "wet ink" signatures and electronic signatures. Second, the amendments to Section 116(b) clarify that the Section 116(a) safe harbor may be relied upon as a basis for using an electronic transmission to document director, stockholder, member, and incorporator consents and for signing and delivering those documents by electronic means.

In connection with the amendments to Section 116, conforming changes were made to several other provisions of the General Corporation Law. Section

108(c) of the General Corporation Law was revised to permit an incorporator or initial director to rely on Section 116 as a basis to document, sign, and deliver a consent by electronic means, unless the use of Section 116 is expressly restricted or prohibited by the certificate of incorporation. Section 141(f) of the General Corporation Law was amended to reflect that directors may rely on Section 116 as a basis to document, sign, and deliver a consent by electronic means, unless expressly restricted or prohibited by the certificate of incorporation or bylaws. The amendments add a new subsection (c) to Section 212, which deals with proxies, to clarify that a stockholder may rely on Section 116 as a basis to document a proxy and to sign and deliver a document evidencing the proxy, unless restricted or prohibited by the certificate of incorporation or bylaws. Finally, Section 228 of the General Corporation Law, which governs stockholder action by consent in lieu of a meeting, was revised in several respects to reflect that consents may be executed and delivered in accordance with Section 116, unless the certificate of incorporation or bylaws expressly restrict or prohibit consents from being so documented, signed, or delivered, and to harmonize the provisions dealing with the execution and delivery of consents in writing or by electronic transmission. Notably, these conforming amendments are designed to confirm the application of the safe harbor provisions of Section 116 to consents and instruments that were previously capable of being executed and delivered through electronic means by reference to other statutory provisions; the amendments should not be used as a basis to call into question the validity of board or stockholder consents otherwise given in conformity with the General Corporation Law prior to the enactment of Section 116(a) or the amendments.

NOTICES TO STOCKHOLDERS

When Section 116 was added to the General Corporation Law in 2019, corresponding amendments to Section 232 of the General Corporation Law were made to address the manner in which notices could be given to stockholders. Before the 2019 amendments, Section 232 provided that notices would be deemed given by various means of electronic transmission so long as the stockholder had consented to receive notice through such means. A key objective of the 2019 amendments was to dispense with the need for the corporation to receive consent from stockholders to deliver notice to them by electronic mail. Thus, in 2019, Section 232(a) was amended to specify that the corporation could give notice in writing and that such notices "shall be given" when given by mail, courier service, or electronic mail in the manner provided in that subsection. Section 232(b), as amended in 2019, continued to provide that, without limiting the manner in which notice could otherwise be given, notice could be given by "a form of electronic transmission consented to by the stockholder to whom the notice is given." Although the consent requirement for notices by electronic transmission in Section 232(b) was never intended to override the specific authority to give notice by electronic mail pursuant to Section 232(a), the continuing reference to a notice by "electronic transmission"—which includes electronic mail—in Section 232(b) arguably created some ambiguity. To eliminate any doubt as to whether notices to stockholders may be given by electronic mail without the need for their consent, the 2020 amendments revise Section 232(a) so that it states expressly that a corporation may give a notice by electronic mail in accordance with Section 232(a) without obtaining the consent required by Section 232(b).

Other Amendments

CORPORATION NAME

In 2019, the Delaware Limited Liability Company Act was amended to introduce the concept of "registered series" of a limited liability company. Different from a "protected series," a registered series is intended to qualify as a registered organization under the Uniform Commercial Code and, accordingly, its formation requires the filing of a certificate of registered series with the Delaware Secretary of State. At that time, Section 102(a) of the General Corporation Law was amended to provide that the name of a corporation must be distinguishable from the name of a registered series of a limited liability company on file with the Delaware Secretary of State. As corresponding amendments to the Delaware Revised Uniform Partnership Act became effective in 2020, Section 102(a) was amended to provide that the name of a corporation must be sufficiently distinguishable from the name of a registered series of a limited partnership on file with the Delaware Secretary of State.

PROVISIONS RELATING TO THE DELAWARE SECRETARY OF STATE

Section 135 of the General Corporation Law, which deals with the resignation of a registered agent and the appointment of a successor registered agent, was amended to eliminate the requirement that the Secretary of State issue specified certificates upon such an appointment, consistent with its current practices. Section 266 of the General Corporation Law, which deals with a conversion of a corporation to another entity, was also amended to reflect the current practice of the Secretary of State relating to the issuance of a certified copy of a certificate of conversion to a non-Delaware entity. Section 377(b) of the General Corporation Law was amended to conform the process relating to the resignation of a registered agent of a foreign corporation to the process applicable to the resignation of a registered agent of a corporation under Section 136. Finally, Section 391(a)(16) of the General Corporation Law was amended to include the maximum fee payable to the Secretary of State for a written report of a record search.

2021 Amendments to the Delaware LLC and Partnership Acts

Amendments to 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) have been approved by the Delaware General Assembly and were signed by Delaware Governor John Carney on June 30, 2021. 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) providing safe harbor procedures for the ratification of void and voidable acts and transactions, (ii) clarifying the standards governing default information rights under the LLC and Partnership Acts, (iii) confirming the broad authority of conflicted persons to delegate managerial authority, (iv) modifying the provisions governing statutory public benefit Delaware LLCs and statutory public benefit Delaware LPs (collectively, Statutory Public Benefit Entities), and (v) confirming that Delaware GPs that opt out of separate entity status characteristics as permitted by the GP Act remain governed by the GP Act. All of the proposed amendments became effective on August 1, 2021.

Ratification of Void or Voidable Acts and Transactions

The amendments add a new subsection to each of the LLC and Partnership Acts that provides a safe harbor procedure for (i) the ratification of acts or transactions taken by a Delaware LLC, Delaware LP, or Delaware GP that are void or voidable when taken, and (ii) waiving failures to comply with any requirements under the limited liability company agreement or the partnership agreement, as applicable, of a Delaware LLC, Delaware LP, or Delaware GP that make such acts or transactions void or voidable. The amendments are intended to provide a rule different from that applied in each of *CompoSecure, L.L.C. v. Cardux,* LLC, 206 A.3d 807 (Del. 2018), and *Absalom Trust v. Saint Gervais LLC,* 2019 WL 2655787 (Del. Ch. June 27, 2019), in which the relevant Delaware court applied a rule that void acts or transactions generally may not be ratified. In *CompoSecure,* the Delaware Supreme Court declared that a Delaware LLC is unable to ratify acts or transactions rendered void by the plain language of its limited liability company agreement. The Delaware Supreme Court defined void acts as those that are "*ultra vires* and generally cannot be ratified." In *Absalom Trust,* the Delaware Court of Chancery applied the *CompoSecure* rule in determining that a transaction deemed "null and void" by the express contractual terms of a Delaware LLC's limited liability company agreement is incapable of being ratified.

The amendments allow the ratification of acts or transactions that are void or voidable when taken (or the waiver of the failure to comply with any requirements of the limited liability company agreement or the partnership agreement, as applicable, making such act or transaction void or voidable) by the persons whose approval would otherwise be required under such agreement at the time of such ratification or waiver (i) for such act or transaction to be validly taken, or (ii) to amend such agreement in a manner to permit such act or transaction to be validly taken. Under the amendments, any act or transaction ratified (or the waiver of the failure to comply with any requirements of such agreement) is given retroactive effect and deemed validly taken at the time of such act or transaction. The amendments expressly provide that the applicable new subsection being added to each of the LLC and Partnership Acts is not to be construed to limit the ratification or waiver of void or voidable acts or transactions by other means permitted by law. Accordingly, the amendments are not intended to preclude or restrict other valid means of ratification or waiver or to impair the effectiveness of valid ratifications and waivers effected prior to the adoption of the amendments.

The amendments additionally provide a procedure whereby the entity, a member, a manager, or a partner, as applicable, and any person claiming to be substantially and adversely affected by a ratification or waiver (excluding any harm that would have resulted had the act or transaction been valid when taken) may petition the Delaware Court of Chancery for a determination with respect to the validity and effectiveness of any such ratification or waiver effected pursuant to the new subsections of the Delaware LLC and Partnership Acts.

If an amendment to a limited liability company agreement or partnership agreement to permit an otherwise void or voidable act to be validly taken requires notice to any persons under the terms of such agreement, and the ratification or waiver of such act or transaction is effectuated by the persons whose approval would be required to amend such agreement, notice of the ratification or waiver must be given following such ratification or waiver to such persons who would have been entitled to notice of the amendment and who have not otherwise received notice of, or participated in, such ratification or waiver.

Application of "Necessary and Essential" Test to Information Rights

In books and records cases involving Delaware corporations, Delaware courts have long held that a stockholder's right to inspect a corporation's books and records is limited to information that is "necessary and essential" to the stockholder's stated purpose for such information. However, in *Murfey v. WHC Ventures,* LLC, 236 A.3d 337 (Del. 2020), the Delaware Supreme Court declined to apply an analogous standard to a limited partner's request to inspect certain books and records of a Delaware limited partnership under a contractual books and records provision contained in the applicable partnership agreement, holding that limited partners are not limited to inspecting books and records that are "necessary and essential" to the purpose for inspection where the partnership agreement did not expressly condition a contractual inspection right upon satisfying the "necessary and essential" standard.

The amendments to the LLC and Partnership Acts provide that a member or partner who is entitled to obtain information for a stated purpose (whether under the LLC Act, the LP Act, or the GP Act, as applicable, or a limited liability company agreement or partnership agreement, as applicable) may obtain such information as is "necessary and essential" to achieving that purpose, unless such right has been expanded or restricted in a limited liability company agreement or partnership agreement, as applicable. To the extent current law does not apply the "necessary and essential" test to a member's or partner's (i) statutory rights to obtain information for a purpose reasonably related to such person's interest, or (ii) contractual rights to obtain information for a stated purpose, the amendments are intended to change current law.

Confirmation of Broad Authority to Delegate Managerial Authority

Each of the LLC and Partnership Acts contains a similar general default provision addressing the broad right of members, managers, and partners to delegate managerial authority. The amendments to the LLC and Partnership Acts expand this broad authority by providing that a member or manager of a Delaware LLC, a general partner of a Delaware LP, and a partner of a Delaware GP may delegate any of its rights, powers, or duties, including any core governance functions, to manage and control the business and affairs of such entity regardless of whether such person has a conflict of interest with respect to the rights, powers, or duties being delegated, and that the person to whom such rights, powers, or duties are delegated shall not be deemed to be conflicted solely by reason of a conflict of interest of the delegating party. The amendments seek to create a rule different than that applied by the Delaware Court of Chancery in *Wenske v. Bluebell Creameries, Inc.,* 214 A.3d 958 (Del. Ch. 2019), that a conflicted person is legally disabled from delegating authority over the subject matter as to which such person is conflicted. The amendments also make clear that any delegation may be made to a committee of one or more persons.

New Provisions Governing Statutory Public Benefit Entities

In a development that may be of significant interest to social entrepreneurs, the LLC Act and the LP Act were recently amended to enable Delaware LLCs and Delaware LPs to elect to be Statutory Public Benefit Entities. In general, a Statutory Public Benefit Entity is a for-profit limited liability company or limited partnership that is intended to produce a public benefit and to operate in a responsible and sustainable manner. To that end, a Statutory Public Benefit Entity is required to be operated in a way that balances the pecuniary interests of the members or partners, as applicable, of such Statutory Public Benefit Entity, the best interests of those materially affected by such Statutory Public Benefit Entity's conduct, and such Statutory Public Benefit Entity's purported public benefit.

Each Statutory Public Benefit Entity is currently required in its certificate of formation or certificate of limited partnership, as applicable, to (i) identify itself as a Statutory Public Benefit Entity, and (ii) set forth one or more specific public benefits to be promoted by such Statutory Public Benefit Entity. "Public benefit" is statutorily defined broadly as "a positive effect (or reduction of negative effects) on one or more categories of persons, entities, communities or interests (other than members or partners, as applicable, in such capacities) including, but not limited to, effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature." Under the amendments, a Statutory Public Benefit Entity is also required to identify such specific public benefit and its existence as a Statutory Public Benefit Entity in its limited liability company agreement or partnership agreement, as applicable. The amendments further provide that the public benefit listed in the limited liability company agreement or partnership agreement will control as among the members, managers, and partners, as applicable, and other persons bound by such agreement, in the event there is an inconsistency between the applicable agreement and certificate, and that a provision in the applicable agreement or certificate will not be effective to the extent it is inconsistent with the applicable provisions of the LLC Act or the LP Act. Additionally, the amendments also obligate the managers, members, or general partners, as applicable, of a Statutory Public Benefit Entity to promptly amend such Statutory Public Benefit Entity's certificate of formation or certificate of limited partnership, as applicable, if such person becomes aware that a specific public benefit to be promoted is inaccurately set forth in such certificate.

The amendments also allow an existing Delaware LLC or Delaware LP to become a Statutory Public Benefit Entity either by (i) complying with the applicable requirements specified in its limited liability company agreement or partnership agreement, as applicable, or (ii) amending its certificate of formation or certificate of limited partnership, as applicable, and its limited liability company agreement or partnership agreement, as applicable, to comply with the statutory requirements.

Delaware GPs that Opt Out of Separate Entity Status Characteristics Remain Governed by GP Act

The general default rules under the GP Act provide that (i) a Delaware GP is a separate legal entity distinct from its partners, (ii) property acquired by a Delaware GP is property of the Delaware GP and not of the partners individually, and (iii) a partner is not a co-owner of partnership property and has no interest in specific partnership property, unless, in each case, the partnership agreement and a statement of partnership existence or statement of qualification modify these default rules. The amendments to the GP Act confirm that, unless the partnership agreement of such Delaware GP provides otherwise, a Delaware GP that has a partnership agreement and a statement of partnership existence or statement of qualification modifying one or more of such default rules, such as the rule that a Delaware GP is a separate legal entity, continues to be governed by all other provisions of the GP Act, including provisions relating to the dissolution of the Delaware GP.

The new 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. The amendments to the LLC Act, the LP Act, and the GP Act are contained in Senate Bill Nos. 114, 116, and 115, respectively. ■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