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Richards, Layton & Finger | Recent Developments in Delaware Law

Front cover: Offices of Richards, Layton & Finger
at 10th & King Streets, Wilmington, Delaware.

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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 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.

—Richards, Layton & Finger

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Lebanon County Employees' Retirement Fund v. Collins: Breach of Fiduciary Duty Claims Were Timely Against Directors of Opioid Distributor but Demand Was Not Excused

In *Lebanon County Employees' Retirement Fund v. Collins,* 2022 WL 17687848 (Del. Ch. Dec. 15, 2022), and 2022 WL 17841215 (Del. Ch. Dec. 22, 2022), the Delaware Court of Chancery issued two separate decisions in short succession addressing breach of fiduciary duty claims that were brought against directors and officers of AmerisourceBergen Corporation for their alleged actions and inactions in connection with the company's role in the ongoing opioid epidemic in the United States. In the first decision, the court held that the plaintiffs' claims were timely and refused to dismiss them for lack of timeliness because several of the alleged wrongful actions and inactions fell within the actionable period. In the second decision, the court held that a majority of the directors in office could have impartially considered whether or not to pursue the plaintiffs' claims against the defendants; therefore, demand was not excused, and the claims were dismissed in their entirety.

AmerisourceBergen is one of the largest distributors of pharmaceutical products in the world and one of three major wholesale distributors of opioid pain medication in the United States. As an opioid distributor, AmerisourceBergen is required to comply with extensive federal regulations, including maintaining "effective controls against diversion of [opioids] into other than legitimate medical, scientific, research and industrial channels," and must also "design and operate a system to disclose to the registrant suspicious orders of [opioids]."

Beginning in 2007, AmerisourceBergen encountered warning signs related to its opioid distribution practices when the federal Drug Enforcement Agency suspended the company's license for a distribution center in Orlando, Florida after concluding that the company had failed to maintain effective controls against the diversion of its opioids into improper channels. By 2013, several state attorneys general were investigating AmerisourceBergen's business practices surrounding opioid distribution. Despite these investigations, in 2015 officers of AmerisourceBergen proposed implementing a revised order-monitoring program (the "revised OMP"). Under its existing program, AmerisourceBergen flagged and reported to the DEA suspicious orders using static thresholds. Under the revised OMP, the company would only flag orders that met the static criteria and were inconsistent with a particular customer's dynamic pattern of orders, and then report those orders to the DEA. After the audit committee of the board of directors reviewed the revised OMP and reported on the same to the board, the revised OMP went into effect. Notably, AmerisourceBergen was already reporting suspicious orders at profoundly low rates compared to its peers. Under the revised OMP, the company's reporting of suspicious orders declined further. This was largely because even if a pharmacy's order was flagged as suspicious under the static criteria, the second filter would no longer flag orders if the pharmacy's order was consistent with the pharmacy's recent pattern of orders.

In 2017, a steady stream of red flags came to the board's attention: the audit committee was informed that AmerisourceBergen entered into a $16 million settlement with West Virginia to resolve claims surrounding its opioid distribution; the Energy and Commerce Committee of the United States House of Representatives opened an investigation into the company's practices; Senator McCaskill, the ranking member of the United States Senate Committee on Homeland Security and Governmental Affairs, began investigating the company's anti-diversion efforts; and a consortium of attorneys general from 41 states requested documents and information from the company concerning its opioid distribution practices. By 2018, AmerisourceBergen was facing 840 cases in state and federal courts as well as investigations by the Department of Justice and United States Attorneys' Offices. Furthermore, in 2018, the House Committee and Senator McCaskill released marring reports concluding that AmerisourceBergen failed to meet its reporting obligations regarding suspicious orders and failed to address suspicious order problems.

In May 2019, the plaintiffs requested books and records from AmerisourceBergen. The company rejected the request and litigated the demand for the next two years before the plaintiffs ultimately prevailed. Throughout 2020 and 2021, additional cases were filed against the company. In 2021, AmerisourceBergen agreed to pay over $6 billion to settle nationwide multidistrict litigation and incurred hundreds of millions of dollars in legal defense fees settling and resolving other lawsuits related to its opioid distribution practices. As part of the 2021 settlement, the company agreed to implement several internal changes to improve its distribution and anti-diversion practices, including a new board-level compliance committee to oversee the new anti-diversion control team.

Plaintiff stockholders sued directors and officers of AmerisourceBergen in the Delaware Court of Chancery, contending that such directors and officers breached their fiduciary duties by making affirmative decisions and conscious non-decisions that led to harm suffered by the company. The plaintiffs asserted two theories of breach: a red-flags claim under the second prong of *Caremark* and a *Massey* claim. Under the red-flags claim, the plaintiffs asserted that the officers and directors were confronted with a deluge of subpoenas, investigations, and lawsuits, all while reporting incomprehensibly low numbers of suspicious orders as the opioid epidemic worsened. The plaintiffs contended that, based on those red flags, the directors and officers knew that the company was violating federal and state laws and needed to implement stronger systems of oversight, but did nothing about it. For their *Massey* claim, the plaintiffs argued that the officers and directors "knowingly prioritized profits over law compliance."

In its first decision, the court addressed a matter of first impression for Delaware courts: when a red-flags or *Massey* claim accrues for purposes of the doctrine of laches. The court first looked to the analogous statute of limitations for claims of breach of fiduciary duty at law to determine that three years was the appropriate period for determining whether the plaintiffs' claims were timely under the doctrine of laches. Next, the court analyzed when the three-year limitations period began to run. The court considered and expounded on three separate approaches: the discrete act method, continuing wrong method, and separate accrual method.

Under the discrete act method, the court looks at the discrete wrong, counts forward from that date to determine when the limitations period ends, and examines whether the claim was brought within that period. Any claim brought after the limitations period has run is barred, and any "subsequent continuation of the improper conduct is treated as [a] not-separately-actionable implementation of the original decision or the damages flowing from it." Under the continuing wrong method, the limitations period does not commence until the defendant ceases wrongful conduct in a series of wrongful acts. So long as a challenge is brought within the limitations period of the cessation of the wrongful conduct, plaintiffs are permitted to challenge any wrongful act in the series of wrongful acts, regardless of whether those acts occurred within the limitations period. Under the separate accrual approach, "each continuation or repetition of the wrongful conduct [is] regarded as a separate cause of action for which suit must be brought within the period beginning with its occurrence." Consequently, under the separate accrual method, plaintiffs "can seek to impose liability and recover damages for any portion of the wrongful conduct where the statute of limitations has not yet run, but not for wrongful conduct that occurred earlier."

After examining the public policy implications as well as the implications on the claims before it of each of the three methods, the court held that the separate accrual method was appropriate to apply to the red-flags claim. The court determined that the discrete act method was not appropriate in this case because the red-flags claim inherently possessed an "ongoing dimension" to explicitly or implicitly ignore red flags and did not relate solely to one affirmative decision. Additionally, the court reasoned that in a red-flags claim, there is often more than one red flag to be ignored, and the effects of ignoring red flags do not usually cause immediate or cognizable harm to potential litigants. Accordingly, the court held that the discrete act method was ill suited to the claims before the court.

Similarly, the court concluded that the continuing wrong approach "affords full significance to the ongoing nature of the decision to ignore red flags, but de-emphasizes the reality that the ongoing act started at some point" and would permit litigants to sue on all wrongful, but potentially stale, conduct dating back to the first wrongful act. In contrast, the court held that the separate accrual approach was appropriate because such approach would not encompass all possible conduct dating back to the earliest possible wrongful conduct, but it would recognize the ongoing nature of red-flags claims by creating new accrual dates as the wrongful conduct continues. This method, according to the court, would encompass the "bulk of the harm."

The separate accrual approach was appropriate because it would not encompass all conduct dating back to the earliest possible wrongful conduct, but it would recognize the ongoing nature of red-flags claims by creating new accrual dates as the wrongful conduct continues.

The court held that the separate accrual method was appropriate for the *Massey* claim as well. The court acknowledged that the primary difference between the *Massey* claim and the red-flags claim was that it alleged a specific decision to pursue profits over legal compliance, while the red-flags claim merely alleged a conscious decision to ignore red flags. The court reasoned, however, that with respect to accrual frameworks, the claims were sufficiently similar to warrant application of the same separate accrual method: both claims involved ongoing wrongs, it may be difficult for someone outside the company to identify a specific point at which the wrongful conduct was made, and harm and damages to the company arose and increased over time.

The court held that under the separate accrual approach, the actionable period could have started on May 21, 2016, three years prior to the plaintiffs' books and records request, but because the plaintiffs were content to use October 20, 2019 as the starting point, the court held that the actionable period began to run three years earlier, on October 20, 2016. Because many of the allegations concerned actions and inactions of the defendants during the actionable period, the court held that the plaintiffs' claims were timely and refused to dismiss the complaint for lack of timeliness. Furthermore, the court explained that while liability and damages ultimately would hinge on the actions and inactions of the defendants during the actionable period, evidence from before October 20, 2016 could still be relevant and admissible to illuminate whether the defendants breached their fiduciary duties.

With the timeliness issue settled, the court in its second decision addressed the defendants' motion to dismiss for the plaintiffs' failure to make a demand on the board to pursue the claims. The plaintiffs argued that nine out of ten of the company's current directors were in office during the period of the alleged wrongdoing. The plaintiffs maintained that because such directors ignored the red flags and made the decisions to prioritize profits over legal compliance, those directors faced a substantial risk of liability for the plaintiffs' claims and were therefore incapable of making an impartial decision on whether to initiate a lawsuit against themselves for their alleged wrongs. Accordingly, the plaintiffs argued that demand was excused.

With respect to both the red-flags claim and the *Massey* claim, the court first acknowledged that the complaint, on its own, pled sufficient facts to infer at the pleadings stage that the defendants did consciously ignore red flags and prioritize profits over legal compliance and that those inferences would ordinarily be sufficient to warrant demand excusal. The court held, however, that because of a recent federal court decision determining that AmerisourceBergen had complied with its

anti-diversion obligations, it was impossible to infer that "the Company failed to comply with its anti-diversion obligations" or "that a majority of the directors ... face[d] a substantial likelihood of liability on the plaintiffs' claims." In this regard, the court explained that although the recent decision of the U.S. District Court for the Southern District of West Virginia was not preclusive, it was persuasive.

In the West Virginia case, the City of Huntington and the Cabell County Commission alleged that AmerisourceBergen created a public nuisance by contributing to the opioid epidemic. As part of AmerisourceBergen's principal defense, the company argued that its activities complied with the law and therefore could not constitute a nuisance as the plaintiffs argued. After a thorough review of the company's anti-diversion efforts, dating back to 1996, the district court held that AmerisourceBergen had not violated its anti-diversion obligations under federal law. The Court of Chancery held that in light of the district court's decision, it was not possible to infer that the company failed to comply with its anti-diversion obligations or knowingly prioritized profits over legal compliance, each of which was a necessary element of the plaintiffs' red-flags claim and *Massey* claim, respectively. Therefore, it was not possible to infer that a majority of the directors who were in office at the time of the plaintiffs' complaint faced a substantial likelihood of liability for the alleged wrongs. Because a majority of the directors in office could have therefore impartially considered whether or not to pursue the litigation, the Court of Chancery dismissed all claims for failure to plead demand futility.

Construction Industry Laborers Pension Fund v. Bingle: Court of Chancery Opinion Highlights the Scienter Requirement for a Successful *Caremark* Claim

In *Construction Industry Laborers Pension Fund v. Bingle,* 2022 WL 4102492 (Del. Ch. Sept. 6, 2022), the stockholder plaintiffs filed a derivative lawsuit against SolarWinds Corporation's board of directors, alleging that the board breached its fiduciary duties in connection with a cybersecurity attack by failing to adequately oversee the risk of such attack. The court granted the defendants' motion to dismiss under Rule 23.1, finding that since the *Caremark* claim was not viable, there was no substantial risk of liability attaching to a majority of the board, and therefore demand on the board would not have been futile.

SolarWinds was a publicly traded company that provided information technology infrastructure management software. Its software was used by a wide range of clients, ranging from Fortune 500 companies to United States government agencies, and SolarWinds' revenue was entirely dependent on the sale of its software. SolarWinds' primary product was the Orion Platform, the use of which required the software to have access to clients' information technology systems.

In December 2020, SolarWinds discovered that Orion had suffered a major cyberattack. According to the complaint, Russian hackers were able to penetrate SolarWinds' Orion software and use it to insert malware that gained access to and attacked up to 18,000 of SolarWinds' clients' systems. Following the announcement of this cyberattack, SolarWinds' stock dropped significantly, "with its value ultimately discounted by almost 40%." Further, SolarWinds became the subject of multiple government investigations and stockholder lawsuits. Here, the plaintiffs sought to hold the board liable for such damages, which the plaintiffs alleged resulted from the board's failure to adequately oversee cybersecurity risks—a *Caremark* claim. In response, the defendants filed motions to dismiss.

The court first noted that in order to survive a motion to dismiss, a stockholder bringing a *Caremark* claim must clear the high bar of pleading facts sufficient to establish that the directors acted in bad faith. Historically, "only utter failures by directors to impose a system for reporting risk, or failure to act in the face of 'red flags' disclosed to them so vibrant that lack of action implicates bad faith, in connection with the corporation's violation of positive law, have led to viable claims under *Caremark*."

Notably, here the plaintiffs did not allege that SolarWinds violated any laws. Rather, the directors were alleged to have failed to monitor corporate efforts in a way that prevented cybercrimes. The court noted that while it might be possible to "envision an extreme hypothetical" where a board's bad faith failure to monitor business risks could give rise to a successful *Caremark* claim, it was not clear if cybersecurity attacks by malicious third parties "present[ed] a sufficient nexus between the corporate trauma suffered and the board for liability to attach." The court chose not to decide that question because the claims, as pled, could be resolved via the "traditional two prong *Caremark* analysis."

The court began its analysis by noting that Delaware case law "demonstrate[s] that it is necessary to assess a director's good or bad faith in connection with a plaintiff's allegations before an oversight liability claim can be deemed viable." "[T]o act in bad faith, the directors must have acted with scienter, in that the directors had 'actual or constructive knowledge that their conduct was legally improper.'" The court explained that, for purposes of the Rule 23.1 motion to dismiss, the plaintiffs were required to plead with particularity facts supporting a finding of scienter. Though the plaintiffs alleged that the board acted contrary to positive law, the court found that the plaintiffs cited only published guidance that the board may have failed to follow, rather than any legal or regulatory framework that had evolved with respect to cybersecurity. The court similarly found that the complaint failed to plead with particularity that the board "intentionally acted with a purpose inimical to the corporation's best interests." The court found that the plaintiffs' argument that the board acted with conscious disregard for its duties by intentionally failing to act in the face of a known duty to act, "either by ignoring red flags so vibrant that scienter [was] implied, or by utterly failing to put in place a mechanism for monitoring or reporting risk," was the best argument. Still, the court held that the plaintiffs failed to plead scienter with particularity and that an inference of scienter would not be reasonable under the facts presented.

With respect to red flags—the second *Caremark* prong—the court concluded that SolarWinds' board did not ignore any red flags related to cybersecurity risks. The plaintiffs argued, among other things, that a cybersecurity briefing presented to the board's nominating and corporate governance committee constituted a red flag that was ignored by the board. The court disagreed, concluding that the briefing was not a "red flag," but "an instance of oversight" showing that the directors were in fact monitoring risks. Furthermore, the court found that the plaintiffs' arguments pertaining to other alleged red flags, such as SolarWinds' use of "a jejune, even farcical, password" that compromised security, were insufficient because the plaintiffs did not plead that such facts were ever brought to the board's attention.

As for the implementation of a monitoring and/or reporting mechanism—the first *Caremark* prong—the court held that the SolarWinds board did not utterly fail to implement a reporting system for cybersecurity risks because both the corporate governance committee and the audit committee were charged with oversight responsibility for cybersecurity—though such committees were charged with reporting to management, rather than the board. In the case of the corporate governance committee, affirmative facts pled indicated that the committee met and discussed the pertinent issue of cybersecurity. Notably, however, the court described the reporting systems SolarWinds had in place as "subpar," noting, among other things, that the board did not receive any reports from either committee with respect to cybersecurity for over two years. "[A] subpar reporting system between a Board subcommittee and the fuller Board[, however,] is not equivalent to an 'utter failure to attempt to assure' that a reporting system exists." Accordingly, the court found that "[w]ithout a pleading about the Committees' awareness of a particular threat, or understanding of actions the Board should take, the passage of time alone under these particular facts does not implicate bad faith."

> **"A subpar reporting system between a Board subcommittee and the fuller Board is not equivalent to an 'utter failure to attempt to assure' that a reporting system exists."**

Finding that the plaintiffs failed to allege particularized facts that could support a reasonable inference of bad faith by SolarWinds' directors and that the *Caremark* claim therefore was not viable, the court granted the defendants' motion to dismiss for failure to establish demand futility.

City of Detroit Police and Fire Retirement System v. Hamrock: General Red Flags Are Not Sufficient to Support *Caremark* Liability for Specific Corporate Trauma

In *City of Detroit Police and Fire Retirement System v. Hamrock*, 2022 WL 2387653 (Del. Ch. June 30, 2022), stockholders of NiSource, Inc. brought a *Caremark* claim against NiSource's directors after gas pipe explosions during a pipe repair damaged 131 structures, destroyed five homes, left several people injured, and killed one person. The court held that the plaintiff had failed to allege sufficient facts to support a *Caremark* claim against the defendant directors. In particular, the court held that even though the defendant directors were aware of general "red flags," the red flags at issue did not put the defendant directors on notice of the risk of the explosions. Because the *Caremark* claims were not sufficiently pled, the defendant directors did not face a substantial likelihood of liability. And because the directors did not face a substantial likelihood of liability, the court held that the plaintiff failed to establish that demand on the board was futile, and the case was dismissed.

NiSource is an energy company whose subsidiaries operate over 50,000 miles of natural gas pipelines that service over 3 million customers. The NiSource board had an environmental, safety and sustainability committee that was charged with "overseeing the programs, performance and risks relative to environmental, safety and sustainability matters." The committee also had the responsibility to review NiSource's practices regarding public, contractor, and employee safety, as well as review major legislation and regulations that pertained to the responsibilities of the committee. The committee regularly held meetings during the time leading up to the explosions.

NiSource operates in a field heavily regulated by federal and state laws. Under federal and state regulations in Massachusetts, gas operators, including NiSource's subsidiary, Columbia Gas of Massachusetts ("CMA"), were required to prepare and follow an operation and maintenance manual for each pipeline. Further, in 2015 the American Petroleum Institute issued a recommended practice with respect to pipeline safety management that NiSource had embraced and was in the process of implementing among its subsidiaries, but had not yet implemented at CMA at the time of the explosions.

In September 2018, CMA was replacing a century-old, problematic cast iron pipeline with a more modern pipeline in Lawrence, Massachusetts. The pipeline that was to be replaced was a low-pressure pipeline, and the pressure of the gas in the pipeline was regulated by a control line or sensing line. A common problem with these types of pipelines was their ability to over-pressurize and input a high amount of gas into customers' homes due to a single failure, such as an improperly disconnected control line. CMA did not maintain accurate records of the control lines of its pipelines. Before CMA began work on the pipeline in Lawrence, it developed a work package that contained detailed documents describing the work to be done. While CMA employees, including supervisors and engineers responsible for safety on such projects, discussed the control lines at issue for the project, the ultimate work package did not refer to control lines. When CMA employees worked on the pipeline, they used a bypass pipe to maintain service while they worked on the main pipe. However, documents in the work package failed to include plans for relocating the control lines from the main pipe to the bypass pipe, and the workers did not relocate the control lines to the bypass pipe. As a result, the main pipe had no gas flowing through it and the control line detected no gas flow, which prompted the system to increase the volume of natural gas in the bypass pipe and the lines it was then connected to. This over-pressurized the system, filled several buildings with a significant amount of gas, and upon ignition resulted in several explosions. The explosions damaged 131 structures, destroyed five homes, left several people injured, and killed one person.

The National Transportation Safety Board began an investigation of the explosions shortly thereafter. The NTSB issued five safety recommendations while its investigation was ongoing, four of which were directed at NiSource and focused on NiSource's inadequate recordkeeping requirements for its subsidiaries. The NTSB, after concluding its investigation, also found that NiSource did not require its subsidiaries to maintain adequate records of their natural gas systems, and this lack of proper documentation of the CMA natural gas system in part led to the omission of the sensing line in the work package developed for the pipeline replacement project in Lawrence.

The Massachusetts attorney general also investigated NiSource, and the parties reached a $56 million settlement. The United States Attorney's Office investigated NiSource and ultimately brought criminal charges against CMA, following which CMA pled guilty and paid a $53 million fine plus additional restitution. NiSource also entered into a deferred prosecution agreement with the United States Attorney's Office, under which it was required to divest CMA. The court also appointed an independent monitor to oversee NiSource's compliance. Finally, NiSource was required to implement additional safety measures to fix the issues identified.

In April 2021, a stockholder of NiSource brought a derivative suit in the Delaware Court of Chancery against several of the directors of NiSource at the time of the explosions. The defendants moved to dismiss for failure to plead demand futility.

Because the action was derivative, the plaintiff was required to first plead demand futility before its claim could continue. The plaintiff alleged that demand was futile because the defendants each faced a substantial likelihood of liability based on the claims raised by the plaintiff. Under *Zuckerberg*, whether demand was futile hinged on whether the plaintiff had adequately alleged its *Caremark* claim. The court also explained that *Caremark* required plaintiffs to either allege that "(1) the directors utterly failed to implement any reporting or information system or controls, or [(2)] having implemented such a system or controls, [the directors] consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."

The court then turned to the plaintiff's claim that the board failed to implement a monitoring and reporting system that was effective, particularly in connection with the "mission-critical" risk of pipeline safety. The court agreed with the plaintiff that pipeline safety was a mission-critical risk for NiSource as a pipeline operating company, but held that the plaintiff's other allegations conceded that the board and the environmental, safety and sustainability committee considered pipeline safety, discussed issues with compliance and pipeline safety laws, and demonstrated that the board had made a good faith effort to have in place an adequate monitoring system.

"General risks are not 'red flags' of a specific corporate trauma."

Separately, the plaintiff argued that NiSource repeatedly allowed its subsidiaries, including CMA, to operate in violation of pipeline safety laws instead of spending the money needed to ensure that the subsidiaries complied with all laws and regulations, and that this lawlessness was a *Caremark* violation. The court disagreed, finding that it could be reasonably inferred from the facts in the complaint that NiSource (i) was one of the first pipeline operators to embrace newly developed safety standards in the industry and start implementing such standards at its subsidiaries, (ii) was working to replace its aging pipeline and outdated recordkeeping system on a state-by-state basis, and (iii) was developing a pipeline safety management system. Furthermore, in 2017, the NiSource board accelerated implementation of this pipeline safety management system. While the court acknowledged that in hindsight some better business decisions could have been made concerning implementation of higher safety standards, the court concluded that the board's actions did not demonstrate a level of "lawlessness" that amounted to a *Caremark* violation.

The plaintiff also alleged that the board was aware of several red flags regarding pipeline safety but consciously ignored them in bad faith. On this front, the court held that the plaintiff had adequately alleged that the board was aware of the risks poor recordkeeping posed to NiSource generally, as well as the specific risks it posed to certain NiSource subsidiaries. The complaint cited two previous instances where poor recordkeeping caused pipeline safety issues and violations of law at NiSource subsidiaries. At NiSource's Ohio subsidiary, poor recordkeeping in part led to an explosion in 2015 at a service pipeline that did not appear in the company's records. The Ohio subsidiary paid a large fine to settle litigation in the wake of the explosion, and both the board and the environmental, safety and sustainability committee were aware of these events. NiSource's Indiana subsidiary was sued by a regulatory agency for committing over 261 violations of pipeline safety laws. Pursuant to a settlement of the suit, the Indiana subsidiary reported another 617 violations. The court agreed that both the board and the committee were aware of these violations because they received reports from management specifically on the topic.

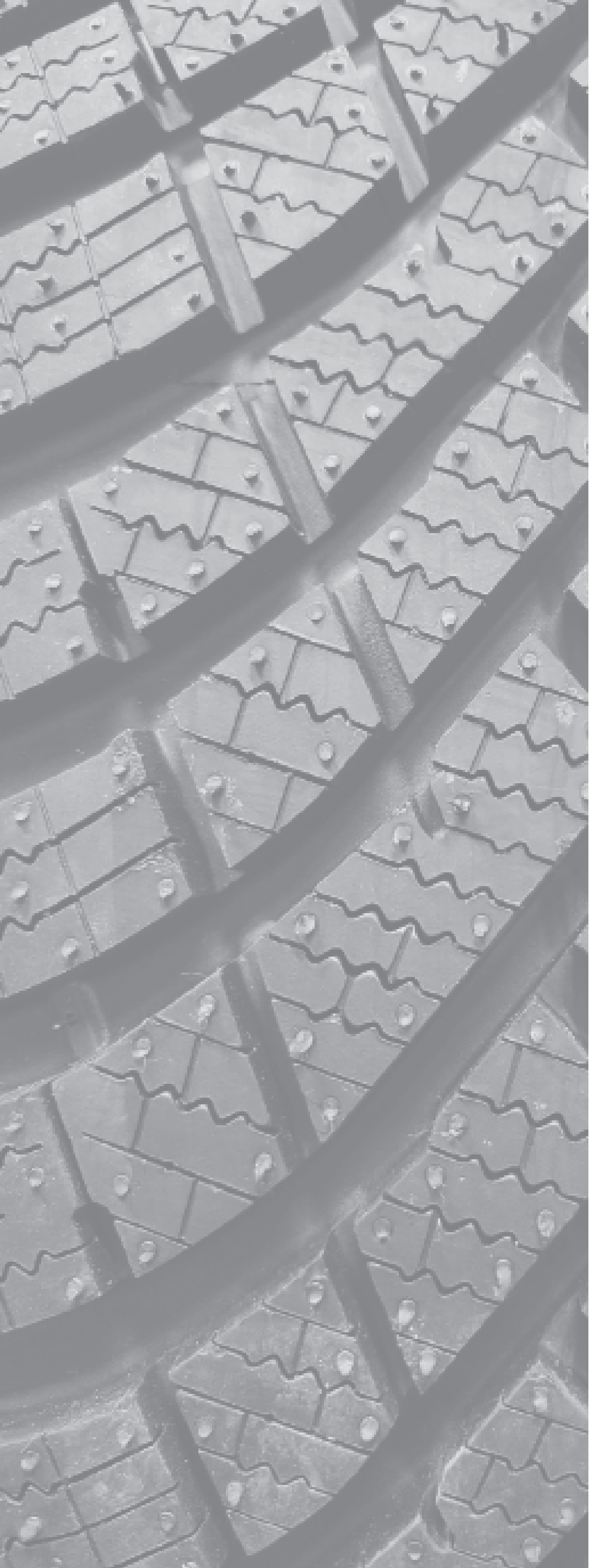
Second, the court held that even though the plaintiff alleged that the board was aware of the risks of recordkeeping violations at the Ohio and Indiana subsidiaries, the court said the board was not aware of the specific risk of poor recordkeeping concerning the control lines at CMA. The court ruled that the plaintiff had not adequately pled facts showing that the board was aware of a notice issued by NiSource and CMA in 2015 that discussed how a "catastrophic event" could occur if a control line malfunctioned and caused an over-pressurized system. But, the court held, the plaintiff did not allege that the board discussed the notice or that the notice was referenced in any materials presented to the board. The court also held that the plaintiff's attempts to establish that the board was aware of a history of over-pressurization events at CMA failed. Of the five events the plaintiff identified, the court held that the plaintiff had only discussed one with specificity, an over-pressurization event that occurred in Taunton, Massachusetts, and the plaintiff only alleged that the board became aware of the Taunton event after the explosions at issue, meaning that the red flag arrived too late to provide the board with notice of the specific risks leading to the explosions.

The court concluded that the plaintiff had shown that the board had general knowledge of recordkeeping issues, as well as knowledge of specific recordkeeping issues at certain subsidiaries—but not with respect to issues at CMA. The court explained that in order for the plaintiff to succeed on its *Caremark* red flag theory, the plaintiff must plead facts that show the red flag was in some way connected to the subsequent corporate trauma. The court held that "[g]eneral risks are not 'red flags' of a specific corporate trauma." Consequently, the court reasoned that NiSource's general recordkeeping issues and recordkeeping issues outside of CMA were not related closely enough to the issues that ultimately caused the explosions. Therefore, because the plaintiff had not alleged sufficient particularized facts to support its *Caremark* claim and the defendants did not face a substantially likelihood of liability, demand was not excused, and the court granted the defendants' motion to dismiss.

Fiduciary Duties

In re BGC Partners, Inc. Derivative Litigation: Chancery Court Finds Transaction Entirely Fair to Buyer and Its Minority Stockholders Despite a Flawed Process

In *In re BGC Partners, Inc. Derivative Litigation,* 2022 WL 3581641 (Del. Ch. Aug. 19, 2022), the Delaware Court of Chancery, in a post-trial opinion, held that defendant BGC Partners, Inc.'s acquisition of Berkeley Point Financial, LLC from an affiliate of Cantor Fitzgerald, L.P. and simultaneous investment of $100 million in a Cantor affiliate's mortgage-backed security business was entirely fair to BGC and its minority stockholders even though "the process was marred" by the actions of Howard Lutnick, the controlling stockholder of BGC and Cantor, and William Moran, the chair of the BGC special committee formed for purposes of the transaction.



BGC was a publicly traded brokerage and financial technology company whose predecessor entity was formed when it spun off from Cantor. At the time of the transaction, Lutnick was the chairman and CEO of both Cantor and BGC, was the sole stockholder of Cantor's managing partner, and held voting control of BGC via such managing partner and his indirect ownership of approximately 55% of Cantor. BGC acquired Newmark, a commercial real estate services company, in 2011 as part of its efforts to expand its real estate platform. In 2014, Newmark acquired Apartment Realty Advisors ("ARA"), a brokerage company that brokered the sale of multifamily properties, but Newmark remained at a disadvantage relative to its competitors because it still was not a full-service platform that could broker the sale of properties, originate loans, and service those loans. Specifically, Newmark lacked an "agency lender"—a real estate finance company pre-approved to originate and sell multifamily and commercial real estate loans on behalf of government-sponsored enterprises ("GSEs"), such as Fannie Mae and Freddie Mac—to pair with its brokerage services.

Prior to the disputed transaction, Berkeley Point was a private commercial real estate finance company and one of the few pre-approved agency lenders. In April 2014, Berkeley Point was acquired by Cantor Commercial Real Estate Company, LP ("CCRE"), which was then owned by Cantor and various outside investors. Between 2014 and 2016, Berkeley Point experienced growth driven by factors that included a strengthening multifamily real estate market and specific synergies with Cantor-affiliated entities, including Newmark and ARA. Berkeley Point, Newmark, and ARA benefited from the synergistic relationship. Specifically, BGC was able to fill the gap in its platform through a referral relationship with Berkeley Point. The referral relationship, however, was imperfect.

Newmark and Berkeley Point's executives found that the referral system was not streamlined and the lack of integration stood in contrast to competitors. Newmark also worried that, without in-house agency lending capabilities, it might lose ARA brokers when it came time to renegotiate their contracts, harming its multifamily platform. The only way for Newmark to secure its desired in-house GSE lending capabilities was by acquiring an agency lender, like Berkeley Point.

The possibility of BGC acquiring Berkeley Point was first raised by Lutnick in February 2017 at a meeting of the audit committee of BGC's board of directors. At such time, CCRE was made up of two businesses: Berkeley Point and a commercial mortgage-backed securities ("CMBS") business. Agreements had been reached with each of CCRE's investors through which "Cantor agreed to pay approximately $1.1 billion in the aggregate for the 88% of CCRE it did not own." A sale of Berkeley Point to BGC was the next step so that it could be combined with Newmark before Newmark went public. Lutnick "proposed that the Company be authorized to attempt to resolve terms and close the transactions by the end of the quarter" and commented on a possible purchase price in the low $700 million range. This comment was not viewed as an offer by other board members. Lutnick then discussed related-party considerations for the potential acquisition, given that he was an officer and controlling stockholder of both BGC and Cantor. Accordingly, a special committee, comprised of all of the members of the board except for Lutnick, was established to act on BGC's behalf with respect to the proposed transaction.

Shortly thereafter, Moran and Lutnick discussed the special committee and—at Lutnick's request—Moran agreed to serve as the special committee's chair. Moran then began seeking out advisors for the special committee and ran the retention of such advisors past Lutnick. In early March, Houlihan Lokey and Sandler were interviewed as potential financial advisors to the special committee, but Moran was the only committee member who participated in such telephonic meetings. Lutnick was also present.

On March 14, the board formally reestablished the special committee and fully empowered the committee to evaluate the proposed transaction and retain any advisors deemed appropriate. The special committee subsequently met, designated Moran and Dr. Linda Bell as co-chairs, and determined to retain Sandler as its financial advisor and Debevoise as its legal counsel.

The special committee's process was underway by mid-March 2017. Between March and June, the special committee conducted substantial due diligence and met at least nine times. Cantor initially proposed a structure through which BGC would (i) purchase a 95% interest in Berkeley Point for $850 million, with an option to purchase the remaining 5% for $30 million no sooner than five years following closing, and (ii) invest $150 million in CCRE's CMBS business with a preferred return and option to exit the investment after five years. As the process unfolded and the special committee conducted its diligence and discussions with advisors, "acquiring 100% of Berkeley Point had become [the special committee's] top priority" and would have been a "walkaway point ... in final negotiations without a major concession in price." On June 6, after over a month of negotiations, the special committee and Cantor reached a handshake agreement whereby BGC would (i) purchase Berkeley Point outright for $875 million, and (ii) invest $100 million in CCRE's CMBS business for five years. Furthermore, pursuant to the agreement, BGC would receive a preferred 5% return on the CMBS investment, with Cantor unable to receive distributions from the business until the preferred return was met. Such agreement was "subject to the completion of due diligence and negotiation of definitive agreements."

Five weeks later, on July 13, 2017, the special committee received a fairness opinion for the Berkeley Point acquisition and a reasonableness opinion for its CMBS investment from Sandler. That same day, the special committee unanimously determined that the transaction was in the best interest of BGC and recommended to the board that it approve such transaction. On July 16, the board adopted the special committee's recommendation and approved the transaction. The transaction agreements were executed the next day, and the acquisition and investment closed on September 8, 2017.

The plaintiffs—BGC stockholders—filed suit on behalf of BGC against Lutnick, two Cantor entities, and the four special committee members, alleging breaches of fiduciary duties in connection with the transaction. By the time litigation reached the trial stage, the only claims remaining were breach of fiduciary duty claims against Lutnick (and the Cantor entities he controlled) and Moran.

At trial, the plaintiffs alleged a series of problems that allegedly fatally undermined the fairness of the transaction, including that the transaction was a *fait accompli* constructed by Lutnick, the special committee was ineffective because it repeatedly acceded to Lutnick's whims, and Cantor withheld valuation information from the special committee.

"Perfection is an unattainable standard that Delaware law does not require, even in a transaction with a controller."

The plaintiffs also argued that the special committee accepted an inflated price for Berkeley Point designed to cover Cantor's tax liability and that the $100 million investment was "money losing."

After first determining that the demand requirement was excused, the court determined that the entire fairness standard of review applied, as it was undisputed that Lutnick (and the other Cantor defendants) stood on both sides of the transaction. Though the defendants did not ask the court to shift the burden of proof to the plaintiffs, the court concluded "that the Special Committee was independent, fully empowered, and well-functioning, warranting a burden shift under the *Lynch* doctrine." Nevertheless, "[r]egardless of who [had] the burden," the court held "that the transaction was entirely fair to BGC and its minority stockholders."

With respect to the fair dealing inquiry, the court identified "some defects in the process." Lutnick's presence "loomed large at times," as he initiated the deal discussions and had a hand in selecting the special committee's co-chairs and advisors. Additionally, the court found that some information was "slow rolled" to the special committee and the final negotiations unfolded over a compressed time period. Despite these flaws and considering the totality of the evidence, the court held that the process was fair, noting, "Perfection is an unattainable standard that Delaware law does not require, even in a transaction with a controller." Evidence supporting this conclusion included that (i) the deal was not timed to benefit Cantor, (ii) the special committee devoted substantial time to its work and retained independent advisors, and (iii) the deal was reached following arm's-length bargaining where the special committee obtained its desired structure and a favorable price. In particular, the court emphasized that the composition of a special committee is of central importance when evaluating the fairness of its process. The court found that Lutnick did not dictate the special committee's membership, as it was comprised of all of BGC's directors other than Lutnick, and that even though he had a role in selecting the special committee's chairs, "[t]he misstep was ... largely remedied after the Special Committee was fully empowered and voted to designate Bell and Moran as co-chairs."

The court found that at least a majority of the members of the special committee were independent for purposes of a fair dealing analysis. With respect to Moran, the court found that he was independent of Lutnick but that "during the deal process, Moran acted at times in a way that ... was 'not the best practice.'" Among other things, Moran (i) agreed to serve as chair at Lutnick's request, (ii) worked with Lutnick to identify advisors for the special committee, (iii) communicated with Lutnick about diligence and timing, and (iv) did not tell the other special committee members about certain of his earlier interactions with Lutnick. Though "[t]hese instances of questionable behavior marred the deal process," the court found that the evidence showed that Moran pushed back on multiple occasions, he knew his job was to advocate for the stockholders, and he was "a positive force when it came to ultimate price and terms reached." Accordingly, the court found there was "no evidence that Moran jeopardized the substance of the Special Committee's independent process." With respect to the special committee's advisors, the court held that, despite Lutnick's role in their retention, such advisors "were qualified, independent, and not beholden to Cantor."

The court found that the special committee was "well informed of the material facts when it voted to approve the transaction," was "deeply engaged," and "exerted their bargaining power against Lutnick and prevailed in obtaining consequential concessions." Accordingly, the court held that the Berkeley Point acquisition and CMBS investment were the product of fair dealing.

The court next turned to the fair price inquiry. In holding that the price was fair, the court reviewed the analyses conducted by both parties' experts and ultimately concluded that such analyses created a "fairness range" extending from $805 million to $1.164 billion. The purchase price of $875 million fell within that range, and so the court deemed the price for BGC to be fair. The court additionally found that the CMBS investment was financially fair. Accordingly, for the foregoing reasons, the court held that the transaction was fair in all respects to BGC and its minority stockholders.

Finally, the court addressed the plaintiffs' claim that Moran breached his duty of loyalty under the second prong of *Cornerstone*. Under *Cornerstone*, a non-independent director who acts "to advance the self-interest of an interested party" can be held liable for a non-exculpated claim. The court explained that the plaintiffs could only prevail if they showed both that Moran was not independent of Lutnick and that he actively furthered his interests. The court referenced the findings in its fair dealing analysis and found that, even though Moran's behavior was flawed—and perhaps even grossly negligent—Moran did not act disloyally.

Manti Holdings, LLC v. Carlyle Group Inc.: Court of Chancery Refuses to Dismiss Fiduciary Claims Based on "Need for Liquidity" Theory

In *Manti Holdings, LLC v. Carlyle Group. Inc.*, 2022 WL 1815759 (Del. Ch. June 3, 2022), the Delaware Court of Chancery applied the entire fairness standard of review to the sale of Authentix Acquisition Company, Inc. to Blue Water Energy even though the sale was with an arm's-length, unconflicted third party because Authentix's controlling stockholder allegedly received a unique benefit in the sale: immediate liquidity to the stockholder's own investors. After determining that

entire fairness was the appropriate standard of review, the court refused to dismiss the plaintiff stockholders' claim for breach of fiduciary duty against certain of Authentix's directors and Authentix's controlling stockholder. The court concluded that it was reasonably conceivable under the alleged facts that the sale did not reflect a fair price or process because it was rushed, did not factor in favorable contract renewals secured by Authentix, was pushed by a controlling stockholder seeking to sell quickly, and was never approved by an independent special committee of the Authentix board of directors or by Authentix's minority stockholders.

In 2015, Authentix began exploring a sale of the company. During this period, the board was composed of five directors: Steve Bailey, Michael Gozycki, Bernard Bailey, Paul Vigano, and Lee Barberito. Authentix selected Baird to serve as its banker. Initially, Baird represented that it could achieve a sale of Authentix "in excess of $200 million."

Early in the sale process, Baird identified a "customer concentration" risk with a key Authentix customer, Saudi Aramco. Importantly, Saudi Aramco had announced that it was reconsidering whether to renew its contract with Authentix, which was set to expire in May 2016. Furthermore, two additional Authentix customers, the governments of Ghana and Cameroon, raised similar concerns regarding the renewal of their contracts. This collective "customer concentration" risk stalled the sale process until late 2016.

When the sale process was reinitiated, Baird presented the board with four potential buyers. Two of the potential buyers presented bids with "holdbacks" contingent on the renewal of contracts with Saudi Aramco, Ghana, and Cameroon. After a few rounds of bidding, the board granted Intertek Group plc—with a bid of $140 million, $85 million of which was guaranteed and $55 million of which was contingent on the renewal of the Saudi Aramco and Ghana contracts—exclusivity. Of the five directors on the board, only Lee Barberito voted against granting Intertek exclusivity.

Believing that the Intertek bid was insufficient, Barberito requested and received "permission to solicit third parties to make an independent bid." Defendant Steve Bailey imposed a one-week deadline on Barberito, explaining that he "was under pressure to sell Authentix because it was one of the last investments still open in the applicable fund," and Carlyle U.S. Growth Fund III Authentix Holdings, L.P., Authentix's largest stockholder, needed to monetize and close that fund so the money could be returned to its investors. Ultimately, Barberito procured one timely bid from a third party. However, after meeting with Authentix, that bidder withdrew from the sale process and recommended a replacement bidder, Blue Water Energy.

In April 2017, the board voted, over Barberito's objection, to proceed with the sale to Intertek, which was offering consideration of $115 million without contingencies. However, after missing multiple milestones and delaying the close of the sale, Intertek lowered its bid to $85 million guaranteed with an additional $35 million contingent on certain post-closing conditions.

Meanwhile, Blue Water Energy continued to conduct due diligence and, in July 2017, submitted a revised bid to purchase Authentix, offering $77.5 million guaranteed, plus an additional $27.5 million contingent on the payment of a receivable from Ghana and achievement of future financial metrics. Barberito "urged the Board to withdraw from the sale process rather than sell at that price." After this request, the other Authentix directors "stopped providing [Barberito] with updates" on the sale process. In mid-August 2017, Authentix renewed contracts with Saudi Aramco and Ghana and extended its contract with Cameroon, effectively mitigating the previously identified "customer concentration" risk. Authentix also earned a new contract with the U.S. Federal Reserve Bank.

Despite the changed circumstances, in September 2017, the board voted, over Barberito's objection, to proceed with the sale to Blue Water Energy. Before the vote, Paul Vigano explained to Barberito in an allegedly "apologetic telephone conversation" that he was "under orders" from Authentix's second-largest stockholder to "approve the Sale because of its business relationship with Carlyle." Subsequently, Carlyle, as the majority stockholder of Authentix, executed a written consent to the sale. The sale was not submitted to any other stockholders for approval. Under the terms of a stockholders agreement, Authentix's stockholders, including the plaintiffs, were subject to a drag-along that provided that if a sale was approved by the board and the holders of at least 50% of the then-outstanding shares of stock, such stockholders were obligated to "consent to and raise no objections against" the sale.

Under Authentix's capital structure, the "preferred stockholders were entitled to be paid the first $70 million of any sale consideration, and the common stockholders were only entitled to receive distributions above the first $70 million." As such, Carlyle, which held a majority of Authentix's preferred stock, was set to receive the bulk of the $77.5 million in guaranteed consideration.

The plaintiff stockholders brought suit in the Delaware Court of Chancery asserting, among other things, breaches of fiduciary duty by Carlyle and directors Steve Bailey, Michael Gozycki, and Bernard Bailey. The defendants moved to dismiss the complaint pursuant to Rule 12(b)(6) for failure to state a claim. The plaintiffs argued that the sale was a conflicted transaction subject to an entire fairness review. The court agreed.

Regarding the "conflicted controller" argument, "Delaware courts have identified two categories of conflicted controller transactions that implicate the entire fairness standard: (a) transactions where the controller stands on both sides; and (b) transactions where the controller competes with the common stockholders for consideration." Here, the plaintiffs did not contend that the controller sat on both sides of the sale; rather, they argued that the controller, Carlyle, competed with the common stockholders for consideration during the sale. The court explained that a controller competes with common stockholders for consideration when it receives "something uniquely valuable [from the transaction] ... even if the controller nominally receives the same consideration as all other stockholders." Applying the law to the alleged facts of the case, the court held that the transaction was conflicted because Carlyle received a unique benefit in the sale; namely, access to quick cash to further its own interests in closing out the applicable Carlyle fund. Supporting its conclusion that the sale was a conflicted controller transaction, the court highlighted the purported "urgency" and "pressure" on the board to close the deal so that Carlyle could monetize and close certain of its funds; the failure of the director defendants to revisit the terms of the sale after renewing contracts with three key customers; the exclusion of Barberito, the sole dissenting director, from the sale process; and Carlyle's entitlement to nearly all of the proceeds of the sale because of its preferred stock holdings.

> **"The reality is that rational economic actors sometimes do place greater value on being able to access their wealth than on accumulating their wealth."**

In so holding, the court rejected the defendants' argument that a controller's unique need for liquidity cannot constitute a disabling conflict. While agreeing with the defendants that there is a general presumption that stockholders "have an incentive to seek the highest price for their shares," the court nonetheless reasoned that "the reality is that rational economic actors sometimes do place greater value on being able to access their wealth than on accumulating their wealth."

Applying the entire fairness standard to the claims, the court held that the plaintiffs sufficiently alleged facts to support their claim that there was an unfair process or unfair price. In particular, the court noted that the complaint sufficiently alleged that (i) despite the elimination of the "customer concentration" risk, the board failed to reevaluate or negotiate a better price for the sale, (ii) Carlyle pushed the board towards the sale for its own interests, and (iii) the sale was never approved by a committee of disinterested and independent directors or by Authentix's minority stockholders.

With respect to the individual director defendants, the court explained that because Authentix had a 102(b)(7) exculpatory provision in its charter, the claim also had to sufficiently allege breaches of the duty of loyalty against the individual director defendants to survive the motion to dismiss. On this issue, the court noted that Gozycki and Steve Bailey were dual fiduciaries—that is, they were simultaneously directors of Authentix and directors and officers of certain Carlyle entities. Because the interests of Carlyle diverted from those of the common stockholders, Gozycki and Bailey faced "inherent conflicts of interest," yet they did nothing to "insulate the Sale process from their influence" (e.g., by forming an independent special committee of the board). Instead, they participated in the sale process and ultimately cut out the sole dissenting director, Barberito, from the sale process. Additionally, the court relied on the allegation that Bailey stated he was motivated to sell Authentix because "it was time for Carlyle to monetize and close th[e] fund" as further evidence of potential disloyal conduct. Similarly, with respect to Bernard Bailey, the court noted that Bernard was an officer of Authentix and that as an officer he lacked independence for purposes of evaluating matters that implicated the interests of a controller. Consistent with the court's view, the court relied on the allegation that Bernard Bailey stated during the sale process that he "worked for Carlyle" and "had been told to sell [Authentix]." Consequently, the court held that it was reasonably conceivable that the director defendants "acted disloyally with respect to the Sale."

Because it was reasonably conceivable that Carlyle and the director defendants acted disloyally with respect to the sale, the court rejected the motion to dismiss the fiduciary duty claims against Carlyle and the director defendants.

Goldstein v. Denner: Fiduciary Duty Claims Regarding a Sale Process, Related Public Disclosures, and Insider Trading Survive Motion to Dismiss

In *Goldstein v. Denner,* 2022 WL 1671006 (Del. Ch. May 26, 2022) ("*Denner I*"), the Delaware Court of Chancery denied a motion to dismiss, finding that the plaintiff stated reasonably conceivable claims that certain directors and officers breached their fiduciary duties by (i) disloyally favoring a sale of the company to capture profits on shares purchased based on inside information, and (ii) concealing material information from the company's board of directors. In a separate opinion issued shortly thereafter—*Goldstein v. Denner,* 2022 WL 1797224 (Del. Ch. June 2, 2022) ("*Denner II*")—the court denied a motion to dismiss, finding that the plaintiff stated reasonably conceivable claims against a director and officer for breaching his fiduciary duty of loyalty by engaging in insider trading and against his hedge fund for aiding and abetting such breach.

In February 2017, Biogen, Inc. spun off Bioverativ, Inc., which became a new, publicly traded Delaware corporation. A few months later, in May 2017, Sanofi S.A. approached two of Bioverativ's directors, Alexander Denner and Brian Posner, and expressed an interest in purchasing Bioverativ at a price "in the range of $90 per share in cash"—roughly 64.1% over market. Denner and Posner declined the offer, stating that Bioverativ was not for sale. As alleged, Denner and Posner did not inform Bioverativ's board of directors about their meeting with Sanofi.

Shortly after meeting with Sanofi, Denner directed Sarissa Capital Management, L.P., a hedge fund that he controlled, and its affiliates to drastically increase their holdings in Bioverativ by purchasing over a million shares of company common stock. Such purchases violated Bioverativ's insider trading policy, and Denner was set to make a considerable profit if Bioverativ was sold to Sanofi at the proposed transaction price of $90 per share. Denner again did not disclose the stock purchases to the board.

Standing in the way of Denner's alleged "intention of making a quick profit on the sale of [Bioverativ]" was Section 16 of the Securities Exchange Act of 1934, which requires an "insider and his affiliates [to] disgorge short-swing profits from purchases and sales of shares within a six-month period." Accordingly, for Denner to avoid Section 16 liability, a transaction with Sanofi could not close until after November 2017.

In October 2017, as the end of the Section 16 short-swing period neared, Denner invited Sanofi to bid as part of a preemptive single-bidder process. Sanofi's initial offer was for $98.50 per share. However, Bioverativ's management team and financial advisors valued Bioverativ considerably higher—specifically, the board received a presentation in November 2017 that valued Bioverativ at $150.21 per share. On January 3, 2018, after pushback on its initial offer, Sanofi increased its bid to $101.50. That same day, the board received an analysis that valued Bioverativ at $158.16 per share. At a meeting held on January 4, the board determined to counter Sanofi's offer at $105 per share, which Sanofi accepted conditioned on Bioverativ granting exclusivity through January 26, which it did. The board met on January 19 and received a new set of projections—which dramatically reduced Bioverativ's value despite there being no changes in Bioverativ's long-term prospects or business outlook—for the bankers to use for their fairness opinions. With such fairness opinions in hand, the board approved an agreement and plan of merger with Sanofi (the "Transaction"). The first-step tender offer closed in March 2018, with holders of 65.2% of the common stock having tendered their shares, and the Transaction closed promptly thereafter. Denner and Sarissa received a profit of approximately $50 million.

The plaintiff filed suit in the Delaware Court of Chancery asserting, among other things, that Denner, Posner, and certain other directors and officers breached their fiduciary duties in connection with the sale process by (i) failing to obtain the highest value reasonably available for Bioverativ's stockholders, and (ii) making false and/or misleading public disclosures (collectively, the "Sale Process Claims"). The plaintiff separately asserted a claim against Denner for breach of fiduciary duty under *Brophy v. Cities Service Co.* and a claim against Sarissa for aiding and abetting such breach (collectively, the "Insider Trading Claims"). The defendants moved to dismiss the complaint for failure to state a claim on which relief can be granted. The court addressed the Sale Process Claims in *Denner I* and the Insider Trading Claims separately in *Denner II*.

In *Denner I*, as a threshold matter, the court first addressed whether the fiduciary duty claims should be dismissed pursuant to the *Corwin* cleansing doctrine, which provides that "when a transaction not subject to the entire fairness standard is approved by a fully informed, uncoerced vote of the disinterested stockholders, the business judgment rule applies." Because the approval by the stockholders must be fully informed, "[t]o defeat *Corwin* cleansing, a plaintiff only needs to plead the existence of one disclosure violation." "At the pleading stage, the operative question is whether the complaint 'supports a rational inference that material facts were not disclosed or that the disclosed information was otherwise materially misleading.'" The court found that *Corwin* was inapplicable because the plaintiff successfully alleged that it was reasonably conceivable that certain of Bioverativ's public filings were inaccurate, misleading, and/or incomplete.

The plaintiff alleged that Bioverativ's public filings did not adequately disclose Denner's and Posner's interactions with Sanofi and the board. For example, Bioverativ's Schedule 14D-9, among other things, did not (i) disclose the date of Denner's initial interaction with Sanofi, (ii) accurately describe the May 2017 meeting between Sanofi, Posner, and Denner since it did not mention Sanofi's offer to acquire Bioverativ at a price "in the range of $90 per share," and (iii) disclose Denner's and Posner's subsequent discussions with the board and Sanofi regarding the potential transaction. The court found that it was reasonably conceivable that certain of the inadequate or undisclosed information was "material" and that, even if it was immaterial, "[d]irectors have an obligation to provide an accurate, full, and fair description of significant meetings or other interactions between target management and a bidder." In so holding, the court was unmoved by the defendants' reliance on public disclosures made by Sanofi, which often contained information absent from Bioverativ's disclosure. As the court reasoned, "[t]he defendants must fulfill their own disclosure duties. They cannot rely on the bidder to do it for them."

The defendants argued that Delaware law does not require a "play-by-play" description of events leading to a transaction. While this principle is generally true, the court held that "the early meetings [with Sanofi] were material in their own right" and that "once the defendants traveled down the road of partial disclosure of the history leading up to the

[Transaction] ..., they had an obligation to provide the stockholders with an accurate, full, and fair characterization of those historic events." As the court concluded, "the complaint's allegations reflect[ed] a pattern of omissions and inaccuracies designed to obscure the fact that Denner and Posner were engaging in discussions with Sanofi ... without the Board's knowledge or approval," rendering *Corwin* inapplicable.

The plaintiff separately argued that the Schedule 14D-9 was materially misleading because it failed to disclose that Denner caused Sarissa to purchase over 1 million shares of company stock immediately after Sanofi approached him with its initial bid. As the court noted, "[u]nder Delaware law, stockholders are 'entitled to know that certain of their fiduciaries have a self-interest that is arguably in conflict with their own.'" The court therefore found that the financial incentives and motivations of Denner were information that should have been disclosed to the stockholders. The court was unpersuaded by Denner's contention that Sarissa's "total stock ownership" was disclosed in the Schedule 14D-9. As the court reasoned, it was the "timing" of Sarissa's stock purchases, not the "total stock ownership," that was problematic and therefore required disclosure.

The plaintiff additionally argued that the Schedule 14D-9 provided a materially misleading description of (i) the "Tax Matters Agreement," which imposed temporary "suboptimal conditions" because it restricted potential buyers, and (ii) Bioverativ's internal valuations of its stock—including the original and "slashed" valuations and the associated fairness opinion. "The practical effect of the Tax Matters Agreement was to prevent Bioverativ from engaging credibly with any potential buyer that had discussed an acquisition of Bioverativ with Biogen before the Spinoff." Such restriction, however, would have expired approximately one year after the board approved the Transaction—facts that were omitted from the disclosure. The court found that because such details were omitted, the discussion of the Tax Matters Agreement was materially misleading. With respect to the defendants' failure to disclose the more optimistic projections, the court found that the plaintiff pled facts making it reasonably conceivable that such projections were reliable and therefore material.

Finding that the plaintiff pled, at a minimum, at least one disclosure violation, the court held that *Corwin* could not cleanse the Transaction. Instead, since the Transaction involved a sale of Bioverativ for cash, the court applied the "enhanced scrutiny" standard of review. "A court applying enhanced scrutiny asks whether the directors' conduct fell within a range of reasonableness." Applying such standard to the Transaction, the court held that the board's conduct fell outside the range of reasonableness. As the court reasoned, the complaint supported a reasonable inference that Denner had self-interested reasons to secure a quick transaction with Sanofi, and as such, the sale process did not achieve "the best value reasonably available to the stockholders."

Denner faced a "dual fiduciary problem" in connection with his role at Bioverativ and Sarissa. Since the interests of Bioverativ and Sarissa "diverge[d]," Denner "face[d] an inherent conflict of interest." While Sarissa's stock holdings in Bioverativ would generally imply that its interests aligned with Bioverativ's stockholders, exceptions exist. Of note, activist hedge funds may value liquidity more than the average stockholder does. As such, the court found that it was "reasonably conceivable that Denner had a disabling conflict" given his short-term investment interests. Specifically, the court highlighted how Denner followed his "playbook" to achieve a sale of Bioverativ—i.e., by (i) acquiring a stake in Bioverativ (here, based on inside information), (ii) populating the board with insiders, and (iii) achieving a near-term sale. "When a defendant acts in accordance with a known playbook, the plaintiff gets the benefit of an inference at the pleading stage that the defendant is following the playbook." The court therefore found that there was a reasonable inference that Denner wanted Bioverativ to be sold via "a quick, non-competitive sale process with Sanofi" so that he could "lock-in a sure gain on his illicit stock purchases." In other words, the court found a reasonable inference that Denner acted in his own best interests, rather than those of Bioverativ and its stockholders.

Considering the above, the court reasoned that Denner tainted the sales process and, by not disclosing his actions, prevented the board from taking steps to neutralize his conflicts. Relatedly, the court noted that the board's single-bidder process with Sanofi was unreasonable. The court found that there was a reasonable inference that the market was not yet fully valuing Bioverativ and that the defendants were aware of that. Finally, the court highlighted Denner's role regarding the "slashed projections" and how they ultimately led to the undervalued final price of $105 per share. Taken together, the court held that the plaintiff's well-pled allegations supported an inference that the board's actions fell outside the range of reasonableness.

Denner tainted the sales process and, by not disclosing his actions, prevented the board from taking steps to neutralize his conflicts.

The court next held that non-exculpated claims were brought against Denner, Posner, and certain, but not all, of the remaining directors. Regarding Denner and Posner, the court reasoned that they acted in bad faith by concealing their discussions with Sanofi from the board. Moreover, with respect to Denner, the court highlighted his violation of Bioverativ's insider trading policy and his general manipulation of the sale process as indicia of bad faith. The court also found non-exculpated claims against certain, but not all, of the remaining directors for reasons including, *inter alia*, a lack of independence from Denner. Lastly, the court held that (i) non-exculpated claims were sufficiently pled against two officer defendants based on their "symbiotic" relationship with Denner, and (ii) non-exculpated claims were sufficiently pled against all the director and officer defendants based on the false and misleading statements and material omissions in the Schedule 14D-9. Accordingly, the defendants' motion to dismiss the Sale Process Claims was denied.

In the subsequent *Denner II* opinion, relying on the same set of operative facts, the court addressed the defendants' motion to dismiss the Insider Trading Claims. The plaintiff alleged that (i) Denner breached his fiduciary duty of loyalty by causing Sarissa to purchase shares after he learned material, non-public information regarding Sanofi's interest in acquiring Bioverativ, and (ii) Sarissa aided and abetted such breach. The defendants moved to dismiss for failure to state a claim and lack of standing. The court held that the plaintiff stated a reasonably conceivable claim against both Denner and Sarissa.

Addressing the fiduciary duty claim, the court found that the complaint adequately alleged a claim against Denner under the *Brophy* standard, which requires a showing that the fiduciary possessed "material nonpublic company information" and "used that information improperly by making trades because she was motivated, in whole or in part, by the substance of that information" (i.e., scienter). Regarding the "materiality" prong of *Brophy*, the court reasoned that Sanofi's initial offer of $90 per share—a 64.1% premium over the stock's current trading price—would have been significant to a rational investor and, as such, would have influenced the trading price of Bioverativ's stock. The court was unpersuaded by the defendants' argument that Sanofi's "initial expression of interest was not material because it was a 'casual inquiry.'" The court reasoned that the so-called "price-and-structure rule"—i.e., that there was no duty to disclose until there was an agreement on price and structure—no longer governed under Delaware law. Regarding the scienter prong of *Brophy*, the court reasoned that it was reasonably conceivable that Denner's stock purchases via Sarissa were motivated by Sanofi's initial interests in Bioverativ: "[w]ithin eleven days after Sanofi's initial expression of interest, Sarissa increased its stock ownership from 155,000 shares to 1,010,000 shares—a nearly 85% increase." Accordingly, the court held that both *Brophy* prongs were satisfied.

Addressing the claim against Sarissa for aiding and abetting Denner's breach of fiduciary duty under *Brophy*, the court first noted that Sarissa only challenged the second element of an aiding and abetting claim—i.e., the existence of a breach of a fiduciary duty. Analyzing that singular element, the court held that, "[f]or the reasons discussed in the prior section, the complaint supports a reasonable inference that Denner was a fiduciary who breached his duties."

The court next turned to the defendants' lack of standing argument. As the court noted, a *Brophy* claim is a derivative claim. Additionally, there is a "continuous ownership requirement, which mandates that a derivative plaintiff hold shares of the corporation continuously throughout the derivative action." Accordingly, "a merger in which the plaintiff's shares are converted into other consideration results in the plaintiff no longer holding stock and thus losing standing to assert the derivative claim." However, the plaintiff invoked *Parnes v. Bally Entertainment Corporation*, which held that "a plaintiff can bring a direct claim challenging a merger that results, in whole or in part, from conduct that otherwise might be viewed as giving rise to a derivative claim." The court agreed with the plaintiff that the *Parnes* exception applied to the Insider Trading Claims and rejected the defendants' lack of standing defense. In so holding, the court was unpersuaded by the defendants' argument that "the magnitude of the potential recovery on the Insider Trading Claims is immaterial in the context of the Transaction" and that the alleged misconduct didn't affect the "the fairness of the merger price or the fairness of the process that led to the merger." In finding that the alleged misconduct *did* affect the "fairness of the process," the court cited its holding in *Denner I* and noted that it was reasonably conceivable that the sale process fell outside the range of reasonableness. The court was equally unpersuaded by the defendants' argument that the *Brophy* claim duplicated the Sale Process Claims and should be dismissed on that basis. The court cited to Court of Chancery Rule 8, which permits a plaintiff to plead theories in the alternative, and reasoned that the *Brophy* claim thus provided a non-duplicative avenue of recovery.

Finding that the *Brophy* claim and the aiding and abetting claim were viable and that the plaintiff had standing, the court denied the defendants' motion to dismiss.

Corporate Governance and Public Company Issues

City Pension Fund for Firefighters and Police Officers v. The Trade Desk, Inc.: Decision to Extend Dual-Class Stock Structure Subject to Business Judgment Review under *MFW.*

In *City Pension Fund for Firefighters and Police Officers v. The Trade Desk, Inc.*, 2022 WL 3009959 (Del. Ch. July 29, 2022), the Delaware Court of Chancery dismissed a stockholder complaint that alleged that the CEO and several directors and officers of The Trade Desk, Inc. violated their fiduciary duties in connection with an amendment to Trade Desk's certificate of incorporation that prolonged voting control for the CEO and co-founder of Trade Desk, Jeffrey Green, finding that the transaction complied with the six-element framework set forth in *Kahn v. M & F Worldwide Corporation* ("*MFW*") and was therefore subject to business judgment review.

Trade Desk had two classes of common stock: Class A, which was publicly traded and entitled holders to one vote per share, and Class B, which was not publicly traded and entitled holders to ten votes per share. The certificate of incorporation restricted ownership of the Class B common stock by requiring that any transfer of the Class B common stock to someone that was not a "Permitted Transferee" would cause that stock to convert, on a 1-to-1 basis, into Class A common stock. Additionally, if the outstanding shares of Class B common stock ever represented less than 10% of the outstanding shares of Common Stock, then the shares of Class B common stock would convert into shares of Class A common stock on a 1-to-1 basis (the "Dilution Trigger"). The Class B stockholders had controlled Trade Desk since its IPO.

As of March 2020, Green owned nearly all of the Class B shares and maintained control of the voting power of Trade Desk, but his percentage of outstanding Class B shares was nearing 10% of the outstanding shares of common stock and at risk of tripping the Dilution Trigger. Because Green wanted to sell his shares without losing voting control, he began exploring a possible amendment to the certificate of incorporation to eliminate the Dilution Trigger. On May 29, 2020, Green called for a special meeting of the board of directors, which was held on June 3. The board discussed the Dilution Trigger and formed a special committee empowered to consider the Dilution Trigger and Trade Desk's dual-class structure. The special committee was comprised of Lise J. Buyer, Gokul Rajaram, and David B. Wells.

The special committee retained its own legal and financial advisors and met twice before authorizing counsel to inform Green's counsel that the committee was willing to consider a proposal to extend Trade Desk's dual-class structure. Green's counsel responded that Green was interested in making a proposal under the *MFW* framework and that such proposal would feature a "business rationale" for the extension. Green's initial proposal included removal of the Dilution Trigger in exchange for the addition of an automatic conversion of the Class B shares into Class A shares upon one of the following: (i) the seven-year anniversary of the adoption of the amendment (the "Sunset Provision"); (ii) the discretion of the board if Green was removed for cause from his position as CEO, president, or director of Trade Desk; or (iii) a date specified by the holders of at least 66⅔% of the outstanding shares of Class B common stock. Green also proposed the addition of provisions that would permit stockholders to act by written consent, so long as Green and/or his affiliates held more than 50% of the voting power of Trade Desk's shares and would entitle stockholders holding at least 10% of the voting power to call special meetings. With the proposal, Green asserted that continuation of the dual-class structure at Trade Desk would help Trade Desk maintain the long-term perspective that has made it successful.

The special committee met and discussed the proposal on four separate occasions before submitting a counter-proposal, which, among other things, (i) decreased the Sunset Provision from seven to five years, (ii) removed the "for cause" limitation with respect to Green's removal, (iii) added a new dilution trigger, (iv) modified the threshold for the right to call special meetings to 20% of the outstanding common stock, instead of 10% of the voting power, and (v) gave Class A stockholders the right to elect directors. Green objected to the new dilution trigger and the right of Class A stockholders to elect directors. After further negotiations, the parties agreed to a term sheet that provided for, among other things, (i) the removal of the Dilution Trigger entirely, (ii) a five-year sunset provision, (iii) the right of Class A stockholders to elect one director if the board has eight or fewer directors and two directors if the board has nine or more directors, (iv) the right of independent directors to elect a lead independent director, (v) the right of stockholders holding 20% of the outstanding shares to call a special meeting, and (vi) the ability of stockholders to act by written consent, so long as Green and/or his affiliates hold 50% or more of the voting power of Trade Desk.

The board met twice to consider the proposed amendment to the certificate of incorporation (the "Dilution Trigger Amendment"). At the September meeting, the board was informed that the Dilution Trigger was expected to trip in the second quarter of 2021; at the October meeting, the board approved the Dilution Trigger Amendment, with Green and two other members abstaining from the vote due to their ownership of Class B shares. The board called a special meeting of stockholders on December 7, which was adjourned to solicit additional voting support. The meeting reconvened on December 22, and the Dilution Trigger Amendment was approved by 52% of the unaffiliated shares. Following such approval, Green resumed selling his Class B shares.

A few days before the December 7 special stockholder meeting, Trade Desk's compensation committee held a meeting at which it considered a stock option grant to Green in his capacity as CEO, which potential grant options included an award amounting to 5% of Trade Desk's equity. The stockholders were informed of this prior to voting on the Dilution Trigger Amendment. Almost a year later, the board approved a stock option grant to Green that would enable him to purchase up to 19.2 million shares of Class A common stock over a ten-year period, assuming he met certain requirements.

In June 2021, the plaintiff filed a complaint asserting breach of fiduciary duty against Green in his capacity as a controlling stockholder, and against the board and certain officers, including Green, based on their actions imposing the Dilution Trigger Amendment on Trade Desk and its stockholders and failing to disclose Green's desire to sell his shares, and the anticipated date that Trade Desk's dual-class structure would end. The defendants moved to dismiss, arguing that, although the Dilution Trigger Amendment was an interested transaction, the transaction satisfied *MFW* and therefore should be subject to review under the business judgment standard, rather than the presumptive entire fairness standard. The plaintiff argued that the defendants did not satisfy two of the six requirements under *MFW*: (i) that the special committee be independent, and (ii) that the vote of the minority stockholders be informed.

With respect to the independence of the special committee, the plaintiff argued that (i) the committee's chair, Buyer, lacked independence such that she undermined the independence of the whole committee, and (ii) the committee "labored under a controlled mindset." Finding that the plaintiff failed to allege well-pled facts supporting that it was reasonably conceivable that Buyer's compensation was material, the court focused its analysis on whether Buyer sufficiently controlled the special committee to warrant a finding that the entire committee was compromised. The plaintiff's sole evidence in support of such concerned the selection of one of the two financial advisors to the special committee. The plaintiff presented an email with the subject line "For what it's worth," in which Buyer informed the committee that she received a strong recommendation to hire the advisor and pointed out that the advisor's website discussed advising special committees on the specific issue they were considering. The court held that the plaintiff did not plead sufficient facts alleging that "Buyer's conduct dominated or subverted the Special Committee process so as to render the entire committee defective, even if she was determined to be lacking independence."

The plaintiff next argued that the committee "labored under a controlled mindset" because the committee

members knew that if they sided with Green on the issue, their positions as directors would be secure. Finding such argument unsupported by any well-pled facts, the court found that, at most, the plaintiff had

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shown that the directors agreed with Green's proposal to extend the dual-class capitalization structure, not that the committee members were beholden to Green or that they suffered from any disabling interest in the transaction. The court concluded that the plaintiff's allegations merely "infer wrongdoing from business judgment decisions" and that, because the plaintiff failed to plead facts showing that the committee acted with gross negligence, such claim failed.

As to whether the stockholder vote was informed, the plaintiff argued that the defendants did not sufficiently disclose: (i) Green's desire to sell his Class B stock, (ii) Trade Desk's expectations regarding when the Dilution Trigger would be tripped, (iii) advice from the special committee's financial advisor, (iv) Green's counsel's statement that a business rationale would be needed for the transaction; (v) the special committee's efforts to get stockholder support for the Dilution Trigger Amendment, and (vi) the compensation committee's consideration of a stock option grant to Green. Noting that the question of materiality is a "context-specific inquiry," the court found that none of these alleged omissions were material.

With respect to the first point, the court found that the plaintiff failed to plead facts to support that it was reasonably conceivable that Green's desire to sell stock meant that he was desperate for liquidity. The court reasoned that the purpose of the Dilution Trigger Amendment was to maintain the Class B stock, the "obvious effect" of which clearly meant that Green would be able to sell more shares without risk of automatic conversion, and therefore found that the inclusion of Green's desire to sell would not have significantly altered the total mix of information available to the stockholders. With respect to the disclosure that the Dilution Trigger could occur as early as March 2021, the court held that the date was not knowable and the "Board was not obligated to provide additional possibilities, opinion or characterizations as to a Dilution Trigger date that it did not have."

The court next rejected the plaintiff's argument that the failure to disclose one slide of its financial advisor's preliminary presentation, which identified "Potential Levers" including "Economic Considerations," was material. The court found that such slide contained "generalized information regarding what stockholders might find more appealing in considering [the] proposal" and held that a disclosure stating that the special committee could have asked for economic consideration, but did not, would have been obvious to any reasonable stockholder reading the proxy statement. Notably, although the court found that it need not address it for purposes of its analysis, the court found meaningful the defendants' distinction that "this case [did] not involve a merger where the committee obtained and relied on a financial advisor's fairness opinion and underlying valuation analysis."

With respect to the alleged failure to disclose that Green's counsel stated that Green understood that he would need to provide a business rationale for the transaction, the court found that the reasonable inference was not that this was an admission that no such rationale existed, but rather a mere acknowledgement that a sufficient rationale was needed to garner support from stockholders since proxy advisory firms such as ISS and Glass Lewis do not typically support dual-class capitalization structures. Such omission, the court found, was therefore not material. As for the disclosure regarding the special committee seeking stockholder support, the court rejected the plaintiff's argument, finding that such information necessarily could not have been included in the initial proxy since such events occurred following the meeting's adjournment. Furthermore, the court noted, such details were disclosed in Trade Desk's supplemental proxy, which stated that Trade Desk was soliciting additional votes following the adjournment. The court explained that the board had authority to solicit votes because Delaware law does not require boards to remain neutral on matters they propose to stockholders. Finally, with respect to the disclosure of the compensation committee's consideration of a stock grant for Green, the court held that the omission was not material because the committee took no action until nearly a year after approval of the proposed amendments, and at the time of the vote on the proposed amendments, the stock grant proposal was entirely speculative.

The court concluded that because the plaintiff failed to plead facts sufficient to challenge the *MFW* framework, the Dilution Trigger Amendment was subject to the business judgment rule. Because the plaintiff did not plead a claim for waste and made no effort to overcome the business judgment rule, the court granted the defendants' motion to dismiss.

Garfield v. Allen, **2022 WL 1641802 (Del. Ch. May 24, 2022):** Grant of Executive Compensation Awards in Excess of Equity Plan Supported Breach of Contract, Breach of Fiduciary Duty, and Unjust Enrichment Claims

In *Garfield v. Allen*, 2022 WL 1641802 (Del. Ch. May 24, 2022), the plaintiff stockholder brought claims for breach of contract, breach of fiduciary duty, and unjust enrichment, contending that the defendants—the company's board of directors, a committee of the board, and the CEO—improperly issued and accepted, as applicable, excessive awards under the company's equity compensation plan.

In 2019, the board of directors of The ODP Corporation approved an equity compensation plan (the "2019 Plan"). Thereafter, the board submitted the 2019 Plan to ODP's stockholders, and the stockholders approved it. The 2019 Plan was administered by a committee of the board. The 2019 Plan authorized the board to grant awards of performance shares, performance units, and other forms of equity-based compensation to officers, employees, non-employee directors, and consultants.

In addition, the 2019 Plan imposed restrictions on the amount of the awards that the committee could grant to any individual in a single year. The maximum number of shares per year that could be subject to an award to any one participant was 3,500,000 (the "Performance Share Limitation").

In March 2020, the committee made two grants of performance shares to ODP's CEO, defendant Gerry P. Smith. Each of the challenged awards entitled Smith to receive a variable number of performance shares, depending on various performance metrics. The final amount to be awarded would be determined by the committee based on ODP's performance over a three-year period that ended in 2023. Under the terms of the challenged awards, if ODP hit the highest performance benchmarks, the number of shares Smith would be entitled to receive was 4,733,840 shares.

In March 2021, the plaintiff sent a letter to ODP asking the board to modify the performance shares granted to Smith so that the maximum potential payout did not exceed the Performance Share Limitation. In April 2021, ODP responded to the plaintiff that it would not take any action in response to his letter, contending that the number of shares that may become payable pursuant to the challenged awards was not yet known, and the board interpreted the 2019 Plan differently than the plaintiff such that the Performance Share Limitation only applied to a subset of Smith's challenged awards. Thereafter, in May 2021, the plaintiff filed a complaint in the Delaware Court of Chancery alleging breach of contract, breach of fiduciary duty, and unjust enrichment.

As a preliminary matter, the defendants argued that the plaintiff's claims were unripe and thus non-justiciable. More specifically, the defendants contended that the plaintiff's claims were "contingent on future events" since the parties would not know if Smith would receive shares in excess of the Performance Share Limitation until after the three-year measurement period. The court disagreed. The court held that the challenged awards gave Smith a present, vested right to receive shares in excess of the Performance Share Limitation and that settled Delaware case law interpreting grants of equity-based awards permitted the grant of the award to be challenged without having to wait until the CEO's performance was evaluated and the actual number of shares awarded was determined. The court reasoned that to hold otherwise would create a "Catch-22" with the applicable three-year statute of limitations because a plaintiff would be unable to challenge the decision to make a challenged award until after the statute of limitations would have expired.

With the ripeness issue settled, the court next addressed the plaintiff's breach of contract claim, which centered on the contention that the committee breached the Performance Share Limitation when it approved the challenged awards. The defendants argued that the 2019 Plan was not a contract. The court again disagreed, holding that settled Delaware case law had already determined that stockholder-approved equity compensation plans are contracts—contracts between a corporation's board and its stockholders. Next, the court held that the plain language of the 2019 Plan did "not permit the committee to grant awards to a single participant in a single fiscal year where the 'maximum number of shares' that [were] 'subject to' the Awards [could] exceed 3,500,000." According to the court, it did not matter that the committee was given discretionary authority to interpret the 2019 Plan and then interpreted the Performance Share Limitation in a manner that arguably made the challenged awards not violate the Performance Share Limitation because the committee's interpretative authority was "subject to" the terms of the 2019 Plan, which clearly set forth a maximum number of shares that could be subject to an award—a maximum that could not be altered by committee interpretation. Because the challenged awards granted to Smith entitled him to up to 4,733,840 shares, the court held that the complaint stated a claim for breach of the 2019 Plan.

The defendants also argued that the plaintiff failed to plead damages stemming from the breach. On this point the court held that the plaintiff need not plead monetary damages to sustain a breach of contract claim. Instead, it need only plead causally related harm, which the plaintiff had done—i.e., the plaintiff pled that the committee committed an unexcused violation of the Performance Share Limitation, which harmed ODP's stockholders.

The court next addressed the plaintiff's claim for breach of fiduciary duty against the board, the committee, and Smith. As the plaintiff alleged, the committee breached its fiduciary duties by approving the challenged awards despite knowing they violated the Performance Share Limitation, Smith breached his fiduciary duty by accepting the challenged awards despite knowing of the violation of the Performance Share Limitation, and the board breached its fiduciary duties by refusing to remedy the unauthorized grant of the challenged awards pursuant to the demand letter.

The defendants argued that the plaintiff failed to state a claim for breach against any defendant because the committee's decision was protected by the business judgment rule. The court found this argument unpersuasive. First, the court reasoned that the "business judgment rule only applies when directors make a discretionary judgment ... within the scope of their authority." Because the board had no authority to act outside of the clear limits imposed by the Performance Share Limitation, the business judgment rule did not protect its decision. Second, the court held that because the facts alleged supported a reasonable inference that the defendants violated an unambiguous restriction on their fiduciary authority by their failure to act in good faith compliance with legal limitations on their authority under the Performance Share Limitation, the plaintiff had also sufficiently asserted a claim for breach of the duty of loyalty. Under this line of reasoning, the court held that even if the business judgment rule had been applicable, it was rebutted by pleadings supporting a violation of the duty of loyalty. Therefore, the court held that the business judgement rule did not protect the defendants and that the complaint stated a claim for breach of fiduciary duty against the committee and the board.

In addressing the breach of fiduciary duty claim against Smith, the court held that the complaint stated a viable fiduciary duty claim because it was reasonable to infer that Smith, as the CEO and a board member, knew about the Performance Share

Limitation and that the challenged awards violated the limitation.

Finally, the court held that the complaint stated a viable fiduciary duty claim against the board for not fixing the challenged awards as requested in the plaintiff's letter to ODP. In so holding, the court invoked *Caremark* and reasoned that the board's conscious decision to leave the challenged awards in place, despite having a clear fix readily available, supported an inference that it acted disloyally and in bad faith. However, for policy reasons, this outcome gave the court some pause. The court acknowledged that its decision to hold that a separate cause of action was created by the failure of the board to take action in response to the demand letter could create other problems—for example, plaintiffs sending demand letters to (i) try to extend a limitations period that would otherwise expire, or (ii) bring a larger pool of deeper-pocketed defendants into an action. Despite these concerns, the court opined that courts could address and refine these issues further in future decisions on a case-by-case basis. In this case, the court held that the pled facts supported a separate fiduciary duty cause of action based on the board's rejection of the demand letter.

The court next addressed the plaintiff's derivative claim for unjust enrichment against Smith. Generally, a claim for unjust enrichment in Delaware requires a plaintiff to plead: "(1) an enrichment, (2) an impoverishment, (3) a relation between the enrichment and impoverishment, (4) an absence of justification, and (5) the absence of a remedy provided by law." The court found that the plaintiff had satisfied each element of an unjust enrichment claim.

First, the court reasoned that Smith currently possessed a right to receive the challenged awards, even if he did not exercise his right. Thus, the alleged facts made it reasonably conceivable that Smith had been enriched. With respect to the second element, the court held that the challenged awards gave Smith rights. Those rights came at the expense of ODP. Accordingly, the alleged facts made it reasonably conceivable that ODP was impoverished. In analyzing the impoverishment element, the court noted that impoverishment was not strictly necessary. Rather, under applicable precedent, the dispositive question was whether the plaintiff had alleged that Smith "received a *benefit,* that [Smith's] receipt of the benefit was unjustified, and that there [was] some connection between the benefit unjustly received and an invasion of the plaintiff's legally protected rights." For this reason, in addressing the third unjust enrichment element, the court held that because an impoverishment

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is not strictly necessary, neither is establishing a relationship between the impoverishment and the enrichment. Nonetheless, the court reasoned that in this case there was a direct link between the impoverishment and enrichment because Smith received rights at the expense of ODP.

In holding that the fourth unjust enrichment element was sufficiently pled, the court reasoned that there was no conceivable justification for the committee's decision to make grants that exceeded the Performance Share Limitation. The court explained that it was not opining on whether the compensation paid to Smith was excessive; rather, the court was merely holding that, based on the alleged facts, the challenged awards exceeded the Performance Share Limitation—an excess for which the court held it was reasonably conceivable there was no justification. With respect to the fifth element, the court held that "[o]utside a dispute over jurisdiction ... it is not necessary for a plaintiff to plead or later prove the absence of an adequate remedy at law." In other words, the court held that it is adequate to plead the first four elements of an unjust enrichment claim if the plaintiff has another basis for equitable jurisdiction. The fact that the plaintiff asserted claims for breach of contract and breach of fiduciary duty, which could provide an adequate remedy, did not defeat the claim for unjust enrichment. Instead, the court held that it had jurisdiction over the plaintiff's unjust enrichment claim under the clean-up doctrine and refused to dismiss the plaintiff's unjust enrichment claim.

The defendants argued that the stockholders' approval of a say-on-pay vote at ODP's 2021 annual meeting ratified the challenged awards. The court was unpersuaded, explaining that for a stockholder vote to ratify prior action, the stockholders "must be told (i) specifically what they are voting on and (ii) what the binding effect of a favorable vote will be." In this instance, the court reasoned that the say-on-pay vote did neither. In fact, according to ODP's own proxy material, the say-on-pay vote was an expressly "advisory vote" on an "advisory proposal" without ratifying power. Furthermore, it was a bundled proposal—not one on which the stockholder expressed a specific opinion on one item. According to the court, "if stockholders are not adequately informed of the consequences of their acts, then the ratification is not valid." Similarly, the court held that "[i]f the consequences of the stockholder vote are unclear or ambiguous, then the ratifying vote will not have legal effect." Because the ratification raised by the defendants relied on a bundled, advisory, and insufficiently specific vote, the court held that the stockholder vote failed to ratify the challenged awards.

After determining that (i) the plaintiff's claims were ripe, (ii) the complaint stated a claim for breach of contract, breach of fiduciary duty, and unjust enrichment, and (iii) the ratification argument failed, the court denied the defendants' motion to dismiss.

Brown v. Matterport, Inc.: Bylaw Lock-up Provisions Not Binding on Stockholder Following de-SPAC

In *Brown v. Matterport, Inc.,* 2022 WL 89568 (Del. Ch. Jan. 10, 2022), the Delaware Court of Chancery held that lock-up transfer restrictions adopted in connection with the merger of Matterport Operating, LLC ("Legacy Matterport") with and into Gore

Holdings VI, Inc., a special purpose acquisition company, did not apply to shares held by Legacy Matterport's chief executive officer, William Brown.

Gore and Legacy Matterport agreed to a business combination (the "de-SPAC merger" and the entity that survived the de-SPAC transaction, "Matterport") on February 7, 2021. As consideration for the de-SPAC merger, Legacy Matterport stockholders would be given the "right to receive 4.1183 shares of Matterport Class A common stock per share of Legacy Matterport owned" (the "Consideration").

The de-SPAC merger was conditioned upon Gore adopting amended bylaws prior to the consummation thereof. On July 21, 2021, Gore adopted the amended bylaws, which became effective the next day. Section 7.10(a) of the bylaws imposed transfer restrictions on certain shares of the Matterport Class A common stock:

> [T]he holders (the "Lockup Holders") of shares of Class A common stock ... of the Corporation issued (i) as consideration under that certain Agreement and Plan of Merger, dated as of February 7, 2021 ... or (ii) to directors, officers and employees of the Corporation and other individuals upon the settlement or exercise of restricted stock units, options or other equity awards outstanding immediately following the closing of the Business Combination Transaction in respect of awards of [Legacy Matterport] outstanding immediately prior to the closing of the Business Combination Transaction ... may not Transfer any Lockup Shares until the end of the Lockup Period.

Section 7.10(d) of the bylaws defined "Lockup Shares" as "shares of Class A common stock held by the Lockup Holders immediately following the closing of the Business Combination Transaction." The lock-up provisions would expire 180 days after the de-SPAC merger closed.

The de-SPAC merger closed on July 22, 2021. Pursuant to the terms of the merger agreement, Legacy Matterport stockholders were required to execute and submit a letter of transmittal to Matterport's transfer agent surrendering their Legacy Matterport shares to receive the Consideration; until so surrendered, each share of Legacy Matterport stock represented only the right to receive the Consideration.

Brown sought a declaration that the bylaw's transfer restrictions did not apply to his shares of Matterport Class A common stock and he could freely transfer such shares. The court agreed and held that Brown was not subject to the restrictions.

On September 3, 2021, Brown filed an amended verified complaint, which sought a declaration that the transfer restrictions set forth in the bylaws did not apply to his shares of Matterport Class A common stock and that he could therefore freely transfer such shares. The Court of Chancery agreed and held that Brown was not subject to the transfer restrictions in Section 7.10 of the bylaws, finding that he did not own Lockup Shares as defined therein.

The court found that the definition of Lockup Shares was not ambiguous and therefore looked to the "plain language of the provision." The bylaws defined Lockup Shares as "the shares of Class A common stock *held* by the Lock-up Holders *immediately following* the Business Combination Transaction." Brown argued that he did not hold his shares of Matterport Class A common stock "immediately following" the closing of the de-SPAC merger because he was not issued such shares until at least November 5 and 19, 2021. Notably, Brown was not issued the Consideration sooner because he did not deliver a letter of transmittal, as required by the terms of the merger agreement, until November 2021. The court noted that after closing and before Brown delivered the letter of transmittal and received the Consideration, he held "only the right to receive Matterport Class A common shares."

Though the defendants argued that Brown's reading of the provision would "'nullify' the transfer restrictions because 'no Legacy Matterport stockholder received Matterport shares' instantly after the transaction closed," the court found that the evidence demonstrated that some Legacy Matterport stockholders "would have received their Matterport shares within a few days of closing." The court found that such timing "could be viewed as consistent with a plain reading of the bylaw." The court did not define the exact time period that would constitute "immediately following," but found that "obtaining shares over 100 days after closing is not 'immediately.'" Thus, Brown's shares of Class A common stock were not Lockup Shares under Section 7.10(d) of the bylaws, and he therefore was not subject to the transfer restriction.

Proxy Contests

In re Aerojet Rocketdyne Holdings, Inc.: Court of Chancery Addresses Use of Company Resources in Split Board Proxy Contest

In *In re Aerojet Rocketdyne Holdings, Inc.*, 2022 WL 2180240 (Del. Ch. June 16, 2022), the Delaware Court of Chancery issued a declaratory judgment stating that the defendant directors, including the CEO of Aerojet Rocketdyne Holdings, Inc., violated the principle of corporate neutrality when they used Aerojet resources to support their slate of director nominations and discredit the plaintiff directors' slate of director nominations in a proxy fight between members of an evenly split board, and declared those actions unauthorized and void.

The Aerojet board of directors consisted of eight members, including Aerojet's CEO, Eileen Drake, and Aerojet's executive chairman, Warren G. Lichtenstein. Lichtenstein also served as the executive chairman of Steel Partners Holdings, GP Inc., which held a 5% stake in Aerojet. In December 2020, Lockheed Martin Corp. and Aerojet entered into an agreement and plan of merger whereby Lockheed would acquire Aerojet. Leading up to the execution of the agreement, Drake and Lichtenstein were at odds regarding how Aerojet should handle the transaction. Additionally, the transaction was subject to review by the Federal Trade Commission, and Lichtenstein became concerned that the FTC would block the transaction. Lichtenstein wanted the board to engage in contingency planning, but Drake thought such planning would violate the merger agreement. The FTC did eventually sue to block the merger on January 25, 2022, and Lockheed terminated the agreement.

While the FTC was reviewing the merger, Drake made several complaints about Lichtenstein to Aerojet's general counsel. Drake sent multiple memos describing the "erosion of trust" between her and Lichtenstein and claiming that Lichtenstein had discussed the future of Aerojet if the merger did not close with individuals outside the company. Drake also expressed her concerns that Lichtenstein would remove her as CEO and that his contingency planning demands were distracting to the board. The board formed a committee of the six non-management directors (all directors excluding Drake and Lichtenstein) to investigate Drake's allegations. The investigation was ongoing throughout the events leading up to and during the litigation, and on May 2, 2022, the committee issued a memorandum to Drake and Lichtenstein summarizing its findings. The committee found that Lichtenstein's contingency planning was not harassment or a violation of Aerojet's policies or bylaws, but formally reprimanded Lichtenstein for discussing the merger and Drake's future with third parties and mandated that he make no further statements to individuals outside of Aerojet.

In January 2022—before the FTC antitrust suit—as part of Lichtenstein's contingency planning efforts, Lichtenstein decided to nominate a slate of company directors in case the deal did not close. Stockholder nominations were required to be submitted by February 5, 2022. Lichtenstein proposed resolutions to the board to nominate all sitting directors except for one, who was planning to resign at the 2022 annual meeting. Drake objected, arguing that the proposal did not comply with Aerojet's corporate governance guidelines, and the board did not hold a vote on the proposal. After the FTC sued to block the merger, Lichtenstein sent materials to the board for another meeting, which consisted of a set of resolutions adopting a proposed letter agreement between Steel and Aerojet that provided that Steel would forego its right to nominate its own slate of directors in exchange for the contractual equivalents of the resolutions Lichtenstein proposed at the previous meeting. The meeting never occurred.

On January 28, Steel notified Aerojet that it intended to nominate a slate of directors, which included Lichtenstein, three other members of the current board, and three new directors (the "Steel Slate"). The non-management committee of the board met to discuss the Steel Slate. In response to the Steel Slate, the committee agreed to nominate a slate of directors consisting of all seven of the eight incumbent directors who desired to stand for reelection. But when resolutions were circulated the next day, one member of the committee objected, and the resolutions were never adopted by the committee.

Once the board became divided, neither faction had a right to use Aerojet resources to support their cause because Aerojet was required to remain neutral, and the defendants violated this principle.

On February 1, Steel publicly disclosed the Steel Slate. In response, the defendants had Aerojet issue a press release stating that there was an ongoing investigation into Lichtenstein and that the Steel Slate was a "disruptive proxy contest ... driven by [Lichtenstein's] personal concerns and desire to secure his board position and gain leverage in the context of the Company's internal investigation." The press release was reviewed by multiple officers of Aerojet, Aerojet's outside counsel, and other advisors. Lichtenstein and the other current directors included in the Steel Slate were not given a chance to review the press release before it was issued.

On February 2, the board attempted to meet to pass resolutions that would permit three of the current directors to exercise the board's authority to respond to the Steel Slate, but because the plaintiff directors did not appear, the board could not reach a quorum. On February 4, the entirety of the board met, and the board rejected two proposals to adopt resolutions—one proposal from each faction of the board—intended to deal with the apparent deadlock on the board.

On February 7, the plaintiffs—which included Lichtenstein and the three sitting directors included in the Steel Slate—filed a complaint seeking declaratory and other equitable relief. Specifically, they sought a declaratory judgment that no entity or individual could act on Aerojet's behalf without approval of the board, that actions taken without board approval were invalid, and that Aerojet must remain neutral in the election of directors. The plaintiffs also filed a motion for a temporary restraining order, which the court granted to maintain the status quo at Aerojet. The TRO prohibited any person or entity that could exercise control over Aerojet from taking any actions on behalf of Aerojet without board approval and prohibited such persons or entities from using Aerojet resources to support any candidate for the upcoming election of directors.

After the TRO was issued, Drake nominated her own slate of directors consisting of herself, the three sitting directors not included in the Steel Slate, and four new directors (the "Drake Slate"). The defendants—which included Drake and three sitting directors included in the Drake Slate—answered the complaint and asserted affirmative defenses and several counterclaims. The court held a three-day trial in May 2022.

The court first considered the question of whether certain actions taken by the defendant directors were invalid. The court found that under Aerojet's bylaws, a quorum of the board was five of eight directors. Because the defendant directors, four of the eight directors, did not constitute a quorum, the court held that any actions they took on behalf of Aerojet, including the February 1 press release and accompanying SEC filings, the retention of counsel to threaten litigation, and the payment of a retainer to such counsel, were all invalid acts.

The court next addressed whether the principle of corporate neutrality was violated. The court held that, to the extent that the defendants used Aerojet resources to respond to the Steel Slate, claimed attorney-client privilege to withhold Aerojet documents from the defendants, and contacted major stockholders about the February 1 press release, they violated the principle of corporate neutrality. The court also rejected the defendants' several arguments that corporate neutrality was inapplicable. It rejected the claim that Lichtenstein was an activist who nominated the Steel Slate to entrench himself on the board irrespective of the outcome of the investigation into him, reasoning that a stockholder's decision to nominate directors is a simple act of corporate democracy, not necessarily a hostile attack on the company. Further, the court held that here, Lichtenstein was not acting as an activist trying to change the direction of the company—evidenced by the fact that a majority of the directors in the Steel Slate were incumbents. The court also held that the fact that the Drake Slate included the CEO did not give that set of directors of the divided board the right to use Aerojet resources to benefit themselves or disable their opposing directors. The court concluded that once the board became divided, neither faction had a right to use Aerojet resources to support their cause because Aerojet was required to remain neutral, and the defendants violated this principle.

The court then granted the plaintiffs' request for an injunction that mirrored the TRO. The court reasoned that an injunction was appropriate because (i) the plaintiffs succeeded on the merits of their claims; (ii) the TRO was no longer going to be in place upon the court reaching its final decision, leaving the plaintiffs vulnerable to additional misconduct by the defendants before the election; and (iii) the balance of equities favored the plaintiffs. The court also ordered the parties to prepare a corrective disclosure for Aerojet to issue explaining that the company's prior disclosures concerning the Steel Slate and the investigation were not authorized by the board, and the company did not take a position on the pending director election. According to the court, these disclosures were necessary because the prior disclosures improperly used Aerojet's name and logo to support one faction of the board and improperly

indicated that Aerojet was opposed to the Steel Slate. In addition to this relief, the court held that the $250,000 retainer paid to Aerojet's counsel was unauthorized and void because it was not approved by a majority of the board.

The court also rejected the defendants' unclean hands argument. The court concluded that both the plaintiffs and the defendants were responsible for the deadlocked board and that the defendants failed to prove that the plaintiffs' hands were dirty enough to deny them any relief, especially given that the beneficiary of the requested relief was Aerojet's electorate.

Finally, the court rejected the plaintiffs' request to hold the defendants in contempt for violations of the TRO. The court reasoned that while the defendants had violated the TRO by allocating corporate resources and personnel to further Drake's faction, a contempt remedy was not appropriate because, among other things, the remedies already granted by the court provided sufficient protection against the risk of future misconduct.

Totta v. CCSB Financial Corp.: Voting Limitation in Charter Held to Have Been Invalidly Enforced

In *Totta v. CCSB Financial Corp.*, 2022 WL 1751741 (Del. Ch. May 31, 2022), the board of directors of CCSB Financial Corp, at CCSB's 2021 annual meeting in response to a proxy contest by an insurgent stockholder, invoked a provision in CCSB's certificate of incorporation that prohibited a stockholder from exercising more than 10% of CCSB's voting power in an election (the "Voting Limitation") and instructed the election inspector to not count votes above the Voting Limitation that were submitted by the insurgent, his slate of nominees, and an entity affiliated with a nominee's father. But for the invocation of the Voting Limitation, the insurgent stockholder's slate of nominees would have won election to the board. The plaintiffs, the insurgent's company and nominees, sued under Section 225 of the General Corporation Law of the State of Delaware (the "DGCL"), asking the Court of Chancery to invalidate the board's instruction to the inspector of

elections. The court agreed and held that the board's instruction was improper.

The Voting Limitation, found in Article FOURTH of CCSB's certificate of incorporation, provided that "'in no event' shall any 'person' who 'beneficially owns in excess of ten percent (10%) of the then-outstanding shares of Common Stock ... be entitled, or permitted to any vote in respect of the shares held in excess of the Limit.'" Article FOURTH further empowered the board to interpret and enforce the Voting Limitation "in good faith and on the basis of such information and assistance as was then reasonably available."

Prior to CCSB's 2020 annual meeting, "the Board had never applied the Voting Limitation. This was so even though, in at least one prior election, a stockholder holding more than 10% of [CCSB's] outstanding common stock voted all of its shares." In connection with the 2020 annual meeting, long-time stockholder Park G.P., Inc. submitted nominees for the two director seats up for election. David Johnson, sole stockholder of Park and long-time stockholder of CCSB, voluntarily subjected himself to the Voting Limitation, as did Mari Usera, CCSB's president and chief executive officer. According to the inspector of election's 2020 report, Park's nominees lost the 2020 election.

In September 2020, Park nominated for the three directorships up for election at the 2021 annual meeting (i) Park's president, DeAnn Totta, (ii) Laurie Morrissey, beneficial owner of 100 CCSB shares, and (iii) Chase Watson ("C. Watson"), manager of MLAKE 96 LLC, which owned 500 CCSB shares. Following such nomination, Johnson sold 19,500 CCSB shares to his long-time friend David Watson ("D. Watson"), father of C. Watson and owner of CCSB stockholder DEW, LLC. Notably, "[t]he Federal Reserve did not object to the sale, conclude that DEW was part of the Johnson Control Group, conclude that Johnson and DEW were acting in concert, or ask for any other information from Johnson after the sale to DEW."

On December 17, 2020, in response to multiple requests from CCSB, Johnson provided CCSB with a statement of ownership concerning his stock that stated that he beneficially owned 87,348 shares as of September 30, 2020 and 73,948 shares as of December 3, 2020. On January 20, 2021, the board held a meeting at which, among other things, the board concluded that Johnson's transfer of shares to D. Watson was conducted "to avoid the 10% beneficial ownership rule and that the individuals may be acting in concert." The board did not ask Johnson for follow-up information and did not investigate whether any other stockholder was potentially acting in a manner that could justify invoking the Voting Limitation, including Usera. On January 27, D. Watson sent CCSB a letter in which he stated, among other things, that DEW did not have any agreement to vote CCSB shares and DEW was not an affiliate of any other CCSB stockholder.

The board met the morning of the 2021 annual meeting and, among other things, determined "that Johnson, his wife, D. Watson, C. Watson, Morrissey, and Totta were 'acting in concert in order to get their alternate slate elected' in what the board considered to be a violation of the Voting Limitation." The board then instructed the inspector of elections to not count a total of 37,416 votes, including all of DEW's 37,175 shares, not just the 19,500 that DEW had purchased from Johnson in November. CCSB's 2021 annual meeting was called to order immediately following the board meeting, and following the tabulation of votes, it was announced that the incumbent slate of directors had received 36,477 more votes. "There [was] no evidence that Usera or the board informed the stockholders that they had instructed [the inspector] not to count the 37,416 votes for Park's nominees before the meeting."

The plaintiffs subsequently sought a declaration from the Court of Chancery that the 37,416 votes should not have been excluded. The court agreed. In reaching its holding, the court reasoned that the incumbent board's actions must be twice tested, first to resolve whether their actions were legally valid, and second to determine if their actions survived enhanced scrutiny under *Blasius Indus., Inc. v. Atlas Corp.*

To determine if the incumbent board's actions were legally compliant, the court first looked at the Voting Limitation by applying general rules of contract interpretation. Pursuant to the terms of the Voting

Limitation, a person who owned in excess of 10% of the common stock could not vote their shares in excess of 10%. The certificate of incorporation defined "person" as "a group acting in concert," among other things. Thus, the court found that "a plain reading of the Voting Limitation and the definitions immediately following it compel the conclusion that a 'group acting in concert' 'who beneficially owns in excess of 10% of the then-outstanding shares of Common Stock' may not vote shares in excess of the 10% limit."

After concluding that the Voting Limitation could theoretically provide a basis for CCSB to exclude stockholder votes, the court next determined whether the standard was applied correctly. Because the certificate of incorporation did not define "acting in concert," the court looked to dictionary definitions and definitions relied on by federal securities laws and other areas of the DGCL: "persons act in concert when they have an agreement, arrangement, or understanding regarding the voting or disposition of shares." The court noted that the "existence of an agreement, arrangement, or understanding is a sufficient basis for invoking an acting in-concert provision. An undefined reference to 'acting in concert' cannot reasonably go beyond that definition. It cannot be enough that the stockholder plans to vote the same way as another stockholder, is acquainted with another stockholder, or even has a business relationship with another stockholder." "Stockholder voting rights are sacrosanct," and any attempt to limit such rights, the court held, must be plain and unambiguous.

Here, the question of whether the stockholders had an "agreement, arrangement, or understanding" hinged on the relationship between two stockholders, D. Watson and Johnson. Finding no evidence to support that Johnson and Watson "were acting in concert pursuant to a mutual agreement, arrangement, or understanding," the court posited that it was unsurprising that Johnson would sell his shares in excess of 10%, as they were "useless" to him, and unobjectionable that D. Watson would vote for his son as director. The court further found that there was no evidence of a "quid pro quo" for D. Watson's vote from Johnson. Accordingly, the court concluded that there was insufficient evidence to find that D. Watson and Johnson were acting in concert, and therefore the board's decision to instruct the inspector of elections not to count D. Watson's votes was legally invalid.

"Stockholder voting rights are sacrosanct," and any attempt to limit such rights, the court held, must be plain and unambiguous.

After concluding such decision was legally invalid, the court evaluated the board's conduct under principles of equity. The court rejected CCSB's numerous arguments that the business judgment rule, rather than *Blasius,* should apply to such analysis. CCSB first argued that the conclusive and binding provision in Article FOURTH required the court to evaluate the board's election determinations under the business judgment rule. The court disagreed, finding that corporations cannot modify their fiduciary duties or standards of review in their charter. CCSB then argued that plaintiffs should always bear the burden of proof in Section 225 actions. The court disagreed, finding that the cited cases were inapplicable since plaintiffs therein only challenged the legal validity of board actions, unlike the present case in which the plaintiffs also challenged the board's conduct under principles of equity. CCSB further argued that the standards dictated in *Blasius* should not apply because, as held in *Williams v. Geier, Blasius* should be applied rarely. The court found that although *Williams* stands for such proposition, it does not mean that *Blasius* should not be applied to the instant case. CCSB additionally argued that enhanced scrutiny should only be applied to evaluate instances when a board increases or decreases the number of board seats, as was the case in *Blasius* and *Pell v. Kill*. The court disagreed, holding that *Blasius* applies when the "primary purpose" behind board action is to "interfere with or impede exercise of the shareholder franchise." In this case, the stockholders were not given a chance to vote their shares; thus, the court found, *Blasius* clearly applied. Lastly, CCSB argued that enhanced scrutiny did not apply because the Voting Limitation was adopted on a "clear day" with no threat of litigation. The court found this distinction irrelevant, holding that even when voting restrictions are adopted on a "clear day," those voting restrictions may still be subject to enhanced scrutiny. For these reasons, the court rejected CCSB's argument to apply the business judgment rule and applied *Blasius*.

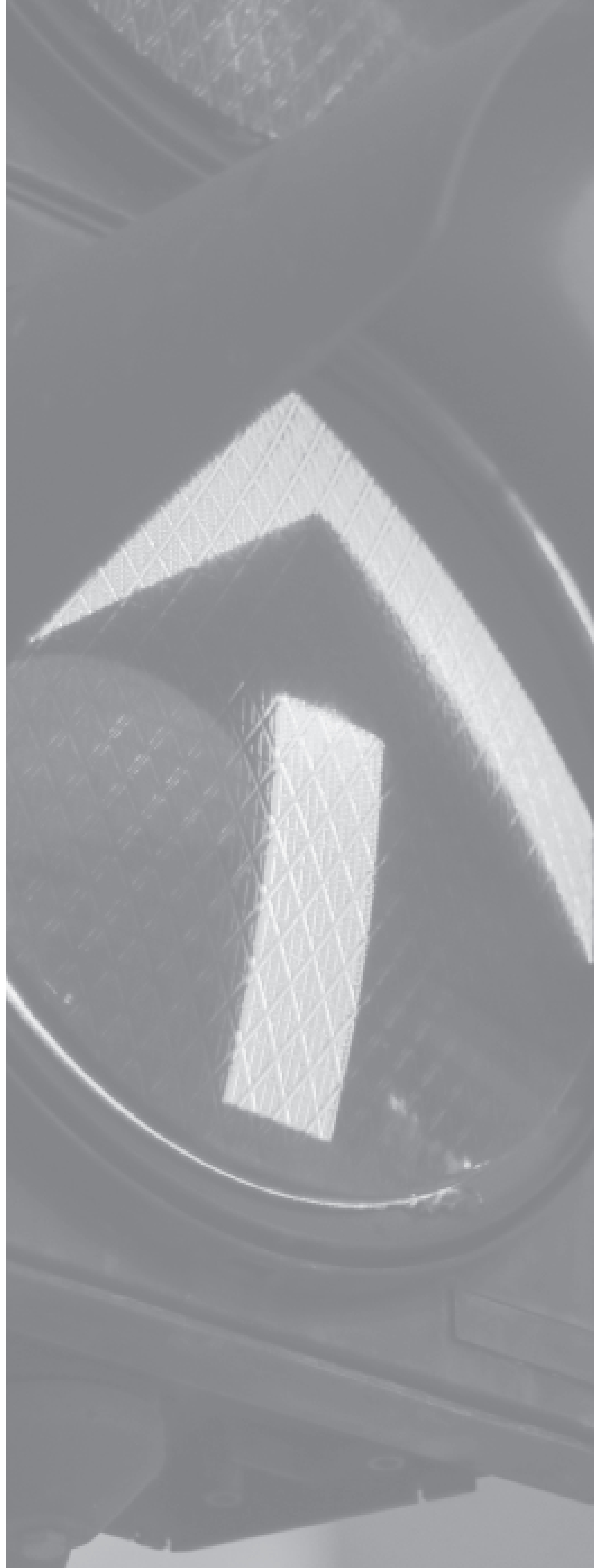
In evaluating the board's actions under *Blasius*, the court first ascertained the "primary purpose" of its conduct. The court concluded that it was "self-evident" that the instruction to not count certain votes interfered with the ability of certain stockholders to vote their shares. Thus, the court found it clear that the primary purpose was to interfere with the stockholder vote.

Next, the court evaluated whether the board had a compelling justification. The board's purported sole justification to exclude the votes at issue was to protect the shareholders from a takeover attempt of an insurgent who might attempt to sell CCSB. The court found that this argument had several flaws. First, the court found that the board was staggered, so even if the insurgent stockholders were entirely successful, the new board would not be able to implement their agenda immediately. The court further noted that even if the insurgent nominees, once seated, proposed to sell CCSB, that decision should be left to the stockholders, and the "board does not have an obligation to 'protect' stockholders from that outcome." In fact, the court held, "the board has an affirmative obligation not to interfere with stockholder franchise without a compelling justification."

The court therefore found that the board's actions were both legally invalid and void under *Blasius* for failure to demonstrate a compelling justification.

Strategic Investment Opportunities LLC v. Lee Enterprises, Inc.: **Director Nominations Properly Excluded for Failure to Comply with Advance Notice Bylaw**

In *Strategic Investment Opportunities LLC v. Lee Enterprises, Inc.*, 2022 WL 453607 (Del. Ch. Feb. 14, 2022), the Delaware Court of Chancery



found that Strategic Investment Opportunities' nomination notice failed to comply with the "clear and unambiguous" terms of Lee Enterprises, Inc.'s advance notice bylaw, specifically because (i) such notice was not submitted by a stockholder of record, and (ii) Strategic Investment Opportunities did not use Lee Enterprises' nominee questionnaire forms, which were made available to record holders.

On November 26, 2021—the date of Lee's nomination deadline, which had been disclosed in January 2021— Opportunities submitted to Lee's secretary and general counsel a notice of nomination of two directors, along with a letter signed by Cede & Co. as stockholder of record. Lee's bylaws, which had been adopted by the company's board and took effect in June 2019, contained advance notice requirements for stockholders seeking to nominate candidates to the board. Among other things, the bylaws required that a nominating stockholder (i) be a stockholder of record "at the time such notice [of director nomination] is delivered to the Secretary" of the company, and (ii) complete and sign a questionnaire and written representation in "the form to be provided by the Secretary upon written request of any stockholder of record within 10 days of such request."

Alden Global Capital LLC, the indirect parent of Opportunities, first began evaluating a potential acquisition of Lee in the fall of 2021 and, on November 19, 2021, made the decision to bid for the company. On November 22, 2021, after considering over the weekend whether to nominate a slate of candidates, Alden requested that its broker, J.P. Morgan Securities LLC, convert 1,000 of Opportunities' shares of the company to book the entry form "as soon as possible." Alden acknowledged that the transfer could take two to three days and requested that JPMorgan "facilitate asap due to Thanksgiving and voting deadlines." That same day, Opportunities requested that Lee provide an electronic copy of the form of questionnaire and written representation and agreement as set forth in the bylaws. On November 23, 2021, following discussions among the secretary, certain directors who were up for election, and certain outside advisors, Lee sent Opportunities a letter rejecting such because the company's records did not reflect that Opportunities was a stockholder of record. The rejection letter noted that "[s]hould [Opportunities] subsequently become a stockholder of record of the Company and submit a compliant request for the [forms], the Company w[ould] evaluate that request."

As of November 23, 2021, Alden's request to transfer the shares in record name had not been completed. In light of the time constraints, Alden requested, among other things, that Cede, as record holder, execute a proposed letter, a draft of which was sent by JPMorgan on November 22, without any information about the individuals Opportunities was seeking to nominate. After providing various comments, Cede's executed letter stated:

> At the request of [JPMorgan], on behalf of Opportunities, Cede & Co. in its capacity as holder of record of the Shares, hereby delivers the nomination by Opportunities of certain individuals for election as directors at the 2022 annual meeting of stockholders of the Company.... Cede understands that Opportunities is also delivering a separate letter in connection with this Letter, which, Cede understands, provides additional information regarding the nomination.

On November 26, 2021, the nomination deadline date, Opportunities' counsel sent an email to Lee which attached the nomination notice and the letter from Cede, which the email described as a letter signed by the stockholder of record. Over the course of the next week, Lee's corporate governance committee, which included the directors who were up for election, met several times with the company's outside counsel to discuss the nomination notice. On December 2, 2021, the full board met to discuss the nomination notice and determined that such notice was invalid. On December 2, 2021, Opportunities became a stockholder of record. Lee's counsel responded to Opportunities' email on December 3 and detailed that the company had rejected the nomination notice because it did not comply with the bylaws.

Opportunities filed its action on December 15, alleging that Lee breached its bylaws and that the board breached its fiduciary duties in connection with the board's rejection of the nomination notice. The court denied Opportunities' request for declaratory and injunctive relief.

The court found that the advance notice bylaw was unambiguous and that the nomination notice did not comply with the record holder requirement or the questionnaire requirement, each as set forth in the bylaws. The court found that Cede's letter accompanying the nomination notice did not fulfill the record holder requirement because the letter did not demonstrate that Cede, as the record holder, was making the nomination. Instead, the letter stated that Cede was delivering "the nomination by Opportunities of certain individuals for election." Furthermore, Cede's letter was devoid of any of the information regarding the nominees that was required by the advance notice bylaw—it did not even contain the nominees' names. The court found that nothing in the letter reflected "an intention by Cede to 'nominate' directors under any commonly accepted meaning of that word."

Moreover, the court found that the nomination notice failed to satisfy the advance notice bylaw's questionnaire requirement. After Lee rejected Opportunities' request for the questionnaire, Opportunities completed and submitted a questionnaire that it proposed was "substantially similar in scope to forms of written questionnaire provided by a company's secretary in like situations." The court noted that the bylaws "unambiguously required that Opportunities submit its nominees' completed form of [Lee's] questionnaire" and that Opportunities simply did not submit those forms. Opportunities argued that it could not have completed the company's forms because it never received them. The court found, however, that "Opportunities' failure to satisfy the record holder requirement [was] also determinative on the matter of the form requirement."

After finding that the nomination notice did not comply with the "clear and unambiguous requirements" of the bylaws, the court next conducted an equitable analysis to determine if the court should nonetheless invalidate the board's actions. The court determined that enhanced scrutiny was the appropriate standard of review, noting that such standard "may be invoked ... where the board's actions 'could have the effect of influencing the outcome of corporate director elections or other stockholder votes having consequences for corporate control.'"

Under enhanced scrutiny, the defendants must "identify the proper corporate objectives served by their actions" and "justify their actions as reasonable in relation to those objectives." The court found that the board was justified in rejecting the nomination notice, as Opportunities had failed to comply with the validly enacted advance notice bylaw that had a "legitimate purpose." In support thereof, the court noted that the "relevant bylaw requirements could readily have been satisfied by any stockholder" and that there was "no evidence of manipulative conduct." The bylaws were adopted on a clear day, and the board did not engage in conduct that has been held as inequitable, such as setting meeting dates that "made it impossible for a stockholder to give timely notice of a nomination." Moreover, the court found that the advance notice bylaw—particularly the record holder requirement—was "neither facially problematic nor unreasonable as a matter of policy. It [was] not an empty formalism." The court continued, "Reliance on record ownership ensures order and gives the corporation certainty that the party attempting to take action based on a right incidental to share ownership is, in fact, a stockholder."

"The decision to nominate directors is generally not one that a well-intentioned stockholder should make hastily."

Opportunities had known about the advance notice requirements for a significant period of time, yet it submitted a nomination "less than three hours before the deadline." The holding in *Lee Enterprises* demonstrates that "[t]he decision to nominate directors is generally not one that a well-intentioned stockholder should make hastily," and the choice to "wait until the last minute to begin the process of submitting a nomination" will leave no room for error.

Dissolutions and Sales of All or Substantially All Assets

Stream TV Networks v. SeeCubic: Delaware Supreme Court Rejects the Common Law "Failing Business" Exception

In *Stream TV Networks v. SeeCubic,* 279 A.3d 323 (Del. 2022), the Delaware Supreme Court reversed the Delaware Court of Chancery and held that an agreement to transfer and assign all of a corporation's assets to its secured creditors in satisfaction of the corporation's debt obligations required prior stockholder approval under the corporation's charter. The Delaware Supreme Court concluded that the corporation's charter, which required prior approval of its Class B stockholders for a "sale, lease or other disposition of all or substantially all" of the corporation's assets, was triggered by the corporation's agreement with its creditors. Specifically, the court held that the term "other disposition"—a term unique to the corporation's charter and not included in Section 271 of the General Corporation Law of the State of Delaware (the "DGCL")—was sufficiently broad to cover the contemplated transfer of assets and assignment of rights to the corporation's creditors. The Supreme Court also held that the common law "failing business" exception (if it ever existed in Delaware) to the stockholder approval requirement for a sale, lease, or exchange of all or substantially all of a corporation's assets under Section 271 did not survive the adoption of the statutory predecessor to Section 271. Because the privately structured foreclosure transaction constituted a disposition of all or substantially all of the corporation's assets and the "failing business" exception was unavailable, the transaction could not move forward without stockholder approval.

In 2020, Stream TV Networks, Inc., a 3D technology development company, encountered financial difficulties and defaulted on its loans with two of its secured creditors, each of which held a separate series of secured notes. To address the company's financial difficulties and defaults, Stream's board of directors, led by its independent outside directors, created a resolution committee of two independent outside directors and granted the committee the "full power and authority of the full Board of Directors to resolve any existing or future debt defaults or claims, and any existing or future litigation, or threats thereof, on behalf of [Stream], without further action being required from the Board of Directors or any executive of the company." Notably, two of Stream's other directors, the Rajan brothers, who were also officers of the company and together held a sufficient number of high-vote Class B common stock to control a majority of Stream's outstanding voting power, abstained from the vote forming the resolution committee.

Ultimately, the resolution committee entered into an omnibus agreement pursuant to which Stream assigned all of its assets to SeeCubic, a new entity established by the secured creditors, in exchange for the forgiveness of Stream's outstanding debt. In the omnibus agreement, Stream's Class A common stockholders were given the opportunity to exchange their shares in Stream for an identical number of shares in SeeCubic. The Rajans, on the other hand, were permitted to maintain an indirect interest in SeeCubic through Stream, which would be issued shares in SeeCubic.

The Rajans were not a party to the omnibus agreement, were dissatisfied with the proposed restructuring, and attempted to nullify it through various avenues. With the Rajans' intent clear, the parties to the omnibus agreement attempted to negotiate with the Rajans in the hope that the Rajans would support the proposed restructuring. The negotiations ultimately failed, and the Rajans and Stream filed suit and moved for a temporary restraining order to bar SeeCubic from attempting to enforce the omnibus agreement. Both sides submitted competing motions for preliminary injunctive relief. The Rajans/Stream claimed that Class B stockholder approval of the omnibus agreement was required under a class vote provision in Stream's charter and under Section 271.

The Delaware Court of Chancery disagreed with the Rajans and held that no stockholder approval was required for the transfer of assets contemplated by the omnibus agreement. In pertinent part, Section 271 requires stockholder approval for a corporation to "sell, lease or exchange all or substantially all" of its assets. The Court of Chancery held that the language of Section 271 was ambiguous as to whether it applied to the omnibus agreement because while the terms "sale" and "exchange" could include the contemplated transfer of assets from Stream to SeeCubic, that result was only plausible and not mandated. As a result, the court looked to principles of statutory construction for guidance. Ultimately, the court concluded that at common law there existed a "failing business" exception to the requirement to receive stockholder approval for a sale, lease, or exchange of all or substantially all of a corporation's assets. That is, stockholder approval was not required to sell, lease, or exchange all or substantially all of a corporation's assets if that business was insolvent. The court further held that the insolvency exception was not preempted by the adoption of the statutory predecessor to Section 271. Accordingly, the court concluded that Section 271 did not require a stockholder vote for the approval of the omnibus agreement because Stream was insolvent.

In addressing the class vote provision, the court noted that the charter required "the affirmative vote or written consent of the holders of a majority of the then-outstanding shares of Class B Voting Stock, voting as a separate class," for the company to consummate an "Asset Transfer." The charter defined "Asset Transfer" as

> a sale, lease or other disposition of all or substantially all of the assets or intellectual property of [Stream] or the granting of one or more exclusive licenses which individually or in the aggregate cover all or substantially all of the intellectual property of [Stream].

After comparing Section 271 to the class vote provision and the definition of "Asset Transfer" in the charter, the court held that the two were sufficiently similar such that the "failing business" exception to Section 271 likewise applied to the class vote provision. Furthermore, the court concluded that if the drafters of the charter had wanted to require a class vote before a secured creditor could foreclose on pledged/mortgaged assets, they should have included language in the charter encompassing that type of transaction. Therefore, the Court of Chancery granted SeeCubic's motion for a preliminary injunction and eventually a permanent injunction, preventing Stream from interfering with the omnibus agreement and declaring the agreement to be valid and binding. Stream appealed.

On appeal, the Delaware Supreme Court reversed. The Supreme Court held that (i) the class vote provision unambiguously required Class B stockholder approval, rendering Section 271's default voting rule irrelevant; (ii) the Court of Chancery erred when it looked first to Section 271 prior to construing the charter and bypassed the charter's plain terms in order to apply the "failing business" exception to Section 271; and (iii) the adoption of the statutory predecessor to Section 271 superseded any such "failing business" exception (if one had previously existed in Delaware).

First, the Supreme Court reasoned that the charter's definition of "Asset Transfer" differed materially from Section 271. Under the charter, "Asset Transfer" was defined to include sales, leases, and *other dispositions* of assets, while Section 271 is limited to sales, leases, and *exchanges* of assets. The court reasoned that "[t]he drafters could have simply tracked the language of the statute, but did not" and concluded that the phrase "other disposition" has a meaning that is different and broader than the term "exchange," and that, for this reason, the court did not need to look to Section 271 for interpretive guidance.

Next, in interpreting "other disposition" pursuant to Delaware's rules of contract interpretation, the court consulted various dictionaries before concluding that "other disposition" was broad enough to encompass the assignment of assets contemplated in the omnibus agreement. Specifically, the court explained that "[a]n assignment of all rights, title and interest in the assets of the Company to [SeeCubic] is a 'disposition' because it is a type of transfer or relinquishment of property." Therefore, the court concluded that the transaction contemplated by the omnibus agreement unambiguously constituted an "Asset Transfer" under the charter, which meant prior stockholder approval from Stream's Class B stockholders was required to duly authorize the omnibus agreement.

The Supreme Court went on to clarify that a common law "failing business" exception, assuming that one ever existed in Delaware, did not survive the enactment of the statutory predecessor to Section 271. In its reasoning, the court noted that while there was some early support for such an exception at common law, no Delaware case had expressly adopted the exception. Moreover, the court stated that regardless of whether the exception existed at one time in Delaware, "Section 271 was intended to occupy the field and that no such insolvency exception survive[d]" its enactment. According to the court, the plain language of Section 271 "contain[ed] no exceptions and is not ambiguous" and "[a]s such, the language of the statute should be conclusive of the General Assembly's intent."

A common law "failing business" exception did not survive the enactment of the statutory predecessor to Section 271.

Finally, in addressing the apparent concern that its ruling would undercut the value of secured interests and create a conflict between Sections 271 and 272 of the DGCL, the court explained that (i) its ruling did not present a barrier to the secured creditors foreclosing on Stream's debt in foreclosure proceedings in Superior Court, and (ii) no party had argued that judicial foreclosure proceedings implicated Section 271.

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

In *In re Altaba, Inc.*, 2022 WL 1133125 (Del. Ch. Apr. 18, 2022), the Delaware Court of Chancery ruled that

Altaba, Inc. must retain $800 million as security to cover potential liabilities related to Canadian litigation as part of its dissolution process.

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 3 billion users. Various plaintiffs subsequently filed lawsuits against Altaba related to the data breaches, including six class action lawsuits filed in five different Canadian provinces. Canada lacks a mechanism for consolidating class actions across provinces; therefore, Altaba needed to seek resolution of each lawsuit individually.

In 2019, Altaba elected to dissolve pursuant to the long-form dissolution process (the "Elective Path") under Sections 280 and 281(a) of the General Corporation Law of the State of Delaware (the "DGCL"). The Elective Path, among other things, contemplates a statutorily prescribed notice and claims procedure and court proceedings involving the establishment of reserves sufficient to satisfy prospective claims. Notably, the Elective Path "requires the court to 'determine the amount and form of security that will be reasonably likely to be sufficient to provide compensation' for any claim that is 'the subject of a pending action, suit or proceeding to which the corporation is a party.'"

In accordance with Section 280(a)(1), Altaba sent notices to the plaintiffs in all six Canadian actions. Two responded: the plaintiff in Ontario and the plaintiff in Saskatchewan (together, the "Canadian Claims"). In January 2020, Altaba engaged in mediation with Ontario counsel regarding the amount of security Altaba should retain for the Ontario action. Altaba and Ontario counsel agreed that Altaba need only reserve $50 million as security, and in July 2020, that claim settled for $15 million. The effectiveness of the settlement, however, was conditioned on both final approval from the Ontario court and the dismissal or permanent stay of the Saskatchewan action. The Ontario court approved the settlement in February 2021, but the Saskatchewan action remained pending at the time of this litigation. The question before the Court of Chancery was whether the reserve of $50 million was reasonably

likely to provide sufficient compensation for the Canadian Claims.

Section 280(c)(1) of the DGCL requires that the court "determine the amount and form of security that will be reasonably likely to be sufficient to provide compensation" for any claim that is "the subject of a pending action, suit or proceeding to which the corporation is a party." Under such test, Altaba bore the burden of proving that the proposed \$50 million security was "reasonably likely to be sufficient."

Altaba argued that its proposed \$50 million security was appropriate and reasonably likely to be sufficient to satisfy the remaining Saskatchewan claims

"By facilitating an upfront judicial determination, the Elective Path does not eliminate the difficulties inherent in setting an amount of security. It just changes the decisionmaker who must make them."

because a stay or dismissal of the Saskatchewan action was the most likely outcome of that litigation. While the court agreed that a stay or dismissal of the Saskatchewan claims was the most likely outcome, it found that identifying the reasonably likely or most likely outcome and setting a security for that outcome was not the correct standard. Rather, the appropriate standard asks whether the security provided will be reasonably likely to compensate the claimant under *all* potential outcomes.

"Delaware's dissolution statute obligates a dissolved corporation to use its assets to satisfy creditors before distributing 'any remaining assets' to stockholders. That mandate reflects the absolute priority rule." In conducting its analysis, the court emphasized the importance of following a conservative approach when a court sets the amount of security.

> By facilitating an upfront judicial determination, the Elective Path does not

eliminate the difficulties inherent in setting an amount of security. It just changes the decisionmaker who must make them. The risk remains that the reserve will turn out to be insufficient. If stockholders receive a liquidating distribution based on an inadequate reserve, then those stockholders have received a distribution to which they were not entitled, contravening the rule of absolute priority. Respect for the absolute priority rule calls for a conservative approach to security that protects the interests of creditors.

The court looked at all possible outcomes for the Canadian Claims, ranging from dismissal of the actions, settlements, or full trials, and agreed that under the most likely outcome—a stay of the Saskatchewan action—the $50 million security would be sufficient. The court found, however, that if certain claims were settled or proceeded to trial, there was a possibility that $50 million would be "woefully insufficient" to satisfy all creditors based on the amount of potential liability. The court therefore focused on how "unlikely [adverse] results would have to be before the Altaba's proposed security would be adequate" and determined that Altaba's proposed $50 million would be sufficient only if Altaba could prove that it had "a better than 89.4% chance of prevailing in the Saskatchewan Action." The court reasoned that while it was unlikely that Saskatchewan counsel would proceed to trial and obtain a result of $800 million or reach a settlement, Altaba did not prove that Saskatchewan counsel had less than a 10.6% chance of success.

Only Saskatchewan counsel presented evidence as to the value of the claims, which it estimated to be between $800 million to $2.8 billion. The court therefore determined that setting the security at $800 million was "reasonably likely" to cover all creditors across the range of all scenarios. The court noted that Altaba "could have convinced the court of some discount from $800 million" but did not argue that point and instead solely argued for $50 million as security. Accordingly, Altaba was ordered to reserve $800 million until the final resolution of the Canadian Claims.

Appraisal Rights

In re GGP, Inc. Stockholder Litigation: Pre-Closing Dividend Constitutes Merger Consideration for Purposes of Appraisal

In *In re GGP, Inc. Stockholder Litigation,* 282 A.3d 37 (Del. 2022), the Delaware Supreme Court reversed, in part, the Delaware Court of Chancery's ruling on a motion to dismiss regarding claims brought by stockholders of GGP, Inc., alleging, among other things, that the defendants designed a large pre-closing dividend in connection with a merger to "improperly eviscerate GGP stockholders' appraisal rights," and that the defendants "breached their fiduciary duty of loyalty by failing to provide GGP stockholders with a fair summary of their appraisal rights and [not] disclosing all material information relevant to GGP stockholders asked to vote in favor of the [merger] or pursue appraisal." Ultimately, the court held that it was reasonably conceivable that the director defendants of GGP breached their fiduciary duty of disclosure in connection with the descriptions of appraisal rights and the merger included in the proxy statement that sought stockholder approval for the transaction.

In 2010, Brookfield Property Partners made a large investment in GGP, which helped it emerge from bankruptcy. In connection with the investment, Brookfield was entitled to appoint three directors to the GGP board, which at the time had nine seats. In November 2017, Brookfield, owning about 35% of GGP, made an unsolicited offer to purchase the shares of GGP that it did not already own. GGP formed a special committee to negotiate with Brookfield. Over the course of the next few weeks, the special committee discussed the offer and then rejected it, partly because of "concern that many GGP stockholders would be restricted from, or otherwise not interested in, owning units of Brookfield," which was a non-REIT Bermuda entity.

Brookfield and the GGP special committee continued to negotiate over the course of the following weeks. Throughout negotiations, Brookfield strongly pushed for an appraisal right closing condition that would allow Brookfield to terminate the transaction if stockholders holding a specified number of shares demanded appraisal. After much back and forth on the issue, the appraisal rights condition was not included in the final draft of the merger agreement. Instead, the merger consideration was structured as a large pre-closing dividend of cash (or shares of Brookfield or a new Brookfield entity, depending on the individual stockholder's election), which amounted to roughly 98.5% of the consideration and $0.312 per share in cash at closing.

The proxy statement informed the GGP stockholders that they were "entitled to exercise their appraisal rights solely in connection with the merger," and that the per-share merger consideration ($0.312) would be paid upon consummation of the merger. The court noted that the payment in connection with the closing of the merger was distinct from the pre-closing dividend, which was worth approximately 98.5% of the consideration and would be paid one day before closing. Additionally, after the stockholders had voted to approve the merger and the appraisal deadline had passed, an election form was distributed to stockholders, which instructed them to review the proxy statement and stated that "[a]ppraisal is only available with respect to the Merger Consideration." The proxy statement defined "Merger Consideration" as "the per share merger consideration multiplied by the merger share number," and "per share merger consideration" as the amount that was not the pre-closing dividend, or $0.312 per share.

The plaintiff stockholders brought suit, claiming that "by divorcing the appraisal remedy from the large pre-closing dividend and linking it to the meager 'per share merger consideration,' Brookfield and the GGP directors led them to believe that a fair value determination in an appraisal proceeding would be limited to the value of post-dividend GGP," such that, "coupled with other descriptions of how the transaction was to be effected," the stockholders "believe[d] that their appraisal rights had either been eliminated or so reduced as to be meaningless." Further, the plaintiff stockholders claimed that by taking such action, the GGP directors, with the aid of Brookfield, breached their fiduciary duties.

The Court of Chancery disagreed, concluding that, because the court had the "'flexibility' to consider the Pre-Closing Dividend as a 'relevant factor' and adjust its fair-value determination accordingly," the stockholders were not denied their right to seek appraisal. Moreover, the Court of Chancery found that, although the appraisal disclosures could have been more clear, they were sufficient, and therefore the plaintiffs failed to state a claim.

With adequate information, the GGP stockholders "could have made a judgment about the value of the total consideration ... and their view of the fair value of GGP as a going concern," but instead they were "left to guess" how an appraisal would consider "the Pre-Closing Dividend."

The Delaware Supreme Court agreed with the Court of Chancery (for different reasons) that the structure of the transaction did not "effectively and unlawfully eliminate[] appraisal rights," but concluded that the proxy statement's appraisal disclosures were insufficient. The court found the proxy statement's merger and appraisal rights disclosures to be, "at best, materially misleading."

The Supreme Court held that the pre-closing dividend was, as a matter of Delaware law, merger consideration because "it was conditioned on the Transaction's approval" and, as alleged, "paid with Brookfield's funds in the same wire as the Per-Share Merger Consideration." As such, according to the court, an appraisal of GGP "would have valued ... [GGP] as if the Pre-Closing Dividend and Per-Share Merger Consideration had not been paid."

Next, the court determined that the stockholder's receipt of the pre-closing dividend did not effect a forfeiture of the right to seek appraisal. While the court acknowledged that in the usual case, acceptance of merger consideration would extinguish a stockholder's right to demand appraisal, the

Brookfield-GGP transaction was "not the general or usual case." The court reasoned that the stockholders had no choice in the matter: (i) stockholders received the pre-closing dividend before closing regardless of whether they supported or dissented from the merger; (ii) the pre-closing dividend constituted 98.5% of the merger consideration; and (iii) the tiny merger consideration was 1.5% of the total amount paid to stockholders. Therefore, acceptance of the pre-closing dividend and the tiny per-share merger consideration did not constitute acceptance of the transaction's terms or waive appraisal rights.

Next, the court found that it was reasonably conceivable that the director defendants breached their duty of disclosure in connection with the proxy statement's disclosures relating to appraisal rights. The court explained that throughout the 344-page proxy, GGP and Brookfield repeatedly divorced the pre-closing dividend from the proxy's description of the amount stockholders would be entitled to receive in appraisal. Specifically, the court found the proxy's appraisal rights notice section to be misleading. In the appraisal rights section, the proxy disclosed that in an appraisal proceeding, the fair value of each share of GGP would be determined by the court and that such fair value "'may be greater than, the same as or less than' 31 cents." Several disclosures through the proxy were drafted in the same manner—suggesting that the appraisal value of a stockholder's share ultimately may not include the pre-closing dividend. The court went on to hold that such misleading statements were also material, because stockholders would have wanted to know that an appraisal would have valued GGP on a pre-closing dividend basis. The court concluded that with adequate information, the GGP stockholders "could have made a judgment about the value of the total consideration ... and their view of the fair value of GGP as a going concern," but instead they were "left to guess" how an appraisal would consider "the Pre-Closing Dividend."

Additionally, the court found it reasonably conceivable that the proxy statement's description of appraisal rights was meaningful to the stockholders' evaluation of the eligibility criteria set forth in Section 262 of the General Corporation Law of the State of Delaware (the "DGCL"). Section 262(g) of the DGCL requires a court to dismiss appraisal proceedings with respect to shares of publicly listed stock if the shares of stock entitled to appraisal immediately before the merger are entitled to more than $1 million in consideration provided in the merger. Because of the misleading disclosures in the proxy, the court concluded that the stockholders also were misled to believe that they would need to reach the $1 million threshold by aggregating shares worth $0.31, rather than $23.50, which would be a vastly more difficult threshold for stockholders to satisfy.

Finally, after considering the above, the court concluded that it was reasonably conceivable that the director defendants breached their duty of disclosure in a way that may not be exculpated (i.e., one made in bad faith) because they intentionally tried to "dissuade [stockholders] from exercising appraisal rights." In considering this issue, the court noted that (i) Brookfield repeatedly demanded an appraisal rights condition during negotiations; (ii) the bifurcated merger consideration structure was introduced only after the special committee rejected the condition; and (iii) the director defendants did not offer an alternative reason for the unique structure.

Notably, two justices concurred in part and dissented in part. The dissenting justices agreed that the pre-closing dividend did not eviscerate stockholder appraisal rights and that the pre-closing dividend was, in fact, merger consideration. However, the dissent disagreed with the majority that the proxy was materially misleading and that the plaintiffs pled a reasonably conceivable breach of the duty of disclosure.

Corporate Transactions and Contract Drafting

Arwood v. AW Site Services, LLC: Court of Chancery Finds Delaware Is—or Should Be—a Pro-Sandbagging Jurisdiction

Arwood v. AW Site Services, LLC, 2021 WL 705841 (Del. Ch. Mar. 9, 2022), is a post-trial opinion in

which the Delaware Court of Chancery held, among other things, that the plaintiff, John D. Arwood, breached an asset purchase agreement (the "APA") between Arwood and Broadtree Partners, LLC's acquisition vehicle, AW Site Services, LLC ("AWS"). In so holding, the court found that Delaware "is, or should be, a pro-sandbagging jurisdiction" and that the doctrine of sandbagging is only triggered when a buyer has actual knowledge that a representation or warranty is false before the transaction closes.

Arwood's nationwide waste management brokerage business was comprised of several companies (collectively, "Arwood Waste") and had two primary lines of business—rentable portable toilets and rentable roll-off dumpsters. For a fee, Arwood Waste served as the middleman between the commercial and residential customers seeking to rent a dumpster or portable toilet, and the local haulers and suppliers who would fill the orders.

In early 2018, Broadtree Partners, LLC, a private equity fund, approached Arwood about potentially acquiring Arwood Waste. As talks between the parties progressed, Broadtree realized that "Arwood was a decidedly unsophisticated seller" who had not maintained any financial records, did not know how to prepare them, and did not know how to package a business to be sold. To resolve this problem, a Broadtree principal and operating partner was dispatched to perform extensive due diligence and, in the process, prepare a detailed set of financial statements. During the six-month diligence process, Broadtree was given unfettered access to Arwood Waste's business records, billing software, and other accounts and records—including access to Arwood's business and personal bank records.

Once the diligence was complete and the financial statements were created, Broadtree successfully negotiated for a reduced purchase price by asserting that "Arwood was drawing revenue from sources that Broadtree could not reliably replicate post-closing." With an agreed-upon price of $16 million, the parties executed the APA, as drafted by Broadtree. The APA provided that $1.41 million of the purchase price be held in escrow, which included $1.26 million for indemnification obligations and $150,000 for working capital adjustments. Under the APA, Arwood made several standard representations and warranties, including that the financial statements developed by Broadtree were accurate and that the sellers had materially complied with the law. Additionally, on the date the transaction closed, Arwood and AWS entered into a two-year employment agreement, which provided that Arwood would serve as AWS's chief marketing officer and serve on its board of directors.

Issues began to surface shortly thereafter, when it was discovered that the business's profits were materially lower than anticipated pre-acquisition. Furthermore, rumors began to swirl regarding fraudulent billing practices pre-acquisition. The discrepancies in pre- and post-closing profits were primarily attributed to two pre-closing practices of Arwood Waste: (i) the regular fabrication of certain overage fees when the company failed to obtain receipts from haulers, and (ii) the indiscriminate charging of filing fees related to mechanic's liens on the property of customers who refused to pay bills, regardless of whether such liens could legally be filed or if the lien had been filed at all.

Following the discovery of Arwood's improper practices, the relationship between the parties began to deteriorate, and AWS and Broadtree ultimately refused to release certain escrow funds. Arwood subsequently filed the underlying lawsuit seeking to recover such funds, and AWS filed counterclaims alleging, among other things, fraud and breach of certain representations and warranties in the APA. The opinion primarily focused on AWS's counterclaims, and the court found that AWS failed to prove fraud but succeeded on its breach of contract claim.

The court held that AWS failed to prove that Arwood acted with the requisite scienter for fraud. In so holding, the court focused on the evidence that Arwood granted Broadtree unlimited access to Arwood Waste's business, that Arwood intended to have a continuing professional relationship with AWS post-closing, and that Broadtree was highly sophisticated while Arwood was "an alarmingly unsophisticated businessman." Likewise, the court found AWS did not justifiably rely on Arwood's misrepresentations or omissions. Broadtree had unfettered access to Arwood's personal and business financials, as well as password-protected access to Arwood Waste's records. This unusual access, the court found, was provided because Broadtree and AWS knew that Arwood did not have the requisite skills to provide an accurate picture of the business, and therefore Arwood Waste's financials and the underlying data could not be trusted. The court further found that Broadtree and AWS "spent substantial time confirming Arwood Waste's revenue" while "wholly ignor[ing] other aspects of the business" and reduced the purchase price by nearly 25% after months of diligence. Such evidence, the court found, supported a finding that Broadtree was aware that Arwood Waste's recordkeeping was flawed, passed "warning sign after warning sign," but proceeded to execute the APA and close on the transaction anyway.

Given that Delaware's public policy "respects the freedom of parties in commerce to strike bargains and honors and enforces those bargains," the court held that sandbagging is permitted by Delaware law.

The court next addressed "sandbagging," which, in the context of an acquisition, refers to a situation where a buyer knows a representation or warranty is false prior to closing, nevertheless closes, and then proceeds to sue the seller post-closing for a breach of that same representation or warranty. Specifically, the court analyzed (i) whether "sandbagging" can be used as a defense under Delaware law, and (ii) whether "sandbagging" is implicated if the buyer should have known the representation or warranty was false but did not have actual knowledge of the falsity.

The court held that Delaware is a "pro-sandbagging" jurisdiction. In so holding, the court emphasized that "Delaware is 'more contractarian' than most states," Delaware courts enforce both good and bad contracts, and to prohibit sandbagging would be to deviate from this long-established principle. The court recognized that sandbagging could create perverse incentives and acknowledged other potential ethical objections to the practice. Still, it reasoned that parties to a contract are free to manage the risk of sandbagging by expressly permitting or prohibiting it. Given that Delaware's public policy favors private ordering and "respects the freedom of parties in commerce to strike bargains and honors and enforces those bargains," the court held that sandbagging is permitted by Delaware law.

The court then found that sandbagging is not implicated unless a buyer has actual knowledge that a representation or warranty is false prior to closing. In coming to this conclusion, the court relied heavily on the Delaware Supreme Court's opinion in *Eagle Force Holdings, LLC v. Campbell,* which suggested that the buyer's actual knowledge of falsity, not constructive inquiry, animates the sandbagging inquiry. The court also clarified that sandbagging is likewise not implicated where such a lack of knowledge is the product of reckless indifference. The court explained that anything short of actual knowledge is insufficient to implicate sandbagging. With this framework established, the court held that Broadtree was recklessly indifferent to—but did not have actual knowledge of—the falsity of certain representations and warranties prior to closing, and therefore the defense of sandbagging was not available for AWS's counterclaims of breaches of representations and warranties.

Turning then to such counterclaims, the court held that AWS successfully proved that Arwood had breached certain representations and warranties under the APA. Specifically, the court found that the billing practices regarding weight overages and the repeated placement of false liens on customer projects were unlawful, and therefore that Arwood breached Section 3.20 of the APA, which provided that "[e]ach Seller Entity has materially complied with and is currently in compliance with all Laws of federal, state, local and foreign governments." As a result of such breach, the court found that AWS was entitled to damages in the amount of $3.9 million—the maximum available in light of the damages cap in the APA. ■

LIMITED LIABILITY COMPANIES AND PARTNERSHIPS

Bruckel v. TAUC Holdings, LLC: Delaware Court of Chancery Confirms Essentially Unfettered Right of Access of Managers to Limited Liability Company's Documents on Ongoing Basis

In *Bruckel v. TAUC Holdings, LLC,* 2023 WL 116483 (Del. Ch. Jan. 6, 2023), the Delaware Court of Chancery clarified a previous decision regarding a manager's right to inspect the books and records of an LLC under Section 18-305 of the LLC Act and under the relevant LLC agreement. The court held that the plaintiff manager had continuous contractual and statutory rights to inspect the meeting minutes, emails, and other documents related to informal meetings between other managers.

Bruckel arose out of a dispute between the managers of TAUC Holdings, LLC, a Delaware limited liability company. Matthew Bruckel is a founding member and manager of TAUC who fell out of favor with the other four managers on TAUC's board of managers (the "Favored TAUC Managers"). At a previous trial, the court held that Bruckel had both a contractual right to TAUC's books and records, because TAUC's LLC agreement granted Bruckel unrestricted access to books and records, and a statutory right to books and records under Section 18-305, which states that a manager of an LLC has a right to inspect the books and records of a company that are reasonably related to their role as a manager.

> If business is sometimes conducted informally, then even supposedly informal communications are books and records that managers are entitled to inspect.

After trial, in an effort to avoid the court's ruling, the Favored TAUC Managers largely ceased having formal meetings and instead held dozens of informal "weekly group updates," each involving only a few of the Favored TAUC Managers at a time. The Favored TAUC Managers argued that they were not obligated to produce all emails and meeting minutes surrounding these and other meetings because those documents were outside the substantive and temporal scope of the court's previous holding. The court ultimately sided with Bruckel and required that he be allowed to inspect all documents and communications in question.

First, the court clarified the substantive extent of Bruckel's right to review books and records. The court held that "what the other managers are being given and documents that reflect how the other managers meet and act collectively" are the best proxies for what is reasonably related to a manager's status as manager. The court also noted that the way in which managers conduct their business is important to determining which records and communications must be disclosed. If business is sometimes conducted informally, then even supposedly informal communications are books and records that managers are entitled to inspect. Even though the weekly group updates were supposedly informal, the court held that the "managers acted as managers in settings other than Board meetings," and, as a result, Bruckel was entitled to minutes of those meetings and to related communications under Section 18-305.

Second, the court clarified the temporal scope of Bruckel's inspection rights. The Favored TAUC Managers argued that they were only obligated to produce books and records up to the date of the trial. The court rejected this assertion and held that Bruckel had a continuing right to inspect books and records both under Section 18-305 and TAUC's LLC agreement. Regarding Section 18-305, the court stated that managers need to inspect books and records to fulfil their fiduciary duties, and that "[a]s long as a sitting manager owes fiduciary duties, she is entitled to receive whatever the other managers are given." Regarding TAUC's LLC agreement, the court noted that Bruckel had an unrestricted and ongoing contractual right to books and records, which was not limited to the scope or timing of Bruckel's lawsuit.

Boardwalk Pipeline Partners, LP v. Bandera Master Fund LP: Delaware Supreme Court Reverses Trial Court Decision and Finds Correct Entity Made Determination as to Exercise of Call Right and Was Presumed to Have Acted in Good Faith Based on Reliance on Counsel

In *Boardwalk Pipeline Partners, LP. v. Bandera Master Fund LP,* --- A.3d ----, 2022 WL 17750348 (Del. Dec. 19, 2022), the Delaware Supreme Court heard an appeal relating to the exercise of a call right to cause a master limited partnership to repurchase publicly held units upon the occurrence of certain events as contemplated by its partnership agreement. The *Boardwalk* court reversed the Delaware Court of Chancery's decision that the call right at issue had been improperly exercised, holding that (i) the sole member in the corporate structure was the proper entity to determine whether the opinion of counsel required to be obtained under the partnership agreement in connection with the exercise was acceptable; (ii) the sole member reasonably relied on the opinion of counsel in directing the general partner of the limited partnership to exercise the call right; (iii) the sole member and the general partner were therefore entitled to the benefit of a conclusive presumption that they had acted in good faith as provided in the partnership agreement; and (iv) the sole member and the general partner were therefore exculpated from damages thereunder.

Boardwalk Pipeline Partners, LP (the "Boardwalk MLP") was a master limited partnership that benefited from favorable tax policy available to entities of its type. It was managed by a general partner (the "Boardwalk GP"), which in turn was managed by its general partner (the "Boardwalk UGP"). The Boardwalk UGP was managed by a board of directors (the "Boardwalk UGP Board") comprised of both independent and sponsor-appointed members, in addition to having a sole member (the "Boardwalk Sole Member") to which certain decisions were reserved under its governing documents. The Boardwalk Sole Member was wholly owned by the Boardwalk sponsor and managed by a sponsor-appointed board of directors (the "Boardwalk Sole Member Board").

The partnership agreement governing the Boardwalk MLP (the "Boardwalk LPA") contained a call right that could be exercised by the Boardwalk GP in certain circumstances pursuant to a contractually prescribed formula. Specifically, the Boardwalk GP was permitted to exercise the call right if it received an opinion of counsel providing that the Boardwalk MLP's tax status "ha[d] or [would] reasonably likely in the future have a material adverse effect on the maximum applicable rate that c[ould] be charged to customers." Other relevant provisions in the Boardwalk LPA specified that the opinion of counsel must be "acceptable" to the Boardwalk GP and that, in making the acceptability determination, the Boardwalk GP would be acting in its individual capacity rather than its managerial capacity and would be free of any fiduciary duties in so acting. The Boardwalk LPA also exculpated the Boardwalk GP from liability for monetary damages in the absence of bad faith, fraud, willful misconduct, or criminality on the part of the Boardwalk GP and provided that the Boardwalk GP would be conclusively presumed to have acted in good faith if it acted in reliance on expert advice.

In 2016, a D.C. circuit court ruling that challenged the existing tax framework, the passage of legislation lowering the federal corporate income tax rate, and action taken by the Federal Energy Regulatory Commission in response to the foregoing developments created uncertainty in the market and caused a significant drop in the price of Boardwalk MLP units. Thereafter, the Boardwalk sponsor began consulting with legal counsel regarding the feasibility of exercising the call right. A few months later, counsel to the Boardwalk GP issued a legal opinion (the "Boardwalk GP Opinion") providing that the contractual condition to exercise of the call right had been met.

In order to address the opinion acceptability requirement contained in the Boardwalk LPA, a second outside law firm was engaged. The firm issued a legal opinion to the Boardwalk Sole Member Board (the "Boardwalk Sole Member Opinion") providing that it would be reasonable (i) to conclude that the Boardwalk Sole Member, rather than the Boardwalk UGP Board, was the correct body to determine the acceptability of the Boardwalk GP Opinion, and (ii) for the Boardwalk Sole Member to determine that the analysis and conclusions contained in the Boardwalk GP Opinion were acceptable. Following this advice, the Boardwalk Sole Member Board determined that the opinion was acceptable and caused the Boardwalk GP to exercise the call right. A lawsuit followed, alleging (i) that the Boardwalk GP had breached the Boardwalk LPA by exercising the call right without the opinion of counsel requirement having been met, (ii) that the Boardwalk GP had breached the Boardwalk LPA through the payment of a deflated purchase price per unit or, alternatively, had breached the implied contractual covenant of good faith and fair dealing by causing a decline in the Boardwalk MLP unit price and then paying a lower purchase price, and (iii) tortious interference and unjust enrichment claims against the Boardwalk UGP, the Boardwalk Sole Member, and the Boardwalk sponsor. The Court of Chancery found in favor of the plaintiffs and, having determined that the Boardwalk GP had acted in bad faith and that the exculpation provision in the Boardwalk LPA was therefore unavailable to it, awarded damages.

The Delaware Supreme Court addressed the issue of who had the authority to determine the acceptability of the Boardwalk GP Opinion.

On appeal, the Delaware Supreme Court first addressed the issue of who had the authority to determine the acceptability of the Boardwalk GP Opinion. The court held that the Court of Chancery had erred in determining that the Boardwalk LPA was ambiguous on this point simply because it did not identify the ultimate decisionmaker, reasoning that it was necessary for the governing documents of the entities in the corporate structure to be read together in order to resolve this question. In finding that the Boardwalk Sole Member, rather than the Boardwalk UGP Board, was the proper actor, the court noted that (i) the Boardwalk LPA provided that this determination was an "individual capacity" decision as opposed to a "general managerial authority" decision and that it therefore directly implicated the upper-tier governing documents; (ii) the Boardwalk LPA was clear about designating certain items as being within the authority of the Boardwalk UGP Board, which it did not do in respect of the call right; and (iii) the limited liability company agreement of the Boardwalk UGP (the "Boardwalk UGP LLCA") granted the Boardwalk Sole Member "exclusive authority to cause the [Boardwalk UGP] to exercise the rights of the [Boardwalk UGP] and [the Boardwalk GP], as general partner of the [Boardwalk] MLPc" and listed the call right as one of these rights. The court went on to note that this conclusion was supported by the public disclosures made in connection with the offering of units in the Boardwalk MLP, which provided context for both Boardwalk's intent and the terms on which public unitholders had agreed to purchase their units, and that the Boardwalk UGP LLCA defined "Opinion of Counsel" as an opinion that was acceptable to the Boardwalk Sole Member.

Having determined that the Boardwalk Sole Member was the appropriate decisionmaker, the Supreme Court then addressed the applicability of the exculpation and expert reliance provisions contained in the Boardwalk LPA. The court disagreed with the Court of Chancery that the Boardwalk GP could not rely on the Boardwalk Sole Member Opinion to meet the exculpation standard due to the opinion having been rendered at the Boardwalk Sole Member Board level, holding that exculpation generally applies to the board-level actors managing an entity rather than the non-decisionmaker agents of such entity. As a result, the court reasoned that while the Boardwalk Sole Member Board had obtained the opinion, the conclusive presumption of good faith for relying on expert advice inured to the benefit of the Boardwalk GP because the Boardwalk Sole Member Board had caused the Boardwalk GP to exercise the call right. The court therefore determined that the Boardwalk GP, through the Boardwalk Sole Member, was entitled to rely on the conclusive presumption of good faith and was exculpated from damages.

Two justices wrote in concurrence that they would reverse the Court of Chancery's holding that the Boardwalk GP Opinion was rendered in bad faith on the basis that the Court of Chancery had erred in reviewing the Boardwalk GP Opinion *de novo* and engaging in a substantive evaluation of the legal correctness thereof, instead of applying a deferential standard focused on whether counsel had acted in good faith in rendering the opinion.

In re P3 Health Grp. Holdings, LLC: Court of Chancery Finds Chief Legal Officer of LLC and Person Who Had No Official Role with LLC but Made Decisions on Behalf of and Directed Management of LLC Were Both "Managers" under the LLC Act for Purposes of Personal Jurisdiction

In *In re P3 Health Grp. Holdings, LLC,* 282 A.3d 1054 (Del. Ch. 2022), the Delaware Court of Chancery dismissed a motion for lack of personal jurisdiction. The court held that an LLC's chief legal officer was a manager within the meaning of 6 *Del. C.* § 18-109(a) and implicitly consented to service of process. Ultimately, the court reasoned that the chief legal officer materially participated in the LLC's management, qualifying her as a manager under Section 18-109(a).

P3 Health Group Holdings, LLC, a Delaware LLC, was managed by a board of eleven managers. Hudson Vegas Investment SPV, LLC, a minority unit holder, brought a breach of fiduciary duty claim against P3's general counsel and chief legal officer, Jessica Puathasnanon. Puathasnanon moved for dismissal for lack of personal jurisdiction, arguing that there was improper service of process under Section 18-109(a) of the LLC Act. Specifically, Puathasnanon argued that she was not a company manager and did not consent to service of process.

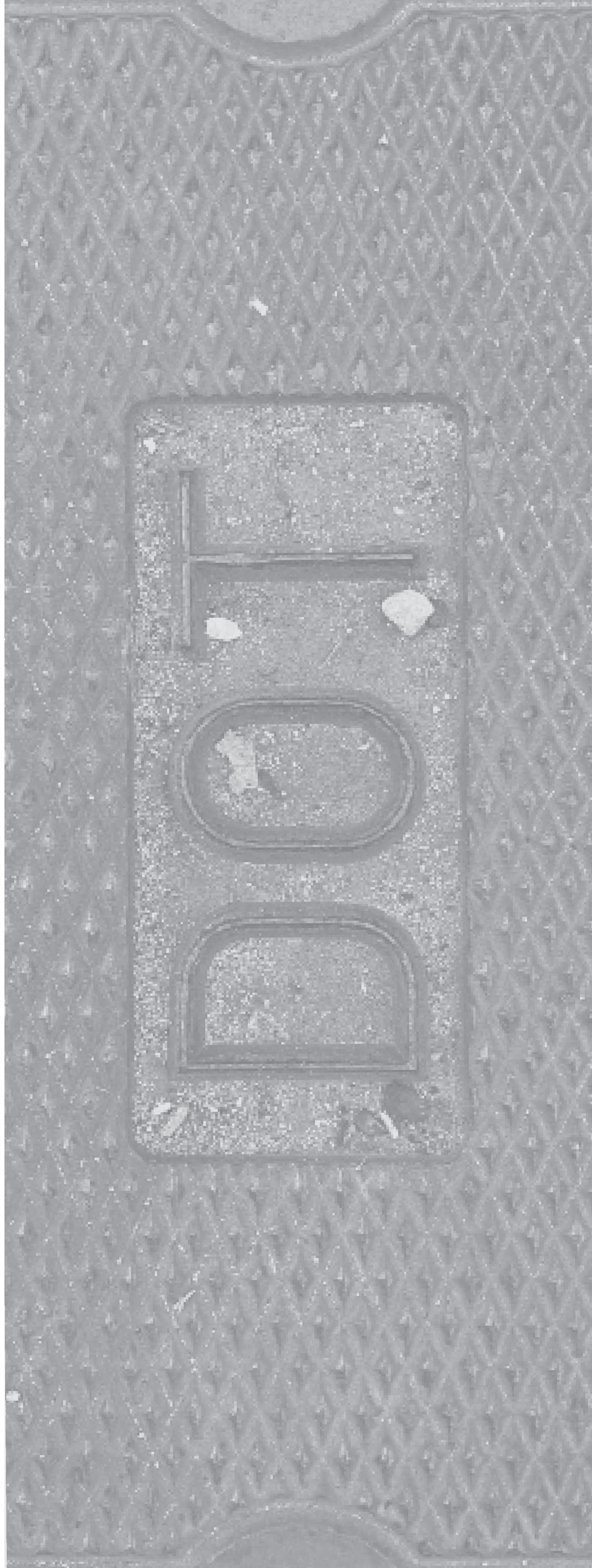
Section 18-109(a) states that an LLC manager consents to the service of process through the LLC's registered agent by agreeing to serve as a manager for the LLC. Section 18-109(a) defines a "manager" as either (i) a person officially named as a manager in the company's governing documents ("formal manager"), or (ii) a person, not formally named, who materially participates in the management of the LLC (“acting manager”).

The court found that Puathasnanon was an acting manager and consented to service of process for three reasons. First, the court interpreted the plain meaning of “material participation” to include personnel in senior roles who perform functions consistent with those roles. Here, Puathasnanon was named the chief legal officer and general counsel. Further, Puathasnanon performed functions consistent with those roles, including working with outside counsel to shape P3’s merger strategy and guide the board in effectuating the merger. Second, the court applied the technical meaning of “material participation” as interpreted under the tax code. The court noted that one such test to determine if a taxpayer materially participated in a business is whether the taxpayer worked more than 500 hours

The court interpreted the plain meaning of “material participation” to include personnel in senior roles who perform functions consistent with those roles.

a year in the role. Using this test to inform its analysis, the court found that, as chief legal counsel and general counsel, Puathasnanon materially participated in P3’s management by working more than 500 hours a year in a senior management position. Third, the court analogized Section 18-109(a) to 10 *Del. C.* § 3114(b), which states that a corporate officer implicitly consents to service of process by voluntarily accepting the appointment. Section 3114(b) specifically names, among other officers, the chief legal officer as a role consenting to service. The court found that Section 3114(b) was analogous to Section 18-109(a), despite Section 18-109(a) not listing specific officers. Ultimately, the court found that Puathasnanon consented to service of process by accepting a role as a chief legal counsel.

In the same decision, the court also denied a motion to dismiss for lack of personal jurisdiction filed



by Sameer Mathur, a principal of Chicago Pacific Founders Fund, L.P., a Delaware limited partnership private equity fund that controls P3 through control of a majority of the eleven seats of the P3 board of managers.

Mathur argued that his purported service of process under Section 18-109(a) of the LLC Act was ineffective because he was not a “manager” of P3 within the meaning of Section 18-109(a). Mathur never held any official role with P3, as a manager, officer, employee, or otherwise, and was never designated as a manager by P3. Nevertheless, the court noted that an individual who has a significant role in managing a limited liability company or who plays a significant part in an activity or an event that constitutes part of the management of such limited liability company “participates materially” in the management of the limited liability company and is a “manager” under Section 18-109(a). While Mathur had no official role with P3, facts and documents presented to the court demonstrated that in connection with the year-long negotiation and ultimate consummation of the de-SPAC merger that led to this litigation, Mathur made decisions on behalf of P3, directed P3’s management to take actions, instructed P3’s advisors to perform work without authorization from P3’s management, berated P3’s legal counsel for not sending documents to him before circulating them to the wider group, and received materials for and attended P3’s board meetings (despite his not being on P3’s board). The court held that taking these actions on behalf of P3 and in connection with the de-SPAC merger constituted a significant role in the management of P3. As a result, the court found that Mathur was a “manager” within the meaning of Section 18-109(a) and could be validly served with process pursuant to that section.

In making this finding, the court rejected Mathur’s arguments based on the “control overlay test”—that an individual cannot effectively control an entity if a different party is designated as the “sole manager” of such entity, and such individual therefore cannot be subject to personal jurisdiction in Delaware. The court concluded that the control overlay test conflicts with the plain language of Section 18-109(a).

Baldwin v. New Wood Resources LLC: Delaware Supreme Court Reverses Trial Court and Holds Implied Covenant of Good Faith and Fair Dealing Applies with Respect to Whether Former Manager Was Entitled to Indemnification

In *Baldwin v. New Wood Resources LLC,* 283 A.3d 1099 (Del. 2022), the Delaware Supreme Court reversed a trial court decision and held that the covenant of good faith and fair dealing was implied where an individual's right to indemnification under an operating agreement was to be determined by the majority interest holder of the limited liability company. Richard Baldwin, the initial plaintiff, served as a manager of New Wood Resources LLC, a Delaware limited liability company. ACR Winston Preferred Holdings LLC held approximately 85.52% of New Wood's then-outstanding units, making it the majority holder of New Wood.

Although Delaware gives maximum effect to the principle of freedom of contract, the LLC Act specifically prohibits the elimination of the implied covenant.

There was a dispute as to whether Baldwin was entitled to indemnification for certain costs pursuant to the New Wood operating agreement. Section 8.2 of the New Wood operating agreement entitled Baldwin to indemnification only if he had acted in good faith. The operating agreement also provided that ACR Winston, as the majority interest holder, was entitled to determine whether Baldwin adhered to the good faith standard for purposes of being entitled to indemnification.

ACR Winston executed a written consent stating that Baldwin had not acted in good faith for purposes of indemnification. The written consent did not explain the rationale for the determination, nor did it provide evidence of bad faith by Baldwin. Baldwin challenged the determination by ACR Winston on behalf of New Wood denying him indemnification. The trial court denied Baldwin's challenge and held that the implied covenant of good faith and fair dealing was not applicable with respect to the good faith determination contemplated by Section 8.2 of the New Wood operating agreement. The trial court reasoned that imposing an additional "free-floating" good faith covenant would result in subjecting every provision to "fact-intensive and unyielding judicial review" inconsistent with Delaware law.

On appeal to the Delaware Supreme Court, Baldwin asserted, among other things, that the implied covenant of good faith and fair dealing was applicable to the good faith determination required under Section 8.2. The Supreme Court agreed with Baldwin and held that the implied covenant was applicable and acted as a "gap-filler," because a determination of entitlement to indemnification may not be made in bad faith. The court noted that although Delaware gives maximum effect to the principle of freedom of contract, the Delaware Limited Liability Company Act specifically prohibits the elimination of the implied covenant in Section 18-1101(c).

The court noted that drafters of LLC agreements are not expected to include "obvious and provocative" conditions in agreements, such as one stating that a manager would not mislead members. The court held that it would be "too obvious" to demand the express inclusion of the implied covenant that a determination under the LLC agreement be reached in good faith. The court also noted precedents reinforcing the underlying principle that if one party is given discretion in determining whether a condition has occurred, that party must use good faith in making that determination.

Ultimately, the New Wood operating agreement required ACR Winston to make a "subjective discretionary determination as to whether an indemnitee has met a specific standard of conduct." The court reasoned that, as the operating agreement did not expressly state whether the determination must be made in good faith, if indemnification could be denied for any reason, including in bad faith, the good faith determination would be

rendered meaningless. The court reversed and remanded the trial court's judgment, intending to give Baldwin an opportunity to prove whether New Wood did in fact breach the implied covenant that the court held to be implied in Section 8.2 of the operating agreement.

In re Cadira Grp. Holdings, LLC Litig.: Court of Chancery Finds 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.

Drafters of a limited liability company agreement must make their intent to eliminate traditional fiduciary duties plain and unambiguous.

Murfey v. WHC Ventures, LLC: Delaware Supreme Court Decision Prompts Amendment to Delaware LP Act Providing 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 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.

On appeal, the Delaware Supreme Court agreed with the Court of Chancery's proper-purpose analysis, but it declined to import a "necessary and proper" requirement into the WHC partnership agreements, emphasizing the freedom of contract in the alternative entity context. 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.

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.

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. ■

Recent Developments in Delaware Law

2022 Amendments to the Delaware General Corporation Law

Legislation amending the General Corporation Law of the State of Delaware (the "DGCL") was signed into law on July 27, 2022. The 2022 amendments to the DGCL, among other things, (i) enable corporations to include in their certificates of incorporation provisions exculpating specified executive officers for certain breaches of fiduciary duty; (ii) harmonize the provisions governing the issuance of stock, on the one hand, and options and rights to acquire stock, on the other, including with respect to the board's delegation of the power to issue stock and options and rights to acquire stock; (iii) reduce the vote required to effect a conversion of a Delaware corporation to another entity; (iv) provide additional flexibility to non-U.S. entities domesticating to Delaware as a corporation to effect corporate acts in connection with a plan of domestication, including by dispensing with the need for approvals by the directors and stockholders of the domesticated corporation in respect of matters approved by the non-U.S. entities pursuant to the plan; (v) revise the provisions governing appraisal rights, including to allow beneficial owners to make appraisal demands in their own name and to provide appraisal rights in the case of a conversion of a Delaware corporation to another entity; (vi) eliminate the requirement to make the stocklist available during a meeting of stockholders, including a meeting conducted solely by remote communication; (vii) update the provisions relating to notice of stockholders' meetings to add procedures governing the adjournment of virtual meetings in circumstances where a technical failure has occurred; and (viii) require corporations whose duration expire by a specified date to file a certificate of dissolution in connection with the expiration of their duration.

Except as noted below, the amendments became effective on August 1, 2022. The amendments to Section 262 (dealing with appraisal rights) are effective only with respect to mergers, consolidations, or conversions adopted or entered into, as applicable, on or after August 1, 2022. The amendments to Section 266 are effective only with respect to corporations converting pursuant to resolutions of the board of directors approving such conversion that are adopted on or after August 1, 2022. The amendments to Section 388 are effective only with respect to corporations as to which a plan of domestication is entered into on or after August 1, 2022, or, if no plan of domestication is entered into in connection with the domestication, any such corporations with respect to which the approvals required by Section 388(h), as amended, are obtained on or after August 1, 2022.

Exculpation of Specified Executive Officers

The 2022 amendments revised Section 102(b)(7) of the DGCL to authorize a corporation to include in its certificate of incorporation a provision to eliminate or limit the monetary liability of specified executive officers for breach of the duty of care. As used in amended Section 102(b)(7), the term “officer” means a person who at the time of an act or omission as to which liability is asserted is deemed to have consented to service by the delivery of process to the registered agent of the corporation pursuant to Delaware’s long-arm statute, Section 3114(b) of Title 10 of the Delaware Code. As Section 3114(b) does not apply to residents of Delaware, given that they are already subject to personal jurisdiction in Delaware, Section 102(b)(7), as amended, treats Delaware residents as if they were non-residents. Thus, by reference to Section 3114(b), the “officers” entitled by statutory default to be covered by an exculpatory provision 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; and (iii) an individual who, by written agreement with the corporation, has consented to be identified as an officer for purposes of Section 3114(b).

As with directors, the provision may not exculpate such officers from liability for 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 stock redemptions, stock repurchases, or dividends; or any transaction in which the officer derived an improper personal benefit. Unlike the elimination and limitation of liability allowed for directors, Section 102(b)(7), as amended, will not allow for any elimination or limitation of liability of the covered officers for claims brought by or in the right of the corporation, including derivative claims.

Section 102(b)(7) was originally adopted in 1986, largely in response to the crisis in the directors’ and officers’ insurance market that followed the Delaware Supreme Court’s opinion in *Smith v. Van Gorkom,* where it found that the directors had acted with haste in approving a merger and failed to consider all material information available to them, thereby breaching their duty of care. 488 A.2d 858 (Del. 1985). At the time, Delaware’s Corporation Law Council, which is responsible for proposing amendments to the DGCL, considered several alternatives to address the issue, including amending Section 145(b) of the DGCL to allow the corporation to indemnify directors for judgments and amounts paid in settlement of claims brought by or in the right of the corporation, amending Section 145(g) to allow for captive insurance and imposing statutory limits on liability. Those alternatives were rejected at the time, as the Corporation Law Council at the time of the original adoption of Section 102(b)(7) concluded that giving corporations the power, through their certificates of incorporation, to determine whether to limit or eliminate director liability more directly addressed the issue.

By its terms, Section 102(b)(7), as originally adopted, applied only to directors. The original omission of officers was deliberate. First, it was believed that officers would bring matters to the board of directors and would be protected by the fact that the board will have made the decision. Second, at the time Section 102(b)(7) was adopted, Section 3114 of Title 10 provided that directors were deemed to consent to service of process in the State of Delaware, but it did not apply to officers. Thus, other than officers who also served as directors, it was difficult for non-resident officers to be named as defendants in proceedings in Delaware. In 2003, however, in the wake of a series of corporate scandals involving Enron, Worldcom, and others, and in light of the fact that changes in corporate governance stemming from, among other things, the Sarbanes-Oxley Act resulted in a reduction in the number of inside directors, Section 3114 was amended to add the executive officers noted above. In the years following the amendment to Section 3114, fiduciary litigation involving officers solely in their capacity as such remained relatively rare, but more recent changes in the M&A litigation landscape have made executive officers a target for claims of breach of fiduciary duty, including the duty of disclosure. For example, in *Morrison v. Berry,* 2019 WL 7369431 (Del. Ch. Dec. 31, 2019), the Court of Chancery dismissed claims against the outside directors of Fresh Market that had approved the company's acquisition by a private equity firm, but allowed the claims against the company's general counsel and chief executive officer to proceed on the basis that, in light of the plaintiff-friendly pleading standard, the court found it reasonably conceivable that the officers were grossly negligent in preparing the disclosure document. The *Morrison* court's ruling essentially held that once a disclosure violation had been found, allegations against officers who prepared the disclosure document would effectively proceed (even where the omitted disclosures may have been close calls that the Court of Chancery itself did not initially deem material omissions). Subsequent opinions of the Court of Chancery have followed that reasoning. *See, e.g., City of Warren Gen. Emps.' Ret. Sys. v. Roche,* 2020 WL 7023896 (Del. Ch. Nov. 30, 2020); *In re Baker Hughes Inc. Merger Litig.,* 2020 WL 6281427 (Del. Ch. Oct. 27, 2020).

In large part, the amendments to Section 102(b)(7) were enacted in response to the perverse outcome in which claims for breach of the duty of disclosure against directors were being dismissed, while the same claims against the officers were allowed to proceed. Given corporate law's stringent construction of "gross negligence," which requires a showing of conduct bordering on recklessness, it is difficult to conceive of a fact pattern in which an officer of a public company that, with the assistance of outside counsel, prepared a disclosure document was in fact "grossly negligent" in doing so. Nevertheless, the lack of exculpation for officers gives stockholder plaintiffs the ability to continue to exert litigation pressure to drive a settlement. Despite the difficulty those plaintiffs would face in proving, after trial, that an officer was grossly negligent, defendants rationally may wish to settle the claims to avoid the costs and distraction of litigation.

While the amendments to Section 102(b)(7) protect specified executive officers from monetary liability arising out of claims for breach of the duty of care brought directly against them by stockholders, as is frequently the case in the M&A context, they do not prevent the board of directors from pursuing claims against officers in the name of the corporation, nor do they prevent stockholders from bringing derivative claims in which officers are alleged to have breached their duty of care. Thus, the amendments recognize the basic structure of the Delaware corporation—that directors are principally responsible for oversight of the corporation and the long-term best interests of stockholders, while officers are responsible for management of the corporation's day-to-day affairs. Given that basic design, directors must have the ability to rely on officers—and should have the opportunity to pursue claims for breach of the duty of care against officers who fall short of their obligations. In terms of derivative litigation, the board of directors will in most cases retain the ability to determine whether to pursue claims for breach of the duty of care against officers, given that stockholders will either have to make a demand on the board to pursue litigation or demonstrate that such a demand would be futile, which should prove difficult where the board is composed of a majority of disinterested, independent directors.

As with an exculpatory provision that applies to directors, an exculpatory provision for officers will not apply by default; it must be included in the certificate of incorporation and will apply only with respect to acts or omissions occurring while it is in effect. Similarly, if the provision were subsequently amended to eliminate the exculpatory protection afforded to officers, the exculpatory protection will continue to apply with respect to acts or omissions taken while the provision was in effect, unless the provision otherwise provides at the time of the act or omission. As exculpatory provisions for officers must be included in the certificate of incorporation, it is likely that many newly formed corporations, as well as corporations that are pursuing an initial public offering, will include provisions in their certificates of incorporation that exculpate officers to the fullest extent permitted by law. It remains to be seen how institutional investors and proxy advisors will react to proposals to amend the certificate of incorporation of existing public companies to provide exculpation to officers. In light of the structure of the amendments to Section 102(b)(7), which do not allow for exculpation of officers against claims brought by or in the right of the corporation and principally protect them for a narrow class of direct claims in which executive officers are alleged to have breached their duty of care, there would not seem to be a principled objection to the inclusion of such a provision.

Issuance of Stock and Options

Historically, the creation and issuance of stock and options and rights to acquire stock were within the sole province of the board or a duly empowered committee of the board. In 2001, Section 157 was amended to allow the board to delegate to officers the power to allocate options and rights to purchase stock, subject to certain limitations. The 2001 amendment to Section 157, however, continued to require the board to fix the terms of the rights or options, including the purchase price. In 2013 and 2015, primarily in response to questions around the validity of stock issued in connection with at-the-market programs, Section 152 was amended to allow the board to delegate the power to issue stock, subject to broad parameters fixed by the board. At that time, no corresponding changes were made to Section 157, which already included provisions allowing for a limited measure of delegable authority.

The 2022 amendments made several changes to Sections 152, 153, and 157 to harmonize the process by which the issuance of stock and options or rights to acquire stock may be authorized. The prior differences in the statutory procedures applicable to the authorization of stock issuances, on the one hand, and issuances of options and rights to acquire stock, on the other hand, created some complications, particularly for those responsible for the design of equity incentive plans. By creating greater consistency among the statutory provisions governing the

issuance of stock and options and rights to acquire stock, the 2022 amendments will help to eliminate the opportunity for "foot-faults" in authorization and give corporations greater flexibility in establishing their internal procedures for equity incentive programs.

Specifically, the amendments allow the board (or a duly empowered committee) to delegate its authority to issue stock or options or rights to acquire stock by adopting a resolution that fixes the following: (i) the maximum number of shares of stock, rights, or options that the delegate may issue or sell, (ii) a time period during which the issuances or sales may occur, and (iii) the minimum amount of consideration to be received for the issuances or sales. Consistent with the prior provisions of the DGCL, under the amendments, such minimum consideration to be received for the issuance of stock having a par value may not be less than the par value of the shares so issued, but an amount equal to the par value of any treasury shares would not need to be received in exchange for their disposition, as the corporation would have already received the minimum consideration for the issuance of such shares. Where the delegation applies to the issuance of rights or options, the resolutions must fix the foregoing parameters for the rights or options to be issued and the shares of stock issuable on exercise thereof. That is, the resolutions must specify, for example, the maximum number of options or rights that are available for issuance by the delegate as well as the maximum number of shares that may be purchased upon the exercise of the rights or options. In addition, the resolution that provides for the delegation to a person or body may not permit the person or body to issue rights or options to such person or body.

Sections 152, 153, and 157 permit delegation to a person or body "in addition to the board of directors." This language is intended to confirm that the procedures relating to the delegation of power under Sections 152(b), 153(c), and 157(c), and the statutory restrictions on delegated power, do not apply to delegations to committees of the board, which may, as is currently the case, be delegated full powers of the board, without regard to any of the other limitations on the authority of a delegate. Moreover, the amendments make clear that a duly empowered committee of the board may delegate the committee's authority to issue or sell stock, rights, or options to a person or body by complying with the applicable provisions of the DGCL relating to delegation.

Sections 152, 153, and 157 also clarify that a board resolution providing for the issuance or sale of stock, rights, or options may be made dependent on "facts ascertainable" outside the resolution. The 2022 amendments continue to provide that the consideration paid for issuances or sales of stock, rights, and options may be set by reference to a formula provided in the board resolution (e.g., market price at the time of issuance). In addition, if the board is authorizing a transaction for the issuance or sale of stock by, for example, approving a stock purchase agreement, the consideration received by the corporation and the other terms of the issuance may be made dependent on the provisions in the agreement and on determinations by a person or body, such as an expert who makes determinations that might result in an adjustment to the number of shares issued. By contrast, if the board is delegating to a person or body the authority to enter into a transaction to issue or sell stock, rights, or options, such as authorizing an officer to make stock or option grants to employees or to issue stock in an "at-the-market offering," the delegate cannot make the determinations regarding the three parameters in Sections 152(b) and 157(c). Thus, the board (or committee) would have to establish the minimum consideration, the maximum number of shares or options or rights, as applicable, and the period during which the issuances or sales could be made.

In addition to broadening the authority that may be delegated under Section 157, the 2022 amendments eliminate the requirement that the terms of a right or option be set forth or incorporated by reference in an instrument evidencing the rights or options. Thus, the amendments expressly clarify that rights or options may be issued in book-entry or electronic form.

Conversion

Section 265 of the DGCL, which governs the conversion of other entities to a Delaware corporation, has been amended to specify that the approval of the conversion under the document, instrument, agreement, or other writing governing the internal affairs of the converting entity, and the approval of the certificate of incorporation by the same authorization required to approve the conversion, must occur before the time the certificate of conversion filed with the Delaware Secretary of State to effect the conversion becomes effective.

Section 266 of the DGCL, which governs the conversion of a Delaware corporation to another entity, used to require the unanimous consent of all stockholders, voting or nonvoting, to approve the conversion. At the time the conversion statute was adopted, the unanimity requirement served as a means to avoid the need to address whether appraisal rights should apply in the context of a conversion. It also served to ensure that if stockholders became owners of an entity with dramatically different attributes—including an entity like a general partnership that would render equity holders liable for the debts of the partnership—the stockholders will have consented to that treatment. In practice, the unanimity requirement limited the use of the conversion statute to wholly owned subsidiaries or closely held corporations.

Section 266 has been amended to provide that a conversion may be approved by the vote of the holders of a majority in voting power of the outstanding shares entitled to vote thereon. In recognition of the fact that a conversion could result in a corporation becoming a partnership (with stockholders becoming general partners with unlimited liability for the debts of the partnership), the amendments require the express consent of any stockholder that will become a general partner in connection with a conversion. In addition, given that many stockholders, including preferred stockholders, invested on the basis that conversions would be practically impossible to consummate (and they negotiated protective provisions or other rights with that premise in mind), the amendments make clear that any provision of the certificate of incorporation of a corporation incorporated before August 1, 2022, or voting agreement or other written agreement between the corporation and any stockholder entered into before that date, that restricts or prohibits the consummation of a merger or consolidation shall be deemed to apply to a conversion unless the certificate of incorporation or agreement otherwise provides. Thus, for example, protective provisions of existing corporations that require a separate vote of the holders of preferred stock (or one or more series thereof) to approve a merger will be construed to require the same vote to effect a conversion. Nevertheless, going forward, investors should be careful to ensure that, if they want to obtain veto rights over conversions, they specifically negotiate for blocking rights over conversions. Without those express contractual rights, investors run the risk of having their shares cancelled or converted into another form of consideration (either cash, securities, or other property) in a conversion. Investors should also review the terms of any "deemed liquidation" provisions to ensure that they will obtain the rights they seek to receive if the corporation consummates a conversion transaction that changes the nature of their investment. Although investors should consider negotiating for such rights, they will not be entirely unprotected. As described below, Section 262 of the DGCL has been amended to give stockholders appraisal rights in connection with conversions. From a practical standpoint, the availability of appraisal rights will have the effect of deterring many private corporations from converting to another entity, as the prospect of a liquidity event will make it economically infeasible to complete the conversion.

Domestication

The 2022 amendments make several significant changes to Section 388 of the DGCL, which allows for the domestication of a non-U.S. entity to a Delaware corporation. Under amended Section 388, the non-U.S. entity may adopt a plan of domestication setting forth the terms and conditions of the domestication, including the manner of exchanging or converting the equity interests of the non-U.S. entity to be domesticated and any other details or provisions deemed desirable. The plan may also set forth corporate action to be taken by the domesticated corporation in connection with the domestication. Those specified corporate acts must be approved in accordance with the requirements of applicable non-U.S. law before the effectiveness of the domestication. Once so approved, any such corporate action that is within the power of a Delaware corporation under the

DGCL that is set forth in the plan of domestication will be deemed to have been authorized, adopted, and approved, as applicable, by the domesticated corporation and its board of directors, stockholders, or members, as applicable, and will not require any further action of the board of directors, stockholders, or members of the domesticated corporation. If any such corporate action requires the filing of a certificate with the Delaware Secretary of State (e.g., a certificate of amendment or a certificate of merger), the certificate shall state that no action by the board of directors, stockholders, or members of the corporation otherwise required by any other section of the DGCL is required in accordance with Section 388 of the DGCL. The amendments provide that the terms of a plan of domestication may be made dependent upon facts ascertainable outside of such plan if the manner in which such facts operate upon the terms of the plan is clearly and expressly set forth in such plan. The amendments further provide that a certificate of domestication shall certify that, prior to the time the certificate of domestication becomes effective, the domestication will be approved in accordance with the document, instrument, agreement, or other writing, as the case may be, governing the internal affairs of the non-U.S. entity and the conduct of its business or by applicable non-U.S. law. If a plan of domestication is adopted, the certificate of domestication must certify that all provisions of the plan shall be approved prior to the effectiveness of such certificate in accordance with all applicable non-U.S. law (including any approval required under non-U.S. law for the authorization of the type of corporate action specified in the plan of domestication). The amendments to Section 388 provide transaction planners substantial flexibility in structuring transactions in which an entity domesticates to Delaware. For example, if a special purpose acquisition corporation (or SPAC) domesticates to Delaware in connection with a proposed business combination transaction, it could include as part of its plan of domestication further amendments to its certificate of incorporation—and it could rely on the approval of the plan of domestication to effect those changes, without the need for additional board and stockholder approval of the newly domesticated Delaware corporation.

Appraisal Rights

Section 262 was amended in several respects. First, the amendments provide that beneficial owners may, in their own name, make a demand for appraisal, subject to specified procedures and requirements. Under the prior Section 262, only stockholders of record could make a demand for appraisal. As a result, stockholders of public companies, many of whom hold their shares in "street name," were required to cause the actual registered owner of the shares (usually Cede & Co.) to submit the demand on their behalf. In recognition of the fact that, where shares are held in street name, the record owner is not the real party in interest, Section 262 was amended in 2007 to allow beneficial owners to initiate an appraisal proceeding and to exercise other rights under the statute, such as requesting the statement regarding the number of shares not voted in favor of the transaction and for which appraisal demands have been received and the number of holders thereof. But the statute continued to require the initial demand to be made by the holder of record. The 2022 amendments allow beneficial owners, in their own name, to make the demand for appraisal. A beneficial owner must comply with the requirements of Section 262(d)(3) to demand appraisal, including its requirement that the beneficial owner who demanded appraisal directly continuously maintains beneficial ownership of the shares. Conforming changes to the other subsections of Section 262 clarify the manner in which a beneficial owner may participate in the appraisal process and an appraisal proceeding. Among other things, these conforming changes confirm that beneficial owners and record holders who have duly demanded appraisal may request a statement setting forth the aggregate number of shares not voted in favor of a merger, consolidation, or conversion, as applicable, and with respect to which appraisal demands have been received, and the aggregate number of stockholders or beneficial owners holding or owning such shares (with the record holder of shares owned by a beneficial owner who has duly made an appraisal demand not being considered a separate stockholder holding such shares for purposes of calculating the aggregate number of holders).

In connection with the amendments to Section 266 reducing the vote required to approve a conversion,

Section 262 was amended to provide appraisal rights to stockholders in connection with a conversion of the corporation, unless appraisal rights are denied pursuant to the “market out” exception set forth in amended Section 262(b). In general, current Section 262(b)(2) provides that, where shares of stock are listed on a national securities exchange or held of record by more than 2,000 stockholders on the record date for determining stockholders entitled to notice of the meeting of stockholders to vote upon the merger or consolidation, those holders will not be entitled to appraisal rights in such merger or consolidation unless their shares are converted into anything other than shares of the surviving corporation, shares of stock of another corporation (or depository receipts in respect thereof) that are listed on a national securities exchange or held of record by more than 2,000 stockholders, cash in lieu of fractional shares, or any combination of the foregoing. The reference in Section 262(b) that conditioned the first prong of the market out exception on the stockholders' holding listed shares (or shares held of record by more than 2,000 stockholders) as of the record date for determining stockholders entitled to notice of the meeting to vote upon the merger or consolidation gave rise to the question as to whether the language of the market out should be clarified to confirm that the exception, if otherwise applicable, should apply regardless of whether the relevant transaction is approved at a meeting or by consent in lieu of a meeting. Accordingly, in addition to ensuring the market out exception that would otherwise apply will govern conversions, mergers, and consolidations, the 2022 amendments revise Section 262(b) to confirm that the market out exception, if available, applies regardless of whether the merger, consolidation, or conversion was approved at a meeting of stockholders or by consent of stockholders in lieu of a meeting. In addition to making changes to the market out exception, Section 262(b) was amended to eliminate appraisal rights in connection with a merger, consolidation, or conversion of an entity that has domesticated as a Delaware corporation pursuant to Section 388, if the merger, consolidation, or conversion is authorized in accordance with Section 388, as amended pursuant to the 2022 amendments.

Section 262 formerly required that a copy of Section 262 (and if the corporation is a nonstock corporation, Section 114) be included in the notice of appraisal rights. In general, the statute is reproduced in full as an annex to the notice. The amendments to Section 262(d) provide that, in lieu of reproducing the applicable sections of the DGCL in full, a corporation may instead include in the notice information directing the persons entitled to appraisal to a publicly available electronic resource to access Section 262 (and Section 114, if applicable) without subscription or cost. An electronic resource would include the website maintained on behalf of the State of Delaware on which those statutes are posted.

Sections 262(j) and (k) were amended to clarify the manner in which the expenses of a stockholder or beneficial owner who participated in an appraisal proceeding may be charged pro rata against the value of all the shares entitled to an appraisal award. Unless the Court of Chancery orders otherwise, expenses awarded under Section 262(j) are not charged against a person who properly withdraws such person's demand for appraisal or is dismissed from the proceedings under Section 262(k) without a reservation of jurisdiction. The amendment to Section 262(k) further clarifies that a stockholder or beneficial owner may withdraw a demand for appraisal with respect to less than all of the shares for which such person initially demanded appraisal.

Stocklist

Section 219 used to require corporations to prepare a list of stockholders entitled to vote at a meeting of stockholders and to make the list available for ten days before the meeting and during the time and place of the meeting, including, in the case of a virtual meeting, on a reasonably accessible electronic network. Although the requirement to make the list available during the meeting has been included in the DGCL since its enactment in 1899, it has little practical benefit in the modern era. The list is of no use to an insurgent stockholder mounting a proxy contest; rather, an insurgent will typically need to obtain a stocklist pursuant to Section 220 of the DGCL well in advance of the meeting. The lack of a practical use for making the list available at the meeting was balanced against legitimate concerns regarding the potential for misuse of the list, particularly where the corporation is holding a virtual meeting and is required to post the list on an electronic network.

Notice of Meetings

Section 222, which deals with the requirement to give notice of meetings of stockholders, was amended in several respects. First, Section 222(a) was revised to make clear that notice of a meeting of stockholders shall be given in accordance with Section 232, which was amended in 2019 to specify the manner in which notice may be given, clarifying that notice could be given by mail, courier, or electronic mail or, with the consent of a stockholder, pursuant to other specified means of electronic transmission. Second, Section 222(b) was amended to address issues that are unique to the functioning of virtual stockholders' meetings. The amendments make clear that, unless the bylaws otherwise require, when a meeting is adjourned, including due to a technical failure to convene or continue the meeting by remote communication, notice need not be given if the time, date, and place of the meeting (and, to the extent applicable, the means of remote communication for the meeting) are announced at the meeting, displayed during the time scheduled for the meeting on the electronic network used for the virtual meeting, or set forth in the notice of the meeting. Thus, to address the possibility that technical failures may prevent the meeting from being convened, corporations may include in their meeting notices a statement that provides an advance adjournment notice. To address the possibility that a meeting site will crash while a virtual meeting is underway, corporations may post on the meeting site the adjournment procedures in the event of a crash.

Stockholder Consents

In 2014, Section 141(f), which allows unanimous consent of directors in lieu of a meeting, and Section 228, which deals with consent of stockholders in lieu of a meeting, were amended to provide that directors or stockholders could execute a consent and that such consent could be placed in escrow (or similar arrangement), to become effective at a future date within 60 days. At the time, Section 141(f) made clear that any consent delivered by a person who was not then a director could give a consent that would become effective at such a future date, so long as the person was a director at the time the consent became effective. That provision was deemed necessary in light of case law holding that only directors could give consents. A similar provision was not included in Section 228 on the theory that Section 213(b) of the DGCL already provides for the fixing of a record date for determining stockholders entitled to give consent. Nevertheless, to avoid any uncertainty on the issue, Section 228(c) was amended to confirm that a person may give a consent of stockholders, to be effective at a future date or in accordance with instructions, before such person is a stockholder, so long as the person is a stockholder at the time the consent becomes effective. These provisions of amended Section 228(c) also apply to consents given by members of nonstock corporations.

Dissolution

By default, a Delaware corporation has perpetual existence. Under Section 102(b)(5), however, a corporation may include in its certificate of incorporation a provision limiting its existence to a specified date. Currently, where a corporation has so limited the duration of its existence, there is no express requirement for the corporation to file any additional instrument with the Delaware Secretary of State confirming that it has ceased to exist. The lack of a requirement to file such an instrument has created challenges for the Secretary of State in determining the status of corporations whose terms have expired. The 2022 amendments require any corporation that has adopted a provision limiting its existence to a specified date to file a certificate of dissolution. Consistent with Section 103(d), which allows for a certificate to be filed with a future effective date within 90 days of the filing date, the certificate of dissolution must be filed within 90 days of the date on which the corporation's duration is fixed to end. The certificate, when filed in advance, would specify the date on which it would become effective (i.e., the date on which the corporation's duration terminates). The amendments also recognize that not all corporations with a limited duration will file a certificate of dissolution as required. The amendments provide that the failure to timely file a certificate of dissolution shall neither affect the expiration of any corporation's existence on the date specified in its certificate of incorporation nor eliminate the requirement that the corporation file a certificate of dissolution. To address the possibility that a corporation will so fail to file a certificate of dissolution, the statute, as amended, provides that any certificate of good standing issued after the date on which the corporation's existence terminates shall be of no force or effect.

Miscellaneous

The DGCL requires various instruments—including certificates of incorporation and amendments thereto as well as instruments to effect various acts, such as mergers, conversions, and dissolutions—to be filed with the Delaware Secretary of State. In general, any such instrument is effective at the time it is filed with and accepted by the Secretary of State, unless it provides that it will become effective at a specified date within 90 days after the filing date. Under Section 103(b)(2) of the DGCL, a person's filing of an instrument with the Secretary of State constitutes an oath or affirmation, under penalty of perjury, that the facts stated therein are true. The 2022 amendments amended Section 103(b)(2) to clarify that a person's execution of an instrument constitutes an oath or affirmation, under penalty of perjury, that the facts stated therein are true at the time such instrument becomes effective.

Section 502(a)(3) of Title 8 of the Delaware Code was amended to clarify that the principal place of business address included in the annual franchise tax report that a corporation is required to file may not be the address of the corporation's registered office unless the corporation maintains its principal place of business in Delaware and serves as its own registered agent.

Section 503 of Title 8 of the Delaware Code was amended to make changes regarding the large corporate filer status and the effectiveness of any redesignation thereof. In general, corporations that are classified as large corporate filers, and therefore subject to the increased franchise tax rates, will need to notify the Secretary of State if they cease to meet the criteria for being treated as large corporate filers. If the notice is not given, they will continue to be taxed at the rate applicable to large corporate filers. Accordingly, the provision of such notice to the Secretary of State should be added to the closing checklists for going-private mergers involving public corporations.

The 2022 amendments to the DGCL make several important changes, continuing Delaware's commitment to updating its corporate law annually to address issues affecting corporations and practitioners. ■

2022 Amendments to the Delaware LLC and Partnership Acts

Delaware has recently adopted legislation amending the Delaware Limited Liability Company Act (LLC Act), the Delaware Revised Uniform Limited Partnership Act (LP Act), and the Delaware Revised Uniform Partnership Act (GP Act) (collectively, the LLC and Partnership Acts). 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).

The 2022 amendments include: (i) confirming the permitted methods to execute certificates of limited liability company interests and partnership interests; (ii) clarifying the timing of a signatory's oath or affirmation of facts stated in instruments filed with the Delaware Secretary of State; (iii) providing clarification on the timing of when requisite approvals are required to be obtained with respect to conversions and domestications; (iv) confirming that protected and registered series of a Delaware LLC or LP are bound by the limited liability company agreement or partnership agreement of such Delaware LLC or LP whether or not such series executes such agreement; (v) confirming that the limited liability company agreement or partnership agreement of a Delaware LLC, LP, or GP may include or incorporate multiple documents that govern its business and affairs; (vi) clarifying the effects on protected and registered series in connection with the revival of a cancelled Delaware LLC or LP; and (vii) updating certain procedures relating to service of process upon the manager or liquidating trustee of a Delaware LLC. The amendments became effective on August 1, 2022.

Execution of Certificates of LLC and Partnership Interests

The LLC and Partnership Acts were amended in 2019 to include the addition of provisions relating to the execution of documents by electronic signature and the delivery of documents by electronic transmission (collectively, the Electronic Signature and Delivery Provisions). The Electronic Signature and Delivery Provisions explicitly state that any act or transaction contemplated or governed by the LLC and Partnership Acts or a limited liability company agreement or partnership agreement may be provided for in a document, and an electronic transmission will be deemed the equivalent of a written document. Whenever the LLC and Partnership Acts or a limited liability company agreement or partnership agreement require or permit a signature, an electronic signature is a permissible mode of executing a document.

The Electronic Signature and Delivery Provisions currently set forth certain documents and actions that are not governed thereby, including a certificate of limited liability company interest or partnership interest. While the Electronic Signature and Delivery Provisions expressly state that the foregoing shall not create any presumption regarding the lawful means to document a matter, or sign or deliver a document, addressed by these excluded items, some uncertainty has arisen relating to the permitted methods of executing certificates representing limited liability company interests and partnership interests.

The amendments update the Electronic Signature and Delivery Provisions of the LLC and Partnership Acts to confirm that a signature on a certificate of limited liability company interest or partnership interest may be a manual, facsimile, or electronic signature. This update facilitates modern transactions by providing greater flexibility with respect to the manner of executing certificates representing ownership interests of Delaware LLCs, LPs, and GPs.

Timing of Signatory's Oath or Affirmation of Facts Contained in Filed Instruments

The LLC and Partnership Acts require various instruments to be filed with the Delaware Secretary of State with respect to Delaware LLCs, LPs, and GPs. In general, any such instrument is effective at the time it is filed with the Delaware Secretary of State, unless it provides that it will become effective at a future specified date or time within 180 days after the filing date. At the same time, under the LLC and Partnership Acts, the execution by a person of an instrument filed with the Delaware Secretary of State constitutes an oath or affirmation, under the penalties of perjury, that, to the best of such person's knowledge and belief, the facts stated therein are true. The amendments to the LLC and Partnership Acts clarify that a person's execution of an instrument constitutes an oath or affirmation that the facts stated therein shall be true at the time such instrument becomes effective and not at the time it is executed.

Timing of Requisite Approvals of Conversions and Domestications

The LLC and Partnership Acts permit other entities (including foreign entities) to convert to and non-United States entities to domesticate in the State of Delaware as Delaware LLCs, LPs, or GPs. Prior to the enaction of the amendments, the LLC and Partnership Acts provided that, prior to the filing of a certificate of conversion or certificate of domestication with the Delaware Secretary of State to effect a conversion or domestication, (i) the conversion or domestication shall be approved in the manner provided for by the document, instrument, agreement, or other writing, as the case may be, governing the internal affairs of the converting or domesticating entity and the conduct of its business or by applicable law as appropriate; and (ii) a limited liability company agreement or partnership agreement shall be approved by the same authorization required to approve the conversion or domestication (jointly, the Requisite Conversion and Domestication Approvals). As stated above, in general, any instrument filed with the Delaware Secretary of State is effective at the time it is filed, unless it provides that it will become effective at a future specified date or time within 180 days after the filing date. The amendments amended the LLC and Partnership Acts to contemplate the possible use by transaction parties of a future specified effective date or time in a certificate of conversion or certificate of domestication and provide that the Requisite Conversion and Domestication Approvals are required to occur prior to the time a certificate of conversion or certificate of domestication becomes effective instead of prior to the time of its filing with the Delaware Secretary of State. The amendments provide greater flexibility to transaction parties in structuring conversions and domestications, including with respect to the particular timing of obtaining the Requisite Conversion and Domestication Approvals.

LLC/Partnership Agreements

The LLC and Partnership Acts provide that a Delaware LLC, LP, and GP are not required to execute their respective limited liability company agreement or partnership agreement and that they are bound by the limited liability company agreement or partnership agreement whether or not they execute such agreement.

The LLC Act and the LP Act were each amended in recent years to permit a new type of series known as a "registered series," which is formed by the filing of a certificate of registered series with the Delaware Secretary of State. A registered series qualifies as a registered organization under the Uniform Commercial Code and facilitates the use of a series Delaware LLC or LP in secured financing transactions. Series created under Sections 18-215(b) of the LLC Act and 17-218(b) of the LP Act, both before and after the enactment of these recent amendments, are now known as "protected series," which are not formed by the filing of a certificate with the Delaware Secretary of State. Under the LLC Act and the LP Act, an existing protected series is able to convert to a registered series, and a registered series in turn is able to convert to a protected series. The amendments to the LLC Act and the LP Act confirm that any registered or protected series of a Delaware LLC or LP is not required to execute the limited liability company agreement or partnership agreement of such Delaware LLC or LP and is bound by the limited liability company agreement or partnership agreement of such Delaware LLC or LP whether or not the registered or protected series executes such agreement. The synopsis to the amendments states that such amendments are not intended to imply that other references to "limited liability company" or "limited partnership" in the LLC Act or the LP Act do not include protected series or registered series of a Delaware LLC or LP (to the extent required by the context).

The amendments also amend the definition of "limited liability company agreement" in the LLC Act and the definition of "partnership agreement" in each of the Partnership Acts to confirm that such agreement may consist of one or more agreements, instruments, or other writings and may include or incorporate one or more schedules, supplements, or other writings containing provisions as to the conduct of the business and affairs of the Delaware LLC, LP, and GP (and, with respect to a Delaware LLC or LP, any series thereof).

Effect of Revival on Protected and Registered Series

If certain conditions are met, Section 18-1109 of the LLC Act and Section 17-1111 of the LP Act provide for the ability to revive a Delaware LLC or LP whose certificate of formation or certificate of limited partnership has been cancelled because such Delaware LLC or LP failed to (i) obtain and designate a new registered agent prior to the expiration of 30 days after the filing by a registered agent of a certificate of resignation, (ii) obtain and designate a new registered agent within 30 days after the Delaware Secretary of State has given notice that its registered agent has been enjoined from acting as a registered agent, or (iii) pay the annual tax due to the State of Delaware for a period of three years from the date it was due. Once a certificate of revival is filed in accordance with the LLC Act or the LP Act, a Delaware LLC or LP and all registered series thereof that have been formed and whose certificate of registered series has not been cancelled is revived with the same force and effect as if its certificate of formation or certificate of limited partnership had not been cancelled. The amendments clarify that a revival of a Delaware LLC or LP will also (i) revive each protected series thereof that has not been terminated and wound up, and (ii) validate all contracts, acts, matters, and things made, done, and performed by any protected or registered series thereof or by the members, managers, partners, employees, and agents of such series during the time when the certificate of formation or certificate of limited partnership was cancelled with the same force and effect and to all intents and purposes as if such certificate remained in full force and effect. In addition, the amendments provide that as a result of a revival of a Delaware LLC or LP, all real and personal property, and all rights and interests, which belonged to any protected or registered series thereof at the time the certificate of formation or certificate of limited partnership was cancelled, or which were acquired by any protected or registered series thereof following the cancellation of such certificate, and which were not disposed of prior to the time of revival, will be vested in the applicable protected or registered series after the revival as fully as they were held by such series at, and after, as the case may be, the time such certificate was cancelled.

Service of Process on Managers and Liquidating Trustees of Delaware LLCs

Service of process upon the manager or liquidating trustee of a Delaware LLC under the LLC Act is generally effectuated by serving the Delaware LLC's registered agent in the State of Delaware with a copy of such process. If the Delaware LLC does not have a Delaware registered agent, the LLC Act allows service of process to be made upon the Delaware Secretary of State. Prior to the enaction of the amendments, following this service of process being made, the Prothonotary or the Register in Chancery of the court in which the civil action or proceeding is pending must, within seven days of such service, deposit in the United States mail, by registered mail, postage prepaid, true and attested copies of the process, together with a statement that service is being made pursuant to Section 18-109(b) of the LLC Act, addressed to the manager or liquidating trustee at the registered office of the Delaware LLC, and at the manager's or liquidating trustee's address last known to the party desiring to make such service. The amendments to the LLC Act require that such copies of the process and statement be addressed to the principal place of business of the Delaware LLC (if such address is known) rather than to the registered office of the Delaware LLC. The amendments to the LLC Act do not change the existing requirement that such required copies and statement also be sent to the manager's or liquidating trustee's address last known to the party desiring to make such service.

The amendments reflect Delaware's continuing commitment to maintaining statutes governing Delaware LLCs, LPs, and 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. 275, 274, and 276, respectively. ■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