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# 2021 Delaware Corporate Law Year in Review - Part 1 of 3

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The Delaware Supreme Court, Court of Chancery, and Complex Commercial Litigation Division of the Superior Court continued to serve as the preeminent courts for corporate and M&A litigation in 2021. The courts issued a historic volume of opinions, orders, and transcript decisions that provide valuable guidance regarding issues highlighted in this GT Update, including potential liability of board advisors, officers, and buyers in M&A; limits on stockholder voting, communications, and takeover activities; interpretation of M&A provisions related to material adverse effects, ordinary course operation, and fraud claims; the scope of protections for directors acting in reliance on experts; and access to director emails, texts, and records via statutory demands and litigation discovery. We expect this level of activity and development of corporate law principles to continue in 2022.

## Oversight Obligations

Directors have an obligation to oversee corporate operations by making good faith efforts to establish monitoring and reporting systems and to react to red flags of corporate misconduct. This oversight obligation continued to draw attention in 2021, particularly where a corporation had mission-critical operations in heavily regulated industries. In one case, a claim alleging failure by the board of an airplane manufacturer to adequately oversee airplane safety following two crashes within a few months survived dismissal.[1] The board may have failed to establish controls related to flight safety, given the lack of a board committee for safety issues, the absence of board discussion related to safety issues in meeting minutes, and the lack of protocols for management reporting to the board. The board also may have disregarded a red flag related to airplane safety—i.e., the first deadly crash—where it did not inquire or investigate but belatedly treated the crash as an anomalous public relations and litigation problem. Other boards may have failed in their fiduciary duties, one when it flatly rejected a stockholder demand to rectify serious noncompliance with applicable law in a public company's capital structure,[2] and another where it may have failed to comply with its charter provisions for approval of conflicted transactions.[3] In contrast, claims challenging the exercise of oversight obligations by three other boards were dismissed at early stages of litigation.[4] Key aspects of those cases, which reflected adequate board oversight, included the creation of board committees to monitor key regulatory issues, meeting minutes documenting board discussion of litigation and

enforcement actions, punishments meted out by the company for regulatory noncompliance, a ban on a potentially problematic line of business, and implementation of fraud-prevention software.

## D&O Compensation, Indemnification, and Insurance

Director compensation has been a significant topic of Delaware litigation in recent years, continuing in 2021 with a focus on the related approval process. In one case, stockholder approval of an equity incentive plan was challenged on the grounds that the company's proxy statement failed to state that directors would receive awards under that plan for their previous efforts in connection with the company's IPO.[5] Disclosures that the plan would be used for recognition of significant contributions, however, sufficiently informed stockholders even though the specific awards were not stated in the proxy statement. In other cases, compensation packages were subjected to extensive litigation, including a special litigation committee review culminating in a settlement where directors agreed to forfeit some or all of their stock options.[6]

The Delaware Supreme Court also affirmed lower court decisions that D&O insurance coverage of losses arising from fraudulent conduct does not violate Delaware public policy.[7] The Delaware General Assembly is also considering an amendment to Section 145 of the Delaware General Corporation Law (the DGCL), which would permit corporations to use captive insurers that may provide coverage beyond the scope of indemnifiable conduct.[8]

## Officers, Advisors, and Buyers in Fiduciary Litigation

*Protections for good faith reliance.* Officers and advisors can play an important role in the board's exercise of its oversight and other responsibilities, and the DGCL provides the board with protection when relying on them in good faith.[9] For example, the board of an insurance company was protected against oversight claims relating to inaccurate company disclosures regarding capital reserves and GAAP compliance, because the board had relied on its outside auditor.[10] The board was protected because of its reliance on advice regarding complex issues and documentation in meeting minutes reflecting that reliance. The court in another case at the pleading stage confirmed that, in the context of stock repurchases and dividend payments, where directors have heightened exposure to personal liability under the DGCL, directors were fully protected when it was later determined that the company lacked requisite surplus, because the directors had relied on management and advisors for determining the existence of surplus.[11]

*Limits on reliance and delegation.* Directors are, however, limited in their ability to delegate to advisors and officers and, after delegating authority, are expected to remain active in managing officers' potential conflicts. Such protection is unavailable when the expert is known or pressured not to act in good faith when giving a contrived opinion, by taking unrealistic and counterfactual assumptions, knowingly relying on artificial predicates, and engaging in goal-directed reasoning.[12] In another case, fiduciary duty claims survived against a special committee that delegated significant responsibility for running a strategic review process to the CEO, who was known to have conflicts arising from his relationship with the company's controlling stockholder.[13] That committee also failed to reassert control over the process after learning of the CEO's violation of the committee's process guidelines, engaged a financial advisor known to have a relationship with the CEO, and delegated the preparation of the company's proxy statement to the CEO, which exacerbated the potential conflicts and may have abdicated disclosure obligations. Another company's failure to disclose current relationships between the board's financial advisor and a merger counterparty, including the proportion of the advisor's income received from the counterparty, undermined stockholder approval of the transaction for lack of full information.[14]

*Claims against officers, advisors, and buyers*. Delaware fiduciary litigation in 2021 also targeted officers who allegedly breached their fiduciary duties or misled the board, and advisors and buyers who allegedly aided and abetted fiduciary breaches by affirmatively misleading corporate fiduciaries or knowingly participating in their fiduciary breaches. Unlike directors, officers cannot be exculpated from a breach of the duty of care by charter provision, which makes it easier for such claims to survive a motion to dismiss. For example, in one case, fiduciary duty claims against the CEO and CFO survived, based on a fraud on the board theory that those officers had sought to retire and receive significant transaction payouts; disfavored bidders who proposed a stock deal; favored cash bidders by not informing other bidders of the board's bid deadline, provided only the cash bidders with information to shape their bids, and allowed breaches of standstill agreements; and failed to fully report this information to the board.[15] A fiduciary duty claim against another company's CEO and fraud on the board claim against the board's financial advisor were allowed to proceed where the officer and advisor appeared to have misled the board about a bidder that was not favored by management and to have tipped the management-favored bidder with information about the disfavored bidder's offer.[16] And allegations against a third CEO-director pertained to his officer capacity, in which he lacked exculpation and was exposed to liability under a gross negligence standard, were permitted to proceed on the basis that his conduct may have been taken as an officer at the board's instruction or involved discussion of management's plans.[17]

The Delaware decisions in 2021 also counsel that claims in merger cases may survive against the buyer, as a result of its knowing participation in potential fiduciary misconduct such as preparation of inadequate proxy materials or due to its knowledge that conflicted officers were inappropriately favoring that buyer and the buyer seized on that knowledge including by violating a standstill and lowering its bid at the last minute.[18]

## Procedures for Management of Potential Conflicts

In 2021, the Delaware courts emphasized the board's role in identifying and managing potential conflicts, including through procedures intended to mitigate the impact of conflicts on a transaction. Board decisions made by independent and disinterested directors or resulting from a conflict-cleansing process can receive greater judicial deference. Thus, fiduciary duty claims subject to heightened scrutiny, such as change of control or controlling stockholder transactions, can potentially be dismissed or subjected to a reduced standard of judicial review.

*Existence of control and potential conflicts*. A threshold matter for management of potential conflicts is identification of a material interest or relationship that could create a conflict, including whether one or more stockholders are exercising corporate control that imposes fiduciary duties. In one case, a control group may have existed where three longtime friends founded a company, held themselves out as founders and partners who jointly managed other portfolio companies, indirectly controlled 90% of the company's voting power, and collectively negotiated a tax-free reorganization to meet their desire for liquidity.[19] In another case, the court found no controller where a stockholder owned 35.3% of the company's stock and had no ability to direct board or management action.[20]

When there is a controlling stockholder, there is a question whether the stockholder is free to exercise its rights without considering other stockholders or must consider other stockholders' interests. For example, on the one hand, a controlling stockholder did not influence the corporate machinery by informing an independent committee that he would not support a transaction that would require his consent and eliminate his control, when another transaction was available that involved acquisition of that company and another company he controlled.[21] On the other hand, directors on a controlled company board lacked independence from the controller, for purposes of considering a

demand to bring litigation claims against the controller, because of compensation for board service that constituted just over half of a director's household income and another director's reverence for the controller.[22]

*Director abstention*. Although a potentially conflicted director may abstain from deliberations, Delaware courts may examine closely the effectiveness of an abstention solely from a final vote. For example, directors' abstentions from board meetings related to a merger were ineffective to alleviate the impact of potentially conflicted directors who may have been actively involved in earlier negotiations.[23] Abstention also may not provide the desired protection at the pleading stages of litigation because it can be difficult to determine on a preliminary record that directors completely recused themselves. In a case illustrating the challenges of a dual fiduciary, a controlling stockholder sat on the boards of two companies that he controlled, and his recusal from board votes regarding a transaction between the two companies was ineffective to summarily defeat a fiduciary duty claim.[24] That controller was alleged to have known about one company's investigation into potential accounting misconduct and, when the other company's board considered purchasing a subsidiary not implicated in the investigation, the controller did not disclose any knowledge of the investigation to the rest of the purchaser's board.

*Board committees*. An empowered and effective committee of disinterested and independent directors can also help to manage potential conflicts. But in two cases, fiduciary duty claims survived against directors on special committees constituted to negotiate potential mergers at allegedly controlled companies. In one, the committee chairperson lacked independence based on her close friendship with the other company's CEO and ambition to run her own Silicon Valley business with substantial financing from that company (which was run by an important Silicon Valley entrepreneur).[25] In the other, the committee may not have effectively neutralized the controller's influence, in light of its delegation to a conflicted CEO after his violation of the committee's process guidelines and engagement of a financial advisor with a close relationship to the controller.[26] In another case, however, a special litigation committee demonstrated its independence and the reasonableness of its investigation into insider trading claims, where the committee directors had no financial interests and few relationships with company insiders, and the committee engaged outside counsel and issued a 377-page report stating that the alleged insider information was not material and didn't motivate insiders' trades.[27] The court agreed, after applying its own business judgment, with the committee's determination to dismiss the fiduciary duty claims.

*Approvals by disinterested stockholders and independent directors*. Since the Delaware Supreme Court's *MFW* and *Corwin* decisions,[28] procedures have been further developed for cleansing claims and obtaining early dismissal of fiduciary claims that would have been subject to entire fairness review or enhanced scrutiny. The Delaware courts have observed that a rhythm has emerged in such litigation: plaintiffs argue first that a significant minority stockholder is a conflicted controller subject to entire fairness review (e.g., that it has formidable power or potent influence over management and independent directors' decision-making) unless the transaction complied with the *MFW* procedures, and second that any approval by disinterested stockholders was not fully informed and uncoerced under *Corwin*.[29]

In two cases, the significant stockholders were not found to be controllers, and fiduciary claims were cleansed under *Corwin* (without regard to *MFW*) where a 35% stockholder had three board designees and a right to accumulate another 10%,[30] and where a longtime private equity sponsor's position had been reduced over several years from just over 50% to 19% before the cash sale of the company.[31] In those cases, the plaintiffs unsuccessfully challenged the adequacy of stockholder disclosures regarding the background of the transaction, the significant stockholder's unique

interests, and interests and relationships of directors and advisors. However, *Corwin* cleansing was denied where approval by a stockholder, whose shares were necessary to reach a majority of the disinterested shares, was not counted as part of the fully informed, disinterested, or voluntary approval of a merger, because of an earlier stock purchase agreement that obligated the stockholder to approve such a merger and provided for unique benefits and penalties.[32] *Corwin* cleansing was also denied with respect to claims regarding a merger, where the proxy statement omitted disclosure that the board's financial advisor was simultaneously representing an affiliate of a significant stockholder of the company and the company's merger counterparty on a transaction of approximately twice the value of the merger.[33] Although the length of the relationship and amount of that financial advisor's prior fees from the significant stockholder were disclosed, the omission regarding the simultaneous engagement was considered extraordinary. In a third decision, where a controlling stockholder received the same consideration as other stockholders in a merger, *Corwin* cleansing was denied for failure to disclose a financial advisor's information tip to a favored bidder.[34] Although payment of the same consideration provided a safe harbor from entire fairness review, enhanced scrutiny remained the standard of review applicable to whether stockholder value had been maximized in the end-stage transaction.

In a case challenging a controlling-stockholder transaction, the standard of review was returned from entire fairness to business judgment under *MFW* where the independent director committee was effective and the unaffiliated stockholders were fully informed.[35] In other cases, however, entire fairness remained the standard of review where: (1) the *MFW* procedures were not put in place until after outside advisors were hired, executives met and discussed post-merger operations, and preliminary diligence was substantially completed;[36] (2) the *MFW* conditions were imposed by an agreement that was set to expire, the stockholder vote only reached a majority by including the shares held by the company's joint venture partner, the controller threatened to cut off the company's financing, information was shared without committee approval, and the company's valuations may have been deficient;[37] and (3) the unaffiliated stockholders were not informed that the individual who controlled the company and its acquirer was permitted to represent the company in an arbitration over a key asset of the company.[38]

Other cases involving disputes over corporate control provide guidance regarding improper manipulation of directors. While affirming the Court of Chancery, the Delaware Supreme Court stated that board actions were invalid when a preferred director, whose presence was required for a quorum, was tricked into attending the meeting by other directors who intended to take different actions than suggested in the notice and to consolidate control over the company.[39] Another controlling stockholder may have acted inequitably—for the purpose of obtaining board approval of an allegedly unfair merger—by securing generous post-merger compensation for the CEO as a quid pro quo for the CEO's support, while other directors may have acted disloyally by facilitating those efforts.[40]

*Important litigation tests*. Within a few days, the Delaware Supreme Court issued two opinions addressing key tests used in corporate litigation. The court consolidated and clarified the demand futility standard for determining whether a stockholder is permitted to bring litigation on behalf of the company without first demanding that the board bring the litigation, explaining that the relevant question is whether a majority of the directors considering whether to bring a claim are disinterested—that is, they neither received a material benefit nor faced substantial likelihood of liability from the alleged misconduct—and independent of any such interested parties.[41] The court also overruled its previous decision that dilution or overpayment claims against a controlling stockholder are both derivative and direct in nature.[42] The court noted that there is no reason to allow such claims to be brought directly against controllers when they are considered classically derivative

when not brought against a controller.

**FOOTNOTES**

[1] *In re The Boeing Co. Deriv. Litig.*, C.A. No. 2019-0907-MTZ (Del. Ch. Sept. 7, 2021).

[2] *Drachman v. Cukier*, C.A. No. 2019-0728-LWW (Del. Ch. Oct. 29, 2021) [BioDelivery Sciences].

[3] *Lacey v. Mota-Velasco*, C.A. No. 2019-0312-SG (Del. Ch. Feb. 11, 2021) [Southern Copper].

[4] *Pettry v. Smith*, C.A. No. 2019-0795-JRS (Del. Ch. June 28, 2021) [FedEx]; *Fisher v. Sanborn*, C.A. No. 2019-0631-AGB (Del. Ch. March 30, 2020) [LendingClub]; *Richardson v. Clark*, C.A. No. 2019-1015-SG (Del. Ch. Dec. 31, 2020) [MoneyGram].

[5] *Pascal v. Czerwinski*, C.A. No. 2020-0320-SG (Del. Ch. Dec. 16, 2020) [Columbia Financial] (reserving for subsequent decision whether the directors' actual awards were granted in breach of their fiduciary duties).

[6] *Alpha Venture Capital Partners LP v. Pourhassan*, C.A. No. 2020-0307-PAF (Del. Ch. Apr. 19, 2021) (TRANSCRIPT) [CytoDyn].

[7] *RSUI Indemnity Co. v. Murdock*, C.A. No. 154, 2020 (Del. Mar. 3, 2021) [Dole Food].

[8] Senate Bill No. 203 (Dec. 16, 2021).

[9] 8 Del. C. §§ 141(e), 172.

[10] *Genworth Financial, Inc. Consol. Deriv. Litig.*, C.A. No. 11901-VCS (Del. Ch. Sept. 29, 2021).

[11] *In re The Chemours Co. Deriv. Litig.*, C.A. No. 2020-0786-SG (Del. Ch. Nov. 1, 2021).

[12] *Bandera Master Fund LP v. Boardwalk Pipeline Partners, LP*, C.A. No. 2018-0372-JTL (Del. Ch. Nov. 12, 2021) [Boardwalk Pipeline].

[13] *In re Pattern Energy Grp. Inc. S'holders Litig.*, C.A. No. 2020-0357-MTZ (Del. Ch. May 6, 2021).

[14] *Tornetta v. Maffei*, C.A. No. 2019-0649-KSJM (Del. Ch. Feb. 23, 2021) (TRANSCRIPT) [Pandora].

[15] *In re Columbia Pipeline Grp, Inc. Merger Litig.*, C.A. No. 2018-0484-JTL (Del. Ch. Mar. 1, 2021).

[16] *Firefighters' Pension Sys. of the City of Kansas City, Missouri Tr. v. Presidio Inc.*, C.A. No. 2019-0839-JTL (Del. Ch. Jan 29, 2021) [Presidio].

[17] *In Re Oracle Corp. Deriv. Litig.*, C.A. No. 2017-0337-SG (Del. Ch. June 21, 2021).

[18] *Columbia Pipeline*.

[19] *In re Tilray, Inc. Reorganization Litig.*, C.A. No. 2020-0137-KSJM (Del. Ch. June 1, 2021).

[20] *In re GGP, Inc. S'holder Litig.*, C.A. No. 2018-0267-JRS (Del. Ch. May 25, 2021).

[21] *RCS Creditor Trust v. Schorsch*, C.A. No: 2017-0178-SG (Del. Ch. Mar. 18, 2021) [RCS Capital].

[22] *In re BGC Partners, Inc. Deriv. Litig.*, C. A. 2018-0722-LWW (Del. Ch. Sept. 20, 2021).

[23] *Pandora*.

[24] *RCS Capital*.

[25] *Oracle*.

[26] *Pattern Energy*.

[27] *Diep v. Sather*, C.A. No. 12760-CM (Del. Ch. July 30, 2021) [El Pollo Loco].

[28] *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) [M & F Worldwide] (standard of review is returned from entire fairness to business judgment when the transaction is irrevocably conditioned from the outset on approvals by an uncoerced and fully informed vote of unaffiliated stockholders and an independent director committee that satisfies its duty of care); *Corwin v. KKR Fin. Holdings LLC*, No. 629, 2014 (Del. Oct. 2, 2015) [KKR Financial] (claims subject to enhanced scrutiny are cleansed by approval of fully informed, uncoerced vote of disinterested stockholders).

[29] *GGP*.

[30] *GGP*.

[31] *Kihm v. Mott*, C.A. No. 2020-0938-MTZ (Del. Ch. Aug. 31, 2021) [Tesaro].

[32] *Pattern Energy*.

[33] *Pandora*.

[34] *Presidio*.

[35] *Franchi v. Firestone*, C.A. No. 2020-0503-KSJM (Del. Ch. May 10, 2021) [Firestone].

[36] *In re: Pivotal Software, Inc. S'holders' Litig.*, C.A. No. 2020-0440-KSJM (Del. Ch. June 29, 2021) (TRANSCRIPT).

[37] *The MH Haberkorn 2006 Trust v. Empire Resorts, Inc.*, C.A. No. 2020-0619 (Del. Ch. Jul. 23, 2021) (TRANSCRIPT) [Empire Resorts].

[38] *Ligos v. Isramco, Inc.*, C.A. No. 2020-0435-SG (Del. Ch. Aug. 31, 2021) [Isramco].

[39] *Bäcker v. Palisades Growth Capital II*, No. 156, 2020, (Del. Jan. 15, 2021) [QLess].

[40] *In re CBS Corp. S'holder Class & Deriv. Litig.*, C.A. No. 2020-0111-JRS (Del. Ch. Jan. 27, 2021).

[41] See, e.g., *United Food & Commercial Workers Union v. Zuckerberg*, No. 404, 2020 (Del. Sept.

23, 2021) [Facebook].

[42] *Brookfield Asset Management, Inc. v. Rosson*, No. 406, 2020 (Del. Sept. 20, 2021) [TerraForm Power].

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