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Mid 2023 Delaware Corporate and M&A Law Update

Article By:

Anthony W. Clark

Nathan P. Emeritz

Justin E. Mann

Bryan T. Reed

Glenn J. Thompson

Over the past few months, Delaware courts have continued to address important M&A and corporate issues. Significant corporate law developments have also arisen from state and federal courts in California. Below are some highlights and practical takeaways related to important developments in Delaware law.

CORPORATE

Advance Notice Bylaws and Board Action Affecting the Stockholder Franchise. Delaware courts are sensitive to the stockholder franchise but also appreciate the important role played by advance notice bylaws that often contain strict deadlines for submitting dissident slates for director elections. The Delaware Court of Chancery recently declined to require a corporation to waive its advance notice deadline to enable a board faction to nominate its own slate, finding that disregarding the deadline was not warranted based on certain board decisions, such as refusal to discipline the CEO, because that did not constitute a radical shift or material change that would substantially alter the direction of the company. In another case, the Delaware Supreme Court consolidated the Blasius compelling justification standard into Unocal enhanced scrutiny, explaining that when a board action interferes with the stockholder franchise, but does not have an inequitable purpose, the directors must show that their actions were reasonable in relation to their legitimate objective and did not coerce a particular vote (and thereby satisfy a closer fit between means and ends than in the traditional Unocal defensive measures context). The Court also affirmed that invalidity prescribed by Schnell for inequitable action would be appropriate where the board interfered with the stockholder franchise for selfish reasons or while lacking a good faith basis.[1]

Board Discretion Regarding Corporate Strategy, ESG Matters, and Decisions with Political Implications. The board has the authority and responsibility to manage all affairs of a Delaware

corporation, including decisions relating to ESG issues and having political implications. The Delaware Court of Chancery recently rejected a stockholder's demand for corporate books and records purportedly sought for the purpose of investigating potential wrongdoing by directors overseeing corporate response to Florida HB 1557, the "Parental Rights in Education" bill. The court found that the stockholder had not satisfied the relatively low bar for establishing a proper purpose required for such a demand.[2]

Contractual Exercise and Renegotiation by Corporate Fiduciaries. Corporate fiduciaries are permitted to exercise rights under contracts with the company but, if they act as directors or officers to cause the company to exercise discretion with respect to that contract, litigation claims challenging their conduct may be subject to judicial scrutiny. A recent fiduciary duty claim survived dismissal where a director and CFO may have triggered a company call right in a transaction potentially not contemplated by the contract, and then used their control over the company to cause it to renegotiate the contract, resulting in terms more favorable to the CFO.[3]

Officer Fiduciary Duties to Inform and to Obey the Board. Officers and directors owe the same fiduciary duties, but the contextual application of officers' duties has been less explored by case law. The Court of Chancery recently addressed three disclosure obligations of officers in a tender offer and squeeze-out merger where LLC members had no approval right and were cashed out. First, the officers, who were found to have fiduciary duties under the terms of the LLC agreement, had an obligation to obey the board, which may include not making disclosures, unless obedience would be "so obviously wrong that compliance itself would constitute a breach of duty." Second, the officers may have breached an obligation to inform the members of significant transactions that do not require member approval, such as unilaterally taking their equity interests. Third, the officers conceivably breached an obligation not to make misleading partial disclosures by giving disclosures about the squeeze-out merger, which omitted information concerning background, negotiations, pricing, company prospects, or board and independent committee rationales for their approvals.[4]

Dispute Resolution Authority of Arbitrators, Experts, and Directors. Contractual dispute resolution procedures may be less costly than litigation, but they are also subject to limits depending on the type of resolution proposed. In one recent case, the Delaware Court of Chancery confirmed that an arbitrator may have significant authority to make binding decisions, while an expert determination tends to be narrowly focused on matters within its expertise. In that case the "Accounting Firm" responsible for resolving earn-out disputes under a stock purchase agreement was viewed as an expert and not an arbitrator, based on the lack of words related to "arbitrating" and limits on the scope of a dispute resolution proceeding (e.g., 30 days for a decision). In two Delaware Supreme Court cases, the Court determined that a stock option agreement could grant a board committee "exclusive" authority to resolve disputes over interpretation of the agreement (including the scope of that committee's authority), but a court was thereafter expected to conduct de novo review of the committee's determinations, because (a) the committee was more akin to an expert than an arbitrator and (b) the provision required the committee to make legal determinations (not factual findings within its expertise). In another case, the Court held that a charter provision could not eliminate director liability or judicial review of board determinations of limits on stockholder voting power related to federal banking regulations. [5]

Waivers and Private Ordering Related to Fiduciary Duties. Fiduciary duties are a fundamental element of the internal affairs of corporations under Delaware law, as is the policy favoring private ordering, which includes waivers of core corporate rights under certain circumstances. The National Venture Capital Association Model Voting Agreement includes a covenant not to sue for breach of fiduciary duty in connection with a specified sale of the company. That covenant may be enforceable

when narrowly tailored, reasonable under close judicial scrutiny, and not limiting of liability for intentional breaches of fiduciary duty. For instance, that standard may be satisfied by narrowly defining the terms of an applicable transaction and limiting application of the covenant to uber-sophisticated parties with counsel, negotiating power, adequate information, and awareness of the implications of the covenant. Such a covenant would face deep judicial skepticism in other scenarios, such as in a stock letter of transmittal, an agreement binding a retail stockholder, or an employee stock grant or compensation plan.

MERGERS & ACQUISITIONS

Transactions with Significant Stockholders. Judicial scrutiny of breach of fiduciary duty claims challenging transactions with significant stockholders has continued with guidance regarding the court's view of advisable and inadvisable processes. Although exclusion of one such stockholder, who was conceivably a controller on a motion to dismiss, was inadequate to obtain early dismissal, the court found after trial that the stockholder was not a controller and the transaction was not unfair, based in part on the independence of a committee that negotiated vigorously for the best deal. Another such transaction was also found after trial to be fair, based on the initiation, timing, structure, negotiation, and approval of the transaction. And in three other such transactions, the court explained that postclosing management agreements would be examined more closely when they provided material benefits instead of continuing preexisting arrangements; that alleged failure to conduct a market check, selection of potentially conflicted advisors, and low valuation of litigation claims did not indicate a lack of care necessary to undermine a MFW process; and that the "ab initio" requirement was satisfied when the MFW dual conditionality was imposed before conflicts arose with respect to economic bargaining related to the controller's postclosing employment. [6]

Buyer Aiding & Abetting Liability. The Delaware Court of Chancery has recently explored the typically remote possibility of buyer liability for aiding and abetting a breach of fiduciary duty, finding facts to support such a claim in two cases. The court explained in one case that the relevant sale process had three phases: (1) bidding by the buyer and other bidders when sell-side management was found to be motivated for a quick sale and communicated that desire to the buyer, (2) persistent unsolicited efforts to acquire the target including breaches of standstill provisions (e.g., don't ask, don't waive) when management seemed to acquiesce after the target board terminated the process, and (3) between signing and closing when the deal documents contained provisions for buyer sign-off on disclosures to seller stockholders and the buyer would have known that its earlier activities were not fully disclosed. Delaware courts will harshly view buyers who obtain privileged access to disloyal sell-side factors and use that relationship to ignore guardrails or violate boundaries established by the sell-side board in a persistent and opportunistic manner. In another case, an aiding and abetting claim survived where the buyer was involved in restructuring a transaction to channel consideration away from a specific sell-side investor that the other sellers were seeking to exclude from the deal. [7]

Waiver of Post-Closing Indemnification Rights. Recent cases have addressed the effectiveness of waivers by pre-closing target company officers of their indemnification rights under pre-closing contracts and governing documents. The pre-closing officers in one case, who were knowledge parties but not signatories to the relevant merger agreement that provided for continuation of indemnification under preclosing bylaws but eliminated indemnification with respect to any breach of the merger agreement, executed resignation letters containing releases. The releases and elimination of indemnification rights under the pre-closing bylaws were not enforced against the officers, because the release was not clear and unequivocal, especially as to an officer who had not been permitted to see the merger agreement. In another case, however, the former officer did not have indemnification rights under the preclosing company's agreements and bylaws, after the officer

sold his shares under a stock repurchase agreement that contained a broad release of all claims against the company other than certain claims arising under that repurchase agreement.[8]

Stockholder Approval of Merger Agreement and Substantial Asset Sale. The Delaware General Corporation Law (DGCL) sections related to mergers contemplate steps to be taken in a particular sequence. The Delaware Court of Chancery recently emphasized that the signed merger agreement attached to non-stock member or stockholder consents must be dated and not have blank placeholders. The court also explained that wrongful coercion, such as threatening to seize assets or terminate the entity, can taint the approval of a merger agreement. The period for demanding appraisal rights also will not begin, with respect to a merger approved by stockholder consent, until the stockholders have approved the merger agreement and notice of that consent has been given. In the separate context of a sale of substantially all assets, Delaware case law provides a range of considerations for determining whether the sold assets represent substantially all assets on quantitative and qualitative bases. A recent decision determined that a sale of approximately 37-38% of the company's total assets and 57-62% of the company's revenue, which sale required the company to alter operations but did not affect its existence or purpose, did not constitute a sale of substantially all assets. As a result, the sale did not violate Section 271 or the board's fiduciary duties for failure to obtain a stockholder vote.[9]

Fiduciary Duties in Insolvency and Distressed Transactions. The Delaware Court of Chancery recently confirmed that, when a corporation is insolvent, creditors become residual claimants that have standing to bring fiduciary duty claims. The court found that the directors and officers may have approved a foreclosure arrangement based on their belief that fiduciary duties had shifted from stockholders to creditors. The court rejected this view of fiduciary duties, as well as a perceived improper focus on advancing the interests of employees, stating that fiduciary duties in insolvency do not shift away from the corporation and its stockholders. In another case involving the related context of distressed financings, the court noted the troubling aspects of such transactions involving exclusion of directors from board meetings, actions of a secretly formed restructuring committee to structure a dilutive financing for a company that may been down to its final months' of cash remaining, payment of legal fees for parent holding companies' employees, and inadequate disclosure to minority stockholders expected to waive related claims with 15 days to consider participation. The court also noted concerns about another equity transaction where the board (controlled by certain investors) may have restructured the transaction for almost all of the deal consideration to flow directly or indirectly to all but one of the company's investors, including to their affiliates that were creditors of the company, and the sellers agreed to indemnify the buyer from claims by the excluded investor. There, the court also noted that debt held by insiders can be equitably subordinated, diminishing its value, which could be relevant for purposes of determining consideration owed to the creditor and the solvency of the company.[10]

Effect of Disinterested Stockholder Approval on Claims for Injunctive Relief against Defensive Measures. The Corwin line of Delaware case law provides that fully informed, uncoerced approval by disinterested stockholders may cleanse claims for breach of fiduciary duty not involving a conflicted controlling stockholder. The Delaware Court of Chancery recently explained, however, that such cleansing does not apply to foreclose actions for injunctive relief. In the recent case, the court rejected Corwin cleansing as to alleged defensive measures adopted by the board of a public company whose diminished stock price made it an attractive takeover target. Those measures implicated Unocal entrenchment concerns in connection with a sale of shares that could have been important in director elections (those shares were (i) required to vote for the board's director nominees, (ii) required to vote either according to the board's recommendation as to non-routine matters or pro rata with other stockholders, and (iii) subject to transfer restrictions requiring board

approval and preventing transfer to competitors or certain activist investors). [11]

Specific Performance Denied in Busted International Deal. After several busted deal cases in recent years where the Delaware Court of Chancery awarded specific performance, the court recently confirmed that such an award is in its discretion and remains subject to many factors including the practicability of international enforcement. This busted de-SPAC deal involved a Philippine corporation with a history of internal corporate governance issues and parallel legal proceedings in Philippine courts. The Delaware Court of Chancery denied specific performance and identified numerous challenges to enforcement of a specific performance award, including complications with respect to the SEC process for issuing securities of that Philippine corporation, "dodgy" bargains to secure political intervention, limits on the court's coercive powers outside of the United States, and conflicting international judicial decisions. Although this case involved unusual facts, international deal planners should bear this in mind with respect to typical merger agreement provisions such as those for remedies, dispute resolution, and related matters. [12]

RELATED TOPICS AND OUTLOOK

Mid-Year Trends Related to Delaware Corporate and M&A Law. Several notable trends related to Delaware corporate law have emerged in 2023, including increasing proposal and adoption of amendments to public company charters providing for exculpation of officer liability under Section 102(b)(7) as amended in 2022.[13] We have also seen directors, officers, and investors of private companies navigating issues regarding fiduciary duties and DGCL provisions applicable to distressed financings and potential insolvency, including dilution of current investors and inclusion of pay-to-play and pullup financings designed to terminate existing liquidation preferences and other investor rights. The complexities of distressed financings and M&A transactions may add complexity to board discussions and disinterested director and stockholder approval requirements contained in stockholders' agreements.

Forum Selection Provisions Regarding Exchange Act Claims and Claims by California-Based Litigants. Forum selection provisions are expressly permitted under Delaware law and generally enforceable, though questions have arisen whether the Securities Exchange Act of 1934 prohibits such provisions from requiring that derivative claims under the Exchange Act be brought in state court and whether the California constitution prohibits enforcement of such provisions as to claims by California-based litigants who are entitled to civil jury trials. Although the 9th Circuit stated that state courts would lack jurisdiction to hear those Exchange Act claims, the circuit rejected arguments that forum selection provisions were unenforceable with respect to those claims. The circuit noted that stockholders could bring those claims directly in federal court and that Section 115 of the DGCL permits such provisions. This decision also maintains a split with the 7th Circuit, which may lead to resolution of the issue by the US Supreme Court.[14] The California Fourth Appellate District recently held that, because the Court of Chancery effectively does not offer jury trials, enforcement of a facially valid charter and bylaw provisions selecting the Court of Chancery as the exclusive forum would operate as an impermissible implied waiver of the right to a jury trial, which is nonwaivable under the California constitution before commencement of a dispute. The state appeals court affirmed denial of a motion to dismiss, based on the forum selection provision, claims brought in California state court against the Delaware corporation's officers, employees, and largest stockholder and third parties for fraudulent concealment, promissory fraud, breach of contract, breach of fiduciary duty, and violations of California's Unfair Competition Law, as to which the California-based plaintiffstockholder demanded a jury trial on all claims to which the right to a jury trial attached. [15] Counsel should keep this in mind when drafting forum selection provisions.

2023 Amendments to Delaware Entity Statutes. Delaware has adopted several important amendments to the DGCL, which are discussed in a separate GT Update, but we highlight a few here. The amendments have reduced or eliminated the stockholder approval standard for certain forward and reverse stock splits and changes in the number of authorized shares under Section 242. Following litigation over a disputed transaction related to foreclosure, significant updates to Section 272 permit certain sales, leases, or exchanges of collateral assets securing a mortgage or pledge without stockholder approval under Section 271. The stockholder approval standard has also been reduced to a majority of the outstanding voting power for Delaware corporations to domesticate as non-US entities under Section 390, and that provides additional flexibility for Delaware corporations desiring to domesticate outside of the United States while potentially continuing their existence as a Delaware corporation. Amendments to Delaware's LP Act, LLC Act, and GP Act permit a subscription agreement to provide for its irrevocability, which can be important in equity financings with closings over an extended period. [16]

National Venture Capital Association Updates Its Model Amended and Restated Certificate of Incorporation. The NVCA's model charter, which provides form language for many venture capital-backed corporations, has been updated. Some changes account for developments in Delaware law since the prior version, such as clarification of the designation of classes and series of stock and the incorporation of statutory conversions and domestications into the deemed liquidation and protective provisions. Other changes reflect alternative options and provisions that are sometimes negotiated in venture capital financing transactions. We anticipate that these updated model provisions will begin finding their way into preferred-stock financings and governing documents. Care should be given when considering which updated language to include in transactions going forward, as is always true when considering open-source forms.[17]

FOOTNOTES

1 Sternlicht v. Hernandez, C.A. No. 2023-0477-PAF (Del. Ch. June 14, 2023); Coster v. UIP Companies, Inc., No. 163, 2022 (Del. June 28, 2023).

2 Simeone v. The Walt Disney Co., C.A. No. 2022-1120-LWW (Del. Ch. June 27, 2023).

3 Atallah v. Malone, C.A. No. 2021-1116-SG (Del. Ch. July 19, 2023). In In re Golden Nugget Online Gaming, Inc. Stockholder Litig., Consol. C.A. No. 2022-0797-JTL (Del. Ch. June 8, 2023) (TRANSCRIPT), the court also addressed the related point that the entire fairness standard of review may apply to a transaction where an employee-controlling stockholder negotiates new post-closing employment terms, but it may not apply if the employment agreement is continued on pre-transaction terms.

4 Cygnus Opportunity Fund, LLC v. Washington Prime Group, LLC, C.A. No. 2022-0718-JTL (Del. Ch. Aug. 9, 2023). Although this case arose in the context of a LLC, the discussion of fiduciary duties may be applied to transactions involving corporations. In the court's analysis of the claims against each officer, the court noted that the CEO had signed a letter to minority unitholders regarding the disclosures, but otherwise the court inferred that it was conceivable that the CEO, the CFO, and the chief accounting officer and vice president of finance were aware of the transactions, privy to relevant

5 ACON Igloo Holdings, LLC v. Dometic Corp., C.A. No. 2022-1057-LWW (Del. Ch. May 18, 2023) (TRANSCRIPT); Terrell v. Kiromic Biopharma, Inc., No. 299, 2022 (Del. May 4, 2023); CCSB Financial Corp. v. Totta, No. 424, 2022 (Del. July 19, 2023).

6 In re Oracle Corporation Derivative Litig., Consol. C.A. No. 2017-0337-SG (Del. Ch. May 12, 2023); In re Tesla Motors, Inc. Stockholder Litig., No. 181, 2022 (Del. June 6, 2023); Golden Nugget Online Gaming; City of Dearborn Police & Fire Revised Retirement System (Chapter 23) v. Brookfield Asset Management Inc., C.A. No. 2022-0097-KSJM (Del. Ch. June 9, 2023) (TRANSCRIPT); City of Sarasota Firefighters' Pension Fund v. Inovalon Holdings, Inc., C.A. No. 2022-0698-KSJM (Del. Ch. July 31, 2023) (TRANSCRIPT).

7 In re Columbia Pipeline Group, Merger Litig., Consol. C.A. 2018-0484-JTL (Del. Ch. June 30, 2023); Breakout Ventures LLC v. Sileo Management Holdings, LLC, C.A. No. 2022-0539-JTL (Del. Ch. June 12, 2023) (TRANSCRIPT).

8 LPPAS Representative, LLC v. ATH Holding Company, LLC, C.A. Nos. 2020-0241-KSJM & 2020-0443- KSJM (Del. Ch. May 2, 2023); Javice v. JP Morgan Chase Bank, N.A., C.A. Nos. 2022-1179-KSJM & 2023-0040-KSJM (Del. Ch. May 8, 2023) (TRANSCRIPT); Kokorich v. Momentus Inc., C.A. No. 2022- 0722-MTZ (Del. Ch. May 15, 2023).

9 In re The Amyotrophic Lateral Sclerosis Association, C.A. Nos. 2023-0054-JTL & 2023-0413-JTL (Del. Ch. Apr. 25, 2023) (TRANSCRIPT); Flexer v. Runtriz, Inc., C.A. No. 2022-1020-NAC (Del. Ch. June 5, 2023) (TRANSCRIPT); Altieri v. Alexy, C.A. No. 2021-0946-KSJM (Del. Ch. May 22, 2023) (ORDER). In the Broadscale OC Investors case mentioned above, the court also paused over whether a foreclosure and license transaction triggered a charter-based protective provision applicable to a sale, lease, transfer, exclusive license or other disposition of substantially all of that corporation's assets (though the court did not pass on whether that transaction required a stockholder vote under Section 271).

10 Broadscale OC Investors, LP v. Clayton, C.A. No. 2020-0262-PAF (Del. Ch. May 8, 2023); Mellado v. McDowell, C.A. No. 2023-0620-SG (Del. Ch. June 30, 2023) (TRANSCRIPT); Breakout Ventures LLC v. Sileo Management Holdings, LLC, C.A. No. 2022-0539-JTL (Del. Ch. June 12, 2023) (TRANSCRIPT).

11 In re Edgio, Inc. Stockholders Litig., Consol. C.A. No. 2022-0624-MTZ (Del. Ch. May 1, 2023).

12 26 Capital Acquisition Corp. v. Tiger Resort Asia Ltd., C.A. No. 2023-0128-JTL (Del. Ch. Sept. 7, 2023).

13 See Nathan Emeritz and Justin Mann, GT Alert: Preparation of Corporate and M&A Documents for Proposed 2022 Delaware Corporate Law Amendments (May 2022).

14 Lee v. Fisher, No. 21-15923 (9th Cir. June 1, 2023). Compare Seafarers Pension Plan v. Bradway, 23 F.4th 714 (7th Cir. 2022).

15 EpicentRx, Inc. v. EpiRx, L.P., Super. Ct. No. 37-2022- 00015228 (Cal. App. 4th Sept. 21, 2023).

16 Diane Ibrahim, Nathan Emeritz, and Justin Mann, GT Alert: Preparation of Corporate and M&A Documents for Proposed 2023 Delaware Corporate Law Amendments (August 2023).

17 National Venture Capital Association, Model Documents (Sept. 2023). These revisions relate to issues raised by Garfield v. Boxed, Inc., C.A. No. 2022-0132-MTZ (Del. Ch. Dec. 27, 2022), as discussed in GT Alert: 2022 Delaware Corporate Law Year in Review, and the 2022 and 2023 amendments to the DGCL, as discussed in the GT Alerts regarding 2022 and 2023 Delaware corporate law amendments referenced above. In other recent cases, the Delaware Court of Chancery and Supreme Court have provided general support for certain provisions commonly used in the NVCA model Amended and Restated Certificate of Incorporation, including the statement that actions taken without preferred stockholder approval under the model protective provisions are “null and void ab initio,” see Holifield v. XRI Investment Holdings LLC, No. 407, 2022 (Del. Sept. 7, 2023), and

Sept. 12, 2023); Vestal v. Carvana Co., C.A. No. 2022-0609-KSJM (Del. Ch. Sept. 14, 2023).

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