Hogan Lovells

2024 Securities, Shareholder, and M&A Litigation Outlook

April 2024

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The Outlook for 2024

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2023 was a busy year, with both the Delaware courts and others, including the U.S. Supreme Court, weighing in on shareholder and M&A litigation issues. The Delaware Court of Chancery issued several notable decisions on issues critical to companies incorporated in Delaware as well as those seeking to engage in transactions with Delaware-incorporated entities. Over the past year, our coverage has highlighted four trends.

- The Delaware courts continued to address Section 220, issuing decisions that demonstrated the importance of permitting stockholders to exercise Section 220 rights if they have met the requirements, including that of having identified a proper purpose.
- The Delaware courts provided additional guidance on the application of *Corwin* cleansing. Specifically, the courts found that cleansing was appropriate in the absence of allegations supporting a reasonable inference that a vote was not fully informed. Conversely, the application of cleansing was deemed inappropriate when stockholders were unaware of material conflicts or when a deal included long-lasting defensive measures.
- The Delaware courts, once again, issued decisions that further developed the law surrounding *Caremark* claims. There has been a resurgence of *Caremark* claims since the 2019 *Marchand v. Barnhill* decision, which addressed the duty of oversight to as it relates to corporate officers; the appropriate showing needed to plead a *Caremark* claim; the applicable statutes of limitations and tolling principles; and the scope of facts that a court can consider.
- Many of the decisions issued in 2023 turned on a close reading of contractual language, both in standalone agreements—such as voting agreements—as well as in foundational documents such as partnership and LLC agreements. These decisions demonstrate the significant impact that contractual language can have on shareholder claims.

In addition, several courts, including the U.S. Supreme Court, issued notable decisions that impact corporations and shareholders in Delaware and beyond, among which were opinions related to the interpretation of the phrase "such security" in the Securities Act of 1933 and the mechanisms available to enforce fee-advancement orders. More detail on these trends and cases can be found below.

In 2024, we expect to see the Delaware courts continue to develop the law in these and other areas. At the end of 2023, there remained several cases pending in Delaware that addressed transactions with controllers or conflict-of-interest issues. Decisions in these cases, which are expected this year, will provide insight into the courts' views of who is a controlling shareholder, what constitutes a conflicted transaction, and when and how special committees should be implemented. In 2024, we expect more *Caremark* claims to be filed, thereby giving rise to more opinions further shaping the contours of the *Caremark* doctrine. 2024 also may see developments around ESG. Companies and shareholders alike continue to juggle "greenwashing," "greenhushing," new ESG disclosure rules, and the consequent uptick in backlash litigation. Whereas ESG litigation is filed across the nation based on numerous different theories, the one case pending before the Delaware courts alleges a breach of fiduciary duty for actions beneficial for the company yet result in a "net-negative" impact on society. Guidance from Delaware courts on ESG issues will be significant for Delaware-incorporated entities and beyond.

Executive Summary

Caremark

The Delaware courts once again issued decisions further developing the law surrounding *Caremark* claims, which have seen a resurgence since the 2019 *Marchand v. Barnhill* decision.

In *Segway, Inc. v. Cai*, the Delaware Court of Chancery dismissed a breach of fiduciary duty claim for failure to allege "sufficient facts to support a reasonable inference that the fiduciary acted in bad faith," reaffirming that the bar for pleading a *Caremark* claim remains high for both corporate officers and directors.

In *Lebanon County Employees' Retirement Fund v. Collis*, the Delaware Supreme Court reversed the Delaware Court of Chancery's dismissal of *Caremark* claims against a company's directors, finding that the court erred when it took judicial notice of another court's factual findings at the pleading stage, which the Delaware Supreme Court found inappropriate under both Delaware Rules of Evidence 201 and 202.

Section 220

The Delaware courts continued to address Section 220 in this past year, issuing decisions that demonstrated the importance of permitting stockholders to exercise their rights to inspect a company's books and records when the stockholders have met the requirement of stating a proper purpose.

In *Lawrence B. Seidman v. Blue Foundry Bancorp*, the Delaware Court of Chancery held that the defendant's conduct in response to the plaintiff-shareholder's "clearly defined and established right to inspect the Company's books and records" was "glaringly egregious" and warranted an award of attorneys' fees and expenses. The defendant's "serious vexatious behavior" included wrongly refusing to produce documents, insisting in bad faith on an in-person deposition of the plaintiff, and waiting until the very end of discovery to assert a meritless "improper purpose" defense.

In *Cezary Pietrasik v Kraus Hamdani Aerospace, Inc.*, the Delaware Court of Chancery declined to accept a magistrate's recommendation to deny a plaintiff-stockholder's request for certain books and records, finding that although the plaintiff may have an improper purpose of bringing a personal lawsuit, the plaintiff also had legitimate objectives supporting the inspection requests, such as investigating corporate wrongdoing.

Corwin

The Delaware courts provided additional guidance on the application of *Corwin* cleansing, including two cases in which *Corwin* cleansing did not apply.

In *In re Mindbody Inc., Stockholder Litigation*, the Delaware Court of Chancery held that the company's CEO breached his fiduciary duties by influencing a merger sale process in favor of his preferred buyer and declined to apply *Corwin* cleansing because the stockholders were not aware of the CEO's conflicts or favor of the buyer.

Similarly, in *In re Edgio Stockholders Litigation*, the court declined to apply *Corwin* cleansing to a transaction involving measures that restricted investors' voting and transfer rights, finding that *Corwin*'s rationale of allowing "stockholders to make free and informed choices based on the economic merits of a transaction" did not apply to claims seeking to enjoin defensive measures. Instead, the court concluded that *Unocal*'s enhanced-scrutiny standard was appropriate, because the defense measures were designed to apply for years into the future, creating a risk of entrenchment.

By contrast, in *Teamsters Local 677 Health Services & Insurance Plan v. Martell*, the court granted the defendant's motion to dismiss under *Corwin*. The court held that the complaint failed to identify any disclosure deficiency because the disclosure document did, in fact, disclose the allegedly omitted information concerning the board's antitrust concerns; further, the court reasoned that the plaintiff did not identify any documents obtained from his Section 220 demand that contained facts that should have been, but were not, disclosed about the CEO's post-merger employment.

Contract Interpretation

A number of court decisions turned on analysis of contractual language, both in standalone agreements, such as voting agreements, as well as foundational documents such as partnership and LLC agreements. These decisions demonstrate the significant impact that contractual language can have on shareholder claims.

The Delaware Supreme Court issued two decisions, one reversal and one affirmance, focused on contract interpretation.

In *Boardwalk Pipeline Partners, L.P. v. Bandera Master Fund, LP*, the Delaware Supreme Court reversed the lower court's finding of contractual ambiguity, holding instead that when all of the partnership organization agreements were harmonized. Emphasizing the "maximum flexibility" accorded to the drafters of partnership agreements under Delaware law, the court supported a finding that the general partner of a master limited partnership had properly exercised its call rights.

In *Holifield v. XRI Investment Holdings LLC*, the Delaware Supreme Court affirmed the lower court's determination that a "No Transfer Provision" in an LLC agreement that stated that a noncompliant transfer is "void" rather than "voidable," prevailed over any equitable considerations.

The Delaware Court of Chancery also affirmed the freedom to contract in *New Enterprise Associates 14. V. Rich*, which addressed a contract provision that obligated the signatories: (a) to vote in favor of a transaction approved by the board and a majority of preferred stockholders, and (b) not to sue in connection with such a transaction. The court found the covenant not to sue was facially enforceable due to its presence in a voting agreement that had been executed by sophisticated parties.

In *Texas Pacific Land Corporation v. Horizon Kinetics LLC*, the Delaware Court of Chancery found that investors violated a stockholder's agreement that required them to vote in favor of certain types of board proposals. The court reached its holding after ruling on the inapplicability of certain exceptions that it had found ambiguous and thus had interpreted in light of extrinsic evidence.

And in *Lee v. Fisher*, an *en banc* panel of the U.S. Court of Appeals for the Ninth Circuit enforced a forum-selection clause requiring that all derivative actions be brought in the Delaware Court of Chancery and, in so doing, rejected claims that the clause violated the exclusive federal jurisdiction provision of the Securities Exchange Act of 1934, Delaware General Corporation Law, and public policy.

Other Notable Decisions

Several courts, including the U.S. Supreme Court, issued notable decisions on other issues that impact corporations and shareholders in Delaware and elsewhere.

In *Slack Technologies, LLC v. Pirani*, the U.S. Supreme Court declined to define the term "such security" in Section 11 of the Securities Act of 1933 to encompass untraceable, unregistered shares from direct listings.

In an explicit effort to end the "merger tax" created by the number of "legally meritless" M&A disclosure cases filed in Delaware courts, the Delaware Court of Chancery held in *Anderson v. Magellan Health, Inc.* that mootness fees for settled cases can be awarded only where the plaintiff secures supplemental disclosures that are "plainly material."

In *Gandhi-Kapoor v. Hone Capital, LLC*, the Delaware Court of Chancery held that, although not generally available to enforce money judgments, an order of civil contempt and equitable relief in the form of a daily fine were appropriate remedies for non-compliance with an order related to advancement.

Finally, in *Newman v. KKR*, the court dismissed a shareholder derivative suit arising from an equity financing transaction, holding that the plaintiff failed to plead demand futility because he did not allege with particularity that (a) the audit committee lacked independence from the majority shareholder making the investment, or (b) the defendants acted in bad faith.

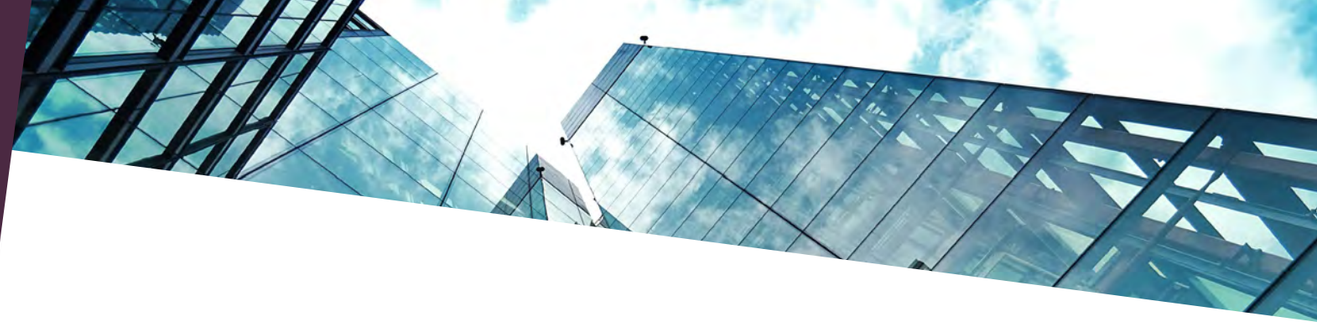
Caremark

Segway, Inc. v. Cai: Delaware Chancery Court reaffirms *Caremark* bad faith requirement

C.A. No. 2022-1110-LWW (Del. Ch. Dec. 14, 2023)

Why it is important

In *Segway, Inc. v. Cai*, the Delaware Court of Chancery dismissed a breach of fiduciary duty claim for failure to allege "sufficient facts to support a reasonable inference that the fiduciary acted in bad faith." The plaintiff alleged that Segway's former president ignored customer issues, which caused Segway's accounts receivables to increase and profitability to decline. The Court found that these allegations related to "generic financial matters" and fell short of "the sort of red flags that could give rise to *Caremark* liability if deliberately ignored. The Court rejected Segway's "misimpression" of the Court's recent decisions regarding *Caremark* liability for officers and reaffirmed that the high bar for pleading a *Caremark* claim remains the same whether the defendant is an officer or director.



Summary

Segway, Inc. is a personal transportation device designer and manufacturer. In April 2015, it was acquired by a subsidiary of Ninebot (Beijing) Tech Co., Ltd. Following its acquisition, Segway maintained its own operations, including its own board of directors, officers, employees, and financial and accounting systems.

Judy Cai was appointed as Segway's interim president in December 2015 and promoted to president in 2018. During her time at Segway, Cai worked as its in-house accountant and was responsible for Segway's tax matters. Following its acquisition in 2015, Segway suffered a decline in sales of its branded products, began downsizing its operations, and by 2020, Segway closed its headquarters and laid off nearly all of its employees. Cai's employment was terminated in November 2020.

During Ninebot's integration of Segway's financial information into Ninebot's systems – and after Cai's termination – Ninebot discovered that the information Cai provided was incorrect and did not match Segway's actual numbers in its financial records, including US$5 million in accounts receivable that was "not properly recorded and/or booked." Segway brought suit against Cai, alleging a *Caremark* claim for breach of fiduciary duty for knowing, but failing to address, customer issues that caused an increase in Segway's accounts receivable. Cai moved to dismiss the single breach of fiduciary duty claim in the amended complaint.

The Court of Chancery granted Cai's motion to dismiss the *Caremark* claim, finding that Segway did not allege facts sufficient "to support a reasonable inference that the fiduciary acted in bad faith." The Court noted that "[u]nder *Caremark*, bad faith can be established when

fiduciaries (1) 'utterly fail to implement any reporting or information system or controls,' or (2) 'having implemented such a system or controls, consciously fail to monitor or oversee its operations,' which disables them 'from being informed of risks or problems requiring their attention.'" The court interpreted Segway's claim as alleging breach of fiduciary duty under the second prong of *Caremark* based on allegations that Cai "consciously disregarded" certain "red flags" in Segway's accounting and failed to advise the appropriate parties of such anomalies.

The court, however, found that Segway's allegations were "an ill fit" for a *Caremark* claim because there were no "red flags" or "wrongdoing" alleged. For example, Segway did not allege that Cai overlooked any accounting improprieties, fraud, or other material legal violations. The court ultimately concluded the allegations amounted to ordinary business issues that did not rise to the extraordinary case of bad faith required under *Caremark*. The court cautioned against using the *Caremark* doctrine as "a tool to hold fiduciaries liable for everyday business problems," stating instead that it "is intended to address the extraordinary case where fiduciaries' 'utter failure' to implement an effective compliance system or 'conscious disregard' of the law gives rise to a corporate trauma."

In rejecting granting Cai's motion to dismiss, the court noted that "Segway appears to believe that the high bar to plead a *Caremark* claim is lowered when the claim is brought against an officer." The court rejected Segway's position, finding it to be "a distressing reading of our law." The Segway decision reaffirms that a *Caremark* claim (against officers and directors, alike) remains "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment" that requires bad faith.

Lebanon County v. Collis: Delaware Supreme Court reverses dismissal of *Caremark* claims

No. 22, 2023 (Del. Dec. 18, 2023)

Why it is important

In *Lebanon County Employees' Retirement Fund v. Collis*, the Delaware Supreme Court reversed the Delaware Court of Chancery's dismissal of *Caremark* claims against the directors of AmerisourceBergen Corporation that arose from the company's distribution of opioids. The Delaware Supreme Court found that the Court of Chancery erred when it took judicial notice of another court's factual findings at the pleading stage. The Delaware Supreme Court found that the Court of Chancery "effectively adopt[ed] the factual findings of another court in another case," which was "a departure from the principles that animate the concept of judicial notice." This opinion provides important guidance on the scope of judicial notice under Delaware Rules of Evidence 201 and 202 as well continued development of the *Caremark* doctrine.

Summary

In *Lebanon County Employees' Retirement Fund v. Collis*, No. 22, 2023 (Del. Dec. 18, 2023), the Delaware Supreme Court reversed the Court of Chancery's dismissal of shareholders' *Caremark* and *Massey* claims against the directors of AmerisourceBergen Company (AmerisourceBergen or the Company). The plaintiffs asserted a "prong two" *Caremark* claim against AmerisourceBergen, alleging that the directors of the Company failed to oversee AmerisourceBergen's compliance with laws governing the distribution of opioids. The plaintiffs also asserted a related *Massey* claim that the directors prioritized profits from the sale of opioids without dedicating sufficient resources to compliance efforts, like anti-diversion control systems.

In December 2022, Vice Chancellor Laster dismissed the case based on a decision in AmerisourceBergen's favor by a West Virginia federal court in opioid-related multidistrict litigation (the West Virginia Decision). After a two-month trial on the merits, the West Virginia court found that "no culpable acts by defendants caused an oversupply of opioids…" Vice Chancellor Laster concluded that the federal court's findings were "not preclusive," but they were "persuasive." For Vice Chancellor Laster, the West Virginia court's findings "knock[ed] the stuffing out of the plaintiffs' claim[s]" and made it impossible to infer that a majority of the directors who were in office when the complaint was filed face a substantial likelihood of liability on the plaintiffs' claims. Thus, the Court of Chancery dismissed the case for the plaintiffs' failure to allege demand futility under Rule 23.1.

On appeal, the Delaware Supreme Court found that the Court of Chancery erred by taking judicial notice of the West Virginia Decision under Delaware Rule of Evidence (D.R.E) 202. The Supreme Court pointed out that D.R.E. 202 can be invoked for judicial notice "of case law" in other courts, such as recognizing rules or principles of law, but not for judicial notice of facts. The Court of Chancery thus improperly relied on the West Virginia Decision's factual findings as the "sole basis" for the court's denial of the defendant's motion to dismiss.

The Supreme Court further analyzed whether D.R.E. 201 could support taking "adjudicative notice" of the factual findings in the West Virginia Decision. The Supreme Court acknowledged that it "has not addressed whether a court can take adjudicative notice of the factual findings of another court." As a result, it analyzed federal court decisions regarding Federal Rule of Evidence 201 and concluded that it would be improper to take adjudicative notice of other courts' factual findings "when the underlying fact is reasonably disputed." Here, the Supreme Court concluded that a defendant's liability was "reasonably disputed" and taking adjudicative notice under D.R.E. 201 would "unfairly deprive[] the plaintiffs of the opportunity to prove the truth of their well-pleaded allegations." Accordingly, the Supreme Court found that the Court of Chancery improperly gave the West Virginia Decision "preclusive effect."

The Delaware Supreme Court also took issue with the timing of Vice Chancellor Laster's demand futility analysis. Here, the West Virginia Decision was released while briefing on the motion to dismiss in the Court of Chancery was already underway. The Supreme Court emphasized that demand futility should be considered as of the date the complaint is filed.

A rare reversal, this decision provides important guidance for both the plaintiffs and the defendants litigating *Caremark* claims as well as those involved in parallel litigation of any kind where similar or identical issues may be litigated simultaneously in Delaware and other forums.

Section 220

Seidman v. Blue Foundry: egregious defense against books and record request prompts fee shifting

No. 2022-1155-MTZ (Del. Ch. July 7, 2023)

Why it is important

In *Lawrence B. Seidman v. Blue Foundry Bancorp*, the Delaware Court of Chancery awarded US$223,651.60 in attorneys' fees and expenses to a plaintiff stockholder because of the defendant's "glaringly egregious litigation conduct" in defending against a books and records request pursuant to Section 220 of the Delaware General Corporation Law. Defendant's "serious vexatious behavior" warranted fee shifting, as the company unnecessarily prolonged litigation over a "clearly defined and established right to inspect the Company's books and records."

Summary

Shareholder Lawrence B. Seidman (Plaintiff) opposed Blue Foundry Bancorp's (Blue Foundry or the Company) proposed equity incentive plan and sought access to the company's books and records pursuant to Section 220 of the Delaware General Corporation Law. Blue Foundry rejected the demand, claiming that Seidman lacked a proper purpose. Plaintiff ultimately filed suit in Delaware Court of Chancery to obtain the requested books and records, which Blue Foundry opposed until two days before trial. At that time, the parties filed a proposed final order and judgment that resulted in production of about seventy-five pages of records by Blue Foundry. After this order was entered, the plaintiff filed a motion for an award of US$223,651.60 in attorneys' fees and expenses.

The Court of Chancery granted the plaintiff's request for fees due to the "glaringly egregious" behavior of Blue Foundry. For example, the court found that the Company unnecessarily prolonged litigation by refusing to produce any documents and declining to disclose what (if any) formal board materials existed. It also increased litigation cost by insisting "in bad faith" on an in-person deposition of the plaintiff in Delaware. The plaintiff's counsel had informed Blue Foundry that Seidman was in Florida and had offered to make him available for a remote deposition, but Blue Foundry was adamant (for "no real reason," according to the court) that the deposition take place in-person in Delaware. Blue Foundry also waited until the very end of discovery to assert an improper purpose defense (which the court called "unsupported"), depriving the plaintiff the opportunity to take discovery on the defense. The court even found Blue Foundry's decision to force the plaintiff to file suit to "secure a clearly defined and established right" to inspect the Company's books and record to be, in itself, grounds for fee shifting.

The Court identified a number of other issues with Blue Foundry's litigation conduct as well. The Company presented "several falsehoods" and "multiple misrepresentations" to the Court and pressed "merits-based defenses" that were clearly inappropriate in a books and records dispute.

This case serves as a reminder to practitioners that the Court of Chancery expects legitimate requests under Section 220 to be analyzed and addressed seriously by a corporation, and that counsel and the parties will avoid taking positions or engaging in tactics that needlessly multiply what are intended to be summary proceedings.

Pietrasik v. Kraus Hamdani Aerospace: despite plaintiff's "rancor," Delaware Court grants 220 demand

C. A. 2022-1069-LM (Del. Ch. Nov. 16, 2023)

Why it is important

After a de novo review of the record following a Magistrate in Chancery's final report, Vice Chancellor Fioravanti of the Delaware Court of Chancery declined to accept the Magistrate's recommendation to deny a plaintiff-stockholder's books and records requests for documents beyond those the company already had provided. The magistrate found that the plaintiff's "primary purpose" was to bring a personal lawsuit against the co-founder of the company, which is not a proper purpose under Section 220. Upon review, Vice Chancellor Fioravanti disagreed and instead concluded that the plaintiff also had legitimate objectives supporting the inspection requests sufficient to be a "proper purpose" under Section 220 as well as a credible basis to suspect wrongdoing.

Summary

The plaintiff (Plaintiff) is a stockholder and former employee of defendant Kraus Hamdani Aerospace, Inc. (the Company). Plaintiff served a demand to inspect eleven categories of company books and records pursuant to 8 Del. C. § 220. The Company provided some but not all of the requested documents. A Magistrate in Chancery issued a final report recommending denial of inspection beyond the books and records the company had already provided (the Final Report). Supported by evidence of the Plaintiff's personal animus toward the company's co-founder, Fatema Hamdani (Hamdani), the Magistrate concluded that Plaintiff was pursuing the requests with the improper purpose of preparing for a personal lawsuit against the co-founder. Plaintiff challenged this ruling by filing a Notice of Exceptions (the Exceptions) from the Final Report.

After de novo review of the record following the Final Report, Vice Chancellor Fioravanti granted Plaintiff's Exceptions and declined to accept the Final Report, finding that Plaintiff's inspection requests targeted information that could prove that Hamdani had mismanaged the company by exposing it to liability as a government contractor and by misappropriating corporate assets.

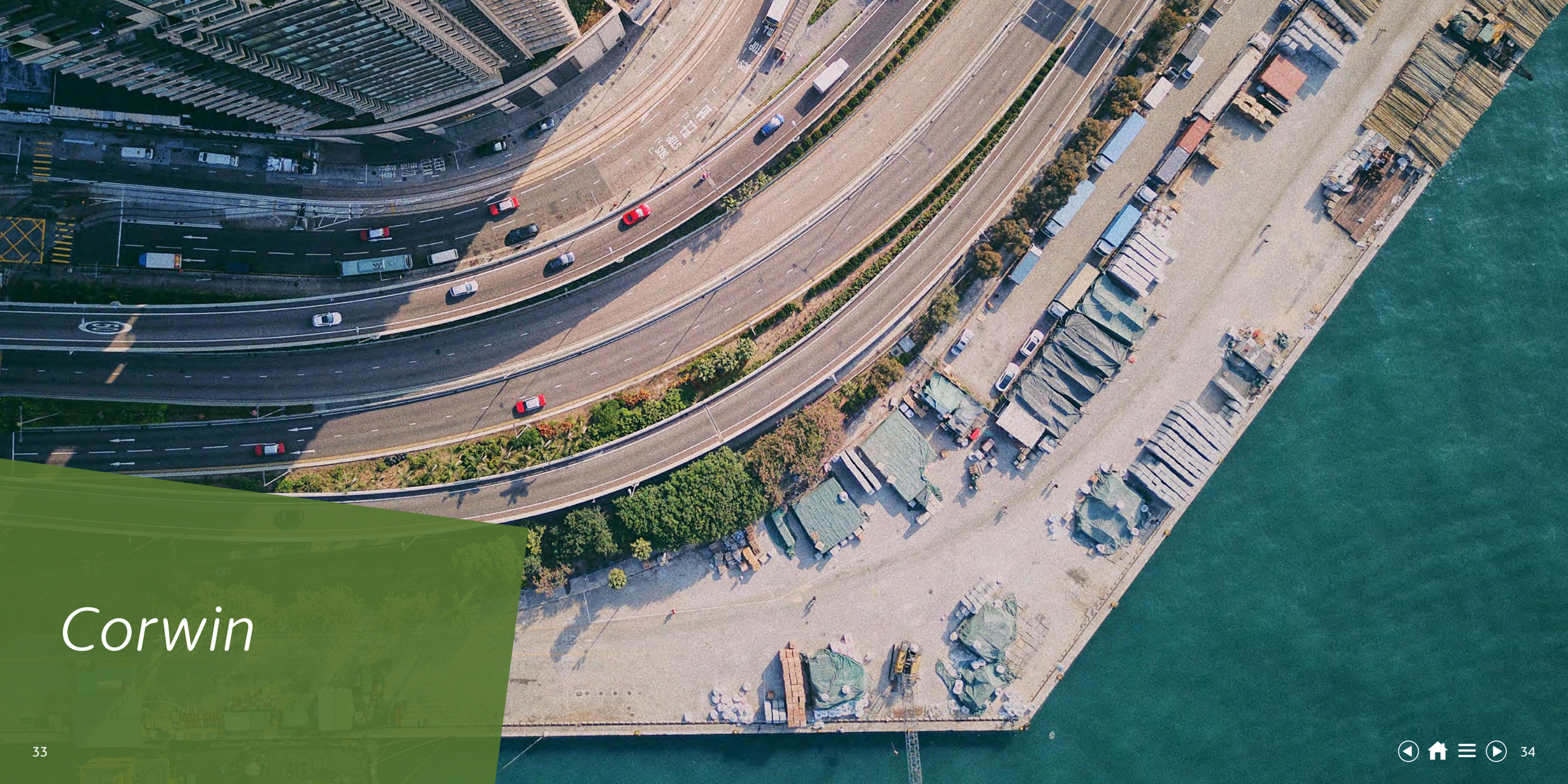
The court began its analysis by emphasizing that a stockholder will satisfy its initial burden to obtain inspection of books and records to investigate wrongdoing or mismanagement if the stockholder can establish, by a preponderance of the evidence, any "credible basis" for inferring possible mismanagement warranting further investigation. In this case, the Company did "not seriously challenge" the evidentiary record supporting such an inference. As a result, the burden shifted to

the Company to make a "fact intensive and difficult" showing that the "primary purpose" of the inspection request was improper.

The Company's argument that Plaintiff's purpose was improper relied on evidence, including testimony by Plaintiff, indicating Plaintiff's "rancor" for Hamdani and Plaintiff's intention to file a personal lawsuit against Hamdani. But the Vice Chancellor found potential personal animus by the Plaintiff "does not undermine his primary purpose of investigating mismanagement and the perceived harm that Hamdani has caused the Company."

After granting Plaintiff's Exceptions and declining to adopt the Final Report, the court remanded the matter to the Magistrate to consider the scope of the inspection and application of attorneys' fees, which were not part of the Magistrate's Final Report.

As this case confirms, stockholders demanding inspection have a low burden of proof in showing a "proper purpose" for their books and records requests, and can demonstrate a proper purpose even in instances where there is evidence of possible ulterior motives or personal interests that go beyond the bringing of derivative claims.



Corwin

In re Mindbody Inc., Stockholder Litigation: Court finds unfair sale process

C.A. No. 2019-0442-KSJM (Del. Ch. Mar. 15, 2023)

Why it is important

In re Mindbody Inc., Stockholder Litigation, C.A. No. 2019-0442-KSJM (Del. Ch. Mar. 15, 2023), the Delaware Court of Chancery held that a CEO breached his fiduciary duties by taking steps the court found tilted a merger sale process in favor of his preferred buyer and by making incomplete, misleading or false disclosures regarding the sale process and his interactions with the buyer. The court also found the buyer liable for aiding and abetting the CEO's breaches and held the buyer and the CEO jointly and severally liable for damages of US$1 per share, which the court found reflected the difference between the purchase price and the amount the buyer would have had to pay to acquire the company but for the misconduct.

Summary

Defendant Richard Stollmeyer founded Mindbody, Inc., a software-as-a-service company serving the fitness, wellness, and beauty industry, in 2000. In 2015, he took the company public while remaining its CEO. Following the IPO, Stollmeyer held Class B shares that gave him the second largest block of votes; however, these shares were due to be diluted in October 2021 under a sunset clause, which would reduce his voting power to less than 4%. Mindbody's largest stockholder at the time, Institutional Venture Partners (IVP), was considering an exit due to the same sunset provision. For these and other reasons, Stollmeyer decided he wanted to sell the company.

In August 2018, an investment banker offered to connect Stollmeyer with a private equity firm and potential acquirer, defendant Vista Equity Partners Management, LLC. Stollmeyer met with Vista representatives in September 2018, but while he disclosed the meeting to Mindbody's board, he did not detail the meeting or discuss his meeting with the investment banker. The Board directed Stollmeyer to familiarize himself with the topic of potentially selling Mindbody but not to get "too far advanced" in his conversations with Vista.

The following month, Stollmeyer requested and held a meeting with Vista's founder to discuss Vista's potential acquisition of Mindbody. Stollmeyer then took further steps to discuss a possible sale with the investment banker and Vista, without fully informing or receiving authorization from Mindbody's board. The board created a transaction committee, but it was chaired by a company shareholder with a personal interest in an expedited sale, and engaged the same investment banker that had introduced Stollmeyer to Vista. The investment banker later tipped Vista off to Mindbody's target sale price, giving Vista a further advantage in bidding to acquire the company. Vista submitted a formal bid, which it later revised to US$36.50 per share, and on December 23, 2018, the parties signed a Merger Agreement for Vista to acquire Mindbody.

The owners of the second largest block of Mindbody shares brought suit in the Court of Chancery on behalf of a class of Mindbody's stockholders. The Plaintiffs claimed that Stollmeyer and members of the Board breached their fiduciary duties in connection with the Merger, and that Vista aided and abetted those fiduciary breaches. As to Stollmeyer, the Plaintiffs argued that he: (1) breached his fiduciary duties to stockholders by tilting the sale process in favor of Vista; and (2) committed disclosure violations by omitting details of the sale process and information related to Mindbody's revenue. The plaintiffs also alleged that Vista aided and abetted the sale process breaches and disclosure violations.

The Court analyzed the plaintiffs' claims under Revlon, evaluated the viability of *Corwin*, and assessed disclosure as an independent path to liability. The Court ultimately found that the conduct leading to the Merger fell outside the range of reasonableness.

In its Revlon analysis, the court found that Stollmeyer suffered from disabling conflicts as a fiduciary because he was (1) motivated by his need for liquidity; (2) partial to Vista before the formal sale process began; and (3) was aware of timing challenges for effectuating the transaction. The court found that the Board was unaware of Stollmeyer's conflicts or resulting defects in the sale process, that the board had failed to adequately oversee Stollmeyer as a result, and that his actions had deprived the Board of the information necessary to participate in a reasonable decision-making process.

The court also held that *Corwin* cleansing did not apply because stockholders were not aware of Stollmeyer's conflicts or the way in which the process favored Vista.

The court found that Vista aided and abetted Stollmeyer's disclosure violations because Vista knew the materiality of the information omitted from the Proxy Materials, which it had removed from the Investment Committee materials. Furthermore, the Merger Agreement contractually obligated Vista to correct any material omissions in the Proxy Materials, which it did not do despite participating in drafting and reviewing those materials. The court found defendants jointly and severally liable for damages of US$1 per share, reflecting the difference between the purchase price and the price the court found Vista would have paid under a fair process.

Delaware court holds *Corwin* does not cleanse claims based on "enduring alleged entrenchment devices"

No. 2022-0624-MTZ (Del. Ch. May 1, 2023)

Why it is important

In *In re Edgio Stockholders Litigation*, No. 2022-0624-MTZ (Del. Ch. May 1, 2023) the Delaware Court of Chancery, in denying a motion to dismiss, evaluated a stockholder action to enjoin a transaction in light of one party's adoption of measures restricting investors' voting and transfer rights as part of a potential business combination. The Court declined to apply *Corwin* cleansing despite the approval of a fully informed, uncoerced majority of stockholders, due to the nature of the claims. Instead, the court held that plaintiffs sufficiently alleged facts to infer that the defensive measures in the deal were designed to entrench the board, such that Unocal's enhanced scrutiny applied at the pleading stage of this action for injunctive relief. This case helps Delaware corporations considering implementing defensive measures to better understand the consequences of such measures.

Summary

Limelight Network Inc., a telecommunications company (Limelight or the Company) saw its stock price drop from a high of US$8.19 in July 2020 to US$4.33 by January 2021, leading to market speculation the Company could be a target for activist investors. Instead, Limelight agreed to combine with Edgecast, Inc., a business unit under Yahoo that offered cloud solutions.

Limelight conducted due diligence, and the parties agreed on an all stock deal worth approximately US$300 million, with the possibility of additional stock-based earnout consideration of US$100 million (the Acquisition). The Acquisition resulted in Limelight changing its name to Edgio, Inc., with Yahoo's parent company, College Parent, L.P., (College Parent) to receive 35% of the shares and three seats on Edgio's nine member board.

As part of the Acquisition, College Parent entered into a stockholders agreement with the Company that included three provisions that were contested in the litigation (the Challenged Provisions). These included:

- College Parent must vote in favor of the Board's recommendations with respect to director nominations and against any nominee not recommended by the Board (the Director Voting Provision).
- For other non-routine matters submitted for stockholder vote, College Parent must either vote in favor of the Board's recommendation or pro rata with all other Company stockholders (the Vote Neutralization Provision).
- College Parent is restricted for two years from transferring its shares without the Board's consent, and is prohibited its transferring it shares for an additional twelve months to a list of fifty activist investors named by the Board. (the Transfer Restrictions).

A fully informed, uncoerced majority Limelight stockholders voted in favor of the stock issuance, and the Acquisition closed on June 15, 2022.

On July 18, 2022, a group of stockholders, although not challenging the benefits of the business combination itself, asserted a direct claim for breach of fiduciary duty against the Edgio and its directors. The stockholders asserted that the inclusion of the Challenged Provisions was a breach of the directors' fiduciary duties, an attempt to create a "35% voting bloc contractually committed to protecting the Board" and meant "to deter and defeat any activist threats to the incumbent directors." The stockholders asked the court to enjoin the enforcement of the Challenged Provisions, but did not seek monetary damages.

Defendants moved for dismissal under the framework of *Corwin v. KKR Financial Holdings*, 125 A.3d 304 (Del. 2015), arguing that, the Board's decisions regarding the Challenged Provisions were protected by the business judgment rule because the Acquisition had been approved by a fully informed, uncoerced vote of disinterested stockholders. Further, defendants argued the enhanced scrutiny standard that applies to director decisions with identifiable conflicts of interest, established in *Unocal v. Mesa Corporation*, 493 A.2d 946 (Del. 1985), did not apply in the absence of any investor threat and corresponding director defensive action.

In a lengthy and detailed opinion, Vice Chancellor Morgan T. Zurn disagreed with the defendants and denied the motion to dismiss, concluding that *Corwin* stops "short of cleansing claims seeking to enjoin defensive measures." Rather, the Court reasoned that *Corwin*'s business judgment rule protections did not apply to claims to enjoin defensive measures. Instead, Unocal's enhanced scrutiny standard applied to the directors' actions in this case, because *Corwin*'s rationale of allowing "stockholders to make free and informed choices based on the economic merits of a transaction" did not apply to defensive measures that would apply for years into the future.

The court noted that Delaware law "has consistently recognized that the harm caused by entrenching measures is irreparable and evades economic valuation." Plaintiffs pleaded that the company experienced a significant drop in its stock price and "up until six months before the challenged provisions were agreed upon," analysts had speculated that the company "may be an activist threat." Given such allegations, along with the defensive nature of the Challenged Provisions (in particular the Transfer Restrictions), it was "reasonable to infer that the Board negotiated for and obtained the Challenged Provision to defend against a threat of activism." In the face of this "naked entrenchment vehicle," the court held that a stockholder vote would not provide *Corwin*'s business judgment rule protections. Because Unocal's enhanced scrutiny applied, and defendants did not argue they had met this burden, the Court denied their motion to dismiss.

Mere disagreement with merger decision not a cognizable claim under Delaware law

C.A. No. 2021-1075-NAC (Del. Ch. January 31, 2023)

Why it is important

The Delaware Court of Chancery, in *Teamsters Local 677 Health Services & Insurance Plan v. Martell*, C.A. No. 2021-1075-NAC (Del. Ch. January 31, 2023), granted the defendant's motion to dismiss under *Corwin*. The court found that the board materials and the proxy statement unambiguously contradicted the disclosure violation and breach of fiduciary duty claims brought in connection with the acquisition of CoreLogic, Inc. As the complaint relied primarily on an article paraphrasing the words of the CEO of the losing bidder in the acquisition, the court classified such claims as conclusory and found that the complaint insufficiently alleged facts to support the claims therein.

Summary

CoreLogic, Inc. (CoreLogic) is a corporation that provides financial, property, and consumer information, analytics, and intelligence. In June 2020, CoreLogic received an unsolicited joint proposal from two funds to acquire CoreLogic, which CoreLogic's board of directors (the Board) rejected. This failed bid led to significant interest in CoreLogic, and the Board initiated a process to seek strategic alternatives. Ultimately, CoreLogic narrowed the field of bidders to two: (1) CoStar Group Inc. (CoStar) submitted a strategic bid that included cash and stock; and (2) Stone Point Capital LLC (Stone Point) and Insight Partners LLC (Insight) submitted a financial bid. After months of negotiations with both bidders, CoreLogic accepted the financial bid from Stone Point and Insight.

Following the rejection of CoStar's bid, an article reported that Andrew Florance, CoStar's CEO, stated that he thought CoreLogic's executives did not want to merge with CoStar because they feared losing their jobs. The plaintiff, a common stockholder of CoreLogic, then filed a books and records action against CoreLogic pursuant to Section 220 of the Delaware General Corporation Law to investigate "potential wrongdoing." Following the receipt of documents, plaintiff filed a complaint alleging that the sale process was infected by the desire of Frank Martell, CoreLogic's CEO, to protect his job. The complaint included (1) claims alleging disclosure violations related to antitrust concerns and Martell's interests in post-merger employment; and (2) a breach of fiduciary duty claim against Martell.

As a preliminary matter, the court ruled that the entire fairness standard did not apply and that "the Complaint must be dismissed under *Corwin*, unless the Complaint supports a reasonable inference that the vote was not fully informed." The court went on to explain that the plaintiff had the initial burden to identify a deficiency in disclosure document. Here, the plaintiff alleged four deficiencies related to the antitrust disclosures in the Proxy Statement, and, alternatively, alleged that the Proxy Statement omitted material information regarding Martell's interest in securing post-merger employment.

With regard to the antitrust disclosures, plaintiff alleged that the disclosures were false because (1) CoreLogic did not raise antitrust concerns until December 2020, (2) there was no explanation for the Board's antitrust concerns, (3) CoreLogic failed to retain antitrust counsel, and (4) CoStar was not a CoreLogic's competitor. The court rejected each of these allegations, finding that the Proxy Statement disclosed that the Board's antitrust concerns arose in July 2020 and included explanations for the Board's antitrust concerns. The plaintiff abandoned the third allegation regarding failure to hire antitrust counsel. Finally, the court found plaintiff's argument that CoStar was not a competitor to be misplaced as antitrust laws protect competition, not competitors, and determined that the Proxy Statement disclosed the Board's concern with the impact the merger would have on customers and the regulatory scrutiny the merger would receive.

The court also rejected plaintiff's claim that there was a disclosure violation because the Proxy Statement omitted information about Martell's interest in post-Merger employment. The plaintiff alleged that Martell must have discussed post-merger employment because he was retained after the merger closed, but could not point to any documents or communications to support this allegation, despite receiving documents in response to the Section 220 demand. Accordingly, the court found the complaint failed under *Corwin*.

The court further held that even if *Corwin* were inapplicable, the complaint failed to state a breach of fiduciary duty claim against Martell. Plaintiff alleged that Martell drove the sale process, directed the Board to approve with the merger with Insight and Stone Point, and was motivated by his own self-interest regarding his employment and pay. The court rejected these claims, finding the complaint devoid of facts from which to infer that Martell had led the Company away from CoStar. The court observed that none of the 11 outside directors of the Board were beholden to Martell nor were alleged to have been conflicted. Rather, three of the directors had been nominated by entities during a proxy contest, and the court stated that an allegation that these three directors were "supine" was "not only conclusory, but, frankly, strains belief." In addition, the Board's advisors were not alleged to be conflicted, nor beholden to Martell, or alleged to have provided inaccurate information to the Board. The court also noted that Martell did not appear to play a role in the Board's consideration or determination of their preference for deal terms. Therefore, the court found that there was no reasonable inference that Martell exerted improper influence over the sale.

Contract Interpretation

Delaware Supreme Court reverses US$690 million judgment in Boardwalk Pipeline Partners

288 A.3d 1083 No. 1, 2022 (Del. Dec. 19, 2022)

Why it is important

In *Boardwalk Pipeline Partners, L.P. v. Bandera Master Fund, LP*, 288 A.3d 1083 (Del. 2022), the Delaware Supreme Court reversed a Delaware Court of Chancery decision that had awarded nearly US$690 million to plaintiffs. Emphasizing the "maximum flexibility" of drafting partnership agreements under Delaware law, the court found that the General Partner of a Master Limited Partnership was entitled to a conclusive presumption of good faith when exercising a call right to acquire all the public units to the detriment of minority unitholders. The Supreme Court rejected the Court of Chancery's construction of the partnership documents, which had found "ambiguity" in the Partnership Agreement and would have required a "protective check" on the General Partner's discretion. Instead, the Supreme Court sought to harmonize all of partnership organizational documents when concluding that they "unambiguous[ly]" supported proper exercise of the call right.

Summary

In 2005, Boardwalk Pipeline Partners, LP (Boardwalk) went public as a Delaware Master Limited Partnership (MLP). Boardwalk's subsidiaries operated interstate natural gas pipeline systems; it formed the MLP, in part, to take advantage of tax benefits from Federal Energy Regulatory Commission (FERC) regulations. In 2018, a FERC policy change prompted Boardwalk to explore opportunities to exercise its "call right" to take the MLP private through acquisition of all public units at a purchase price that was based on a trailing market average.

At issue in the appeal was whether Boardwalk's General Partner properly exercised that call right. Plaintiffs (minority unitholders) claimed that Boardwalk, the General Partner, and other defendants breached the Partnership Agreement by not meeting the "opinion of counsel" requirement and by paying a deflated price per unit upon exercise of the call right. Plaintiffs also brought other causes of action against defendants, such as unjust enrichment and tortious interference.

The structure of the MLP was a key part of the Delaware Supreme Court's decision. Boardwalk was controlled by its General Partner, Boardwalk GP, LP (General Partner or GP). The General Partner had its own general partner, Boardwalk GP, LLC (GPGP). The GPGP, in turn, had both a board of directors (GPGP Board) and a sole member, Boardwalk Pipelines Holding Corp. (Sole Member). Under the GPGP's LLC Agreement, the Sole Member had "exclusive authority" to cause the LLC to "exercise the rights" of the LLC and those of the General Partner.

Exercise of the call right required that the General Partner receive an "Opinion of Counsel" that "the Partnership's status as an association not taxable as a corporation and not otherwise subject to an entity-level tax for federal, state or local income tax purposes has or will reasonably likely in the future have a material adverse effect on the maximum applicable rate that can be charged to customers . . . ." As defined in the Partnership Agreement, an "Opinion of Counsel" must be "acceptable to the General Partner." The Partnership Agreement did not address which entity would act on behalf of the General Partner in determining the "acceptability" of the opinion, though (as discussed below) the Delaware Supreme Court concluded that the LLC Agreement did provide such detail. Pursuant to the Partnership Agreement, the General Partner was conclusively presumed to act in good faith if it acted in reliance on the advice or opinion of legal counsel.

The General Partner received an opinion of counsel from Baker Botts that the FERC policy change met the requirements for exercise of the call right (Baker Botts Opinion), including the "material adverse effect" requirement. Baker Botts also concluded that the Sole Member was responsible for the second step of determining whether the Baker Botts Opinion was "acceptable."

The Sole Member then retained Skadden, Arps, Slate, Meagher & Flom LLP to assess "acceptability" of the Baker Opinion. Skadden concluded that it would be reasonable for the Sole Member's Board to find that the Baker Botts Opinion was "acceptable," as that term is used in the Partnership Agreement (Skadden Opinion).

The General Partner thus acted through the Sole Member in obtaining advice from Skadden that it would be reasonable to accept the Baker Botts Opinion. This resulted in the General Partner exercising its call right.

In November 2021, the Court of Chancery held a four day trial. The court found that the General Partner had not received a "bona fide" opinion of counsel, characterizing the Baker Botts Opinion as "a contrived effort to reach the result that the General Partner wanted." As a result, the General Partner could not rely on the Baker Botts Opinion to escape liability. The Court of Chancery then determined that the Partnership Agreement was ambiguous as to whether the Sole Member or the GPGP Board should make the decision to find the Baker Botts Opinion "acceptable." Ultimately, the court found that the GPGP Board (with four independent members) should have determined whether the Baker Botts Opinion was acceptable, so as to serve as a "protective check" on the General Partner and to protect the partnership more broadly. The Court of Chancery also concluded that, because the General Partner had pushed Baker Botts to provide the opinion it wanted, Baker's scienter could be imputed to the General Partner. Plaintiffs did not contend (and the Court of Chancery did not find) that the Skadden Opinion was the product of bad faith or willful misconduct.

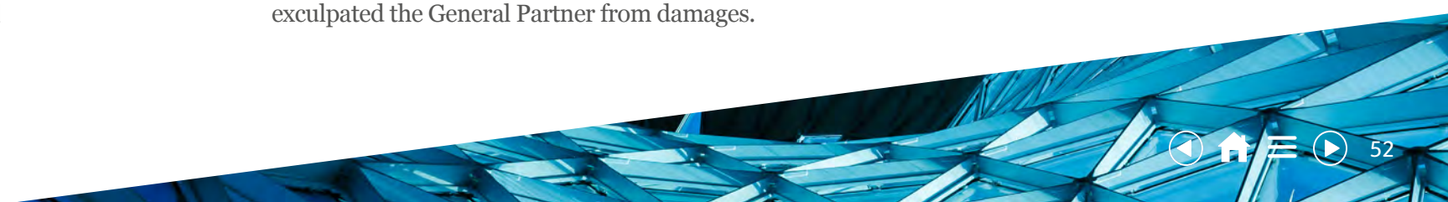
The Court of Chancery awarded US$689,827,343.38 in damages, pre and post-judgment interest on that amount, and an award of fees.

The Delaware Supreme Court reversed, emphasizing that Delaware law affords limited partnerships the "maximum flexibility over investments and operations," including disclaiming the general partner's fiduciary duties. The Supreme Court sought to harmonize different parts of the MLP's organizational agreements, explaining that the Court of Chancery's analysis "went off track when the court read the Partnership Agreement in isolation and not as part of the MLP's overall governance structure."

According to the Supreme Court, when the LLC Agreement and Partnership Agreement were read together, they "unambiguously" gave the Sole Member the exclusive authority to cause the exercise of the call right, since the Sole Member had the power to determine the acceptability of the Baker Opinion for the General Partner. Further, because there was no allegation that the Skadden Opinion was the product of bad faith, the conclusive presumption of good faith applied to the Sole Member's reliance on the Skadden Opinion. As a result, the Sole Member Board's good faith actions on behalf of the General Partner exculpated the General Partner from damages.

Regarding scienter issues, the Supreme Court cited *Dieckman v. Regency GP LP*, 2021 WL 537325 (Del. Ch. Feb. 15, 2021), aff'd, 264 A.3d 641 (Del. 2021) for the point that agency law should not displace the Sole Member Board and the MLP's contractual terms as set forth in the Partnership Agreement and LLC Agreement. Pursuant to such documents, the Sole Member Board was the decisionmaker with respect to determining "acceptability" of the Baker Opinion, so it was inappropriate to impute any scienter by the Baker Botts law firm to the General Partner under agency principles.

In a concurrence, two Justices criticized the Court of Chancery's second-guessing of the Baker Botts Opinion, noting the Court should have applied a more deferential standard of review pursuant to *Williams Cos., Inc. v. Energy Transfer Equity, L.P.*, 2016 WL 3576682 (Del. Ch. June 24, 2016), aff'd, 159 A.3d 264 (Del. 2017). The concurrence states that Delaware law "does not permit a trial court to substitute its legal interpretation for one reached by counsel in good faith." The concurrence concluded that "the law does not require that opinions of counsel be substantively correct. What the law requires is that lawyers undertake a good faith effort. Such good faith effort is entitled to deference."



Holifield v. XRI: Delaware Supreme Court reinforces primacy of freedom of contract for LLC agreements

No. 407, 2022 (Del. Sept. 7, 2023)

Why it is important

In *Holifield v. XRI Investment Holdings LLC*, No. 407, 2022 (Del. Sept. 7, 2023), the Delaware Supreme Court affirmed the lower court's determination that the defendant violated XRI Investment Holdings' LLC agreement when he transferred his member units "for consideration" to a special purpose vehicle. The court held that the "No Transfer Provision" in the LLC agreement, which stated that a noncompliant transfer is "void" rather than "voidable," prevailed over equitable considerations and required the Court to find the transfer incurably void. In reaching this decision, the Court reaffirmed its ruling in *CompoSecure L.L.C. v. CardUX, LLC* (CompoSecure II). This decision reaffirmed that LLCs are "creatures of contract" and that nothing in Delaware public policy prohibits LLC members from tailoring their rights and obligations through LLC agreements.

Summary

Gregory Holifield co-founded XRI's predecessor entity. In August 2016, he sold his controlling interest to funds affiliated with an investment bank. Out of that transaction emerged XRI, a Delaware limited liability company. XRI's LLC Agreement designated two classes of membership interests— "Class A Units" and "Class B Units." Holifield' and his co-founder held Class B Units and the investment bank held all the Class A Units. The LLC Agreement prohibited members from transferring their member interests (the No Transfer Provision), except if made for consideration to certain "Permitted Transferees," such as an entity owned solely by the transferring member. Any transfer that violated the No Transfer Provision was "void."

Around 2018, Holifield and his co-founder proposed a transaction that involved, in part, Holifield transferring his Class B Units to a special purpose vehicle (the Blue Transfer). XRI approved the Blue Transfer in June 2018 on the assumption that it was a "Permitted Transfer" under the LLC Agreement. In April 2019, Holifield provided additional documentation concerning the Blue Transfer, at which point XRI became concerned that the Blue Transfer was not a "Permitted Transfer" and violated the LLC Agreement.

In the action underlying this appeal, XRI sought a declaration that the Blue Transfer was void under the LLC Agreement. After a one-day trial, the Court of Chancery held that the Blue Transfer was not a Permitted Transfer because it was made "for consideration." The court concluded that transfers other than Permitted Transfers were required to be approved by the XRI board and because the Blue Transfer was not approved, it violated the No Transfer Provision. In reaching this conclusion, the trial court relied on the Delaware Supreme Court's decision in *CompoSecure LLC v. Cardux LLC*, C.A. No. 177, 2018 (Del. Nov. 7, 2018) (CompoSecure II). There, the court held that where the plain language of an LLC agreement states that a noncompliant act is "void" instead of "voidable," the contractual language prevails over the equitable defense of acquiescence and requires courts to deem the act incurably void.

Holifield appealed the Chancery Court's decision and urged the Delaware Supreme Court to overturn CompoSecure II. The Court declined to do so for four main reasons.

First, the court found that CompoSecure II was consistent with the well-established principle in Delaware corporate law that LLCs are "creatures of contract" that significant contractual freedoms not available in the corporate context. In the alternative entity context, "equity will not save a bad contract."

Second, the court noted that this freedom of contract in LLC agreements extends to contractually specified incurable voidness, finding that "nothing in Delaware law or public policy prohibits parties to an LLC agreement from contracting for incurable voidness."

Third, the court noted that the legislative response to CompoSecure II favored adherence to its rule. Following Composcore II, the General Assembly amended Delaware's LLC law to provide that LLC may ratify certain acts that are void due to lack of necessary LLC approval. However, the statutory amendment only addressed ratification of the LLC's own breaching acts, not the acts of LLC members.

Finally, the court concluded that the Delaware's stare decisis principles weighed against overruling CompoSecure II. There was no "clear manifestation of error" or urgent reasons to overrule the decision, which, though only five years old, settled an issue in an area of the law that has been "thorny" for "a very long time." The court, therefore, would not upset this easily administrable rule based on a narrow majority or change in court composition.

New Enterprise Associates: Stockholders' advance waiver of fiduciary duty claims is enforceable

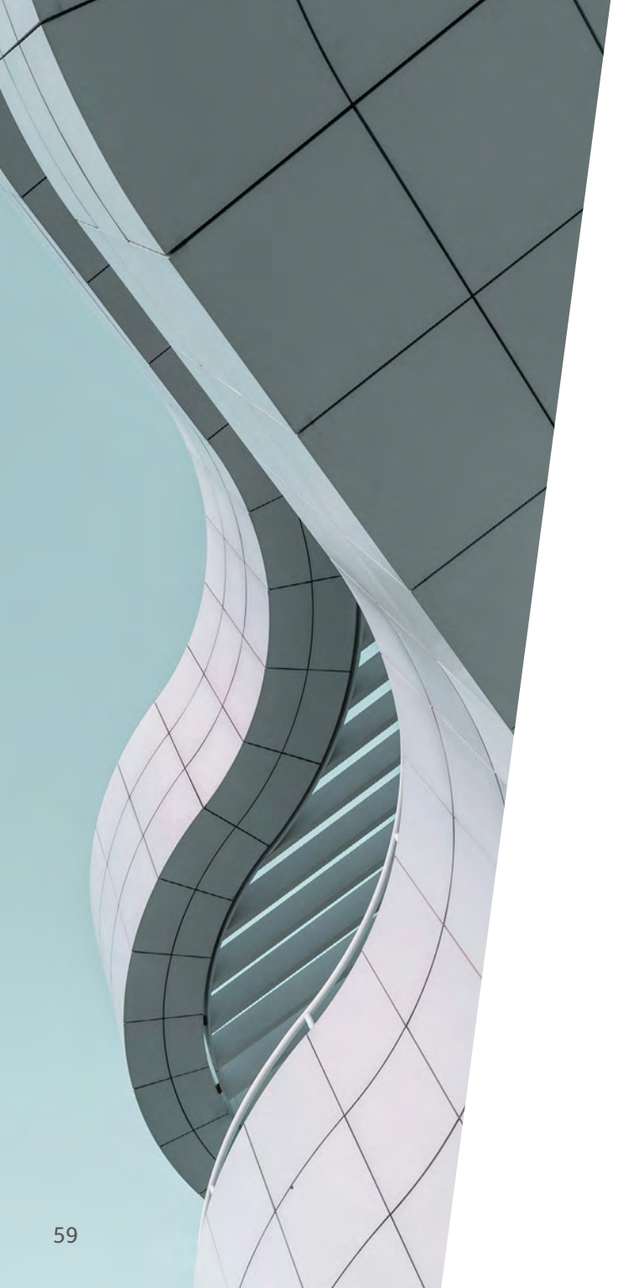
C.A. No. 2022-0406-JTL (Del. Ch. May 2, 2023)

Why it is important

In *New Enterprise Associates 14. v. Rich*, the court held that a covenant not to sue in a voting agreement executed by sophisticated stockholders was facially enforceable even though it limited claims for breach of fiduciary duties. The court found that fiduciary duties in Delaware can be tailored in advance to permit specific actions that might otherwise constitute a breach of fiduciary duty, especially if the limitations are included in a stockholder agreement concerning stockholder rights. The court's analysis rejected several arguments, including that the duty of loyalty is too important to waive, enforcing the duty of loyalty is essential to corporations, and allowing advance waiver of the duty of loyalty blurs the line between corporations and LLCs. The court did, however, find that public policy does not permit contractual exculpation for tort liability based on intentional wrongdoing, and so denied the motion to dismiss because the claims involved facts suggesting bad faith.

Summary

In *New Enterprise Associates 14 v. Rich*, No. 2022-0406-JTL (Del. Ch. May 2, 2023), the plaintiffs (Plaintiffs) were a group of sophisticated venture capital firms that invested heavily in a start-up called Fugue, Inc. (the Company) starting in 2013. In mid-2020, Plaintiffs urged the Company to pursue a liquidity event, which prompted a sales process that ultimately failed. By the end of the first quarter of 2021, the Company's CEO, Josh Stella, informed the Company's board of directors (the Board) that the process had failed, the company needed capital, and the best option was to engage in a recapitalization led by Defendant George Rich (the Recapitalization). Rich's terms for the Recapitalization included a requirement that twenty-nine key stockholders sign a voting agreement (the Voting Agreement). As relevant here, the Voting Agreement included a drag-along right, which: (1) obligated all signatories to vote in favor of any transaction approved by the Board and a majority of the preferred stockholders (the participants in the Recapitalization) that meets a list of eight criteria, and (2) included a convent not to sue Rich, his affiliates, and his associates over any such sale. Plaintiffs agreed to the Recapitalization, declined to participate in it, and signed the Voting Agreement. The Recapitalization took place in April 2021.



A drag-along sale soon materialized. A potential acquiror contacted Stella in late June 2021, and negotiations began. Shortly thereafter, in mid-July, the two independent directors on the Board resigned, leaving only Rich, Stella, and David Rutchik, who had participated in the Recapitalization. A week later, the Board authorized the issuance of nearly 4 million additional shares of preferred stock at the same price and on the same terms as the Recapitalization, which were "extracted . . . when the Company was low on cash and had no alternatives." Then, on July 29, 2021, the Board also approved grants of stock options, including large grants to themselves. Plaintiffs discovered these two transactions (the Interested Transactions) after reviewing a distribution waterfall circulated in connection with the closing of the sale in February 2022. Despite the fact that the merger met all eight criteria to constitute a drag-along sale, Plaintiffs had already refused to sign a joinder agreement and voting form in favor of the merger because Stella and Rich did not attest that they had not communicated with the acquirer regarding a potential transaction before the Recapitalization.

The discovery of the Interested Transactions prompted Plaintiffs to do what they had covenanted not to do in the Voting Agreement – sue over a drag-along sale. Plaintiffs asserted, among other things, that the Interested Transactions involved obvious self-dealing on terms unfair to the Company but highly favorable to Rich, Stella, Rutchik, and their associates, and therefore constituted breaches of the fiduciary duty of loyalty. Plaintiffs alleged that the approval of the drag-along sale also was a breach of fiduciary duty because it extinguished sell-side stockholders' standing to pursue breach of fiduciary duty claims based on the Interested Transactions and because it failed to provide consideration for those fiduciary duty claims. The defendants, which include Rich, Stella, and Rutchik, moved to dismiss the action, asserting, among other things, that the covenant not to sue in the Voting Agreement bars Plaintiff's claims.

The Court of Chancery, having denied the motion to dismiss for failure to state a claim on other grounds, evaluated the covenant not to sue in its May 2, 2023 decision. Plaintiffs argued that the covenant is facially invalid because Delaware law does not allow parties to waive fiduciary duties except in the limited circumstances set forth in Sections 102(b)(7) and 122(17) of the Delaware General Corporate Law (DGCL). They did not argue that it was induced by fraud or overreaching or that they did not understand it or its implications when they signed the Voting Agreement—in fact, the covenant was based on a model provision sponsored by the NVCA, an organization of which one of the plaintiffs is a member. The court rejected Plaintiffs' argument as overly absolutist, saying that it failed to account for a variety of permissible forms of fiduciary tailoring, ignored the difference between attempts to limit fiduciary duties in the constitutive documents of an entity and an agreement to do so in a stockholder-level agreement, and failed to pay heed to the importance of private ordering in Delaware law.

Vice Chancellor Laster explained that, contrary to Plaintiffs' bright-line proposition, Delaware law has long allowed fiduciary obligations in the trust and agency contexts to be modified by contracts including narrow purpose clauses or provisions specifically authorizing conduct that would otherwise constitute a breach of loyalty. And Delaware's corporate law has accommodated these traditional forms of fiduciary tailoring in addition to explicitly allowing certain types of fiduciary tailoring or limitations on fiduciary accountability in §§ 102(b)(7), 122(17), 102(a)(3), 141(a), 145, 327, and 367 of the DGCL as well as in various common law doctrines. In particular, § 122(17), which authorizes advance renunciation of corporate opportunities, and the common law doctrine allowing stockholders to ratify certain interested transactions in advance both resemble traditional fiduciary tailoring by authorizing conduct that would otherwise constitutes a breach.

VC Laster also emphasized the contractarian nature of Delaware law and the overall philosophy that sophisticated parties "can and should 'make their own judgments about the risk they should bear.'" This commitment

"should be at its height when stockholders enter into agreements about how they will exercise stockholder-level rights." Those rights, which include the rights to sell, to vote, and to sue, are the personal property of the stockholder, so the stockholders are free to contract over each of the rights. And, in the context of a voting agreement like the one at issue here, the stockholders have explicitly consented to the limitations on their rights. These considerations weighed heavily in favor of finding the covenant to be valid.

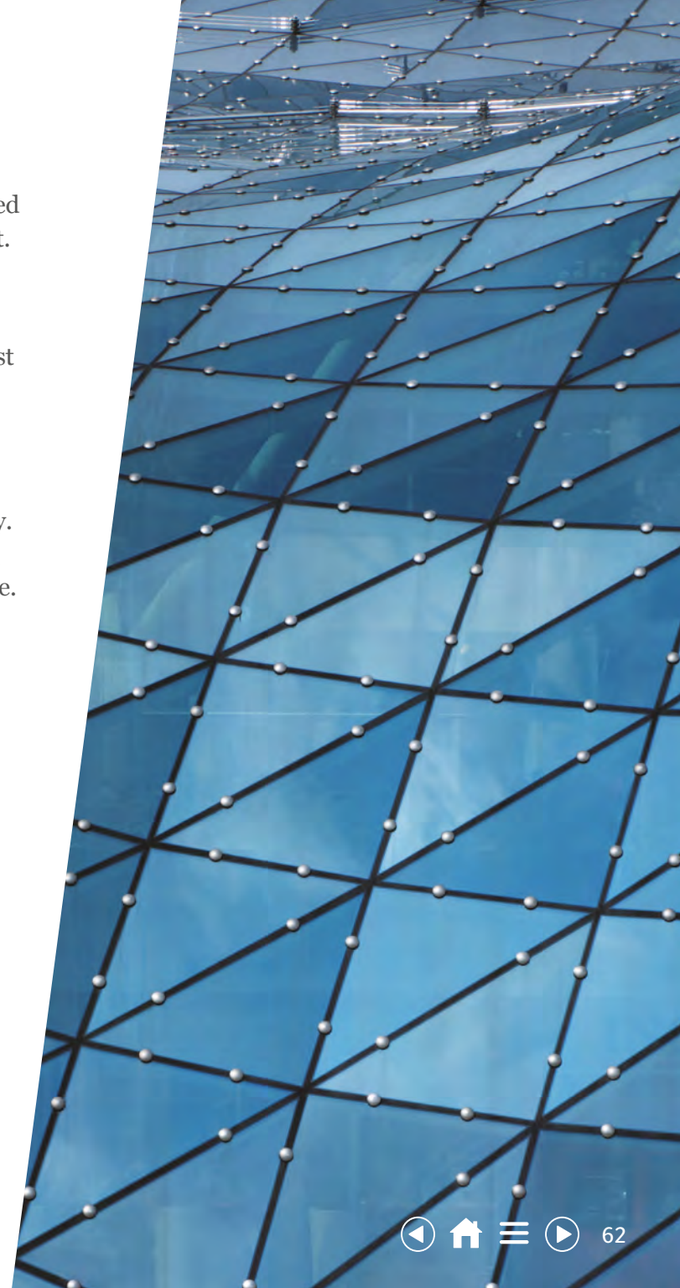
The Court also raised and rejected four additional arguments

- The court dismissed the argument that breach of fiduciary duty is too big to waive by pointing out that Delaware law allows individuals to waive even more fundamental rights such as the right to trial by jury and the right to counsel in a criminal case, as well as statutory rights associated with property ownership, employment, and the right to speak freely.
- The court considered the argument that the guarantee of certain immutable, standard fiduciary rights was essential to Delaware's corporate brand, but held that private ordering, especially by means of a stockholder-level agreement, is also a fundamental component of Delaware's corporate brand.
- The court rejected the slippery slope argument that allowing the covenant and similar waivers of fiduciary claims would collapse the distinction between corporations and LLCs because the distinctions exist at the constitutive document and governing statute level and are not affected by a stockholder-level agreement.
- The court reviewed the Delaware Supreme Court's decisions in *Manti Holdings, LLC v. Authentix Acquisition Co.*, 261 A.3d 1199 (Del. 2021), a case involving a covenant not to assert appraisal rights, to anticipate how that court might approach this issue. Vice Chancellor Laster concluded that, under Manti's framework, a broad, unspecified waiver of fiduciary duties or a covenant to never assert claims for breach of fiduciary duty regardless of facts might be facially invalid, but a covenant like the one at issue, which appeared in a contract that was bargained-for, involved counsel, and was signed by sophisticated stockholders who understood the covenant and its consequences, is not facially invalid.

The Court ultimately concluded that a provision like the covenant should be analyzed in two steps. First, the provision must be narrowly tailored to address a specific transaction. Second, it must survive close scrutiny for reasonableness.

The covenant at issue passed both tests—it applied to only transactions that meet eight specific criteria and, as described above, it is reasonable to enforce it against the sophisticated stockholders who signed the Voting Agreement.

Before simply enforcing the covenant and dismissing the case, however, the Court raised one final issue—Delaware's public policy against contracts that attempt to exculpate parties for fraudulent or bad faith acts. According to this policy, the covenant is invalid to the extent that it seeks to prevent assertions of claims for intentional or bad faith breach of fiduciary duty. Given the self-dealing alleged in the complaint, the covenant was not a bar to claims in this case.



Texas Pacific: Following trial, Delaware Court rules investors violated stockholders agreement

C. A. 2022-1066-JTL (Del. Ch. Dec. 1, 2023)

Why it is important

In *Texas Pacific Land Corporation v. Horizon Kinetics LLC*, the Delaware Court of Chancery ruled in a post-trial opinion that investors violated a stockholders agreement by failing to vote in favor of a board proposal to increase the number of authorized shares of Texas Pacific Land Corporation (the Company). The defendant investor group argued that certain exceptions to a "Voting Commitment" allowed the group not to vote in favor of the board's proposal. After finding that the exceptions to the Voting Commitment were ambiguous—and that the stockholder agreement's prohibition on considering negotiation and drafting of the agreement as extrinsic evidence was enforceable—the court considered other extrinsic evidence and concluded that the provisions did not exempt the investors from complying with the Voting Commitment. The court also held that the Company's disclosure failures in the proxy statement did not constitute "unclean hands" and the Company was entitled to judgment in its favor.

Summary

Texas Pacific Land Corporation (the Company) is one of the largest landowners in Texas and was originally constituted as a trust that issued a fixed number of trust certificates. In January 2021, the Company converted from a trust to a corporation. In connection with that change, a group of investors seeking board seats entered into a stockholders agreement pursuant to which the investors were required to vote in favor of board proposals, subject to exceptions for major transactions and environmental, social, and governance matters (the Voting Commitment). A material issue during the conversion process was whether the Company could authorize or issue additional equity, given that the Company's equity previously had been fixed. The issue was tabled and never resolved. After failing to consummate two potential acquisitions due to the Company's inflexible equity structure, the Company's board proposed to increase the number of authorized shares (the Proposal). Two of the signatories to the stockholders agreement (the Investor Group) voted against the Proposal.

The Company filed suit against the Investor Group under Section 225 of the Delaware General Corporation Law. The Investor Group argued that: (i) the share issuance fell under the exceptions in the stockholders agreement to the Voting Commitment; and (ii) the Company's disclosure deficiencies in the proxy statement obviated the Investor Group's obligation to comply with the Voting Commitment under the doctrine of unclean hands.

The court disagreed, holding that: (i) extrinsic evidence of the Investor Group's subjective beliefs about the terms of the Voting Commitment resolved ambiguous terms in

the Company's favor; and (ii) the disclosure failures did not constitute unclean hands in the context of the voting commitment. The court therefore deemed the shares issued.

A corporation seeking to limit stockholders' voting rights must first prove the existence of such a limitation. Here, however, the Voting Commitment was an unambiguous limitation on the Investor Group's voting rights. As a result, the Investor Group bore the burden of proving that an exception the Voting Commitment applied. These exceptions included matters "related to" mergers, acquisitions, and recapitalizations, along with ESG matters. The court held that each party offered reasonable interpretations of the exceptions to the Voting Commitment, rendering the exceptions ambiguous. After determining that none of the exceptions was, on its face, applicable to the share issuance, the court turned to extrinsic evidence to interpret the meaning of the exceptions.

Importantly, the court held that a provision of the stockholders agreement, prohibiting the use of drafting history in interpreting the agreement, was enforceable, and that expert testimony on trade usage was non-dispositive. Therefore, the court considered other extrinsic evidence indicating the parties' course of performance, including correspondence and contemporaneous notes of conversations between members of the Investor Group and third parties. Based on that evidence, the court found that the Investor Group believed in advance of the vote on the Proposal that the Voting Commitment would obligate them to vote in favor of the Proposal. The court thus concluded that the Investor Group failed to prove that any exception to the Voting Commitment applied.

Finally, the court held that the doctrine of unclean hands, based on one misrepresentation and one omission in the proxy statement, would not bar the Company's success on the merits. The court first cited precedent holding that the duty of disclosure does not apply in connection with a contractual obligation, such as the Voting Commitment. The court then noted that the doctrine of unclean hands is unavailable when the party claiming the doctrine had itself acted inequitably. The Investor Group had violated the standstill provision in the stockholders agreement by actively campaigning against the Proposal in communications with other stockholders, foreclosing the possibility that the disclosure violations, even if material, would render the doctrine of unclean hands unavailable to the Company.

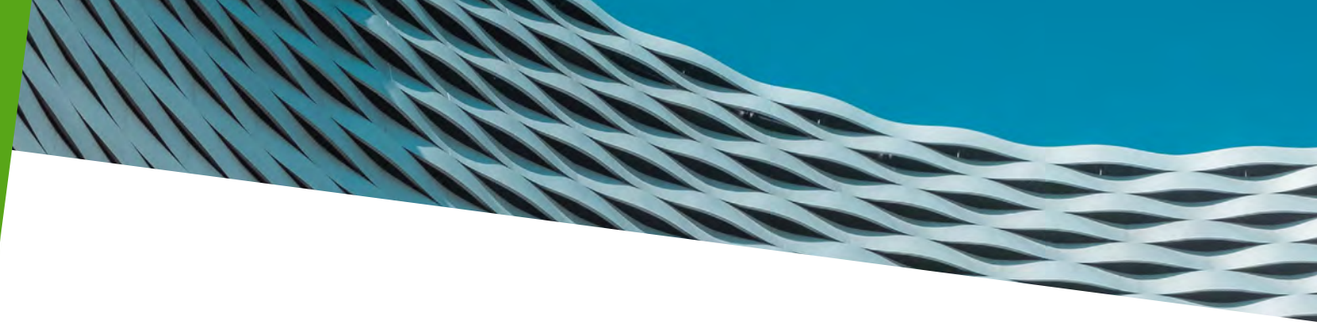
This case provides a helpful analysis on the enforceability of contractual provisions designed to prevent courts from considering evidence of the parties' negotiations. However, central to the court's holding was its finding that the restriction did not unduly limit the court's ability to consider the extrinsic evidence needed to interpret the ambiguous provisions. It remains unclear whether a contractual provision foreclosing consideration of all extrinsic evidence would be enforceable.

Lee v. Fisher: Ninth Circuit enforces forum selection clause to bar derivative action

No. 21-15923 (9th Cir. 2023)

Why it is important

In *Lee v. Fisher*, No. 21-15923 (9th Cir. 2023), an en banc panel of the U.S. Court of Appeals for the Ninth Circuit affirmed the district court's dismissal of a shareholder derivative action against The Gap, Inc. Plaintiff Noelle Lee alleged that the forum selection clause in The Gap's bylaws violated the Securities Exchange Act of 1934, Delaware General Corporation Law, and public policy by requiring that all derivative actions be brought in the Delaware Court of Chancery. The Ninth Circuit found the clause enforceable and, as a result, split with the Seventh Circuit, which declined to enforce a similar forum selection clause in *Seafarers Pension Plan ex rel. Boeing Co. v. Bradway*, F.4th 714 (7th Cir. 2022).



Summary

Plaintiff Noelle Lee brought this derivative action in the U.S. District Court for the Northern District of California against The Gap, Inc., a clothing retailer incorporated in Delaware. Lee alleged that The Gap's 2019 and 2020 proxy statements included misstatements regarding corporate governance, which prevented shareholders from submitting fully informed votes. Although Lee brought the action in California, The Gap's bylaws contained a forum selection clause requiring all derivative actions to be brought in the Delaware Court of Chancery.

Lee argued that The Gap's forum selection clause was void because: (1) the clause violated the anti-waiver provision of § 29(a) of the Exchange Act; (2) enforcing the clause would go against the public policy of allowing shareholders to bring § 14(a) claims as derivative actions; and (3) the clause violated § 115 of the Delaware General Corporation Law (DGCL). The Ninth Circuit rejected all three arguments.

First, the Ninth Circuit concluded that § 29(a) of the Exchange Act only prohibits waivers of "substantive obligations" and only applies to "express waivers of noncompliance." Here, the forum selection clause was not an express waiver of non-compliance despite § 27(a) of the Exchange Act giving federal courts exclusive jurisdiction over § 14(a) actions. The Ninth Circuit noted that this did not prohibit Lee from bringing a direct action, and concluded that the forum selection clause did not waive compliance with the substantive obligations of § 14(a) of the Exchange Act and SEC Rule 14a-9.

Second, the Ninth Circuit rejected Lee's public policy argument that the federal forum strongly favors permitting shareholders to bring derivative claims under § 14(a). The Ninth Circuit, however, found that no such public policy existed. In addition, the Ninth Circuit noted two shifts in federal jurisprudence: (1) that "the [Supreme] Court now looks to state law rather than federal common law to fill in gaps relating to federal securities claims, and, under Delaware law, a § 14(a) action is direct, not derivative;" and (2) the Supreme Court "now views implied private rights of action with disapproval, construing them narrowly, and casting doubt on the viability of a corporation's standing to bring a § 14(a) action."

Third, the Ninth Circuit dismissed Lee's argument that the forum selection clause is invalid under Delaware law. The court concluded that § 115 of the DGCL does not state that a forum selection clause cannot require a federal claim to be brought in Delaware state court. Using *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. 2020) as support for its conclusion, the Ninth Circuit noted that § 115 does not cover whether bylaws are permitted to require federal claims to be brought in state court or whether forum selection clauses have to consider jurisdictional requirements. In Salzberg, the Delaware Supreme Court held that federal claims are not considered "internal corporate claims" under § 115.

With respect to the circuit split, the Seventh Circuit previously held in Seafarers held that a derivative § 14(a) action is considered an internal corporate claim and forum selection clauses must comply with jurisdictional requirements. The Ninth Circuit disagreed with this reasoning, noting in particular that the Seventh Circuit did not consider the holding in Salzberg, nor did the Seventh Circuit consider that a plaintiff could still bring a direct action even if they could not bring a derivative action.

Other Notable Decisions

Slack v. Pirani: Supreme Court says no Section 11 liability for untraceable shares in direct listing

No. 22–200 (2023)

Why it is important

In *Slack Technologies, LLC v. Pirani*, the Supreme Court declined to redefine the term "such security" in the Securities Act of 1933 to encompass untraceable, unregistered shares from direct listings. This decision, which the Supreme Court itself noted was not "particularly novel," reaffirms the majority of lower court decisions that had similarly required traceability. In this particular matter, because the plaintiff did not prove that the shares he had purchased were registered, he did not demonstrate traceability to the registration statement at issue. As a result, the Supreme Court reversed the decision of the U.S. Court of Appeals for the Ninth Circuit, which had denied the defendants' motion to dismiss on this ground.

Summary

On June 20, 2019, Slack Technologies, Inc. (Slack), a technology company that offers an instant messaging platform, went public via direct listing, offering 118 million shares pursuant to a registration statement and another 165 million unregistered shares. Direct listings enable a company's existing shareholders to sell their shares – both registered and unregistered – directly to the public without the need for a traditional initial public offering. Plaintiff Fiyyaz Pirani (Plaintiff) purchased 250,000 shares of Slack, including 30,000 shares the day Slack went public.

Shortly after going public, Slack's share price plummeted. Plaintiff filed a class action lawsuit under the Securities Act of 1933 (the '33 Act), alleging that Slack's registration statement contained material misstatements and omissions regarding the value of the company. Slack moved to dismiss the complaint, arguing that the '33 Act only permits a cause of action for "such security" traceable to the registration statement and that Pirani never alleged that he purchased shares traceable to the registration statement as opposed to the unregistered shares Slack offered the same day.

In the courts below, Plaintiff argued that the term "such security" should be interpreted to include untraceable shares in direct listings. Going against longstanding and widely accepted precedent, the U.S. District Court for the Northern District of California agreed with Plaintiff and denied Slack's motion to dismiss, but certified its opinion for interlocutory appeal. On appeal, a divided panel of the Ninth Circuit agreed with the Northern District of California and Plaintiff.

The U.S. Supreme Court sided with Slack and reversed the Ninth Circuit's decision. The Supreme Court employed several principles of statutory construction to interpret the phrase "such security" in concluding that the term referred to a security that is traceable to a specific registration statement. The Supreme Court considered the dictionary definition of "such" as well as the use of "such" elsewhere in the '33 Act, noting that throughout the '33 Act, "such" is consistently used to "narrow the law's focus." For example, the Supreme Court noted that Section 5 of the 1933 Act provides that "'[u]nless a registration statement is in effect as to a security,' it is unlawful 'to sell such security.'" The Supreme Court reasoned that in that provision, "the term 'such security' clearly refers to shares subject to registration." The Supreme Court also noted that the '33 Act limits possible recovery for a claim under Section 11 to the total value of the registered shares, making it illogical to extend Section 11 liability to unregistered shares without also extending the possibility of damages to unregistered shares as well.

In reaching its conclusion, the Supreme Court rejected Plaintiff's arguments that "such security" should be read more broadly because Plaintiff offered no suggestion of the limit of his broad reading or explanation of how the broad reading could "be squared with the various contextual clues" in the '33 Act. The Supreme Court also rejected Plaintiff's policy argument that "a broader reading of 'such security' would . . . expand liability for falsehoods and misleading omissions and thus better accomplish the purpose of the '33 Act," finding instead that the '33 Act – in contrast to the more expansive Securities Exchange Act of 1934 – was designed to be a more limited statute.

Ultimately, the Supreme Court noted that its opinion was not "particularly novel" and that many prior cases also had concluded that 1933 Act liability extends only to "securities . . . traceable to the particular registration statement alleged to be false or misleading." The Supreme Court remanded the matter to the lower court for a determination of whether Plaintiff can establish traceability.

Anderson v. Magellan: Delaware Court of Chancery elevates standard to justify mootness fees

C.A. No. 2021-0202-KSJM (Del. Ch. July 6, 2023)

Why it is important

In *Anderson v. Magellan* Health, Inc., the Delaware Court of Chancery raised the standard for awarding mootness fees in settled M&A disclosure cases that resulted in supplemental disclosures, holding that fees can be awarded only where the plaintiff secures supplemental disclosures that are "plainly material" rather than just "helpful," which was the prior standard. The court issued its ruling after substantial briefing, including the submission of an amici curiae brief by two professors, and found that the heightened standard was necessary to reduce the number of strike suits in Delaware courts and end what it termed a problematic "merger tax" created by "legally meritless disclosure claims."

Summary

Centene, a publicly traded healthcare company, agreed to acquire Magellan Health, Inc. (Magellan), a managed healthcare provider, on January 4, 2021. Earlier, in 2019, Magellan had conducted a sale process in which 24 prospective bidders entered confidentiality agreements containing "don't ask, don't waive" provisions. These provisions—part of a sale process that was separate from the negotiations that led to the Centene deal—were not fully described in the proxy statement issued in connection with the Centene deal. A stockholder challenged the 2021 acquisition by Centene, arguing that the don't-ask, don't-waive provisions impeded the process leading to the Centene deal and that proxy was materially deficient because the don't-ask, don't-waive provisions were not fully disclosed. The plaintiff moved for expedited proceedings and filed a motion for preliminary injunction that was "slightly over a single page," but never prosecuted or briefed the motion. Magellan provided supplemental disclosures with additional detail on the don't-ask-don't-waive provisions and agreed to waive some of the don't-ask-don't-waive provisions that remained in effect. No other bidders emerged, and Magellan stockholders approved the merger. The plaintiff agreed these actions mooted his claims and stipulated to dismissal.

The parties were unable to agree on a mootness fees, so the plaintiff filed a motion for counsel an award of US$1.1 million in attorneys' fees and expenses. Magellan, supported by Professors Sean J. Griffith and Minor Myers as amici curiae, argued the benefits were nominal and warranted fees of only US$75,000–$125,000.

Chancellor McCormick issued a bench ruling authorizing fees of US$75,000. The Court explained that Delaware courts, under the corporate benefit doctrine, allow fee awards to plaintiffs' counsel for beneficial results produced for the defendant corporation even without a favorable adjudication. However, the court must make an independent determination of the reasonableness of the amount requested, with primary consideration being "the benefit achieved in light of the nature of the claims and the likelihood of success on the merits."

In analyzing the value of the waiving of the don't-ask, don't-waive provisions, the Court noted that "loosening deal protection devices makes topping bids more likely" and that sizeable fees have previously been awarded for challenges to such provisions. In those cases, Delaware courts viewed the attorney's actions as conferring benefits on the corporation regardless of "whether or not a topping bid actually emerge[d]." Chancellor McCormick noted, however, that the plaintiffs "can only take credit for the increased likelihood of a topping bid . . . due to the plaintiff's efforts." Here, the waivers the corporation provided as part of the settlement only increased the number of potential bidders by three, none of which expressed any serious interest in Magellan. Thus, the plaintiff's efforts had resulted in a very small increase in the likelihood of a topping bid and therefore did not justify a fee award.

With regard to the supplemental disclosures, the court noted that Delaware courts have been increasingly critical of disclosure-only settlements, culminating in Trulia in 2016, where the Chancery Court announced that disclosure-only settlements would be approved only if the disclosures were "plainly material." Months later, in Xoom, the Chancery Court "ratchet[ed] down the standard from 'material' to 'helpful' when evaluating a petition for mootness fees based on the issuance of supplemental disclosures. Chancellor McCormick noted that the result of this relaxed standard was a diaspora of deal-litigation in a variety of federal courts, where plaintiffs' attorneys repackaged their claims for breach of fiduciary duty as federal securities claims.

Referring to these cases as a "merger tax of deal litigation," the court held that, moving forward, mootness fees would only be granted when the information is "material." However, because the parties had not argued for a different standard, the court applied the Xoom standard ("helpful") to the plaintiff's case, finding that the Supplemental Disclosures were "marginally helpful" and awards the plaintiff US$75,000. The court intoned that this award, which "represents less than Movants' lodestar . . . should send a signal that these sorts of cases are not worth the attorneys' time" and that had they "been required to meet the materiality standard, it seems unlikely there would have been any award at all."

Gandhi-Kapoor v. Hone Capital, LLC: Court issues US$1,000-a-day order to enforce advancement order

No. 2022-881-JTL (Del. Ch. July 19, 2023)

Why it is important

In *Gandhi-Kapoor v. Hone Capital, LLC*, the Delaware Court of Chancery held respondents Hone Capital LLC and certain related companies in contempt for failing to either object to or advance litigation expenses to its former CFO. In doing so, the Court found that, though contempt is not generally available to enforce money judgments, it was appropriate for an advancement order because untimely advancement may prejudice the covered person's ability to defend the underlying litigation. The Court therefore imposed equitable relief in the form of a daily US$1,000 fine. This case warns Delaware corporations that serious consequences can arise from a decision to entirely ignore advancement obligations.

Summary

Hone Capital LLC (Hone) and CSC Upshot Ventures I, L.P. (Upshot) (together the Companies) are indirect subsidiaries of a private equity fund. Petitioner Gandhi served as Hone's CFO. Gandhi was terminated and Hone subsequently filed a lawsuit against her in California Superior Court, alleging, among other things, that Gandhi breached her fiduciary duties by engaging in fraud. In that lawsuit, Hone seeks a declaratory judgment that Gandhi is not entitled to her profit interest.

In defending these claims and pursuing counterclaims, Gandhi incurred litigation expenses. Gandhi sent a written demand letter to the Companies asking for an advancement of her expenses and then filed a complaint in the Delaware Court of Chancery to enforce her advancement rights.

After initially stipulating that Gandhi was entitled to advancement, Hone moved to vacate the stipulated order. At the same time, Gandhi moved for summary judgment. The Court ruled in favor of Gandhi and found that Gandhi was entitled to advancement from both Hone and Upshot.

Gandhi subsequently submitted written demands for advancement to the Companies over the course of several months, but neither of the Companies objected to those demands or paid the amounts claimed by the applicable deadlines. Given the non-responsiveness of the Companies, Gandhi asked the court to hold the Companies in civil contempt for failing to comply with the Advancement Order. She also asked the court to (1) appoint a limited purpose receiver to compel compliance, (2) impose a fine of US$10,000 per day on each Company until they comply, and (3) award her the fees and expenses incurred in pursuing contempt.

Vice Chancellor Laster granted Gandhi's request in part. The court found that the extreme nature of the Companies' behavior met the elements of civil contempt: the Companies failed to comply with a court order of which (i) they had notice and (ii) by which they were bound.

The court then considered whether civil contempt was an appropriate remedy to enforce an advancement order. Under Delaware law, the general rule is that "a party that holds a money judgment must resort to [recognized] collection mechanisms," such as wage garnishment or possession and sale of assets at a sheriff's sale. The court then noted that there are certain situations in which alternative remedies may be appropriate.

For example, court's often issue interim orders, such as fee-shifting, that "must be paid before the end of the action, otherwise they lose much of their effect. The court reasoned that "[c]ontempt sanctions provide the mechanism for mid-case enforcement of interim awards." Applying that rationale here, the court reasoned that the Companies' noncompliance with the Advancement Order, an interim award, warranted contempt sanctions.

The court also concluded that additional relief is appropriate when recognizing collection methods are inadequate, such as when a defendant intends to transfer money out of the court's jurisdiction. Here, the court found that traditional collection methods would not be sufficient because a company's failure to timely dispute or pay an advancement demand might irreparably harm the litigation position of the party seeking advancement. Thus, the Court held that the need for timely relief in an advancement proceeding also weighs in favor of allowing contempt sanctions.

Newman v. KKR: Suit dismissed by Delaware Chancery Court for failure to plead demand futility

C.A. No. 2022-0310-NAC (Del. Ch. Sept. 5, 2023)

Why it is important

In *Newman v. KKR*, the Delaware Court of Chancery dismissed a shareholder suit against Transphorm, Inc.'s Board and KKR, the largest shareholder, for failure to plead demand futility. The plaintiff alleged that the Board breached its fiduciary duties by approving an equity financing transaction (the Private Placement) in which KKR participated. The Court held that the plaintiff failed to plead demand futility because the plaintiff did not allege with particularity that Transphorm's Audit Committee lacked independence from KKR. The plaintiff also failed to adequately allege that the Audit Committee faced a substantial likelihood of liability on the claims asserted, which distinguished this case from the recent decision in *Ontario Provincial Council of Carpenters' Pension Tr. Fund v. Walton* (Del. Ch. Apr. 26, 2023). Plaintiff's "disagreement" with the Audit Committee over the Private Placement did not amount to the allegations necessary to support a bad faith claim.

Summary

Transphorm Inc. (the Company) is a semiconductor company. The Company's largest shareholder was KKR Phorm Investors, L.P. (KKR), holding up to 47.3% of the Company's shares. KKR was entitled to reseat a majority of the Board at any time.

In November 2021, the Board of Directors, including the Audit Committee, met to consider an equity issuance in which KKR would invest US$5 million and third parties would invest $15 million (the Private Placement). The Board concluded that this transaction would be in the best interests of its shareholders and gave its written consent. At the same meeting, acknowledging that KKR would be considered a "related party" under the Company's related party transaction policy, the Audit Committee reviewed and approved KKR's participation in the transaction. Third parties, not KKR, led the negotiation of the terms governing KKR's participation in the Private Placement. Also, those terms required KKR to participate at arm's-length.

Individual shareholder Joel Newman (Plaintiff) filed a derivative suit against the Board and KKR, without first making a demand on the Company. Plaintiff alleged that (1) KKR breached its fiduciary duties by participating in the equity issuance, and (2) the Company's seven directors (including its four Audit Committee members) breached their fiduciary duties by approving the Private Placement. The defendants moved to dismiss the complaint for failure to plead demand futility.

The court agreed that Plaintiff had failed to allege demand futility and granted the defendants' motion to dismiss.

First, the court held that Plaintiff had not sufficiently pleaded that the Audit Committee lacked independence from KKR. The court noted that directors are presumed to be independent and here, the plaintiff did not allege that the directors were personally interested in KKR's participation in the Private Placement. Plaintiff also did not allege any particularized facts showing that KKR exerted pressure on the Audit Committee. Although KKR owned almost 50% of the Company's stock and allegedly had enough voting power to remove the Audit Committee directors from the Board, KKR was not a "controller" unless it exercised "actual control" over the corporation's affairs generally, or with respect to the Private Placement at issue. Plaintiff made no such allegations, and the court found that the "potential" ability to exercise control was not sufficient to excuse demand.

Second, the Court found that Plaintiff failed to adequately allege that defendants acted in bad faith. Plaintiff offered various theories on how defendants acted in bad faith, including that the Audit Committee "disregarded" the Company's related party transaction policy. Plaintiff tried to analogize the facts of this case to *Ontario Provincial Council of Carpenters' Pension Tr. Fund v. Walton*, 2023 WL 3093500 (Del. Ch. Apr. 26, 2023) ("Walmart"), by arguing that the Board's "failure to record a mechanical progression" through each part of the related party transaction policy meant that the Audit Committee did not actually consider "any" factor. The Court concluded that the case was "nothing like Walmart," which involved a "well-pleaded" *Caremark* claim based on an "alleged decision to ignore clear red flags surrounding the company's non-compliance" that suggested "no discussion occurred at the board level" about such non-compliance. In contrast, in the KKR case, there were clear records of the Audit Committee's review and approval of the transaction pursuant to the related party policy.

Without particularized allegations showing lack of independence, demand is not excused under 2021's Zuckerberg test.

Securities, Shareholder, and M&A Litigation Practice Overview

Securities, Shareholder, and M&A Litigation Practice Overview

At Hogan Lovells, we guide companies – and their officers and directors – through all types of disputes that arise with their investors, shareholders, and transactional partners. You must engage seasoned litigators who will work with you through the full lifecycle of the dispute to protect your interests. We are the team to have on your side, whether to obtain favorable outcomes at the earliest possible stage or to defend your interests all the way to verdict through appeal, when necessary.

We have a unique approach to defending our clients in securities, shareholder, and M&A litigation. First and foremost, we work with you to identify and prioritize your business objectives. We also help you develop the factual and legal framework to drive the proper narrative. We put together the right team to handle your matter, including lawyers across different practices, geographies, and industry experience. We are able to do this in a cost effective way through use of our advanced technology platforms, such as machine learning and other types of AI, to review documents, prepare litigation outcome assessments, help surface new insights, and realize other efficiencies and enhance service quality.

We bring extensive experience spanning all industries, focusing on the following areas:

1. Corporate governance litigation
2. Private company M&A disputes
3. Public company M&A litigation
4. Federal securities litigation
5. Investment fund disputes and litigation

Corporate governance litigation

Shareholders frequently challenge decisions made by the boards of directors at both public and private companies; our role is to advise, and when necessary defend, companies and their directors against these challenges. We have successfully done so in a wide array of contexts, including M&A transactions, dissolutions, recapitalization plans, compensation awards, bylaw amendments, and voting rights agreements.

We also are frequently involved early in corporate transactions to help clients navigate the conflicts of interest – and other potential pitfalls – that often later give rise to shareholder litigation. We represent special committees of the board in investigating shareholders' allegations of misconduct. And when shareholders make books and records demands on a company under Section 220 of the Delaware General Corporations Law, or similar state laws, prior to making a litigation demand, we have significant experience in successfully limiting or opposing inappropriate demands.

Private company M&A disputes

Disputes between the buyer and the seller in private company M&A transactions arise in several predictable areas:

1. Purchase price disputes in which one party (usually the buyer) seeks to re-negotiate the deal price through the use of a post-closing price adjustment provision;

2. Earn-out disputes in which the parties disagree about whether deferred portions of the purchase price are payable based on the target's post-closing performance; and

3. Indemnification disputes where one party (usually the buyer) seeks indemnification for breach of representations and warranties in the purchase agreement.

Working with our Corporate M&A colleagues, we review transaction documents to craft the most favorable terms for your company, and if a dispute later arises – whether in arbitration or in court, we have substantial experience litigating the complex accounting and contract issues involved.

Public company M&A litigation

Recent data reflects that, in more than 90 percent of public company M&A transactions, lawsuits are filed by shareholders that purport to challenge the transactions; in transactions in excess of US$100 million that number is over 95 percent. Working together with our M&A group, we advise directors on relevant litigation issues prior to the M&A announcement and aggressively defend the predictable suit when filed, aiming to prevent plaintiffs and their lawyers from disrupting transactions that the board has found to be in the best interest of the company and its stockholders. We also have experience representing companies when faced with tender offers or proxy battles that can arise in conjunction with announced M&A transactions.

Federal securities litigation

We have deep experience representing public companies and their officers and directors in all types of securities litigation in courts across the United States. We have successfully defended clients in cases involving initial and secondary offerings alleging violations of Sections 11 and 12 of the ’33 Act and fraud claims under Section 10(b) of the ’34 Act. We defend companies in proxy litigation and short-swing trading cases. Underwriters and auditors also rely on us to defend them, and our lawyers have won victories for all of the major accounting firms and the leading investment banks.

Investment fund disputes and litigation

We have represented funds of all types – private equity, venture capital, distressed debt, REITs, and investment management companies – in disputes at the portfolio company and fund level. These disputes have run the gamut, involving any of the following:

- investor complaints by limited partners and shareholders;
- board disputes and/or contests for board control;
- corporate governance rights or creditor rights, both in and out of bankruptcy;
- allegations of alter ego and veil piercing;
- minority shareholder rights when the funds are not in a control position; and
- damages claims when an investment suffers loss or when a portfolio company or fund is threatened with such claims.

Private equity funds are repeat players in private M&A and corporate governance disputes, and so are we, having developed significant experience representing fund sponsors in these disputes. The sponsors also can have unique disputes with their own minority partners or investors, whether over capital calls, investor rights, or management decisions under the terms of the fund documents, and we advise and represent funds in these disputes.

Key Victories

Key Victories

We are a **team of experienced litigators** focused on helping our clients achieve their key business objectives. In 2023, we continued our rich history of success on behalf of our clients. Notably, our team…

- Secured a **major trial win** for a leading U.S.-based global aerospace company defeating claims of breach of contract and tortious interference.
- Represented a U.S. entrepreneur on her **successful acquisition of a controlling interest** in a National Women's Soccer League (NWSL) franchise, following a league investigation and the firing of the team's coach. The process leading up to the sale was highly contentious which included several actions of threatened litigation.
- Successfully represented the majority owners of a **major real estate development company** in a corporate control dispute involving claims of fraud and breach of fiduciary duty against the company's chairman. Our team leveraged a powerful lawsuit into a highly favorable settlement, paving the way for sale transactions unlocking hundreds of millions of dollars in shareholder value.

We have extensive experience litigating **federal securities class actions**. In addition, we are regularly called upon to act as *amicus curiae* counsel, weighing in for our clients in the key securities law cases before the Supreme Court and other state appellate courts. Over the last 12 months, we…

- Have been representing an automotive company in 1933 Act and 1934 Act class actions alleging that the Company **made false and misleading statements in its IPO registration statement** concerning the safety of its autonomous driving technology and engaged in undisclosed related party transactions – cases in the motion to dismiss phase pending in the United States District Court for the Southern District of California, California state court, and the United States District Court for the Southern District of New York.
- Representing **Mallinckrodt plc** and its current and former directors and officers in a '34 Act class action alleging that the company failed to timely disclose a dispute with a key regulator that resulted in US$600 million in retroactive penalties and a reduction of US$100 million per year in future revenue – case pending in the discovery phase in the United States District Court for the District of New Jersey.
- Representing **Mallinckrodt plc** and its current directors and officers in a '34 Act class action alleging that the company made false and misleading representations concerning its liquidity, ability to pay upcoming debt obligations, and the risk of a second Chapter 11 bankruptcy filing – case pending in the United States District Court for the District of New Jersey.
- Have been representing the board of directors of a major automotive manufacturer in a '34 Act class action and parallel derivative litigation arising from the company's settlement with the U.S. Department of Justice resolving allegations that the company used "defeat devices" to evade emissions testing regulations.
- Representing a **parts supplier in the automotive industry** in a federal securities lawsuits involving allegations of false and misleading statements pertaining to pricing initiatives, operations, and external factors affecting financial margins.
- Represented a life sciences company in a Securities Exchange Act of 1934 class action following a US$700 million decline in the company's market capitalization, which was allegedly caused by **an FDA announcement that declined to approve the company's biologics licensing application**.
- Have been representing a co-founder and board member of a company in connection with a Securities Exchange Act of 1934 class action pending in the U.S. District Court for the Eastern District of New York in relation to a **SPAC vehicle that raised US$100 million-plus in capital to focus on ESG-friendly mining investments**. The defendant is facing allegations that the company overvalued certain assets and did not operate in an environmentally friendly manner.
- Acted as ***amicus curiae*** in support of a leading securities industry trade organization in important cases before the U.S. Supreme Court and the Supreme Court of Colorado concerning developments in jurisprudence related to the Securities Act of 1933.

Our team litigated a number of derivative litigation cases in 2023, securing important victories for our clients. We…

- Have been advising a former Chief Compliance Office of a Fortune 5 company on a **massive stockholder derivative litigation, filed in Delaware Court of Chancery**, alleging that the company's directors and officers breached their fiduciary duties by failing to detect and prevent improper opioid sales. This suit, if successful, would further expand the *Caremark* doctrine and create substantial additional personal liability risks for board members and officers of all Delaware companies.
- Have been representing a **majority shareholder and board member of a publicly-traded technology company** in a consolidated derivative action brought by purported shareholders in the Delaware Court of Chancery and a consolidated securities class action brought by purported shareholders in the Southern District of California. Both actions involve allegations of, among other things, false and misleading statements pertaining to the company's product safety testing and improper third-party and related-party transactions.

In **M&A litigation matters**, we handled numerous cases in connection with hundred million-dollar deals, including…

- Represented a **leading U.S.-based telecommunications fund** in connection with a dispute between the co-controllers and a sale process that led to a US$1.6 billion transaction. As a result of an investigation by our firm, our client discovered that one of the controllers had attempted to conduct a sale process of the company without the company's knowledge.
- Claims against a **U.S.-based private holding company** in fraud and breach of contract litigation pending in Delaware Court of Chancery arising from the US$106 million purchase of a data storage company, which was favorably settled following completed document discovery and depositions.
- Litigation for a **major American multinational investment bank** regarding allegations of fraud committed against the bank during the diligence process by a company that the bank acquired, seeking nearly US$175 million in damages on behalf of the bank.
- Negotiations for a **professional sports league** related to a termination of a merger agreement, and entry into a term sheet for a new merger agreement. Our team assisted with negotiating a settlement in response to claims regarding the terminated merger agreement, and successfully assisted with avoiding threatened litigation in this matter.

In addition, we are litigating a number of other large cases across a broad array of industries including…

- Representing the co-creator of a **social networking site** after the site owner's successful IPO didn't acknowledge her contributions to the company's early strategy development and her insights into desired features for the targeted audience.
- Previously represented a **leading U.S.-based global medical device company** in an investigation by the SEC into stock trading activity by certain current and former company employees in advance of a quarterly earnings announcement that surprised analysts and the market as a whole with positive revenue and sales volume results during the COVID-19 lockdown period.
- Representing a South American, state-controlled **oil company** on a litigation over international investments of over US$200 million in a failed offshore drilling company that planned to explore oil and gas deposits off the coast of Brazil, with allegations of fraudulent inducement to invest with compensatory damages, punitive damages, and prejudgment interest of more than US$700 million.

These examples represent just a sample of our team's experience and successes in 2023. We are poised and eager to help our clients tackle new challenges in 2024 – and beyond.

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