WILSON
SONSINI

2021 DELAWARE CORPORATE LAW AND LITIGATION YEAR IN REVIEW

Table of Contents

Introduction .... Page 1

Potential Oversight Liability for Boards of Directors .... Page 2

The Increased Use of the Public Benefit Corporation Form .... Page 2

Busted Deals and Lessons for M&A .... Page 3

Stockholders' Ability to Access Director Emails and Communications .... Page 5

Delaware Supreme Court Guidance for Private Company Governance .... Page 6

Introduction

A number of Delaware law and related corporate governance developments occurred in 2021 that should be of significant interest to boards, management, and stockholders of Delaware corporations. The year was busy for the Delaware courts, which issued hundreds of noteworthy corporate decisions, as well as for corporate activity and practice. This *2021 Delaware Corporate Law and Litigation Year in Review* focuses on the Delaware law-related corporate governance issues that we think are most noteworthy for those who run Delaware corporations and those who invest in them.

In particular, we address: potential oversight liability for boards of directors; the increased use of the public benefit form, particularly in the midst of an increased focus on environmental, social, and governance issues and the purpose of the corporation; busted deals and lessons for mergers and acquisitions practice going forward; stockholders' ability to access director emails; and an important decision by the Delaware Supreme Court on private company corporate governance.

It also bears noting that the Delaware courts have continued to address other recurring matters that are important for corporations, including board independence and director conflicts of interest, controlling stockholder conflicts of interest, and various procedural rules relating to stockholder litigation over fiduciary duties. This publication focuses on the most novel and practice-changing developments of the year.

Potential Oversight Liability for Boards of Directors

Stockholders continued to bring oversight claims against boards of directors this past year, gaining ongoing traction in an area of the law that has historically been very difficult for plaintiffs. The obligation of oversight, broadly speaking, requires directors to (1) make a good-faith effort to ensure there are monitoring and reporting systems in place to allow for the corporation's legal compliance and (2) respond to red flags that arise.

The test for directors is favorable to them: an oversight claim requires a plaintiff to allege either that (1) "the directors utterly failed to implement any reporting or information system or controls" or (2) "having implemented such a system or controls," directors "consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[1] In other words, directors must have either completely failed to establish a reporting system or they must have turned a blind eye to red flags in front of them, and there must be a sustained or systemic failure of the board's oversight.

In some recent cases, however, plaintiffs have had success where the facts supported a strong pleading-stage claim, particularly where the oversight issues affected "essential and mission critical" areas of the business. These claims are important for directors to understand, given plaintiffs' success and various lessons from the recent case law. The most recent example is a suit brought against Boeing's board of directors relating to its handling of the Boeing 737 MAX airplane crashes.[2] The Court of Chancery allowed the claims to proceed past a motion to dismiss, identifying the following as the key problems, at least based on the plaintiff's allegations: (1) as in other recent successful oversight claims, the board record allegedly did not reflect much or any time dedicated to airplane safety issues, even though they are "mission critical" to Boeing's business; (2) allegedly only the audit committee handled "risk" issues, but its activities mostly related to financial risk, and no board committee was specifically tasked with overseeing airplane safety; (3) the company allegedly had a culture that prioritized profits, political connections, and efficiency over engineering and safety, all the way up to the composition of its board; and (4) there was allegedly no regular process or protocols requiring management to report airplane safety issues to the board. Boeing's board ultimately settled the case for $237.5 million. That case, along with others in recent years, underscores some important points for directors to consider, including: setting the proper tone at the top; identifying critical oversight issues; determining whether the board or an existing committee has the capacity to address them or whether a different committee is needed; and ensuring adequate whistleblowing and reporting mechanisms are in place. As with other significant corporate governance issues, it is also critical that the board and its committees build a good record around these issues, to reflect its efforts and fend off challenges to its oversight activities.

At the same time, it is important to remember that oversight claims still involve a high bar for plaintiffs and that far from all claims are successful. For example, in 2021, the Court of Chancery dismissed oversight claims against directors and officers of Marriott International, Inc. relating to its 2018 cyberattack that resulted in the disclosure of personal information of up to 500 million Marriott guests.[3] The record reflected that cybersecurity was consistently considered a top-level risk by the board, the board and audit committee were regularly updated on risks and mitigation measures, outside consultants were engaged and advised on cybersecurity issues, mechanisms were in place for management to report red flags up to the board, and there was no specific allegation of knowledge of violations of applicable law. Although, according to the case, mitigation of the underlying data security risk may have proceeded more slowly than it should have in some respects, there was not a sustained or systemic failure of oversight that subjected directors to potential liability.

The Increased Use of the Public Benefit Corporation Form

In 2021, the purpose of the corporation and environmental, social, and governance issues received ongoing attention. The market also began making particularly notable use of recent statutory developments relating to the Delaware public benefit corporation (PBC), a form of for-profit corporation in which fiduciaries are obligated to balance stockholders' monetary interests, the best interests of those materially affected by the corporation's conduct, and a particular public benefit purpose selected by the corporation. This balancing requirement replaces the rule for a traditional Delaware corporation, which is that—although boards have considerable latitude in how they oversee the business and can take into account a wide range of factors in making decisions—a board's decisions must ultimately relate to advancing stockholder value.

In 2013, Delaware introduced the statutory framework for Delaware law-governed PBCs and then, through 2020, implemented amendments to reduce the barriers to become a PBC. Ultimately, by late 2020, the statute no longer imposed supermajority stockholder votes, or triggered unique appraisal rights, for a

traditional Delaware corporation to opt into the PBC structure.

Following those amendments, and consistent with the increased focus on corporate purpose, there was an upswell in usage of the PBC form for both public and private companies. In January 2021, stockholders of Veeva Systems Inc. voted overwhelmingly to become the first publicly traded corporation to convert to the PBC form, with nearly 90 percent of the outstanding voting power, and 99 percent of the votes cast, supporting the change.[4] United Therapeutics Corporation also converted in the fall, again with overwhelming stockholder support.[5] Our firm advised both companies on their conversions. Other notable companies converting to the PBC form in 2021 post-IPO include Amalgamated Financial Corp. and Broadway Financial Corporation. PBCs entered the public markets in 2021 through all the various ways that were available to companies in 2021: IPOs of special purpose acquisition companies or "SPACs" (Sustainable Development Acquisition I Corp.), de-SPAC mergers (AppHarvest, Inc. and Planet Labs PBC), direct listings (Warby Parker Inc.), and traditional IPOs (Coursera, Inc., Zymergen Inc., Allbirds, Inc., and Zevia PBC). More and more private companies are operating as PBCs as well—there were approximately 3,000 PBCs in Delaware in 2020, and the number has only increased since then. Like other corporations, PBCs were active on all fronts in 2021: our PBC clients were involved in financing rounds, acquisitions, sales, and other major corporate events. While there is still no Delaware case law directly on point discussing public benefit corporations, it is only a matter of time before the increased market activity in the PBC space translates into judicial guidance in this regard.

Busted Deals and Lessons for M&A

Following a busy year in 2020 for "busted deal" litigation brought on by the economic conditions resulting from the COVID-19 pandemic, Delaware courts in 2021 again issued several noteworthy decisions in this area.

In April 2021, then-Vice Chancellor (now Chancellor) Kathaleen St. Jude McCormick "[c]halk[ed] up a victory for deal certainty" by ordering a private equity buyer to close its $550 million acquisition of a private cake decorating company.[6] In that case, the seller's business initially "declined precipitously," with its sales falling more than 60 percent year-over-year for the first few weeks following signing in early March 2020—right as the U.S. started to feel the effects of the pandemic. But, as 2020 wore on, the business began to recover, with 2020 annual revenue ultimately declining only 14 percent, and adjusted EBITDA declining 25 percent, relative to 2019. Like many companies dealing with the effects of the pandemic, the seller decided shortly after signing to make a partial draw of $15 million on its revolving credit facility out of an abundance of caution, although it never spent the funds and fully repaid them by August 2020. The seller also cut various business costs, including labor costs, in the midst of the pandemic; notably, these were steps it had taken during prior business downturns.

According to the court, the buyer developed "a case of buyer's remorse" when it believed that celebrations and related cake orders would decline during the pandemic and as it considered the capital needs of its other portfolio companies, resulting in the buyer's decision in April 2020 to terminate the deal. The seller sued for specific performance and, after the court initially denied a request to hold a trial in a matter of weeks during the height of the pandemic, the case was set for trial in January 2021.

The court ultimately rejected each of the buyer's grounds for termination. First, the court concluded there was no material adverse effect (MAE) in the seller's business as defined in the purchase agreement, remarking that a "short-term hiccup" will not suffice and that, absent some specific agreement by the parties, a MAE will only exist where there has been a "durationally significant" change to the business that is "consequential to the company's long-term earnings power over a commercially reasonable period." The court noted that scholars and the court have considered sustained decreases in profits in the "40% or higher range" to support the finding of a MAE, which did not occur here, as the seller's business recovered later in 2020. In any event, the court found that, because the vast majority of the decline in the seller's sales was related to shelter-in-place and closure orders across the country, it also fell within the purchase agreement's carve-out from the definition of a MAE for effects "related to . . . government orders."

Second, the court said that the buyer could not rely on the covenant to operate in the ordinary course (here, based on the seller cutting costs and drawing on its revolver) as a basis to avoid closing. In particular, the court focused on the precise language of the purchase agreement requiring the seller to operate "in a manner consistent with the past custom and practice" and concluded that required a comparison to the seller's prior business practices. Thus, the court found that the seller had a historic practice of cutting costs when the company's sales decreased. Likewise, although the seller's 2020 draw on its

credit facility was larger than prior draws, the company had drawn on the facility five times since 2017. The court also faulted the buyer for not giving the seller the opportunity to cure any alleged breach of the covenant, as the agreement required—because the seller ultimately did not spend the funds, the court reasoned that the seller could clearly have cured any breach.

Finally, the court rejected the buyer's argument that it did not have to close the deal because debt financing was no longer available. Under the terms of the agreement, specific performance was only available if "the full proceeds of the Debt Financing have been funded" to the buyer. The court concluded, however, that the debt financing became unavailable only because of the buyer's wrongful demands of the lenders and refusal to move forward under the agreed-upon terms.

In the other major "busted deal" decision in 2021, the Court of Chancery similarly ordered specific performance of a merger agreement to acquire a medical device company that offered ambulatory cardiac monitoring devices.[7] There, the buyer attempted to back out of the deal not because of economic changes related to COVID-19, but because it claimed that a significant change in the Medicare reimbursement rates applicable to the seller's products constituted a MAE under the contract.

In a detailed 112-page opinion featuring a deep dive into the Medicare regulatory environment facing the parties, the court found that the rate change did not "substantially threaten[] the overall earnings potential of [the company] in a durationally-significant manner" because the buyer did not meet its burden of proving that it was reasonably expected that the current Medicare reimbursement rates—which are subject to ongoing regulatory changes—would endure for a commercially reasonable period. The court further concluded that one of the exclusions in the definition of MAE in the merger agreement—carving out changes in the broadly defined term "Health Care Law"—encompassed the Medicare rate change. And the exception to those exclusions for changes that had a "materially disproportionate impact" on the seller as compared to "similarly situated" companies, the court found, was not applicable. The court again parsed the language of the agreement, observing that the term "similarly situated" required a comparison to companies with a similar product mix and, therefore, it rejected the buyer's effort to base that comparison on companies in the broader industry that were not affected by the rate change. The court also rejected the buyer's related defense based on the more general contractual notion of frustration of purpose—concluding that the buyer could not carry that high burden given, among other things, that the seller was able to show that its clinically superior technology was unchanged.

The Delaware Supreme Court also weighed in with an opinion affirming a Court of Chancery decision from late 2020 that had permitted a buyer to escape its acquisition of a hotel chain.[8] The trial court had found that a downturn in the hotels' business resulting from the COVID-19 pandemic did not result in an MAE, but that the buyer was not obligated to close the deal because the seller breached certain covenants, including the covenant to operate in the ordinary course. On appeal, the seller argued, among other things, that the trial court's decision in effect negated the parties' careful allocation of pandemic risk to the buyer through the MAE provision and that the ordinary course covenant should permit "reasonable, industry-standard responses" to systemic risks—like the pandemic—that were allocated to the buyer by the MAE provision.

The Delaware Supreme Court disagreed and again focused on the language of the contract. The court noted that the covenant did not choose the actions of industry participants as the "yardstick" to measure the seller's actions, but instead required the seller to operate only "in the ordinary course of business, consistent with past practice in all material respects"—i.e., it measured compliance with its own operational history. The court also described the provision as "absolute" and noted the absence of an "efforts" qualifier, which would have required the seller only to use a certain level of efforts to operate in the ordinary course, as found elsewhere in the agreement.

Moreover, the Delaware Supreme Court observed that ordinary course covenants and MAE provisions serve different purposes: the former reassure the buyer that the seller has not materially changed its business or business practices during the pendency of the transaction; the latter allocates the risk of changes in the economics, namely the value of the seller. According to the court: "Buyers want to know both that the business is operated in the same way and that the business is worth about the same amount. How a business operates between signing and closing is a fundamental concern distinct from the company's valuation." The seller was not "hamstrung" by the ordinary course covenant, the court observed, as it only required the seller to seek consent before making any changes, which the contract provided could not be unreasonably withheld.

Thus, the clear takeaway from these cases is that the contract language matters. Although we continue to see Delaware courts tilt in favor of deal certainty, buyers and sellers should expect the language of their acquisition agreements to be strictly enforced.

Stockholders' Ability to Access Director Emails and Communications

We also continued to see case law developments in 2021 on stockholder access to director communications sought in litigation. Among other things, there were several notable decisions reinforcing stockholders' qualified—yet significant—right to demand access to corporate books and records, which can include board minutes and board communications. Early in the year, the Court of Chancery ordered Facebook to produce director emails on a limited subject to a stockholder in response to such a demand.[9] The stockholder sought director communications to investigate potential oversight claims in connection with the unauthorized release of client data. Because the court concluded that there was evidence that the more typical types of corporate books and records the company had already produced—e.g., board materials and minutes, and a special committee report regarding the alleged data breach—were insufficient for the stockholder's stated purposes for inspection, the court ordered the production of non-privileged, board-level emails regarding a narrow topic the other materials did not address. Although the production of emails in response to a books and records demand remains the exception, companies and board members should be mindful of this possibility.

Around the same time, the Delaware Supreme Court reiterated that boards that conduct business without formally documenting their actions through conventional corporate records such as board minutes and resolutions do so at their own peril. The court once again held that a company that only kept its records through informal means such as emails and text messages was required to produce those informal communications in response to a books and records demand.[10]

The Court of Chancery also addressed, in two separate decisions, a new wrinkle on the application of attorney-client privilege: whether an outside director's use of another company's email account for emails related to his or her board service waived the attorney-client privilege—which only protects confidential communications—with respect to those communications. In December 2020, in litigation over SoftBank's aborted $3 billion tender offer for shares of WeWork, the company's former founder argued that certain Sprint employees' use of Sprint email accounts to do WeWork-related business for SoftBank waived the attorney-client privilege over those emails. The court ultimately agreed based on the unique facts of that case and ordered the production of the privileged emails. It remained to be seen, however, whether the same result would apply to the more typical use by an outside director of his or her employer's email account for board service.

In the fall, stockholders in the ongoing litigation over a recapitalization at Dell Technologies picked up that question, arguing that the use by an outside director of the Dell board of his former employer's email account for his Dell-related board communications waived privilege.[11] The stockholder plaintiff argued that the other company's email policy allowed it to access emails in some circumstances and, therefore, the director could not have had a reasonable expectation of privacy with respect to those communications.

The court considered four factors to determine whether the director's use of the email account had waived the attorney-client privilege: (1) whether the employer corporation maintains a policy banning personal or other objectionable use or providing that the account is not private at all; (2) whether the employer corporation actually monitors or accesses employees' work emails; (3) whether third parties have a right to access the employee's computer or emails; and (4) whether the employee was aware of the policy.

The court concluded that the Dell director had not waived privilege because, under the terms of the employer's email policy, employees had a reasonable expectation of privacy with respect to their email communications. Importantly, the policy allowed for the use of company email accounts for limited personal use. Although other factors, including that the employer reserved the right to monitor emails if necessary and that the Dell director was aware of the policy, weighed in favor of finding a privilege waiver, the first factor was the "dominant" factor and outweighed the other factors, serving to preserve privilege in that particular instance. It appeared significant to the court that the former employer had allowed the director to continue to use his account following his retirement as CEO, which signaled that both parties understood that the account would be used for personal reasons.

Following these decisions, directors and companies should be mindful of a director's use of email for board-related communications. One way to avoid the type of fact-intensive analysis that could result in having to produce privileged emails would be either to use an email account provided by the company on whose board he or she serves or set up a separate "Gmail"-type account, which is generally private and not subject to monitoring. At a minimum, directors who choose to use a separate email account that may be subject to third-party access should take steps to understand the policies governing that account and ensure the policies are consistent with all parties' expectations. Finally, companies or firms that have employees who sit on the boards of other

entities should consider their email policies and whether changes should be made to reflect the parties' common understanding that company email accounts will be used for such purposes.

Delaware Supreme Court Guidance for Private Company Governance

In September, the Delaware Supreme Court issued a landmark decision addressing governance in the private company context: *Manti Holdings, LLC v. Authentix Acquisition Company, Inc.*[12]

The particular issue in the case was whether or not stockholders of a private corporation can agree prospectively to waive statutory appraisal rights—that is, the right to later go to court to seek the fair value of their shares following a merger. The court concluded that, at least based on the facts in the case—involving a sophisticated stockholder, who was represented by counsel and who had agreed in a stockholder agreement to waive appraisal rights—such a waiver was enforceable.

More generally, the case upheld a concept that underpins the governance of thousands of private companies: that Delaware corporations, boards, and investors can engage in some measure of private ordering. The court rejected sweeping arguments in the case that Delaware corporations involve various mandatory, fundamental rules—including appraisal rights—that cannot be modified by contract. The court also rejected the argument, which would have been upsetting to practice, that Delaware corporations cannot be party to a stockholders' agreement.

The case did not directly address various other issues, such as the enforceability of contractual agreements and waivers by less sophisticated stockholders or what other types of rights (such as stockholders' statutory rights to inspect a company's books and records) can or cannot be waived. But, for now, the decision provides some welcome flexibility and predictability for private Delaware corporations.

Contributors

Adrian Broderick
Partner
abroderick@wsgr.com

William B. Chandler III
Partner
wchandler@wsgr.com

Shannon German
Partner-Elect
sgerman@wsgr.com

Ryan Greecher
Partner
rgreecher@wsgr.com

James Griffin-Stanco
Partner-Elect
jstanco@wsgr.com

Amy Simmerman
Partner
asimmerman@wsgr.com

Brad Sorrels
Partner
bsorrels@wsgr.com

Brian Currie
Associate
bcurrie@wsgr.com

Lindsay Faccenda
Associate
lfaccenda@wsgr.com

Ryan Hart
Associate
rhart@wsgr.com

Jason Schoenberg
Associate
jschoenberg@wsgr.com

Endnotes

[1] *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

[2] *In re The Boeing Co. Derivative Litig.*, No. CV 2019-0907-MTZ (Del. Ch. Sept. 7, 2021).

[3] *Firemen's Ret. Sys. of St. Louis v. Sorenson*, No. CV 2019-0965-LWW (Del. Ch. Oct. 5, 2021).

[4] Veeva Systems Inc., Current Report (Form 8-K) (Jan. 14, 2021), https://www.sec.gov/ix?doc=/Archives/edgar/data/0001393052/000162828021000464/veev-20210113.htm; *see also* https://www.wsgr.com/en/insights/wilson-sonsini-advises-veeva-systems-in-pbc-conversion.html

[5] United Therapeutics Corp., Current Report (Form 8-K) (Oct. 1, 2021), https://www.sec.gov/ix?doc=/Archives/edgar/data/0001082554/000110465921121499/tm2128821d1_8k.htm; *see also* https://www.wsgr.com/en/insights/wilson-sonsini-advises-united-therapeutics-on-pbc-conversion.html.

[6] *Snow Phipps Grp., LLC v. KCAKE Acquisition, Inc.*, C.A. No. 2020-0282-KSJM (Del. Ch. Apr. 30, 2021).

[7] *Bardy Diagnostics, Inc. v. Hill-Rom, Inc.*, C.A. No. 2021-0175-JRS (Del. Ch. July 9, 2021).

[8] *AB Stable VIII LLC v. MAPS Hotels & Resorts One LLC*, Case No. 71, 2021 (Del. 2021).

[9] *Employees' Ret. Sys. of R.I. v. Facebook, Inc.*, C.A. No. 2020-0085-JRS (Del. Ch. Feb. 10, 2021).

[10] *Durham v. Grapetree, LLC*, 246 A.3d 566 (Del. 2021).

[11] *In re Dell Techs. Inc. Class V S'holders Litig.*, C.A. No. 2018-0816-JTL (Del. Ch. Sept. 30, 2021) (TRANSCRIPT).

[12] 261 A.3d 1199 (Del. 2021).

Disclaimer

This communication is provided as a service to our clients and friends and is for informational purposes only. It is not intended to create an attorney-client relationship or constitute an advertisement, a solicitation, or professional advice as to any particular situation.

WILSON
SONSINI

650 Page Mill Road, Palo Alto, California 94304-1050 | Phone 650-493-9300 | Fax 650-493-6811 | www.wsgr.com

Austin Beijing Boston Brussels Hong Kong London Los Angeles New York Palo Alto San Diego San Francisco Seattle Shanghai Washington, DC Wilmington, DE

© 2022 Wilson Sonsini Goodrich & Rosati, Professional Corporation. All rights reserved.