Hogan Lovells

2023 Securities, Shareholder, and M&A Litigation Outlook

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The Outlook for 2023

In this past year, we saw an uptick in in-person court proceedings as the effects of the pandemic subsided, a decrease in pandemic-related litigation, and a return to many of the core issues facing Delaware companies operating nationally and internationally in an increasingly challenging economy.

The Delaware Court of Chancery continued to contend with high case volume, issuing numerous game-changing opinions while continuing to churn out important commentary on critical issues of Delaware law. Over the past year, our coverage has highlighted five trends.

- Delaware courts continued to define the boundaries of *Caremark* claims following the Delaware Supreme Court's decision in *Marchand v. Barnhill* in 2018.
- Delaware courts applied its strictest standard, the "entire fairness" standard, to several M&A transactions that involved individuals and entities receiving unique benefits not given to the other participants in the deal.
- Special purchase acquisition company (SPAC)-related litigation generated several decisions, some relying on traditional principles to decide familiar issues, and some breaking new ground.
- In two notable opinions, Delaware courts explored the bounds of equity, in one instance using equitable powers to craft an unprecedent remedy, and in another noting that, at times, the legally mandated outcome is inherently inequitable.
- Delaware courts opined on several interesting issues related to the impact of liquidation and insolvency on core issues such as asset transfers, delinquency proceedings, and whether a custodian appointed under the DGCL could revive, rather than liquidate, an abandoned company.

In addition, 2022 brought a number of other notable opinions addressing a variety of issues, including appraisal, forum selection, "ordinary course" covenants, "sandbagging," special committees, and discovery in foreign jurisdictions. More detail on all of these trends and cases can be found below.

Looking to 2023, we anticipate that *Caremark* will continue to be an area of focus for Delaware courts. Indeed, less than a month into 2023, the Delaware Court of Chancery issued an opinion in *In re McDonald's Corporation Stockholder Derivative Litigation* confirming that officers have *Caremark* oversight responsibilities. In addition, ESG issues continue to be top of mind for companies. These issues likely will lead to additional litigation, including *Caremark* litigation and books-and-records claims. And, while there were fewer SPAC IPOs in 2022 than in 2020 or 2021, there remains a high likelihood of SPAC-related litigation in 2023 as the periods for de-SPAC transactions reach expiration. Finally, economic turmoil may lead to increased litigation as companies contend with uncertainty and distressed situations.

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Executive Summary

Caremark

Delaware courts continued to contend with a reinvigorated *Caremark* doctrine throughout 2022, with mixed results for the parties involved. In *City of Detroit Police & Fire Ret. Sys. on Behalf of NiSource, Inc. v. Hamrock*, the court granted a motion to dismiss where the record showed an active committee overseeing pipeline safety and none of the red flags (although they existed) would have put a reasonable board member on notice of the risk of a pipeline explosion. In *Construction Industry Laborers Pension Fund v. Bingle*, the court also granted a motion to dismiss on similar grounds, finding that cybersecurity was "mission critical" but that plaintiffs had not alleged that SolarWinds violated any laws and had not alleged sufficient particularized facts to create an inference that the directors had acted in bad faith in breach of their duty of loyalty.

In *Lebanon County Employees' Retirement Fund v. Collis*, the court addressed the statute of limitations in the *Caremark* context, finding that the plaintiffs could assert claims for conduct that occurred within the three-year period prior to their books and records request, rather than the three-year period prior to filing their derivative action.

Caremark will continue to occupy the courts in 2023, with decisions in cases that are a closer call working to define the boundaries of the *Caremark* doctrine going forward.

Entire Fairness

In 2022, the Delaware Court of Chancery issued decisions in several cases in which the "entire fairness" standard, the most stringent standard under Delaware law, applied. In *Cellular Telephone Partnership Litigation*, the court applied the entire fairness standard to "freeze-out" transactions involving AT&T. The court took issue with nearly every aspect of the deal, ultimately conducting its own valuation that was three times higher than the deal price. In *In re Tesla*, the court was similarly critical of many aspects of the deal, but, in light of a determination that the deal price was nevertheless fair, the deal satisfied the entire fairness test.

Finally, in *Manti Holdings, LLC*, the court applied the entire fairness standard based on allegations that the private equity firm involved received a "unique benefit" and then denied the motion to dismiss under that standard because the plaintiffs adequately alleged breaches of the duty of loyalty. Similarly, in *In re Carvana Co.*, the court found that the stockholders in this derivative action pleaded demand futility by alleging facts showing that two of the six directors had deep personal and professional ties to a third director, who received a material personal financial benefit in the transaction at issue and, because of that benefit, entire fairness review was appropriate.

Over the next year, the court is certain to face additional matters that further define both when the entire fairness standard is appropriate as well as what allegations are sufficient to meet that standard.

SPACs

Along with the SPAC boom on the transaction side has come an uptick in SPAC-related litigation. In 2022, the court issued several decisions related to SPAC and de-SPAC deals. In *In re MultiPlan Corp. Stockholders Litigation*, the court denied a motion to dismiss fiduciary duty claims, deciding as a matter of first impression that the entire fairness standard of review applied to the de-SPAC transaction because the transaction was a conflicted controller transaction and because a majority of the board was not disinterested or independent.

Not all SPAC-related litigation presents issues of first impression. For example, in *Brown v. Matterport, Inc.*, the Delaware Court of Chancery held that transfer restrictions restricting trade of stock "outstanding immediately" after a de-SPAC merger did not apply to an officer who received his stock more than 100 days after the merger, applying traditional principles of contract interpretation to decline to rewrite unambiguous contractual language.

Similarly, the court used traditional principles in *Buzzfeed, Inc., et. al. v. Hannah Anderson, et al.* to conclude that, because post-SPAC "New Buzzfeed" was not a party to the pre-SPAC Buzzfeed's employment agreements, the arbitration provisions contained within them did not require New Buzzfeed to arbitrate the claims.

Despite a reduction in the number of SPAC-transactions in 2022, we expect new SPAC-related litigation to continue in 2023, and we likely will see a few more interesting decisions while recently filed complaints work their way through the court system.

(In)Equitable Outcomes

While the Delaware courts often issue critical opinions on issues of first impression, the court issued two opinions in 2022 that were notable for the manner in which the court's equitable powers were – and were not – exercised.

In *In re Stream TV Networks, Inc. Omnibus Agreement Litigation*, the Delaware Court of Chancery exercised its broad equitable powers to provide an unprecedented order that divested shares and reassigned ownership. Stream TV Networks ("Stream") had transferred its assets – comprised primarily of shares in a Delaware subsidiary – to its secured creditors in order to extinguish its secured debt. But the Delaware Supreme Court declared the underlying agreement to be invalid because it did not receive the requisite approval from Stream's majority shareholders. Secured creditors responded by engaging in a series of "coordinated acts" "choreographed" over an "extended lunch over" as part of an "overarching plan" to frustrate the Court's earlier orders and seize control of the shares. On remand, the court issued a judgment ordering the secured creditors to return the assets to Stream. The court acknowledged that this was an extraordinary remedy, but extraordinary facts required the court to exercise broad powers in shaping its relief.

In *XRI Investment Holdings LLC v. Holifield*, the Court of Chancery found that defendant Holifield violated a No Transfer Provision in the limited liability company agreement of XRI Investment Holdings LLC when he transferred shares to a special purpose vehicle. Although "the law require[d] this result," the court found it an "inequitable result" and that the outcome was "disquieting to a court of equity." The court found that Holifield proved XRI's acquiescence, but that the LLC agreement's mandate that unpermitted transfers were "void," rather than "voidable," meant that all equitable defenses were inapplicable, according to binding Delaware Supreme Court precedent. As a result, the court indicated that it was bound by pre-existing law and granted judgment in XRI's favor. In doing so, the court urged the Delaware Supreme Court to reconsider its precedent in connection with any appeal to avoid such inequitable outcomes in the future.

Liquidation and Insolvency

In 2022, the Delaware Court of Chancery tackled several cases involving the liquidation and insolvency of the entity at issue and weighed several unique issues. In *In re Rehabilitation of Scottish Re (U.S.), Inc.*, the court considered, as a matter of first impression, that in a delinquency proceeding for an insurance company under Delaware law, there is no per se requirement that a rehabilitation plan meet a "liquidation standard" to obtain court approval. In *In re Forum Mobile, Inc.*, the court considered whether a custodian appointed under Section 226(a)(3) of the DGCL could revive an abandoned business and determined that the plain language of that section permits a custodian to liquidate, but not revive, an abandoned business.

The Delaware Supreme Court weighed in on issues surrounding the role of a stockholder vote in connection with an asset sale by an insolvent company. In *Stream TV Networks, Inc. v. SeeCubic, Inc.*, the Delaware Supreme Court found that the sale agreement – in essence, a privately structured foreclosure transaction – constituted an "asset transfer" under Stream's charter, triggering a class vote provision that required the approval of Stream's Class B stockholders. The court further held that a "board only" insolvency exception no longer existed following the enactment of DGCL § 271 and its predecessor governing the sale of a corporation's assets.

Other Notable Decisions

In between breaking new ground on SPACs and continuing to shape the bounds of *Caremark* claims, the court also issued several other notable opinions.

In *Ramcell, Inc. v. Alltel Corp.*, the court declined to adopt either party's valuation in an appraisal action and instead blended the two valuations, taking parts of each to reach its own valuation.

In *Lee v. Fisher*, the Ninth Circuit affirmed the dismissal of a shareholder derivative suit against The Gap Inc. (Gap), alleging violations of Section 14(a) of the Securities Exchange Act of 1934, based on a Gap bylaw requiring that any derivative action be brought in the Delaware Court of Chancery.

In *Level 4 Yoga, LLC v. CorePower Yoga, LLC*, the Delaware Court of Chancery granted Level 4, the owner of franchised yoga studios, an order of specific performance and compelled the buyer, a franchisor, to close under an asset purchase agreement after finding no Materially Adverse Event or breach of the ordinary course covenant based on compliance with the franchisor's COVID-19-related directives.

In *Arwood v. AW Site Services LLC*, the court confirmed Delaware's status as a "pro-sandbagging" state and clarified that, under Delaware law, a buyer's pre-closing knowledge will not bar its ability to bring claims for breached representations and warranties, unless the agreement contains anti-sandbagging provisions. The court also clarified the standards for showing justifiable reliance in connection with fraud claims.

In *Joseph Lawrence Ligos v. Isramco, Inc.*, the court found that the plaintiff failed to adequately allege that: (1) the Special Committee defendants lacked independence; (2) the Special Committee defendants acted in bad faith in negotiations with Naphtha; and (3) the Special Committee defendants acted in bad faith by omitting materials from the Merger proxy.

Caremark

Hamrock: No *Caremark* liability for natural gas explosion

Why it is important

In *City of Detroit Police & Fire Ret. Sys. on Behalf of NiSource, Inc. v. Hamrock*, No. CV 2021-0370-KSJM, the Delaware Court of Chancery granted a motion to dismiss duty of oversight claims against an energy company's directors following a pipeline explosion. Acknowledging that recent caselaw has underlined that, for "mission critical" operations, a "board's oversight function must be rigorously exercised," the court nonetheless found that the defendants did not face a substantial likelihood of oversight-related liability sufficient to support a finding of demand futility because: (1) the record showed an active committee overseeing pipeline safety; and (2) that, even though certain red flags were present, none of them would have put a reasonable board member on notice of the risk of a pipeline explosion.

Summary

NiSource, Inc. is an energy holding company with natural gas and electricity businesses. One of NiSource's former subsidiaries attempted to repair a natural gas line, which led to natural gas explosions (the Greater Lawrence Explosions) that caused significant damage, numerous injuries, and one fatality. Following the Greater Lawrence Explosions, NiSource settled an investigation by the Massachusetts Attorney General for US$56 million, pleaded guilty to criminal violations of portions of the Natural Gas Pipeline Safety Act, and paid restitution and a US$53 million fine, and entered into a deferred prosecution agreement that appointed an independent monitor and required the implementation of certain safety procedures.

Following these events, the plaintiff filed a derivative suit against the board of directors of NiSource (the Board), alleging a duty of oversight claim under both prongs of *Caremark*. The defendants moved to dismiss, arguing that the plaintiff failed to plead demand futility.

The plaintiff argued that a majority of NiSource's Board faced a substantial likelihood of liability under the second prong of the Zuckerberg demand futility test. The Delaware Court of Chancery disagreed with the plaintiff, finding that the Board did not face a substantial likelihood of liability for the plaintiff's alleged *Caremark* claim and granting the defendants' motion to dismiss.

The court took each prong of *Caremark* in turn. First, the court found that the plaintiff failed to plead that the Board completely failed to implement a system to monitor the "mission critical" risk of pipeline safety. The plaintiff's complaint actually demonstrated that the Board and one of its committees, the ES&S Committee, did in fact monitor and report on pipeline safety. The court pointed to at least 14 instances to support the Board's and ES&S Committee's oversight of the issue, all from documents the plaintiff obtained pursuant to a Section 220 demand and included in its complaint. As a result, there was not an "utter failure" to monitor pipeline safety.

Second, the court found that the Board and the ES&S Committee did not violate the law for profit or ignore red flags that led to the Greater Lawrence Explosions. The former theory, which was based on the 2011 *In re Massey Energy Co.* case, alleged that NiSource's business model profited from violating laws meant to regulate natural gas pipelines. The court found that the facts in Hamrock simply did not rise to the level of the scheme in *Massey*, noting that the Board had "multiple committees dedicated to compliance risk" and had, at various times, taken steps to implement various safety precautions.

With respect to red flags, the court found that, although the plaintiff adequately pleaded that the Board was aware of certain alleged red flags, those red flags were too attenuated from the Greater Lawrence Explosions to be proximate cause, meaning they would not have given a reasonable observer notice of the risk of the Greater Lawrence Explosions. In particular, the court found that the Board knew that poor recordkeeping presented a significant risk generally, but did not know of specific facts that indicated the potential for the Greater Lawrence Explosions.

Based on this analysis, the court concluded that the Board did not face substantial liability for the plaintiff's *Caremark* claims, and thus that demand was not futile. The court therefore dismissed the complaint.

SolarWinds: Caremark liability rejected in cybersecurity oversight claim

Why it is important

In *Construction Industry Laborers Pension Fund v. Bingle*, (C.A. No. 2021-0940-SG (Del. Ch. Sept. 6, 2022)) (SolarWinds), the Delaware Court of Chancery granted a motion to dismiss a derivative suit against the directors of SolarWinds Corporation for allegedly breaching their duty of loyalty by failing to take steps to prevent a cybersecurity attack, finding that the plaintiffs had not alleged a viable *Caremark* claim under Delaware law. The court found that “cybersecurity, for online service providers, is mission critical.” However, dismissal was nonetheless warranted because the plaintiffs had not alleged that SolarWinds violated any laws and had not alleged sufficient particularized facts to create an inference that the directors had acted in bad faith in breach of their duty of loyalty, as they were required to plead to demonstrate demand futility under *Caremark*.

Summary

In 2020, SolarWinds Corporation, which sells information technology management software, was the victim of a cyberattack by Russian hackers. The attack implanted malware in SolarWinds’ software in an attempt to target SolarWinds’ clients, which included Fortune 500 companies and U.S. government agencies such as the Department of Homeland Security and the Department of Defense. After public disclosure of the attack, SolarWinds’s stock value plunged nearly 40 percent. SolarWinds stockholders filed a derivative suit against SolarWinds’ corporate directors, alleging they “failed to adequately oversee the risk to cybersecurity of criminal attack.”

The Delaware Court of Chancery dismissed the complaint for failing to plead specific facts sufficient to create an inference of bad faith on the part of a majority of the directors.

The court explained that the plaintiffs’ *Caremark* claim – a derivative claim against corporate directors for failure to oversee operations – was “a flavor of breach of the duty of loyalty, which itself requires an action (or omission) that a director knows is contrary to the corporate weal.” The court further explained that, historically, only violations of positive law have led to viable claims under *Caremark*.

The court found that “cybersecurity, for online service providers, is mission critical,” but noted that guarding against cybercrimes was a business risk, not an action associated with ensuring a corporation’s compliance with “positive law.” The court noted that whether *Caremark* liability can exist for failure to oversee business risk remains an open question in Delaware law, but added that “a violation of law or regulation is still likely a necessary underpinning to a successful pleading.” The court did not resolve this issue, however, because it found the plaintiffs’ allegations insufficient to support an inference that the directors acted in bad faith or with intent to harm the corporation, as would be required to state a viable *Caremark* claim.

Court of Chancery Rule 23.1 requires that stockholders seeking to bring a derivative suit first make demand for directors to act. Failure to make a demand is only excused when the plaintiffs can plead facts sufficient to establish an inference that demand would be futile. Here, the plaintiffs made no demand. To survive a motion to dismiss, therefore, the court explained that the plaintiffs had to show that at least half of the directors were substantially likely to be liable under their *Caremark* theory of liability.

The plaintiffs alleged that a majority of directors faced a substantial likelihood of liability under both prong one and prong two of *Caremark*. They alleged that the majority of the board failed to implement and monitor a system of reporting and controls for cybersecurity (*Caremark* prong one) and that, even if such a monitoring system was in place, the directors failed to sufficiently oversee it because they overlooked "red flags" that signaled risk (*Caremark* prong two).

The court explained that, to avoid *Caremark* liability, the directors must have made a good faith effort to satisfy prongs one and two of *Caremark*. And therefore it was "necessary to assess a director's good faith or bad faith in connection with a plaintiff's allegations before an oversight liability claim can be deemed viable." Bad faith could be shown through a director (i) acting with a purpose other than the best interests of the company, (ii) intending to violate positive law, or (iii) failing to act in the face of a known duty to act.

The court found that the plaintiffs had not alleged that the directors (i) acted intentionally with a purpose other than the best interests of the company; (ii) violated positive law; or (iii) failed to act in the face of a duty to act. The court rejected the plaintiffs' arguments that various events – a cybersecurity briefing, cybersecurity presentation, and third-party email – were red flags that manifested a duty to act, finding that these incidents indicated the potential lack of an effective reporting system, not allegations supporting an inference of bad faith.

Lebanon County Employees' Retirement Fund v. Collis: Guidance into timeliness of derivative claims

Why it is important

In *Lebanon County Employees' Retirement Fund v. Collis*, C.A. No. 2021-1118-JTL (Del. Ch. Dec. 15, 2022), the Delaware Court of Chancery denied a motion to dismiss as untimely a derivative action against a pharmaceutical distributor's officers and directors. Noting that the timeliness principles governing *Caremark* red-flags claims and *Massey* claims alleging that a fiduciary acted disloyally by causing a company to seek profit by violating the law was an issue of first impression, the court decided on a "separate accrual approach" that views "a series of related decisions and conscious nondecisions as a sequence of wrongful acts" each giving rise "to a separate limitations period." Therefore, the court concluded that the plaintiffs could assert claims for conduct that occurred within the three-year period prior to their books and records request.

Summary

AmerisourceBergen is one of the largest wholesale distributors of opioids in the United States. The company has faced a number of investigations, enforcement actions, and litigation related to its business strategies, placing it "at the center of America's tragic opioid epidemic." More specifically, AmerisourceBergen is alleged to have sold increasingly larger quantities of opioids to questionable purchasers despite incurring a significant increase in legal risk. In 2021, the company agreed to pay over US$6 billion as part of a nationwide resolution of multidistrict litigation.

The plaintiffs' derivative claim sought to shift the responsibility for the harm of that settlement agreement from the company to its officers and directors under two theories: (1) a Caremark "red flag" theory, in which directors can be held liable if they consciously fail to monitor or oversee a reporting system or controls, and (2) a Massey theory, based on allegations that the company's officers and directors took actions that knowingly prioritized profits over law compliance. Although the alleged conduct began in 2010, the plaintiffs did not seek books and records until 2019 and did not file their derivative claim until 2021. AmerisourceBergen argued that the derivative claim was outside the three-year statute of limitations and therefore untimely.

The court acknowledged that "[n]o Delaware court has addressed how to determine when a Red-Flags Claim or a Massey Claim accrues." The court therefore considered whether to apply the discrete act method, the continuing wrong method, or the separate accrual approach. The court found both the discrete act method—when a specific decision constitutes a discrete wrongful act that causes the claim to accrue—as well as the continuing wrong method—when a series of inextricably related decisions and conscious non-decisions are treated as a continuing wrong—were inappropriate. Ultimately, the court settled on the "separate accrual approach" as a "Goldilocks regime that falls in between a too-defendant-friendly discrete act approach and a too-plaintiff-friendly continuing wrong approach."

Under the separate accrual approach, the court looks to when a plaintiff begins to "vigilantly pursu[e] its claims" rather than when the suit is filed. For a derivative action, that can be when a plaintiff begins to seek books and records. Therefore, the plaintiffs' claims regarding a "litany of events" in the three years prior to their books and records request were timely.

A short time later, in *Lebanon County Employees' Retirement Fund v. Collis*, C.A. No. 2021-1118-JTL (Del. Ch. Dec. 22, 2022), the plaintiffs' claims were dismissed for failure to plead demand futility. Nevertheless, the court's decision provides useful guidance on the timeliness of derivative claims brought on *Caremark* red-flags or *Massey* theories of liability.

Entire Fairness

In re Cellular: AT&T breached duty to minority partners with unfair and self-interested freeze out

Why it is important

In *In re Cellular Telephone Partnership Litigation*, C.A. No. 6885-CVL, the Chancery Court held that AT&T breached its duty of loyalty to its minority partners when it enacted a Freeze-Out transaction that dissolved a cellular telephone service partnership and paid each minority partner their pro rata share of the value of the partnership, as determined by AT&T. Applying the entire fairness standard to the transaction, the court took issue with nearly every aspect of the deal and the price. The court undertook its own valuation of the partnership, and came to a valuation more than three times higher than AT&T had paid, increasing it from US$219 million to US$714 million. As a result, AT&T was required to pay an additional US$9 million to minority partners.

Summary

In October 2010, AT&T transferred all of the assets and liabilities of its cellular telephone service partnership in Salem, Oregon, into a newly formed affiliate of AT&T. This dissolved the existing partnership, and cashed out the minority partners at a price determined by a valuation firm retained by AT&T.

The partnership, and a number of other similar partnerships, were created in the 1980s as a result of Federal Communications Commission lotteries that awarded the rights to construct telephone networks in specific geographic areas along with the right to provide continuing cellular telephone service to those areas. By 2007, AT&T, the majority partner in many of these partnerships across the country, began exploring the best way to eliminate the minority partners. AT&T had (accurately) predicted that revenue for cellular communications and data services was about to grow significantly, and that buying out minority partners at that time would be cheaper than buying them out down the road.

In 2010, AT&T began a series of "freeze-out" transactions intended to eliminate the minority partners in the existing general partnerships (the Freeze-Out). The Freeze-Out was purportedly for administrative savings purposes. AT&T hired PricewaterhouseCoopers LLP (PwC) to conduct a valuation in advance of the Freeze-Out. The minority partners were given an option to accept an offer from AT&T at a five percent premium to the PwC valuation, or they would be frozen out at the value set by PwC.

A majority of the minority partners voted against the Freeze-Out offer. In late 2011, the former minority partners filed lawsuits alleging that AT&T breached the partnership agreement, and breached its fiduciary duties by conducting the Freeze-Out through an unfair process and at an unfair price.

Numerous cases were filed challenging substantially similar transactions across the country. The Salem, Oregon partnership case filed in the Chancery Court was coordinated, but not formally consolidated, with the other cases, and served as the first bellwether trial.

The parties spent eight years in contentious discovery. The case went to trial in December 2020. The court issued a first decision in September 2021, addressing the plaintiffs' breach of partnership agreement claims. A second decision, released in March 2022, addressed the remaining breach of fiduciary duty claims.

The court found that AT&T breached its duty of loyalty by engaging in an unfair and self-interested transaction process at the expense of the minority partners. The court applied the entire fairness standard because of AT&T's position on both sides of the transaction and found that the transaction did not satisfy that test because AT&T had not carried its burden to prove either fair dealing or fair price.

With respect to fair dealing, the court took issue with the timing, negotiation, and structure of the transaction process, as well as AT&T's longstanding relationship with the financial advisor hired to do the valuation.

- **Timing**: The court found that AT&T timed the Freeze-Out to take advantage of the data revolution, rejecting AT&T's attempts to distinguish 2007 internal discussions from the actual transactions in 2011.
- **Negotiation and structure**: The court noted the lack of negotiation with the minority partners and took issue with what it viewed as a coercive deal structure, noting that AT&T created a two-step process that put unfair pressure on minority partners to accept the front-end price in order to avoid being inevitably cashed out at a lower value.
- **Financial advisor**: The court found that AT&T's prior relationship with PwC, and the parties' interactions throughout the valuation, cut against AT&T's attempt to prove fair dealing.

Regarding fair price, the court found that AT&T's expert used unreliable valuation methods and that documents showed that AT&T believed the partnership was worth more than the PwC valuation.

Because AT&T did not show fair price or fair dealing, as required by the entire fairness test, the court held that AT&T breached its duty of loyalty. The court went on to explain that it had the power to "fashion any form of equitable and monetary relief as may be appropriate, including rescissory damages." To that effect, the court sought to determine the value of what the minority partner plaintiffs had, before the Freeze-Out, based on the operative reality of the partnership at the time of the transaction.

The court conducted its own discounted cash flow analysis, selecting what it considered to be reasonable inputs, but giving the plaintiffs the benefit of the doubt.

The court concluded that the partnership's actual fair valuation was US$714 million, rather than AT&T's valuation of US$219 million. The minority partners were thus entitled to US$13.4 million, rather than the US$4.1 million they had received. Damages therefore came to a total of US$9.3 million.

In re Tesla: fair price may ameliorate procedural defects under entire fairness review

Why it is important

Tesla Motors Stockholder Litigation arises out of Tesla's acquisition of SolarCity, a market leader in manufacturing and installing solar energy generation systems. On two occasions in 2015 and 2016, Elon Musk suggested to Tesla's board that Tesla acquire SolarCity, but the Board declined to pursue an acquisition. When Musk proposed the acquisition for a third time in May 2016, the Tesla board agreed to pursue it. Tesla shareholders sued the Board, including Musk, alleging that Musk, as Tesla's controlling shareholder, had overruled the Board and caused Tesla to acquire an insolvent SolarCity at an unfair price. The Court of Chancery found that Musk and the Tesla board failed to apply basic Delaware corporate governance standards. However, Tesla shareholders ultimately benefited from the transaction, because share price under the terms of the SolarCity acquisition was a "fair price." Therefore, the transaction satisfied Delaware's most stringent standard of review – entire fairness.

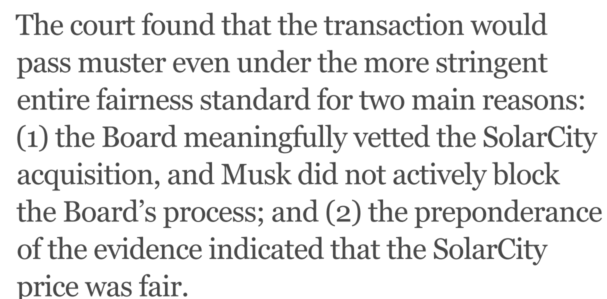
Summary

SolarCity was a market leader in manufacturing and installing solar energy generation systems. From 2015 to 2016, SolarCity was facing liquidity problems. Twice, Elon Musk, then CEO and chairman of the Tesla board (the Board), proposed to the Board that Tesla acquire SolarCity. The Board declined twice, but then agreed to acquire SolarCity in May 2016 when Musk proposed acquiring SolarCity for a third time. Due diligence revealed that SolarCity's financial condition was even worse than publicly disclosed. Thus, the Board lowered its bid for SolarCity and conditioned acquisition on approval by minority shareholders. The shareholders approved the merger in November 2016.

Certain Tesla shareholders subsequently filed suit against each of the Tesla board members, including Elon Musk in the Delaware Court of Chancery. The plaintiffs claimed that Musk, as Tesla's controlling shareholder, had overruled the Board and caused Tesla to acquire an insolvent SolarCity at an unfair price.

The plaintiffs settled with all of the Board members except Musk, who opted for a trial on the remaining claims: breach of fiduciary duty as controlling shareholder, unjust enrichment, and waste. After an 11-day trial, post-trial briefing, and oral argument, the court dismissed all counts against Musk.

The court acknowledged, but did not decide, several conflicts issues, ultimately concluding that, even with these conflicts, the price of the transaction was fair. First, the court observed that Musk was a shareholder in both the target and buyer, but declined to decide whether Musk's stake in SolarCity and Tesla (approximately 20 percent for both companies) was enough under Delaware law to make him a "controlling" shareholder. Second, the court noted that a majority of the Tesla Board was conflicted (with many directors also owning shares in SolarCity as well as Musk's other company, SpaceX), but declined to decide whether the transaction should be judged by the entire fairness standard or business judgment standard.



The court found that the transaction would pass muster even under the more stringent entire fairness standard for two main reasons: (1) the Board meaningfully vetted the SolarCity acquisition, and Musk did not actively block the Board's process; and (2) the preponderance of the evidence indicated that the SolarCity price was fair.

The court found there to be both weaknesses and strengths in the Tesla Board's process. In terms of weaknesses, (1) the Board did not form a special committee of independent directors to negotiate the acquisition; (2) Musk failed to recuse himself from all discussions about the acquisition and, in fact, actively participated in some of the Board's discussions; and (3) Musk discussed the acquisition with SolarCity leadership without notifying the Board that he was in contact with the target.

The court found that the Board did implement a number of safeguards, however, including, (1) the Board was led by a director who had no affiliation with SolarCity or Musk's other companies; (2) Musk did recuse himself from some Board discussions, and, more importantly, Musk did not vote in any matter relating to SolarCity; and (3) the Board had pushed back against Musk's suggestions, twice declining to pursue the merger, lowering the offer following diligence, and declining to make a bridge loan to Solar City.

Ultimately, the court concluded that Musk had not "coerced" the Board at any point, even when the Board went against his wishes. The court pointed out that the Board even required a vote by disinterested shareholders in favor of the acquisition, a vote that is not required under Delaware law.

However, the primary reason that the acquisition met the entire fairness standard was on "substantive" grounds – the "fair price" that Tesla shareholders received. The court rejected the plaintiffs' assertion that SolarCity had no value on its own because SolarCity had a successful product and because, since the merger, Tesla had recognized significant cash flows from the acquisition. Moreover, SolarCity's financial issues were fully disclosed to shareholders; news media had reported on SolarCity's financial problems and the Board had lowered its price in response to due diligence findings.

The court noted that Musk and the Board had failed to implement certain processes under well-established Delaware law and that much of this litigation could have been avoided if those processes had been implemented. However, the "astronomic rise in Tesla's stock price post-Acquisition is noteworthy…hindsight suggests that [Musk] is right." While this decision does not render the rules of good corporate governance in conflicted transactions obsolete, it does demonstrate how a court may separate out procedural and substantive aspects of a conflicted transaction.

While prior Delaware precedent suggested that procedural failings would usually doom a conflicted transaction, this decision suggests that, in the end, a fair price may make up for some procedural deficiencies.

Manti v. Carlyle: Allegations of rushed private equity exit trigger entire fairness sale scrutiny

Why it is important

In *Manti Holdings, LLC v. Carlyle Group Inc.*, C.A. No. 2020-0657-SG (Del. Ch. June 3, 2022), the Delaware Court of Chancery held that minority investor claims could proceed against a private equity firm, Carlyle, and related directors for allegedly rushing to sell a company at below fair market value in order to conclude the sale quickly and secure a return on their preferred shares that could be distributed to Carlyle's investors. The court held that the complaint alleged that "Carlyle received a unique benefit" from closing quickly and that the "entire fairness test" therefore applied, "the highest standard of review in corporate law." The court further held that the plaintiff adequately alleged breaches of the duty of loyalty by the Carlyle directors, including because of their divergent interests relative to common stockholders and because "the Board formed no special committee to insulate the Sale process from their influence."

Summary

Manti Holdings, LLC v. Carlyle Group Inc., C.A. No. 2020-0657-SG (Del. Ch. June 3, 2022) arose out of the sale of Authentix to Blue Water Energy in 2017. Authentix began the sale process in October 2016, eventually narrowing the field to two companies: Intertek and Blue Water Energy. Intertek proposed a final offer of US$85 million, with an additional US$30 million contingent on Authentix meeting certain post-closing financial metrics. The Authentix board nonetheless elected to proceed with a sale to Blue Water Energy for US$77.5 million plus US$27.5 million in additional contingent consideration.

In August 2017, one of the plaintiffs, Manti Holdings, LLC, through its board representative, urged the board to withdraw from the sales process and postpone it for another year rather than sell at Blue Water's offer because of several positive developments in Authentix's business. The board chose to proceed with the Blue Water Energy transaction and, in September 2017, the stockholders were notified that the board and its majority shareholder, The Carlyle Group, Inc. (Carlyle), voted to approve the sale. The sale was not put to a stockholder vote because the Stockholder Agreement contains a "drag along" provision that requires "other holders" to consent and raise no objections against the sale if the sale is approved by the board and the holders of at least 50 percent of the then-outstanding shares, which Carlyle held.

Following the sale, the plaintiffs brought suit against Carlyle and the three directors they asserted were associated with it, challenging the sale under the "entire fairness" test and alleging breaches of the duty of loyalty by the director defendants. The defendants moved to dismiss, arguing that the allegations failed to state claims under Rule 12(b)(6), and that the plaintiffs waived their right to challenge the sale under the Stockholders Agreement. The plaintiffs asserted claims for breach of fiduciary duty against Carlyle and the director defendants, unjust enrichment, aiding and abetting a breach of fiduciary duty, and civil conspiracy.

The court held that the "entire fairness" standard potentially applied in this case and that dismissal

of the plaintiffs' fiduciary claims was therefore inappropriate. The entire fairness standard, the highest standard of review in corporate law, requires that a deal be at a fair price and the product of fair dealing. The court concluded that entire fairness was appropriate because (1) the plaintiffs alleged that Carlyle would uniquely benefit from a quick closing, and (2) the director defendants cut out the lone dissenting board member, Manti's designee. After finding a conflicted transaction, the court held that the plaintiffs' allegations of unfair dealing and an unfair price met the "low burden" required to survive a motion to dismiss in a case under the entire fairness test. Among other things, the plaintiffs had alleged that Authentix's value was depressed due to uncertainty as to whether certain material contracts would be renewed; yet even after the contracts were renewed, the board approved a sale at a price reflecting renewal uncertainty. The plaintiffs also cited evidence that Carlyle had expressed a desire to close the sale quickly, and noted that the sale was never approved by an independent special committee of the board or by Authentix's minority stockholders.

Regarding the director defendants, the court considered each director individually. Two of the director defendants were dual fiduciaries who held positions with both Carlyle and Authentix. The court found that they faced a potential conflict of interest because Carlyle had a unique interest in a quick sale and would receive a profit as a preferred shareholder, whereas Authentix's common stockholders would receive little to no consideration unless the company sold for a higher price. Therefore, the court found a reasonable inference that they acted disloyally in connection with the sale. The court also found the allegations sufficient to state a claim as to the other director defendant because he allegedly stated that he worked for Carlyle and was told to sell the company.

The court also found that the plaintiffs had adequately alleged unjust enrichment as an alternative theory of liability, rejecting the defendants' argument that Carlyle could not have been "enriched" by allegedly selling its shares for less than fair value. The court also upheld the unjust enrichment claim against Authentix's CEO because, under his employment agreement, he would receive a cash bonus equal to a percentage of the sale consideration if Authentix sold for between US$50-80 million.

Finally, the court quickly dismissed the aiding and abetting and conspiracy claims. Since the court already found that Carlyle and the director defendants owed fiduciary duties to Authentix minority stockholders, the plaintiffs failed the "knowing participation by a defendant who is not a fiduciary" requirement.

The plaintiff's remaining claims, breach of fiduciary duty against Carlyle and the director defendants, and unjust enrichment against Carlyle and Bernard Bailey, are still pending before the court.

In re Carvana: Demand is futile when directors are "thick as thieves" with beneficiary of misconduct

Why it is important

The Delaware Court of Chancery, in *In re Carvana Co.*, No. 2020-0415-KSJM (Del. Ch. June 30, 2022), applied the recently adopted Zuckerberg test for demand futility and denied the defendants' motion to dismiss. The court found that the stockholders in this derivative action pled demand futility by alleging facts showing that two of the six directors had deep personal and professional ties to a third director, defendant Ernest Garcia III (who received a material personal financial benefit in the transaction at issue), such that they could not objectively consider a demand to pursue litigation against Garcia III. The court then found that the plaintiffs stated a viable breach of fiduciary duty claim, and that the transaction at issue, a US$600 million stock offering to Garcia, his father, and a few other select investors during a March 2020 pandemic-related dip in stock prices, would be subject to entire fairness review because it was not approved by a majority of disinterested directors.

Summary

Carvana Co. (Carvana) is an e-commerce platform for buying and selling used cars founded by defendant Ernest Garcia II (Garcia II) and his son Ernest Garcia III (Garcia III), who is the CEO, President, and Chairman of Carvana. Together, the Garcias control 92 percent of the voting power in Carvana.

According to the complaint, after the stock market declined in February 2020 due to the onset of the COVID-19 pandemic, Carvana and its management reviewed the business to assess whether it needed an influx of capital. The plaintiffs alleged that Garcia III and his team determined that Carvana did not need more capital to survive the pandemic because it could cut costs and streamline operations, and had reached a significant new financing agreement with a major lender.

Nevertheless, while Carvana's stock was trading down from US$110 on February 21, 2020 to less than US$30 on March 20, 2020. The plaintiffs allege that Garcia III began to orchestrate a capital raise through a non-public direct offering. According to the complaint, Garcia III handpicked investors to participate in the offering, and led a rushed negotiation and board approval process (though he abstained from the final board vote). The direct offering closed on March 30 at US$45 per share, with each of the Garcias purchasing US$25 million worth of Carvana stock. The plaintiffs allege that, as soon as the short-swing trading period expired, Carvana's stock price had soared, and Garcia II sold Carvana shares for a total of US$478.4 million. Section 220 demands and stockholder suits followed, with the court consolidating the cases in January 2021.

The defendants moved to dismiss the consolidated complaint for failure to allege demand futility and failure to state a claim.

Focusing on the third prong of the demand futility test recently adopted by the Delaware Supreme Court in Zuckerberg, the court considered whether the allegedly conflicted directors lacked independence from a defendant

who received a material personal financial benefit from the alleged misconduct that would be the subject of the litigation. The court concluded that two of Carvana's directors lacked independence from the Garcias, who had received material financial benefits in the direct offering at issue.

The court found that the first potentially conflicted director, Gregory Sullivan, lacked independence from Garcia II, because Garcia II gave Sullivan a job at DriveTime (another used-car business owned by the Garcia family) after Sullivan was censured by the New York Stock Exchange for actions he took on behalf of Garcia II. Sullivan rose through the ranks at that job to eventually become the CEO; and then, when Sullivan left DriveTime to invest his savings into a new business, Garcia II made a significant investment into that venture. The court concluded that it was reasonably conceivable that Sullivan could not objectively consider a demand to bring litigation against Garcia II, "the man who allegedly saved [Sullivan's] career, helped generate [Sullivan's] personal wealth, and financially shores [Sullivan's] current livelihood."

With regard to the second director, Ira Platt, the court found that the plaintiffs adequately pled facts showing that Platt was conflicted because he gave Garcia III his first job after college, Garcia III later gave Platt's son an internship at Carvana, Garcia II appointed Platt to numerous lucrative director positions, and the Garcias caused Carvana to gift Platt nearly US$30 million worth of Carvana equity when no other directors received similar grants.

Given that Carvana had a six-member board, and that there was no dispute that the Garcias had received personal financial benefits in the direct offering, these allegations were sufficient to show demand futility.

The court wrapped up its decision by rejecting Garcia III's arguments that (a) he could not be liable for breaching his fiduciary duties in approving the transaction because he abstained from the final board vote, and (b) that the transaction should be subject to the business judgment rule. On the first argument, the court noted that abstaining from a final vote is a fact-intensive argument that "does not provide a get out of jail free card" at the motion to dismiss stage, particularly where the plaintiffs alleged facts showing that Garcia III played a significant role in negotiating, structuring, and approving the direct offering. On the second argument, the court determined that the plaintiffs had already established, at least at the pleading stage, that half of the board was conflicted in approving the direct offering, and therefore that the entire fairness test applied and not the business judgment rule.

SPACs

In re MultiPlan: De-SPAC transaction warrants entire fairness review

Why it is important

In *In re MultiPlan Corp. Stockholders Litigation*, C.A. No. 2021-0300-LWW, the Delaware Court of Chancery denied motions to dismiss a shareholder complaint filed against a special purpose acquisition company (SPAC), its sponsor, and directors and officers, among others. The shareholders alleged that the SPAC's fiduciaries failed to disclose material information regarding the SPAC's acquisition that induced the shareholders' decision not to exercise their redemption right. As a matter of first impression, the court held that the entire fairness standard of review applied to the de-SPAC transaction because the transaction was a conflicted controller transaction and because a majority of the board was not disinterested or independent. While the court noted that its decision was largely grounded in the alleged disclosure failures rather than the structural implications of a SPAC transaction, the ruling raises the risk of increased scrutiny for de-SPAC transactions.

Summary

In January 2022, the Delaware Court of Chancery issued a much-anticipated ruling that applied traditional fiduciary principles to a de-SPAC merger. The claims at issues arose from a business combination between Churchill Capital Corp. III (Churchill), a SPAC, and MultiPlan Inc., a healthcare cost management provider. Churchill was one of several SPACs founded by Michael Klein (Klein), who allegedly maintained unilateral control over the appointment of the SPAC's board of directors and controlled the sole shareholder of the sponsor entity (the Sponsor).

Churchill's 2020 initial public offering (IPO) offered units, with each unit consisting of one share of Class A common stock and a fractional warrant. The SPAC's board and the Sponsor received Class B founder shares. If the SPAC struck a deal within 24 months, public shareholders could redeem their units for Class A shares and retain their warrants regardless of whether they voted for the deal. Class B shares would convert into Class A common stock at a one-to-one ratio. Absent a deal, the Class A shareholders would receive their pro rata share of the amount from the IPO in addition to interest, but the Class B shares would expire as worthless.

Five months after the IPO, Churchill's board of directors approved a merger with MultiPlan, Inc. (MultiPlan), and subsequently the shareholders overwhelmingly approved the deal. However, after the merger closed, MultiPlan's stock price dropped precipitously after a research report stated that MultiPlan's largest customer was building an in-house platform to compete with MultiPlan. Two shareholders filed class action complaints alleging breaches of fiduciary duty by the SPAC's directors, officers, and Klein (as controlling shareholder) for failing to disclose that MultiPlan's biggest customer was poised to become MultiPlan's biggest competitor.

In its analysis, the court rejected three of the defendants' threshold arguments. First, the court found that the plaintiffs' claims were direct rather than derivative, as the claims implicated harm arising out of the shareholders' redemption right rather than a right belonging to the SPAC. Second, the court held that the obligation to disclose all material information about the proposed merger arose from the directors' fiduciary duties, and was not a contractual obligation arising from the redemption right set forth in the SPAC's certificate of incorporation. Third, the court rejected the argument that the shareholders' claims were "holder claims," finding instead that the shareholders had "an active and affirmative choice" to divest or remain invested in the post-merger entity.

Moving on to the substance of plaintiffs' claims, the court concluded that the entire fairness standard, as opposed to the business judgement rule, applied. The court found that entire fairness was appropriate because the plaintiffs adequately alleged that: (i) Klein, as controller of the SPAC, received a unique benefit to the detriment of the minority shareholders; and (ii) a majority of the board of directors was conflicted. Klein's conflict stemmed from the differing treatment of Class A and Class B shares if no deal were consummated: Class B shares "would benefit from virtually any merger" because such shares would otherwise be worthless, but Class A shares would only benefit from a deal if the share price increased post-merger. The court rejected arguments that entire fairness was inappropriate because the alleged conflicts were based on "structural feature[s]" of the SPAC structure. The court found that just because "this structure has been utilized by other SPACs does not cure it of conflicts."

The board's conflict, like Klein's, stemmed from the difference in the treatment of Class A versus Class B shares. In addition, the court found the directors to lack independence because Klein appointed the SPAC directors and retained the exclusive power to remove them and because the plaintiffs adequately alleged that each director had a personal or employment relationship with Klein.

Applying entire fairness, the court found that the plaintiffs adequately pleaded that the MultiPlan deal involved neither a fair price nor a fair process because the directors failed to disclose all material information about MultiPlan's largest customer's plans to compete with MultiPlan.

Brown v. Matterport: Court of Chancery addresses share transfer restrictions after de-SPAC merger

Why it is important

In *Brown v. Matterport, Inc., et al.*, C.A. No. 2021-0595-LWW (Del. Ch. Jan. 10, 2022), the Delaware Court of Chancery held that transfer restrictions restricting trade of stock "outstanding immediately" after a de-SPAC merger did not apply to an officer who received his stock more than 100 days after the merger. While the issues presented by SPACs and de-SPAC mergers may be new, in this case the court applied traditional principles of contract interpretation to decline to rewrite unambiguous contractual language.

Summary

In February 2021, Gores Holding VI, Inc., a SPAC, acquired a target company, Matterport Operating LLC (Legacy Matterport), in a de-SPAC merger. Following the merger, Legacy Matterport became a wholly-owned subsidiary of the surviving entity, Matterport Inc. Legacy Matterport stockholders, including plaintiff William J. Brown, the CEO of Legacy Matterport, had the right to receive shares of Matterport Class A common stock.

In anticipation of the merger, Gores Holding adopted amended and restated bylaws. The new bylaws imposed transfer restrictions on shares of Matterport Class A common stock. The transfer restrictions prevented certain holders of Class A common stock "immediately following the closing" from trading their shares for 180 days post-merger. Brown brought suit against Matterport alleging (i) the transfer restrictions did not apply to him, (ii) the transfer restrictions were invalid, and (iii) individual defendants violated their fiduciary duties in connection with the merger.

The court bifurcated the matter, granting expedited review on the first claim – whether Brown's shares were subject to the transfer restrictions. The defendants argued that Brown's reading of the transfer restrictions would render it a nullity and produce an absurd result because no Legacy Matterport shareholder received shares "immediately following" the merger. Finding the language of the bylaws unambiguous, the court held that the transfer restrictions applied only to shareholders who held shares "outstanding immediately following the closing" of the merger. Unlike other shareholders who received their shares within a few days of closing, Brown did not receive his shares in Matterport until approximately three and a half months after the merger, after he sent a letter of transmittal to Matterport's transfer agent, which the court concluded did not fit the plain language definition of "immediately." As a result, the court concluded Brown did not obtain his shares "immediately" following the merger, and thus he was not bound by the transfer restrictions.

Brown's remaining claims, including his breach of fiduciary duty claims against Legacy Matterport's former directors, are still pending before the court.

Buzzfeed, Inc. v. Hannah Anderson: Buzzfeed not bound by pre-SPAC employment arbitration provisions

Why it is important

In *Buzzfeed, Inc. v. Hannah Anderson*, C.A. No. 2022-0357-MTZ (Del. Ch. Oct. 29, 2022), the Delaware Court of Chancery held that "New Buzzfeed," the company that emerged following Buzzfeed's SPAC transaction and subsequent IPO, was not bound by arbitration provisions contained in the employment agreements of employees of pre-SPAC Buzzfeed. A group of employees filed mass arbitration claims against New Buzzfeed in connection with the IPO, alleging that they were damaged when they could not participate in the IPO because they held a different class of stock than was offered in the IPO. Because New Buzzfeed was not a party to the pre-SPAC Buzzfeed's employment agreements, the arbitration provisions contained within them did not require New Buzzfeed to arbitrate the claims.

Summary

In December 2021, Buzzfeed, Inc. (Old Buzzfeed), operating as a private company, engaged in a SPAC transaction and IPO to form Buzzfeed, Inc. (New Buzzfeed), a publicly traded digital media, news, and entertainment company. Employees of Old Buzzfeed had been given stock options in Old Buzzfeed as part of their compensation package. After the SPAC transaction, the employees' Old Buzzfeed stock was automatically converted into the equivalent class of stock in New Buzzfeed. The employees alleged, however, that they were unable to convert their New Buzzfeed stock into tradeable shares in time to participate in New Buzzfeed's IPO because a different class of stock was offered in the IPO than the class of stock they received in New Buzzfeed.

Based on an arbitration provision in their employment agreements with Old Buzzfeed, the employees filed mass arbitration claims against New Buzzfeed, four of its officers and directors, and the IPO transfer agent. New Buzzfeed, along with its officers and directors named in the arbitration, in turn filed a complaint in the Chancery Court to (1) enjoin the arbitrations, (2) declare they are not bound by the Old Buzzfeed employment agreements' arbitration provisions, and (3) declare the employees, as New Buzzfeed stockholders, were instead bound by the forum selection clause in New Buzzfeed's charter requiring actions be brought in Delaware Chancery Court. New Buzzfeed moved for summary judgment, and the employees moved to dismiss the complaint for lack of subject matter jurisdiction and lack of personal jurisdiction.

First, the court determined that it had subject matter jurisdiction over the claims. Because an arbitration clause is essentially a specialized forum-selection clause, the court would not have jurisdiction over a dispute that, on its face, falls within an arbitration clause. To analyze this issue, the court looked to (1) whether there was a conflict between several potentially relevant dispute resolution provisions; and (2) whether there was clear and unmistakable evidence that the parties intended to delegate issues of substantive arbitrability to an arbitrator. The court found no conflict and no evidence of intent to arbitrate because Old Buzzfeed's employment agreements were not binding, and thus presented no conflict or evidence of intent to arbitrate.

Second, the court found that it had personal jurisdiction over the nonresident employees, who argued that New Buzzfeed's charter's forum selection was unenforceable as applied to them. The court found the employees had not demonstrated that enforcing the forum selection clause would place them at an unfair disadvantage or otherwise deny them their day in court. Nor did they show why Delaware's public policy favoring arbitration should control over Delaware's public policy requiring courts to give effect to forum-selection clauses unless they are fundamentally inequitable or contrary to positive law.

With no binding arbitration provision and no agreement by the plaintiffs to arbitrate, the court granted plaintiffs' motion for summary judgment and entered a declaratory judgment that plaintiffs did not enter into arbitration agreements with the employees and did not agree to arbitrate the employees claims, and the court issued a permanent injunction against the arbitrations. However, the court denied plaintiffs' request for a declaratory judgment that the employees were bound by the forum selection clause in New Buzzfeed's charter. The court found that, because it was uncertain whether the employees would try to renew their claims in this or any other forum, this relief would be impermissibly advisory.

(In)Equitable Outcomes

In re Stream TV Networks: Delaware imposes unprecedent remedy for coordinated stock transfer

Why it is important

In *In Re Stream TV Networks*, No. 2020-0766-JTL (Oct. 3, 2022), the Delaware Court of Chancery exercised its broad equitable powers to provide an unprecedented remedy. Stream TV Networks (Stream) had transferred its assets to its secured creditors, including shares of another company, Technoactive, in order to extinguish its secured debt. Through a coordinated process, the secured creditors then transferred Technoactive shares away from Stream. The Delaware Supreme Court declared that transfer invalid and, on remand, the court ordered the secured creditors to return the assets to Stream. The court acknowledged that this unprecedented use of Chancery Rule 70(a) was an extraordinary remedy, but found it necessary to ensure an equitable result.

Summary

Stream TV Networks, Inc. (Stream), a company developing and commercializing technology allowing viewers to watch 3D content without 3D glasses, had been suffering financial difficulties. To extinguish its secured debt, Stream entered into an Omnibus Agreement with its shareholders and two of its secured creditors, Hawk and SLS Holdings VI (SLS). Per the Omnibus Agreement, Stream would transfer its assets to a new entity formed by SLS and Hawk, SeeCubic. SLS and Hawk would then cancel Stream's debt. The Stream assets included common stock from Technovative, a separate company. SeeCubic served as SLS and Hawk's designee.

Litigation over the validity of the Omnibus Agreement ensued, with the Delaware Supreme Court ultimately declaring the Omnibus Agreement invalid because a majority of Class B common stock holders did not approve it. By the time of that opinion, Stream's assets had been transferred to SeeCubic, so the Delaware Court of Chancery issued a judgment ordering SeeCubic to transfer legal title of the Stream assets back to Stream and forbidding anyone from interfering with those assets until they had been restored to Stream. Hawk intervened, seeking to confirm that secured creditors still had rights to the Stream assets. The court denied Hawk's motion, stating that the secured creditors had to wait to exercise their rights after SeeCubic returned the Stream Assets to Stream.

Subsequently, in a series of transactions over approximately 90 minutes, SeeCubic, Hawk and a Technoactive director, Shad E. Stastney, worked to ensure Hawk's control specifically over the Technoactive shares at issue. Stream filed an emergency motion alleging that SeeCubic, Hawk, and Stastney had acted in concert to circumvent the court's order that Stream gain control over the shares. SeeCubic argued that it had transferred the Technoactive shares to Stream, and therefore had fulfilled the court's post-remand order.

The court found that even though Stream briefly had possession of the Technoactive shares, SeeCubic, Hawk, and Stastney clearly had worked together to ensure that the Technoactive shares would end up with Hawk. The court pointed to the "choreographed sequence of events" and complex legalese sent between the parties as evidence that Hawk, SeeCubic, and Stastney had planned and coordinated amongst themselves to avoid the court's post-remand order.

Finding SeeCubic, Hawk, and Stastney in contempt, the court used its discretion under Court of Chancery Rule 70(a) to divest Hawk of its ownership of the Technoactive shares and to vest ownership of said shares with Stream. The court acknowledged that this was an unprecedented remedy, but considered it a fair and equitable result. The court also issued a ten-day injunction against SeeCubic, Hawk, Stastney, and anyone else working with them, barring them taking any action to interfere with Stream's ownership of the Technoactive shares.

Court of Chancery Rule 70(a) had never been used to address the ownership of shares. Confronted with extraordinary facts, however, the court felt that "extraordinary facts will call for extraordinary remedies," and that divesting ownership of the shares was necessary to effectuate the court's original judgment. This case, while extreme, serves as a warning that courts will use their discretion to direct equitable remedies as they deem appropriate.

XRI Investment Holdings v. Holifield: Delaware Chancery Court declares Delaware 'pro sandbagging'

Why it is important

In *XRI Investment Holdings LLC v. Holifield*, C.A. No. 2021-0619-JTL, the Court of Chancery found that defendant Holifield violated a No Transfer Provision in the limited liability company agreement of XRI Investment Holdings LLC when he transferred shares to a special purpose vehicle. Although "the law require[d] this result," the court found it an "inequitable result" and that the outcome was "disquieting to a court of equity." The court found that Holifield proved XRI's acquiescence, but that the LLC agreement's mandate that unpermitted transfers were "void," rather than "voidable," meant that all equitable defenses were inapplicable, according to binding Delaware Supreme Court precedent. As a result, the court indicated that it was bound by pre-existing law and granted judgment in XRI's favor. In doing so, the court urged the Delaware Supreme Court to reconsider its precedent in connection with any appeal to avoid such inequitable outcomes in the future.

Summary

Defendant Holifield and non-party Gabriel co-founded XRI Investment Holdings LLC to explore uses for non-potable water sources in the oil and gas industry. In August 2016, Holifield and Gabriel sold a controlling interest in XRI to certain funds affiliated with an investment bank. As a result of the sale, the funds held Class A units while Holifield and Gabriel held Class B units.

In 2018, Holifield attempted to use his Class B units to secure a loan to XRI. Such a pledge of units required board approval, per XRI's limited liability company agreement (the LLC Agreement), and Holifield learned that the five-member board of XRI was unlikely to approve the pledge. As a result, Holifield explored alternative structures with the aid of employees of XRI, eventually deciding to proceed by using a special purpose vehicle (SPV). Holifield created an SPV, called GH Blue Holdings, LLC (Blue), effected a "Permitted Transfer" of his Class B units, and, in turn, used those units to facilitate a loan to XRI (the XRI Loan). Under the LLC Agreement, a "Permitted Transfer" was designed to allow unitholders to transfer units for estate planning purposes.

In August 2020, however, Holifield defaulted on the XRI Loan. Various litigation ensued, including the case that led to this decision from the Delaware Court of Chancery. In this litigation, XRI asserted a claim for breach of contract against Blue and Holifield for breaching the LLC Agreement. The trial took place in June 2022. Following the trial, the court found that XRI proved that Holifield violated the No Transfer Provision in the LLC Agreement, even though it considered the outcome inequitable based on the defense of acquiescence.

XRI based its breach of contract claim on two theories: first, that Holifield's transfer of his Class B units violated the provisions of the LLC Agreement prohibiting the transfer of units (the No Transfer Provision); and second, that XRI also argued that Holifield's transfer to Blue violated the LLC Agreement's prohibition on encumbering units (No Encumbrance Provision).

The court focused on the No Transfer Provision theory and declined to reach the issue of the No Encumbrance Provision because it found that XRI did not prove that such a violation would affect the outcome of the case.

Regarding the No Transfer Provision theory, the court found that Holifield could not prove that the transfer of his Class B units to Blue was "made without consideration," one of the elements required for the transfer to be a Permitted Transfer. Because Holifield could not do so, XRI stated a claim for breach of contract.

Holifield asserted several defenses, including that the doctrine of acquiescence barred XRI's request for relief. The court found that Holifield proved acquiescence, but that acquiescence was nevertheless unavailable to Holifield based on the language of the LLC Agreement. Specifically, the court found acquiescence based on the actions of XRI and its employees, who knew that Holifield was seeking to use his units to raise capital, helped Holifield develop structures that would permit him to do so, and failed to say anything about the transfer to Blue for years after it occurred. After a lengthy academic discussion, the court also concluded that acquiescence, an equitable defense, was available to Holifield in an action at law.

Unfortunately for Holifield, the LLC Agreement provided that if a transfer violated the No Transfer Provision, it was "void," and Delaware Supreme Court precedent prohibited the court from applying equitable defenses because "void" means void *ab initio*. As a result, the court entered judgment in XRI's favor, but found that the result was inequitable based on the evidence demonstrating XRI's acquiescence. The court found that the outcome was "disquieting to a court of equity," and proceeded to lay out reasoning to allow for the application of equitable defenses in cases where a contract is void *ab initio*. The court was clear: "No one should be misled. The approach suggested by this decision does not currently reflect Delaware law." The court proceeded to set out an alternative framework for the Delaware Supreme Court to consider. That rationale would "restrict determinations that acts were void *ab initio* to those acts that contravene limitations imposed by the state, not agreements by private parties" and would "apply regardless of the language used in the parties' contract." In the view of the court, the regime would avoid outcomes that are "contrary to the equities of the case," such as the outcome in *XRI*.

Liquidation and Insolvency

Rehabilitation of Scottish Re: No *per se* liquidation standard for insurance rehabilitation plans

Why it is important

In *In re Rehabilitation of Scottish Re (U.S.), Inc.*, C.A. No. 2019-0175-JTL (Del. Ch. Apr.18, 2022), the Delaware Court of Chancery ruled, as a matter of first impression, that in a delinquency proceeding for an insurance company under Delaware law, there is no per se requirement that a rehabilitation plan meet a "liquidation standard" to obtain court approval. Under the "liquidation standard," a rehabilitation plan must provide claimants at least "liquidation value," or the value they would have received in a liquidation proceeding. The court found that neither statutory nor common law creates a bright line rule that mandates this standard. However, liquidation value remains significant because a claimant only has standing to advance a constitutional objection to a rehabilitation plan if it receives less than liquidation value. Therefore, claimants must receive information sufficient to enable them to assess if they will receive liquidation value under any rehabilitation plan.

Summary

Scottish Re (U.S.), Inc. (SRUS) is a licensed provider of health and life insurance that exclusively provides reinsurance and coinsurance. SRUS stopped taking new business in 2008, but has maintained its pre-existing financial commitments with a number of cedents and retrocessionaires. Years before the instant action, SRUS began experiencing financial difficulties related to its yearly renewable term life insurance policies. To fulfill its continued obligations, SRUS, as a wholly-owned subsidiary, previously relied on financial support from its parent companies. When those parent companies filed for bankruptcy in 2018, SRUS' financial picture worsened.

By early 2019, the Insurance Commissioner of the State of Delaware (the Commissioner) determined that SRUS was in financial distress and commenced a delinquency proceeding. The Court of Chancery subsequently placed the company into receivership and appointed the Commissioner as the statutory receiver for the company. On June 30, 2020, the Commissioner filed a proposed plan of rehabilitation, though no final plan has yet to be submitted to the court.

Once SRUS' claimants reviewed the proposed plan, a series of disputes emerged regarding the nature and types of information that the Commissioner planned to provide to claimants. Briefing these issues revealed a deeper issue that divided the parties: the parties did not agree on whether or not the liquidation standard should apply to the rehabilitation plan. A group of 57 cedents and five retrocessionaires argued that the court could not approve any plan that did not provide, at a minimum, liquidation value to the claimants. The Commissioner and a separate group of seven retrocessionaires disagreed.

The Court of Chancery recognized that this was an issue of first impression. After considering relevant Delaware statutory law, case law, secondary sources, and public policy, the court determined that, in a delinquency proceeding under Delaware law, neither statutory nor common law requires the Commissioner to meet the liquidation standard in order to obtain court approval of a rehabilitation plan. In particular, the court noted that Delaware's statutory scheme for evaluating a proposed rehabilitation was silent on whether the liquidation standard applied, unlike other statutory frameworks cited by the claimants. The court also noted that the balance of policy considerations counseled in favor of action on this issue from the General Assembly instead of the court.

Evaluating decisions from other jurisdictions to have considered the issue, the court emphasized that each of these authorities derived from a pair of Depression-era decisions from the U.S. Supreme Court and the Supreme Court of California, both arising out of the rehabilitation of Pacific Mutual Life Insurance Company of California. See *Carpenter v. Pac. Mut. Life Ins. Co. (Carpenter I)*, 74 P.2d 761 (Cal. 1937), aff'd sub nom. *Neblett v. Carpenter (Carpenter II)*, 305 U.S. 297 (1938). After conducting a close read of these decisions, the court determined that these decisions "were about standing."

The decisions did not hold that a rehabilitation plan must meet the liquidation standard or that a court may not approve a rehabilitation plan that did not meet that standard. Rather, the Pacific Mutual decisions held that a rehabilitation plan that satisfied the liquidation standard could not give rise to constitutional challenges.

Accordingly, the court held that a claimant would have standing to object if it could show that the plan fails to provide it with liquidation value, in which case the court would consider the objection on its merits. The court therefore required the Commissioner to provide sufficient information about the rehabilitation plan to enable claimants to determine whether they should object.

In re Forum Mobile: Section 226(a)(3) cannot turn defunct business into blank check company

Why it is important

In *In re Forum Mobile, Inc.*, C.A. No. 2020-0346-JTL (Del. Ch. Feb. 3, 2022), the Delaware Chancery Court held that Section 226(a)(3) of the Delaware General Corporation Law (DGCL) does not authorize the court to appoint a custodian to revive an abandoned business. The court outlined the decades-long public policy against allowing entrepreneurs in the capital markets to use sections of the DGCL to revive defunct entities for use as vehicles to access the public markets, but acknowledged intervening changes in the federal securities laws that might impact that policy. After considering input from the SEC through a court-appointed amicus curiae, the court concluded that the plain language of the statute allows the court to appoint a custodian under Section 226(a)(3) to liquidate, but not revive, an abandoned business.

Summary

Synergy Management Group LLC (Synergy) seeks out defunct entities with surviving public listings to make these entities available to those who want to enter the public markets without the time and expense of an IPO. Synergy identified Forum Mobile, Inc., a company declared void by the Delaware Secretary of State on March 14, 2014. Although the company was deregistered and all operations ended, its shares continued to have a CUSIP number.

Synergy sought an order from the Delaware Court of Chancery appointing Synergy's president as a custodian on May 8, 2020. Synergy planned to use Forum as a blank check company, which, through a reverse merger, would allow another company to enter the public market without the time and costs associated with an IPO. Synergy's petition asked the court to appoint Synergy's president as a custodian to pay certain of Forum Mobile's outstanding fees due to the state, to allow the company to continue as an ongoing concern for stockholders, and to permit certain measures to facilitate a special meeting to elect a new board of directors.

The court denied the petition, finding that the plain language of Section 226(a)(3) permitted the appointment of a custodian for very limited purposes, which did not include the revival of a defunct business. Before turning to the plain language, however, the court engaged in a public policy analysis. The court noted that other entrepreneurs had tried to use the DGCL in similar ways, but that the Delaware courts maintained a policy since 2002 against facilitating this shortcut, and instead encouraged use of the formal IPO process to go public.

After acknowledging recent changes to federal laws that might require a change in that public policy, the court appointed an amicus curiae to independently review the petition and consult with the SEC. The SEC did not take a position about whether the petition should be granted under Delaware law, but reiterated that granting the petition would not enable Synergy to circumvent federal securities laws governing disclosure. The amicus curiae recommended granting the petition but with appropriate safeguards to prevent abuse.

The court found, based on the SEC's input, that the previously followed public policy alone did not warrant denial of the petition, but concluded that the plain language of Section 226(a)(3) did not provide authority for a court-appointed custodian to revive a corporation that has been abandoned. The plain language of the statute permits a custodian to be appointed when a corporation has "abandoned its business and has failed within a reasonable time to take steps to dissolve, liquidate or distribute its assets." Prior cases established that, in general, the authority of a company's custodian is to continue the business and not liquidate its affairs and distribute its assets, with a specific exception for custodians appointed under Section 226(a)(3). Custodians appointed under this exception thus have the power only to liquidate the corporation's affairs and distribute its assets.

As evidenced by the rise in SPAC transactions, market participants recently have been looking for ways to participate in the public markets without the time and expense of an initial public offering. In this opinion, the Delaware Court of Chancery made clear that Section 226(a)(3) would not be an option for those seeking to do so.

Stream TV Networks v. SeeCubic: Delaware court rejects "board only" insolvency exception

Why it is important

In *Stream TV Networks, Inc. v. SeeCubic, Inc.*, the Delaware Supreme Court reversed the Delaware Court of Chancery's finding that the board of Stream TV Networks, Inc. (Stream) could sell all of Stream's assets without a stockholder vote due to Stream's insolvency. The Delaware Supreme Court found that the sale agreement – in essence, a privately structured foreclosure transaction – constituted an "asset transfer" under Stream's charter, triggering a class vote provision that required the approval of Stream's Class B stockholders. The court further held that a "board only" insolvency exception no longer existed following the enactment of DGCL § 271 and its predecessor governing the sale of a corporation's assets.

Summary

Stream TV Networks, Inc. (Stream), a company developing and commercializing technology allowing viewers to watch 3D content without 3D glasses, suffered financial difficulties. In 2019, several of Stream's shareholders proposed that Stream restructure, but Stream's founders and directors, the Rajan brothers, rejected a proposed omnibus agreement (the Omnibus Agreement). After continuing financial difficulties through 2020, however, Stream's two newly appointed outside directors, who together formed a resolution committee with "the full power and authority of the full Board of Directors to resolve any existing or future debt, defaults, or claims, and any existing or future," approved the Omnibus Agreement. The Omnibus Agreement provided that Stream would assign its assets to a new corporate entity, SeeCubic. It gave holders of Stream's Class A common stock the right to exchange their shares for an identical number of shares of SeeCubic's common stock and issued Stream itself one million shares of SeeCubic's Class A common stock.

On September 8, 2020, Stream, through the Rajan brothers, filed suit seeking to bar SeeCubic from seeking to enforce the Omnibus Agreement. SeeCubic filed counterclaims against Stream and third-party claims against the Rajan brothers. The Delaware Court of Chancery preliminarily, and then permanently, enjoined Stream and the Rajan brothers from interfering with the Omnibus Agreement. The court found that SeeCubic was entitled to injunctive relief because the resolution committee had the authority to bind Stream to the Omnibus Agreement and that neither DGCL § 271 (which permits a Delaware corporation to sell, lease, or exchange all, or substantially all, of its property and assets as its board of directors or governing body concludes is in the best interest of the corporation) nor a class vote provision (the Class Vote Provision) in Stream's charter rendered the Omnibus Agreement invalid. In analyzing § 271, the court

found that § 271 was ambiguous as to whether it applied to the type of transfer at issue. Based on legislative history, the court concluded that § 271 did not supersede the traditional common law rule requiring unanimous shareholder approval before selling all of a corporation's assets. The court further concluded, however, that there was an insolvency exception to the common law rule such that a financially failing company may sell the assets of the corporation without shareholder approval.

Stream and the Rajans appealed, making four main arguments: (1) that the Class Vote Provision unambiguously required Class B stockholder approval and rendered § 271's default voting rule irrelevant; (2) that the court erred by looking first to § 271 before construing the corporation's charter; (3) that § 271 superseded any such common law exceptions assuming that such an exception ever existed; and (4) that the ruling, as a matter of public policy, would upset and undermine Delaware's contractarian focus and the predictable application of its corporate laws, including § 271.

In addressing whether the Class Vote Provision required Class B majority stockholder approval of the Omnibus Agreement, the Delaware Supreme Court agreed with Stream that the Court of Chancery improperly analyzed the issue by applying its interpretation of § 271 to the clear and unambiguous language of the charter provision. The Delaware Supreme Court held that the Omnibus Agreement effected an "asset transfer" under Stream's charter, requiring a vote of the Class B stockholders pursuant to the Class Vote Provision. The Delaware Supreme Court rejected the Court of Chancery's reliance on § 271's language as an interpretive guide in construing the language of the Class Vote Provision, and held that no insolvency exception existed. Moreover, the Delaware Supreme Court found that an insolvency exception allowing a board alone to sell all of a company's assets would inject uncertainty and potential inconsistency into the general corporate laws of Delaware, which would, in turn, undermine the jurisdiction's status as a contractarian state.

Other Notable Decisions

Ramcell, Inc. v. Alltel: DE Court averages valuation models to arrive at fair market value of shares of forum-selection clauses

Why it is important

In *Ramcell, Inc. v. Alltel Corp.*, C.A. No. 2019-0601-PAF (Del. Ch. July 1, 2022), the Court of Chancery reviewed a 2019 short-form merger between Alltel Corporation (Alltel) and Jackson Cellular Telephone Co. (Jackson), that resulted in the cancellation of Jackson's stock in exchange for US$2,963 per share. Ramcell, Inc. (Ramcell), a holder of approximately 155 shares of Jackson stock, dissented and exercised its statutory appraisal rights. At trial, Ramcell's expert valued the shares as high as US$36,016 per share while Alltel's expert testified and valued the shares as low as US$5,690.92 per share. The Court chose to weight and average the models of both experts. Thus the court adopted a valuation of US$11,464.57 per share. The Court further held that because petitioner received a fair value judgment that was higher than the merger consideration, there was no bad faith conduct, and did not incur excessive costs, and all costs should be paid by respondent Alltel.

Summary

Jackson Cellular Telephone Co. (Jackson) provided wireless communications products and services in the FCC designated Jackson Metropolitan Statistical Area (MSA), centered around Jackson, Mississippi. In 2009, Verizon Communications, Inc. (Verizon) acquired Jackson's majority owner Alltel, and combined Jackson's operations with its own.

In April 2019, Alltel, then owner of 90% of the outstanding common stock of Jackson, effected a short-form merger in which holders of Jackson stock received US$2,963 per share. Ramcell, the holder of less than a 1% interest in Jackson, did not consent to the merger. On August 5, 2019 Ramcell exercised its appraisal rights under 8 Del. C. § 262, seeking a statutory appraisal for its 155.4309 shares of Jackson's stock.

At trial, both Alltel and Ramcell presented expert testimony as to the fair value of Jackson as of April 4, 2019. While both parties' experts agreed the proper methodology to measure the value of the company was a discounted cash flow (DCF) model, the experts arrived at "vastly different valuations" of the company: US$5,690.92 according to Alltel, and as much as $36,016 according to Ramcell.

Rather than adopting one expert's valuation, the court determined that the best way of calculating fair market value was to blend the approaches of the two experts. The court noted that there were three basic components to a DCF model: (1) Future Cash Flow Estimates, (2) the Discount Rate, and (3) Terminal Value.

For the Future Cash Flow component, the court found that "[n]either party persuasively established that the projections used in their DCF model were reliable." As a result, the court averaged the two sets of projections, giving Alltel's a weight of 70% and Ramcell's a weight of 30%. This allocation reflected the Court's greater confidence in Alltel's use of concrete historical financials while accounting for drawbacks in Ramcell's approach of calculating subscriber numbers.

For the Discount Rate, the court criticized each expert's approach, noting Ramcell's expert "simply assumed" Jackson's rate was the same as Verizon's 6.8% and Alltel's expert's selection of data for his model "did not inspire confidence in his approach" and his resulting 12.9% rate. The court again turned to a blended approach and arrived at a figure of 7.847% using a combination of both experts' figures.

For Terminal Value – the present value of all the company's future cash flows beginning after the projection period – the court sided with Ramcell's expert, who persuasively presented averages of industry growth forecasts with discounts for Jackson MSA-specific characteristics. But, due to some inaccuracies with the data used by Ramcell's expert, the court adjusted the growth rate downward slightly to 2.2%.

Putting together these three components, the court calculated a final weighted average of US$11,464.57 per share, for a total judgment of US$1,781,948.74. Because the court's final price was greater than the merger price, the court found that the default rule of awarding costs to the surviving corporation should be followed, and thus ordered that Alltel pay costs and fees to Ramcell.

Lee v. Fisher: Circuit split on enforceability of forum-selection clauses

Why it is important

In *Lee v. Fisher*, 34 F.4th 777 (9th Cir. 2022), the Ninth Circuit affirmed the dismissal of a shareholder derivative suit against The Gap Inc. (Gap), alleging violations of Section 14(a) of the Securities Exchange Act of 1934, based on a Gap bylaw requiring that any derivative action be brought in the Delaware Court of Chancery. Due to the Exchange Act's exclusive federal jurisdiction provision, this decision would effectively allow corporations to close all courthouse doors to derivative actions alleging violations of Section 14(a). Earlier this year, however, the Seventh Circuit held in Seafarer's Pension Plan ex rel. *Boeing Co. v. Bradway* that a similar Boeing bylaw was unenforceable because it would mean the plaintiff's derivative Section 14(a) claim may not be heard in any forum.

Summary

The plaintiff filed a derivative action in the Northern District of California alleging that Gap and its directors failed to engender meaningful diversity in company leadership and made false and misleading statements in its proxy statements about the level of diversity it had achieved in violation of Section 14(a) and a variety of state laws. The defendants moved to dismiss based on the document of forum non conveniens based on Gap's forum-selection bylaw, which directed that any derivative action be brought in the Delaware Court of Chancery. The district court found the bylaw to be enforceable and dismissed the case, prompting the plaintiff to appeal to the Ninth Circuit, arguing that the bylaw was unenforceable because it violates public policy by foreclosing her ability to bring a derivative Section 14(a) claim in any court.

The Ninth Circuit affirmed. The court began by noting Supreme Court precedent that creates a strong presumption in favor of enforcing forum selection clauses and places the burden on the plaintiff to establish "extraordinary circumstances" weighing against the application of the forum selection clause. It then looked to Ninth Circuit precedent to determine whether a strong federal public policy against the enforcement of this forum-selection clause was present.

The court held that the strong public policy in favor of enforcing forum-selection clauses supersedes both the Exchange Act's anti-waiver provision and federal courts' obligation to hear cases within their jurisdiction. It also rejected the plaintiff's argument under the Exchange Act's exclusive jurisdiction provision because it found that the bylaw did not contravene the exclusivity provision because the bylaw did not force the Delaware Court of Chancery to adjudicate Section 14(a) claims, it merely prevented

federal courts from hearing Section 14(a) claims brought derivatively. The court also rejected the plaintiff's arguments that Delaware law created a public policy that prevented enforcement of the forum-selection bylaw, noting that the plaintiff would still have some reasonable recourse in the Delaware Court of Chancery.

Significantly, the court further found that the plaintiff waived the argument that the bylaw was contrary to Delaware corporation law by failing to make it in the district court or in her opening brief. In so holding, the court side-stepped the argument that carried the day in the *Seventh Circuit in Seafarers Pension Plan v. Bradway*, 23 F.4th 714 (7th Cir. 2022). There, a divided panel of the Seventh Circuit held that a forum selection bylaw mandating that all derivative actions filed against the Boeing Company be brought in the Delaware Court of Chancery was unenforceable as applied to a derivative 14(a) claim, because Section 115 of the Delaware General Corporation Law does not empower corporations to use forum-selection bylaws to avoid claims subject to exclusive federal jurisdiction.

Level 4 Yoga v. CorePower Yoga: COVID-19 shutdown not grounds for asset purchase repudiation

Why it is important

In *Level 4 Yoga, LLC v. CorePower Yoga, LLC*, C.A. No. 2020-0249 (Del. Ch. March 1, 2022), the Delaware Court of Chancery granted Level 4, the owner of franchised yoga studios, an order of specific performance and compelled the buyer, Level 4's franchisor, to close under an asset purchase agreement after finding that (1) Level 4 had not breached its ordinary course covenant by complying with the franchisor's directives to temporarily shut down its studios at the outset of the COVID-19 pandemic and (2) no Materially Adverse Effect had occurred. The court found that the parties had intentionally structured their purchase agreement as a "one-way gate" requiring that closing take place, without any conditions to closing, to purposefully account for the fact that Level 4 was not a voluntary seller after the franchisor had invoked a contractual call option. The court therefore awarded Level 4 specific performance, damages, and interest for the franchisor's unexcused failure to close.

Summary

In May 2019, CorePower Yoga exercised a contractual call option that required its franchisee, Level 4 Yoga, to sell all of Level 4's assets, namely numerous yoga studios, to CorePower. The acquisition of all of Level 4's studios was memorialized in an Asset Purchase Agreement (APA) later that year. However, shortly before the first scheduled closing approached, the COVID-19 pandemic began. CorePower directed all of its franchisees, including Level 4, to shut down their studios as a result of the pandemic on March 26, 2020, a week before the first scheduled closing was to occur under the parties' purchase agreement. Level 4 complied. CorePower then tried to use the fact that Level 4 had shut down its studios as evidence that there had been a Materially Adverse Event substantially affecting the seller's business, and further argued that Level 4 was no longer operating in the Ordinary Course of Business and therefore was in violation of the parties' purchase agreement. CorePower further argued that Level 4 had repudiated the purchase agreement and sought to delay and/or terminate the scheduled transactions. Level 4 refused to delay the planned series of closings and insisted the transactions go forward. Level 4 brought suit, seeking an order of specific performance compelling CorePower to close under the Asset Purchase Agreement and damages.

After a five day bench trial, the Court of Chancery ruled in Level 4's favor and granted it specific performance and compensatory damages for CorePower's delay in closing. The court found that that the parties had intentionally structured their purchase agreement as a "one-way gate" requiring that closing take place, without any conditions to closing, to purposefully account for the fact that Level 4 was not a voluntary seller once CorePower had invoked its call option. The court found that the absence of any conditions

to closing or express rights to terminate evidenced the parties' intention to close even if one party was in breach. In addition to finding no contractual basis for termination, the court further found that CorePower had no common law right to terminate the purchase agreement because Level 4 was not in material breach since the agreement required Level 4 to be in compliance with its franchise agreement and the franchise agreement obligated Level 4 to shut down as directed by CorePower. The court further rejected CorePower's argument that a Material Adverse Effect had occurred, finding that the timeframe required for measuring a Material Adverse Effect was "years rather than months," such that Level 4's shutdown for less than a week at the time of CorePower's repudiation was insufficient. The court also found that Level 4's temporary shutdown of operations was within the ordinary course of business under the parties' agreement because CorePower's franchise agreement required that Level 4 follow CorePower's directions. Following CorePower's directions, the court found, was Level 4's ordinary course of business, even if the direction to shut down was not ordinary.

Because Level 4 did not breach the APA, CorePower was in breach by refusing to go through with the asset purchases. The court awarded Level 4 specific performance requiring CorePower to close the transaction, damages for operating losses incurred after the scheduled closing date, and pre-and post-judgment interest.

Arwood v. AW Site Services: Delaware Chancery Court declares Delaware 'pro sandbagging'

Why it is important

In *Arwood v. AW Site Services LLC*, C.A. No. 2019-0904-JRS (Del. Ch. March 9, 2022), the Delaware Court of Chancery held that "Delaware is a 'pro-sandbagging jurisdiction,'" meaning that, absent a provision to the contrary, an M&A buyer is entitled to seek indemnification for breaches of contractual representations even if it knew or should have known of the breaches at the time of contract. The court further stated that, even where available, sandbagging could not arise as a defense unless the buyer had actual knowledge that a representation was false at the time it was made, and that even reckless disregard for the truth was insufficient. The case clarifies that, under Delaware law, a buyer's pre-closing knowledge will not bar its ability to bring claims for breached representations and warranties, unless the agreement contains anti-sandbagging provisions. The court also clarified the standards for showing justifiable reliance in connection with fraud claims.

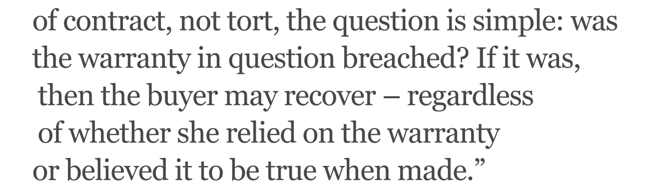
Summary

At issue in *Arwood v. AW Site Services LLC* were claims by the sellers of a waste management business that they should not be responsible for breaches of financial and other contractual representations concerning their former business because the buyer was, or should have been, aware that the representations were false at signing.

The transaction involved somewhat unusual facts. The plaintiff had founded the business at issue but had not marketed it for sale. The court found that he "did not know how to package a business to be sold"; "had not valued his businesses"; "did not maintain any financial records"; and "did not know how to prepare them." After expressing an interest in acquiring the business, the seller granted the buyer "extraordinary" access to the business so that the buyer could perform valuation and prepare a "detailed set of financials." The parties negotiated a price and the transaction closed.

Following the closing, the buyer discovered what it alleged was a fraudulent overbilling scheme. The buyer refused to release US$1.41 million in escrowed funds, claimed fraud, and demanded indemnification for breaches of the seller's representations and warranties concerning the company's financial statements, its compliance with laws, and other matters. The seller demanded the release of the escrowed funds and sued when the buyer refused. Among other things, the seller argued that the buyer could not recover for breaches of contractual representations that it knew were false at the time of contract – a sandbagging defense.

The Court of Chancery rejected the sellers' argument following a bench trial, despite finding that the buyer "knew as much about the businesses" as the sellers, holding that "[t]he sandbagging defense is inconsistent with our profoundly contractarian predisposition." The court held that "[v]iewed through the lens



of contract, not tort, the question is simple: was the warranty in question breached? If it was, then the buyer may recover – regardless of whether she relied on the warranty or believed it to be true when made."

The court also held that a sandbagging defense – if it were even available – could only be viable if the buyer had actual knowledge of the falsity of a representation, and that even reckless indifference to the falsity of a representation would be insufficient.

Finally, the court rejected the sellers' fraud claims, finding no evidence of intent to defraud by the seller, whom the court found was "unsophisticated," and who had granted the buyer "unfettered access" to the business to permit the buyer to conduct its diligence review. The court found that a buyer claiming fraud could show reasonable reliance on false information by showing that it did not have or recklessly disregard knowledge of the falsity of the information, but held that the buyer had not met that showing.

The court further allowed the buyer to recover up to the contractual cap but rejected the buyer's claims for losses in excess of the cap because the buyer failed to show fraud.

Joseph Lawrence Ligos v. Isramco, Inc.: Court dismisses breach of fiduciary duty claims

Why it is important

In *Joseph Lawrence Ligos v. Isramco, Inc., et al.*, C.A. No. 2020-0435-SG (Del. Ch. Nov. 30, 2022), the Delaware Court of Chancery granted a motion to dismiss a shareholder class action complaint alleging that the members of the Special Committee of Isramco, Inc. breached their duties of loyalty in connection with a cash-out merger subject to entire fairness review. The plaintiff alleged that the Special Committee members were conflicted because they were selected by the company's controlling stockholder, who also was alleged to control the buyer, Naptha. In a prior ruling, the court denied the controlling stockholder's motion to dismiss based on the MFW framework, finding there was a plausible inference that the stockholder vote was not fully informed. In this ruling, the court granted the Special Committee defendants' motion to dismiss, finding that even though the transaction's outcome was "not great," the complaint failed to adequately plead a lack of independence or bad faith to support a non-exculpated claim.

Summary

Nonparties Isramco and Naphtha completed an all-cash going-private transaction. Naphtha's main businesses focused on the exploration and production of oil and natural gas. Until the consummation of the merger, Defendant Tsuffh was Isramco's President and Chairman of its Board. Tsuff indirectly controlled all entities on both sides of the transaction. Defendants Max Pridgeon, Asaf Yarkoni, and Nir Hasson all served as members of the Board until the closing of the Merger.

Defendants Pridgeon, Yarkoni, and Hasson were selected to serve as members of the Special Committee. The Special Committee noted the potential impact of an arbitration concerning royalties owed to Isramco by a Tsuff-controlled entity related to production in an offshore Israeli oil field, the Tamar Field. Since Isramco's interest in revenues from the Tamar Field was a primary source of revenue, the Tamar Arbitration was a key factor impacting valuation. After several days of in-person negotiations, the Special Committee eventually accepted Naphtha's offer of US$121.40 per share.

Ligos, a minority stockholder squeezed out in the merger, filed a complaint on June 4, 2020, alleging that Tsuff and the Special Committee defendants breached their fiduciary duties and were unjustly enriched. In Ligos I, Tsuff moved to dismiss, arguing that the business judgment rule applied pursuant to *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014). The court denied the motion, finding that there was a plausible inference that the stockholder vote was not fully informed because the proxy failed to disclose that the Board approved Tsuff's participation in the Tamar Arbitration and his participation itself, both of which would have been material to a stockholder's evaluation of the proposed merger.

Turning to the Special Committee defendants' motion to dismiss, the court held that *In re Cornerstone* provided the appropriate legal standard to determine whether Ligos pleaded a viable, non-exculpated claim against the Special Committee defendants for breach of the duty of loyalty. The court focused its analysis on (1) the Special Committee defendants' interest in the transaction and independence from Tsuff; and (2) the Special Committee defendants' good faith.

First, the court noted that Ligos did not assert facts indicating that the Special Committee defendants were interested in the merger. Rather, Ligos argued that the Special Committee defendants lacked independence from Tsuff. The court rejected the argument that Tsuff's position as a controller militates against a finding of independence. Analyzing the allegations as to each director, the court found that the complaint's conclusory allegations regarding board service, employment and approval of Tsuff proposed transactions were conclusory and insufficient to allege any beneficial relationship or material benefit that would cause a breach of the duty of loyalty.

Second, the court concluded that the Complaint's allegations were not sufficiently egregious to find it reasonably conceivable that the Special Committee defendants were acting against Isramco's interests, including allegations regarding: (1) the Board's decision to allow for Tsuff's participation in the Tamar Arbitration; (2) the Special Committee's disclosure of a price floor; (3) the "rapid" acceptance of Naphtha's final offer; and (4) the failure to investigate Naphtha's risks to Isramco business. The court also rejected the claim that the omission of certain information from the proxy, including with respect to the Tamar arbitration, supported a finding of scienter.

Since there were no surviving non-exculpated claims, the court held that the Complaint failed to state a claim, and granted the Special Committee defendants' motion to dismiss.

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 trial lawyers** focused on helping our clients achieve their key business objectives. In 2022, we continued our rich history of success on behalf of our clients. Notably, our team:

- Obtained **a major win** on behalf of one of the largest real estate companies in Europe and its executive officers who were sued for RICO violations, among other things, by a hedge fund investor in federal court in New York. We successfully argued the case on appeal. In September, the Second Circuit affirmed the District Court's decision dismissing the case at the pleading stage.
- Won a **unanimous ruling** from the Delaware Supreme Court, which affirmed that, as a matter of equity, the "affirmative deception" by the founder/director of a tech company voided his attempted "coup d'état" to take control of the company from our client, the board of directors.
- Successfully argued, and was **granted a motion to dismiss a putative class action** for an energy client, which rejected the plaintiff's claim that the defendants acted in violation of the shareholder agreement and breached fiduciary duties.
- Won a **two-day bench trial** in Delaware Bankruptcy Court regarding a contested sale process.
- Achieved a set of major victories on behalf of a **Texas-based private energy company** and its CEO in multiple cases brought by investors for breach of contract and fraud, with two summary judgment rulings resulting in dismissal of all claims.

Our team litigated a number of cases in **Delaware** and beyond in 2022, representing our clients in several high-profile matters and securing important victories. We:

- Represented 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.
- Representing a **major American multinational investment bank** in litigation regarding allegations of fraud committed against the bank during the diligence process by a company that the bank acquired, seeking nearly US$200 million in damages on behalf of the bank, and in related litigation in the Delaware Court of Chancery regarding advancement and indemnification rights.
- Representing a **digital assets and blockchain client** in a high-profile litigation in the Delaware Court of Chancery arising out of their termination of a US$1.2 billion merger with an IT service company.
- Representing the former chief compliance officer of one of the world's largest retailers in **stockholder derivative litigation** alleging that the directors and officers breached their duty of oversight in failing to monitor the pharmacy division's efforts to limit improper distribution of opioid products and allowing the Company to become exposed to billions of dollars in regulatory fines and penalties. A motion to dismiss pending in Delaware Chancery Court.
- Represented 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.
- Won a motion to dismiss on behalf of our **energy client** in the New York Supreme Court Commercial Division in a putative class action brought by a minority shareholder alleging that our client's directors violated their fiduciary duties.
- Achieved successful settlement of claims brought by the **receivers of the infamous Platinum Partners hedge fund** in the Southern District of New York against one of the alleged partners of the fund's management company.
- Achieved the successful settlement of claims brought by **sellers of a business** in federal court in Oregon accusing our client of breach of contract in failing to pay the required "earn out" payment under a stock purchase agreement.
- 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 and received substantial media coverage.

We have extensive experience litigating **federal securities class actions**. Over the last 12 months, our team:

- Represented a life sciences company in a '34 Act class action, and accompanying **section 220 demands and related stockholder derivative litigation**, 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** for its lead product candidate. A favorable settlement was approved by the U.S. District Court for the Southern District of New York in January 2023.

- Representing a co-founder and former board member of a mining company in connection with a '34 Act 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 investments**.
- Representing the directors and officers of a life sciences company in a '34 Act class action alleging **that the directors and officers failed to timely disclose a dispute with a regulator that led to a $600 million retroactive penalty and a DOJ False Claims Act** case that sought nearly US$2 billion in damages.
- Representing the founder of an electric vehicle and trucking company in '33 Act and '34 Act class actions pending in the U.S. District Courts for the Southern District of New York and the Central District of California, and **stockholder derivative litigations** pending in Delaware Chancery Court and Delaware Superior Court.
- Representing private equity fund in connection with **investor litigation risk and regulatory matters** arising from collapse of Silicon Valley Bank.
- Representing a private equity firm in connection with litigation and R&W claims arising from **portfolio company's US$125+ million acquisition** of digital marketing business.

In addition, we are actively litigating a number of large cases across a broad array of industries. We are currently:

- Representing a co-creator of a **social networking site** in an idea theft action premised on defendants' failure to compensate her for providing the vision and creative direction of the platform at its inception, and defendants' use of her ideas for the purpose of selling shares in Pinterest's 2019 IPO.
- Representing a **media company** in an ongoing shareholder and corporate governance dispute over the ownership and control of a nationally recognized news publication.
- Representing an **international telecommunications company** in defending "earn out" claims brought by the sellers of a business in a M&A transaction.
- Representing an **independent energy company** in a busted deal, fiduciary duty and trade secret litigation related to the acquisition of a several hundred million dollar natural gas storage facility.
- Representing a **cyber-security company** in major disputes between shareholders and creditors with a dissident shareholder group fighting for control of the board; at the heart of the dispute is the dissident's attempt improperly to control the company's intellectual property.
- Representing **corporate officers** in connection with litigation filed in federal court in North Carolina based on claims that they manipulated the signature authority over a Distributed Autonomous Organization (DAO) designed to hold tokens in a block chain network.
- Representing a **high-net-worth private investor in Qatar** in the Southern District of New York, in connection with claims that he was fraudulently induced to invest millions of U.S. dollars in a fraudulent Ponzi scheme.
- 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 2022. We are poised and eager to help our clients tackle new challenges in 2023 – and beyond.

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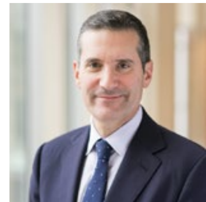

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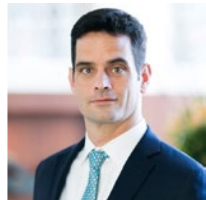

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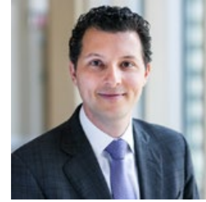

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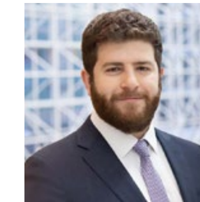

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