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Should Delaware Law Protect Corporate Officers?

The Debate at Tulane

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Editor's Note: Vice Chancellor Lori Will recently noted that a proposed amendment to section 102(b)(7) is soon to be taken up by the Delaware legislature that would give stockholders and companies the option to adopt a charter amendment that would exculpate officers from non-loyalty claims. She said she expected to see the final result early this summer. The Tulane Corporate Law Institute in the spring included a panel discussion on this issue moderated by Professor Lawrence Hamermesh, the executive director of the Institute for Law and Economics at the University of Pennsylvania Law School.

Professor Lawrence Hamermesh: We're here to examine the question of officer liability, monetary liability for claims of breach of duty of care, and the question of whether or not Delaware's exculpation statute, section 102(b)(7) of the General Corporation Law, is sufficiently broad or needs to be broadened in order to address and permit exculpation with respect to such claims. That's the question.

My involvement in this, before I introduce the panel, is as a co-author with Leo Strine and Jack Jacobs, of an article in *The Business Lawyer* that, among other things, raises this question of the potential for expanding or extending exculpation under 102(b)(7) to officers, to some extent. So I'll introduce the panel, I'll give a brief overview of where we're headed, and then we'll launch in. The game here with our panel is to identify which panelist is not like the others. We've got something like the movie Three Men and a Baby. We've got four bald men and a vice chancellor.

Chief Justice Leo E. Strine: It's now streaming on Hulu actually.

Professor Hamermesh: By the way, none of these panelists is unknown to the group here, I'm sure, but Randy Baron, briefly, is a partner at Robbins Geller Rudman & Dowd in San Diego, specializing in securities litigation, corporate takeover litigation, and breach of fiduciary duty claims. My favorite appellation from his biography is, "He is a titan of the industry," and definitely a superstar in Delaware shareholder litigation, as well as elsewhere. Among his other credentials though, he's a co-teacher of corporate and transactional litigation at NYU with another panelist, Vice Chancellor Will. And the rest of these introductions are all about Penn Law, which is where I'm housed.

Next panelist, Scott Luftglass, litigation partner at Fried Frank, co-head of their securities and shareholder litigation practice. Scott is, among many other things, guest lecturer on M&A topics and litigation at Yale Law School and at Penn and Boston College. He's on the board of advisors of the Institute for Law and Economics at Penn Law, and a co-author of *Takeover Defense: Mergers and Acquisitions*, a treatise widely recognized as a definitive legal resource in the area.

So our next panelist is Leo E. Strine Jr. Nowhere will I more deeply abridge a biography than for Leo. He's a graduate of Penn Law in 1988. He is the Michael L. Walker Distinguished Fellow in Law and Policy at Penn Law School and a Senior Fellow at the Harvard Program on Corporate Governance. And of course, as everybody knows, former Chief Justice of the Delaware Supreme Court, former Chancellor, former Vice Chancellor of

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the Court of Chancery.

The last panelist is Vice Chancellor Lori Will. She just reached her first anniversary on the bench and before that, was a partner at Wilson Sonsini Goodrich & Rosati, and also a JD from nowhere other than Penn Law School. So with that, let me give folks a little overview of where we're headed with this program.

I'm going to ask Leo, first, to introduce a little bit of a history of section 102(b)(7) and some parallel developments that inform our proposal with regard to the possibility of amending 102(b)(7). And then we're going to spend a little time going over some, but definitely not all, of the cases in which officers have been targeted with breach of duty of care claims. And I'll invite Scott and Randy to walk us through some of those cases. After that, we'll pause and invite Vice Chancellor Will to share with us her views about how litigation in this area has trended and some of the implications for the court and for litigants.

"I think we're looking for a solution. I just don't think we have a problem."

– Randall Baron

Geller Rudman & Dowd

At that point, I'll invite Leo to return and describe specifically the proposal that we've put forward in our article, and then launch into a discussion of the pros and cons of that proposal and the policy considerations, after which we will pick ourselves up off the floor and wrap up. So with that, Leo, let me invite you to tell us a little bit about the background of 102(b)(7) and how we got to where we are today before we get into the cases.

Chief Justice Strine: Thanks, Larry. It's really appropriate on a Friday in Lent, the day after St. Patrick's Day, to talk about exculpation. It's really seasonally, thematically on point. I'm going to start with two scary words, *Van Gorkom*. That's going to be a bit of a theme of mine, because like a boomerang or a slasher villain, we may be seeing the Return of *Van Gorkom*, but you can't talk about this subject without Van Gorkom.

Van Gorkom, as you know, is a bit of a time warp machine. A board of directors in 1980, when the print on Marty Lipton's famous Takeover Bids in the Boardroom article wasn't even dry, and when there wasn't an internet to read it, a board did a third-party deal. The CEO was retiring. He seized an opportunity at the Chicago Lyric Opera. Got a hugely lucrative price from a third-party bidder. They shopped the heck out of the company for longer than you can believe. If you want a go-shop, read that case. They shopped in every market of the world. And then the Delaware Supreme Court got around to deciding the case five years later. Reversed the Court of Chancery. In my view, in a competition with an entrepreneurial judge in New Jersey who had written a case about due care, basically he excoriated everyone, wrote this lengthy opinion, and subjected the directors who had gotten this remarkable business result to personal liability.

Well, this did not go over so well. There was an insurance crisis. Companies couldn't get affordable D&O insurance, wasn't particularly good for Delaware's brand. And it was tin ear because the institutional investors at the time, if you recall what they were afraid of, was managerial entrenchment and that boards of directors would resist takeover offers. So it was a little bit odd that this company, which sold itself for a lucrative premium to a third party bid, that the independent directors, who included people like the Dean of the Chicago Business School, some of the elite CEOs at the time, were held liable.

So Delaware enacted section 102(b)(7). This was in 1986, not 1995. I just want to say that, because there was a recent opinion that made a little bit of a faux pas on that, but it was enacted very famously and everyone in the Delaware bar and bench, and that includes our national friends, knew about it. Even though I at the time had bangs so that you can imagine how far away that was. And I was thinking more about public service and politics, and how the '80s music was really terrible. Even I heard about this. This is not a small thing in our state.

And so what was done was to enact a provision that allowed for companies to adopt a charter provision, which would exculpate directors from claims for due care. It's also important to situate this in the context of the time when you did not have super majority independent boards, and when most of the key officers of the company were in fact directors. It was often, at the time, three or four directors who were management. If you had a majority of directors who were not management, many of them were more like outside directors necessarily than independent directors.

But the debate in Delaware was, really, that the duty of loyalty is really central. We have to have the ability through derivative suits and representative suits to enforce that. But it really

should be a decision of the stockholders and the company to decide whether this was open season on due care. And so 102(b)(7) was enacted.

There was a debate over whether to include officers. And there were a few things in the history about this, about why that didn't happen. One, officers are different in the sense that the company itself might get into an employment dispute or something like that, where you would want to enforce the duty of care in such an instance through the company. 102(b)(7), as originally crafted, was really directed, to be honest, at representative and derivative suits, but it actually exculpates directors broadly from all duty of care claims, even from the company itself, brought through the other members of the board of directors.

There's also this notion that you wanted officers to come to the board with problems, and that if they were subject to a potential due care claim, they would be more likely to bring subjects to the board. But then there was another key, just reality. Delaware was a little narrow in thinking about things. There was no way to sue an officer in Delaware who was only an officer. We had a director consent statute, which got around *Shaffer v. Heitner*. I may be giving some of you who don't read law a nightmare. I mean, we had somebody up there yesterday named Pennoyer, anybody think about that? And so the point was you couldn't get anybody, you couldn't sue an officer in Delaware. So it was also seen, in this debate, as not necessary.

So to do my Admiral Stockdale moment, who am I? Why am I here? To remember the famous vice presidential debate. Why are we talking about this? Well, it really was the change, Larry, in the director consent statute that brought together, by happenstance, the current situation. And I am to blame with my good friend, Bill Chandler, in many ways. And Larry, a shout out to Penn. It was an article in the University of Pennsylvania Law Review. Bill Chandler and I wrote an article in the wake of Sarbanes-Oxley on the new federalism of corporate governance. And we pointed out that, because of the change of boards of directors in their composition, and moving towards having boards where really, the only officer, Randy, on the board might be the CEO, is you'd have 10 outside independent directors and the CEO. And we saw frauds. You saw some of the market frauds at Enron, WorldCom, and others, where chief financial officers, chief operating officers, folks who weren't on the board had engaged in breaches of the duty of loyalty.

There was no way to acquire jurisdiction over those officers in Delaware. And so we suggested expanding the reach of the director consent statute to cover certain named officers, Larry, in the company, so that they could be held accountable for breaches of fiduciary duty in Delaware. At that time, there was really no history of suing officers over due care. Our proposal was really focused on the real concern that has always animated corporate law in terms of officers or insiders, which is the duty of loyalty, the potential for self-dealing, the usurpation of corporate opportunity.

And in keeping with Delaware's tradition, the Corporate Law Council, promptly, I think Larry, basically the next year in 2004, and I may have gotten... I think it's right, 2004, amended 3114. And so for the first time, you could sue an officer, but this also created imbalance. Because in representative actions and derivative actions, you now had a situation where, although the courts were saying that the fiduciary duties of officers were the same, their liability exposure was not the same.

We'll talk about the cases coming on, but the reality is then you could sue the directors only for duty of loyalty, but someone who was solely an officer, you could purport to state due care claims against them, even if frankly, they operated in concert with the board and under the supervision of the board. There's a natural incentive, obviously, for people trying to win lawsuits to use leverage that they're given. And so there's been a changing litigation dynamic. So, Larry, I think that's the background, unless you have anything. And I'll turn it back to you so you can get Scott and Randy in to talk about some of the cases that illustrate what's come out of this history and why there's a policy discussion to be had.

Professor Hamermesh: What's interesting about your chronology there is that it ends in 2004 with the amendment of 3114 extending long arm jurisdiction. But as we'll see in a moment, the case law that we're going to be talking about doesn't pick up until about 10 years later. So there's an interesting lag before this opening is filled with actual litigation. We're going to be talking a lot about officer liability for disclosure problems, proxy statements and elsewhere, and officers tend to be the ones to implement and prepare the proxy statements. They have become targets to some extent of claims of lack of care in preparing those statements and therefore subject to potential liability, not exculpated, of course, under 102(b)(7).

Chief Justice Strine: And Larry, I wanted to

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get to the discussion of the current cases. But if we want to fill out the historical "why," when forum shopping became prevalent, it became more expensive for companies to pursue a motion to dismiss. And the traditional practice, honestly, in what I call non-Revlon Revlon cases, where there had really been no frustration of any bidder and the cases were being dismissed at the call of the calendar with no consideration, because there would be a motion to say, "Look, there was a fully informed stockholder vote." Folks would dismiss the case at that point, because nothing had panned out and it would go away. But forum shopping folks started to pay settlements. As we know, we had all the disclosure-only settlements. With the reduction in forum shopping and the reminder what our law was about the effect of a vote, Larry, there was more incentive on the defense side to just bring the motion because you could do it viably.

"That just feels like a parade of horribles that seems horribly unlikely."

– Scott Luftglass
Fried, Frank

But there was legitimately obviously more incentive on the plaintiff's side than to point to deficiencies in the disclosures and to open the door to a substantive inquiry about whether the directors had breached their duties in connection with the sale process. And so I think, Larry, to some extent, that explains this. And obviously, it's easier to state a care claim, even though you're supposedly, and we'll talk about this I hope later, you're supposed to have to state a gross negligence claim, not simply pointing to a material disclosure. But it's obviously easier to plead out a care claim. And it was also just the heightened salience of the disclosures themselves. And I think that explains some of the pleading dynamics and the case dynamics that we'll talk about.

Professor Hamermesh: Great. So what we'll do is launch into a brief discussion of some of the cases. I'm going to invite Scott to start off. Scott, I'm not sure which cases you'd like to address, but I'm hoping you can cover at least maybe the first two, *Chen* and *Cirillo*.

Scott Luftglass: Sure, Larry. Thanks. First off, I just want to say thank you to Tulane, and to Bill, and to Rita, and to David. I think for a lot of us, this is the first time we've been reassembled at an event like this, and it feels really good for everyone to be back together, perhaps maybe not on a Friday morning, but that's the luck of a draw, I suppose. So it's funny. I very much believe, to the surprise of no one, that 102(b)(7) should be extended to officers. Randy and I were talking about this in the room before, and he said, "I don't want to blindside you, but I'm going to take a position that says, I think the law should remain as it is. I was not exactly stunned that my fellow brother in the plaintiffs' bar would disagree with my position that 102(b)(7) should be extended.

Just to frame this up a bit, I think that when I read these cases, what I find most dissatisfying is that, as the former chief justice just said, to state a care claim, you have to plead gross negligence. And in a lot of these cases, there is not really a substantive engagement on the gross negligence question. There's a question at least as to disclosures about materiality. And then when you read the care part of the discussion or the 102(b)(7) exculpation non-applicability, it really focuses on loyalty. And the question I would ask you if you had the time, and I suspect you don't, to read the 10 or 12 cases that are here, is if you extended 102(b)(7) to situations involving officers, would the decision come out differently and would you be happy or unhappy with that outcome? Because I think that really is how you highlight the policy question.

So let's start off, if we could, with *Chen v. Howard-Anderson*, which is a decision by Vice Chancellor Laster in 2014 involving the sale of Occam to Calix. So Occam sold to Calix. There was a dispute about the projections, about whether they were late-created, and whether the investment bank that represented Occam didn't really engage on the projections until later. There was a dispute about whether or not an alternative buyer had been given the short shrift, so to speak, and hadn't been carefully loved, and fed, and worked through the process. There was an allegation, which I think was undisputed, that the company's management didn't timely enter into a nondisclosure agreement with the alternative bidder. And then there were some very substantive, and frankly, credible challenges about the quality of the market check that was conducted. It was conducted over a 24-hour period over July 4th weekend. Seven buyers were contacted. The name of the seller was not included in the notice. They were told they had 24 hours to respond. Five of the seven said that they were interested, but couldn't move on that timetable.

One of the seven said that they were still looking into it, but weren't saying "No," and none of the seven were progressed in the process.

So when you say those words out loud, it doesn't exactly sound like a superlative sales process, but it also doesn't sound necessarily like it's a care issue. And what's interesting is that the allegations that the plaintiffs made and that came up on a summary judgment motion was that the CEO and his brethren were very much interested in only doing a deal with Calix, that he had an arrangement with Calix, that he wanted to make sure that the board didn't get any traction with the alternative bidder, and therefore, to the surprise of no one, the director defendants moved for summary judgment, and there were two sets of claims that had to be evaluated.

The first set of claims were the typical sales process claims, and the second set of claims were the disclosure claims. On the care claims, the director defendants were all dismissed. Vice Chancellor Laster found that there was no improper motive that was animating their activity and therefore no conflict of interest, therefore no loyalty claim, and 102(b)(7) exculpation would cover and cloak any alleged issues with respect to the satisfaction of the duty of care.

With respect to the CEO and the CFO, who were named as defendants, the court looked at their behavior and looked at the sales process that was employed and concluded that they were acting in their own interests in wanting to advance the transaction with Calix at the expense of an alternative transaction, and they were not dismissed. Vice Chancellor Laster applied, at the post closing stage, the intermediate standard of review of enhanced scrutiny. In what I thought was very well phrased—and I suspect Leo will also think it was well said, because he was quoting you. He said, "The metric of reasonableness employed in the intermediate standard review enables a reviewing court to smoke out mere pretextual justifications for improperly motivated decisions." And that was quoting the former chief justice, the former chancellor in *Dollar Thrifty*.

What's interesting in that is that's loyalty. To do something in effect to conceal an improperly motivated decision, that's not a care claim. That's not a gross negligence allegation. That is a core loyalty claim. So the 102(b)(7) issue here, in my view, is a distraction. It really is that if there was 102(b)(7) application on officers, this case would proceed against these individuals. So that's not a reason to keep something on the books that doesn't make sense.

The second part of that decision, very quickly, was that the disclosures were held at the summary judgment phase to be a material issue that needed further litigation. But again, what was a little bit dissatisfying about that is there was no engagement, really, on whether or not it was an issue of gross negligence. The analysis stops at materiality. That makes sense, I think, in a preliminary injunction hearing. It makes less sense in a post-closing damages issue when you're dealing with the duty of care claim, which goes to the point that Leo made earlier.

So that's the *Chen* decision. I take away from the *Chen* decision that it wouldn't have come out the other way if 102(b)(7) applied to officers. That's not the case for the next decision, and the second decision I'll talk about, which is the *Cirillo* decision that Chancellor Bouchard decided. It's a little bit of a quirky case. It's one of those cases that you scratch your head at. An affiliate of Endo Pharmaceuticals acquired DAVA Pharmaceuticals—

Chief Justice Strine: Can I interrupt?

Mr. Luftglass: Of course.

Chief Justice Strine: I just want to say, if you scratch your head enough, you end up looking like Randy, Scott, Larry, and I. It's just a warning.

Mr. Luftglass: I feel mildly harassed, but only mildly. Also a little interested. That's okay. So anyway, the—

Randall Baron: I will say I'm the only one who truly embraced my loss of hair.

Chief Justice Strine: Exactly.

Mr. Baron: You guys are still trying somewhere. I'm not.

Mr. Luftglass: Hey, I'd like to understand where Randy thinks I'm trying, but—

Chief Justice Strine: Just give him credit. Scott had a comb-over until last week and we said, "We won't do the panel with you."

Mr. Luftglass: I retract what I said earlier about mildly. So this was the classic case. We've all been there, where you approve a transaction by written consents, but the written consents aren't effective and they don't include the legally required information. All of us have an had that moment in our lives. So they sent out written consents for 99 percent of the company, but the

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consents were wrongly dated and therefore not effective under Delaware law. And then they failed to include Delaware required disclosures that give individuals the ability to figure out whether or not they do or don't want to consent. So that was not exactly a shining moment, but it ended up being, with respect to the directors, validated under Delaware 205. And that is, for those who don't know, kind of a no harm, no foul, no bad intent part of the DGCL that allows ratification of a prior corporate act that, due to a technicality, wouldn't otherwise stand on its own.

"Like a boomerang or a slasher villain, we may be seeing the return of Van Gorkom."

– Former Justice Leo E. Strine, Jr.
Wachtell

But what was strange about this decision was that that took care of the directors. At the same time the directors were being dismissed, there was a motion by the plaintiffs to amend their pleading to add a new claim against the founder, and president, and general counsel for sending out the notices. The record at that point had been fully developed, because it was a summary judgment motion as to the directors. So everyone in the case knew the facts.

The facts were regrettably that everyone relied on outside counsel exclusively to prepare the notice. It was an unintentional mistake by outside counsel preparing the notice. So there had been a fully factually developed record. And yet, because 102(b)(7) doesn't apply to a care claim, the court very reluctantly, and in Chancellor Bouchard's words, "skeptically," said that he was constrained to effectively allow the amendment, allow the case to proceed. And ultimately, the directors who had been dismissed, there's no change there, but for the CEO and for the general counsel, this case went on. And months later the case ultimately got dismissed again at the summary judgment phase. That, to me, is a failure of 102(b)(7) not applying to directors, sorry, to officers. There's no reason this case needed to go on. There was no loyalty allegation, and there was already a factually developed record. So that's an example here where I think this is actually a problem.

I would say, before I turn it over to Randy—who apparently has more deeply embraced his baldness than I have, which by the way, Randy, my wife would be really surprised to hear that I haven't fully embraced my baldness.

The question is, what's the problem? In other words, what really is happening here with these cases or what's happening in the market? I think two things are happening in the market. Three, really. One is these cases become more difficult to settle. Insurers have to spend more on defense costs and ultimately more on settlement, which drives up insurance premiums. Those insurance premiums ultimately are born by the public shareholders that Randy represents. That's not a good thing.

The second thing is there is a chilling effect. You have more officers now who wonder whether they're being hung out to dry here. And in particular, there are a number of cases where you have CFOs who are really, when you look at the behavior that's alleged against them, it's really being driven by a CEO under whom they work. And they don't have visibility, necessarily, of what's going on in the boardroom, because they're not attending the board meetings. But somehow, they're being held responsible, and that's a problem because qualified and talented individuals will be less likely to serve. The third thing is just, it's not necessarily, in my view, at least intellectually honest to have this gap when it wasn't really the purpose, again, to establish this gap. So with that, Randy, tell me why I'm wrong.

Mr. Baron: Great. Can't wait. So look, we all have to acknowledge that we come from a conflicted standpoint as well. I clearly want a lot to stay the same. I think it's better for shareholders. If it's better for shareholders, it's fully better for me and my firm. I think that Scott and Leo are both working for defense firms. It's better for—

Chief Justice Strine: Yeah. Except I'm not going to take that.

Mr. Baron: Well, look. It just is the reality.

Chief Justice Strine: I'm just not, because, I'm sorry, but Larry and I have written about this stuff for a long time.

Mr. Luftglass: By the way, for those of you scoring at home, that was 37 seconds.

Chief Justice Strine: That was 30 seconds.

Mr. Luftglass: Randy made it 37 seconds.

Chief Justice Strine: I'm just saying you want to take that shot?

Mr. Baron: Look, it's not a shot. It's just the reality.

Chief Justice Strine: It's a shot.

Mr. Baron: It's the reality that it is a pro-defense argument in order to limit liability. It's a pro-plaintiff's argument to say that it's the same. That's all I'm saying. And let's be also clear that the history of 102(b)(7), and when Gil Sparks was speaking in the minutes, he made very clear that the objective of 102(b)(7) from the outset was to encourage outside directors to continue serving. We are not in a crisis in which we are losing C-suite executives. We are not in a situation in which millionaires are saying, "I don't want to accept millions of dollars to do this because there's some risk that there is going to be liability for a duty of care claim," which we all acknowledge now is fundamentally recklessness.

That's not the issue that we have. We don't have that crisis. And while we talk about it, these recent cases, we're also not in a situation in which there haven't been duty of care claims against officers going well before now. I mean, we can look at Disney, for example. Where in Disney, there were trials of duty of care claims and Chancellor Chandler ultimately found that it didn't rise to the level of due care. It wasn't the reckless conduct of the officers involved. There are a number of cases in which there were duty of care claims. Most of them weren't successful, but they happened but more recently.

So what my position on this, before I go into the cases, is that we have a solution that is looking for a problem. We don't have a crisis and to the extent that we're worried about insurance carriers, I'm just going to throw out there that insurance carriers are always looking for ways to increase their rates. They are always looking for something. And we can't, in Delaware, decide our law based upon carriers trying to increase their rates.

Mr. Luftglass: Randy, you're the human embodiment of the reason that they increase their rates. You're like the life form of that.

Mr. Baron: And also, Gil Sparks, when there was the discussion about adding officers to 102(b)(7), and there was an extensive discussion about that. He noted that, by not having officers exculpated under 102(b)(7), that we are actually encouraging those officers to bring these decisions to the board themselves, rather than having them go off roguely and make those decisions. Further, he noted that while there was a discussion about jurisdiction, he said that, one, 3114 was likely to be amended. Admittedly, it took a lot longer than I think he anticipated. And that he also said that there were in fact cases concerning officers. So again, what is the problem that we have here?

I think the other issue that we have to look at is, do we really want to protect this millionaire class of people that are generally making millions as officer directors? Not what the directors were making back in 1985. And do we want to do that when they are in a very different position than directors are? Because remember, directors are coming in. Most of them are outside directors as the Chief Justice acknowledged. Most of them are outside directors. They're coming in. They are not inside. They don't have the details of what's going on within the company. It is the officers, particularly the C-suite officers, who have that information. And is there some reason that we do not want to hold this millionaire class liable for a standard, which is fundamentally recklessness, in doing their jobs and protecting the company and its shareholders?

I go back to something that, again, the Chief Justice said back when there was the hullabaloo over aiding and abetting against investment bankers. He said, "Why are we so concerned about a standard that is really high against investment bankers when we have police officers and firemen who are being held to a standard of simple negligence, and they're out there getting $30,000 or $40,000 a year for doing their job?" And again, that's the perspective I have as to, why are we really looking to reduce the liability for these folks?

So I'm looking at the cases. And what strikes me about all the cases and the recent cases is, why are we so concerned? There has not been a *Smith v. Van Gorkom* finding. There has not been a trial in which we're holding some officer liable for millions and millions of dollars, causing qualified officers to go away.

So let's go to *Roche* because I'm only going to talk about *Roche* so that Leo can start yelling back at me. I think I wanted to talk about Roche because I think that this is the epitome of what, at least the Chief Justice and others, would call a foot fault. And a situation in which, ultimately, the CEO is held potentially liable. Because it was only on a motion to dismiss, and it was only on a reasonable conceivability standard, or possibly breaching his duty of care. And in *Roche*, what we have is a case in which, based on a very limited record, and again, I think, as a caveat,

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it's my case. I'm the one who brought it. It was being defended by Wachtell Lipton. So this is a case that we know well. And in this case, it was based on a very limited production at a 220 stage. And in it, we pled claims against both the CEO director and the executive chairman. Only those two, we didn't plead it against the outside director because we didn't have evidence that they were—

Mr. Luftglass: Randy, can I interrupt you for a second on that, just because we do this a lot. We tease each other, we screw around with each other. This is actually, I think, from a defense lawyer's perspective, something that Randy's firm deserves some credit for, and that is that this is selective litigation in the sense that this isn't suing all the directors. It's not, throw a whole bunch of stuff against the wall. It is actually more of a rifle shot suit. And I do think that's worthy of mention.

Mr. Baron: Thank you. And I think that our goal with it was to try to target those defendants who were actively involved, rather than wasting the time on questions of the outside directors who were not actively involved. And we pled duty of loyalty claims against both Roche and the executive chairman. We also made very clear that we were pleading specific claims against the officers for the conduct that is officer conduct. So we're not pleading it against officers for director conduct. It's not for conduct in which they are making the ultimate decision. It is the stuff that is in the trenches. It is the creation of the projections. It is the negotiations that you are talking about, or in this case, it is the filing of the proxy statement, which in this case, the board of directors fundamentally sent that duty down to the executive officers in order to draft that proxy statement.

And that's in a number of cases, including Fresh Market and in a world in which we are highly concerned about what's in the proxy statement, because after *MFW* and *Corwin*, what we have shifted to in our state is to a situation in which we're saying, "We are truly relying on shareholders to be able to bless this." We are saying, "Shareholders are necessary in making this decision, and we are making sure that that information is in the proxy statement."

So what might be a foot fault is really now critical. It is critical that the information is there, and the information that VCF found that was material in this case, went to the core of the case. There was a set of forecast projections that were actually in the board books that were right next to the ones that were not presented in the proxy statement, that showed a significant greater value that shareholders who were voting on this deal would want to know. There was also a false statement regarding the go-shop, how it was actually different than what was in the merger agreement.

So again, there are some indications that shareholders believed that the go-shop was providing this market check but it was a real question as to whether shareholders wouldn't know. Don't think of this as a foot fault. This is critical information. And we get back to the question that Scott really raised, which is, do we need a way to get to that? Is there a way to actually challenge that conduct from the people who are making millions of dollars?

I want to add to this. Roche ultimately isn't the person that we want to protect. Roche was making millions of dollars a year as a single-trigger change-of-control for this private equity deal. She ended up making $4 million and change off golden parachutes while keeping her job. And she got an increased equity stake that would be valued at $40 to $50 million. That is not the person that I think we need to protect.

Nor do I think that people are going to stop being C-suite executives if you are actually ultimately held liable, if ultimately, that case goes to trial, and ultimately meets the standard of proof, which is going to be fundamentally recklessness, which I don't know how we're going to do that, but I think that's going to be a lot of work. It's not a simple, "Oh, they made disclosures. They knew better." I don't think that's going to win these cases at trial. I don't think there's any evidence that they have. So again, I think we're looking for a solution. I just don't think we have a problem.

Professor Hamermesh: Thanks. Thanks, Randy. And before we continue the discussion about the policy questions that you've teed up, I did want to invite Vice Chancellor Will to share with us her thoughts about how this litigation has shaped up and how it's affected the court.

Vice Chancellor Will: Thank you, Larry. I think it's fair to say that there's been an uptick in the number of cases involving officer liability that we're seeing in the court. I wouldn't say that my docket's drowning in those cases, but it's a question that we're confronted with regularly. And I think you can see that from the first slide,

there have been a lot of recent decisions. In my own view, I think one of the biggest challenges in dealing with these matters is really a doctrinal one. If we take fiduciary duties, we know that officers and directors owe the same duties, but they don't have the same defenses under 102(b)(7). They just don't. And if I step back and think about the statute, I think the policy import is that it strikes a balance in terms of how directors are treated. So without 102(b)(7) for directors, there could be much less of an escape valve for meritless litigation.

The trade-off is that it probably means you are missing some viable care claims against directors. It's just the reality. I think that's an appropriate trade-off. Some care breaches might be going unchecked, but it's reducing wasteful litigation. I think it's value preserving for the corporation, and it reduces burdens on the parties and the court. The court's focus then, I think rightly, is on loyalty issues. I think perhaps everyone on this panel would agree that when it comes to directors maybe we could agree on that one thing. But then why is the same policy and that careful balance not applied to officers in the same way? I can see both sides of the debate. And I think Scott and Randy just laid them out better than I could have. Gross negligence is not a low bar, and it shouldn't be a low bar. And it's true that officers get paid a lot more money than directors. So you could see a view that they might be expected to take on more of the risk.

I don't think that changes the doctrinal imbalance that I just talked about. And from my standpoint on the court, that doctrinal imbalance can lead to some imbalances in the litigation itself. So let's say that the board which approved the deal is exculpated, they're dismissed under 102(b)(7). But an officer who signed the proxy stays on and there's a single care claim that's left. It's just the pleading stage. There's no finding of liability, but it can lead to some extensive litigation. If the claim is about the proxy, let's say the disclosures in the background section, you can see discovery sweeping in the entirety of the process. And we're thinking about damages, quasi-appraisal damages, for example. Now, you're getting into valuation issues. So I think that's a big question for the court. And I'd be curious to hear from Scott and Randy how you're thinking about damages and discovery in a case like that.

Mr. Luftglass: I think I would be surprised actually, if we disagree on this one. I think that if you have a material omission or misleading disclosure in a proxy and you have adequately pled gross negligence as to care on it, or it happens to be a loyalty, I think Delaware law directs you to quasi-appraisal damages in that situation.

Mr. Baron: Yeah. I don't know how it's going to work out. Again, there haven't been any cases that have gone all the way through trial in order to make that determination. So I think that you're probably at least starting at a base of quasi-appraisal. I don't think you can do a breach of fiduciary duty case without having an understanding of what the intrinsic value of the target company is. So you're going to actually have to do that discovery to understand that. I also think, in order to prove recklessness or gross negligence, you're going to have to try to prove at least as close to loyalty as possible. So you're going to have to have an understanding of the entire transaction. So I do think it's the full scope of discovery. I think that the issue is, though, for me anyway, is that we have this tendency in Delaware to pull out theories of liability as opposed to the claim itself. And the underlying claim in these cases is breach of fiduciary duty. And ultimately, through discovery, I think Scott's right. I think that more likely than not, by the time we get to trial, we are either going to be able to prove what is functionally a loyalty claim or not a loyalty claim. But the fact that we're not getting over that hurdle at the motion-to-dismiss phase, I don't think really changes much. And I think that there was an opinion written in the superior court that really questions whether we dismiss theories of liability versus claims themselves. And I think that that actually applies here.

Vice Chancellor Will: Well, you can see where it might lead to a number of disputes that the court has to decide motions practice and maybe even a trial. I think there's another complexity that's worth talking about also. For a judge at the pleading stage, you're often confronted with the question of whether an individual defendant is wearing her officer hat or her director hat. And on a 12(b)(6) standard, which is necessarily plaintiff-friendly, and thinking about whether a claim is just reasonably conceivable, you can see why a judge who is applying our law as it currently exists might say that a care claim against someone allegedly acting in her officer capacity survives a motion to dismiss.

But if you think about it practically, it's not easy to take the same person and split them into two different roles. I'm struggling with how to think about that myself. And I think it really highlights the imbalance that I talked about earlier. You can have the same person who's excul-

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continued

pated as a director, but not exculpated as an officer. And it just creates unique challenges for the court in navigating that, and for the litigants how to bring the case forward. So that's my perspective on the current state of affairs as it presently stands. I think there's a good amount of imbalance in litigation and in the doctrine, and officers have a lot more exposure to protracted litigation.

Professor Hamermesh: Thanks, Vice Chancellor. That's very helpful. Leo, I'm sure you have some things to say. I know we've had some things to say in response to Randy, but I think the time has come to maybe engage in a little more detailed exploration of the policy considerations that Randy and Vice Chancellor Will have teed up.

Chief Justice Strine: Thank you, Larry. And I think it pivots nicely off of the discussion that was just had, and what Vice Chancellor Will said, and it'll frame the policy discussion at the policy proposal, which is a stockholder-focused proposal, and it actually pivots off the last discussion of the role of institutional investors. But I think we have to understand the different landscape that we're in. Sorry gang--learn your corporate law history. *Revlon* and *Unocal* were not damages standards. They're injunctive standards. When you do a preliminary injunction around the material disclosure, you want one of the roles Delaware has played, especially when people brought injunctions, because they actually wanted the deal to fail. That was the old style disclosure injunction. We think this deal is stinky and you're hiding something. Not that we want the deal to succeed, and that arbitrage doubts it. So materiality in an injunction, is frankly, if there's a material omission, we're not really looking at gross negligence. It's not a liability issue. It's the stockholders should get the material information advanced.

After that, *Revlon* and *Unocal* are situational. What is your objective? The objective of what you're doing is to try to get the best value reasonably attainable. To hold a director liable, you've got to show that they had a conflicting self-interest and somehow benefited from it or that they acted in subjective bad faith. It's not reasonableness. And one of the problems with these cases, Randy, honestly, is they are Van Gorkom and they confuse everything, and they pour back in injunctive standards without rigorously looking at it. It also ignores the difference in the context. It blames officers for being incentivized in the way that investors have chosen to incentivize them.

Mr. Baron: What do you mean by that?

Chief Justice Strine: Very easy.

Mr. Baron: So you're talking like increased equity?

Chief Justice Strine: Yeah. And I'm going to get out of this. At the end, I'm going to let you guys finish. Officers take their pay on the comm. Many corporate officers would love to be in a situation where, frankly, they didn't have as many activism campaigns. They could be more respected in the community. They could have primarily what they get in cash. They have been told they can't do that. They have been told that they should tie their fates to that of the stockholders and they should be willing to give up their career if a deal is good for the stockholders. In exchange, they get the same liquidity as stockholders, the same liquidity. That's what I love, the liquidity event. You're an officer. You get liquidity in the deal

I don't know what the hell... Non-rateable benefits are everywhere. It's a great thing for society. I mean, if we could extend the non-rateable benefit concepts to everybody, we'd all feel better. Because we'd be getting non-rateable benefits. They get liquidity. They get wealth. What is their wealth? Is it non-rateable? No. Do they get non pro rata compensation? No. Whatever their equity is, they sell into the deal price. The whole point about that, and there's a prior era of cases that recognized this, that said, "Frankly, if you have stock in equity and you can get $38 rather than $35 per share, you'd probably do that." The stockholders get to vote on the deal. All these cases, they're super majority of independent directors, classified board incidence is way down. Pre-market signing checks are way up. It's never been easier to buy a company. That's why there isn't hostility. You don't have to be hostile. And yet, we have more claims. And there are cases that hold that if the officer is willing to sell into the deal, they're conflicted. And if they're willing to remain and work for someone, they're conflicted. And the only logical consistency in that is that they're always conflicted. The case is muddied care and loyalty because of the exculpation clause. And as Scott puts out, it is a big difference between a court agonizingly finding a foot fault, which some of the cases do, and then

determining that there's been a pleading of gross negligence against an officer. And a lot of the cases don't make that second step analysis.

Quasi-appraisal gang, what's quasi-appraisal? It's a class action. How would that be? What would the appraisal have been against it? It would've been against the company. And my good colleague, Vice Chancellor Lamb and Chancellor Chandler, we used to talk about this. Quasi-appraisal's a weird thing. And honestly, if we're going to impose it against a single officer, so you mentioned a salary she had, which I've got to say, maybe the plaintiff's bar has taken less than they would, but not that shocking to lawyers in the room. And certainly not anything that some of our plaintiff's lawyers successful friends haven't seen. It's just going to face a quasi-appraisal for the whole class.

Well, how about, "Here's the disclosure we pled, here's the information, put your money back or you can get your money, you can put your money into this and seek appraisal." Those of you who want do that now have the information, and you can do that. And you can do it against the company. Maybe that makes sense. I heard that the rifle shot win on disclosure is not going to frame discovery.

What Vice Chancellor Will's going to be asked is the full monty. I've seen opinions that wield the sword of Damocles over the dismissed directors and say, "Any dismissal is interlocutory and we can bring you back in." There is the asymmetric cost of discovery, the cost of discovery comes to the company. And so there's always settlement value. And so I think we have... And again, I'd urge you to read the cases after you read *Van Gorkom*. And wonder whether we're back in *Van Gorkom*, and you're aware the boardroom is exactly like what Stockholder Abacus wanted. And there's a lot of hidden costs, because these cases are just the tip of the cost spectrum. But our proposal is modest. It's not to let the defense bar decide. There was debate, Larry, we talked about whether you could just grandfather in an exculpation clause for officers.

No, that's not the Delaware way. The proposal is that stockholders can decide for themselves, in concert with companies, whether to amend the charter, to exculpate officers, but not from direct liability to the company for duty of care. So if the board actually sees Vice Chancellor Will in an employment dispute, that would be then and we, by the way, under *Zuckerberg*, if we're going to trust independent directors this much, supposedly they can sue.

But it would insulate—if and only if the stockholders approve and adopt the amendment—the officers from duty of care liability in a derivative action, or representative action. Ass Scott pointed out and, Randy, if what you're saying is true, which is that most of these cases turn on loyalty, you would just simply have to plead a loyalty claim. I agree with *Chen*. The finding in *Chen* is a loyalty thing in that it talks about the preferring your interest. But for the court, I think Vice Chancellor Will, it would be analytically easier because the lens of the whole case then is on loyalty.

You analytically look, if it's one of these *Revlon* cases, you look at whether, for some improper reason, the board failed to seek the highest value reasonably attainable. Obviously, officers will continue be the focus of that. I would hope that people would give them a little bit more credit for being willing to do the right thing. Because it sounds like if they're willing do either thing, they're held to be conflicted, but I think it'd be a cleaner thing. And Randy, I don't think it's going to shut down your business.

And I would also say this. I actually do believe that the stockholder voice is more vibrant than ever. I think that's why we talk about it in every panel. And I don't think . . . Larry and I are not proposing that management get to do this. We're proposing an option for the stockholder community to be able to consider this and determine whether it's good for them. And I honestly think that the people who have their money at stake actually should be given this legitimate choice. That is the measured notion of this policy proposal. And ultimately, if the investor community does not support it, it won't happen.

Professor Hamermesh: I'd like to give Scott a chance to raise something that we talked about in preparation for this session, then turn it back to Randy to make some any further comments about what you and Vice Chancellor Will just said, Leo. But Scott, when we talked, you had some perspective that was the product of looking at discussions with the D&O carriers and how this issue plays out in those negotiations. I don't know if you able to put forward that, but that was interesting, I thought.

Mr. Luftglass: Look, this affects the D&O market in two ways. The one way which we've talked about already is that it drives up insurance premiums. And I'll say this, Randy, to a comment you made that it's not a crisis right now. You saw that first slide. Vice Chancellor Will noted the concentration of dates from 2020 and 2021 that represented 80 percent of the cases.

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You try to stop a problem before it becomes an overwhelming problem. You don't wait for it to become an overwhelming problem to stop it. So that's how I think about the insurance market in that respect.

But this also completely screws up settlement dynamics in cases, because what happens when you go to a D&O carrier and you say, "Okay, we had nine insureds, we had eight independent directors," as Leo rightly noted is the trend in terms of the proportion. And we had one CEO here and we have a CFO and everybody's been dismissed except for the CFO. And this is a case where the damages analysis is saying that it's a case that should settle for $30 million. So we'd like to go up two levels in the tower and have a 30 million dollar settlement.

The first thing they say is that's ridiculous that have to have an allocation discussion. You're looking at one individual and the amount of fault, if you will, attributable to that individual is disproportionate to both the number of individuals in the suit that were insureds and disproportionate to the amount of culpability more generally. And then you don't access that tower, they just refuse. So then who bears the cost of that? The people that bear the cost of that is the buyer, who, in that situation, had absolutely nothing to do with it whatsoever. And you're imposing then another cost, if you will, on a disparate shareholder community. And the irony is if you're worried about the Vanguards and the State Streets, they're 35 percent owners in that company too, if it's a public company. So I guess you say it's a solution without a problem. And I understand, I don't agree with it, but I understand your perspective on that. I view it as having a whole bunch of systemic costs that just don't need to be there. An analogy, which I think is imperfect and I know it doesn't relate directly to the insurance, but if you think about 203, we've had really interesting 203 litigation in the last several years, and it's being weaponized in a way that wasn't intended. If you think of all of the entire body of Delaware case law and the DGCL, it's all about behavioral economics. It's all about incentivizing certain behaviors and disincentivizing others.

The objection I've had with the 203 litigation is that it serves no purpose to incentivize better behavior. It's just loopholes and technicalities and I don't see how having 102(b)(7) not apply to officers is actually encouraging better behavior on their part or discouraging bad behavior. I think it's just creating a systemic screw up here. And to Leo's broader point, when you read these cases, I think it creates a challenge to judges as to how to find their way to the answer that frankly just is adding complexity for complexity's sake.

Mr. Baron: Well, so much to respond to in so little time.

Mr. Luftglass: You've got 14 minutes, man.

Mr. Baron: I don't want to spend that much time on it, but let's talk about D&O insurers. I mean, first off, they are always complaining about something. Their job is how to charge the most money and pay out the least. This is what we get for D&O insurers. The idea that you have a single officer, we often have single people, we often have a single director, we often have one or two, even ultimately post trial. So in *Rural Metro*, we didn't ultimately have everybody. We settled out most of the people before. So again, I think that's not a valid argument that you're left with the CEO, as opposed to two of the three directors or some portion of the board.

Even worse is if you really raise this issue, if we're ultimately reducing the liability, we are just building in another litigation, because what happens is, assume we go through a motion to dismiss and the court says, "Okay, you have pled a material nondisclosure in the proxy statement, but you don't meet the standard of care." What's going to happen next? Somebody's going to pick that opinion up, go file in federal court, a federal 14(a) proxy claim, because the standard under a 14(a) proxy claim is just simple negligence. So you have a 14(a) proxy claim that's up there. Now, insurers are going to have to insure that 14(a) proxy claim. Now, you've just basically doubled that potential litigation.

Mr. Luftglass: Hey Randy, let me pause you for a second because one of your arguments that you keep making is, "We've got all these problems. So what's one more? We have all these inefficiencies, so what's one more?" I don't particularly find that intellectually satisfying, but I'm just one guy. The challenge with what you just said is that under either circumstance, whether 102(b)(7) applies or doesn't apply to officers, once you get that finding in a case, someone can go to federal court and file that case anyway. In other words, in the hypothetical world where if it's a material nondisclosure, you can go to federal court anyway.

Mr. Baron: That's not what's happening though. I mean, we have—

Mr. Luftglass: I think every defense lawyer in this room spends at least 30 percent of their day dealing with federal disclosure cases filed.

Mr. Baron: But those cases are not going forward. If there is a breach of fiduciary duty claim that involves the merger, that's going. Those federal cases are not going. The release of those settlements will release that 14(a) claim as well. We're not having that problem. What I'm saying is that your claim is that we are going to reduce coverage costs by taking them out of Delaware. They're just going elsewhere. They are going elsewhere with a lower standard. I think personally, that these cases should be litigated in Delaware where the issue is the merger where we're actually discussing the merger itself as opposed to 14(a) cases. And you know I've done them. And I did them before we were getting 220. I'm like, "Well, we should go to federal court." We came back to Delaware, because again, I think Delaware's the right place to do it. I think that with judges like the Vice Chancellor and the bench we have that this is the right way to deal with all the issues related to the merger but doing this is going to cause further litigation back in the federal court.

Mr. Luftglass: That just feels like a parade of horribles that seems horribly unlikely.

Mr. Baron: Have you seen a lack of that? I mean, have we seen that there's a tendency of my brethren in the plaintiff's bar to react to something that happens in Delaware by going to federal court? I mean, it happens all the time. It's going to happen again.

Mr. Luftglass: Leo, were you going to say something Leo?

Chief Justice Strine: No, I think we ought to yield our remaining time to the person who doesn't suffer from male pattern baldness.

Mr. Baron: I agree with that.

Mr. Luftglass: I've never felt worse about myself than sitting on this panel.

Vice Chancellor Will: I don't have much to add beyond what I said before. I really think the discussion highlights some of the problems that we're facing as litigants and as the court on how to navigate these issues. There seems to be a potential solution to it that would solve that imbalance. But at least for now, I think there's a lot to wait and see.

Chief Justice Strine: Vice Chancellor Will, how do you think about the shape of discovery, if really, the only surviving claim is a targeted, due care disclosure claim and somebody says, "Well, but the remedy could be quasi-appraisal." What is the shape of discovery? Is it first you go to the disclosure violation and that's where it is? Or is it, frankly, plenary discovery as if all the other defendants were still in the case?

Vice Chancellor Will: It's tricky. As I mentioned before in the hypothetical, if the disclosure is about the background section, you could see people wanting discovery into the entire process, but then you've lost all of the efficiency of dismissing the directors who were the actual decision makers, the ones approving the deal. They're no longer in the case. So the discovery is still immensely broad, there's a lot of damages that you have to wrestle with, but you have one narrow disclosure claim that's left. So that seems like an incredible imbalance to me where the discovery should be the rifle shot, the narrow focus that Randy was talking about in the *Roche* case.

Mr. Luftglass: One thing I'm struck by when we're talking about that is that defendants also have, actually, an incentive under the system to have more discovery into the process of putting together the proxy in the background section. The reality is, and I'm sorry for my fellow defense brethren for throwing us into the mix here, but CEOs and CFOs aren't starting with a blank Microsoft Word document and drafting a proxy statement. That's just not how it works. Usually, it's outside counsel that does an initial draft, works with advisors like bankers to see if it's complete, and then goes to a client. And the clients reviewing that, necessarily like anyone who's doing a supervisory review of everything, are guided by what's already been done already. To defend on a lot of these cases, CEOs and CFOs need that discovery to show that it really was a village putting together this disclosure, that it wasn't them trying to actively conceal something from the shareholders. So there's actually an incentive for defendants to have a little bit broader discovery there too.

Vice Chancellor Will: So Scott, in that case, would you see a risk of the directors, who might

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have been exculpated, being brought back into the case? Because that's some loss of efficiency too.

Mr. Luftglass: I absolutely do. I mean, this is the problem that Leo mentioned earlier about the way some of these opinions discuss the dismissal of directors. We had one of these cases where we spent hours and hours celebrating and then longer time worrying if we were going to come back in. You really feel like when you have directors who have been dismissed, you're actively monitoring that docket and you're actively talking to the counsel for the defendants that are still in the case, "What's going on? What are you hearing? When's that motion-to-amend deadline going to pass?" And even then, you still worry that you can get right up to trial and someone's going to try to bring it back in.

Mr. Baron: But isn't that the risk in every case? Take the result in *Cornerstone*. The result in *Cornerstone* is, "We're going to let out on the motion-to-dismiss phase those individual directors who don't meet their duty of loyalty." But those cases go forward against the main participant. And in those situations, in which the evidence shows through discovery that they're liable, then those people are brought back in. That happens all the time.

Mr. Luftglass: I think it's a little different, because look. I think *Cornerstone* really was providing a vehicle for frankly, the resolution of an entire matter. I think sometimes, there are exceptions where people come out, but this is a situation where, by definition, you have this route to keep a vestige of the case and then that case can explode.

Chief Justice Strine: Can I ask Vice Chancellor Will a question? I think, if you read the history of 102(b)(7), from 1986, it was anticipated it would be used at the pleading stage. This is not new. Cornerstone was just a reemphasis of longstanding things. Aren't we losing, Vice Chancellor, a little bit of the business judgment rule? Because the whole idea here is, what's a little odd, I, Randy, have to say. And I get where you come from on this, is when it's really been a collective business judgment and the entire board of directors is out of the case, it's just unusual on your Delaware law to have it. And when I was thinking about the shape of the discovery, maybe the shape of discovery should be, what is the CFO's involvement in that disclosure? We'll assume it's a material omission and we'll just go through that. And if it was not grossly negligent, case over. And then if it was grossly negligent, maybe the scope opens up, but that's the first inquiry.

Vice Chancellor Will: Right. But it's—

Professor Hamermesh: Yeah, I'm sorry. We just have a couple minutes left and I want to make sure we wrap up here, but Vice Chancellor, I'm sorry I interrupted you. Why don't you go ahead?

Vice Chancellor Will: Oh, no, please go ahead.

Professor Hamermesh: Okay. Just a couple things. What you've just been talking about raises a question that I think Scott may have alluded to earlier, but I do want to highlight it before we go. And that is one of the less satisfying aspects of the case law that we've seen, which allows these care claims to go forward against officers, is a lack of clarity about pleading gross negligence. And is there a meaningful pleading requirement there, or is it enough to say, "There's been a material misstatement or omission, or at least some evidence of that. Therefore, I can essentially assume a viable or conceivable gross negligence claim." If that's all it takes, that's one thing. If you have to be more specific, that's another thing.

The last thing I want to say is in response to something Randy mentioned about the history of this sort of claim, and I think Randy, you referred to *Disney*. You are right that there were at least potential claims or actual claims against officers in their capacities as such in that case. But what's new in the case law, as far as I know, is care claims being pursued in a class action as opposed to a derivative action. And that's where, it seems to me, the action really is these days. And that's where I think that Scott and Leo are most concerned about the growth in litigation. So we're almost done. 30 seconds each, any last comments from the panelists?

Mr. Baron: No, I think I've said my piece.

Professor Hamermesh: Great. And thank you all. It's been an interesting conversation and we'll continue the discussion elsewhere, I'm sure.

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34th Annual Corporate Law Institute
Tulane University Law School 2022

Officer Exposure for Duty of Care Claims:

Is it time to revisit Section 102(b)(7) coverage?

Panelists:
The Honorable Leo E. Strine, Jr.
Wachtell, Lipton, Rosen & Katz, LLP

The Honorable Lori W. Will
Vice Chancellor, Court of Chancery

Lawrence Hamermesh (Moderator)
Widener University, Delaware Law School
Institute for Law & Economics, Penn Law

Randall Brown
Robbins Geller Rudman & Dowd LLP

Scott B. Luftglass
Fried, Frank, Harris, Shriver & Jacobson

Officer Exposure for Duty of Care Claims: Is it time to revisit Section 102(b)(7) coverage?

§102(b)(7): Summary

- Section 102(b)(7) of the Delaware General Corporation Law ("DGCL") authorizes a corporation to include in its certificate of incorporation a provision eliminating "the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director," subject to certain limitations that, taken together, limit exculpation to breaches of a director's duty of care.
  - Does not encompass breaches of the director's duty of loyalty or a failure of the director to act in good faith.
- Under the DGCL, this exculpation is limited to actions or omissions in a director capacity; it does not extend to actions or omissions in an officer capacity.

§102(b)(7): History

- Enacted in 1986 in response to the *Smith v. Van Gorkom* shock of 1985
- Motivated by the high cost and unavailability of traditional directors' and officers' liability insurance exacerbated by *Van Gorkom*
- Officers were ultimately not included in§102(b)(7).
  - A majority of the drafters believed that excluding officers would encourage them to bring issues to the board for resolution
  - Delaware's long-arm statute also did not permit jurisdiction over officers at the time of enactment
  - Delaware's long-arm statute was amended in 2004 to provide personal jurisdiction over presidents, CEOs, COOs, CFOs, CLOs, controllers, treasurers, and chief accounting officers
    - *See* Lawrence A. Hamermesh, Jack B. Jacobs & Leo E. Strine, Jr., *Optimizing the World's Leading Corporate Law: A 20-Year Retrospective and Look Ahead* 62–73 (Harv. L. Sch. Program on Corp. Governance, Discussion Paper No. 2021-12, 2021)

Overview of Officer Liability for Disclosures

- Preparation of proxy materials is often delegated to management.
- Because officers are not protected by Section

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continued

102(b)(7), they may not be dismissed (and may become a potential source of liability) even if bad faith is not alleged.
- Courts consider actual wielding of authority in the officer capacity, such as extensive involvement with (or signing) the proxy.

Recent Officer Cases

- *Chen v. Howard-Anderson*, 87 A.3d 648 (Del. Ch. 2014)
- *Cirillo Fam. Tr. v. Moezinia*, 2018 WL 3388398 (Del. Ch. July 11, 2018)
- *Olenik v. Lodzinski*, 208 A.3d 704 (Del. 2019)
- *Morrison v. Berry*, 2019 WL 7369431 (Del. Ch. Dec. 31, 2019)
- *Voigt v. Metcalf*, 2020 WL 614999 (Del. Ch. Feb. 10, 2020)
- *In re Coty Inc. S'holder Litig.*, 2020 WL 4743515 (Del. Ch. Aug. 17, 2020)
- *In re Mindbody, Inc.*, 2020 WL 5870084 (Del. Ch. Oct. 2, 2020)
- *In re Baker Hughes Inc. Merger Litig.*, 2020 WL 6281427 (Del. Ch. Oct. 27, 2020)
- *City of Warren Gen. Emps.' Ret. Sys. v. Roche*, 2020 WL 7023896 (Del. Ch. Nov. 30, 2020)
- *In re Columbia Pipeline Grp., Inc.*, 2021 WL 772562 (Del. Ch. Mar. 1, 2021)
- *In re Pattern Energy Grp. Inc. S'holders Litig.*, 2021 WL 1812674 (Del. Ch. May 6, 2021)
- *Teamsters Local 237 Additional Sec. Benefit Fund v. Caruso*, 2021 WL 3883932 (Del. Ch. Aug. 31, 2021)

Chen v. Howard-Anderson

- In September 2010, Occam Networks, Inc. ("Occam") announced a merger with Calix, Inc. ("Calix").
- Following closure of the merger in 2011, plaintiffs filed suit against Occam's directors and officers, alleging they breached their fiduciary duties by (i) making decisions during Occam's sale process that fell outside the range of reasonableness and (ii) issuing a proxy statement that contained materially misleading disclosures and material omissions.
- The defendants moved for summary judgment.
- Court granted director-defendants' motion for summary judgment on the sales process claims, but not the officers'.
  - Record supported an inference that certain decisions fell outside the range of reasonableness, but evidence did not support an inference that the directors acted with an improper motive.
  - Occam's CEO and CFO were not protected by Occam's § 102(b)(7) provision.
  - Plaintiffs cited actions that CEO and CFO took that could support a reasonable inference of favoritism toward Calix consistent with their "personal financial interests," including CEO's delayed follow-up with another interested party ("Adtran") and CEO and CFO's participation in due diligence presentations with Adtran during which Occam gave Adtran the impression that Occam was not interested in a transaction.
- Court denied the motion for summary judgment on the disclosure claims.
  - Record supported an inference that the proxy contained materially misleading disclosures and omissions, and that the defendants knew about the issues before approving the proxy.
- Case later settled for $35 million.

Cirillo Fam. Tr. v. Moezinia

- In August 2014, an affiliate of Endo Pharmaceuticals, Inc. ("Endo") acquired DAVA Pharmaceuticals ("DAVA").
- To expedite consummation of the merger, DAVA's outside legal counsel suggested that it obtain stockholder approval by written consent.
  - DAVA eventually obtained written consents from all of its stockholders except the plaintiff, who owned 0.27% of DAVA's shares.
- DAVA sent the plaintiff a notice stating that the merger was approved by a majority of stockholders and providing information about how to seek appraisal.
  - Notice was deficient in two ways: (i) written consents of DAVA's nine largest stockholders were not dated properly, rendering them invalid and (ii) it did not contain required information that would allow a stockholder to make an informed decision whether to pursue appraisal.
- Plaintiff filed suit one month after the merger closed, asserting damages against DAVA and its directors because of the dating defects and asserting that directors breached their fiduciary duties by failing to include material information.
- Plaintiff also moved to amend its complaint to add, in relevant part, a breach of fiduciary duty claim against DAVA's founder

and president and general counsel for sending and/or permitting the notice to be sent.

- Court granted defendants' motion to dismiss in its entirety.
  - Stockholder approval of the merger would be validated under 8 *Del. C.* § 205.
  - DAVA's directors reasonably relied, in good faith, on the advice of outside counsel with respect to the preparation of the notice.
- Court permitted plaintiff to amend its complaint to add a breach of fiduciary duty claim against DAVA's founder and president and general counsel for sending and/or permitting the notice to be sent.
  - Officers owe the same fiduciary duties as directors.
  - § 102(b)(7) cannot exculpate officers and would not protect the president and general counsel even though they also serve as directors.
  - President and general counsel are not shielded from liability under § 141(e) for actions they took as officers.
  - Plaintiff identified a "theoretical" path to recovery, but Court was skeptical of its likelihood of success because record demonstrated that president and general counsel relied in good faith on outside counsel.
- Court later granted officers' motion for summary jugment.

Olenik v. Lodzinski

- Plaintiff, a stockholder of Earthstone Energy, Inc. ("Earthstone"), brought class and derivative claims against Earthstone's directors and officers challenging a business combination between Earthstone and Bold Energy III LLC ("Bold").
- Plaintiff alleged that EnCap Investments L.P. ("EnCap") controlled Earthstone and Bold and caused Earthstone stockholders to approve an unfair transaction based on a misleading proxy statement.
- Court of Chancery dismissed the case, holding (i) the proxy statement informed the stockholders of all materials facts and (ii) interactions between EnCap, Earthstone, and Bold never rose to the level of bargaining and thus *MFW* protections applied.
- Plaintiff appealed.
- On appeal, Delaware Supreme Court affirmed the Court of Chancery's dismissal of disclosure claim, but held that plaintiff pled facts supporting a reasonable inference that EnCap, Earthstone, and Bold engaged in "substantive economic negotiations" before Earthstone's special committee put *MFW* conditions in place.
- Earthstone's CEO and executive vice president specifically engaged in substantive economic negotiations with Bold and EnCap before *MFW* conditions were put in place.
  - Supreme Court agreed with plaintiff that the officers were not exculpated by §102(b)(7) because complaint plead breach of loyalty claims <u>and</u> breach of fiduciary duty claims against them as officers.
- Plaintiff pled facts sufficient to support a reasonable inference that EnCap acted as Earthstone's controlling stockholder while negotiations took place between Earthstone and Bold, which set the "financial playing field for later negotiations."

Morrison v. Berry

- After Apollo acquired Fresh Market in 2016, a stockholder uncovered documents in a books and records action indicating that Fresh Market's board failed to disclose an agreement between the company's founder, his son (a large stockholder), and Apollo in the company's federal securities filings recommending stockholders accept the tender offer.
- Delaware Supreme Court reversed Court of Chancery's order dismissing the breach of fiduciary claims and aiding and abetting claims against the directors, the founder, and his son.
- On remand, plaintiff added fiduciary claims against Fresh Market's former CEO and general counsel and aiding and abetting claims against Apollo, special committee's banker, special committee's lawyers, and the CEO's son (a director, former CEO, and Vice Chairman).
- Court granted director-defendants' motion to dismiss but permitted the breach of fiduciary claims against founder, general counsel, and former President/CEO to move forward.
  - President/CEO and general counsel may have breached their duties of care in overseeing the sales process and disclosures.
    - Claim against President/CEO for gross negligence and disloyalty in connection with the 14D-9 was sustained because of his role in preparing it.

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- Claims that the general counsel omitted material information from the 14D-9 were sustained: (i) that the founder lied to the board about his agreement with Apollo, (ii) the founder's statements suggesting a "clear preference" for Apollo and "unwillingness to consider an equity rollover with other parties," (iii) the founder's indication that he might sell his shares if The Fresh Market did not embark on a sale, and (iv) the "depth and breadth" of shareholder pressure.
- Plaintiff's duty of care claims against the officers only survived because Section 102(b)(7) does not apply to officers.

Voigt v. Metcalf

- NCI Building Systems, Inc. ("NCI") completed a merger in July 2018 with Ply Gem Parent, LLC ("New Ply Gem")
- Clayton, Dubilier & Rice ("CD&R") owned 34.8% of NCI and was also a 70% owner of New Ply Gem
- A stockholder derivative suit alleged, among other claims, that CD&R, certain board members, and the CEO of NCI breached their fiduciary duties in connection with the transaction because NCI purchased New Ply Gem for $600 million more than a valuation made a few months earlier
- Four of the directors were dismissed because they were protected by an exculpatory provision and had no "compromising relationships or sources of influences."
- Court declined to dismiss breach of fiduciary duty claim against director/CEO.

  Complaint contained allegations that supported a reasonable inference that director/CEO, acting in his capacity as an officer, favored the deal "out of loyalty to CD&R."
  - CEO may have engaged in misconduct when providing his assessment of the transaction to the board and by advocating in favor of the deal.
  - When making this finding, the Court cited to *Gantler v. Stephens*, 965 A.2d 695, 709 n.37 (Del. 2009):

    "Although legislatively possible, there currently is no statutory provision authorizing comparable exculpation of corporate officers."
- Case later settled.

In re Coty Inc. S'holder Litig.

- In April 2019, JAB Holding Company S.à.r.l. ("JAB") acquired 150 million shares of Coty, Inc. ("Coty") through a partial tender offer.
- Tender offer was conditioned on Coty's independent directors' approval and recommendation of offer to Coty's shareholders.
- Special committee was formed comprising of Coty's independent directors except Coty's CEO, who previous served as CEO of a JAB affiliate.
  - Five other Coty directors had ties to JAB and therefore did not directly participate in discussions.
  - Board accepted special committee's recommendation to present the tender offer proposal to shareholders, and tender offer closed.
- Coty filed its Schedule 14-D Recommendation Statement, which stated that, other than the JAB-affiliated directors, Coty was not aware of any actual or potential material conflicts of interest between any of Coty's executives and directors, including the special committee, and Coty.
- Coty shareholders sued, alleging, in relevant part, that the board breached its fiduciary duties by initiating the tender offer and failing to disclose the special committee's conflicts of interest.
- CEO moved to dismiss the breach of fiduciary duty claims against him because Coty's §102(b)(7) provision exculpates directors from breaches of the duty of care and plaintiffs failed to allege a non-exculpated claim against him.
- Court disagreed:
  - A director who also serves as an officer is not protected from liability under §102(b)(7) if there are allegations that support a rational inference the director "may have acted out of loyalty to [the controller]" and "could have breached his duties in his capacity as an officer."
  - Court found that it was reasonably conceivable CEO acted to advance JAB's interest in the tender offer because as CEO he:
    1. voted to approve stockholders' agreement and recommended that stockholders sell their shares to JAB;
    2. ensured that special committee and its financial advisor used "understated" financial projections; and

3. failed to provide clarity on Coty's strategic plan before the tender offer.

In re Mindbody, Inc.

- In February 2019, Vista Equity Partners Management LLC ("Vista") acquired Mindbody, Inc. ("Mindbody") for $1.9 billion.
- Plaintiffs alleged that Mindbody's CEO and director, CFO, and an outside director tilted the sale process in Vista's favor due to various conflicts of interest.
  - Plaintiffs alleged that CEO was motivated by a need for "liquidity and the prospect of future employment with Vista," CFO was motivated by the prospect of future employment, and outside director, who was nominated to the board by a venture capital stockholder, was motivated by the stockholder's desire to exit its Mindbody investment.
- Defendants moved to dismiss, contending that the involvement of an informed and engaged board defeated any claim for liability and that the merger was ratified under *Corwin* by a fully-informed, uncoerced stockholder vote.
- Court held that plaintiffs adequately pled claims for breach of fiduciary duty against the CEO and CFO.
  - *Corwin* did not apply because the stockholder vote was not fully informed.
  - It was reasonably conceivable that CEO, as a director, had a subjective desire for near-term liquidity and the opportunity to continue as CEO of the post-merger entity.
  - It was also reasonably conceivable that CEO tilted the sale process in Vista's favor by (i) lowering guidance to depress Mindbody's stock and make it a more attractive target and (ii) providing Vista with timing and information advantages over other bidders.
  - CFO, as a non-director, was not protected by Mindbody's §102(b)(7) provision.
  - It was reasonably conceivable that CFO acted with gross negligence and breached his duty of care throughout the sale process by failing to disclose Visa's expression of interest to Mindbody's board and providing Vista with timing and informational advantages.

In re Baker Hughes Inc. Merger Litig.

- In July 2017, Baker Hughes merged with the oil and gas division of General Electric ("GE").
- Because GE did not have audited financial statements when the transaction was negotiated, it provided unaudited financial statements, but the parties conditioned closing on Baker Hughes' receipt of audited financial statements.
- Baker Hughes held the right to terminate the merger if the audited financial statements differed from the unaudited financial statements in a manner that was materially adverse to the intrinsic value of GE.
- GE's audited financial statements reflected $4 billion of goodwill impairments not reflected in the unaudited financial statements.
- Baker Hughes issued a proxy that represented that any differences between the audited and unaudited financial statements were not material.
- Stockholders brought two fiduciary duty claims against the CFO and former CEO of Baker Hughes
- Court dismissed disclosure claim against Baker Hughes' CFO because complaint did not allege that she drafted or disseminated the proxy.
  - Allegation that she would have reviewed and authorized dissemination of the proxy because she was CFO was insufficient to plead *scienter* or gross negligence.
- Court declined to dismiss duty of care claim against Baker Hughes' former CEO, Chairman and President.
  - Court found it was reasonably conceivable that he breached his duty of care with respect to the preparation of proxy because (i) he signed proxy as Chairman and CEO, and (ii) proxy did not include the unaudited financials, which was the only source of GE historical financial information available to Baker Hughes before it signed the merger agreement and which was required by the merger agreement to be attached to the merger agreement.
  - Former CEO filed a still-pending motion for summary judgment on September 3, 2021.

City of Warren Gen. Emps.' Ret. Sys. v. Roche

- Following Blackhawk Network Holdings, Inc's IPO, its growth strategy was largely fueled by acquisitions. Shortly after lower-

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ing earnings guidance, private equity investors contacted Blackhawk about a potential transaction.
- Blackhawk's CEO advocated for the transaction as a path to finding future acquisitions, and the transaction eventually closed.
- Plaintiff brought a single breach of fiduciary duty claim against Blackhawk's CEO and Executive Chairman, alleging that they, motivated by personal gain (future employment and a financial windfall), manipulated Blackhawk's board to push through the sale and helped prepare a materially misleading proxy.
- Court found that there were no credible allegations that the defendants were interested, lacked independence, or acted in bad faith.
- Court found, however, that plaintiff stated a claim for breach of duty of care related to allegedly misleading disclosures in the proxy.
  - First, defendants were not protected by Blackhawk's §102(b)(7) provision.
  - Second, only CEO participated in preparing the proxy.
  - Third, two disclosures in the proxy were materially misleading: (i) proxy failed to adequately disclose financial projections based on an acquisition strategy that showed a higher value for Blackhawk, and (ii) proxy materially mispresented the merger's go-shop provision.
  - *Corwin* did not apply because the vote was not fully informed.
- Court granted defendants' motion to dismiss, except to the breach of fiduciary duty claim against the CEO.

In re Columbia Pipeline Grp., Inc.
- Stockholder challenged sale of Columbia Pipeline Group, Inc. ("Columbia") to TransCanada.
- Plaintiff brought breach of fiduciary duty claims against Columbia's former Chairman/CEO and CFO, as well as an aiding and abetting claim against TransCanada.
  - Plaintiff alleged that CEO and CFO steered the sales process to ensure they would receive change-of-control benefits and breached their duty of disclosure.
  - CEO violated a standstill agreement by having discussions with TransCanada, providing TransCanada with confidential information unavailable to other potential suitors, and demonstrating a pattern of favoritism towards TransCanada.
- As a result of the merger, CEO received retirement benefits of $28.6M ($17.9M more than he would have without the merger), and CFO received benefits of $10.89M ($7.5M more than he would have received without the merger).
- Court refused to dismiss any claims.
  - Plaintiff's allegations supported a reasonable inference that CEO and CFO tilted the sales process in favor of TransCanada, and committed fraud on the board by withholding material information.
  - As officers, CEO and CFO owed fiduciary duties identical to those of directors, including duty to disclose all material information within board's control when it seeks shareholder action.
  - It was reasonably conceivable that CEO and CFO's interest in early retirement and benefits conferred by merger tainted their decisions about what to disclose, supporting reasonable inference that failure to disclose resulted from a breach of duty of loyalty.
  - *Corwin* did not apply because proxy omitted information about the terms (and alleged breaches) of the standstill agreements, the CEO and CFO's retirement plans, and a meeting between the CFO and a TransCanada executive, all of which constituted material omissions.
    - *Corwin* "cleansing" only applies when approval by disinterested stockholders is "fully informed," and stockholders cannot be fully informed in face of material omissions.

In re Pattern Energy Grp. Inc. S'holders Litig.
- Plaintiff challenged an all-cash acquisition of Pattern Energy Group Inc. ("Pattern Energy") by Canada Pension Plan Investment Board ("Canada Pension").
- Pattern Energy was formed by Riverstone Holdings LLC ("Riverstone"), a private equity fund, to operate energy projects.
  - Riverstone was not a Pattern Energy stockholder, but allegedly maintained control through a Riverstone sponsored and controlled entity and through other means.
  - Pattern Energy's CEO and CFO also

held longstanding relationships with Riverstone and held leadership roles there.

- Pattern Energy engaged in a sales process and formed a special committee. After months of negotiations, Brookfield Asset Management ("Brookfield") and Canada Pension submitted offers.
  - Brookfield proposed a stock-only transaction that offered stockholders a 45% premium, but was not predicated on a transaction involving Riverstone.
  - Canada Pension made an all-cash offer at a 14.8% premium, with an offer to buy Riverstone at 1.8x the amount of Riverstone's invested capital, subject to a contingent earnout provision.
  - Special committee requested that Brookfield provide documentation showing that their offer included an agreement with Riverstone, and Brookfield subsequently backed out.
- Plaintiff brought breach of fiduciary duty claims against Pattern Energy's directors and officers, and third party liability claims against Riverstone and affiliated entities.
- Court held that plaintiff stated a breach of fiduciary duty claim against the directors.
  - *Corwin* did not apply because the minority stockholders' approval was partly based on the vote of a large holder of preferred shares that was contractually bound, pre-disclosure, to vote in accordance with the board's recommendation, and therefore its vote was not fully informed.
- Court further held that plaintiff stated a claim for breach of fiduciary duty against certain of Pattern Energy's officers.
  - It was reasonably conceivable that certain officers breached their duty of loyalty by tilting the sales process toward Canada Pension in pursuit of their own interests and Riverstone's (and affiliated entities') interests, and by issuing a materially misleading proxy.
  - Plaintiff adequately alleged that proxy was false or misleading with respect to a number of issues: (i) Goldman Sachs' compensation and potential conflicts with Riverstone, (ii) the importance of a consent right in the sales process, (iii) that Brookfield proposed to pay stockholders over $6 more per share than Canada Pension, and (iv) the special committee's belief that Brookfield's offer was more valuable.

Teamsters Local 237 Additional Sec. Benefits Fund v. Caruso

- Plaintiffs challenged a cash-out merger of Zayo Group Holdings, Inc. ("Zayo").
- Plaintiffs alleged that Zayo's CEO and Chairman, under threat of removal by activist stockholders, breached his fiduciary duties by steering the sale process toward the eventual acquiror so that he could remain as CEO and capture the future upside of the business through a rollover of his stock. They further alleged that the CEO was responsible for disclosure violations related to the proxy.
  - CEO signed the proxy in his capacity as CEO.
- Plaintiffs also alleged that Zayo's board failed to sufficiently oversee and manage the CEO's conduct.
- Court granted the defendant's motion to dismiss in part.
  - A majority of Zayo's board was disinterested and entire fairness therefore did not apply.
  - Specific instances of the CEO's conduct cited by plaintiffs did not create a reasonable inference that Zayo's board failed to oversee the CEO during the sale process or that the CEO breached his fiduciary duties.
- Court declined, however, to grant the defendant's motion to dismiss the disclosure claim.
  - Proxy statement omitted a conversation that took place between CEO and acquiror's representative in which the representative shared acquiror's potential price range and CEO responded that Zayo's board showed willingness to engage at or above a certain price.
  - *Corwin* did not apply because the stockholder vote was not fully informed as a result of the omissions in the proxy.

Recent Officer Cases Where Claims Were Dismissed

- *In re Essendant, Inc. S'holder Litig.*, 2019 WL 7290944 (Del. Ch. Dec. 30, 2019)
- *In re AmTrust Fin. Servs., Inc. S'holder Litig.*, 2020 WL 914563 (Del. Ch. Feb. 26, 2020)

In re Essendant, Inc. S'holder Litig.

- In spring 2018, Essendant Inc. ("Essendant") signed a merger agreement with Genuine Parts Company ("GPC") whereby

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Essendant would combine with a GPC affiliate.

- The agreement contemplated a stock-for-stock transaction that would result in Essendant stockholders owning 49% of the combined company.
- Shortly after signing the agreement, Essendant's board received an all cash offer to acquire Essendant from Sycamore Partners ("Sycamore").
  - As Sycamore was communicating with Essendant's board, it was also making an open-market push to acquire a substantial stake in Essendant. Board responded by adopting a poison pill.
- After further discussions with Sycamore, Essendant's board terminated the agreement with GPC and accepted Sycamore's offer.
- Plaintiffs sued Essendant's board and Sycamore for breaches of fiduciary duty, waste, and aiding and abetting.
  - Plaintiffs alleged that Essendant's board succumbed to pressure from Sycamore and improperly turned GPC away in favor of an inferior proposal.
- Court granted defendants' motion to dismiss in its entirety.
  - Plaintiffs failed to adequately plead: (i) that Sycamore was Essendant's controlling stockholder; (ii) board-level conflicts; (iii) bad faith; (iv) that Essendant's board aided and abetted Sycamore's breach of fiduciary duty; or (v) waste.
- Plaintiffs also failed to adequately plead that Essendant's CEO breached his fiduciary duties.
  - CEO was protected in his capacity as a director due to Essendant's § 102(b)(7) provision.
  - Complaint mentioned only one act taken by CEO in his capacity as an officer: his participation in a phone call wherein he allegedly learned of Sycamore's interest in acquiring Essendant.
  - It was "difficult to discern" how fielding a phone call during which an unsolicited acquisition proposal is communicated, without more, could support a reasonably conceivable inference of a breach of the duty of care or loyalty.

In re AmTrust Fin. Servs., Inc. S'holder Litig.

- Controlling stockholders of AmTrust, Inc. ("AmTrust"), along with a private equity firm, took AmTrust private through a merger that closed in November 2018.
- In conveying their initial proposal to acquire the rest of AmTrust's shares for $12.25 per share, the buyout group conditioned the transaction on receiving the approval of a special committee and a majority of AmTrust's minority stockholders.
- Special committee, after several months of negotiations, voted to approve a $13.50 per share merger.
  - Carl Icahn, a major stockholder, sued the controlling stockholders for breach of fiduciary duty and opposed the proposed share price.
  - Icahn thereafter indicated his support for a transaction at $14.75 per share during discussions with two of the controlling stockholders, but not the special committee.
  - Special committee and AmTrust's board approved an amended merger agreement at $14.75 per share, and 67.4% of AmTrust's unaffiliated stockholders approved the proposal.
- Plaintiffs filed breach of fiduciary duty and aiding and abetting claims against controlling stockholders, AmTrust's directors, and other participants in the buyout.
- Court permitted plaintiffs' breach of fiduciary duty claims against controlling stockholders and self-interested members of the special committee to survive, but dismissed remaining claims.
  - Plaintiffs' breach of fiduciary duty claim against Zyskind, a controlling stockholder, in his capacity as an AmTrust officer, was dismissed.
  - Complaint repeatedly referred to AmTrust's management in describing the merger negotiation process, but did not contain allegations regarding specific actions taken or statements made by Zyskind in his capacity as an officer; only in his capacity as a director.
  - Plaintiffs did not address this deficiency in their brief or at oral argument, and thus waived the issue.
  - Zyskind remained in the case in his capacity as an AmTrust director and as part of its control group.

POLLING QUESTIONS

Do you believe that a single officer should be liable for quasi-appraisal damages

because of a duty-of-care breach regarding disclosures regarding a merger?
- Yes, that is clear Delaware law.
- No, that is an unwarranted extension of Delaware law.
- Not sure.
- What do those words mean?

- Do you believe that Section 102(b)(7) should be amended to address claims against officers?
  - Yes
  - No

- If you were practicing corporate law before 2004, did you consider it likely at that time that non-director officers would be sued in stockholder class actions or breach of the duty of care?
  - Never crossed my mind
  - Sure, happened frequently
  - Sure, I saw it coming down the road

34th Annual Corporate Law Institute
Tulane University Law School 2022

Delaware Developments

Panelists:
The Honorable Collins J. Seitz
Chief Justice, Delaware Supreme Court

William M. Lafferty (Moderator)
Morris, Nichols, Arsht & Tunnell LLP

Kevin R. Shannon
Potter Anderson & Corroon LLP
Elena C. Norman
Young Conaway Stargatt & Taylor, LLP

Patricia L. Enerio
Heyman Enerio Gattuso & Hirzel LLP

Blake Rorbacher
Richards, Layton & Finger, P.A.

Agenda
Zuckerberg
Brookfield
Boeing and other *Caremark* cases
Captive Insurance
SPACs and *Multiplan*
Section 220
Waiver of Appraisal Rights
Controllers

Zuckerberg[1]

- Directors of Facebook faced derivative suit over stock reclassification plan to allow Mark Zuckerburg to sell stock and retain voting control.
- Directors withdrew plan, mooting the litigation.
- Plaintiffs filed new action seeking recovery of costs to company of almost $90m (defense costs and plaintiff's mootness fee award).
- Claims dismissed by Court of Chancery for failure to show demand futility.
- Court of Chancery applied a new, three-part test, blending *Aronson* and *Rales*, tests for demand futility.

[1] *United Food & Commercial Workers Union v. Zuckerberg*, 262 A.3d 1034 (Del. 2021).

Aronson[2] and *Rales*[3]

- *Aronson* applies where it involves the same board that would consider a demand.
  - Demand excused if:
    - at least ½ of directors are not disinterested and independent; or
    - transaction was not otherwise the product of a valid business judgment.
- *Rales* applies where it does not involve the same board, or there is a challenge to board inaction.
  - Demand excused if: a majority of directors could not have properly exercised its independent and disinterested business

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judgment in responding to the demand.

[2] *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), *overruled by Brehm v. Eisner,* 746 A.2d 244 (Del. 2000).

[3] *Rales v. Blasband*, 634 A.2d 927 (Del. 1993).

***Zuckerberg:* New Test**

- Delaware Supreme Court affirmed Court of Chancery's dismissal and adopted Court of Chancery's three part test, which asks, on a director-by-director and claim-by-claim basis, if director:
  (1) received a material personal benefit
  (2) faces a substantial likelihood of liability on any of the claims; and
  (3) lacks independence from someone who (1) or (2).
- Need at least 1/2 of members of demand board.
  - *Aronson*, *Rales*, and progeny still good law.
  - New test applied in:
    - *Genworth Fin., Inc. Consol. Derivative Litig.*, 2021 WL 4452338, at *1 (Del. Ch. Sept. 29, 2021).
    - *Firemen's Ret. Sys. of St. Louis on behalf of Marriott Int'l, Inc. v. Sorenson*, 2021 WL 4593777, at *1 (Del. Ch. Oct. 5, 2021).

Brookfield[4]

- Plaintiff challenged private placement sale by TerraForm Power of common shares to its majority stockholder, an affiliate of Brookfield. Plaintiff asserted dual-natured direct and derivative claims of unfair dilution of voting and economic power.
- After private placement, TerraForm was acquired by a 3rd party in merger cashing out plaintiff's stock.
- Defendants argued that claims are derivative and merger divested plaintiff of standing.
- Court of Chancery denied defendants' motion to dismiss, concluding it was bound by *Gentile v. Rossette*[5] that claims were dual-natured.
- Delaware Supreme Court accepted an interlocutory appeal calling into question *Gentile.*

[4] *Brookfield Asset Management, Inc. v. Rosson*, 261 A.3d 1251 (Del. 2021).

[5] *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006), *overruled by Brookfield Asset Mgmt., Inc.*, 261 A.3d 1251.

Direct or Derivative?

- Supreme Court held that there were doctrinal, practical and policy reasons to overturn recognition of dual-nature claims under *Gentile*:
  1. Conclusion in *Gentile* that economic and voting dilution was an injury to stockholders independent of the corporation when the claim was that private placement was at unfairly low price – was incorrect; injury to economic and voting rights was indirect.
  2. Court ruled that *Gentile* was at odds with *Tooley*[6] in relying on:
     - *In re Tri-Star Pictures,*[7] because *Tooley* rejected the "special injury" test from *Tri-Star*.
     - the presence of controlling stockholder, because *Tooley* focused on the harm, not the wrongdoer.
- The decision:
  - provides 2nd example of Supreme Court's willingness to revisit prior precedent
  - clarifies the direct versus derivative analysis, and
  - limits post-closing exposure for claims arising before and unrelated to cash out merger.

[6] *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004).

[7] *In re Tri-Star Pictures, Inc., Litig.*, 634 A.2d 319 (Del. 1993).

***Caremark:*[8] Overview**

- In 1996, the Court of Chancery in *In re Caremark International Inc.* recognized a director duty to exercise proper oversight.
- *Caremark* asks:
  - whether the board "utterly failed" to implement a reporting system, or
  - whether the board consciously or knowingly failed to respond to red flags or discharge their responsibilities within that system.
- Recently, the Delaware courts have indicated they will engage in a more searching review of whether directors have complied with their oversight duties when the alleged failure involves an "essential or mission

critical" business or operation.

[8] *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

Key Prior Rulings

- *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019) (denying motion to dismiss involving listeria outbreak at ice cream manufacturer).
- *In re Facebook, Inc. Section 220 Litigation*, 2019 WL 2320842 (Del. Ch. May 30, 2019) (granting books and records request regarding potential *Caremark* claims over Cambridge Analytics user privacy scandal).
- *In re Clovis Oncology, Inc. Derivative Litig.*, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019) (denying motion to dismiss involving violations of clinical trial protocols at drug manufacturer).
- *Lebanon County Employees' Retirement Fund v. AmerisourceBergen Corp.**, 2020 WL 132752 (Del. Ch. Jan. 13, 2020), *aff'd*, 243 A.3d 417 (Del. 2020) (denying motion to dismiss involving failure to monitor suspicious pharmacy orders contributing to opioid epidemic).
- *Inter-Marketing Group USA, Inc. on Behalf of Plains All American Pipeline, L.P. v. Armstrong*, 2020 WL 756965 (Del. Ch. Jan. 31, 2020) (granting motion to dismiss involving pipeline rupture and oil spill).
- *Hughes v. Xiaoming Hu*, 2020 WL 1987029 (Del. Ch. Apr. 27, 2020) (denying motion to dismiss involving chronic failure to monitor financial statements).
- *Pettry v. Gilead Sciences, Inc.**, 2020 WL 6870461 (Del. Ch. Nov. 24, 2020) (granting books and records request involving potential *Caremark* claims over extensive anticompetitive activity at drug developer).

***Boeing*[9]**

- *Caremark* claim arose after crashes of two Boeing 737 MAX airplanes and grounding of the 737 MAX fleet.
- Claim sustained against Boeing directors under both prongs because:
  - no process for board to regularly discuss, or receive management reports, on airplane safety
  - no board committee had direct responsibility to monitor airplane safety;
  - finding of scienter (i.e., directors knowingly fell short of meeting oversight obligations); and
  - even if a reporting system in place, the directors consciously disregarded red flags raised in 1st crash, instead treating it as an "anomaly."
- Parties reached $237.5 million settlement that Boeing's D&O insurance carrier would pay.

[9] *In re The Boeing Company Derivative Litigation*, 2021 WL 4059934 (Del. Ch. Sept. 7, 2021).

***Genworth*[10]**

- Claim dismissed against Genworth's directors who allegedly made misleading statements about Company's long-term care insurance business.
- Court held that plaintiff's allegations were "*Caremark*-like," but classified as bad faith breaches of duty of loyalty, because no conscious disregard of a red flag.

  "Indeed, the substance of Plaintiffs' claim is *not* that the Board missed red flags, as to either the LTC or Australian MI Business, but rather that the Board had direct knowledge of the contemporaneous wrongdoing *and participated in it* by endorsing the false and misleading disclosures and allowing them to stand uncorrected. This is not a *Caremark* claim."

[10] *Genworth Fin., Inc. Consol. Derivative Litig.*, 2021 WL 4452338, at *1 (Del. Ch. Sept. 29, 2021).

***Marriott*[11]**

- *Caremark* claim dismissed against Marriott board and officers after cyberattack that exposed personal information of up to 500 million guests.
- Court emphasized growing risks posed by cybersecurity threats do not lower the high threshold that plaintiffs must meet to effectively plead a *Caremark* claim, and that a showing of bad faith "is essential to establish director oversight liability."
- Court found that even though the Company's cybersecurity standards failed to meet industry standards, those standards were not mandated by law and insufficient to meet standard set forth in *Caremark*'s second prong.

[11] *Firemen's Ret. Sys. of St. Louis on behalf of Marriott Int'l, Inc. v. Sorenson*, 2021 WL 4593777, at *1 (Del. Ch. Oct. 5, 2021).

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continued

***Caremark* Claims Arising from Government Investigations: *FedEx*[12] & *LendingClub*[13]**

- *Caremark* claims dismissed against FedEx board and officers in connection with FedEx's alleged illegal cigarette shipment practices.
  - No conscious disregard of duty because board and committees remained aware of enforcement actions, and took remedial and disciplinary actions.
- *Caremark* claims dismissed against LendingClub's board in connection with FTC investigation for deceptive business practices with consumers.
  - No bad faith because committees routinely updated on investigation and consumer complaints.
  - Launch of investigation did not necessarily demonstrate that directors knew or should have known the corporation was violating the law.

[12] *Pettry on behalf of FedEx Corp. v. Smith*, 2021 WL 2644475, at *1 (Del. Ch. Jun. 28, 2021), *aff'd*, 2022 WL 569325 (Del. 2022).

[13] *Fisher on behalf of LendingClub Corp. v. Sanborn*, 2021 WL 1197577, at *1 (Del. Ch. Mar. 30, 2021).

Amendment – Captive Insurance

- Introduced on 12/16/2021 and signed and effective on 2/7/2022.
- Partly in response to concern for *Caremark* claims, amendments to the DGCL authorize a corporation to obtain insurance by or through a "captive insurance company,"
  - "captive insurance company:" an insurer directly or indirectly owned, controlled and funded by the corporation.
  - Insurance may be pursuant to a fronting or reinsurance arrangement (i.e., obtaining insurance from third-party insurer and reinsuring through captive).
- Specifics
  - The statute requires that captive insurance policy exclude any coverage for loss from undue personal profit or financial advantage, deliberate criminal or fraudulent act, or knowing violation of law not otherwise indemnifiable under the DGCL.
    - The conduct of an insured person is not imputed to any other insured person.
    - Proscribed conduct must be established in a final, non-appealable adjudication in underlying proceeding
    - As a result, a captive insurance policy could cover amounts paid in settlement of proceedings containing allegations that, if established, would fall within the exclusions.
    - Synopsis states that this does not exclude coverage for *Caremark* claims "where there is not otherwise a finding that the directors knowingly caused the corporation to violate the law."
- The amendments provide that any determination to make a payment under a captive insurance policy must be made either by a third-party administrator or in accordance with the procedures set forth in Section 145(d).
- If payment is to be made under the captive insurance policy in connection with the dismissal or settlement of a derivative action as to which notice is required to be given to stockholders, the corporation must include in the notice that payment will be made under the captive insurance policy.
- A corporation that establishes a captive insurance program may include in the insurance policy limitations or exclusions from coverage that are in addition to those prescribed by statute.
- Establishing a captive insurance company does not, in and of itself, subject the company to the Delaware Code provisions on insurers.

***SPACs & Multiplan*[14]**

- Despite the uptick in SPAC activity, Delaware courts have not fully explored the nature of SPACs, including:
  - the existence of founder shares
  - disclosures regarding potential forms of conflicts, or
  - existence of the redemption right

Multiplan addresses some of these issues:

"In this decision, *well-worn fiduciary principles are applied to the plaintiffs' claims despite the novel issues presented*."

SPACs: Default fiduciary duty law

- Entire fairness scrutiny may apply where the board of a corporation does not consist of a majority of disinterested directors, or a

transaction involves a conflicted controller.

- "Conflict" may exist where the controller (or majority of directors):
  - a.) stand on both sides of the transaction; or
  - b.)compete with the common stockholders for consideration by:
    - receiving greater monetary consideration than other stockholders
    - receiving a different form of consideration than other stockholders
    - receiving a "unique benefit" even if nominally receiving the same as all stockholders.

SPACs: *Multiplan*

- Entire fairness review applied over direct claims relating to allegedly misleading statements about potential competitive activity from large customer of the de-SPAC target company, Multiplan.
- The court focused on:
  - the incentives associated with founder's shares and the economic benefits received that were not shared by SPAC common shareholders; and
  - the right of SPAC stockholders to make a fully informed decision about whether to redeem their shares.

SPACs: Background of *Multiplan*

- A SPAC was formed in October 2019, and closed $1.1 billion IPO in February 2020.
- Multiplan was the de-SPAC target in which merger agreement approved in summer for $5.678 billion cash/stock deal, with stock valued at $10/share.
- Upon closing, common stockholders had right to redeem shares, and sponsor's upfront contribution would convert into certain percentage of common shares.
- Stockholders vote "overwhelmingly" to approve deal, and fewer than 10% redeemed shares.
- After closing, equity research firm publishes report about a large customer's alleged plans to develop an in-house platform to compete with *Multiplan*.
- Stock price falls to $6.27/share.

SPACs: Direct v. Derivative

- Direct claims brought against (i) controlling stockholder, (ii) directors and (iii) an officer, as well as an aiding and abetting claim against sponsor entity.
- Plaintiffs allege that improper disclosure "impaired the public stockholders' right to divest their shares before the business combination occurred."
- Theory = "[i]n a value-decreasing merger, non-redemptions would be valuable to those holding founder shares."
- Because public stockholders were not fully informed, "they exchanged their right to $10.04 per share – held in trust for their benefit – for an interest in Multiplan."
- Court holds complaint raises direct claims, because public stockholders were impaired of their "informed exercise of their redemption right."

SPACs – Standard of Review

- Court applies entire fairness because controller was conflicted for receiving a unique benefit:
  - The merger had value to common stockholders if post-merger entity was worth $10.04 or more.
  - For sponsor's principal, "given the (non-)value of his stock and warrants if no business combination resulted, the merger was valuable well below $10.04. This is a special benefit."
  - In addition, "in a value-decreasing deal where the post-merger entity is expected to be worth less than $10.04 per share, issuing a share at $10.04 – the effective result of a stockholder choosing not to redeem . . . – is value enhancing to the existing stockholders" so that the sponsor's principal "effectively competed with the public stockholders for the funds held in trust and would be incentivized to discourage redemptions if the deal was expected to be value decreasing."
- Court holds entire fairness also applicable standard because:
  - of allegations of majority interested board.
    - Majority of directors had interest in sponsor with implied market value of between $3.3MM-$43.6MM per director.
      - "A greater than half-million-dollar payout is presumptively material at the motion to dismiss stage."
    - and majority of directors also allegedly lack independence from Principal as serial SPAC directors.
      - "It is conceivable that those directors would 'expect to be considered for directorships' in future

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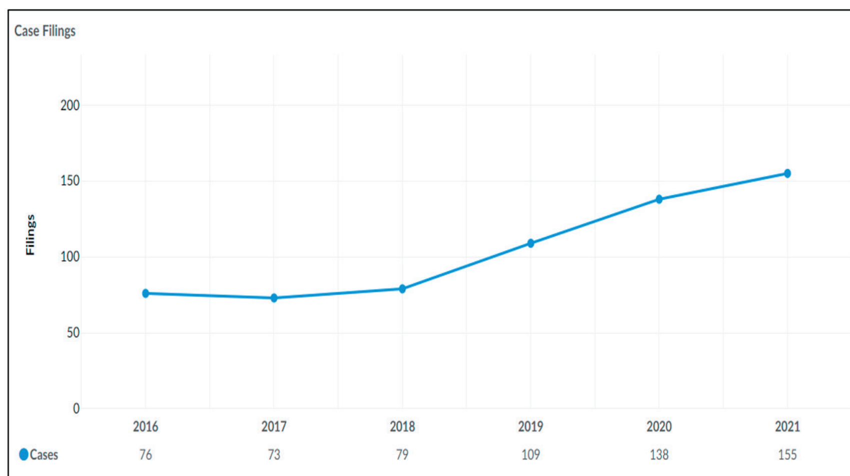
[Principal]-sponsored SPACs and that the founder shares they would receive from those positions were material to them."

SPACs – What is a SPAC sponsor to do?

- Does this mean that all SPAC deals are subject to entire fairness?
  - "That this structure has been utilized by other SPACs does not cure it of conflicts."
  - However, court highlights that claims are tied to alleged disloyal failure to "disclose information necessary for the plaintiffs to knowledgeably exercise their redemption rights."
    - "This conclusion does not address the validity of a hypothetical claim where the disclosure is adequate and the allegations rest solely on the premise that fiduciaries were necessarily interested given the SPACs structure. . . . . ***If public stockholders, in possession of all material information about the target, had chosen to invest rather than redeem, one can imagine a different outcome."***

Books and Records Cases on the Rise

- Lex Machina statistics show steady books and records increase from 2019 to 2020. *(See chart below)*



Lex Machina Source Data, showing Chancery filings in Corporation Law between 2012-10-26 and 2021-12-31, filtered where nature of complaint claim is inspection of books & records.

Section 220 Opinions

- *AmeriSourceBergen Corp. v. Lebanon County Employees Retirement Fund*, 243 A.3d 417, 421 (Del. 2020) (Company's opioid regulations and practices)
- *Employees Ret. Sys. of Rhode Island v. Facebook, Inc.*, 2021 WL 529439, at *5 (Del. Ch. Feb. 10, 2021) (Facebook settlement with FTC)
- *Pettry v. Gilead Sciences, Inc.*, 2020 WL 6870461, at *2 (Del. Ch. Nov. 24, 2020) (development of HIV treatment)
- *Zhang v. Zoox, Inc.*, 2022 WL 275777, at *1 (Del. Ch. Jan. 31, 2022) (discovery in appraisal proceeding limited to Section 220 documents)

Books and Records: *AmeriSourceBergen*[15]

- To state a proper purpose, a stockholder:
  - "need not identify the particular course of action the stockholder will take if the books and records confirm the stockholder's suspicion of wrongdoing."
  - "is not required in all cases to establish that the wrongdoing under investigation is actionable," although the actionability of wrongdoing can be a relevant factor.
- No "purpose-plus-an-end" test

[15] *AmeriSourceBergen Corp. v. Lebanon County Employees Retirement Fund*, 243 A.3d 417, 421 (Del. 2020).

Books and Records: *Facebook*[16]

- Court reaffirmed that it should not order emails to be produced when other materials (*e.g.*, board minutes) would accomplish proper purpose.
- But if non-email books and records are insufficient, Court should order emails to be produced.
- "And as relates to emails, '[Section] 220 does not require the petitioner to meet an unrealistic compelling evidence standard just to obtain [a] discrete set of documents.'"

[16] *Employees Ret. Sys. of Rhode Island v. Facebook, Inc.*, 2021 WL 529439 (Del. Ch. Feb. 10, 2021).

Books and Records: *Gilead*[17]

- *Gilead Sciences* (opinion after trial): "Regrettably, Gilead's overly aggressive defense strategy epitomizes a trend…[D]efendants are increasingly treating Section 220 actions as 'surrogate proceeding[s] to litigate the possible merits of the suit'

and 'place obstacles in the plaintiffs' way to obstruct them from employing it as a quick and easy pre-filing discovery tool.' Defendants like Gilead adopt this strategy with the apparent belief that there is no real downside to doing so, ignoring that this court has the power to shift fees as a tool to deter abusive litigation tactics."

- (Opinion on motion for attorneys' fees):
  - Chancellor McCormick shifted $1.8 million in fees, concluding Gilead had engaged in "vexatious litigation conduct" that satisfied Delaware's "glaring egregiousness" standard.
  - Gilead had:
    - declined to produce a single document to any of the five plaintiffs;
    - argued plaintiffs had not satisfied the lowest possible burden of proof by establishing a credible basis
    - argued any subsequent claims would not withstand a motion to dismiss;
    - misrepresented the record when arguing that plaintiffs' only purpose was to file subsequent litigation;
    - argued each Plaintiff was not knowledgeable about the demands and had abdicated the matter to counsel; and
    - took aggressive positions in discovery.

[17] *Pettry v. Gilead Sciences, Inc.*, 2020 WL 6870461, at *2 (Del. Ch. Nov. 24, 2020).

Books and Records: *Zoox*[18]

- Petitioners were shareholders in private company Zoox. Zoox was acquired by Amazon in a deal that valued petitioners shares at less than a dollar per share. Both petitioners sought appraisals, although they later withdrew appraisal demands for most of their shares leaving only 2000 shares subject to appraisal (valued at less than $2000 at deal price).
- After deal was announced, but prior to closing, petitioners made Section 220 demands to investigate possible wrongdoing. Petitioners lost Section 220 standing, because merger closed before the five-day response period in Section 220 expired. Petitioners voluntarily dismissed their Section 220 action in favor of their appraisal petition.
- Petitioners sought 53 broad categories of documents. Company produced certain board-level documents but objected to producing emails or other ESI.
- Court rejected defendant's proportionality argument in which petitioners' shares were valued at less than $2k, but that "real purpose" of petition was to facilitate pre-suit investigation of fiduciary duty claim. Size of petitioners' stake does not dictate scope of discovery.
- Court accepted defendant's argument that policy considerations militate against granting an appraisal petitioner full discovery where it is clear petitioner's purpose (as evidenced by miniscule economic interest in appraisal action) is to investigate follow-on breach of fiduciary duty claims. Court limited scope of discovery to information they could have obtained in Section 220 action.
- Court included warning to practitioners in a closing footnote:
  "The risk of this holding is that it will inspire defense attorneys to engage in wasteful discovery and motion practice targeting appraisal petitioners' purposes. This should not be the takeaway. The facts of this case are unusual. The findings concerning Petitioners' purpose are based on clear, objectively discernable facts. It would be a mistake to conclude from this decision that it is open season on an appraisal petitioner's purposes."

[18] *Zhang v. Zoox, Inc.*, 2022 WL 275777, at *1 (Del. Ch. Jan. 31, 2022).

Waiver of Stockholder Rights: *Authentix*[19]

- Authentix entered into a stockholders agreement in which provided stockholders would "refrain from the exercise of appraisal rights" in connection with a transaction approved by the board.
- Petitioners filed petition for appraisal after a third party acquired Authentix in a merger, and the common stock of Authentix would receive little to no consideration in the transaction.
- Delaware Supreme Court ruled the stockholders agreement's "refrain" language was unambiguous and reflected an ex-ante waiver of the statutory right to appraisal, and that here, public policy did not prohibit waiver of the right to appraisal.
- An open question for practitioners is which stockholder rights can be waived, and which are "fundamental features of the corporate entity's identity."
- Justice Valihura's dissent found refrain

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obligation to be ambiguous and thus not a clear waiver of appraisal rights, and that appraisal was a mandatory right not subject to waiver.

[19] *Manti Holdings, LLC v. Authentix Acquisition Co., Inc.,* 2021 WL 4165159 (Del. Sept. 13, 2021).

Waiver of Stockholder Rights: *Authentix II*[20]

- Plaintiffs entered into a stockholder's agreement to "consent to and raise no objections against" a sale of Authentix that was approved by the Board and a majority of shareholders.
- Court of Chancery ruled on predicate issue of whether Plaintiffs waived right to bring the post-closing damages action alleging breaches of the duty of loyalty against former corporate directors and alleged controller.
- Court ultimately did not decide the issue of the waivability of fiduciary duty because it found that no waiver occurred here in the first place.
- In a closing footnote, however, the Court hinted that it would not find such a waiver permissible:
- "Finding such waiver effective is a proposition that would blur the line between LLCs and the corporate form and represent a departure from norms of corporate governance, I note, even under the limited circumstances here, discussed above."

[20] *Manti Holdings, LLC v. Carlyle Grp. Inc.*, 2022 WL 444272, at *1 (Del. Ch. Feb. 14, 2022).

Controllers

- A controller is a stockholder who:
  - owns more than 50% of the voting power of a corporation or
  - owns less than 50% of the voting power of the corporation but exercises control over the business affairs of the corporation."
- *In re Viacom Inc. S'holders Litig.*, 2020 WL 7711128, at *11-18 (Del. Ch. Dec. 29, 2020).
- *In re Tilray, Inc. Reorganization Litig.*, 2021 WL 2199123, at *1 (Del. Ch. June 1, 2021).
- *Berteau v. Glazek*, 2021 WL 2711678, at *1 (Del. Ch. June 30, 2021).

In re Pattern Energy Grp. Inc. S'holders Litig., 2021 WL 1812674, at *1 (Del. Ch. May 6, 2021).

Controllers: *Viacom*[21]

- Entire fairness applied to a merger involving controller on both sides because controller obtained a non-ratable benefit to the detriment of the minority stockholders.
- Plaintiffs pled that the controller:
  - historically faced obstacles to exert control over the boards of both corporations,
  - was concerned about controlling both corporations if they remained separate, and
  - could expand and continue control by consolidating corporations and installing loyal management at the combined post-merger entity
- Court discussed whether "mere presence" of a controlling stockholder on both sides is sufficient to trigger entire fairness or whether the controlling stockholder must also receive a benefit "to the exclusion and at the expense" of the minority stockholders.

[21] *In re Viacom Inc. S'holders Litig.*, 2020 WL 7711128, at *11-18 (Del. Ch. Dec. 29, 2020).

Controllers: *Tilray*[22]

- Compare *Viacom* to *Tilray*
  - In *Tilray*, a special committee negotiated a downstream merger in which the controlling stockholder merged into the company.
  - Prior to reorganization, controlling stockholder held 90% of the company's voting power.
  - The merger enabled the controlling stockholder group to obtain valuable tax benefits not available to the minority stockholders.
  - The defendants argued that the transaction should be subject to business judgment review because there were no allegations of self-dealing/no evidence of a benefit obtained by the controller at the expense of the minority.
  - Court of Chancery rejected this argument and explained that the failure to use leverage on behalf of the minority, standing alone, constitutes a detriment to the minority.

[22] *In re Tilray, Inc. Reorganization Litig.*, 2021 WL 2199123, at *1 (Del. Ch. June 1, 2021).

Controllers: *Berteau v. Glazek*[23]

- Standard General, L.P. ("Standard General") was the controller of a publicly traded holding company ("SDI"). SDI held the majority of the common stock of a publicly traded operating company, Turning Point Brands, Inc. ("TPB" or the "Company"). TPB's stock was SDI's only material asset, and TPB's stock traded at a significant premium to that of SDI. To eliminate inefficiencies arising from SDI's existence as an intermediate public company, TPB acquired SDI.
- A special committee appointed by TPB negotiated a forward triangular merger in which SDI merged with the Company.
- The transaction was not conditioned on a majority-of-the-minority approval by the Company's minority stockholders.
- The complaint contained well-pleaded allegations "that SDI . . . received a disproportionate share of the benefit achieved by the transaction not shared with TPB's other stockholders."
- Defendants argued that the transaction should be subject to business judgment review because the "*MFW*" safe harbor should not require a majority-of-the-minority vote for the business judgment rule to apply to parent-subsidiary mergers that do not statutorily require a stockholder vote.
- Court of Chancery rejected this argument, reasoning that the *MFW* doctrine would be undermined if the business judgment standard applied to a controlling stockholder transaction merely because that transaction did not require a stockholder vote.
  - The transaction could have been structured to require a stockholder vote, and the complaint fairly alleged that SDI actively sought to avoid any transaction structure that required stockholder approval.
  - In the absence of a majority-of-the-minority vote condition, the approval of a purportedly independent special committee is not sufficient to trigger the business judgment rule.

[23] *Berteau v. Glazek*, 2021 WL 2711678 (Del. Ch. June 30, 2021)

Controllers: *In re Pattern Energy Group Inc.*[24]

- Class action sustained challenging the $6.1 billion go-private, all-cash sale of Pattern Energy Group to Canada Pension Plan.
- Despite having many hallmarks of a sound sale process – an authorized special committee, input from legal and financial advisors, and offers by multiple viable potential buyers - Court found that controller, a private equity fund that formed Pattern Energy and that controlled its upstream supplier of energy projects, steered sale process of Pattern Energy through the use of the supplier's consent right and leverage of overlapping fiduciary relationships so that controller's interests were prioritized at expense of stockholders.
- Controller had no direct interest in Pattern Energy at time of merger but the two remained "intertwined" operationally and structurally, and also shared a "great number" of overlapping fiduciaries and aligned investments.
- Court's decision was a reminder that a non-stockholder that is in contractual relationship with, or who otherwise exercises "soft power" over, a company can form control group and invite entire fairness review.

[24] *In re Pattern Energy Grp. Inc. S'holders Litig.*, 2021 WL 1812674, at *1 (Del. Ch. May 6, 2021).

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Emerging Trends in SPAC Litigation

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Introduction

Special Purpose Acquisition Corporations ("SPACs")—management-sponsored shell companies created to raise capital through an initial public offering ("IPO")—had a blockbuster year in each of 2020 and 2021. In each such year, the number of companies gone public through a SPAC transaction more than doubled from the prior year and from 2020 to 2021 the proceeds delivered to involved companies quintupled.

A SPAC is formed as a "shell company" and offers its equity to the public despite the absence of either hard assets or operations. Once public, a SPAC's sole aim is to find a private operating company and complete a merger, known as a de-SPAC transaction, through which the SPAC's capital can be directed toward an existing operating business and an existing operating business is able to access public capital markets now and in the future as a public company. Following its IPO, the SPAC has between 12 and 24 months to complete the transaction, otherwise the capital raised from the public is returned and the capital invested by the sponsorship group is generally forfeitted.

In 2021, 610 SPACs conducted IPOs, a tenfold increase over 2019, when only 59 SPACs listed their IPOs on Nasdaq or the NYSE. The number of de-SPAC transactions experienced a corresponding increase with 221 in 2021, up from 26 in 2019.

SPACs are a hot topic in finance and the law, in part because they offer an alternative to the traditional IPO, which may offer "higher valuations, less dilution, greater speed to capital, more certainty and transparency, lower fees, and fewer regulatory demands." But SPACs are not without controversy. Researchers have suggested that the explosion of SPAC activity in 2020 and 2021 was a bubble and that "SPACs on average continue to be a losing proposition" for investors.

As SPAC IPOs and de-SPAC transactions have increased, so has litigation concerning both the offerings and the mergers. This article summarizes trends in federal class actions and state court suits to provide insight on the past, present, and future of SPAC litigation. The article concludes with a brief note on a recent rule proposal by the Securities and Exchange Commission (SEC) related to SPACs.

Federal Courts

Research for this article collected complaints and motions to dismiss filed in 57 putative securities class actions against SPACs, from January 2019 through April 2022.

In 2019, plaintiffs filed six class actions against SPACs. Five of the suits related to the merger process, alleging that defendants made false and misleading statements in their proxy statements relating to the "background of the merger."

Beginning in 2020, plaintiffs tended to favor a new approach, alleging misleading prospective information. While there is still the occasional proxy statement suit, most of the cases focus on allegations that defendants made false and misleading statements with respect to their ability to achieve operations and profitability goals for the combined company in the future. This pattern

mirrors a narrative that has emerged concerning SPACs—that the mergers more often than not fail to produce a successful venture.

For example, in January 2021 plaintiffs filed a putative securities class action against QuantumScape Corp., an entity created through a de-SPAC transaction. The Amended Complaint alleged that despite the company's statements about its ability to create a next-generation lithium battery, the company was not ready to manufacture and market the product as it claimed. The court denied the defendants' motion to dismiss, explaining that plaintiffs sufficiently alleged that defendants' statements about the company's readiness to commercialize its batteries were false and misleading.

In March 2021, plaintiffs filed a putative securities class action against XL Fleet Corp., a company created through a de-SPAC transaction. Plaintiffs alleged that the SPAC "faced increasing pressure to complete a transaction, irrespective of the merits of that transaction," as the deadline for the de-SPAC transaction approached in January 2021. As alleged in the Amended Complaint, this led defendants to ignore or misrepresent the target company's sales pipeline and revenue potential to close the deal. Defendants moved to dismiss, and the court denied the motion, holding that plaintiffs had sufficiently alleged that defendants' statements regarding the company's sales pipeline and revenue figures were materially false and misleading.

This trend in SPAC litigation has continued into 2022. Plaintiffs have filed 11 putative securities class actions against entities created through de-SPAC transactions since the beginning of this year. Of these suits, five allege that defendants overstated the company's prospects post-combination. Three others allege that the SPAC failed to conduct adequate due diligence on the target company. As the year continues, we are likely to see more of this type of litigation involving SPACs.

State Courts

SPACs have also been the subject of litigation in state courts, particularly in New York and Delaware. In New York, at least 45 SPACs were sued by shareholders between September 2020 and December 2021. These suits alleged claims for breach of fiduciary duty against the SPAC's board of directors, and a claim against the SPAC for aiding and abetting a breach of fiduciary duty. Plaintiffs in these cases generally allege that the de-SPAC transaction was not fair to SPAC shareholders and that investors did not receive adequate disclosures regarding the merger. But it does not appear that plaintiffs in New York are litigating these claims—most are settled with supplemental disclosures and payment of "mootness fees" to plaintiffs' lawyers.

In contrast, SPAC litigation in Delaware state courts has resulted in several significant decisions in early 2022. Of note are Court of Chancery decisions in In re Multiplan Corp. Stockholders Litigation ("MultiPlan") and Brown v. Matterport, Inc. ("Matterport").

MultiPlan

MultiPlan is a putative class action against a SPAC, the SPAC's board of directors, officers, and controlling shareholder, and the company that resulted from the de-SPAC transaction (MultiPlan Corp.). The plaintiffs allege that the directors, officers, and controlling shareholder of the SPAC violated their fiduciary duties to the company's shareholders by prioritizing their own financial interests above those of the shareholders during the merger and made false and misleading statements about the merger in SEC filings and public statements.

Defendants moved to dismiss the suit and the court had to determine whether to apply the business judgment rule or the more exacting entire fairness standard as the standard of review. The business judgment rule is the default standard of review in Delaware, while entire fairness is a higher standard that requires a more robust showing by defendants to overcome a breach of fiduciary duty claim.

The court held that the entire fairness standard applied to its review of the de-SPAC transaction because the plaintiffs sufficiently alleged that the controlling stockholder of the SPAC had a conflict related to his stock holdings in the SPAC that gave him an incentive to complete the business combination. Because of the terms of the SPAC's sponsor equity, without a business combination the controlling shareholder's "at-risk" capital (consisting of Class B common stock and warrants held by insiders) would be worthless. Similarly, the SPAC directors' shares would have no value in the absence of a merger. In contrast, non-insider investors would only benefit from a de-SPAC transaction if the value from the de-SPAC transaction caused the value of their shares to exceed the IPO price (otherwise, such shareholders would be better off redeeming their common stock in exchange for a return of the IPO proceeds—a right of public shareholders in SPACs). Finally, the court noted that the SPAC's directors were not independent

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SPACS

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because they were appointed by the controlling shareholder and he had the unilateral power to remove them. Thus, the entire fairness standard applied.

Given the other breach of fiduciary duty cases against SPACs pending in Delaware state court—including one against the SPAC involved in the XL Fleets federal class action—the decision in MultiPlan is a significant development. The relationships between SPAC sponsors and board members are likely to draw attention from plaintiffs' attorneys, and the application of the entire fairness standard in such cases raises the bar for defendants in breach of fiduciary duty cases. Similarly, the disclosures provided to shareholders as part of the de-SPAC transaction process are potential sources of litigation risk as well.

Matterport

The Matterport litigation arises out of a "lock up" put in place as part of a de-SPAC transaction. A lock up is an agreement that prohibits company insiders from selling their shares during a defined period of time after the company goes public. In the SPAC context, a lock-up agreement typically restricts the transfer of SPAC shares by key individuals from the target company following a business combination.

The plaintiff in Matterport was the CEO of a privately-held company targeted by a SPAC for a business combination. In connection with the de-SPAC transaction, the plaintiff was entitled to exchange his shares in the target for shares in the combined company. The combined company adopted new bylaws that included a lock-up provision to restrict the transfer of its shares "outstanding immediately following the closing" of the de-SPAC transaction. The plaintiff sought a declaration that he was not subject to the lock-up in the combined company bylaws and could trade in its shares. The court held that the plaintiff was not subject to the lock-up provision because he did not hold any shares of the combined company "immediately" following closing of the de-SPAC transaction, only the right to receive shares. The transaction closed in July 2021, and the plaintiff did not send executed letters of transmittal to the transfer agent until November 2021—meaning he did not hold shares of the combined company "immediately following" the closing of the de-SPAC transaction.

The Matterport decision illustrates the importance of careful drafting during the de-SPAC transaction process. Otherwise, it may be possible to evade lock up provisions, thereby complicating the business combination and spawning litigation regarding interpretation of the contract language.

SEC Regulatory Action

The SEC recently proposed new rules to increase protections for investors during SPAC public offerings and de-SPAC transactions. The proposed rules make several significant revisions to the regulations. Of particular relevance to the topics discussed above is proposed Item 1603(b) and 1606 of Regulation S-K.

Proposed Item 1603(a) of Regulation S-K would require additional disclosures regarding a SPAC's sponsor, its affiliates, and any promoters of the SPAC. The disclosures would be required as part of registration statements and schedules filed for registered offerings and de-SPAC transactions. The form requires disclosure of the following information:

- The experience, roles, and responsibilities of the SPAC sponsor, its affiliations, and promoters of the SPAC.
- Any agreements, arrangements, or understandings between the sponsor and the SPAC, or between the sponsor and any executives, directors, and affiliates of the SPAC.
- Controlling persons of the sponsor and any persons who have direct or indirect material interests in the sponsor.
- An organizational chart that shows the relationship between the SPAC, the sponsor, and the sponsor's affiliates.
- Tabular disclosure of the material terms of any lock-up agreements with the sponsor and its affiliates.
- The type and amount of compensation (past, future, and present) for the sponsor, its affiliates, and any promoters.
- Nature and amount of any reimbursements to be paid to the sponsor, its affiliates, and any promoters following completion of a de-SPAC transaction.

The goal of Item 1603(a) is to provide information to current and prospective SPAC shareholders regarding potential conflicts of interest between the SPAC and its sponsor. The MultiPlan decision illustrates how these relationships can create litigation risk, but it remains to be seen whether the proposed SEC rule will minimize the risk of breach of fiduciary duty lawsuits in the future.

Conclusion

While SPAC IPOs have slowed considerably in 2022, litigation involving the hundreds of SPACs created in 2020 and 2021 has only just begun. We anticipate that the allegations in future suits will mimic those in the cases discussed above that survived motions to dismiss. We also anticipate active regulation and enforcement by the SEC once the proposed rules come into effect. Time will tell whether the current wave of private litigation and heightened regulation by the SEC will quell SPACs in the future.

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