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2020 DELAWARE CORPORATE LAW AND LITIGATION YEAR IN REVIEW

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Introduction

As in prior years, 2020 involved many significant Delaware law developments that will continue to shape business decisions for companies, boards, and investors in the year ahead. As the preeminent jurisdiction in the country for business disputes, the Delaware courts were extraordinarily busy, due in part to several disputes arising over pending mergers and acquisitions that unraveled in the midst of the pandemic. We do not expect the pace to slow in 2021, and some attention will be trained on the Delaware Court of Chancery given the recent announcement that Chancellor Andre Bouchard will be retiring effective April 30, 2021. This year-in-review publication highlights the recent Delaware law developments that will be of most interest to our clients, and we will continue to monitor developments in the year ahead.

Attorneys from Wilson Sonsini's Delaware office contributed to the content of the *2020 Delaware Corporate Law and Litigation Year in Review*.

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Board Compensation

In 2020, we continued to see increased stockholder litigation activity over board compensation, either in the form of private demand letters to boards of directors or through outright litigation in court. This activity is rooted in a series of recent Delaware cases, which provided that when boards of directors, whether or not majority independent, set their own compensation, that decision is inherently conflicted. As a result, should litigation arise, such compensation is likely to be subject to the more rigorous "entire fairness" standard of judicial review, unless stockholders approve the specific compensation at issue. Under the entire fairness standard, the court determines whether the directors breached their duty of loyalty and whether the compensation and the board's process were entirely fair.

In November 2020, the Court of Chancery refused to dismiss a stockholder claim challenging the compensation of outside directors of a life sciences company with a $2.5 billion market capitalization.[1] The amounts of compensation at issue were $978,251 per director in 2015, $251,064 in 2016, $713,915 in 2017, and $748,652 in 2018, involving a mix of cash and equity. In alleging that the compensation amounts were inappropriately high and unfair, the plaintiff contended that the court should consider not just the company's self-identified peer group, but also companies outside of the company's industry with a similar market capitalization. As of the time of this publication, the case is proceeding through discovery. This line of cases underscores the importance of carefully considering the size and form of board compensation, building a good board process around compensation, and considering a stockholder vote on compensation (although such votes remain atypical).

Board Oversight Obligations

Under Delaware law, and as part of a board's fiduciary duties of care and loyalty, a board of directors has an oversight obligation, pursuant to which the board must implement a system of controls to promote a company's compliance with its legal obligations and respond to any "red flags" that materialize suggesting that a failure in that system has occurred. Although fiduciary-duty-based oversight claims against a board have historically been very difficult for plaintiffs, stockholders have been successful in a series of recent cases involving fairly egregious facts in surviving a company's motion to dismiss such a claim.

The Court of Chancery decided one such case in January 2020.[2] In that case, the court refused to dismiss a claim against a natural gas company following a pipeline rupture that spilled billions of gallons of oil into the Pacific Ocean. According to the facts of the case, the company's CEO testified in subsequent criminal proceedings that no oversight of the company's pipeline integrity occurred at all at the board level. In light of those admissions, the court allowed the claim to go forward. Although the Delaware courts also dismissed a number of oversight claims in 2020, this decision and similar ones before it illustrate the importance of handling corporate crises carefully, constructing board processes, and building the board record in a manner that does not leave a board vulnerable to stockholder claims.

Board Conflicts of Interest Based on Relationships and Personal Interests

For years now, stockholder claims have regularly focused on whether directors have a conflict of interest based on relationships in the boardroom, personal interests, or affiliations—for example, with venture firms, another company, or some other interested party. For their part, Delaware courts have remained attentive to this issue on the basis that courts are unwilling to apply the deferential business judgment rule if half or more of the board has a conflict of interest, or if an officer or director of a corporation conceals a personal conflict of interest from the board when it makes a decision. The cases in 2020 were no exception.

When a Relationship-Based Conflict Exists

Whether a board member has a conflict of interest for Delaware law purposes is fact-specific and contextual, taking into account all circumstances based on the particular decision that a board, or a board committee, is making. The Delaware law inquiry has some similarities to, and can take into account, independence determinations under stock exchange rules, but is separate and distinct.

A 2020 decision[3] illustrates this approach. That decision involved a challenge to Dell's decision to collapse a publicly traded class of tracking stock and exchange it for common stock. Because of potential benefits to the company's controlling stockholders—Michael Dell and a private equity firm—the company established a two-person independent committee of the board of directors to negotiate the transaction. In subsequent litigation, the stockholder plaintiff successfully alleged at the motion-to-dismiss stage that both committee members were not independent of the controlling stockholders. The court focused on a number of factors, including a history of business dealings between one committee member and Dell; a close personal relationship between one of the committee members and Michael Dell individually; and potential signs of

a close friendship between one of the committee members and the managing partner of the private equity firm (specifically, their membership in the same highly exclusive golf clubs, their status as very significant donors to the same university, and their history of playing golf together).

Hidden Conflicts of Interest

A Delaware Supreme Court decision from 2020 illustrates another important type of conflict that can compromise a board's decision-making from a fiduciary duty standpoint: the existence of a conflict that a board member or member of management does not properly disclose to a board.[4] In the litigation over the merger of Towers Watson and Willis, a Towers Watson stockholder successfully alleged that Towers Watson's CEO did not fully disclose to the board that Willis made a proposal to the CEO about a large post-acquisition compensation package for running the combined company. Although the case arose in the deal context, the court's commentary could apply to a host of board decisions, with the court emphasizing that where a fiduciary does not disclose a material matter to the company's board, a board decision that would otherwise be subject to the business judgment rule can be reviewed under the difficult entire fairness standard of review.

Addressing Board Conflicts: The Use of Board Committees

Where several members of a board have a conflict of interest in a board decision, one way to cleanse such a conflict may be to form a board committee composed of independent and disinterested directors to make the decision. In that scenario, the proper use of a board committee can potentially restore the protection of the business judgment rule and prevent an inquiry into whether the board members breached their duty of loyalty. A case from 2020 provides an important lesson, however, that in order to achieve such a result, the board committee must be formed *before* any substantive economic negotiations occur.[5] In that case, the court determined that an independent committee had been formed too late, after pricing discussions about a transaction occurred and after the economic "field of play" had been established.

Addressing Board Conflicts: Director Abstentions

A common question for board members is whether a director who may have a conflict of interest in a particular decision can protect him- or herself by abstaining from the board decision or vote. Case law from 2020 provides pertinent discussion on the topic. In these cases, the Court of Chancery held open the possibility that if a conflicted director abstains from a board's decision-making process from the outset of the process and refrains from relevant discussions, the director may be protected against liability (and the board's process may similarly benefit).[6] In these cases, however, the court concluded that even if that possibility exists, the directors who had such a conflict continued to engage in discussions with fellow board members about the transaction at hand and influenced the board's process, such that there was no real abstention.

Disputes Among Board Members

When board members fall into dispute or have sensitive situations at the board level, not only is the situation difficult, but several questions can arise about how to handle the situation properly from a governance perspective. Two litigations from 2020 provide insight into two recurring issues in this context. The first litigation reiterated the Delaware law principle that where a director is on the "outs" with other directors, the other directors should remain careful not to "ambush" the disfavored director at a meeting—such as by failing to provide proper notice about the meeting to the director or inappropriately misleading that director about board meeting topics.[7] In our experience, these principles can often be properly navigated, but have to be considered so that board decisions at such time are not imperiled.

The second case is a valuable counterpoint to the first case and involved a negotiated separation of a CEO's employment following allegations of sexual harassment at the company and an inappropriate workplace culture. The case provides that it can be appropriate for board members to engage in informal and un-minuted offline conversations that do not include a particular board member where such conversations are handled with care, the excluded board member is dealt with forthrightly, and the board is still holding properly documented board meetings.[8]

Controlling Stockholder Conflicts of Interest

Issues relating to controlling stockholders remain a hotbed of litigation activity in Delaware. In such litigations, the courts have continued to explore several recurring issues that companies with large stockholders frequently navigate. One case exemplifies how courts determine whether a stockholder with less than a majority stake possesses control in the first place. There, the court determined that a 34.8 percent stockholder—a private equity firm—was a controlling stockholder based on a number of facts, including its number of board seats,

its economic relationships to various other board members, and a stockholder agreement that gave it significant governance rights.[9]

Companies and stockholders also continued to litigate the contours of the so-called "*MFW*" framework. Named after a seminal Delaware case, the *MFW* framework can be used to cleanse controlling stockholder conflicts that would otherwise trigger the entire fairness standard of review (that is, where a controlling stockholder engages in a transaction with the company or receives some special benefit compared to stockholders as a whole). This framework provides that parties can restore a transaction to the protection of the business judgment rule if they condition a controlling stockholder transaction up front, before substantive economic negotiations begin, on the approval of (1) an independent committee of the board that is empowered to say "no" to a transaction and (2) fully informed disinterested stockholders.

For example, in the *Dell* case, the court determined that the parties did not properly employ the *MFW* framework where the controlling stockholder-dominated board retained discretion to implement a transaction alternative and the independent committee of the board was not given veto power over such alternative.[10] In another litigation, the court was critical of an *MFW* process where the committee was potentially formed too late in the process, after certain discussions with the controller had occurred, a committee member leaked information to the controller, and the controller potentially influenced the selection of the committee's advisors improperly.[11]

Rights Offerings

When a company engages in a financing round, it is important to consider whether a potential board conflict of interest exists. This is especially common in the private company context, but can arise in the public company context as well. In particular, if half or more of the board is participating in the financing, is affiliated with funds participating in the financing, or is otherwise receiving some special benefit in the transaction, a conflict can exist and a stockholder could question whether the board could be in breach of its duty of loyalty. A similar concern exists if a large stockholder or group of stockholders potentially possesses control and is leading or participating in the financing. In the face of this dynamic, companies and investors frequently ask if a "rights offering"—offering all or many stockholders the right to participate in a financing round—can cleanse such a conflict.

In one case from 2020,[12] the Court of Chancery provided valuable insight into the court's views on rights offerings, echoing themes from a prior 2019 case.[13] In the 2020 case, a private equity firm held a majority of the company's stock and engaged in a financing round with the company at half of the company's valuation from six months prior. The parties conducted a rights offering. Although the court held open the possibility that a rights offering could be beneficial from a fiduciary duty standpoint in certain circumstances, it expressed concern over whether rights offerings favor "abusive" insiders and whether disinterested stockholders are truly able to participate. The court also expressed concern that the rights offering at issue was conducted too quickly over the winter holidays and that directors affiliated with the private equity firm had operated as a "shadow board," making decisions without including the founders who served on the board.

Self-Tender Offers

In an early 2020 case, the Court of Chancery refused to dismiss stockholder claims challenging a company's self-tender offer.[14] The facts of the case were fairly extreme, but the case nonetheless provides valuable insight into the types of factors the Delaware courts will consider should a company's self-tender offer become the subject of litigation, particularly relating to structuring, pricing, and disclosures. The court was critical of several facts in that case. According to the decision, the company had a history of engaging in stock repurchases and granting options at arbitrary prices (including at favorable prices for insiders), and the self-tender offer appeared similarly priced without care. The company's disclosures were inadequate, failing to disclose various details about the company's valuation, benefits to insiders in the transaction, and a potential sale of the company at a higher price, which ultimately came to fruition. More generally, the court expressed concern that a self-tender offer can raise fiduciary duty concerns where a company's insiders may be inclined to price the transaction too low, to the detriment of the company's stockholders.

The Treatment of Preferred Versus Common Stockholders

In transactions where preferred and common stockholders may be treated differently, sensitive governance concerns can arise under Delaware law, both as to structuring issues and fiduciary duty considerations. One 2020 case provides authority for the notion that, as a technical matter, a board of directors can choose to treat classes of stock, such as preferred and common stock, differently in a transaction.[15] In that case, the company sold for $850 million, and the board chose to give the preferred stockholders an amount equal to their liquidation preference,

even though the transaction did not technically trigger the preference. In related commentary, the court suggested, on an issue important for transaction planners, that a company could also choose, particularly in the merger context, to treat stockholders who hold the same class of stock differently *within* the class. At the same time, the court noted that the challenge before it was a validity challenge and that these types of allocation decisions can still be challenged on equitable and fiduciary duty grounds—particularly given Delaware case law, which provides that a board will be expected to prefer the interests of common stockholders over preferred stockholders in many circumstances.

Advance Notice Bylaws and Stockholder Activism

Reflecting the ongoing presence of stockholder activism, two Delaware litigations in 2020 tested the application of a company's advance notice bylaws in the face of stockholder nominations of directors. These cases underscore the importance of ensuring that advance notice bylaws are up to date and that companies carefully handle the procedures attendant to them.

In one case, the Delaware Supreme Court concluded that a stockholder's nominations of directors were invalid where the stockholder failed to supply additional information requested by the company and the company had a right under its bylaws to request additional information.[16] The court was not deterred that the information requested by the company—in the form of a 47-page questionnaire—was in large part irrelevant to the stockholder's nominations.

In another case, the Court of Chancery heard a dispute over whether a stockholder bringing nominations became a stockholder of record in time to bring the nominations—as bylaws generally require—and whether the company had misled stockholders about deadlines in its public disclosures.[17] In the end, the court sided with the company, upholding its rejection of the nominations by determining that the stockholder had not become a record stockholder in time to make the nominations and that the stockholder had not relied on the allegedly erroneous disclosures by the company.

Rights Plans and Delaware's Anti-Takeover Statute

Several cases in the Court of Chancery last year involved issues relating to poison pills and the Delaware anti-takeover statute (Section 203 of the Delaware General Corporation Law (DGCL)), in particular whether stockholder communications and actions tripped restrictions under such mechanisms. These claims were subject only to a low "colorability" standard, given the procedural posture of the cases, but the cases serve as reminders that such restrictions can be given a broad reading at the early stages of litigation, which can allow for discovery and deal delays.

In one case, the court found that a significant stockholder might have reached an "agreement, arrangement, or understanding" under Section 203 about how to vote on a potential transaction without first obtaining board approval—with the upshot that a supermajority stockholder voting standard could be triggered under Section 203. The parties disputed whether discussions about voting or entry into a voting agreement would suffice to create such a result, but the court noted that the complaint was subject only to a low pleading standard, and the stockholders were allowed to proceed with their claims on an expedited basis.[18] Likewise, in another case where a company sought to implement the *MFW* cleansing structure, pre-transaction communications among significant stockholders were found to have potentially violated Section 203—and because that alleged agreement, arrangement, or understanding had not been disclosed, the stockholder vote for purposes of *MFW* may not have been fully informed.[19]

In response to market volatility resulting from the COVID-19 pandemic, an unusual number of companies adopted poison pills in 2020. In two cases, the court considered the enforceability of key provisions of those plans, again on the low pleading standards of a motion to expedite.[20] In those cases, the court found the stockholder plaintiffs had brought colorable challenges to the pills, based on the low and disparate threshold percentage of stock ownership used for triggering the pills (5 percent and 10 percent, respectively, with more permissive treatment of passive stockholders acting under Rule 13(g) of the securities laws) and "acting in concert" provisions that were found to be potentially preclusive of meaningful stockholder communication.

Preferred Stock Redemption Rights

In 2017, the Court of Chancery issued a much-discussed opinion refusing to dismiss a challenge to a board's decision to honor the redemption rights of preferred stock held by a private equity fund. In 2020, the court issued an opinion following a trial in the case.[21] In the prior decision, the court determined that a common stockholder had adequately pled claims alleging that the fund was a controlling stockholder, that the board was conflicted, and that the board wrongly sold off assets and

redeemed the preferred stock to the detriment of common stockholders and potentially in violation of Delaware law requirements that a company remain solvent following the redemption of stock, including that a company can continue to operate as a going concern. In 2020, following trial, the court determined that the plaintiffs were not entitled to damages and that the board's actions had been entirely fair, because the sale of assets did not harm the company and the company's fortunes declined for separate business reasons. The litigation provides important lessons for companies and investors in assessing the strength and nature of redemption rights under Delaware law.

Technical Defects and Validity

As in prior years, the Delaware courts issued noteworthy guidance in 2020 regarding the importance of following technicalities in undertaking foundational corporate action, such as issuing stock or amending the corporate charter. In one case involving a public company, the court determined that the company invalidly issued stock for a variety of reasons. The board lacked a quorum, but nonetheless attempted to act by written consent in lieu of a meeting without a quorum. The company's sole remaining director as a member of the compensation committee purported to approve an equity issuance pursuant to the company's equity plan, which required the committee to have at least two members. The purported stock issuances also violated the limits in the company's relevant equity plan and transcended the number of shares available for issuance under the company's charter.[22] In another case, the court allowed a claim to go forward where a public company miscounted broker non-votes in a stockholder vote on amending the company's charter.[23] The court was also critical of the company in that case for failing to take seriously a private demand letter from a stockholder relating to the problem.

Public Benefit Corporations

Consistent with the increasing focus on corporate purpose, public benefit corporations became a more prominent part of the Delaware law landscape in 2020. Unlike the traditional stock corporation form—under which, pursuant to Delaware law, a board's decisions must ultimately relate to advancing stockholder value—the public benefit corporation (PBC) form requires that a board balance stockholder pecuniary interests, a public benefit specified in a corporate charter, and the best interests of those materially affected by the company's conduct.

From a practice standpoint, several noteworthy developments occurred in 2020, with one high-profile company going public as a PBC, a large public company choosing to convert to a PBC, and hundreds of other private companies incorporating in Delaware as PBCs. From a legal standpoint, the Delaware General Corporation Law was amended in 2020 to, among other things, lower the hurdles for an existing corporation to become a PBC—particularly by providing that, subject to any greater or additional vote required under the company's charter, the conversion of an existing corporation to a PBC will only require a majority vote of stockholders (rather than the heightened vote requirements of the past) and that in no event will such a conversion trigger a right of stockholders to seek appraisal of the fair value of their shares.

LLCs and Partnerships

With contractual flexibility as the cornerstone of alternative entity law, a significant focus of many cases in the alternative entity context is on contractual governance choices and interpreting governing documents. In 2020, there were notable Court of Chancery decisions dealing with fiduciary duties, buyout rights, manager removal, and advancement rights.

Modification of Fiduciary Duties

In litigation challenging a private company acquisition and a preferred unit offering on fairly egregious facts, a waiver of conflicts of interest of the managers of the company and replacement of traditional fiduciary duties with only a contractual duty to act in good faith had a significant impact on which claims the Court of Chancery allowed to go forward.[24] Although certain claims relating to false statements and withholding information survived the motion to dismiss, the court dismissed a breach of contract claim relating to the preferred unit offering in which only members of management and other insiders participated. Regardless of any self-dealing that may have occurred, the court concluded that entire fairness and its accompanying burden shift did not apply because the LLC agreement waived conflicts of interest of the managers, and management participation did not support a claim of bad faith because such participation was explicitly permitted by the LLC agreement. Aiding and abetting claims against a management company were also dismissed because fiduciary duties were eliminated.

Another noteworthy decision[25] from the Court of Chancery highlighted the requirement that any contractual elimination of fiduciary duties in an LLC agreement must be clear and unambiguous, and that, in certain circumstances, blocking rights of minority members may constitute "actual control" resulting in the imposition of fiduciary duties.

The majority members of the company alleged that the minority members orchestrated a scheme to use their contractual blocking rights in the LLC agreement to drive the company's subsidiary into bankruptcy so the minority members could acquire the subsidiary's valuable assets at a steep discount in the bankruptcy sale. The LLC agreement unambiguously imposed contractual duties on the managers analogous to those owed by directors of a Delaware corporation, except with respect to corporate opportunities. The court concluded that the corporate opportunity waiver was not enough to shield the minority members' manager-designee from a breach of the duty of loyalty claim in this case. He had sent an email stating that he was going to "sit back" while the company collapsed so the other defendants to which he was beholden could buy the operating subsidiary's assets "out of bankruptcy very cheap," which indicated behavior beyond the protection of the corporate opportunity waiver. The court reasoned that provisions in the LLC agreement providing that members did not have a fiduciary obligation to make other investment opportunities available to the company and that members could exercise their voting rights in their sole and absolute discretion modified but did not totally eliminate members' fiduciary duties, because any such elimination must be clear and unambiguous, rather than by implication.

Finally, although blocking rights, by themselves, are not sufficient to establish an inference of "actual control," the court concluded that when the blocking rights empower a minority investor to channel the company into a particular outcome, they contribute to an inference of control. In that case, the minority allegedly exercised their blocking rights to prevent the company from financing any of its operations, unilaterally shutting down the company as part of a plan to harm the company and advance their own interests.

USACafes Fiduciary Liability

The flexibility in governance structures in the alternative entity context led to the *USACafes*[26] line of cases, which has held that the persons who ultimately control a corporate general partner of a limited partnership, or a manager or managing member of an LLC, owe fiduciary duties to the limited partnership or LLC. In 2020, the Court of Chancery provided additional data points on when fiduciary duties might apply under these principles.

In an action challenging various transactions by the controllers of a series of funds that invested in mortgage loans to shift debt obligations from earlier raised funds to later raised funds, the court found that an individual who was the president, former chief operating officer, and member of the investment committee of the entity that caused the funds to engage in the relevant transaction and benefited financially from the transaction, and who participated in investment decisions and personally executed transaction documents at issue, exercised sufficient control to justify the imposition of fiduciary duties on him.[27] In contrast, other senior officers of the same entity, but for whom there were no specific allegations of actual control over the funds' assets, did not owe fiduciary duties.

In another 2020 case, the court held that the sole member and controller of an LLC that served as the general partner of a couple of limited partnerships owed fiduciary duties to the partnerships.[28] The partnerships owned income-produced companies and attracted investors with the promise of monthly distributions providing an 8 percent annual rate of return. The general partner's controller and others allegedly siphoned funds from the partnerships for themselves through various financial schemes and hid the financial impacts on the partnerships by using funds in the limited partners' individual capital accounts to fund the monthly distributions to the limited partners. In addition to the general partner itself, the court held that it was reasonably conceivable that the sole member of the general partner (as its undisputed controller) also owed fiduciary duties to the partnerships because he exercised control over the funds of the partnerships.

Buyout Rights

2020 brought several interesting decisions relating to the exercise of contractual buyout rights. The Court of Chancery considered whether a company buyout right of a co-founder and manager's entire 12 percent interest in an LLC for nominal consideration upon the occurrence of certain events, received in exchange for a 0.1 percent incentive interest in the company, was enforceable.[29] The court held that the parties' agreement was supported by consideration and declined to question the sufficiency of the consideration. Noting the sophisticated nature of the parties and concluding that the contractual language was unambiguous, the court did not allow the plaintiff to escape enforcement of the terms he agreed to when those terms became disadvantageous in retrospect. In another 2020 case, the Court of Chancery determined that a buyout provision in an LLC agreement triggered by cessation of a member's employment with the LLC was a call option.[30] The court rejected the company's argument that it could withdraw from the price-fixing process set forth in the LLC agreement for the departing member's units, holding that the buyout provision was a call option that could not be withdrawn once exercised and that the company's notice that it was purchasing the units constituted acceptance.

The Court of Chancery allowed various claims to go forward related to an

alleged scheme by a large unitholder of a master limited partnership to manipulate the trading price of the partnership's units before exercising a call right, even though the partnership agreement eliminated all fiduciary duties of the defendants.[31] The scheme was based on a similar "playbook" followed by the general partner of an unrelated fund to create speculation about the exercise of a call right that was subject to a trailing-market-based exercise price to cause the price to drop before exercising the right, which was the subject of another case before the Court of Chancery in 2019.[32] In that case, the court declined to dismiss claims for breach of the partnership agreement and breach of the implied covenant of good faith and fair dealing.

In the case decided by the court in 2020, the unitholder first engaged in a partial exchange offer in order to acquire a large enough interest in the partnership to trigger a similar call right, which caused speculation about the call right and a drop in the unit price, and then exercised the call right to buy out the minority unitholders at a substantially lower price. Although the partnership agreement eliminated fiduciary duties, the court found that the publicly disclosed non-recommendation by the board of the general partner's parent was a sufficient basis for a claim that the general partner breached a contractual duty to act in good faith, concluding it was reasonably conceivable that the board believed that a partial exchange offer was adverse to the interests of the public unitholders with no offsetting benefits and therefore adverse to the partnership as a whole.

The court also allowed an implied covenant claim to go forward—a claim that is rarely successful—on the basis that the call right implied a requirement so obvious that it need not be expressly stated that the defendants should not act to undermine the protections afforded to the unitholders by the price-protection mechanisms in the partnership agreement. This is consistent with the relatively few cases in which an implied covenant claim has been successful on the basis that a party did not violate an express contractual term, but acted in a way to undermine express rights or protections in the contract.

Board of Manager Mechanics

Another 2020 decision of the Court of Chancery highlights the need to fully address board mechanics when providing for board management in an LLC agreement. The decision related to the removal of a manager of an LLC in the context of a board deadlock.[33] The court determined that neither of two equal joint venture members could unilaterally remove the sitting tiebreaker manager when the LLC agreement addressed appointment of the initial board and filling vacancies, but was silent on the removal of managers. The court reasoned that reading in a unilateral removal right would rewrite the LLC agreement, undermine the parties' chosen governance structure by causing the tiebreaker manager to be beholden to one side, and expose the company to the deadlock its LLC agreement attempted to avoid. Although a unilateral removal right would have undermined the purpose of the tiebreaker manager in that case, the court's resistance to imply a removal right where one is not expressly provided for underscores the need to thoroughly consider all board mechanics when negotiating and drafting agreements in the LLC context, where the statute provides few rules as compared to the DGCL.

Advancement Rights

The Court of Chancery considered whether a broad indemnification and advancement provision in an LLC agreement required the company to advance attorneys' fees and expenses based on claims brought by the plaintiffs against the company.[34] The court rejected the company's argument that it did not have to provide advancement because the LLC agreement did not contain express coverage of such claims, which relied on a line of commercial contract cases under which such claims are only indemnifiable if that intent is expressly stated in the contract. While the court acknowledged that LLC agreements are contracts typically subject to the same interpretive principles as commercial contracts, it concluded that the plaintiffs were entitled to advancement because, unlike most commercial contracts, advancement provisions in LLC agreements are derived from broad statutory authority that does not distinguish between first-party and third-party claims, and such provisions serve the broader public policy of encouraging individuals to serve in management roles.

Stockholder Inspection of Books and Records

Delaware decisions in 2020 continued to encourage the use of books and records demands as tools for stockholders to investigate potential corporate wrongdoing. At the same time, the decisions emphasized the need for stockholders' technical compliance with the Delaware books and records statute (Section 220 of the DGCL)[35] and clarified that only Section 220—and not other jurisdictions' books and records statutes—governs the inspection rights of stockholders of Delaware corporations.[36]

In two of the year's most notable books and records decisions, the Delaware Supreme Court and the Court of Chancery issued strong warnings that they will not credit merits-based defenses to books and records demands where a stockholder has asserted a credible basis to infer mismanagement or other wrongdoing. Most recently, the Delaware Supreme Court reaffirmed the "credible basis" standard and added that "the interjection of merits-based defenses—defenses that turn on the quality of the wrongdoing to be investigated—interferes with" the summary and expeditious purpose of books and records actions.[37] The Delaware Supreme Court's statement came on the heels of a Court of Chancery decision inviting stockholder plaintiffs to seek fee-shifting where the defendant corporation used an "overly aggressive defense strategy" in response to inspection demands and "place[d] obstacles in the plaintiffs' way to obstruct them from employing [their inspection rights] as a quick and easy pre-filing discovery tool."[38] The Court of Chancery's use of stark language decrying the "trend" by which "defendants are increasingly treating Section 220 actions as surrogate proceeding[s] to litigate the possible merits of the suit"[39]—followed by the Delaware Supreme Court's reaffirmation of the credible basis standard and disapproval of merits-based defenses—signals that companies responding to mismanagement-based books and records demands should think twice before rejecting those demands based on the "quality of the [alleged] wrongdoing to be investigated."[40]

In the wake of these decisions, companies should be careful about denying inspection demands made for the purpose of exploring potential wrongdoing by taking the position that the potential wrongdoing is not actionable, whether because it might be subject to a statute of limitations defense, an exculpatory charter provision, or otherwise. Companies also should be careful about denying inspection demands on the basis that the stockholder has not specifically identified the course of action it intends to take if the inspection confirms the stockholders' suspicion of wrongdoing. Rather, the Delaware Supreme Court made clear that, while the actionability of the potential claims the stockholder seeks to investigate is a factor the court can consider, exploring corporate wrongdoing typically is "in and of itself 'a legitimate matter of concern'" for a stockholder demanding inspection and not a basis for denial.[41] Finally, companies are cautioned to be forthright with stockholders regarding the types of documents that exist that could be responsive to the stockholder's request, as well as the sources and custodians of those documents. Companies that are perceived as being evasive to these kinds of requests could open themselves up to additional discovery on those topics in the event the stockholder files a lawsuit to enforce its inspection rights.

M&A Litigation

Busted Deal Litigation in the Era of COVID-19

Mergers and acquisitions were not immune from the pervasive effects of the COVID-19 pandemic. After the pandemic negatively impacted target companies in the midst of pending deals, several buyers asserted that a material adverse effect (MAE) or breach of operating covenants occurred under transaction agreements, giving the buyers a contractual basis to terminate the contract. A wave of busted deal lawsuits followed in the Court of Chancery, which was confronted with the question of whether COVID-19 could give rise to an MAE. Most lawsuits involved acquirers seeking declaratory relief that they were not required to close a transaction or targets suing for specific performance. In many instances, these lawsuits were highly expedited.

Several of these disputes implicated a novel question: What types of exclusions from an MAE might cover the pandemic? A typical MAE clause allocates market risk to the buyer and business-specific risks to the seller, with some MAE clauses specifically carving out pandemics from the definition of an MAE.[42] In the only COVID-19 MAE case to make it to trial in 2020, the Court of Chancery found that the pandemic had not caused an MAE under the purchase agreement because it contained an exception for "natural disasters and calamities."[43] The court was confronted in that same case with another issue frequently raised in these lawsuits: whether a target's efforts to respond to the effects of COVID-19 breached its "ordinary course" operating covenants in the transaction agreement. In finding that the buyer was entitled to walk away from the deal, the court found that the target's actions in response to COVID-19—including layoffs and shuttering locations—were not "consistent with past practice," as the contract required. The court also considered whether a separate covenant in the agreement by the seller to comply with "applicable law" (such as shelter-in-place orders) weighed in favor of a finding that the target operated in the ordinary course, but concluded that the dramatic changes in its business occurred before those orders were issued.

Claims regarding a possible MAE or breach of interim operating covenants are highly dependent on the relevant contractual language and facts. Given the lingering effects of the pandemic, companies involved in M&A should take care in drafting language about MAE carveouts and risk allocation, as well as in defining ordinary course obligations and whether an "efforts" qualifier is appropriate. These litigations also may offer drafting lessons for deals beyond the pandemic. With additional busted deal suits set for trial, further guidance on these issues may come in 2021.

Other Notable Developments in Deal Litigation

In the ongoing litigation involving the sale of The Fresh Market grocery chain to Apollo, the Court of Chancery rejected the stockholder plaintiff's effort to hold the board's deal counsel liable for alleged disclosure violations in the company's public disclosures for the deal.[44] In 2018, the Delaware Supreme Court found that the plaintiff had sufficiently alleged material omissions in those disclosures. The Court of Chancery then dismissed claims related to the disclosures against the company's former independent directors because the plaintiffs could not allege "bad faith" conduct—that the directors intentionally omitted material information—but allowed those claims to go forward against certain of the company's former officers. In its 2020 decision, the court dismissed claims that the board's deal counsel crafted the disclosures in a way that would "evade potential objections from stockholders" because it wanted to collect its fee that was payable only if the transaction closed. The court fairly straightforwardly concluded that deal counsel lacked the requisite scienter—"knowing participation" in any fiduciary duty breaches—and noted that such a fee structure is common among deal counsel and should not be the basis for an aiding and abetting claim.

The Delaware Supreme Court also weighed in on the scope of director and officer liability insurance for a common type of deal suit, statutory appraisal claims.[45] Last year, in a heavily watched litigation, the Delaware Superior Court held that an appraisal claim asserted a "violation" of law within the definition of a covered "securities claim" under the particular policy at issue. Although coverage disputes often turn on the specific language of the policy, many practitioners and market participants were surprised by the decision because appraisal claims are generally thought of as falling outside of the typical D&O policy language that covers losses for claims asserting some form of wrongdoing. In reversing, the Delaware Supreme Court was "compelled by the plain meaning of the word 'violation,' which involves some element of wrongdoing, even if done with an innocent state of mind," and reiterated that Delaware has long recognized that the statutory appraisal remedy does not involve a determination of wrongdoing. Rather, the court said, appraisal proceedings are "neutral in nature" and although courts may consider evidence relating to the deal process, that evidence only goes to what, if any, weight is to be accorded to the deal price. It remains important to consider the specific language of the policy in each instance, but this case will surely lend support to D&O insurers' efforts to limit coverage for such claims.

Intersection of Delaware Law and Other Jurisdictions

This past year, Delaware courts were also asked to address several novel issues that tested the reach of Delaware law. Most notably, the Delaware Supreme Court issued a landmark decision in *Salzberg v. Sciabacucchi* validating forum-selection provisions contained in a corporation's charter to require that securities claims under the Securities Act of 1933—i.e., Section 11 claims challenging a company's registration statement in connection with an IPO—be brought in federal court.[46] This is an important win for pre-IPO companies in that it gives them a significant tool to address the rise of Section 11 claims brought in state court, which often lead to inconsistent and less favorable rulings.

The Court of Chancery previously held that so-called "federal forum provisions" were invalid by construing Section 102 of the DGCL—the provision that broadly permits corporations to adopt charter provisions for the "management of the business and for the conduct of the affairs of the corporation" and to regulate the powers of the corporation, its directors, and its stockholders—as not permitting a provision that regulates litigation arising under federal law.[47] The Delaware Supreme Court disagreed in a broad-ranging opinion that stressed the expansive and enabling nature of Section 102 and the importance that Delaware places on private ordering and permitting corporations to adapt to new situations—like the rise of state court Section 11 litigation.[48] The court concluded that regulation of "intra-corporate litigation" among the corporation's constituents that may arise under federal or other positive law fits squarely within the broad language of Section 102, which is not limited by notions of the "internal affairs" doctrine to regulating internal litigation arising under Delaware state law. Thus, this case will also likely have broader import with respect to other ways in which corporations can innovate.

In addition, although the opinion was limited to the validity of the provisions under Delaware law, the Delaware Supreme Court made a strong case for why the provisions should be upheld by other states when companies go to enforce the provisions to dismiss state court cases. And, in fact, early returns from the second half of 2020 following the decision have borne this out, as a number of courts—including three separate California courts in cases involving Dropbox, Uber, and Restoration Robotics—have enforced the provisions to dismiss Section 11 claims.[49]

In another high-profile decision, the Court of Chancery addressed whether a stockholder *of a Delaware corporation* could seek books and records under the California inspection statute, Section 1601 of the California Corporations Code.[50] Section 1601—like several other sections of the California code—

purports to apply not only to California-chartered companies, but also to foreign companies with a presence in California. Almost two decades ago, the Delaware Supreme Court rejected the application of Section 2115 of the California Corporations Code—often referred to as the "Quasi-California Corporation" statute—that provides for, among other things, cumulative voting for stockholders, as violative of the "internal affairs" doctrine.[51] Consistent with that authority, the court emphasized the importance of having one state regulate a corporation's internal affairs and ensuring consistent expectations among directors, officers, and stockholders across jurisdictions. In this regard, the court observed that the California statute differed from Section 220 of the DGCL, including by granting a broader right of stockholders to inspect stockholder lists and books and records of subsidiaries, and expressly providing for fee-shifting in certain instances. The court identified the right to inspect corporate books and records as an "important part of the governance landscape" and, because the right to inspect corporate books and records is a "core" matter of internal corporate affairs, concluded that Delaware law, rather than California law, applied to the inspection rights of a stockholder of a Delaware corporation.[52]

About Wilson Sonsini's Corporate Governance Practice

Wilson Sonsini's corporate governance attorneys advise the management teams, directors, and special board or management committees of some of the largest companies in the world. We provide trusted legal counsel to help clients resolve their most pressing challenges, address sensitive matters, and pursue their most important strategic opportunities. Additionally, we advise clients on ongoing governance matters that are vital to their businesses, counseling them on the implementation of board best practices, director fiduciary duties, and compliance with state and federal laws. We also conduct investigations on behalf of management, boards of directors, and special board or management committees, and we represent companies in contested matters, including stockholder litigation demands and stockholder actions.

Our corporate governance team applies a multidisciplinary, holistic approach that enables us to offer comprehensive and coordinated legal counsel across all areas related to complex public company matters. Members of the team are regularly called upon to help shape new laws and regulations, with our attorneys serving as advisors to major regulatory bodies in the areas of governance and disclosure.

Our attorneys include expert professionals in offices throughout the world, including in Delaware, California, New York, Washington, Brussels, London, and China. The firm's office in Wilmington, Delaware, is led by six partners and includes more than 25 attorneys who focus their practice on corporate governance and Delaware law and litigation matters. Bill Chandler, who founded the Delaware office, is widely regarded as one of the world's most influential and well-respected jurists on corporate law and governance matters. Also resident in the Wilmington office is former Delaware Supreme Court Justice Randy J. Holland, who joined the firm following his retirement from the court after more than 30 years of service.

For more information on the preceding publication or any corporate-governance-related matter, please contact your regular Wilson Sonsini attorney or any member of the firm's corporate governance practice or Delaware office.

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Endnotes

1 *Alvarado v. Lynch*, No. 2020-0237-AGB (Del. Ch. Nov. 12, 2020) (TRANSCRIPT).

2 *Inter-Mktg. Grp. USA, Inc. v. Armstrong*, 2020 WL 756965 (Del. Ch. Jan. 31, 2020).

3 *In re Dell Techs. Inc. Class V S'holders Litig.*, 2020 WL 3096748 (Del. Ch. June 11, 2020).

4 *City of Fort Myers Gen. Emps.' Pension Fund v. Haley*, 235 A.3d 702 (Del. 2020) (en banc).

5 *Salladay v. Lev*, 2020 WL 954032 (Del. Ch. Feb. 27, 2020).

6 *Voigt v. Metcalf*, 2020 WL 614999 (Del. Ch. Feb. 10, 2020); *Ross v. Lineage Cell Therapeutics, Inc.*, C.A. No. 2019-0822-AGB (Del. Ch. Sept. 21, 2020) (TRANSCRIPT).

7 *Palisades Growth Capital II, L.P. v. Bäcker*, 2020 WL 1503218 (Del. Ch. Mar. 26, 2020), *aff'd*, 2021 WL 140921 (Del. Jan. 15, 2021).

8 *Shabbouei v. Potdevin*, 2020 WL 1609177 (Del. Ch. Apr. 2, 2020).

9 *Voigt*, 2020 WL 614999.

10 *Dell*, 2020 WL 3096748.

11 *Brown v. Empire Resorts, Inc.*, 2019-0908-KSJM (Del. Ch. Feb. 20, 2020) (TRANSCRIPT).

12 *Perry v. Sheth*, C.A. No. 2020-0024-JTL (Del. Ch. Jan. 16, 2020) (TRANSCRIPT).

13 *Strategic Value Opportunities Fund, LP v. Permian Tank & Mfg., Inc.*, C.A. No. 2018-0932-AGB (Del. Ch. Nov. 22, 2019) (TRANSCRIPT).

14 *Davidow v. LRN Corp.*, 2020 WL 898097, at *3 (Del. Ch. Feb. 25, 2020).

15 *In Re Trustwave Hldgs., Inc. S'holder Litig.*, Cons. C.A. No. 2017-0576-JTL (Del. Ch. Apr. 8, 2020) (TRANSCRIPT).

16 *Blackrock Credit Allocation Income Tr. v. Saba Capital Master Fund, Ltd.*, 224 A.3d 964 (Del. 2020), *reh'g denied* (Jan. 29, 2020).

17 *Bay Capital Fin., LLC v. Barnes & Noble Educ., Inc.*, 2020 WL 1527784 (Del. Ch. Mar. 30, 2020).

18 *Hawkes v. Bettino*, C.A. No. 2020-0360-PAF (Del. Ch. May 15, 2020) (TRANSCRIPT).

19 *Hollywood Firefighters' Pension Fund v. GCI Liberty, Inc.*, C.A. No. 2020-0880-SG (Del. Ch. Oct. 27, 2020) (TRANSCRIPT).

20 *Vladimir Gusinsky Revocable Tr. v. Anderson*, C.A. No. 2020-0714-KSJM (Del. Ch. Sept. 10, 2020) (TRANSCRIPT); *Wolosky v. Armstrong*, C.A. No. 2020-0707-KSJM (Del. Ch. Sept. 8, 2020) (TRANSCRIPT).

21 *The Frederick Hsu Living Tr. v. Oak Hill Capital P'rs III, L.P.*, 2020 WL 2111476 (Del. Ch. May 4, 2020).

22 *Applied Energetics, Inc. v. Farley*, 239 A.3d 409 (Del. Ch. 2020).

23 *Drachman v. BioDelivery Scis. Int'l Inc.*, 2019-0728-AGB (Del. Ch. Apr. 14, 2020) (TRANSCRIPT).

24 *MKE Hldgs. Ltd. v. Schwartz*, 2020 WL 467937 (Del. Ch. Jan. 29, 2020), *order enforced* (Del. Ch. Feb. 17, 2020).

25 *Skye Mineral Inv'rs, LLC v. DXS Capital (U.S.) Ltd.*, 2020 WL 881544 (Del. Ch. Feb. 24, 2020).

26 *In re USACafes, L.P. Litig.*, 600 A.2d 43 (Del. Ch. 1991), *appeal refused*, 602 A.2d 1082 (Del. 1991).

27 *Fannin v. UMTH Land Dev., L.P.*, 2020 WL 4384230 (Del. Ch. July 31, 2020), *cert. denied*, 2020 WL 5198356 (Del. Ch. Aug. 28, 2020), *appeal refused*, 238 A.3d 193 (Del. 2020).

28 *Lipman v. GPB Capital Hldgs. LLC*, 2020 WL 6778781 (Del. Ch. Nov. 18, 2020).

29 *Moscowitz v. Theory Entm't LLC*, 2020 WL 6304899 (Del. Ch. Oct. 28, 2020).

30 *Walsh v. White House Prods., LLC*, 2020 WL 1492543 (Del. Ch. March 25, 2020).

31 *In re CVR Ref., LP Unitholder Litig.*, 2020 WL 506680 (Del. Ch. Jan. 31, 2020).

32 *Bandera Master Fund LP v. Boardwalk Pipeline P'rs, LP*, 2019 WL 4927053 (Del. Ch. Oct. 7, 2019).

33 *Franco v. Avalon Freight Servs. LLC*, 2020 WL 7230804 (Del. Ch. Dec. 8, 2020).

34 *Int'l Rail P'rs LLC v. Am. Rail P'rs, LLC*, 2020 WL 6882105 (Del. Ch. Nov. 24, 2020), *cert. denied*, 2020 WL 7698580 (Del. Ch. Dec. 23, 2020), *appeal refused*, 2021 WL 225823 (Del. Jan. 21, 2021).

35 *Martinez v. GPB Capital Hldgs., LLC*, 2020 WL 3054001 (Del. Ch. June 9, 2020) (dismissing statutory claim for inspection under Section 17-305(e) of the Delaware Revised Uniform Limited Partnership Act for failure to include power of attorney with demand); *POSCO Energy Co. v. FuelCell Energy, Inc.*, 2020 WL 6194693 (Del. Ch. Oct. 22, 2020) (suggesting failure to properly indicate whether stockholder is record or beneficial owner can be grounds for dismissal of books and records action); *MaD Inv'rs GRMD, LLC v. GR Cos., Inc.*, 2020 WL 6306028 (Del. Ch. Oct. 28, 2020) (holding stockholder must wait until after 11:59 p.m. on the fifth business day after delivery of a books and records demand on a company before filing a lawsuit for books and records).

36 *JUUL Labs, Inc. v. Grove*, 238 A.3d 904 (Del. Ch. 2020); *see infra* Intersection of Delaware Law and Other Jurisdictions.

Endnotes (cont.)

37 *AmerisourceBergen Corp. v. Lebanon Cty. Emps.' Ret. Fund*, --- A.3d ----, 2020 WL 7266362 (Del. Dec. 10, 2020).

38 *Pettry v. Gilead Sciences, Inc.*, 2020 WL 6870461 (Del. Ch. Nov. 24, 2020); *see also Police & Fire Ret. Sys. of the City of Detroit v. WalMart, Inc.*, C.A. No. 2020-0478-JTL (Del. Ch. Oct. 5, 2020) (TRANSCRIPT).

39 *Pettry*, 2020 WL 6870461, at *2 (internal quotations and citation omitted).

40 *AmerisourceBergen*, 2020 WL 7266362, at *13.

41 *Id.*, at *6.

42 *See generally Verified Complaint*, *Forescout Techs., Inc. v. Ferrari Grp. Hldgs., L.P.*, C.A. No. 2020-0385-SG (Del. Ch. May 19, 2020), 2020 WL 2616144 (concerning an MAE provision with a specific carveout for pandemics).

43 *AB Stable VIII LLC v. MAPS Hotels and Resorts One LLC*, 2020 WL 7024929 (Del. Ch. Nov. 30, 2020).

44 *Morrison v. Berry*, 2020 WL 2843514 (Del. Ch. June 1, 2020).

45 *In re Solera Ins. Coverage Appeals*, 240 A.3d 1121 (Del. 2020) (en banc).

46 227 A.3d 102 (Del. 2020).

47 *Sciabacucchi v. Salzberg*, 2018 WL 6719718 (Del. Ch. Dec. 19, 2018), *rev'd*, 227 A.3d 102 (Del. 2020).

48 *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. 2020).

49 *In re Dropbox, Inc. Sec. Litig.*, No. 19-CIV-05089 (Cal. Super. Ct. Dec. 4, 2020); *In re Uber Techs. Inc. Sec. Litig.*, No. CGC-19-579544 (Cal. Super. Ct. Nov. 16, 2020); *Wong v. Restoration Robotics, Inc.*, No. 18CIV02609 (Cal. Sup. Ct. Sept. 1, 2020).

50 *JUUL*, 238 A.3d 904.

51 *VantagePoint Venture P'rs 1996 v. Examen, Inc.*, 871 A.2d 1108 (Del. 2005).

52 *JUUL*, 238 A.3d at 915.

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