Del. Dispatch: The 2024 Corporate Cases You Need To Know

By **Gail Weinstein, Philip Richter and Steven Epstein** (December 18, 2024)

This article is part of a monthly column that delves into the most significant corporate law cases emerging from Delaware and offers practice points arising from recent court decisions. In this installment, we examine the most important and controversial Delaware court decisions and legislation from 2024.



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2024 has been a watershed year for Delaware corporate law. The Delaware Court of Chancery issued several decisions that some market participants viewed as upending long-standing corporate practices. The decisions led to the amendment of the Delaware General Corporation Law, and even have stimulated debate at some Delaware corporations about potentially reincorporating to another state.

More broadly, the Delaware decisions this year have indicated a generally more technical approach to judicial interpretation of the DGCL, continued increased judicial skepticism of corporate controllers and somewhat less deference to board decisions than in the past.

Enactment of DGCL Amendments

In a trio of seminal decisions — West Palm Beach Firefighters' Pension v. Moelis & Co. (Feb. 23); Sjunde AP-Fonden v. Activision Blizzard (Feb. 29); and Crispo v. Musk (Oct. 31, 2023) — the Court of Chancery appeared to apply a stricter interpretation of, and required stricter adherence to, technical requirements of the DGCL than in the past.

In response, the Delaware Legislature enacted amendments to the DGCL to better align the statute with market practice in certain areas. The amendments became effective, prospectively and generally retroactively, as of Aug. 1.

Notably, however, the court has issued decisions that raise doubts as to whether the amendments adopted in response to Moelis will be effective for their stated purpose of broadly permitting the granting of governance rights in corporate agreements, as discussed below.

Discussion of Reincorporating From Delaware

Moelis, Activision, Crispo and certain other Court of Chancery decisions — such as Tornetta v. Musk (Jan. 30 and Dec. 2) — have stimulated discussion at some Delaware corporations about potentially reincorporating to another state, where the courts may apply lower standards of fiduciary duties for directors and controllers, as well as lower annual franchise taxes and fees. Our research indicates, however, that, since 2021, only eight Delaware corporations, all of them controlled companies, have reincorporated — six to Nevada and two to Texas.

Importantly, in Palkon v. Maffei, the Court of Chancery held on Feb. 20 that TripAdvisor's reincorporation to a state with lower fiduciary standards is subject to entire fairness review, because the stockholders' litigation rights are diminished through such a reincorporation while the directors and any controller obtain the material nonratable benefit of decreased potential personal liability for fiduciary breaches. The court suggested that to satisfy entire fairness, some kind of compensation must be provided to the stockholders.

The appeal of TripAdvisor is pending in the Delaware Supreme Court, and, if the decision is upheld, it may be unlikely that there would be continued interest in reincorporation, particularly among noncontrolled companies.

Governance Rights in Stockholder Agreements — Moelis

In Moelis, the Court of Chancery held that extensive governance rights granted in a stockholder agreement, rather than in the corporate charter, were facially invalid as they violated Section 141(a) of the DGCL, which mandates that Delaware corporations be managed by the board unless otherwise provided in the charter.

In response, the Delaware Legislature enacted new Section 122(18) of the DGCL, which provides that, notwithstanding Section 141(a), governance rights may be granted in any corporate agreement, so long as the provisions do not violate any other laws or the corporation's charter. However, the practical effect of the new section awaits further judicial development.

Notably, in Wagner v. BRP Group (May 28) and Seavitt v. N-Able, Inc. (July 25), the Court of Chancery indicated that, although new Section 122(18) permits the granting of governance rights notwithstanding Section 141(a), many such rights may nonetheless still be facially invalid on the basis that they would violate other sections of the DGCL and/or charter provisions.

In addition, the appeal of Moelis is still pending — as the DGCL amendments by their terms do not apply retroactively to stockholder agreements subject to litigation filed before Aug. 1.

Board Approval of Merger Agreements — Activision

In Activision, the Court of Chancery declined, at the pleading stage, to dismiss claims that the already-closed merger between Activision Blizzard and Microsoft was invalid on the basis that certain procedures followed by Activision's board to approve the merger agreement, while reflecting common practice, did not comply with certain technical requirements set forth in the DGCL. The court also declined to dismiss the claim that, as the merger was invalid, the board had committed an unlawful conversion — i.e., theft — of the plaintiff's shares.

In response, amendments to the DGCL were enacted providing that

- A board can approve a draft merger, or other, agreement that is in "substantially final form" (Section 147) — which means, according to the amendment synopsis, that all of the "material terms" are set forth in the draft or otherwise known to the board;

- Disclosure schedules to a merger agreement are not deemed to be part of the agreement for purposes of the DGCL, and so do not have to be attached to the draft approved by the board (Section 268(b));

- The charter of the surviving corporation of a cash-out merger need not be included in the merger agreement (Section 268(a)); and

- The merger proxy notice can incorporate by reference the description of the merger agreement in the proxy statement (Section 232(g)).

We note that the amendments do not provide guidance as to what terms may be considered to be material for the purposes of determining whether a draft agreement is in substantially final form. Also, the amendments do not address whether a side letter extending a merger agreement drop-dead date may, as the court in Activision suggested, constitute an amendment of the agreement — which, if so, could be invalid if occurring after stockholder approval of the agreement.

Lost Merger Premium Damages — Crispo

In Crispo, the Court of Chancery called into question the enforceability of so-called Con Ed provisions — derived from the U.S. Court of Appeals for the Second Circuit's 2005 decision in Consolidated Edison v. Northeast Utilities — in merger agreements, which provide that, in the event of an impermissible termination of the agreement, damages that the target company can recover include any lost merger premium.

The court reasoned that the target company cannot recover such damages because the merger consideration is paid to the stockholders who, almost invariably, are not third-party beneficiaries.

In response, the DGCL was amended to provide that a right to lost merger premium damages can be enforced through a stockholders' representative appointed at the time the stockholders approve the merger agreement. The amendments do not indicate whether the target company itself could be appointed as the stockholders' representative, nor provide guidance as to issues that may arise in connection with the appointment of a stockholders' representative in the public company context.

MFW Requirements — Match Group

In In re: Match Group (Apr. 4), the Delaware Supreme Court reaffirmed that entire fairness review presumptively applies in any suit where a controlling stockholder stood on both sides of a transaction with the corporation and received a material nonratable benefit. The Delaware justices also held that compliance with the MFW prerequisites — approval by both an independent special committee of directors and a majority of the minority stockholders — is the only route in that context for obtaining business judgment review.

The decision thus rejected an effort among a group of prominent commentators to limit MFW's applicability to the squeeze-out merger context in which Khan v. M&F

Worldwide itself was decided by the justices in 2014.

Importantly, in Match Group, the Supreme Court also established, for the first time, that MFW would not be satisfied unless all — rather than just a majority — of the directors on the special committee approved the transaction.

Executive Compensation — Tornetta v. Musk

Executive compensation traditionally has been considered the paradigm context for judicial deference to a corporation's board. In Tornetta v. Musk (Tornetta I), however, the Court of Chancery on Jan. 30 entirely voided the $56 billion — now worth over $100 billion — 10-year pay package the Tesla board, comprising independent directors, had approved for Musk after he exceeded specified financial targets that represented $600 billion of growth for the company over less than six years, a 13-fold growth in the company's market capitalization.

The court, finding Musk was Tesla's controller, viewed the pay package as a material nonratable benefit to him, and thus applied entire fairness review, with the burden of proof on Tesla. The court found that the board's process was not fair, as the directors did not negotiate with Musk but simply capitulated to the terms he wanted. Also, the court found that Tesla did not prove that the pay package was financially fair.

After Tornetta I was issued, the Tesla stockholders unaffiliated with Musk voted to ratify the pay package — and also approved the company's proposed reincorporation to Texas. Tesla then requested that the court revise its decision that the pay package be rescinded.

In a decision (Tornetta II) issued on Dec. 2, the court rejected revising the rescission for four reasons, each of which alone, the court stated, was a sufficient basis for denying the revision. The court held that:

1. There is no procedural basis on which the outcome of an adverse post-trial opinion can be undone by a stockholder vote;

2. Common law ratification is an affirmative defense, and as such cannot be raised for the first time after a post-trial decision;

3. A stockholder vote standing alone cannot ratify a conflicted-controller transaction; and

4. The Tesla stockholder vote was not fully informed, as Tesla's disclosure indicated that the stockholders' approval would be a comprehensive cure-all, absolving directors of fiduciary breaches and restoring the pay to Musk, whereas, the court stated, at best, effective stockholder ratification only would have shifted the burden of proof.

Of note, the court awarded the plaintiff's counsel a $345 million fee.

Many have reacted to Tornetta II with surprise, understanding the decision as a novel rejection of stockholder wishes with respect to compensation for a company's chief executive. However, the decision reflects the court's adherence to basic principles applicable to controllers, in this case in the context of a controller who was also the chief executive.

The decision indicates that Musk's pay would have been upheld: (1) if MFW had been satisfied, i.e., the pay had been conditioned ab initio on approval by all of the independent directors and a majority of the minority stockholders — which it was not; or (2) absent

satisfaction of MFW, if the pay had been entirely fair, i.e., the process and the price, under a unitary analysis, had been fair to the corporation and its stockholders — which the court had held in Tornetta I that it was not.

Under the second prong, the court noted that if either of the MFW prerequisites had been satisfied, then the burden of proof would have shifted to the plaintiff to prove the unfairness of the pay. The court did not shift the burden based on the stockholder ratification because it found the ratification ineffective — as it was obtained after a post-trial decision rejecting the pay, i.e., as a kind of work-around to that judicial result — and, separately, because the court found the disclosure to stockholders was materially flawed.

The court found that the defendant company did not meet the burden of proving the fairness of the largest pay package ever granted in the history of the public markets. It is uncertain what the judicial result would have been had the burden instead been on the plaintiff to prove unfairness of the pay; the company had considered and/or submitted evidence by independent experts indicating that the pay was fair; and/or there had been less extreme facts relating to the process, the price and/or the perceived level of control.

Tesla, which in the interim has reincorporated to Texas, has stated that it will appeal.

Tornetta II reinforces the applicability of MFW to all conflicted controller transactions, including determining pay for a controller-executive, and establishes that stockholder ratification of a board action — at least in the controller context, but potentially in others — will not be effective if obtained after a post-trial decision rejecting the board action.

Together, the Tornetta decisions:

- Underscore the court's view that executive compensation should involve an active negotiation process rather than capitulation to the executive, no matter how valuable the executive is;

- Suggest judicial skepticism as to the unique value of a superstar CEO such that it would justify such an extraordinary level of compensation;

- Highlight continued judicial skepticism toward corporate controllers generally in the context of self-interested transactions; and

- Underscore the need for vigilance in corporate governance matters, particularly in the controller context.

Controller Fiduciary Duties When Voting Its Shares to Block Board Action

On Jan. 24, in In re: Sears Hometown and Outlet, the Court of Chancery, for the first time, clearly established that, when a controller exercises its stockholder-level voting power to "alter the status quo," even if the controller does not receive a nonratable benefit, the

controller has certain, albeit limited, fiduciary duties. These are duties of care and loyalty that demand that the controller not "harm the corporation knowingly or through grossly negligent action."

Prior to this decision, it was clear that controllers, when using their influence over the board and management to cause the corporation to act, have fiduciary duties to act in the best interests of the corporation and its stockholder — but there were conflicting lines of authority as to whether fiduciary duties apply to a controller when acting solely as a stockholder.

We note that the limited fiduciary duties the court established in Sears Hometown — which most typically would arise when the controller, without a self-interest component, disagrees with the board about how to preserve or create corporate value — appear to be fairly easily satisfiable.

Adviser Conflicts

The Delaware courts have continued their trend in recent years of sharply focusing on conflicts of interest, including financial and legal advisers' conflicts. The courts have emphasized generally a need for more transparency into, and fuller disclosure of, financial advisers' compensation and potential conflicts.

Also, in Firefighters' Pension v. Foundation Building Materials, the Court of Chancery on May 28 declined to dismiss claims challenging the de-SPAC merger of a company with an unrelated third party in an arm's-length transaction, based on potential conflicts of interest of the controller-sponsor and the financial advisers that the court viewed as inherently arising out of the standard Up-C structure the company had utilized for the merger — specifically, the early termination payment, under the tax receivables agreement, that would be triggered on a sale of the company.

Earnouts

2024 earnout decisions, relating to claims that the buyer did not use sufficient postclosing efforts to achieve the earnout, continued a trend in recent years of the court sometimes finding in favor of the sellers, although, historically, Delaware courts held almost invariably in favor of buyers.

In Fortis v. Johnson & Johnson, the Court of Chancery on Sept. 4 awarded damages of $1 billion after finding that the buyer's postclosing actions — which caused the acquired product, a surgical robot, to compete and then combine with the buyer's preexisting robot — breached the inward-looking efforts standard set forth in the parties' agreement that required the buyer to accord the product the same treatment it provided its other medical products with priority status.

In SRS v. Alexion, the Court of Chancery on Sept. 5 **found** that the buyer's postclosing termination of the development program for the antibody it had acquired breached the outward-looking efforts standard set forth in the parties' agreement that required the buyer to use the same efforts a typical biopharmaceutical company would use for a similar product at a similar stage of development under similar circumstances.

The court concluded that, although the buyer had received new data raising safety concerns about the antibody, a hypothetical typical company would have gathered more data rather than terminate the program. Overlaying the court's analysis was the particular factual

context, with the buyer itself having been acquired during the earnout period and its acquirer having publicly promised outsize merger synergies from that acquisition.

In Himawan v. Cephalon, by contrast, the Court of Chancery on April 30 held that the buyer did not breach its contractual obligation to use commercially reasonable efforts.

The court, emphasizing that the agreement expressly granted the buyer complete discretion over postclosing operations, interpreted the efforts standard as being both subjective and objective — meaning that if a reasonable actor when faced with the same circumstances would go forward in its own self-interest, then the buyer was contractually obligated to do the same. The court thus applied an objective standard of reasonableness in the context of the unique facts and circumstances applicable to this buyer.

Notably, the court suggested that applying a purely objective standard — based only on what other companies had done or would do — would be inappropriate in the context of a drug development case, as each set of circumstances around drug development is inherently unique.

Caremark

2024 Caremark decisions reflected a return to the court's historical emphasis on the difficulty of success for plaintiffs on Caremark claims, derived from the Court of Chancery's landmark 1996 decision in In re: Caremark International Inc.

Moreover, in Clem v. Skinner, the court on Feb. 19 expressly discouraged the reflexive filing of Caremark claims following corporate mishaps, in this case concerning Walgreens. Importantly, however, the factual context in the most recent cases arguably was not so egregious as to present a real test of the court's overall approach to Caremark cases.

We would expect it is likely that the court would continue to find potential Caremark liability in cases that actually involve egregious facts following the occurrence of an extreme corporate trauma.

Of note, in Bricklayers Pension v. Brinkley, the court found on July 12 that a board did not breach its Caremark duties even though it had deferred to management dealing with the company's serious, long-standing regulatory compliance problems.

In certain previous Caremark cases, the court has stressed that Caremark requires board-level oversight of compliance risks, and that reliance on management alone to deal with critical compliance risks and problems is insufficient.

Centene, however, indicates that the extent to which reliance on management may be sufficient for the fulfillment of Caremark duties depends on the context. The court found it reasonable to infer in this case that the board knew what steps management was taking to address the problems, and that the overall context was not so extreme that the board was unreasonable in accepting management's assurances that the problems were being handled.

Incorporation by Reference Into a Charter

On July 25, in Seavitt v. N-Able, the Court of Chancery held, for the first time, that a charter cannot incorporate by reference the substantive provisions of a stockholder agreement or other private agreement.

The court reasoned that, notwithstanding Section 102(d) of the DGCL, which permits charter provisions to be "made dependent upon facts ascertainable" outside the charter, permitting incorporation by reference of a private agreement would undermine the public nature of a charter, and, because private agreements can be amended without a stockholder vote, stockholders would be deprived of their right under the DGCL to vote on the amendment of the charter.

Notwithstanding this reasoning, the court held that even a publicly available private agreement could not be incorporated by reference into the charter.

Accordingly, Delaware corporations should review their charters to determine if there are incorporations by reference that ultimately may not be effective, and, with respect to new charters, drafters should carefully consider, and preferably minimize, the inclusion of references to external documents.

Conclusion

2025 promises further interesting developments as practitioners adapt to this year's events and the Delaware courts issue decisions in pending appeals and provide interpretation of the DGCL amendments.

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