Del. Dispatch: The 2023 Corporate Cases You Need To Know

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The historical ebb and flow of mergers and acquisitions is underscored by the continuing post-2021 slump in M&A activity.

But, as usual, business, financial and legal market participants are endeavoring to meet the challenges of economic, regulatory and other headwinds with creativity and adaptation — highlighting that M&A is a permanent feature of the corporate landscape, critical to meeting companies' financial, operational and strategic needs.

Also, corporate and M&A litigation has continued at a fevered pace this year, with the Delaware courts addressing numerous novel issues with important practical implications. We discuss below some of the notable legal trends and developments in 2023.

Pressure on Boards to Take Public Positions on Political Issues

In a politically charged and divisive environment, corporate boards increasingly have been under pressure to take public positions on political issues and events, even those not directly related to the company's business. These issues and events have included, for example, the adoption of state anti-gay legislation, the autoworkers' strike and the Israel-Hamas conflict.

The Delaware courts have acknowledged that corporate speech on external policy matters, such as those involving political, social or religious issues, involves both risks and opportunities for companies.

The courts have been clear that, given the diversity of viewpoints on these types of issues that may be held among a company's stockholders, directors, management, employees and other stakeholders, it is the board's responsibility to weigh the competing corporate considerations and decide what policy in general, and what action in any specific instance, is in the best interests of the corporation and its stockholders.

The Court of Chancery of the State of Delaware **emphasized** in Simeone v. The Walt Disney Company on June 27 that a board's decisions as to whether to speak out, or to take other action, on such issues generally will be accorded judicial deference under the business judgment rule — even if the board's decision resulted in negative consequences for the company.

That was the case for Disney after, at its employees' strong urging, it made public statements against Florida's "Don't Say Gay" law and the state legislature responded by revoking its special tax status.

The broader, ongoing debate over a board's proper role with respect to social impact issues suggests that boards should be sensitive to these types of issues, understand the views of their key stockholders and other stakeholders, anticipate what areas of the company's

business or the board's decision making are most likely to raise these issues, and be proactive in being prepared to respond to challenges in these areas.

Focus on Workers

As workers focus on work-life balance and fair wage issues, corporations and the Delaware courts increasingly have been focusing on employees' health and welfare.

As discussed above, under Delaware law, a board has fiduciary duties to act in the best interest of the stockholders, but has wide leeway to act in the interests of other stakeholders so long as there is any rational basis to conclude that those actions will ultimately redound to the benefit of the stockholders. In various contexts, the Delaware courts have recently emphasized the importance of employees as corporate stakeholders.

Indeed, in In re: McDonald's on March 1, the Delaware Chancery Court characterized "taking care of the corporation's workers" — in that case, the issue being their risk of being sexually harassed — as a "mission-critical" risk for companies that requires board-level oversight.

The court stated in McDonald's that a board, in the exercise of its business judgment, may conclude that addressing the interests of "the workforce that drives the company's profits" is rationally related to building long-term value for the stockholders.

As another example, as discussed above, the Disney board decided to speak out against Florida's Florida's "Don't Say Gay" bill, which led to significant negative consequences for the company.

The Delaware Chancery Court found it permissible that the board, in making its decision, heavily weighted the views of its employees and creative talent, who had pushed for the company to take a public stand against the law.

Indeed, even the plaintiff in Disney conceded that the company's relationship with its employees and creative talent was crucial to the company's success.

Lost-Premium Damages

The Delaware Chancery Court, for the first time, called into question the enforceability of the so-called ConEd provisions. These provisions, which have been routinely included in merger agreements for almost two decades, state that, if a buyer wrongfully terminates a merger agreement, the damages recoverable by the target company will include the merger premium lost to its stockholders.

In Crispo v. Musk on Oct. 31, the court **stated** that lost-premium damages provisions are not enforceable by the target company — because it is the shareholders, rather than the company, that would have received the merger premium if the deal had not been terminated, nor by the target shareholders — unless they are third-party beneficiaries of the merger agreement.

The court suggested that a typical lost-damages provision potentially could be interpreted implicitly to grant third-party beneficiary status to the target stockholders to enforce that provision, but even if so, the court stated, such status would vest only after the target company had exhausted the possibility of a specific performance remedy.

In response to Crispo, an effort is underway to amend the Delaware General Corporation Law to provide a mechanism under which target company stockholders could appoint the target company as their agent to collect lost-premium damages.

Pending any such amendment, practitioners should consider other merger agreement provisions or structures that potentially could effectively provide for lost-premium damages.

Officer Exculpation

Based primarily on uncertainty about stockholder reaction, most corporations have been taking a wait-and-see approach since, in August 2022, it became permissible under DGCL Section 102(b)(7) to adopt charter amendments providing for exculpation of liability for corporate officers for nonderivative claims for breach of the duty of care.

Proxy firms Institutional Shareholder Services Inc. and Glass Lewis & Co. have adopted policies under which they will make voting recommendations on such amendments on a case-by-case basis. So far, ISS has usually recommended in favor, but Glass Lewis has usually recommended against, such amendments that have been proposed.

Strong stockholder support was indicated, however, by the passage of the vast majority of such amendments that were submitted to stockholders for approval during the 2023 proxy season. To date, about 300 corporations have adopted such amendments.

The Delaware Chancery Court, in Electrical Workers Pension Fund, Local 103, IBEW v. Fox Corp. and In re: Snap Inc. on March 29, **held** that, in a multiclass capitalization company, a charter amendment adopting officer exculpation does not, under DGCL Section 242(b)(2), constitute an amendment adversely affecting the rights, powers and preferences of a class of stock such that a separate class vote would be required for approval.

The court reasoned that the amendment did not affect a power, preference or special right of a class that appeared expressly in the corporation's charter.

Buyer Aiding-and-Abetting Liability

An emerging judicial trend in 2023 has been an increased potential for buyer aiding-and-abetting liability for sell-side breaches of fiduciary duties — particularly for private equity buyers — given the greater likelihood of target executives' conflicts of interest.

The trend has occurred particularly with respect to target breaches of the duty of disclosure in connection with the description of the sale process in the merger proxy statement, given the buyer's knowledge of its own dealings with the target in the process.

In contrast to the Delaware courts' historic trend of virtually never holding a buyer or other third party liable for aiding and abetting sell-side fiduciary breaches, in a post-trial decision in In re: Columbia Pipeline, the Delaware Chancery Court found on June 30 the private equity firm buyer liable for aiding and abetting the target CEO's disclosure violations about the company's contacts with the buyer during the sale process.

Columbia Pipeline followed two other recent decisions — In re: Mindbody Inc. Stockholder Litigation on March 15 and Firefighters' Pension System of the City Of Kansas City, Missouri Trust v. Presidio Inc. in 2021 — in which the court also found a buyer liable or potentially liable for aiding and abetting sell-side fiduciary breaches, in these cases, for alleged improper favoritism toward the buyer in the sale process.

We also note that, in two other cases in recent years — Morrison v. Berry in 2020 and In re: Rural/Metro Corp. Stockholders Litigation, affirmed by the Delaware Supreme Court in RBC Capital Markets LLC v. Jervis in 2015 — the court found a target's financial advisor liable for aiding and abetting target directors' or executives' breaches of fiduciary duties in a sale process.

Nonetheless, there is still a high bar for plaintiff success in such claims. Most importantly, a plaintiff must establish that the buyer acted with a scienter — which requires showing that the buyer knowingly participated in the sell-side fiduciary breaches — by creating, exacerbating or exploiting the breaches for its own benefit, at the expense of the target stockholders.

It is to be noted that aiding and abetting claims will subject the buyer to the potential for expansive discovery demands, creating pressure to settle the claims early; liability even when the breacher has no liability, for example, due to exculpation or settlement; and joint and several liability for possibly significant damages, which may not be covered under standard insurance policies.

Also of note, a buyer will not have aiding-and-abetting liability for fiduciary breaches that have been cleansed under the Corwin doctrine — through the target's disclosure to its stockholders.

Buyers should consider taking steps to mitigate the risk of aiding-and-abetting liability. These could include, for example, seeking confirmation from the target that the sale process was free of fiduciary breaches, and/or informing the target board of possible sale process fiduciary breaches when the buyer becomes aware of them.

Director and Officer Oversight Duties — Caremark Claims

Delaware has continued its recent greater receptivity to the survival of Caremark claims — i.e., claims of failure of oversight by directors or officers — at the pleading stage of litigation.

In a series of decisions in the McDonald's case, the Delaware Chancery Court expanded the parameters for Caremark liability, establishing or clarifying for the first time that:

- Caremark duties of oversight apply not only to directors but also to officers;
- Caremark duties apply not only to a company's so-called mission-critical risks but may apply to other key risks even if not rising to the level of mission-critical; and
- Sexual harassment and similar issues — and, indeed, "maintaining workplace safety…[and] tak[ing] care of the corporation's workers" — are mission-critical risks for companies.

However, at the same time, McDonald's reinforces that there is still a high bar to a finding of liability for failure of oversight.

First, the court emphasized that it is only when directors or officers act in bad faith — i.e., engage in knowing and intentional wrongdoing — that Caremark liability arises.

Directors or officers who act to address a problem of corporate misconduct once they learn of it generally should not be deemed to have acted in bad faith, even if the actions they took were insufficient or reflected poor decision making, so long as they were not so off the mark as to suggest bad faith.

Second, as reflected in McDonald's, Caremark claims against officers will likely be dismissed, based on a no-demand-futility defense, if the Caremark claims against the board are dismissed.

The scope of officers' oversight duties under Caremark is yet to be judicially developed. An officer's essential duty appears to be to report information and red flags about problems, within the areas of the officer's responsibilities, up the chain of authority.

The court made clear in McDonald's that although generally an officer's Caremark duties will correspond with the officer's level of authority and areas of responsibility, there will be some information and red flags that are sufficiently material that an officer may have a duty to report them even if they are outside the officer's own areas.

Accordingly, corporations — especially those with many officers, multilevel reporting structures or titles not reflecting actual responsibilities — should reevaluate their practices for assigning officer titles and responsibilities to personnel.

Controllers

The Delaware Chancery Court established, in In re: Oracle Corp. Derivative Litigation on May 12, that a transaction involving a conflicted nonmajority stockholder who had the ability to control the transaction at issue but did not attempt to do so will be reviewed under the business judgment rule, rather than entire fairness.

The decision underscores the advantages of a board's use of an independent special committee to lead the process for a potentially conflicted transaction, as well as the importance of a board's establishing a record as to a potential controller's actions with respect to a transaction.

In Oracle, the court found after trial that Larry Ellison, although he had "outsized influence" at Oracle, had absented himself from the process.

A special committee had functioned effectively to consider and negotiate the transaction. The committee's members and advisors were experienced and independent of Ellison, and the committee conducted extensive due diligence on the target company and negotiated hard on Oracle's behalf, including being willing to walk away from the deal and ultimately obtaining a price below the maximum the committee had decided Oracle should pay.

We note that the court did not address whether, if the court finds that a person was a controller with respect to a transaction, the effective functioning of an independent special committee would cleanse a non-squeeze-out merger transaction that did not require a stockholder vote.

We would also note that, notwithstanding Oracle, in other cases, there could be circumstances under which the court might deem a person with the ability to control a transaction by virtue of their general influence and clout to have controlled a transaction even if they had been fully absented from the process.

Entire Fairness

The Delaware courts have continued their evolution over recent years toward an emphasis on the fairness of price over the fairness of process in the unitary analysis to determine whether a conflicted transaction meets the stringent entire fairness standard.

Accordingly, in contrast to the historical trend of the courts finding almost invariable that, when entire fairness applies, the standard is not satisfied, in certain recent decisions, the courts have found the standard was satisfied, and even when the court viewed the sale process as having been seriously flawed.

In In re: BGC Partners Inc. on Aug. 10 and In re: Tesla Motors Inc. on June 6, the Delaware Supreme Court affirmed the Chancery Court's post-trial decisions holding that the acquisition of a company indirectly controlled by the buyer's controller met the entire fairness standard.

The court reached that holding in BGC notwithstanding what it viewed as serious flaws in the sale process and, in Tesla, notwithstanding that the board did not utilize a special committee to negotiate and approve the transaction.

Other cases in recent years in which the Delaware Chancery Court has found entire fairness satisfied, despite significant flaws in the sale process, include Hsu Living Trust v. Oak Hill in 2020 and ACP Master Ltd. v. Sprint Corp. in 2017.

Nonetheless, and importantly, there is still a high bar to establishing entire fairness. In our view, in the event of a clearly, materially unfair price or process, it would be unlikely that the court would find entire fairness satisfied.

Notably, in both BGC and Tesla, the court found that, notwithstanding the sale process flaws, there was strong evidence that the special committee or board had functioned effectively and achieved a fair price.

MFW

A debate has emerged as to whether the MFW prerequisites — i.e., approval of the transaction by both independent directors and minority stockholders — should have to be met to cleanse fiduciary breaches in all conflicted controller transactions, as has been the case, or whether the MFW prerequisites for such cleansing should be required only in going-private mergers.

Certain Delaware law experts have advocated that, other than with respect to going-private mergers — which, by definition, involve a controller benefitting at the expense and to the exclusion of the minority stockholders — conflicted transactions should be subject to business judgment review so long as either independent directors or minority stockholders approved the transaction.

They have reasoned that MFW's requirement that both approvals be obtained is unnecessary in today's world of primarily institutional investors, sophisticated independent directors and robust disclosure requirements.

In a significant recent development, the Delaware Supreme Court, in May, sua sponte, requested that parties in the appeal of the Delaware Chancery Court's decision in In re: Match Group brief the issue of whether MFW should apply to all conflicted controller

transactions or only to going-private mergers.

The Delaware Supreme Court stated that it was requesting briefing so that it could "provide certainty to boards and their advisors who look to Delaware law to manage their business affairs."

Pending its decision in Match Group, the Delaware Supreme Court may now question in stockholder challenges to conflicted-controller transactions whether MFW cleansing applies in a non-squeeze-out context — or, instead, whether the business judgment standard applies if the transaction was approved by either the independent directors or the minority stockholders.

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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.

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