FRIED FRANK

# M&A/PE Quarterly

**A QUARTERLY ROUND-UP OF KEY M&A/PE DEVELOPMENTS**

## To Our Clients and Friends:

Our thoughts and best wishes are with everyone as we all work to navigate this challenging time. Fried Frank has formed a task force comprised of partners and senior lawyers from across all practice groups and offices to track developments and provide timely guidance to clients on COVID-19-related issues. Last week, we distributed a memo on key issues (available here). Below, we have summarized the M&A/PE-related points. Also below are articles relating to other developments during the first quarter of 2020. Should you have any questions relating to Coronavirus or any other matter, please reach out to your usual Fried Frank contacts. We hope that you and yours are safe and staying well.

*"Business and market disruption and uncertainty is expected to lead to a marked slowdown in M&A activity. Depressed stock prices and general dislocation may lead to an increase in unsolicited bids for companies; and supply chain disruptions may increase restructuring activity. At this time, we see most pending deals moving forward."*

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# M&A/PE Partners

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Bret T. Chrisope

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Steven Epstein

Christopher Ewan

Arthur Fleischer, Jr.*

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Erica Jaffe

Randi Lally

Mark H. Lucas

Scott B. Luftglass

Shant P. Manoukian

Philip Richter

Steven G. Scheinfeld

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David L. Shaw

Peter L. Simmons

Matthew V. Soran

Steven J. Steinman

Gail Weinstein*

Maxwell Yim

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Brian T. Mangino

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Ian Lopez

Dan Oates

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Dr. Juergen van Kann

Dr. Christian Kleeberg

** Senior Counsel*

# COVID-19 M&A/PE Issues and Developments

***Level of activity.*** Business and market disruption and uncertainty is expected to lead to a marked slowdown in M&A activity. Depressed stock prices and general dislocation may lead to an increase in unsolicited bids for companies; and supply chain disruptions may increase restructuring activity. At this time, we see most pending deals moving forward. One reported exception has been Xerox's postponement of its $34 billion unsolicited pursuit of HP, with Xerox stating that all of its focus right now will be on the health and safety of its various stakeholders. On the activism front, there may be new activism-focused funds formed to take advantage of the business and market dislocations; and activists may take advantage of depressed prices to accumulate shares and offer plans for recovery.

***Due diligence.*** Due diligence protocols are being updated to seek to assess the potential impact of the pandemic on target companies. There has been a focus on target company contingency planning; business interruption insurance; supply chain issues; the status of existing contracts and business relationships; and pandemic-related vulnerabilities concerning restrictions on travel and gatherings, ability to work remotely, and the like.

***Banker valuations.*** Banker valuations and fairness committee processes are being updated to take into account the potential impact of the pandemic. One issue of note is that, with declining interest rates resulting in a lower discount rate input to a discounted cash flow (DCF) analysis, the DCF result is higher than it would be if the interest rate were higher–even though the company's value has declined. Bankers need to take into account and explain this anomalous result.

***Definition of a MAC.*** In pending deals, parties are considering whether the pandemic, or the government's response to it, is potentially covered by the definition of a MAC; how to value the potential impact; and whether the durational significance of the impact would or would not trigger the MAC-based condition or right to terminate. An area of focus has been the standard exclusion from most MAC clauses of changes that do not disproportionately affect the company from others in its industry. We have seen in some very recently executed merger agreements a specific exclusion from the MAC definition of the impact of the pandemic.

***Other merger agreement issues.*** Other merger agreement issues include the potential impact of the pandemic (and the governmental responses to it) on (i) the bring-down at closing of representations and warranties; (ii) operation of the business pending closing; (iii) the availability (and cost) of acquisition financing (and remedies for a failure to obtain financing if related to the pandemic); (iv) protection of key executives and continuation of employee-related policies and benefits adopted in light of the pandemic; (v) impact on the timing of the "end date" for closing; and (vi) in the private company context, inclusions or carve-outs from post-closing indemnification. Companies will have to consider when and how to communicate Coronavirus-related developments at the company to their merger agreement counterparty.

***Logistics.*** Logistics will be a challenge requiring significant planning and adaptation, including with respect to conducting due diligence, negotiations, board meetings, litigation, regulatory filings, etc. Health safety concerns, widespread and extended school and daycare closings, government-imposed or recommended travel or other restrictions, and the counterparty's views and policies all will have to be taken into account. Backup plans should be in place in the event key persons involved become unavailable and delays may be inevitable. Of note, the Department of Justice and the Federal Trade Commission have announced that, due to health concerns relating to the pandemic, they will not be accepting hard copies of any premerger notification documents and have put in place a temporary e-filing system. With respect to litigation, we note that in many cases court appearances have been delayed or moved to conference calls. The Delaware Court of Chancery has set guidelines for how trials will proceed if there are issues about personal appearances.

Also, citing concerns about the large number of spectators expected for a trial that was to begin relating to stockholder claims against Elon Musk in connection with Tesla's acquisition of Solar City, Vice Chancellor Slights postponed the trial until after pandemic concerns have resolved.

***Sponsors' ongoing and new fundraising.***
Most major sponsors are continuing closings in ongoing offerings and, to the extent possible, accelerating timing to close where they have final investor documents in hand, rather than holding documents to aggregate them for a larger close. For sponsors ramping up to launch new funds, generally activity has not slowed. However, given the anxiety in the markets and around the overall impacts of the pandemic, many are revising their anticipated timing for first closings to the summer or early in the fall. In limited circumstances, sponsors are seeking to accelerate new fundraising for mandates for which there is a view that there may be buying opportunities in this period of uncertainty or as we emerge from it. In other cases, where their mandates are particularly challenged by the current environment, we have seen sponsors take a pause on current fundraising or delay plans to launch new products.

***Fund agreements.*** *Force majeure* or similar contract avoidance clauses are not broadly incorporated into fund agreements. We have not seen investors seeking to incorporate such triggers into documents being negotiated now. Where such provisions do appear, an examination of their relevance is fact-specific and depends on the application of the relevant governing law.

***Financial contracts***. Market participants need to evaluate how events stemming from the pandemic are dealt with under trading agreements governing derivatives and other financial instruments. In addition to force majeure clauses, market disruption provisions and fallbacks in those contracts may be triggered. Scheduled valuation dates or dates for making payments and deliveries may be postponed due to business interruption and unscheduled holidays. In addition, large and sudden fluctuations in financial markets may trigger demands for collateral. Parties to OTC derivatives and other similar transactions need to monitor and manage their liquidity to ensure they are prepared to meet such collateral posting requirements.

***Liquidity concerns.*** In light of the tremendous turmoil in global markets during the last month resulting from the pandemic and the plunge in oil prices, many companies are focused on ensuring that they have sufficient liquidity to support their operations during a potentially prolonged economic downturn. Major corporate borrowers have been upsizing revolvers and some companies have considered drawing down under existing revolving or term credit facilities and "banking" the funds to ensure that cash remains available to them. Each borrower will need to make a business judgment and weigh the additional costs of borrowing prophylactically against macroeconomic market risks and risks that may affect the particular borrower differently from the overall market because of its industry or particular situation.

***Credit agreements.*** When considering additional borrowing, it should be kept in mind that borrowers are generally required to bring down credit agreement representations and warranties (in all material respects) in connection with a revolving credit facility borrowing. Borrowers should focus in particular on the language of their "no material adverse change" and solvency representations, including whether the MAC rep covers a material adverse change in the Borrower's business "prospects," and whether the solvency representation is limited to historical solvency (at the time of an LBO, for example) or pro forma for the borrowing being made. Borrowers should review their credit agreements for "*force majeure*" or similar provisions that might excuse a revolving lender's obligation to lend in bad economic environments. (Generally in our experience, committed facilities do not include such provisions.)

***Counterparty credit risk.*** Borrowers should remember that, notwithstanding the language of their respective contracts, they remain subject to counterparty credit risk. For the time being, the risk is even greater for lenders in China, Italy, and other countries with severe travel and work restrictions.

***Financial covenants.*** Many sponsor-backed borrowers have financial covenants applicable only to their revolving credit facility that are triggered when the revolving credit facility is drawn in excess of certain thresholds (generally between 30-40%). Often, certain items (*e.g.*, undrawn letters of credit) are excluded subject to a cap. Borrowers should refamiliarize themselves with these covenants (what the levels are, when the covenant is tested, updated compliance projections, etc.).

***Oversight responsibility.*** A board must exercise appropriate oversight with respect to material risks facing the company. COVID-19 may well constitute such a risk for many companies given the global scale, novelty, and potential direct impact on numerous business areas (personnel, supply chain, customers, financing, and so on). We note that the SEC recently has emphasized the need for disclosure of material risks and the extent of the board-level oversight. A board should ensure that it receives relevant and timely updates from management to understand how the company is being affected, as well as the most recent guidance from health organizations.

***Meetings.*** Companies are considering whether to make changes to hold virtual-only or virtual-and-in-person meetings (including annual shareholder meetings) and events. Staples, Inc. has announced that its annual meeting this year will be virtual. Before changing to a virtual annual meeting, companies should consider the company's corporate governance documents, state corporate law, stock exchange requirements, proxy advisory firm policies, and proxy statement disclosure. Companies also should take into account the investor relations impact and should consider engaging with major shareholders about making the change.

***Contingency planning.*** Many companies are forming task forces comprised of senior management to coordinate COVID-19-related issues. A company should develop a comprehensive communications plan to provide consistent messaging to all corporate constituents, including shareholders, lenders and employees. Companies should assess the existing and potential impact of the pandemic on their existing commercial agreements–including whether the pandemic would trigger: a material adverse change or *force majeure* provision or another provision relating to a right to delay performance; a right to revise the terms or terminate the agreement; or a notice requirement. In addition, the potential of an inability to perform by the company or the counter-party should be considered, the potential impact assessed, and next steps considered. When entering into new contracts or business arrangements, the company should evaluate whatever pandemic-related risks are foreseen at that time and consider whether and how those (and unknown) risks should be addressed.

***Insurance.*** Companies should consider whether their insurance policies cover the effects of the pandemic, including any business interruption. Business interruption due to the pandemic may not be covered under a company's classic business interruption policy (which often covers only damages that result from physical damage to the insured's property). Business interruption losses may, however, be covered as an add-on to the company's property or umbrella insurance (although typically there is a force majeure exception to the coverage). It is important to be aware of the specific conditions or exclusions, and the usually strict notice requirements, under these policies. Many current business interruption policies exclude bacterial and/or viral events from coverage. Companies should consider whether to expand their business interruption insurance going forward to cover losses resulting from epidemics or public health emergencies.

# *Developments in Minority Stockholders Being Deemed to be Controllers*—Essendant *and* Voigt

Two recent Court of Chancery decisions address when a minority stockholder may be deemed to be a controller. In one (*In re Essendant Inc. Stockholder Litigation* (Dec. 30, 2019)), the court reaffirmed the well-established generally high bar to a finding that a minority stockholder is a controller based on whether the minority stockholder actually "exercised control over the business affairs of the corporation" such that, "as a practical matter, it [was] no differently situated than if it had majority voting control." To be considered a controller, the court stated, a stockholder's "minority stake [has to be] so potent that independent directors could not freely exercise their judgment, fearing retribution from [the stockholder]." In the other decision, however, *Voigt v. Metcalf* (Feb. 20, 2020), the court emphasized the numerous potential sources of influence a minority stockholder may have and suggested that it may generally be premature at the pleading stage of litigation to rule out a finding of control by a significant minority stockholder who may have had influence over the board.

In *Essendant*, the plaintiff-stockholders brought claims against the company's directors for their decision to terminate an agreement for a stock-for-stock merger with Genuine Parts Company in order to enter into an all-cash deal offered by Staples, Inc. and its private equity firm parent ("S"). At the pleading stage of the litigation, Vice Chancellor Slights rejected the plaintiffs' contention that S, although a minority stockholder, was a controller. In so ruling, the court dismissed the plaintiffs' claims that (i) S had a fiduciary duty to the other stockholders and breached it by pressuring the board to accept its "inadequate" offer for the company; and (ii) the board, by accepting S's offer, breached its duty of loyalty to the stockholders by "caving to the will of [a] controller" rather than seeking to obtain the maximum value reasonably obtainable for the stockholders.

In *Essendant*, there was little evidence of any significant influence by S. S owned just 11.6% of the outstanding shares. It did not nominate any members of the board, have "coercive" contractual rights, or maintain personal or significant commercial relationships with any of the directors. It had not threatened removal or in any way retaliated against any directors. Moreover, there were two other stockholders holding larger voting blocks than it had–thus, the court observed, it would have been difficult for S to "achieve any of [the] markers [of control]." While the factual context did not present the court with a particularly difficult determination, the court confirmed that the test for actual control by a minority stockholder in any particular case "is not an easy one to satisfy."

In *Voigt*, however, Vice Chancellor Laster found, at the pleading stage, that a private equity firm ("C") holding 38.7% of the outstanding shares of a company may have been a controller. C, under a stockholders agreement, had appointed half of the company's directors (half of them being C insiders, and half being nominally independent). Also, C had veto rights over a "lengthy list" of both "significant" and "more basic" business decisions. Moreover, the court found it reasonably conceivable, at the pleading stage, that C had "relationships" with the nominally independent directors it had appointed as well as another director it had not appointed, such that they may have had a "sense of owingness" or "beholdeness" to C. The relationships were based primarily on these directors having been employed, and then (in retirement) having served as directors, at C's portfolio companies. The court concluded that, at the pleading stage, it was reasonably conceivable that these factors, "in the aggregate," may have constituted actual control.

Most importantly, in *Voigt*, the court emphasized that there are numerous potential

sources of influence a minority stockholder may have and that they must be considered "holistically" to determine whether, "in combination," they indicate actual control, even if no one factor standing alone is sufficient to indicate control. The court posited that the very fact of ownership of a large (albeit minority) block is one source of influence. The opinion sets forth a chart that demonstrates that, assuming usual corporate governance provisions and typical stockholder vote-turnout levels, a "35% or [even] less" stockholder generally can prevail on a stockholder vote. Moreover, the court emphasized that a "nuanced," "facts-intensive" inquiry may be required to make a determination about control–making it potentially "premature" to "rule out" a finding of control at the pleading stage. (Of related interest, the court indicated that it may also be premature to determine at the pleading stage whether directors who abstained from voting on a challenged transaction would be absolved of liability on that basis–given that a facts-intensive inquiry could be required to determine what role, if any, the director otherwise played in the "negotiation, structuring or approval of the transaction.")

Accordingly, while both cases reaffirm and apply traditional Delaware principles that have historically created a high bar to a finding that a minority stockholder is a controller, *Voigt* serves as a reminder that a minority stockholder with board appointees and/or other sources of influence is at risk of being deemed a controller. There is a particular risk that at the early pleading stage of litigation the court will not dismiss a claim that is based on allegations of control (given the low standard for dismissal at that stage–*i.e.*, that it is "reasonably conceivable" that there was control).

(We note that, in *Tesla, d*iscussed below, the court addressed the different question whether, once the court decides that a stockholder *is* a controller, entire fairness would apply only if the controller actually exercised control over the board decision at issue. The court answered "yes"–but noted substantial academic and other commentary advocating for the contrary result and suggested that the Delaware Supreme Court could decide to change this aspect of "control"-related jurisprudence.)

## *Court of Chancery Holds Entire Fairness Applies When There is a Conflicted Controller Even in the Absence of Allegations or Proof that the Controller Actually Influenced the Result*—Tesla

In *In re Tesla Motors, Inc. Stockholders Litigation* (Feb. 4, 2020), the Court of Chancery held that the "entire fairness" standard of review applies to the former Tesla, Inc. shareholders' post-closing challenge to Tesla's $2.6 billion merger with SolarCity Corporation, a corporation in which Tesla's major stockholder, Elon Musk, also held a significant equity stake.

### KEY POINT:

The court stated that it is the "ability" to control rather than an actual "exercise" of control that is critical in determining whether the heightened "entire fairness" standard of review applies in a challenge to a transaction involving a controller. Vice Chancellor Glasscock noted that the doctrine of "inherent coercion" (*i.e.*, the assumption that the very presence of a controller is coercive) has been challenged by distinguished Delaware jurists and he stated that their view "perhaps is correct." However, he concluded. "inherent coercion is a presumption embedded in our law" and it is applicable unless and until the Delaware Supreme Court rules otherwise.

**Background.** In 2016, Tesla, Inc. acquired SolarCity Corporation in a merger. Elon Musk, the founder and largest stockholder of Tesla (with a 21.2% equity interest), also owned a significant equity interest in SolarCity, which was struggling financially. Stockholders asserted derivative and direct fiduciary claims against Elon Musk (who, they alleged, was Tesla's controlling stockholder) and the Tesla directors for breaches of fiduciary duty in connection with the merger. The defendants moved to dismiss the claims on the basis that, under *Corwin*, the business judgment rule standard of review applied because Musk was not a conflicted controller and the transaction was approved by the disinterested stockholders in a fully informed and uncoerced vote. Vice Chancellor Slights, at the pleading stage, rejected the defendants' motion to dismiss after finding that the plaintiff alleged facts that supported a reasonable inference that Musk was a controller, thereby triggering entire fairness review. The case proceeded to trial and the parties conducted discovery. The parties settled the claims against the directors and then cross-moved for summary judgment on the claims against Musk. The court rejected the summary judgment motions after concluding that there were open genuine issues of material fact relating to whether Musk was a controller, whether a majority of the Tesla board was conflicted, and whether the stockholder vote approving the merger was fully informed.

**The court rejected the defendants' argument that there was no issue of fact as to whether Musk was a controller because the plaintiffs, after discovery, alleged no facts that showed that Musk "actually coerced" Tesla's stockholders into approving the merger.** The defendants argued that, while at the pleading stage a motion to dismiss could be defeated by a presumption of "inherent coercion" by Musk as an alleged controller, now that full discovery had been afforded to the plaintiffs, they "could no longer ask the Court to presume that Musk's status as a conflicted controller coerced any Tesla stockholder into approving the Merger." The defendants contended that, in the absence of evidence that Musk had "actually coerced" Tesla's disinterested stockholders into approving the merger, the case should be dismissed under *Corwin*. The court noted that the argument raises "the practical question of what quantum of evidence is required actually to *prove* (rather than plead) breach of fiduciary duty claims resting on the theory that a conflicted controlling stockholder and beholden directors overwhelmed the will of the minority to advance the controller's self-interest." The court declined to accept the defendants' position "that the notion of 'inherent coercion,' as it relates to controlling stockholders, evaporates when the case moves beyond the pleading stage." The court found "no support for that position" in the existing Delaware Supreme Court precedent.

The court emphasized that it is "the '*ability*' to control rather than the actual *exercise* of control that is the determinative factor in our controlling stockholder jurisprudence." The reason for this, the court stated, "is the recognition that a controller's influence is "inherently coercive'"–even when no coercion is intended. The court observed that "the theory of inherent coercion" has its critics. The court cited a 2001 article, *Form Over Function*, in which the authors–William T. Allen (former Chancellor of the Court of Chancery), Jack B. Jacobs (former Vice Chancellor and then Delaware Supreme Court Justice) and Leo E. Strine, Jr. (until recently, the Chief Justice of the Delaware Supreme Court)–stated their opinion that the "inherent coercion concern" is "too insubstantial to justify a review standard that requires judges to second-guess a business transaction that rational investors have approved." The court allowed that this view "perhaps is correct"–but that even these proponents of it "recognize in their scholarly advocacy for doctrinal change that inherent coercion is a presumption embedded in our law." The court concluded: "This Court follows Supreme Court precedent, and that precedent is clear: transactions involving conflicted controllers must be reviewed for entire fairness, even when the transaction is approved by the stockholders, because in such instances, the stockholder vote is presumed to be coerced."

The court noted that if the facts proven at trial demonstrate that Musk was Tesla's controller at the time of the merger, the defendants still will avoid liability if the transaction was fair. The court wrote: "Entire fairness review of a merger is not a prejudgment that fiduciary misconduct occurred. It is simply a recognition that because conflicted controller transactions have such a strong potential for self-dealing, absent replication of an arm's-length transaction process, an independent judge should thoroughly examine the transaction's substantive fairness."

**The court found that issues of fact remained as to whether the stockholder vote was fully informed for *Corwin* purposes.** The court observed that, under *Corwin*, the burden of proving that the stockholder vote was fully informed "falls squarely on the board." The court concluded that further investigation of the facts was necessary to determine if it was true that, as the plaintiffs alleged and the disclosure did *not* reflect, SolarCity was on the verge of bankruptcy at the time of the merger.

**The court suggested that paying to acquire an insolvent company conceivably could constitute "waste."** The court held that, even if *Corwin* applied, there was a genuine issue of fact as to whether that transaction may have constituted "waste." The court stated that, "[w]hile a claim for waste is difficult to prove, it is not impossible." The court noted that the plaintiffs claim they will show at trial that SolarCity was "worth almost nothing" when the merger was consummated. "If SolarCity was, in fact, insolvent when Tesla acquired it, that proof may well sustain a waste claim."

## *Delaware Supreme Court Enforces Advance Notice Bylaws Deadlines for Supplemental Information*—BlackRock v. Saba

On January 13, 2010, in *BlackRock Credit Allocation Income Trust v. Saba Capital Master Fund, Ltd.*, the Delaware Supreme Court reversed the Court of Chancery and ruled that an activist shareholder was not excused from complying with clear deadlines in advance notice bylaws for providing supplemental information about proposed director nominees. On January 28, 2020, the Supreme Court rejected Saba's bid for a rehearing of the panel decision.

The advance notice bylaws of two BlackRock closed-end funds required that a stockholder proposing director nominees submit supplemental information about the nominees within five business days after a request therefor from BlackRock. Under the bylaws, the information requested had to (i) be for the purpose of determining whether nominees met the requirements for directors enumerated in the bylaws, (ii) be "reasonably requested" with that scope in mind, and (iii) be "necessary" for the board's determination. Saba proposed director nominees and the funds requested that a director questionnaire be completed for each nominee. Saba did not submit the questionnaires; and, on that basis, the funds treated the nominees as "ineligible." Saba asserted that it did not submit the questionnaires because (as BlackRock conceded) at least one-third of the questions were unrelated to whether the nominees met the director qualification requirements set forth in the bylaws. The Court of Chancery ruled that, because the questionnaires asked for information that was not authorized under the bylaws, BlackRock could not deem the nominees to be ineligible for not providing that information.

The Supreme Court ruled, instead, that Saba's nominees had an obligation to respond to the supplemental information request within the specified deadline. Because the nominees had not responded to the request, they were ineligible and BlackRock had properly excluded them from the election,

the Supreme Court ruled. The Supreme Court emphasized that Saba simply "did nothing and let the deadlines pass"–rather than, for example, respond to those questions that it viewed as permissible under the bylaws or raise concerns with BlackRock about the requested information.

## KEY POINTS

- **The decision validates supplemental information provisions and associated deadlines in advance notice bylaws.** The Delaware courts generally have held that advance nomination bylaws are valid absent "undue restriction on the stockholder franchise" or "inequitable application." In recent years, many public companies have amended their advance notice bylaws to add or expand requirements for supplemental information about director nominees (requiring, for example, the submission of answers to director nominee questionnaires). In addition, many of these provisions require that the requested information be submitted within a specified short timeframe. These provisions have been relatively untested in the courts prior to *BlackRock*.

- **The decision reinforces the importance of clear drafting of advance notice bylaws, as well as their adoption on a "clear day."** The Supreme Court emphasized throughout the opinion that the bylaw provisions at issue were "clear and unambiguous" and had been "adopted on a clear day" (*i.e.*, before a proxy contest was threatened or the company knew that dissident director nominations were going to be made). The Supreme Court wrote that, "to simply let pass a clear and unambiguous deadline contained in an advance-notice bylaw, particularly one that had been adopted on a 'clear day'…would create uncertainty in the electoral setting."

- **The decision underscores that a proponent of director nominees should not simply ignore a clear provision of an advance notice bylaw.** The Supreme Court viewed Saba's failure to raise any objections with BlackRock as "undermining" its later arguments that the questionnaire was impermissibly broad. The court stated that accepting "after-the-fact excuses" for non-compliance with advance notice bylaws could "frustrate the purpose" of the bylaws, which is to create orderly elections and provide fair warning to the company so that it can respond to director nominations. The court wrote: "[Saba] should have raised [its] concern[s] with BlackRock before the expiration of the deadline. What it could not do, without risking disqualification of its nominees, was to stay silent, do nothing, and let the deadline pass."

- **The Delaware courts generally uphold the validity of advance notice bylaws that they view as reasonable.** Another recent case underscores that stockholders generally are required to comply with the plain terms of advance notice bylaws. In *Bay Capital Finance, LLC* v. *Barnes and Noble Education Inc.* (2019), the Court of Chancery precluded an activist from nominating a slate of directors based on the activist's failure to comply with the clear (and, in this case, technical) requirements of the company's advance notice bylaw. The court upheld the validity of the advance notice bylaw requirement that a stockholder must be a stockholder *of record* in order to submit a notice of nomination. The court held that, because the activist stockholder who wished to propose nominees owned shares only in "street name" on the advance notice deadline, its notice was defective and not timely and therefore could be disregarded by the company.

## PRACTICE POINTS

- ***If a proponent of dissident directors views a supplemental information request as invalid in part, generally, it should, within the specified deadline, provide that information which it views as validly requested and raise with the company its specific objections about the information requested or the deadline.*** Although not specifically answered in *BlackRock*, the Supreme Court opinion strongly suggests that, had

Saba, within the specified deadline, answered the questions related to director qualification requirements enumerated in the bylaws and communicated its concerns about responding to the other questions, the Supreme Court would have viewed Saba as having sufficiently complied with the bylaw.

- ***A company should consider the extent to which an advance notice bylaw specifically limits the type of supplemental information that can be requested.*** In *BlackRock*, the bylaw specifically limited the type of information that could be requested. The general director questionnaire that BlackRock used to request supplemental information clearly (by admission of the parties) exceeded the scope of the information authorized by the advance notice bylaw. The Supreme Court stated that, "in a perfect world," BlackRock's request for supplemental information would have identified the portions of the requested information that were "within the bounds" of the director qualification requirements set forth in the bylaws. (The court also stated that it would have been preferable if BlackRock had stated in its supplemental information request what the bylaws-imposed deadline was for submitting the information.) When requesting supplemental information under an advance notice bylaw that specifies the type of information that may be requested, a company could consider either not utilizing a generic, broad-based questionnaire or specifying which questions are within the scope of the bylaw. (The questions that both parties in *BlackRock* agreed were unrelated to director qualification requirements included, for example, those relating to the Iran Threat Reduction and Syria Human Rights Act of 2012, academic probation, sexual misconduct, future business commitments, and nominations to other boards.)
- ***Companies should consider whether the deadline for submitting supplemental information is appropriate in light of the breadth of the request.*** The BlackRock questionnaire was 47 pages long and contained 100 questions; and the bylaws required that the information be submitted within five business days after BlackRock requested it. BlackRock argued that its decisions on the breadth of the questionnaire and the associated deadline should be accorded business judgment deference. During oral argument at the Supreme Court, Justice Karen Valihura asked BlackRock counsel: "What if the questionnaire were 500 questions or the size of the Manhattan phone directory? Do you expect the nominee to sift through that? Is it up to them to figure out what is relevant [and comply within the five-day deadline]?" The Justice's questioning highlights that companies should seek to set reasonable deadlines for responding to supplemental information requests.
- ***Companies should draft advance notice bylaw provisions to be clear and unambiguous and, when possible, should adopt them on a "clear day."*** As discussed, the Supreme Court emphasized that the bylaw provisions at issue in this case were "clear and unambiguous." The court reaffirmed that, to the extent advance bylaw provisions are unclear, "we resolve any doubt in favor of stockholders' electoral rights." The court also emphasized that the bylaws had been "adopted on a clear day." While adoption on a clear day is a helpful fact, it is not mandatory and advance notice bylaws can be validly adopted after, for example, the appearance of an aggressive activist.
- ***Director proponents should read the bylaws carefully.*** The court stated that "a reasonable reading of the record" was that Saba had "misread" the bylaws and, mistakenly, "did not think it had to respond to the [request for supplemental information] within five business days [of the request being made]…." The court viewed Saba's "justifications" for its noncompliance with the deadline as likely being "after-the-fact excuses" for its having missed the deadline.

- ***Director nominee proponents should be prepared to respond to supplemental information requests.*** Where an advance notice bylaw permits company requests for supplemental information, director nominees should anticipate that a request will be made and should seek to ensure that they are in a position to be able to respond within the specified deadline (which may be only a few days after the company's request).

# *Court of Chancery Decision Suggests Heightened Risk of Potential Liability for Officers and Outside Advisors for Flawed Disclosure* —Morrison v. Berry

The most recent decision in the longstanding *Morrison v. Berry* litigation (Dec. 31, 2019) is notable for appearing to suggest that alleged materially flawed disclosure to stockholders about a sale process may *necessarily* lead to a finding, at the pleading stage of litigation, of possible breach of the duty of care (*i.e.*, gross negligence) by the corporate officers who drafted the disclosure.

Under the court's reasoning, a plaintiff's fiduciary claims against a general counsel who drafted the disclosure could in effect automatically survive a motion to dismiss at the pleading stage. Moreover, there would then be a predicate breach for an aiding and abetting claim against the outside legal counsel (although this claim would survive dismissal only if the plaintiff also alleged facts that met the high bar for an inference of scienter–*i.e.*, knowing and intentional wrongdoing–by the outside counsel). The decision thus suggests a newly heightened risk of potential liability under Delaware law for general counsels and outside legal advisors for materially flawed disclosure. Whether the Court of Chancery intended this broad effect is unclear. Clarification on the court's approach awaits further developments in the case.

We note that, at the same time, there is also heightened risk for corporate directors, officers and advisors of Rule 10d-5 liability under the federal securities laws based on the U.S. Supreme Court's adoption (in March 2019) of the *Lorenzo* doctrine (which was expanded, in the first application of the doctrine by a Circuit Court, in the Tenth Circuit's *Maldouf v. SEC* (Aug. 2019)). *Lorenzo* held that those who disseminate false or misleading statements to potential investors with the intent to defraud — even if they are not the author or "maker" of the statement — can be found to have violated subsections (a) and (c) of Rule 10b-5 and related provisions of the federal securities laws. *Lorenzo* is noteworthy because it could be seen as expanding potential liability under Rule 10b-5 and may be used by civil plaintiffs to try to resuscitate exposure for third-party actors who were thought to be outside the ambit of Rule 10b-5 after earlier U.S. Supreme Court decisions in *Janus Capital v. First Derivative Traders* (2011) and *Central Bank of Denver v. First Interstate Bank of Denver* (1994).

The scope of *Lorenzo* also awaits further development–by the Circuit Courts (or, ultimately, clarification by the U.S. Supreme Court). See our memoranda, *Supreme Court Creates Uncertainty About the Reach of 'Scheme' Liability Under Rule 10b-5,* Fried Frank Securities Litigation Update (Spring 2019), p. 1; and *Tenth Circuit Decision in* Maldouf v. SEC *Broadens Scope of Potential Rule 10b-5 Liability for Misleading Statements and Omissions*, Fried Frank Securities Litigation Update (Fall 2019), p. 4.

# *Court of Chancery Further Expands Stockholder Entitlement to Books and Records Under Section 220 Requests*—AmerisourceBergen

Stockholders of AmerisourceBergen Corp. ("ABC") requested access to ABC's books and records relating to the company's "role in America's opioid crisis." ABC denied the request. In *Lebanon Couty Employees' Retirement Fund v. AmerisourceBergen Corporation* (Jan. 13, 2020), Vice Chancellor Laster ordered ABC to grant the request. The decision reflects the court's generally expanded view of stockholder entitlement under Section 220 over the past year–and clarifies that a stockholder need not include in a Section 220 request a statement that its purpose is to bring litigation.

Stockholders have broad rights to access books and records under Section 220 but they must have a "proper purpose" for seeking to obtain the access, which includes determining whether there was wrongdoing or mismanagement by a company's directors or officers. The request cannot be a "fishing expedition"–generally, the stockholder must show that there is an evidentiary basis to suspect wrongdoing or mismanagement warranting investigation. Historically, Section 220 was utilized primarily as a tool to obtain information on which detailed complaints could be drafted prior to filing derivative actions. However, in the past couple of years, at the court's urging, stockholders have increasingly been utilizing Section 220 to determine, *prior to* filing a post-closing class action challenging a merger, whether the complaint could survive dismissal based on business judgment review under *Corwin* or *MFW*.

The ABC stockholders' stated purpose for the request was "to investigate possible breaches of fiduciary duty, mismanagement, and other violations of law" by ABC's directors and officers and to "evaluate the independence and disinterestedness" of the directors and officers in connection with the lawsuits and investigations against the company relating to its sale of opioids. The Vice Chancellor found that each of these purposes was sufficient to grant access under Section 220. The Vice Chancellor stated that, to obtain access under Section 220, a stockholder must show only "a credible basis from which the court can infer a possibility of wrongdoing" by directors or officers–which, he stated, is "the lowest possible burden of proof." The Vice Chancellor observed that ABC had experienced "a significant corporate trauma," and "already ha[d] spent more than $1 billion in connection with the opioid-related lawsuits and investigations," and could face tens of billions of dollars in liability. These facts "can provide the necessary evidentiary basis to suspect wrongdoing or mismanagement warranting further investigation."

ABC argued that the stockholders' purpose was to bring fiduciary lawsuits against the directors and officers and that, because their request did not state litigation as a purpose, the request should not be granted. The Vice Chancellor acknowledged that certain Court of Chancery decisions have held that stockholders must not only state a proper purpose but also "what [the stockholder] will do with the information or the end to which that investigation may lead." The Vice Chancellor rejected that view, stating that Section 220 does not include such a requirement and the Delaware Supreme Court has not imposed it.

Also reflective of a trend of expanded stockholder entitlements under Section 220, over the past year the court has indicated a new willingness to permit access to directors' and managers' emails under Section 220 demands—even emails on *personal* email accounts and texts on *personal* cellphones—at least when key discussions were conducted or decisions were made through emails or texts and were not formally reflected in board minutes or other corporate documents (*Schnatter v. Papa John's* and *K24 v. Palantir*). Further, in one case (*Bucks County v. CBS*), where there were credible allegations of wrongdoing

by the controlling stockholder (Redstone) and the directors of CBS in connection with a specific board committee meeting, even though the plaintiff did not explicitly ask for texts or emails in its Section 220 demand, the court granted access to all of the electronic communications between Redstone and the committee members for the 14 days before and after the date of the meeting because the court was "satisfied that Redstone, the Viacom board and the CBS board communicated by means of text messages and emails." It bears repeated emphasis that directors and managers should be made aware, and periodically reminded, of the need for extreme care with respect to the content of emails. Also, a board generally should memorialize discussions and decisions in formal minutes and should consider adopting a policy prohibiting directors from conducting corporate business through personal email accounts or texts.

Also of note, there is an appeal pending of the Court of Chancery's decision in *High River v. Occidental* (Nov. 14, 2019). In *High River*, Vice Chancellor Slights rejected the Section 220 demand made by entities affiliated with shareholder activist Carl Icahn in connection with their upcoming proxy contest to take control of the Occidental Petroleum Corp. board due to their displeasure with the company's acquisition of Anadarko Inc. The Court of Chancery held that a stockholder's desire to communicate with the other stockholders in a proxy contest about the board's "substantive business decisions" — without allegations of actionable wrongdoing by the board — is not a "proper purpose" for a Section 220 demand. The court emphasized that the plaintiffs simply "disagreed" with the board's decisions, believed the board made "bad decisions," and questioned the board's "deal-making prowess"–and that the plaintiffs had not even alleged, much less proven, that the board was "conflicted, disloyal or in some way interested in the transactions at issue" nor that the board acted in "bad faith." Vice Chancellor Slights characterized the law in this area as "murky," however–and it is expected that the Delaware Supreme Court may now clarify whether facilitation of a proxy contest challenging business decisions is a proper purpose for a Section 220 request (which, if the answer is yes, would significantly facilitate activist stockholder challenges).

## *Asset Managers' Focus on Environmental Issues – and the Development of a Standardized Framework for ESG Reporting*

***BlackRock.*** In his January 2020 letters to fellow CEOs and BlackRock shareholders, BlackRock CEO Larry Fink wrote that climate change has set us "on the edge of a fundamental reshaping of finance" and "has become a defining factor in companies' long-term prospects"; that BlackRock will now "place sustainability at the center of its investment approach" and will begin to reallocate its capital away from fossil fuels; and that BlackRock will now "be increasingly disposed" to vote against directors in uncontested elections at companies that do not provide adequate disclosure about climate risk. BlackRock, the world's largest asset management firm, has about $7 trillion of assets under management. Fink urged that corporations collect and publish disclosures in line with industry-specific guidelines produced by the Sustainability Accounting Standards Board (SASB) or climate-risk disclosures in line with recommendations issued by the Task Force on Climate-Related Financial Disclosures (TCFD). Fink did not address in the letter whether BlackRock would support existing shareholder proposals on environmental issues; potentially make shareholder proposals itself; or call for specific actions on environmental issues in addition to disclosure. Proxy Insight has reported that BlackRock voted in support of environmental proposals 19.4% of the time in

the 2019 proxy season, as compared to 10.6% and 4.4% of the time in the 2018 and 2017 proxy seasons, respectively. BlackRock's updated voting guidelines, which were issued February 13, 2020, state that it expects that companies will issue reports aligned with the Task Force on Climate-related Financial Disclosures and Sustainability Account Standards Board (SASB) standards; state that the firm will make voting decisions on each climate-related shareholder proposal on a case-by-case basis, and may vote against the election of relevant directors, even if it disagrees with the details of a climate-related proposal, where it has concerns regarding the disclosure or management of climate matters.

***State Street.*** The President and CEO of State Street Global Advisors, Cyrus Taraporevala, wrote in his 2020 letter to investors that State Street "believe[s] that addressing material ESG issues is good business practice and essential to a company's long-term financial performance–***a matter of value, not values***." While he cited "some progress," Taraporevala stated: "Unfortunately, fewer than 25% of the companies we've evaluated have meaningfully identified, incorporated and disclosed material ESG issues into their strategies." He criticized "some shareholder activists" for focusing on "specific or narrow ESG issues in piecemeal fashion–often creating confusion for investors, boards and company leadership ***without fundamentally tackling the ESG issues material to long-term shareholder performance***." Taraporevala wrote that, starting this year, State Street "***will take appropriate voting action against board members at companies…that are laggards based on their R-Factor scores and that cannot articulate how they plan to improve their score.***" Launched by State Street this past year, R-Factor (with the "R" standing for "Responsibility") is a transparent scoring system that measures the performance on a company's operations and governance as it relates to financially material and sector-specific ESG issues. State Street draws on data from four providers and uses the SASB materiality framework to generate unique scores for over 6,000 companies listed globally. Taraporevala believes that "***a company's ESG score will soon effectively be as important as its credit rating***." Starting in 2022, State Street's voting action will be expanded to include those companies who have been consistently underperforming their peers on their R-Factor scores for multiple years, "unless we see meaningful change." (All bolding and italics are in the original letter.)

***European Investment Bank.*** The European Investment Bank–which is the EU's lending arm and the world's largest multilateral financial institution–stated in November 2019 that "[c]limate is the top issue on the political agenda of our time," and announced that the Bank will phase out its multibillion-euro funding of all coal, oil, and gas projects by 2021.

***International Business Council (IBC) of the World Economic Forum.*** In January 2020, the IBC released a draft framework for ESG-related reporting, which proposes a set of common disclosures aligned with the United Nations' Sustainable Development Goals. About 120 multinational companies and their CEOs are represented on the IBC. The draft was prepared by a task force that was chaired by Brian Moynihan, Chairman and CEO of Bank of America (and Chairman of the IBC), and included experts from the Big Four accounting firms. The IBC contemplates that the proposed framework would provide a mechanism for standardized ESG-related disclosure in companies' regular investment disclosures such as annual reports and proxy statements in addition to supplemental sustainability or social impact reports. It is expected that, after feedback from companies, investors and others, the proposed set of metrics and disclosures will be finalized in the coming months and then implemented in 2021.

# Notes

## *Court of Chancery Finds Special Committee Directors Were "Interested"*—AmTrust

In *AmTrust* (Feb. 26, 2020), the Court of Chancery held that the merger by which controlling stockholders, together with a private equity firm, took the company private did not comply with the framework set forth in *MFW* for subjecting the transaction to business judgment review because a majority of the special committee members evaluating and negotiating the merger were not "disinterested" in the merger. The opinion clarifies that the *MFW* prerequisite of approval by an "independent" special committee requires that a majority of the members must be not only independent but also *disinterested* (meaning not having any interest in the transaction)—and that a director would be interested in a merger that was expected to extinguish a viable derivative claim for which the director faced potential liability that would be material to him or her.

## *"Commercially Reasonable Efforts" Standard in an Earnout*—Neurvana v. Balt

In *Neurvana Medical v. Balt* (Feb. 27, 2020), the Court of Chancery dismissed claims that Balt (USA), LLC had breached the earnout provision of the agreement pursuant to which it sold a medical device company to Neurvana Medical, LLC. The agreement provided that the buyer would make earnout payments if, post-closing, specified milestones relating to obtaining regulatory approval for the company's product were met. The agreement granted Neurvana sole discretion on how to achieve the milestones, but obligated Balt to use "commercially reasonable efforts" to obtain the regulatory approval. When Balt failed to achieve the key milestone, Neurvana brought suit alleging, among other things, that Balt had breached its obligation to use commercially reasonable efforts.

"Commercially Reasonable Efforts" was defined in the agreement to mean: "using efforts and resources comparable to those which an entity in the medical device industry of similar resources and expertise as the Purchaser and its Affiliates (taken as a whole) generally use in the exercise of its reasonable business judgment to accomplish such activities in an expeditious manner for its own products of similar market potential at a similar stage of development or product life, considering conditions then prevailing."

The court dismissed the plaintiff's claim because the plaintiff focused on Balt's interactions with it–such as not accepting its help, reneging on "promises" made, and not keeping Neurvana informed–rather than pleading facts that would tie Balt's efforts to the "objective yardstick" set forth in the contractual definition of "Reasonably Commercial Efforts." Vice Chancellor Kathaleen McCormick distinguished the court's 2019 *Himawan* decision, in which the court interpreted an almost identical provision in almost identical circumstances. In *Himawan*, she stated, plaintiffs "had pleaded at least some facts tying to the 'relevant yardstick' supplied by the contractual commercially reasonable efforts provision," whereas the *Neurvana* plaintiffs "made *no* effort to apply the 'relevant yardstick'…."

Also of note, the court, citing its 2018 *Akorn* decision as well as various academic studies, stated that, although legal practitioners view various formulations of efforts clauses (*i.e.*, "commercially reasonable efforts," "reasonable efforts," "reasonable best efforts" and "best efforts") in a "hierarchy," surveys of the case law find little support for judicial distinctions among them.

## *Key Upcoming 2020 Proxy Season Trends*

We note the following three trends–and recent SEC actions–that are expected to affect the 2020 proxy season:

- **Increased support for environmental proposals.** Increased support for environmental proposals is expected following the August 2019 announcement of the Business Roundtable's "Statement on the Purpose of a Corporation" (the "BRT Statement"); the December 2019 issuance of the World Economic Forum's "Davos Manifesto" regarding ethical principles for corporations; and the 2019 proxy season representing the third year in a row that shareholder proposals addressing environmental and other social concerns were more prevalent than any other governance proposals (a large majority of which were withdrawn after companies chose to substantially implement the proposals). We note that the focus on ESG by BlackRock and other major advisors (as discussed above) will ensure continued attention to these issues.

- **Continued focus on diversity on boards.**
  - Gender diversity on boards has increased significantly. Of the 432 independent directors added to S&P 500 boards of directors over the 2019 proxy season, a record-breaking 46% were women. Of the new Russell 3000 board seats in 2019, a record 45% were filled by women (compared to 12% in 2008). About 20% of all Russel 300 board seats are now held by women. A majority (56%) of S&P 500 boards now have at least three female directors.
  - Ethnic diversity is also increasing, but more slowly. For the first time, the percentage of ethnic minorities holding Russell 3000 board seats exceeded 10%. At S&P 500 companies, about 15% of new board seats were filled by ethnic minorities. For the first time, the percentage of ethnic minorities on boards of Russell 3000 companies exceeded 10%; and approximately 15% of the new board seats were filled by ethnic minorities.
  - The NYC Comptroller has launched the third stage of his "Board Accountability Project," which calls for 56 S&P 500 companies to adopt the "Rooney rule" (an official policy of interviewing women and minorities) in recruiting for directors and CEOs. In January 2020, Goldman Sachs announced that it will no longer underwrite initial public offerings of companies with all-white-male boards.

- ***Increased Opposition on Say-on-Pay Proposals.*** While shareholders still overwhelmingly support say-on-pay proposals on executive compensation, 2019 saw the highest level of opposition (a "failure" rate of 2.7%) than in any year since 2011 when these proposals were first introduced. At the same time, pay increases for CEOs (across all market segments and almost all industries) reached record highs, with stock-based compensation comprising an increasingly large component (for the first time, at large companies exceeding 50% of the total package).

- ***SEC Response to No-Action Requests Relating to the BRT Statement.*** We note that, in a related development, the SEC staff has denied no-action requests that were made by four major companies that are Business Roundtable members in response to shareholder proposals seeking information on how the companies plan to incorporate the BRT Statement into their business practices. However, the SEC granted one company's similar no-action request on the basis that the proposal had been substantially implemented. In the latter case, the company took the position that it had been operating according to the principles set forth in BRT Statement, as reflected in its publicly available information, including the company's statement of its business principles on its website; Report to Shareholders on "How We Do Business"; Supplier Code of Conduct; Environmental, Social and Governance Report; and most recent Chairman and CEO letter to shareholders.

## *Vice Chancellor McCormick Confirms Certain Recent Trends in Delaware Law*

On February 6, 2020, at the Forum on M&A and Governance hosted by the Berkeley Center for Law and Business at the Berkeley Law School, Vice Chancellor Kathaleen McCormick made the following observations about recent developments in Delaware law: (i) ***Director independence.*** The Vice Chancellor stated that there has been a "slight shift" in Delaware law in favor of finding that "mere friendship" between directors does not render them non-independent of each other. She suggested that the high burden a plaintiff faces in overcoming the presumption of director independence (even at the pleading stage), together with the exculpation of directors under DGCL Section 102(b)(7) (which eliminates personal liability of directors for breaches of the duty of care), more often leaves corporate officers (such as General Counsel and CEOs), rather than directors, with the risk of potential liability. (See our memorandum, *Delaware Supreme Court Reinforces High Bar to a Finding of Director Non-Independence in the Context of Demand Refusal*–McElrath v. Kalanick (Feb. 2020); see also the Court of Chancery's Dec. 31, 2019 decision in *Morrison v. Berry*.) (ii) **Caremark *Claims.*** The Vice Chancellor acknowledged that in three recent decisions the Court of Chancery has denied motions to dismiss *Caremark* claims for failures of oversight by boards, but she stated that those decisions were "unusual" and that there is still a high bar to a plaintiff's succeeding on a *Caremark* claim. See our memorandum, *Delaware Supreme Court Reverses Dismissal of a Fiduciary 'Caremark' Suit After Finding the Board Did Nothing to Assure Board-Level Oversight of Regulatory Compliance–Marchand v. Barnhill ("Blue Bell")* (June 2019). (iii) The Vice Chancellor confirmed that the Delaware courts are seeing more litigation over director compensation as the plaintiffs' bar has shifted away from challenging corporate transactions and disclosure.

## *Ordinary Business Insurance Policy Covered Cyber-Attack Losses*—National Ink

In *National Ink & Stitch, LLC v. State Auto Property & Casualty Insurance Co.* (Jan. 23, 2020), a federal district court in Maryland granted summary judgment in favor of an insured company that the company's ordinary business insurance policy provided coverage for the cost of replacing its computer systems with an entire new computer system following a ransomware attack that prevented the company from accessing its files and using its software. The policy provided coverage for "direct physical loss of or damage to Covered Property." "Covered Property" was defined to include "electronic media and records (including software)," which included both physical storage media and "data stored on such media." The insurance company contended that there was no "direct physical loss" because the company had lost only an intangible asset (its data) and could still use the system hardware. The court held that, under the plain language of the policy, intangible data could suffer "physical loss or damage" (and thus damage to the data and software was covered) and, because the new security measures the company had to add caused the hardware to operate inefficiently, the hardware also had suffered "physical damage" (and thus its replacement also was covered). The decision is a reminder that regular business insurance policies (and not only stand-alone cyber-insurance) may cover losses from cyber events. Companies should evaluate whether there are gaps in the coverage under the combination of their insurance policies (such as cyber, property, crime, and general liability). Also, companies should be alert to any modifications that insurers may make to ordinary business insurance policies to limit or eliminate coverage for cyber events.

## *Reminder that Lawyers Who Represent an LLC Do Not Also Represent the Members*—Hedenberg

A New Jersey appellate court decision reaffirmed the well-established principle that, with only limited exceptions, attorneys who represent a business entity do not also represent the entity's constituents. In *Hedenberg v. Ciardi* Super. Ct. App. Div., Nov. 22, 2019), the appellate court affirmed the trial court's grant of summary judgment in favor of the defendants in a legal malpractice action. In most jurisdictions, generally, the subjective belief of a member of an LLC (or shareholder of a corporation) that he or she was being represented by the attorney for the LLC (or corporation) is not sufficient to support a malpractice claim brought by that individual against the attorney. Instead, generally, an express agreement confirming the representation of the individual (or other evidence of the attorney having provided advice or legal services to the individual) in his or her individual capacity would be required.

In *Hedenberg*, the defendant law firm represented an LLC in negotiating a $32.3 million loan with the LLC's lender. The loan agreement provided that, if the LLC ever declared bankruptcy, the LLC members would be personally liable for repayment of the loan. The LLC thereafter faced dire financial straits and attempted to renegotiate the loan. The lender refused and held to the original due date for the loan. The LLC, following the advice of the law firm, declared bankruptcy. The lender obtained a judgment against the LLC members. The LLC members sued the law firm for malpractice, contending that they viewed the LLC and themselves as "one and the same" and that the law firm never advised them that they could be personally liable for the loan. The court held that an affirmative act by the lawyer is required to create an attorney-client relationship; that nothing that the law firm did would lead sophisticated business people to believe they were being represented in their individual capacities, and that the law firm was under no affirmative duty to inform the plaintiffs that the firm did not represent them. The decision serves as a reminder, however, that lawyers should be alert to who their client is and when it makes sense to advise LLC members or corporate shareholders to obtain their own independent counsel.

## *Regulations Expand CFIUS Authority*

The U.S. Treasury Department, on behalf of the Committee on Foreign Investment in the United States (CFIUS), issued two final regulations implementing the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), effective as of February 13, 2020. Under the regulations, CFIUS' ability to review transactions for national security threats has been expanded beyond transactions that result in foreign control of a U.S. business to include also: (i) non-controlling investments, whether direct or indirect, by foreign persons in U.S. businesses that involve critical technologies, critical infrastructure or sensitive personal data of U.S. persons (TID business) where the foreign person obtains certain non-passive information or access rights; and (ii) certain real estate transactions that do not involve the acquisition of an existing U.S. business. Canadian, Australian and UK investors may be exempt from CFIUS' expanded jurisdiction over these non-controlling and real estate investments due to the new "excepted investor" exemption.

# Fried Frank M&A/PE Memoranda Issued this Quarter

## Evaluating Whether COVID-19 Constitutes a MAC

A critical legal issue that has arisen in recent days is whether the COVID-19 pandemic may constitute a "material adverse change" under existing agreements. The non-existence of a MAC of a target company typically is a condition to closing under an acquisition agreement; and the non-existence of a MAC of a borrower typically is a condition to its drawing down funds under a revolving credit facility. Whether a MAC has occurred is a highly fact-specific inquiry. In each case, it will depend on the specific drafting of the provision and the facts and circumstances. The person seeking to invoke a MAC bears a "heavy burden" to establish that a MAC has occurred.

The specific language of the MAC provision is a critical factor. Essentially, unless a different outcome has been expressly negotiated and reflected in the agreement at issue, in a merger agreement context, all market and systemic risks affecting a target company are effectively allocated to the buyer, and, in a credit agreement context, all such risks are effectively allocated to the lender. It appears that, under most standard MAC provisions, and current law, the COVID-19 pandemic likely would not be deemed by a court to constitute a MAC. However, the inquiry would be fact-intensive and there are circumstances under which it *could* constitute a MAC. Importantly, the evaluation may change over time, with a MAC becoming more possible to the extent the pandemic does not resolve in the relative near-term.

## Update on Legal Issues and Developments Relating to the COVID-19 Pandemic

This memorandum discusses COVID-19-related issues and developments concerning M&A/PE (as summarized above), capital markets, financings, insolvency and restructuring, employees, and real estate.

## Court of Chancery Finds a Merger Is Subject to "Entire Fairness" Because a Special Committee Was Not Formed Early Enough in the Process—Salladay

In *Salladay v. Lev* (Feb. 25, 2020), the Delaware Court of Chancery held, at the pleading stage, that the merger of InterSections, Inc. with an acquisition vehicle formed by the iSubscribed Investor Group would be subject to "entire fairness" review because a majority of InterSections' directors were self-interested and the special committee of independent directors was not formed early enough in the process to counteract their influence. The decision is notable for expressly applying, in a non-*MFW* context, *MFW*'s "*ab initio*" requirement with respect to the formation of a special committee to consider a merger not involving a controlling stockholder. The court found that the committee "entered the negotiations after the point at which it could act to replicate an arm's-length transaction." In the court's view, the committee's formation (about three weeks after the acquiror first approached the company) occurred after "substantive economic discussions" had begun. The court emphasized that, prior to the committee's formation, a company director had suggested to the acquiror a range of values that the board would find acceptable (and the acquiror made its initial bid at the "precise bottom" of that range and ultimately increased its offer to just below the mid-point

of that range). The court also found that, although the merger was approved by the stockholders, business judgment review was not available under Corwin because the vote was not "fully informed." The court found that the disclosure was misleading in suggesting that, if the merger did not occur, the acquiror had a contractual right under a convertible note agreement to take control of the company *subject to* a NASDAQ rule–without clearly disclosing that the Rule would not permit the acquiror to take control unless it owned a majority of the outstanding shares (which it did not). The court also found that the disclosure was incomplete or coercive in not providing the reason that a financial advisor did not accept being engaged by the committee, following which another banker was engaged and produced a fairness opinion in just eight days.

## *Delaware Supreme Court Reinforces High Bar to a Finding of Director Non-Independence in the Context of Demand Refusal*—McElrath v. Kalanick

In *Kalanick* (Jan. 13, 2020), the Delaware Supreme Court upheld the Court of Chancery's decision that dismissed a derivative suit brought by a stockholder of Uber Technologies, Inc. for damages arising from Uber's 2016 acquisition of Ottomotto LLC. The Supreme Court agreed with the Court of Chancery's determination that a majority of the Uber directors in office at the time the complaint was filed were independent and had not acted in bad faith—and, therefore, that pre-suit demand on the board to bring the litigation would not have been "futile" and so was not excused. In recent years, when applying Delaware's well-established principles for determining director independence, the courts have appeared to find non-independence more readily than in the past. Given that the facts in this case do not appear to present a particularly strong case for non-independence, we do not read the decision as necessarily suggesting a change in the court's recent trend in seeming to apply a somewhat higher bar to a finding of director independence in the demand futility context. Separately, the decision reinforces that there continues to be a high bar to a finding of bad faith by independent directors–and that this, in combination with corporate charter exculpation provisions, continues to make it highly unlikely that independent directors would have personal liability for alleged fiduciary breaches except in the most egregious cases.

## *Court of Chancery Reaffirms High Bar for a Minority Stockholder to be Deemed a Controller*—Essendant

In *Essendant* (Dec. 30, 2019), the plaintiff-stockholders of Essendant, Inc. brought claims against the directors for their decision to terminate an agreement for a stock-for-stock merger with Genuine Parts Company in order to enter into an all-cash deal offered by Staples, Inc. and its private equity firm parent, Sycamore Partners. The Court of Chancery, at the pleading stage, rejected the plaintiffs' contention that Sycamore, although a minority (11.6%) stockholder, was a controlling stockholder. (See above, *Developments in Minority Stockholders Being Deemed to be Controllers*.) The decision also reaffirms the presumption of director independence–and that independent directors, as a fiduciary matter, even when *Revlon* duties apply, can legitimately prefer an all-cash deal over a stock deal that is valued higher than the cash offer price (in this case, because there were concerns about the risk of remaining in a highly competitive industry).

## *Court of Chancery Confirms that, Post-Akorn, It Will Evaluate MACs Under the Traditional Framework*—Channel v. Boston Scientific

In *Channel* (Dec. 18, 2019), the Court of Chancery issued its first decision since the Delaware Supreme Court's 2018 *Akorn* decision to evaluate whether an acquiror had a right, under a merger agreement, to terminate a pending acquisition on the grounds that there was a "Material Adverse Effect" or "Material Adverse Change" in the target company. *Akorn* was the first case in which the Court of Chancery, post-trial, found the existence of an MAE and the first post-trial Delaware decision to find that an acquiror had the right to terminate a merger agreement based on an MAE. In *Channel*, by contrast, Chancellor Bouchard ruled, after trial, that there was *not* an MAE and that the acquiror was required to close the merger. *Channel* indicates that, post-*Akorn*, the court continues to evaluate MAEs under the traditional Delaware framework, which sets a high bar to a finding of an MAE. We observe that, even though the court never found an MAE before *Akorn*, the facts in *Akorn* appear to have presented a relatively easy case for a finding of an MAE. At the same time, the facts in *Channel* appear to have presented a relatively easy case for a finding of *no* MAE. Thus, although other commentators have stated that *Channel* confirms that post-*Akorn* there will continue to be a high bar to a finding of an MAE—and although as we read *Akorn*, it did not suggest that there would be any lowering of the traditionally high bar—in our view, *Channel* does not appear to have provided a real test of that theory. The decision is also noteworthy in reaffirming that (as was also indicated in *Akorn*) a contractual obligation to use reasonable best efforts to close a merger agreement requires that a party "take all reasonable steps to solve problems" so that the transaction can be consummated.

## *Appraisal Decision Deducts Certain Merger Synergies from a Financial Buyer's Deal Price and Establishes There is No Right to a Refund on Prepayments*—Panera

*Panera* (Dec. 31, 2018) is notable for being one of the few appraisal cases in which the court has actually made a deduction to exclude from appraised fair value the value of expected merger synergies. The decision provides guidance as to the type of synergies that may be deducted and the type of evidence that will substantiate a deduction. Also, the court, for the first time, affirmed that a buyer that has pre-paid an amount that turns out to be higher than the court's ultimate fair value determination is not entitled to a refund. The decision thus underscores that, as part of any prepayment, the buyer should negotiate with the appraisal petitioners a contractual claw-back right. The decision also serves as a reminder that, notwithstanding the decline in appraisal risk over the past couple of years, appraisal claims may still be made when there are perceived flaws in the sale process. At the same time, the decision highlights the risk to appraisal petitioners of an at-or-below-the-deal-price result—which has significantly discouraged the filing of appraisal claims in the context of arm's-length third party mergers without seriously flawed sale processes.

# M&A/PE Round-Up

## THIS QUARTER, FRIED FRANK WAS REPRESENTED THROUGHOUT THE MARKETPLACE IN MULTIPLE SPEAKING ENGAGEMENTS:

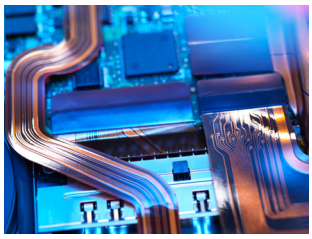
- Corporate partner Amber Banks moderated a panel at Harvard Business School's Venture Capital and Private Equity Conference
- Corporate partner Brian Mangino spoke on a panel at The National Association of Corporate Directors' (NACD) Battlefield to Boardroom development program

## HIGHLIGHTS OF OUR 2020 FIRST QUARTER WORK INCLUDE REPRESENTATIONS OF:



### Permira Funds

Counsel to Permira Funds in its acquisition of a majority stake in Lytx, valuing the company in excess of US$2.5 billion.



### Leidos

Counsel to Leidos in its US$1 billion definitive agreement to acquire L3Harris' Security, Detection, and Automation business.



### CVS Health

Counsel to CVS Health in its sale of Coventry Workers' Comp Services to Mitchell | Genex.

## RECENT FRIED FRANK M&A/PE QUARTERLIES (*click to access*)

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