Insights:
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This issue covers important, developing areas of Delaware corporation law and deal litigation, including an increased focus on officer-related claims in merger litigation, the treatment of *Caremark* claims after *Marchand* and *Clovis*, fiduciary duty actions against executive directors following transactions approved by a disinterested and independent board, and recent guidance regarding when the deferential business judgment standard of review may apply to controlling stockholder "squeeze-out" mergers.

Recent Trends in Officer Liability

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More than a decade ago in the seminal case *Gantler v. Stephens*,[1] the Delaware Supreme Court clarified that officers of Delaware corporations owe the same fiduciary duties of care and loyalty that directors owe to the corporation and its stockholders.

While directors and officers owe the same fiduciary duties, they are not entitled to the same defenses. Section 102(b)(7) of the Delaware General Corporation Law (DGCL) permits a corporation to adopt a provision in its certificate of incorporation exculpating directors from money damages for breaches of the duty of care. Those provisions, which are routinely adopted by Delaware corporations, do not apply to corporate officers.

To adequately plead a breach of the duty of loyalty, a plaintiff must show that fiduciaries acted in a self-interested manner or in bad faith, which is a high bar to meet. By contrast, to plead a breach of the duty of care, a plaintiff must allege only that the fiduciaries acted in a grossly negligent manner, a far lower bar that makes care claims a prime target for stockholder plaintiffs. Even so, until recently, officer liability cases were still few and far between. The rare officer liability claim was typically brought in derivative litigation and involved either allegations of disloyal conduct for which neither a director nor an officer could be exculpated[2] or conduct by an individual serving in both an officer and director role.[3] Claims against an officer for breach of the duty of care — particularly in class action merger litigation — were exceedingly rare.

Over the past year, however, stockholder plaintiffs have increasingly pursued claims against officers for breaches of the duty of care. Moreover, such claims have been raised not only in the derivative context but in class action merger litigation as well, with mixed results.

[1] *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009).

[2] *See, e.g.*, *In re Dole Food Co., Inc. Stockholder Litig.*, C.A. No. 8703-VCL (Del. Ch. Aug. 27, 2015) (finding that Dole's COO/general counsel, who also served as director, was liable for breaching his duty of loyalty to Dole's stockholders); *Ryan v. Gifford*, 935 A.2d 258, 272 (2007) (holding complaint stated claim for breach of duty of loyalty against CFO and vice president).

[3] *See, e.g.*, *Arnold v. Soc'y for Sav. Bancorp, Inc.*, 650 A.2d 1270, 1288 (Del. 1994) (rejecting argument that claims against CEO-director should survive because the plaintiff "failed to highlight any specific actions [CEO] undertook as an officer (as distinct from actions as a director)").

Plaintiffs Target Officers in Deal Litigation

In December 2019, the Court of Chancery's motion to dismiss the ruling in *Morrison v. Berry*[4] shined a new spotlight on officer liability, particularly in a class action merger litigation context. The ruling, which addressed post-closing claims for money damages arising out of the sale of Fresh Market, dismissed duty of loyalty claims against directors but allowed claims against the company's founder/director, CEO and general counsel to proceed.

Of particular significance, the court declined to dismiss claims against Fresh Market's general counsel, holding that the complaint stated a claim for breach of the duty of care based on his alleged gross negligence in "preparing" inadequate merger disclosures. The court explained that, "[g]iven [his] role as General Counsel … [it] c[ould] infer that the omitted facts were omitted with his knowledge." The court also relied on allegations that the CEO, who was also a director, "participated" in his capacity as an officer in drafting the registration statement. The court concluded it was "reasonably conceivable that crafting such a narrative to stockholders, while possessed of the information evincing its inadequacy, represents gross negligence … ."

Since *Morrison v. Berry*, the Court of Chancery has seen a notable uptick in class action deal litigations involving claims against corporate officers, which present plaintiffs' attorneys with an additional avenue for recovery when directors are entitled to greater protections against liability.

For example, in *In re Mindbody, Inc., Stockholders Litigation*,[5] the Court of Chancery denied a motion to dismiss breach of fiduciary duty claims against a chairman/CEO and a CFO/COO in merger litigation challenging the sale of Mindbody. The court found that the complaint supported a reasonable inference that the CEO was conflicted based on an interest in near-term liquidity and an expectation that he would receive post-merger employment; tilted the sales process in favor of the buyer; and "failed to disclose material information to the board," namely, his alleged conflicts in the sales process and communications with the buyer. The court also declined to dismiss duty of care claims against Mindbody's CFO because as an officer, he was "not exculpated by the Company's 102(b)(7) provision," and he had allegedly acted with gross negligence. He allegedly obeyed the CEO's instructions that aided in tilting the sales process to the buyer and was "at least recklessly indifferent" to the steps the CEO took.

A few weeks later, in *In re Baker Hughes Inc. Merger Litigation*,[6] the court addressed breach of fiduciary duty claims against officers in class action merger litigation arising from the July 2017 merger of Baker Hughes Incorporated and the oil and gas segment of GE. Plaintiffs alleged that the proxy statement issued in connection with the transaction failed to disclose unaudited financials provided to the board. Plaintiff stockholders alleged, among other things, that Baker Hughes's CEO/chairman and CFO "breached their disclosure duties" based on that alleged omission. The court sustained claims against the CEO as an officer because "the Complaint allege[d] that '[he] signed both the Proxy, as the Chairman and CEO of Baker Hughes, and the Form S-4, as a person about to become a director of New Baker Hughes.'" The court concluded that "[a]lthough not overwhelming, this allegation [wa]s sufficient to support a reasonably conceivable claim that [he] breached his duty of care with respect to the preparation of the Proxy he signed as Baker Hughes' CEO." On the other hand, the court dismissed claims against the CFO based on "exceedingly thin" allegations.

[4] *Morrison v. Berry, et al.*, C.A. No. 12808-VCG (Del. Ch. Dec. 31, 2019).

[5] C.A. No. 2019-0442-KSJM (Del. Ch. Oct. 2, 2020).

[6] C.A. No. 2016-0638-AGB (Del. Ch. Oct 27, 2020). Recently the Court of Chancery described Baker Hughes as "well reasoned" in *In re USG Corporation Stockholder Litigation*, C.A. No. 2018-0602-SG (Del. Ch. Dec. 1, 2020).

More recently, in *City of Warren General Employees' Retirement System v. Roche*,[7] the Court of Chancery addressed breach of fiduciary duty claims against two officers of Blackhawk Network Holdings, Inc. in class action litigation arising from the June 2018 acquisition of Blackhawk by two private equity firms. Plaintiffs, after demanding to inspect Blackhawk's books and records, alleged that Blackhawk's CEO and its executive chairman breached their fiduciary duties by manipulating the board to favor the buyout and for misleading stockholders through a materially misleading proxy statement. The proxy allegedly contained inaccurate descriptions of the go-shop and misleading projections. The court dismissed the breach of the duty of loyalty claims because the complaint pled neither that they had a "material conflict of interest" nor that the board was manipulated or deceived. The court dismissed the claims against the executive chairman related to the proxy because the complaint did not allege that he was involved in preparing or signing the proxy statement. However, the court, much like in *Baker Hughes*, sustained the claims against the CEO for the allegedly misleading proxy because she was involved in preparing the proxy as an executive officer and she signed it.

The Court of Chancery also recently sustained breach of the duty of loyalty claims in two separate merger litigations against CEOs in *Voigt v. Metcalf*[8] and *In re Coty Inc. Stockholder Litigation*,[9] noting in both cases that exculpation defenses did not apply.

Stockholder Plaintiffs Still Face Hurdles in Stating Claims Against Officers

Although officers are not afforded the same protections as directors under Section 102(b)(7), the Court of Chancery has stopped short of giving plaintiff stockholders a free pass. Rather, a number of cases made clear that to state a claim, they must adequately allege both a breach of the duty of care *and* that the individual against whom they seek to impose liability acted in his or her capacity as an officer and not a director. In three recent cases, the Court of Chancery dismissed claims against officers for failure to state a claim.

In *In re Essendant, Inc. Stockholder Litigation*,[10] the Court of Chancery dismissed breach of fiduciary duty claims raised in a class action merger litigation against a CEO arising from Essendant's merger with Staples. Because the CEO also was a director, the court explained that plaintiffs must "clearly draw the distinction between exculpated claims (due care claims relating to [the CEO/director's] conduct as Essendant Board member) and non-exculpated claims (those relating specifically to his role as CEO)." The court noted that the only officer-specific action that the CEO allegedly took was participating in a phone call with the buyer, which, "without more, [could not] support a reasonably conceivable inference of a breach of the duty of care or loyalty."

Similarly, in *In re AmTrust Financial Services, Inc. Stockholder Litigation*,[11] the Court of Chancery dismissed claims against AmTrust's CEO brought in connection with plaintiff stockholders' challenge to a squeeze-out merger. The court explained that, while the complaint "repeatedly refer[red] to AmTrust management," it did "not contain allegations regarding specific actions taken or statements made by [the CEO] in his capacity as an officer." Further, whenever the complaint did mention the CEO by name, it did so "in his capacity as a director of AmTrust." Accordingly, the court dismissed claims against the CEO in his capacity as an officer (although it sustained claims against him in his capacity as a director and member of the control group).

[7] C.A. No. 2019-0740-PAF (Del. Ch. Nov. 30, 2020).

[8] C.A. No. 2018-0828-JTL (Del. Ch. Feb. 10, 2020).

[9] C.A. No. 2019-0336-AGB (Del. Ch. Aug. 17, 2020).

[10] C.A. No. 2018-0789-JRS (Del. Ch. Dec. 30, 2019).

[11] C.A. No. 2018-0396-AGB (Del. Ch. Feb. 26, 2020).

Finally, in *Rudd v. Brown*,[12] the Court of Chancery dismissed a breach of fiduciary duty claim against a CFO in litigation arising from Apollo Global Management's acquisition of Outerwall. Plaintiffs alleged that the CFO was "conflicted by pursuit of post-close employment," but because the proxy issued in connection with the transaction disclosed that no discussion of post-closing employment had taken place, the court held that the plaintiffs failed to plead a duty of care or loyalty claim.

Books and Records Demands Target Officer Materials

Given the rise of officer breach of fiduciary duty claims in class action merger litigation, it is not surprising that there has been a corresponding uptick in stockholder plaintiffs using the "tools at hand" to obtain books and records demands under Section 220 of the DGCL to build their case against officers.[13]

Although these books and records demands are often resolved out of court, several were the subject of post-trial opinions. For example, in February 2020, the Court of Chancery ordered Empire Resorts to produce books and records so that a stockholder could, among other things, "test whether the Empire ... management [was] motivated during the merger negotiations by the prospects of continued ... employment."[14] In October, the Court of Chancery resolved another Section 220 demand where plaintiffs sought to "investigat[e] possible breaches of fiduciary duty by Grassroots officers and directors in connection with the Company's proposed acquisition," dismissing it on procedural grounds.[15]

Outside the deal context, Section 220 demands focusing on officer breach of fiduciary duty claims continue to proliferate. In *Gharrity v. Tesla, Inc.*, the court ordered Tesla to produce books and records so that a stockholder could investigate, among other things, whether "senior management" breached fiduciary duties in connection with an allegedly misleading Tweet from Tesla's controller, Elon Musk.[16]

In another recent ruling, *Lebanon County Employees' Retirement Fund and Teamsters Local 443 Health Services & Insurance Plan v. AmerisourceBergen Corp.*,[17] in the context of resolving a books and records demand seeking "senior management materials," the Court of Chancery expanded on officer liability, reiterating the longstanding principle that officers are "corporate fiduciaries" who "owe the same duties to the corporation and its stockholders as directors." The court further explained that officers also are "agents who report to the board of directors" and, as such, owe duties to provide information to the board necessary for the directors to carry out their duties, "comply with the board's directives" and "implement a compliance program, monitor its results, and report back to the board."[18]

These rulings, and the continued development in Section 220 law, have paved the way for plaintiffs to use books and records demands not only to bolster derivative claims, but to investigate potential claims against officers in deal litigation as well.

[12] C.A. No. 2019-0775-MTZ (Del. Ch. Sep. 11, 2020).

[13] In recent years, stockholders have increasingly turned to Section 220 to investigate potential wrongdoing in connection with merger transactions. *See Skadden Client Alert*, "Recent Trends in Books and Records Litigation" (Jan. 21, 2020).

[14] *Brown v. Empire Resorts, Inc.*, C.A. No. 2019-0908-KSJM (Del. Ch. Feb. 20, 2020) (TRANSCRIPT); *The MH Haberkorn 2006 Trust, et al., v. Empire Resorts, Inc.*, C.A. No. 2019-0909-KSJM (Del. Ch. Feb. 20, 2020) (TRANSCRIPT); *Glasgow and Brown v. Empire Resorts, Inc.*, C.A. No. 2019-0910-KSJM (Del. Ch. Feb. 20, 2020) (TRANSCRIPT); *Hertz v. Empire Resorts, Inc.*, C.A. No. 2019-0918-KSJM (Del. Ch. Feb. 20, 2020) (TRANSCRIPT); and *Zaks v. Empire Resorts, Inc.*, C.A. No. 2019-0919-KSJM (Del. Ch. Feb. 20, 2020) (TRANSCRIPT).

[15] *MaD Investors GRMD, LLC and MaD Investors GRPA, LLC v. GR Companies, Inc.*, C.A. No. 2020-0589-MTZ (Del. Ch. Oct. 28, 2020).

[16] *Gharrity v. Tesla, Inc.*, C.A. No. 2019-0217-JRS (Del. Ch. Mar. 12, 2020) (TRANSCRIPT).

[17] C.A. No. 2019-0527-JTL (Del. Ch. Jan. 13, 2020), *aff'd*, No. 60,2020 (Del. Dec. 10, 2020).

[18] The *AmerisourceBergen* decision comes on the heels of a recent resurgence in so-called "*Caremark*," or "failure to monitor," claims. While such claims are notoriously difficult to plead and prove, *AmerisourceBergen* seemingly opens the door for plaintiffs to bring books and records demands to investigate claims against officers for failing, as agents of the board, to properly carry out oversight procedures.

Takeaways

- Recent Delaware decisions reaffirm that disinterested and independent directors who conduct themselves in good faith should not face liability for breach of fiduciary duty claims. In particular, where the corporation's certificate of incorporation includes an exculpation provision pursuant to Section 102(b)(7) of the DGCL, directors do not face liability for money damages for breaches of the duty of care, leaving only claims for breach of the duty of loyalty, which are more difficult to prove.
- On the other hand, officers of Delaware companies should be aware of the potential for claims against them for breach of the fiduciary duty of care, even where director liability is exculpated. Like directors, corporate officers owe fiduciary duties to the corporation and its stockholders, but unlike directors, they do not have the benefit of Section 102(b)(7) exculpation for breaches of the duty of care. As a result, even in circumstances where claims are dismissed against directors, officers who play a role in a challenged transaction — for example, by preparing disclosure documents — may face liability if they perform their duties in a grossly negligent manner, the standard necessary to establish a breach of the duty of care.
- It is important to understand that officer liability is not limited to derivative litigation. In the class action merger litigation context, it is imperative for officers tasked with merger-related projects, such as drafting or reviewing stockholder disclosures, to take reasonable steps to inform themselves (and board members) of material information. This is particularly true for officers who sign the proxies or other disclosure documents that are sent to stockholders in connection with the transaction.
- Boards of directors, as well as key officers, should consider (with their outside counsel) whether adequate procedures are in place for reporting merger-related conflicts to the board and ensuring that any such material conflicts are adequately disclosed to stockholders. Regardless of the specific approach a company takes, the critical insight from the recent case law is that some reasonable steps must be taken by officers to ensure disclosure of material information.
- In addition, because officer liability is increasingly the subject of merger challenges, Delaware companies should be prepared to respond to books and records requests aimed at building a challenge to the deal focused not only on the conduct of directors but of officers as well.

Delaware Courts Examine *Caremark* After *Marchand* and *Clovis*

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In 2019, the Delaware Supreme Court issued *Marchand v. Barnhill*,[19] which was soon followed by the Court of Chancery's opinion in *In re Clovis Oncology Derivative Litigation*.[20] Both rulings sustained derivative claims for breach of directors' oversight duties (so-called "*Caremark*" claims) at the motion to dismiss stage, marking the first times Delaware courts allowed such claims to survive the pleadings stage in more than two decades. The Court of Chancery has since issued several additional opinions addressing *Caremark* claims, including several granting motions to dismiss.

Caremark Claims Sustained

Kandi Technologies[21]

In 2014, Kandi Technologies Group publicly announced the existence of material weaknesses in its financial reporting and oversight system, including a lack of oversight by the audit committee and lack of internal controls for related-party transactions. The company pledged to remediate these issues. However, in March 2017, the company disclosed that the prior three years of financial statements needed to be restated, and disclosed that it lacked sufficient expertise relating to GAAP requirements and SEC disclosure regulations and sufficient expertise to ensure the accurate accounting of taxes, as well as the completeness of the disclosure of financial statements. Stockholders initiated federal securities litigation, and the federal district court granted a motion to dismiss.

Stockholder plaintiffs also brought a *Caremark* claim in the Delaware Court of Chancery. On a motion to dismiss, Vice Chancellor J. Travis Laster sustained the *Caremark* claim, stating that

> "the complaint alleges facts that support an inference that the Company's Audit Committee met sporadically, devoted inadequate time to its work, had clear notice of irregularities, and consciously turned a blind eye to their continuation … . [T]he Company suffered from pervasive problems with its internal controls, which the Company acknowledged in March 2014 and pledged to correct. Yet after making that commitment, the Audit Committee continued to meet only when prompted by the requirements of the federal securities laws. When it did meet, its meetings were short and regularly overlooked important issues."[22]

Thus, the court concluded that the plaintiff adequately pled a claim under *Caremark*'s first prong, *i.e.*, that the board conceivably failed to establish a "reasonable system of monitoring and reporting."[23] Notably, the court observed that "[t]he Company could have produced documents in response to the plaintiff's Section 220 demand that would have rebutted [the] inference" that the audit committee "failed to provide meaningful oversight," and that "[t]he absence of those documents is telling because it is more reasonable to infer that

[19] 911 A.2d 362 (Del. 2006).

[20] 2019 WL 4850188 (Del. Ch. Oct. 1, 2019).

[21] *Hughes v. Hu*, C.A. No. 2019-0112-JTL, 2020 WL 1987029 (Del. Ch. Apr. 27, 2020).

[22] 2020 WL 1987029, at *14.

[23] 2020 WL 1987029, at *16.

exculpatory documents would be provided than ... that such documents existed and yet were inexplicably withheld."[24]

AmerisourceBergen Corporation[25]

In 2001, AmerisourceBergen Corporation (ABC) acquired Medical Initiatives, Inc. d/b/a Oncology Supply Pharmacy Services (Pharmacy). From 2001 to 2014, Pharmacy's business was to buy single-dose sterile vials of oncology drugs, put those into syringes and sell the syringes for injection into a cancer patient's body (the Pre-Filled Syringe Program). Those vials were intentionally overfilled to account for human error in filling syringes and to permit medical providers to discharge a small amount before administering. Instead of discarding the unused overfill, however, Pharmacy "pooled" the overfill in an unsterile manner in order to fill, and sell, more syringes. A number of syringes contained "floaters" (*i.e.*, particulates visible to the naked eye), and the "clean room" in which syringes were prepared was found to have unsafe levels of contaminants. Pharmacy's parent company, Specialty (an ABC subsidiary), closed the Pre-Filled Syringe Program in 2014. In September 2017, the U.S. Department of Justice launched an investigation into the Pre-Filled Syringe Program. Specialty admitted wrongdoing in connection with its "pooling" practices and other related practices, and in November 2017, ABC reached a civil settlement with the U.S. Attorney's Office for the Eastern District of New York for $625 million.

[24] 2020 WL 1987029, at *16.

[25] *Teamsters Local 443 Health Servs. & Ins. Plan v. Chou*, C.A. No. 2019-0816-SG, 2020 WL 5028065 (Del. Ch. Aug. 24, 2020).

In October 2019, ABC stockholders filed suit in the Court of Chancery, alleging, among other things, that the majority of ABC's directors and certain of its officers breached their fiduciary duties by failing to implement compliance policies and systems and failing to exercise their oversight responsibilities.[26] In August 2020, the Court of Chancery denied the defendants' motion to dismiss. In its decision, the court focused on the plaintiffs' allegations as they related to *Caremark*'s second prong and reviewed a series of red flags alleged by plaintiffs. In particular, the court held that the director defendants were aware of three "red flags" but failed to take appropriate action. Those red flags were (i) a report prepared by outside counsel that showed that Specialty had "substantial gaps" in its "mission critical compliance mechanisms"; (ii) a *qui tam* suit by Specialty's chief operating officer, which alleged details concerning Pharmacy's problematic use of the overfill; and (iii) a subpoena served by the DOJ on Specialty.[27] According to the court, it could draw a reasonable inference of board knowledge because each of these red flags was either disclosed directly to the director defendants or was referenced in ABC's SEC filings. The court also held that plaintiffs sufficiently alleged a *Caremark* claim against the officer defendants, stating that the director defendants "could not bring their business judgment to bear on a demand to prosecute" claims against the officers because "such litigation would implicate their own wrongdoing."[28]

[26] 2020 WL 5028065, at *14.

[27] 2020 WL 5028065, at *19-24.

[28] 2020 WL 5028065, at *26.

Caremark Claims Dismissed

GoPro[29]

In early 2016, GoPro had planned to roll out two new products — the Karma drone and the latest iteration of its wearable HERO camera. GoPro provided positive revenue guidance for 2016 based on projected sales for both. Once both products were finally launched, the company faced production ramp-up issues, inventory shortages and ultimately a product recall of the drone. As a result, the board adjusted the company's revenue guidance downward and, even so, missed its updated revenue guidance. As a result, the company's stock price declined 12%. Multiple federal securities class actions were filed and survived motions to dismiss. Stockholders also filed derivative actions in the Court of Chancery, alleging that the board wrongfully allowed management to continue to disclose overly optimistic revenue projections.

While plaintiffs claimed that they did not intend to allege a *Caremark* claim, Vice Chancellor Joseph R. Slights noted that "it is difficult to ignore the allegations in the Complaint that walk and talk like *Caremark*," and thus, addressed the "*Caremark*-like allegations" and found they did not state a claim.[30] First, the court found that the board members had no duty to access the company's inventory software and extrapolate on their own that the company had incurable inventory shortages. "Taking a self-guided tour through an ERP system to check inventory levels for a product that would comprise only 10% of the Company's revenue is not the sort of 'oversight' *Caremark* contemplates."[31] Similarly, the court noted that a few YouTube videos showing the drone's battery defect "cannot be considered 'red flags' that were 'waived' in front of the Board. Even if they *were* red flags, the Board met to discuss 'proposed recall plans' just eleven days after the first video was posted. A *Caremark* claim cannot be squared with an allegation the Board *responded* to red flags."[32]

With respect to revenue guidance, the court found that management was "regularly advising the Board that, notwithstanding production difficulties, GoPro was on track to meet its inventory projections and hit its revenue guidance."[33] The court held that "[c]onsidering the *presumption* of directorial good faith, as well as the Board's statutory right to rely on management's reports, the Karma Production Forecast renders unreasonable any inference that the Board *knew* GoPro was headed for a significant revenue miss."[34] In doing so, the court distinguished between the conclusion in the California securities action that certain defendants knew that the inventory was insufficient. The court noted that it was entitled to consider Section 220 documents that were incorporated by reference into the complaint, which the California plaintiffs did not have access to. Moreover, the claims before the California court all pertained to GoPro officers, but in Delaware "the relevant inquiry is whether Plaintiffs have well plead a majority of the *Demand Board* acted with scienter."[35]

TrueCar[36]

TrueCar's stock price fell over 35% after it announced third quarter losses and lowered its guidance because sales generated by USAA, its most important affinity partner, were down 5% from the prior year as a result of a website redesign. A federal securities action followed on the heels of the announcement and stock drop. The district court in the securities action denied defendants' motion to dismiss, and the parties subsequently settled. Stockholders then brought derivative claims against the TrueCar board, including *Caremark* claims.

The Court of Chancery noted that the plaintiffs attempted to plead a "prong two" *Caremark* claim (*i.e.*, that the board ignored significant red flags). Plaintiffs claimed that the red flags consisted of the fact that a prior USAA website change to the location and

[29] *In re GoPro, Inc. Stockholder Derivative Litig.*, Consol. C.A. No. 2018-0784-JRS 2020, WL 2036602 (Del. Ch. April 28, 2020).

[30] 2020 WL 2036602, at *11.

[31] 2020 WL 2036602, at *13.

[32] 2020 WL 2036602, at *13.

[33] 2020 WL 2036602, at *2.

[34] 2020 WL 2036602, at *14.

[35] 2020 WL 2036602, at *14, n.170.

[36] *In re TrueCar, Inc. Stockholder Derivative Litig.*, Consol. C.A. No. 2019-0672-AGB, 2020 WL 5816761 (Del. Ch. Sept. 30, 2020).

prominence of links to TrueCar's website led to substantial loss of traffic from USAA; there were numerous board presentations identifying the USAA relationship as "fragile"; board presentations identified "USAA underperformance" as a top risk; and board presentations projected a declining USAA growth rate.

Chancellor Andre G. Bouchard held that "[t]hese allegations are woefully insufficient to support a reasonable inference that the 'directors were conscious of the fact that they were not doing their jobs, and that they ignored red flags indicating misconduct.'"[37] Specifically, the court held that "vague references to a 'fragile' relationship and 'USAA underperformance' in Board presentations fail to demonstrate with particularity that the directors were made aware of USAA's website redesign, much less that they knew that the redesign would have a material adverse impact on TrueCar's financial performance."[38] Moreover, the fact that the board was made aware of prior website changes "demonstrates that the Company's monitoring systems kept the Board apprised of important developments concerning its relationship with USAA."[39] Thus, the court dismissed the *Caremark* claim.

Esperion Therapeutics[40]

In August 2015, Esperion Therapeutics was in the midst of seeking FDA approval of a new cholesterol drug that was critical to the company's future as a going concern. After Esperion executives attended an End-of-Phase II meeting with the FDA, the company issued a press release summarizing guidance it had received from the FDA. The press release contained "some very good news," including that Esperion would not need to complete a time-consuming "long-term safety study."[41] Shortly thereafter, Esperion's president and CEO made similar statements that were "generally received as positive news."[42] Weeks later, Esperion released another press release, this time summarizing the FDA's meeting minutes. "One analyst noted the FDA minutes were 'worse than consensus expected, and even inexplicably inconsistent with'" statements in the prior press release and conference call.[43] Esperion's stock suffered a near 50% decline following this news. The following year, Esperion received more troubling news from the FDA, causing the stock price to drop by over 40%.[44]

In 2016, stockholders brought a federal securities class action litigation and survived a motion to dismiss. This was followed by a parallel derivative action in the Court of Chancery in which the plaintiff asserted *Caremark* claims, relying on *Caremark*'s second prong. The Court of Chancery granted the defendants' motion to dismiss, noting at the outset that "[u]nlike federal securities actions, however, plaintiffs filing derivative suits in Delaware must adequately plead demand futility to survive dismissal" and "Plaintiff has failed to carry this heightened pleading burden."[45] In rejecting the plaintiff's arguments, the court held that the complaint "failed to plead any facts that would offer a conceivable explanation of *why* any of the Directors, let alone the Outside Directors, would intentionally lie to the market knowing full well the official FDA minutes would contradict their statements in a matter of weeks."[46] The court also rejected the plaintiff's attempt to invoke the "core operations" doctrine, stating that plaintiffs "must plead other particularized facts that support an inference of director knowledge before the core operations doctrine may be invoked to enhance that inference."[47]

[37] 2020 WL 5816761, at *20 (citation omitted).

[38] 2020 WL 5816761, at *20.

[39] 2020 WL 5816761, at *20.

[40] *Owens v. Mayleben*, C.A. No. 12985-VCS, 2020 WL 748023 (Del. Ch. Feb. 13, 2020).

[41] 2020 WL 748023, at *4-5.

[42] 2020 WL 748023, at *5.

[43] 2020 WL 748023, at *5.

[44] 2020 WL 748023, at *5.

[45] 2020 WL 748023, at *1, *6.

[46] 2020 WL 748023, at *8.

[47] 2020 WL 748023, at *8.

Takeaways

- *Marchand* and *Clovis* did not change the approach to reviewing *Caremark* claims but instead involved extremely case- and fact-specific inquiries and findings based on the allegations in the complaints.
- The court will carefully evaluate books and records (or lack thereof) that have been incorporated into the complaint, for whether they support the allegations in the complaint.
- The fact that related federal securities claims have survived a motion to dismiss does not necessarily mean that there is an underlying *Caremark* claim. In *TrueCar*, *GoPro* and *Esperion*, the court dismissed *Caremark* claims even though federal securities claims based on the same facts had survived motions to dismiss.
- After *Marchand*, *Caremark* claims have been on rise, and the increased focus is a good reason for companies and boards to consult with outside counsel to ensure they have adequate controls in place for oversight liability purposes.

Delaware Decisions Highlight Pleading Requirements for Fiduciary Duty Claims in the Face of Disinterested Director Approval

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Several recent Delaware decisions have analyzed allegations attempting to plead breach of fiduciary duty claims against executive directors even though the underlying transaction was approved by a majority-disinterested-and-independent board of directors. These decisions emphasize the need for directors to actively monitor potential conflicts among officers and highlight the pleading requirements for plaintiffs to successfully state a breach of fiduciary duty claim arising from allegations of a "supine" board or a board that was allegedly misled by a conflicted officer.

On June 30, 2020, the Delaware Supreme Court confirmed in *City of Fort Myers General Employees' Pension Fund v. Haley*[48] that a board of directors is permitted to delegate the task of negotiating a transaction to an otherwise conflicted officer of the company. While the Supreme Court acknowledged that "[t]here is nothing inherently wrong with a Board delegating to a conflicted CEO the task of negotiating a transaction," as long as the conflict is "adequately disclosed to the Board and the Board ... properly oversee[s] and manage[s] the conflict," it reversed the trial court's dismissal of breach of fiduciary duty claims because the executive director "failed to disclose his 'interest in the transaction to the board,'" and "'a reasonable board member would have regarded the existence of [the] material interest as a significant fact in the evaluation of the proposed transaction.'"

Two more recent decisions from the Court of Chancery, *In re Mindbody, Inc., Stockholders Litigation*[49] and *City of Warren General Employees' Retirement System v. Roche*,[50] provide additional color on the pleading requirements to sustain a cause of action under this narrow theory. In *Mindbody*, the court refused to dismiss claims against Mindbody's CEO and chairman of the board because the detailed allegations related to his "subjective desire for near-term liquidity and the opportunity to continue as CEO of the post-merger entity" created a conflict, and his failure to inform his fellow directors prevented the court from relying on the disinterested board's approval of the merger to dismiss the claims. By contrast, in *Roche*, the Court of Chancery deferred to the approval of the disinterested board and dismissed fiduciary duty claims because the complaint failed to adequately allege a conflict or that the purported conflict was used to mislead or manipulate the board.

Mindbody

Background

In *Mindbody*, plaintiffs alleged that three defendants "tilted" the company's 2019 sale process in favor of Vista Equity Partners due to conflicts of interest, though the complaint focused primarily on Mindbody's CEO and chairman, Richard Stollmeyer. The Court of Chancery dismissed the claims against an outside director, Eric Liaw, because the complaint failed to make nonconclusory allegations sufficient to state a claim. However, the court refused to dismiss claims against Mr. Stollmeyer and Mindbody's CFO and COO, Brett T. White.

[48] 235 A.3d 702 (Del. 2020) ("*Haley*").

[49] 2020 WL 5870084 (Del. Ch. Oct. 2, 2020) ("*Mindbody*").

[50] 2020 WL 7023896 (Del. Ch. Nov. 30, 2020) ("*Roche*").

Stollmeyer's Alleged Personal Conflicts

Liquidity-driven conflicts

The plaintiffs alleged that Mr. Stollmeyer's "personal financial situation was such that it required cash flow" and he "seemed stretched as of 2018" due to investments in family ventures, loans to family members and friends, a pledge to a local college (of which the majority was unpaid), home renovation plans exceeding $1 million and "a sizeable mortgage." The plaintiffs further alleged that Mr. Stollmeyer needed to increase his liquidity in early 2018 because he told his financial advisor that (i) he would be "digging into" his line of credit to fund expenses, (ii) the sale of his Mindbody stock pursuant to a new 10b5-1 plan was "'top of mind'" for him, and (iii) he likely intended to sell most or all of his stock. Plaintiffs also alleged that Mr. Stollmeyer viewed his net worth as "'locked inside' Mindbody stock," that he was unable to liquidate his pre-merger holdings except under his 10b5-1 plan, and that he made public statements that analogized his situation to "'sucking through a very small straw.'"

The court remarked that it "need not infer that Mr. Stollmeyer subjectively desired near-term liquidity — he said as much himself." The court concluded that "[a]lthough it is a rare set of facts that will support a liquidity-driven conflict theory," Mr. Stollmeyer's "self-professed fatigue of 'sucking through a very small straw' makes it reasonably conceivable that this case fits the rare fact pattern."

Employment-driven conflicts

The court noted that the plaintiffs' liquidity-driven and prospective employment theories of conflicts "work in combination to land a powerful one-two punch on Stollmeyer." Once again, the court noted that it "need not infer that Stollmeyer subjectively desired future employment and compensation from Vista — he said as much himself":

- Mr. Stollmeyer communicated to investment banker Qatalyst that he was "motivated to sell to a buyer who would retain his management team" and was then connected with Vista;
- Mr. Stollmeyer attended the CXO Summit, which he described as "mind-blowing" and "inspiring," and texted a Vista principal that the presentations were "very impressive"; and
- on the day of the merger announcement, Mr. Stollmeyer texted his financial advisors that "Vista's in love with me (*and me with them*). No retirement in my headlights."

As a result, the court found that the complaint adequately alleged that Mr. Stollmeyer harbored a material self-interest that conflicted with the interests of the Mindbody stockholders.[51]

Failure to Disclose Material Conflicts to the Board

The defendants argued that even if Mr. Stollmeyer were conflicted and tilted the sales process in Vista's favor, the claims should be dismissed because the plaintiffs failed to allege that a majority of the Mindbody board that approved the merger was interested or lacked independence. Characterizing the allegations against Mr. Stollmeyer as "degrees more troubling" than those in *Haley*, the court concluded that the plaintiffs adequately alleged that Mr. Stollmeyer "suffered from material conflicts in the sale process that he failed to disclose to the Board" and that the board "would have viewed them as relevant and of a magnitude

[51] The court refused to dismiss duty of care claims against Mr. White because it found sufficient the allegations that he, among other things, "obeyed Stollmeyer's instructions not to disclose Vista's expression of interest to the Board," and provided "timing and informational advantages" to Vista throughout the sales process. Because Mr. White was only an officer of Mindbody, duty of care claims were not subject to dismissal under Mindbody's exculpation provision in its Certificate of Incorporation.

to be important in carrying out their decisionmaking process." These allegations included the same allegations that conflicted Mr. Stollmeyer, as well as the following:

- Mr. Stollmeyer did not immediately disclose Vista's expression of interest to his fellow directors, instructed management not to disclose it, and did not inform the board of his interactions with Vista leading up to and surrounding its expression of interest;
- Mr. Stollmeyer did not inform the board of his dealings with Qatalyst before a later-formed transaction committee also retained Qatalyst; and
- Mr. Stollmeyer eliminated bidders from the sales and go-shop process that he did not wish to work for, while providing timing and informational advantages to Vista by declining to share diligence with other potential bidders and solely providing Vista with comparatively greater data room access and the company's quarterly results.[52]

The court concluded that, while a majority of the board was not even named as defendants in the action, these allegations (among others) made it "reasonably conceivable that the Board lacked material information and failed to adequately oversee Stollmeyer." Thus, "at the pleading stage, the presence of a disinterested and independent majority of the Board [did] not defeat a claim for liability."

Roche

Background

In *Roche*, the plaintiff alleged that two of Blackhawk's executive directors, CEO and President Talbott Roche and Executive Chairman William Tauscher, breached their fiduciary duties solely in their capacities as officers by (i) manipulating the board to approve a buyout by Silver Lake Partners, L.P. and P2 Capital Partners in order to maintain their employment and earn equity in the post-buyout entity, and (ii) misleading stockholders through a materially misleading proxy statement. The Court of Chancery dismissed these claims but sustained a claim for breach of the duty of care against Mr. Roche (in his capacity as CEO) for approving allegedly misleading disclosures in the proxy statement issued in connection with the transaction.

[52]The court also noted that the transaction committee formed by the board initially had a narrower scope of authority and never retained its own counsel.

Failure To Allege Personal Conflicts

Plaintiff alleged that Mr. Roche and Mr. Tauscher were self-interested because activist stockholders threatened their employment with Blackhawk and, as in *Mindbody*, the executives were conflicted by the prospect of future employment post-sale. The court held that there were no facts supporting the plaintiff's claims regarding any fear from an activist and that statements complimentary of management in offer letters did not demonstrate a conflict when there was no allegation that the executive directors entered into employment agreements or discussed terms of employment with the buyers pre-announcement.

Failure To Allege Board Deception or Manipulation

The court also held that, "even assuming the Complaint contained sufficient allegations that Roche and Tauscher suffered from a material conflict of interest (and it does not), the Complaint fails to allege that Roche and Tauscher breached their fiduciary duty of loyalty by manipulating or deceiving the Board into approving the Buyout." While the court noted that none of the nonexecutive members of the board were alleged to have breached their fiduciary duties (and the executive members were named as defendants only in their capacities as officers), the court still found it necessary, as in *Mindbody*, to examine the allegations related to the board's conduct because of plaintiff's allegations of a "supine" or deceived board of directors.

First, the court held that the complaint did not adequately allege that the board was "supine." The complaint did not allege that any of the 10 outside directors were dominated by Mr. Roche or Mr. Tauscher, suffered from any conflict of interest or acted in bad faith. The court found that the allegations of the complaint demonstrated that the board met repeatedly, engaged with management and advisers, and deliberated during regular intervals during the buyout process.

Second, the court held that the complaint did not adequately allege that Mr. Roche and Mr. Tauscher deceived their fellow directors. Notably, despite ultimately sustaining a claim for breach of the duty of care against the CEO Mr. Roche after finding that it was reasonably conceivable that the proxy statement omitted material information or was misleading, the court held that there were no well-pled allegations that he or Mr. Tauscher misled the rest of the board regarding the proxy statement.

Takeaways

- These decisions highlight the recent increase in "supine" or deceived-board claims and the need for directors and officers to disclose potential or actual self-interest related to transactions under consideration. They also serve as a reminder that boards need to actively probe and monitor potential conflicts, particularly when entrusting officers to negotiate potential transactions.
- As officers of a Delaware corporation are not exculpated from monetary liability for breaches of the duty of care under 8 Del. C. §102(b)(7), they may be further susceptible to such allegations in the context of a sales process or related disclosures. See, also in this edition of Insights: The Delaware Edition, "Recent Trends in Officer Liability." Skadden previously discussed recent cases involving officer liability in our March 23, 2020, client alert, "Reevaluating the Board Risk Oversight Process: Implications of Marchand and Other Recent Developments."
- Corporations and their boards of directors should continue to consult internal and outside counsel for guidance regarding the proper evaluation, disclosure and oversight of director and officer conflicts, and committees of the board should always evaluate the need for separate counsel.

Recent *MFW*-Related Developments in Delaware Courts

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In 2014, the Delaware Supreme Court's landmark *Kahn v. M&F Worldwide Corp.*[53] (*MFW*) decision established that the deferential business judgment standard of review could apply to controlling stockholder "squeeze-out" mergers under certain circumstances. Six necessary conditions must be satisfied for a transaction to obtain business judgment review under *MFW*: (i) the transaction is conditioned *ab initio*, or "from inception," on the approval of a special committee and a majority-of-the-minority majority vote; (ii) the special committee is independent; (iii) the special committee is empowered to freely select its own advisers and to say no definitively; (iv) the special committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.

Over the past year, the Delaware Court of Chancery has issued a number of significant decisions that provide further guidance about satisfying *MFW*'s *ab initio* standard, which circumstances are sufficiently coercive as to disable the protective effect of the *MFW* structure, and which rights and responsibilities must be reserved to a special committee of disinterested directors in order to retain the possibility of business judgment review for a controlling-stockholder transaction.

The '*Ab Initio*' Requirement and the Commencement of Substantive Economic Negotiations

In 2018, the Delaware Supreme Court explained in *Flood v. Synutra International, Inc.*,[54] that in order to satisfy *MFW*'s *ab initio* prong, a controller must condition a transaction on the approval of both an *MFW*-compliant special committee of independent directors and a majority-of-the-minority stockholder vote *before economic negotiations begin*. Two recent cases have provided further clarity and guidance about how the court will examine this aspect of *MFW*.

First, in *Salladay v. Lev*,[55] Vice Chancellor Sam Glasscock III considered *MFW*'s *ab initio* prong in the context of a transaction where three members of the Intersections board were alleged to have stood on both sides of its transaction with iSubscribed. On September 27, 2018, a representative of iSubscribed's newly formed merger subsidiary met with Intersections' chairman and CEO, who explained that "the Intersections Board would be receptive to an acquisition offer of $3.50 to $4.00 per share." Thereafter, the Intersections board formed a special committee of independent directors and determined that it would not approve any transaction not supported by the committee.

In denying a motion to dismiss, the Court of Chancery explained that the *ab initio* prong of *MFW* "requires the committee's empowerment prior to 'substantive economic negotiations,' which include valuation and price discussions if such discussions 'set the field of play for the economic negotiations to come.'" In this regard, the court focused on the alleged September 27, 2018, meeting — wherein the parties discussed financial parameters of a potential merger offer that "set the stage for future economic negotiations" — and determined that plaintiffs "adequately [pled] the existence of substantive economic negotiations, pre-Committee, that raise[] a pleading-stage inference that these discussions deprived the Committee of the full negotiating power sufficient to invoke the business judgement rule" under *MFW*.

[53] 88 A.3d 635 (Del. 2014).

[54] 195 A.3d 754 (Del. 2018).

[55] 2020 WL 954032 (Del. Ch. Feb. 27, 2020).

Second, in *In re HomeFed Corp. Stockholder Litigation*,[56] Chancellor Andre G. Bouchard addressed a transaction wherein a controlling stockholder of HomeFed Corporation, acquired all outstanding shares of HomeFed stock by way of a 2:1 share exchange, which closed in July 2019. As early as 2017, the controlling stockholder and HomeFed had discussed a potential take-private transaction, and in December 2017, HomeFed formed a special committee of independent directors to negotiate with the controlling stockholder. The special committee "paused its process" in March 2018, however, when the controlling stockholder informed the committee that it was no longer interested in pursuing a transaction.

Nonetheless, over the following 11 months, the controlling stockholder engaged in direct discussions with HomeFed's largest minority stockholder, whose support was alleged to be essential to secure minority stockholder approval of any potential transaction. After obtaining such support in early February 2019 for a take-private transaction involving a 2:1 exchange ratio, the controlling stockholder formally proposed the transaction to HomeFed and conditioned its offer on HomeFed's agreement to the *MFW* structure.

The Court of Chancery denied a motion to dismiss, after holding that the operative complaint adequately alleged that the controlling stockholder "did not commit to the *MFW* protections before engaging in substantive economic discussions concerning the Transaction." At the earliest, the controlling stockholder had agreed to an *MFW*-compliant transaction structure in a public filing dated February 20, 2019 — but it had received an indication of support for a 2:1 exchange ratio (which the court described as "an important substantive economic term") from the large minority stockholder before that point. Thus, "by engaging in substantive economic discussions ... before committing itself to the twin *MFW* protections, [the controlling stockholder] failed to disable and subject itself to the pressures of negotiating with the Special Committee with those protections in place," rendering *MFW* potentially inapplicable. Of note, the court rejected defendants' argument that substantive economic negotiations are irrelevant to the *MFW* analysis if conducted "between the controller and a minority stockholder with no authority to bind the company as opposed to an authorized representative of the controlled company."

The Existence of Coercion Sufficient To Disable the *MFW* Protections

To comply with *MFW*, a conflicted transaction also must be free of coercion affecting the special committee process or the majority-of-the-minority stockholder vote. This issue was a significant focus of *In re Dell Technologies, Inc. Class V Stockholders Litigation*,[57] which provides guidance as to the types of coercion that courts can identify as impacting the *MFW* analysis.

Dell involved a transaction whereby Dell Technologies, Inc. redeemed its outstanding Series V tracking stock in exchange for either alternative Dell stock or cash. The transaction was conditioned *ab initio* on use of the *MFW* standards. Importantly, however, Dell reserved the right at all times to engage in a "Forced Conversion" of the Series V stock into Dell Class C stock (as permitted by the company's charter) pursuant to a pricing formula purportedly unattractive to existing stockholders. In denying a motion to dismiss, the Court of Chancery found that Dell's reservation of the right to bypass the special committee and majority-of-the-minority stockholder vote and instead engage in a Forced Conversion made it reasonably conceivable that *MFW* would not apply.

[56] 2020 WL 3960335 (Del. Ch. Jul. 13, 2020).

[57] 2020 WL 3096748 (Del. Ch. Jun. 11, 2020).

After rejecting the argument that because the Forced Conversion right appeared in Dell's charter, it could not have led to coercion, the court held that *MFW* may not apply where "a controller's explicit or implicit threats ... prevent a committee from fulfilling its function." Because the special committee's mandate excluded the ability to control whether or not the Forced Conversion could occur, Dell "deprived the Special Committee of the full power to say 'no'" because Dell "reserved the right to engage in a Forced Conversion and threatened both the Special Committee and the Company's stockholders with that alternative." In addition, the court found it reasonably conceivable that "the specter of a Forced Conversion" impacted the majority-of-the-minority vote by causing Dell's Class V stockholders to approve the transaction for reasons other than its merits and deprived them of a vote "free of the sword of Damocles that the Conversion Right presented."

For *MFW* To Apply, the Special Committee Must Do the Negotiating

The *Dell* opinion also expanded on a core *MFW* prong that requires a conflicted transaction to be negotiated by a disinterested and independent special committee. Specifically, in *Dell*, the court held that when other parties (such as minority stockholders) engage in negotiations with a controller in place of a special committee, *MFW*'s protections will not apply.

The redemption transaction in *Dell* that stockholders ultimately approved was initially negotiated between the company and a special committee of independent directors. After the deal was announced, but before the stockholders were scheduled to vote on the transaction, certain large Class V stockholders objected to the value of the committee-negotiated redemption transaction, allegedly prompting Dell to negotiate directly with such stockholders to improve the financial terms of the transaction for the minority. These terms were ultimately approved by both the special committee and the minority stockholders. Although the special committee approved the final transaction, it was alleged to have "abandoned the field and stopped acting as the negotiating agent for the Class V stockholders" during the time when Dell was engaging stockholders directly.

The court found that the special committee's actions gave rise to reasonable inferences that, if true, would disable *MFW* and require entire fairness review. According to the court, "*MFW*'s dual protections contemplate that the Special Committee will act as the bargaining agent for the minority stockholders, with the minority stockholders rendering an up-or-down verdict on the committee's work." Thus, "if the committee's initial work is rejected by the stockholders, that does not mean the committee's role is over." Instead, "the committee must return to the bargaining table, continue to act in its fiduciary capacity, and seek to extract the best transaction available." It can "receive input from stockholders," but must be the primary negotiator throughout the deal process for *MFW* to apply.

*   *   *

The contours and nuances of the *MFW* doctrine continue to develop. The above cases make clear that careful consideration of each of the *MFW* prongs at the outset and throughout any applicable transaction process is paramount. There are lessons to be learned from each of these cases, and how to identify and potentially avoid certain pitfalls that could render *MFW* inapplicable in certain circumstances. Consultation with outside counsel, as early as possible, regarding these and other *MFW*-related issues is critical to best position a controlling stockholder or conflict transaction to comply with *MFW*.

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