Key Takeaways

Skadden

13th Annual Securities Litigation and Regulatory Enforcement Update

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On October 6, 2020, Skadden held part two of our 13th annual "Securities Litigation and Regulatory Enforcement Update" webinar series. The webinar focused on emerging trends in Delaware law. The panelists were litigation practice leader **Edward Micheletti**, litigation partners **Paul Lockwood** and **Jenness Parker**, and litigation associate **Lauren Rosenello.**

The panelists discussed a number of important developments in Delaware corporate law in 2019 and 2020 and how the panelists believe those developments might impact future litigation. Specifically, the discussion focused on (i) recent trends concerning the application of *Corwin*[1] and *MFW*,[2] (ii) developments in the area of officer liability, (iii) the increasing importance of books and records demands and litigation under 8 *Del. C.* § 220, (iv) derivative cases regarding oversight liability and the increased focus on diversity and inclusion, and (v) a recent decision on federal forum provisions.

Below are high-level takeaways on each topic.

Corwin

When a *Corwin* defense is raised, the Delaware courts continue to closely scrutinize the adequacy of disclosures to determine whether the stockholders were fully informed. The panelists discussed three Court of Chancery decisions from 2020 where the court addressed *Corwin* defenses. In each case, the court found material disclosure violations precluded the application of *Corwin*. This trend has underscored the need for defendants to raise traditional defenses to breach of fiduciary duty claims in addition to a *Corwin* defense. In recent cases, the court has been open to bypassing *Corwin* and dismissing complaints on alternative grounds.

Additionally, because pre-closing injunctions challenging proxy disclosures are now rare, the burden to comply with disclosure obligations (and to ensure a defensible disclosure has issued to stockholders) has to be self-imposed before a stockholder vote, to best position a *Corwin* defense in post-closing litigation.

[1] *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015).
[2] *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

MFW

MFW remains an important doctrine for transactions involving controlling stockholders that ordinarily invoke the entire fairness standard of review. When the *MFW* doctrine applies, the applicable standard of review is ratcheted down from entire fairness to the much more favorable business judgment standard of review.

Best practices still dictate that a controller's first communication contain the *MFW* "dual protections" — namely, that any merger be conditioned on both (i) the negotiation and approval by an independent special committee with real bargaining power (the ability to say "no"), and (ii) a nonwaivable majority of the minority stockholder vote. However, *MFW*'s dual protections may be established after initial discussions have occurred, as long as a potential transaction is expressly conditioned on the dual protections *before* economic negotiations begin.

The court has also rejected an *MFW* defense in circumstances where the controlling stockholder bypasses the special committee and negotiates improved transaction terms (*e.g.*, price) with the minority stockholders. This includes circumstances where such negotiations occur *after* the special committee approves a transaction and the deal has been announced.

Officer Liability

There is an increased focus by the plaintiff bar on officer breach of fiduciary duty claims. Officers of Delaware companies must remain alert to potential claims against them, particularly for breach of the fiduciary duty of care, because unlike directors, officers do not benefit from a company's Section 102(b)(7) exculpatory charter that bars money damages for breaches of the duty of care. Plaintiffs recently have been targeting officers who play a role in preparing disclosure documents or are otherwise actively engaged in a transaction on a theory that those officers acted in a grossly negligent manner.

Officers actively involved in preparing disclosures relating to a merger or other transaction should reasonably inform themselves and seek to ensure that all material information of which they are aware is accurately described in the disclosure documents. The Court of Chancery is willing to dismiss claims against officers who also are directors if a plaintiff does not plead specific action taken by officers in their capacity as officers.

Books and Records Demands

Books and records actions under Section 220 have proliferated. Stockholders are relying heavily on books and records actions in the deal context, pre-complaint, to seek information to bring a post-closing damages claim and to defeat *Corwin* defenses.

Given "the reality of today's world,"[3] courts increasingly are likely to grant access to some limited amount of electronic records, including, but not limited to, emails, particularly when key negotiations occur over email and are not documented in traditional board materials, such as minutes or board presentations.

In some cases, the Court of Chancery has taken a staged approach, limiting initial production to formal board materials and allowing plaintiff stockholders to explore whether any other records of the board's decisions exist outside the formal records. In general, maintaining accurate, formal corporate records is important and may help defeat a demand to inspect emails and text messages.

Derivative Litigation and Oversight Liability

Courts considering oversight claims are focused not only on the existence of information and reporting systems but also on the board's monitoring of those systems. Courts are particularly focused on oversight of "mission critical operations," which are especially important in companies that have one or a limited number of products or operations. Courts also are focused on oversight responsibilities at companies subject to substantial federal or state regulation.

Boards can demonstrate active oversight systems by having in place committees that specifically focus on monitoring "mission critical" operations, having in place processes or protocols for management to inform the board of key business risks, and scheduling regular meetings for the board to evaluate key business risks and whether the company's oversight procedures are functioning properly. Boards also should carefully document their oversight efforts in formal minutes.

Diversity and Inclusion

There have been a number of books and records complaints filed regarding diversity and inclusion matters. The Court of Chancery has not yet weighed in on these issues in the context of a Section 220 claim. Stockholders have started to file derivative lawsuits that seek to diversify the board of directors. They also have sent litigation demands to boards of directors regarding these issues.

In addition, the governor of California recently signed a law that requires public companies headquartered in the state to have at least one board member from an underrepresented community by the end of 2021 and at least two or three such members, depending on the board's size, by the end of 2022.

[3] *Schnatter v. Papa John's Int'l, Inc.*, 2019 WL 194634, at *16 (Del. Ch. Jan. 15, 2019); *see also KT4 Partners LLC v. Palantir Techs. Inc.*, 2019 WL 347934, at *10 n.76 (Del. Jan. 29, 2019) (quoting *Schnatter*, 2019 WL 194634, at *16).

Forum Selection Provisions

The Delaware Supreme Court in *Salzberg v. Sciabacucchi*[4] upheld the validity of charter provisions designating the federal courts as the exclusive forum for claims under the Securities Act of 1933. The opinion may provide a tool for companies to avoid duplicative litigation of securities claims in certain federal and state courts and to temper the wave of 1933 Act claims brought in state court.

Private companies that are considering going public should evaluate amending their charter to include federal forum provisions. Companies should consult with outside counsel regarding the appropriate form of federal forum provision and other related issues before adopting such a provision. Public companies whose charters contain such federal forum provisions should consider raising the provision as a defense early on in state court litigations.

[4] 227 A.3d 102 (Del. 2020).