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Developments in Delaware Corporation Law

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The Delaware Court of Chancery's docket exploded with expedited "broken" deal litigation in 2020, driven by the impact of COVID-19. Beyond pandemic-related merger litigation, stockholder plaintiffs remained focused on claims involving controlling stockholders and increased focus on claims against officers for breaches of the duty of care. There were also significant developments in connection with stockholder statutory books-and-records requests.

Broken Deals

Transaction participants in 2020 faced extraordinary and unprecedented circumstances due to COVID-19. In addition to the crisis' uncertain economic impact, many companies faced employee health concerns and government-mandated shutdowns of core business operations, among other things. (See "US M&A Outlook: Rebounding Market Fuels Optimism for Deal Activity in 2021.") As merger parties grappled with the pandemic and its impact on pending deals, expedited litigation in the Court of Chancery was dominated by broken deals, in which sellers sought to force, and buyers sought to avoid, closing transactions. These cases raised novel contract interpretation concepts, including questions surrounding whether the pandemic constituted a "material adverse effect" (MAE) under the specific language of the deal parties' merger agreements, failures to satisfy conditions caused by the pandemic, and compliance with sellers' interim operating covenants and buyers' best efforts covenants. Many of these cases settled, but several gave rise to noteworthy opinions offering guidance for the future.

In one such case, the Court of Chancery issued a post-trial decision in *AB Stable VIII LLC v. Maps Hotels and Resorts One LLC*. The court held that the buyer was not obligated to close because two conditions — one related to the seller operating in the ordinary course, and the other involving a unique, "factually complex" trademark issue — had not been satisfied. In considering the buyer's arguments that the seller had suffered an MAE, the court addressed a number of arguments that had arisen in similar actions during the year, including whether a carve-out for "general economic conditions" in the definition of MAE could include effects arising from a specific event such as the pandemic (it could) and if the pandemic constituted a "natural disaster" or "calamity" (it did).

Ultimately, in that case, the court concluded that the seller had not suffered an MAE. However, it ruled that the buyer established that the seller failed to comply with its covenant to operate in the ordinary course of business consistent with past practice, explaining that the seller was not permitted to "depart[] significantly" from its "normal range of operations" and rejecting the seller's argument that it was permitted to engage in "ordinary responses to extraordinary events." The case is being closely watched for further developments, as the seller has indicated it intends to move to stay the final judgment pending appeal.

This year, we anticipate merger parties continuing to file broken deal litigation premised on pandemic-related issues, although perhaps with less frequency once the pandemic is considered under control and its impact on the economy and businesses has subsided. More generally, we anticipate seeing broken deal litigation filed in the Delaware courts

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on a more frequent basis since the court has broken its historic trend of not letting buyers out of deals through litigation. Two cases — *AB Stable* and 2018's *Akorn, Inc. v. Fresenius Kabi AG*, in which buyers were permitted to walk away from their deals based on failed conditions and covenants — could spur more buyers to pursue a litigation option under the appropriate circumstances.

Controlling Stockholders and *MFW* Developments

Transactions involving controlling stockholders continued to be a primary target of plaintiffs in 2020, and the court provided additional guidance on significant issues, including when a stockholder with less than 50% of the company's voting power will be considered a controller. In *Voigt v. Metcalf*, the court concluded that a complaint adequately alleged that a 34.8% stockholder was a controller, citing various indicia of control, including contractual rights to appoint directors and to proportionate representation on board committees, as well as relationships with directors, key executives and advisers. In its ruling, the court also suggested that in many circumstances, "anything over 40% of the voting power is sufficient to prevail" in a stockholder vote. By contrast, in *In re Essendant, Inc. Stockholder Litigation*, the court dismissed claims arising from a merger involving a less than 12% stockholder where it did not nominate directors or "wield coercive contractual rights," among other things.

The Court of Chancery also issued several important rulings applying the Delaware Supreme Court's 2014 seminal decision in *Kahn v. M & F Worldwide Corporation* (*MFW*), which held that a transaction involving a controlling stockholder will be reviewed under the deferential business judgment rule (as opposed to the far more stringent "entire fairness" standard) if it is conditioned *ab initio* on the "dual protections" of approval by both a well-functioning committee of independent and disinterested directors and a majority of the minority stockholders in an uncoerced, fully informed vote. In *In re AmTrust Financial Services, Inc. Stockholder Litigation*, the court declined to dismiss claims arising from a squeeze-out merger, holding that *MFW* did not apply because three of the four special committee members were interested in the transaction given their status as defendants in derivative actions that were extinguished by the merger.

In addition to director independence, the court also focused on *MFW*'s a*b initio* requirement and special committees' role and authority. In *In re Dell Technologies Inc. Class V Stockholders Litigation*, the court held that *MFW* did not apply to a redemption of shares because, among other reasons, procedural protections were not established "at the outset" given that the special committee formed to negotiate the redemption lacked the ability to "say no" under its mandate and the company allegedly bypassed the special committee to negotiate with certain large stockholders directly. In *In re HomeFed Corp. Stockholder Litigation*, the Court of Chancery also denied a motion to dismiss, holding that the complaint adequately alleged that the controlling stockholder failed to "commit to the *MFW* protections before engaging in substantive economic discussions concerning the Transaction." And in *Salladay v. Lev* — which involved not a controlling stockholder but three directors who owned large stakes and agreed to roll over their interests in the surviving company — the court held that *MFW* could not apply to dismiss the action because the dual procedural protections of a special committee and majority-of-the-minority vote were not in place *ab initio* based on early price discussions with the buyer.

In light of these developments, we expect stockholder plaintiffs to continue to closely scrutinize controller transactions, push the envelope on the level of stockholdings that constitute control and seek ways to prevent *MFW* from applying in order to avoid dismissal at the pleading stage. Implementation of procedural protections at the outset of negotiations, director independence and disinterestedness, and adequate disclosures will remain important issues in controlling stockholder litigation in the coming year.

Merger-Related Officer Liability

Until recently, officer breach of fiduciary duty cases were few and far between, notwithstanding that officers are not entitled to the same defenses as directors. 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, but it does not permit a similar provision for corporate officers. Even so, claims against officers for breaches of the duty of care in merger-related cases were exceedingly rare, with the focus primarily on instances involving a breach of the duty of loyalty.

However, following the Court of Chancery's 2019 decision in *Morrison v. Berry*, which shined a spotlight on officer liability in the merger context, the court witnessed a notable uptick in such claims against corporate officers. Indeed, in *In re Mindbody, Inc., Stockholders Litigation*, the court sustained breach of fiduciary duty claims against a chairman/CEO and a chief financial officer/chief operating officer. It concluded 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, and "failed to disclose material information to the board." The court also concluded that the CFO, who allegedly obeyed the CEO's instructions that aided in tilting the sales process to the buyer, was "at least recklessly indifferent" to the steps the CEO took. In *In re Baker Hughes Inc. Merger Litigation* and *City of Warren General Employees' Retirement System v. Roche*, the court sustained claims against CEOs who signed allegedly misleading merger disclosures. But a number of other cases — including *In re Essendant*, *In re AmTrust Financial Services* and *Rudd v. Brown* — dismissed claims against officers, making clear that plaintiffs 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 as a director.

In the coming year, we expect stockholder plaintiffs to continue pursuing claims against officers with increased frequency. We will be closely monitoring the court's approach to merger-related duty of care claims against officers, particularly in connection with their roles in preparing disclosures relating to merger transactions.

Trends in Books-and-Records Litigation

Plaintiff stockholders also remained focused on Section 220 of the DGCL as a vehicle for obtaining corporate documents before commencing litigation. Section 220 permits stockholders of Delaware corporations to inspect books and records where they have identified a "proper purpose" for doing so. Traditionally, Section 220 was used by stockholder plaintiffs as a way to draft and file a more detailed derivative complaint. Given the decrease in M&A injunction requests over the years, and the corresponding decrease in discovery records created for that purpose, stockholder plaintiffs have turned to Section 220 to access documents and communications that might assist them in similarly crafting a post-closing class action complaint to successfully challenge a merger transaction. In that regard, in recent years, plaintiffs have sought books and records not only to bolster derivative complaints but also to raise defenses against the application of *MFW* and *Corwin v. KKR Financial Holdings LLC* (which held that in the absence of a conflicted stockholder, the fully informed vote of disinterested, uncoerced stockholders will extinguish breach of fiduciary duty claims, leaving only claims for waste).

This trend continued in 2020, with most post-closing merger-related cases being filed after stockholder plaintiffs obtained books and records. In one case from February 2020, *Brown v. Empire Resorts, Inc.*, the court ordered Empire Resorts to produce books and records sought to investigate a merger transaction involving its controlling stockholder, requiring the company to produce documents so that the stockholder could, among other things, explore a "gap" between the company's board minutes and proxy disclosures and to "test whether the Empire board and management were motivated during the merger negotiations by the prospects of continued ... employment."

And, in perhaps the most significant Section 220 development, the Delaware Supreme Court curtailed two primary lines of defense against books-and-records inspections. In *AmerisourceBergen Corp. v. Lebanon County Employees' Retirement Fund*, on an interlocutory appeal of a Section 220 demand where the underlying claims would be derivative in nature, the Supreme Court held that, "when the purpose of an inspection of books and records under Section 220 is to investigate corporate wrongdoing, the stockholder seeking inspection is not required to specify the ends to which it might use the books and records." In addition, the court held that a stockholder who demonstrates a credible basis from which the court can infer wrongdoing or mismanagement is not required to show that the wrongdoing or mismanagement is "actionable" — in other words, that it could be susceptible to challenge in a subsequent lawsuit.

This year, we will be closely watching the impact of *AmerisourceBergen* on books-and-records demands. We anticipate *AmerisourceBergen* will encourage litigation-minded stockholders and will result in an uptick of Section 220 demands, and potentially increased litigation in the Court of Chancery over new or recalibrated defenses to such demands.