Insights:
The Delaware Edition

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If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

This issue covers important, developing areas of Delaware corporation law and deal litigation, including the evolving law on attorney-client privilege for emails on noncompany servers, recent Chancery Court *Caremark* decisions indicating closer judicial scrutiny and potential increased traction for oversight claims, a Delaware Supreme Court decision upholding a waiver of appraisal rights and Delaware court rulings on which affiliates are bound by restrictive covenants.

Law Governing Attorney-Client Privilege for Emails Hosted on Noncompany Servers Continues To Evolve in Delaware

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> See page 5 for key takeaways

Delaware Rule of Evidence 502(b) codifies the attorney-client privilege and insulates from discovery "confidential communications made for the purpose of facilitating the rendition of professional legal services to the client." Rule 502(a)(2) further provides that a "communication is 'confidential' if not intended to be disclosed to third persons other than those to whom disclosure is made in furtherance of the rendition of professional legal services to the client." But what happens when such communications are sent using email accounts that can be accessed by third parties that would normally destroy the privilege?

In 2013, the Delaware Court of Chancery adopted a framework for answering this question, and several recent opinions have applied the framework in various contexts to decide if the attorney-client privilege was maintained. This article analyzes the relevant opinions and provides practical guidance to companies aiming to protect the attorney-client privilege.

The rulings suggest that companies should consider requiring directors and employees to use a company-provided email account or some other email account not subject to potential monitoring when communicating with counsel. Where that is not possible, in-house counsel should carefully evaluate the policies of alternative email systems.

Information Management: Four Factors Analyzed

In a 2013 opinion, *In re Information Management Services, Inc. Derivative Litigation*,[1] Vice Chancellor Laster was the first to address the issue in Delaware of whether a party

[1] 81 A.3d 278 (Del. Ch. 2013).

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had a reasonable expectation of privacy over communications made using a company email account for personal use. In *Information Management Services*, company executives used their company email accounts to correspond with their personal lawyers.

In evaluating whether the executives could maintain privilege over the emails, the court adopted the four-factor analysis set forth in *In re Asia Global Crossing, Ltd*., a 2005 opinion from the United States Bankruptcy Court for the Southern District of New York[2]: (1) Does the corporation maintain a policy banning personal or other objectionable use? (2) Does the company monitor the use of the employee's computer or email? (3) Do third parties have a right of access to the computer or emails? (4) Did the corporation notify the employee, or was the employee aware, of the use and monitoring policies?

Applying the *Asia Global* factors, the court in *Information Management Services* found that three of the four factors weighed against a reasonable expectation of privacy and one factor was neutral. The court also held there was no statutory override that would alter the common law analysis, and it therefore ordered the production of the otherwise-privileged emails.

Lynch v. Gonzalez: Statutory Override

Six years later the issue arose again in *Lynch v. Gonzalez*[3] with Vice Chancellor Morgan T. Zurn holding that the emails in question were privileged because of a statutory override of the controlling jurisdiction. The underlying dispute related to whether one of the plaintiffs, an individual, had properly acquired a majority ownership of Belleville Holdings, a Delaware LLC that was a holding company for ownership interests in various Argentine companies.

The defendant, a former co-manager of Belleville, was ousted by the individual plaintiff as manager but remained a minority holder of Belleville, which was also a plaintiff. The defendant controlled email servers that Belleville previously used and which it was attempting to access in order to comply with its discovery obligations. Defendant denied plaintiffs access and searched the email himself, including emails over which plaintiffs claimed attorney-client privilege.

Defendant argued that plaintiffs had no expectation of privacy in emails sent on the server because they knew defendant could access them. While the court found that the *Asia Global* factors suggest the emails were not confidential, plaintiffs proved that Argentine law[4] provided a statutory override and that plaintiffs had rights of privacy in the email.

In re WeWork Litigation: Use of Another Company's Email

The following year, the issue arose again in *In re WeWork Litigation*[5] when plaintiffs sought to compel defendant SoftBank Group Corp. to produce emails that were sent to or from email accounts hosted by nonparty Sprint, Inc.[6] During the relevant time periods, SoftBank was the majority owner of Sprint and an investor in WeWork, but Sprint was not involved in the WeWork litigation.

At the time, SoftBank's COO simultaneously served as chairman of Sprint and WeWork.

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[2] 322 B.R. 247 (Bankr. S.D.N.Y. 2005).

[3] 2019 WL 6125223 (Del. Ch. 2019).

[4] To determine which law governed the email server, the court looked to the place where the company that has custody of the emails "conducts its business."

[5] 2020 WL 7624636 (Del. Ch. Dec. 22, 2020).

[6] Vice Chancellor Zurn also addressed the issue again the next year in *DLO Enterprises, Inc. v. Innovative Chemical Products Group, LLC*, 2020 WL 2844497 (Del. Ch. June 1, 2020), but despite finding that three of the four factors pointed towards production and one was neutral, declined to rule pending supplemental briefing on a potential statutory override.

Additionally, Sprint's CEO – using his Sprint email account – assisted Softbank's COO with matters related to SoftBank and WeWork. Another Sprint employee was seconded to SoftBank to work as the chief of staff to the SoftBank COO and communicated with the COO using her Sprint email account. SoftBank asserted attorney-client privilege and withheld certain relevant emails that were sent to or from the Sprint email accounts of Sprint's CEO and the Sprint employee who was on secondment to SoftBank.

Applying the *Asia Global* factors as adopted in *Information Management Services*, the court concluded that all four factors weighed in favor of ordering the production of the emails. The court explained that the first factor – does the corporation maintain a policy banning personal or other objectionable use – does not necessarily require an explicit ban on personal use of email. Rather, citing *Information Management Services*, the court explained that the first factor "has been held to weigh in favor of production when the employer has a clear policy banning or restricting personal use, where the employer informs employees that they have no right of personal privacy in work email communications, or where the employer advises employees that the employer monitors or reserves the right to monitor work email communications."[7]

Because Sprint's policy stated that "[e]mployees should have *no expectation of privacy* in information they send [or] receive" on Sprint's network, and that "Sprint reserves the right to review workplace communications (including … *email* ….),"[8] the court concluded that the first factor weighed in favor of production.

Applying the second factor – does the company monitor the use of the employee's computer or email – the court noted that neither side provided evidence regarding whether Sprint actually monitored its employees' emails, but explained that the absence of any such evidence, combined with the language in Sprint's policy explicitly reserving the right to monitor emails, weighed in favor of production.

For the third factor – do third parties have a right of access to the computer or emails – the court noted that "[i]n a dispute like this concerning use of work email, the third factor 'largely duplicates the first and second factors, because by definition the employer has the technical ability to access the employee's work email account.'"[9] Because there was no compelling evidence that the Sprint employees took "significant and meaningful steps to defeat [Sprint's] access" to the emails,[10] the court concluded that the third factor weighed in favor of production.[11]

Applying the fourth factor – did the corporation notify the employee, or was the employee aware of the use and monitoring policies – the court explained that "[i]f the employee had actual or constructive knowledge of the policy, then this factor favors production because any subjective expectation of privacy that the employee may have had is likely unreasonable."[12] In addition to explaining that knowledge of the policy may be imputed to officers and senior employees, the court noted that the record supported the conclusion that the employees were either aware of the policy or at least were aware of the confidentiality concerns between SoftBank and Sprint. The court therefore concluded that the fourth factor likewise favored production.

Given that all four factors weighed in favor of production, the court held that there was no reasonable expectation of privacy over the emails at issue and ordered their production.[13]

[7] *Id.* at *2 (citing *In re Info. Mgmt. Servs.*, 81 A.3d at 287).

[8] *Id.* at *3.

[9] *Id.* at *4 (citing *In re Info. Mgmt. Servs.*, 81 A.3d at 290).

[10] *Id.* (citing *In re Info. Mgmt. Servs.*, 81 A.3d at 291).

[11] The court also found it noteworthy that the Sprint employees had access to either a WeWork- or a SoftBank-provided email account that they could have used for the SoftBank-related business as an alternative to their Sprint email accounts.

[12] *Id.* (citing *Info Mgmt. Servs.*, 81 A.3d at 291-92).

[13] The court did not address whether there was a statutory override.

In re Dell Technologies Inc. Class V: A Reasonable Expectation of Privacy

Several months later, the issue arose again in *In re Dell Technologies Inc. Class V Stockholders Litigation*.[14] In *Dell*, the court addressed whether an outside director of Dell had a reasonable expectation of privacy regarding Dell-related emails he sent or received from an email account hosted by his former employer, Accenture LLP. The case highlights again the importance of the language of the email host's privacy policies.

The director was a former CEO of Accenture who had since retired, but he continued to use his Accenture email account. In addition to his service as an outside director for Dell, the director served on the board of several other companies and used the Accenture email account for his communications for all of his board service.

Plaintiffs sought to compel the production of over 900 emails sent to or from the director's Accenture email account, over which the director asserted attorney-client privilege. The court applied the four-factor test from *Asia Global* to hold that the director had a reasonable expectation of privacy regarding the emails.

In addressing the first factor, the court explained that "[t]his factor will favor production when the company has a policy banning personal use or where the company informs users that they have no right to privacy in communications that use that email account."[15] However, the relevant Accenture email policy in place at the time of the communications "acknowledged that personal use was permissible, that Accenture indicated that it would respect personal use except in specific circumstances, and also that Accenture would need to engage, and would engage, in systemwide monitoring to protect the entity and the system."[16]

[14] C.A. No. 2018-0816-JTL (Del. Ch. Sept. 17, 2021) (TRANSCRIPT).

[15] *Id.* at 49.

[16] *Id.* at 50-51.

The court pointed to specific language in the policy that stated that personal use was allowed as long as the use did not "Interfere with on-going work; Adversely affect the problem handling or security of Information; or Create a significant overload on [Accenture's] Technology."[17] The policy also encouraged employees to mark items as "private" or "personal" if they wished to protect the privacy of their communications, but stated that Accenture "maintains the right … to open items that are marked 'private' or 'personal'" in certain circumstances. Those circumstances included "if there is a reasonable suspicion that the communication is really not personal but is, in fact, business related; … if there's a reasonable suspicion that there's been a criminal offense …; if access is needed in connection with a company-related litigation or an internal or external investigation; … [and] inadvertent access during the company's general monitoring activities …."[18]

The court found that the policy "creates a sense in the ready that they have some expectation of privacy in using [Accenture's] system." The expectation of privacy was heightened in the director's case, the court found, because the director was completely retired from Accenture, and therefore his use of the Accenture email account was entirely personal and noncompany related. The court explained that, in light of the policy, because the director "wasn't interfering with anybody's ongoing work at the company," "wasn't affecting the company adversely," "wasn't creating a systemic overload," and "wasn't engaging in anything that looked like illicit behavior," the director had a reasonable expectation of privacy over his emails.[19]

The court distinguished this situation from that in *WeWork*, noting that *WeWork* involved a stricter policy and "[t]here were also differences in terms of the involvement in the litigation of the sponsor of the email system." Unlike the Sprint email accounts at issue in *WeWork*, because the Dell director

[17] *Id.* at 51.

[18] *Id.* at 52-53.

[19] *Id.* at 54.

was retired, Accenture's relationship with him "is more akin to a third-party provider. It isn't all the way analogous to a Google or an AOL or a Hotmail, but … Accenture was providing him with services analogous to that," the court said.[20] Having found the case distinguishable from *WeWork*, the court concluded that the first factor weighed against production.

The court addressed the three other *Asia Global* factors, and found that each weighed in favor of production. However, the court nonetheless held that the director had a reasonable expectation of privacy, explaining that the first factor "really is the dominant factor in the four-factor analysis."

Although the court found that the director in this instance could maintain privilege over the emails in question, the court provided practical advice on how best to keep outside directors' communications confidential:

> I think a strong argument can be made that the better course is for outside directors to have an email account that they can be confident is not subject to potential monitoring. One can debate whether that's one for each board or one for all of their boards, or whether it's a Gmail account or some other type of more-secure provider. Regardless, that type of corporate hygiene goes a long way to avoiding these types of motions.[21]

[20] *Id.* 55.

[21] *Id.* at 59.

Takeaways

- As the court explicitly advised in *Dell*, one way to maintain privilege and confidentiality over outside director email communications is to require that the director use a company-provided email account or some other email account not subject to third-party monitoring, or communicate through a secure board portal.
- *WeWork* suggests that the same is also true for company employees, whether permanent or temporary. The best practice for a company to ensure that its employees' communications are kept confidential is to require all employees to use a company-provided email or third-party-hosted account where emails are not monitored.
- If it is impracticable for outside directors or employees to use a company-provided email account, in-house counsel should consider reviewing the policy that governs the external email accounts to evaluate whether there are ways to maximize the confidentiality of communications. For example, if the policy requests that users store personal emails in a separate folder, in-house counsel should encourage the outside director or employee to segregate relevant communications.
- Finally, in-house counsel should consider whether there are any statutes in the jurisdictions in which they operate that could impact their own policies regarding email access or those of their outside directors or employees that use noncompany email accounts.

The Risk of Overlooking Oversight: Recent *Caremark* Decisions From the Court of Chancery Indicate Closer Judicial Scrutiny and Potential Increased Traction for Oversight Claims

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> See page 9 for key takeaways

In 1996, the Delaware Court of Chancery issued its seminal decision in *In re Caremark International Inc. Derivative Litigation*,[1] establishing the conditions for director oversight liability under Delaware law. Adopted a decade later by the Delaware Supreme Court in *Stone v. Ritter*,[2] the *Caremark* test imposes liability under two "prongs": where "(a) directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[3]

In the 25 years since *Caremark* was decided, the Delaware courts have repeatedly emphasized that claims for breach of the duty of loyalty premised on lack of oversight are exceedingly difficult to plead. In order to state a *Caremark* claim, a plaintiff must "plead with particularity that the board cannot be entrusted with the claim because a majority of the directors may be liable for oversight failures," which is "extremely difficult to do."[4] In fact, Delaware jurisprudence suggests that "the claim that corporate fiduciaries have breached their duties to stockholders by failing to monitor corporate affairs is 'possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.'"[5] As a result, oversight claims have been few and far between and, when such claims were brought, they rarely survived motions to dismiss.

Then, things changed unexpectedly in 2019. In four cases alleging that boards failed in their duty of oversight, one decided by the Delaware Supreme Court, and three by the Court of Chancery, complaints have survived motions to dismiss. These decisions suggest that directors may be more exposed to such claims than they have been in the past.

In *Marchand v. Barnhill* in 2019, the Delaware Supreme Court concluded that a complaint stated a claim for lack of board oversight where food safety at an ice cream company was the "most central safety and legal compliance issue facing the company," yet there was no board-level compliance reporting for food safety.[6]

Three months later, the Court of Chancery held in *In re Clovis Oncology, Inc. Derivative Litigation* that the board of a drug manufacturer "consciously ignored red flags that revealed a mission critical failure to comply with [a clinical trial] protocol and associated FDA regulations," despite the fact that Clovis was a "monoline company [that] operates in a highly regulated industry."[7] The Court of Chancery explained, "[a]s *Marchand* makes clear, when a company operates in an environment where externally imposed regulations govern its 'mission critical' operations, the board's oversight function must be more rigorously exercised."[8]

[1] 698 A.2d 959 (Del. Ch. 1996).

[2] 911 A.3d 362 (Del. 2006).

[3] *Id.* at 370.

[4] *In re Boeing Company Deriv. Litig.,* 2021 WL 4059934, at *1 (Del. Ch. Sept. 7, 2021).

[5] *Id.* at *67 & n.224.

[6] 212 A.3d 805, 824 (Del. 2019).

[7] 2019 WL 4850188, at *1, *15 (Del. Ch. Oct. 1, 2019).

[8] *Clovis,* 2019 WL 4850188, at *13.

In a 2020 decision, *Hughes v. Hu*, the Court of Chancery held that "chronic deficiencies" in internal controls over financial reporting "support[ed] a reasonable inference that the Company's board of directors, acting through its Audit Committee, failed to provide meaningful oversight over the Company's financial statements and system of financial controls."[9]

Later in 2020, in *Teamsters Local 443 Health Services & Insurance Plan v. Chou*, the Court of Chancery held that the board of a pharmaceutical sourcing and distribution company ignored "red flags" and "permitted a woefully inadequate reporting system with respect to the business line in which [its subsidiary] operated."[10]

On the heels of those cases, the Delaware Court of Chancery has issued two more recent opinions highlighting the critical importance of establishing and monitoring company reporting systems for "essential and mission critical" compliance risk.

Boeing: Bad Faith Adequately Alleged in 'Mission Critical' Context

In *In re Boeing Company Derivative Litigation (Boeing)*, the Court of Chancery sustained a *Caremark* claim at the pleadings stage, holding that stockholder plaintiffs had adequately pled that a majority of the Boeing board of directors faced a substantial likelihood of liability for failing both prongs of *Caremark's* two-part test.[11]

According to plaintiffs, in 2017, the global aerospace corporation began to fulfill customer orders for its new Boeing 737 MAX airplanes, which had been aggressively designed, developed, marketed and produced. In the development and marketing of the 737 MAX, the complaint alleged, Boeing "prioritized (1) expediting regulatory approval and (2) limiting expensive pilot training required to fly the new model." Boeing's "frenetic" pace for the 737 MAX program led, in part, to undisclosed safety issues with the airplanes. These safety issues ultimately led to two separate airline crashes, each killing 150 to 200 passengers. By 2020, Boeing estimated that these disasters, the resulting grounding of the 737 MAX fleet and other fallout had already caused Boeing to incur $22.5 billion in total costs.

In describing the *Caremark* standard, the Court of Chancery emphasized that a well-pled oversight claim "requires not only proof that a director acted inconsistently with his fiduciary duties but also most importantly, that the director knew he was so acting."[12] Because the test is rooted in concepts of bad faith, "a showing of bad faith is a *necessary condition* to director oversight liability."[13] Notwithstanding the high bar for pleading bad faith, however, the court held that plaintiffs adequately pled a claim for breach of the duty of loyalty predicated on lack of oversight under both prongs of the *Caremark* test.

On prong one, based on plaintiffs' allegations, the court concluded that airplane safety was "essential and mission critical" to Boeing's business, yet the board: (i) had no committee charged with direct responsibility to monitor airplane safety; (ii) did not monitor, discuss, or address airplane safety on a regular basis; (iii) had no regular process or protocols requiring management to update the board of airplane safety and instead only received ad hoc management reports that included only positive information; (iv) never received information on yellow and red flags that management saw; and (v) made statements that demonstrated they knew they should have had processes in place to receive safety information.

On prong two, the court found that the complaint adequately alleged that the board ignored the red flags of the first plane crash and consequent revelations about the problems with the 737 MAX. For these reasons, the court denied the motion to dismiss the *Caremark* claim.

[9] 2020 WL 1987029, at *15 (Del. Ch. Apr. 27, 2020).
[10] 2020 WL 5028065, at *2 (Del. Ch. Aug. 24, 2020).
[11] *Boeing*, 2021 WL 4059934, (Del. Ch. Sept. 7, 2021).
[12] *Boeing*, 2021 WL 4059934, at *25.
[13] *Id.* (emphasis in original).

Within a couple months after the *Boeing* decision issued, the parties filed settlement papers seeking the court's approval of a settlement that includes a $237.5 million monetary payment as well as corporate governance reforms.

Marriott: Complaint Dismissed Where Board Was Apprised of Risks and Did Not Disregard Them

In contrast to *Boeing*, in *Firemen's Retirement System of St. Louis v. Sorenson (Marriott)*, the Court of Chancery dismissed a *Caremark* claim, holding that the allegations in the complaint did not meet the "high bar" for pleading a bad faith oversight claim.[14]

Plaintiffs alleged that two years after Marriott International Inc. acquired Starwood Hotels and Resorts Worldwide, Inc. in 2016, Marriott discovered a data security breach that had exposed personal information of up to 500 million guests. An investigation revealed that the cyberattack was perpetrated through Starwood's legacy reservation database. Plaintiff alleged that a majority of the Marriott board faced a substantial likelihood of liability under *Caremark* for their "conscious and bad faith decision not to remedy Starwood's severely deficient information protection systems."

While the court acknowledged that "[t]he corporate harms presented by non-compliance with cybersecurity safeguards increasingly call upon directors to ensure that companies have appropriate oversight systems in place," it nevertheless concluded that "[t]he growing risks posed by cybersecurity threats do not, however, lower the high threshold that a plaintiff must meet to plead a *Caremark* claim."[15] The court highlighted that for either prong of *Caremark*'s test, "a showing of bad faith conduct . . . is essential to establish director oversight liability,"[16] and only a "sustained or systemic failure of the board to exercise oversight . . . will establish the lack of good faith that is a necessary condition to liability."[17]

With this "high threshold" in mind, the court held that plaintiff failed to state a claim under either prong of *Caremark*.[18] Under prong one, plaintiff acknowledged that "the Board and Audit Committee were routinely apprised on cybersecurity risks and mitigation, provided with annual reports on the Company's Enterprise Risk Assessment that specifically evaluated cyber risks, and engaged outside consultants to improve and auditors to audit corporate cybersecurity practices."[19] Furthermore, "[t]he Complaint also describe[d] internal controls over the Company's public disclosure practices" and then noted that when "management received information that the plaintiff describes as 'red flags' indicating vulnerabilities, the reports were delivered to the Board."[20]

On prong two, the court held that plaintiff had not pled particularized factual allegations that the board "knowingly permitted Marriott to violate the law."[21] As for the three "red flags" plaintiff cited for board knowledge of cybersecurity issues, the court concluded that none "were deliberately disregarded."[22] Instead, Marriott management "told the Board that it was addressing or would address the issues presented."[23] Therefore, the court granted the motion to dismiss the *Caremark* claim.

[14] 2021 WL 4593777 (Del. Ch. Oct. 5, 2021).

[15] *Id.* at *12.

[16] *Id.*

[17] *Id.*

[18] Notably, the court applied the newly adopted, three-part demand futility standard from the Delaware Supreme Court's recent decision in *United Food and Commercial Workers Union and Participating Food Industry Employers Tri-State Pension Fund v. Zuckerberg*, 2021 WL 4344361 (Del. 2021). See our September 28, 2021 client alert "Delaware Supreme Court Issues Two Opinions Simplifying Delaware Law on Derivative Claims."

[19] *Id.* at *1.

[20] *Id.* at *13.

[21] *Id.* at *14.

[22] *Id.* at *16.

[23] *Id.*

Takeaways

- Since the Delaware Supreme Court's 2019 ruling in *Marchland, Caremark* claims have been more frequently pursued, and a larger than expected number of them have survived motions to dismiss.
- Despite two and a half decades of *Caremark* decisions stressing the high bar for pleading a breach of the duty of loyalty premised on oversight liability, the recent decisions from the Delaware courts indicate a willingness to entertain well-pled oversight claims involving "essential and mission critical" issues for a company's compliance risk. While these cases repeat the prior court statements about how difficult these claims are to plead, they suggest that, in practice, that may no longer be the case.
- In the past two years, five of 17 *Caremark* claims raised in the Court of Chancery have survived a motion to dismiss — an approximately 30% success rate. It remains to be seen whether the Delaware courts will continue to sustain *Caremark* oversight claims with increased frequency.
- These Delaware law developments highlight the critical importance for companies and their boards to adopt and regularly assess, evaluate and update their internal controls and reporting systems to avoid potential liability under *Caremark*.

Waiver of Appraisal Rights Upheld by Split Delaware Supreme Court

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> See page 12 for key takeaways

In *Manti Holdings, LLC v. Authentix Acquisition Co., Inc*., the Delaware Supreme Court affirmed the Court of Chancery's decision to enforce a waiver of appraisal rights included in a stockholders agreement executed by "sophisticated parties" who owned 100% of the company.[1]

This 4-1 decision reinforces Delaware's longstanding public policy favoring private ordering, but has resulted in speculation (including from the strong dissent in the case) about what rights under the Delaware General Corporation Law (DGCL) are truly non-waivable. Delaware corporations, investors and practitioners should pay close attention to *Manti*'s guidance on contractual waiver of statutory rights.

Background

In connection with a 2008 transaction, Authentix Acquisition Company, Inc. (Authentix) entered a stockholders agreement with all holders of its shares (Stockholders Agreement), which provided that the common stockholders would "refrain from the exercise of appraisal rights with respect to [a board and controller approved] transaction" (Refrain Obligation).

In 2017, a third-party acquired Authentix. Under the merger agreement, the petitioners' stock was canceled and converted into a right to receive merger consideration, which, for common stock, was little to no compensation. The petitioner-stockholders sent timely appraisal demands to Authentix, which reminded the stockholders of the Refrain Obligation and requested withdrawal of the demands. The petitioners refused and filed an appraisal petition in the Court of Chancery.

The Court of Chancery granted summary judgment for Authentix and, in a case of first impression, held that Authentix stockholders waived their appraisal rights by consenting to the Stockholders Agreement and that such appraisal waiver was valid under Delaware law.

The Majority Opinion

On appeal, petitioners argued that (i) they did not waive their appraisal rights in connection with the 2017 merger, and (ii) even if they did, Delaware law prohibited enforcement of the Refrain Obligation.

Contractual arguments

In rejecting petitioners' contractual arguments, the Delaware Supreme Court held that, by signing the Stockholders Agreement, petitioners agreed to a clear and unambiguous waiver of their appraisal rights under the facts presented.

Among other reasons, petitioners argued that they were entitled to pursue their appraisal claims after consummation of the sale of Authentix because the Stockholders Agreement automatically terminated all obligations, including the Refrain Obligation, upon such a sale. Petitioners also argued that the use of the word "refrain" rather than "waive" in

[1] — A.3d —, 2021 WL 4165159 (Del. Sept. 13, 2021).

the Refrain Obligation demonstrated that petitioners did not agree to permanently relinquish their appraisal rights.

The majority found that petitioners' reading of the Stockholders Agreement was "commercially unreasonable" because stockholders could "only 'commence an appraisal proceeding'" after the sale of Authentix closed and the "clear purpose of the Refrain Obligation" was to prevent stockholders from "obtain[ing] a judicial appraisal *after* a Company Sale had closed."

The majority also refused to credit petitioners' attempt to distinguish between an agreement to "refrain" from exercising appraisal rights and an agreement to "waive" those rights, even though both terms were used in various provisions of the Stockholders Agreement. Specifically, the majority concluded that, while the Refrain Obligation used the word "refrain" rather than "waive" with respect to appraisal rights, that was because the Authentix stockholders did not agree under the Stockholders Agreement to completely "relinquish their appraisal rights" in all potential scenarios. Instead, those stockholders "agreed 'to keep [themselves] from' exercising their appraisal rights" if certain conditions were satisfied. The majority held that the sale of Authentix satisfied those conditions.

Policy argument

The majority also held the Refrain Obligation enforceable as a matter of Delaware law and public policy. While the majority noted that "there are certain fundamental features of a corporation that are essential to that entity's identity and cannot be waived," it reiterated that the DGCL is a "broad and enabling statute" that allows for freedom of contract, including the waiver of "mandatory rights," and that "the individual right of a stockholder to seek judicial appraisal is not among those fundamental features that cannot be waived."

In support of its holding, the majority observed that certain provisions of the DGCL contain express prohibitions against waiver but the appraisal statute does not contain similar language. The majority also noted that the waiver conferred a benefit to the corporation and its stockholders by making Authentix a more attractive acquisition candidate. Thus, while stating that "there are contexts where an *ex ante* waiver of appraisal rights would be unenforceable for public policy reasons," the majority held that "sophisticated and informed stockholders, who were represented by counsel and had bargaining power," could preemptively relinquish their appraisal rights for "valuable consideration," and held that such waiver did not contravene Delaware public policy.[2]

The Dissenting Opinion

In a lengthy dissent, one member of the court expressed the view that appraisal rights are one of the DGCL's mandatory provisions and should not be waivable. In addition, the dissent stated that even if such a waiver were permitted, there was none here under the plain language of the Stockholders Agreement – or, at the very least, the language was ambiguous and should be construed in favor of the petitioners.

Like the majority, the dissent stressed the presence of "sophisticated parties." Where sophisticated parties used both the term "waive" and "refrain" in the Stockholders Agreement, the dissent argued that the court should recognize the distinct "narrower" meaning of refrain and Authentix should have negotiated for a "savings clause"

[2]The majority also distinguished the Refrain Obligation from stock restrictions that must be included in a company's charter under Section 151(a). The majority held that the Stockholders Agreement imposed "personal obligations" on the stockholders, not "encumbrances on property rights that run with the stock." The Court emphasized that Authentix only attempted to enforce the Refrain Obligation against sophisticated and informed stockholders, who, represented by counsel, possessed bargaining power. The Court, however, expressed skepticism that such an agreement could bind successors.

continuing the Refrain Obligation beyond termination of the Stockholders Agreement. Further, the dissent expressed concern about the uncertainty the majority decision creates regarding the waivability of other so-called "mandatory" rights under the DGCL.

The dissent viewed the waiver of mandatory rights under the DGCL as an issue best determined by the Delaware legislature, not the Delaware courts, and said that, if such a waiver were to be permitted, it should be enshrined in a company's certificate of incorporation, not a stockholders agreement or a bylaw.

Noting that waiver provisions such as those in the Stockholders Agreement are common in start-up companies, the dissent questioned whether the majority was creating two classes of Delaware corporations: one (typically smaller, closely held corporations) with sophisticated stockholders who can waive mandatory rights and a second (typically larger, publicly traded corporations) that cannot enforce such a waiver against its stockholders.

Takeaways

- This case highlights the importance of careful drafting in stockholders agreements. The *Manti* majority held that the use of the term "refrain" in the Stockholder Agreement's Refrain Obligation provision unambiguously waived appraisal rights under the facts presented, but with another statutory right or slightly different language, the majority might have reached a different conclusion. Moreover, the dissent argued that the language was ambiguous as to whether the parties in *Manti* contracted for "refrain" to mean "waive."
- *Manti* does not provide a list of which DGCL sections the majority viewed as non-waivable "fundamental features of the corporate entity's identity." Thus, the full scope of permissible waivers of "mandatory rights," and the appropriate vehicle for such waivers, remains an open question.
- The majority's repeated emphasis on the presence of "sophisticated stockholders" and bargained-for restrictions may limit the scope of future attempts to enforce a waiver of the appraisal or other "mandatory" rights in different circumstances.

Which Affiliates Are Bound by Restrictive Covenants Hinges on the Language the Parties Chose, Recent Rulings Stress

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> See page 16 for key takeaways

In 2021, the Delaware Court of Chancery issued two decisions addressing when a contractual party's affiliates are bound to restrictive covenants in an agreement. In the first case, *Sixth Street Partners Management Company, L.P. v. Dyal Capital Partners III (A) LP,*[1] the plaintiff alleged that a transfer restriction in an investment agreement was breached when an investor's upstream affiliate agreed to sell a business division that included the investor's general partner. In the second, *Symbiont.io, Inc. v. Ipreo Holdings, LLC*,[2] the plaintiff alleged that a noncompetition provision in a joint venture agreement was breached when the other party to the joint venture was acquired by a competitor of the plaintiff.

The *Sixth Street* decision held that the restriction did not to apply to the upstream affiliate, while in *Symbiont*, the restriction was enforced against a nonparty to the original contract. However, both decisions turned on a close reading of the language of the parties' agreements, and both provide helpful guidance to drafters, highlighting why commercial entities and their attorneys should take care in defining what is encompassed by the term "affiliate."

Dyal Capital: When Are Up-Stream Affiliates Bound to a Transfer Restriction?

The Dyal Capital Partners division (Dyal) of Neuberger Berman Group, LLC (Neuberger) managed funds that acquired passive minority equity stakes in other private investment firms. In 2017, a limited partnership that Dyal managed (Dyal III) invested in Sixth Street Partners (Sixth Street), an alternative asset manager. Dyal III's relationship with Sixth Street was governed by an investment agreement that included certain restrictions on the transfer of Dyal's interest in Sixth Street, and, specifically, that "no Subscriber [*i.e.*, Dyal III] may Transfer its Interests in any Issuer [*i.e.*, Sixth Street]" without prior consent.

In December 2020, Neuberger announced that it had entered into a business combination agreement (BCA) to merge Dyal with Owl Rock Capital Group (Owl Rock) and a special purpose acquisition company called Altimar Acquisition Corporation. Importantly, the transaction was structured so the deal was exclusively between "upstairs' entities" – *i.e.*, Neuberger and Owl Rock – and "[t]he legal and economic relationships between Sixth Street and Dyal III … will not change."

Sixth Street sued, seeking to enjoin the transaction, alleging that the transactions contemplated under the BCA between Neuberger and Owl Rock constituted a prohibited transfer under Dyal III and Sixth Street's investment agreement. Sixth Street argued that, although Dyal III was the only defined "Subscriber" in the investment agreement, the definition of the verb "Transfer," which included "any other similar transaction involving an Affiliate," was intended to prevent any transfer of an interest in Sixth Street by any affiliate of Dyal III up the corporate ladder.

[1] *Sixth Street Partners Mgmt. Co., L.P. v. Dyal Capital Partners III (A) LP,* 2021 WL 1553944 (Del. Ch. Apr. 20, 2021), *aff'd*, 253 A.3d 92 (Table) (Del. 2021).

[2] *Symbiont.io, Inc. v. Ipreo Holdings, LLC*, 2021 WL 3575709 (Del. Ch. Aug. 13, 2021).

In April 2021, Vice Chancellor Morgan T. Zurn of the Delaware Court of Chancery denied Sixth Street's request for a preliminary injunction and held that the plaintiffs failed to demonstrate a likelihood of success in establishing that there was a breach of the investment agreement, and also failed to demonstrate a likelihood of success that Neuberger tortiously interfered with the investment agreement.

The court emphasized that "the Subscriber, Dyal III, is transferring nothing in the Transaction, so the Transfer Restriction is not triggered." The court noted that "Sixth Street's interpretation would have the Court enjoin a transaction at any level of Dyal's corporate pyramid, regardless of whether that entity was explicitly bound by the Transfer Restriction. This runs afoul of Delaware's well-settled respect for and adherence to principles of corporate separateness and freedom of contract, especially in the hands of sophisticated parties that could have expressly bound Dyal III's upstairs entities if doing so reflected their intended agreement."

The court relied on two recent Delaware opinions that declined to extend contract provisions to nonparty upstream entities. The first was the Delaware Supreme Court's holding in *Borealis Power Holdings Inc. v. Hunt Strategic Utility Investment L.L.C.*,[3] where the court refused to bind an upstream owner to "a right of first refusal" provision in its subsidiary's contract. In doing so, the Supreme Court held that the "analysis was governed by the 'subject' of the right of first refusal," and the subject was only the subsidiary, not the owner.

Similarly, in *Sheehan v. Assured Partners, Inc.*[4] the Court of Chancery found that a tag-along right was not triggered, because the subject of the provision was not doing any transferring or selling of its units in the challenged transaction.

Applying these precedents, the court in *Sixth Street* concluded that "the Transfer Restriction is triggered only by the Subscriber's Transfer of its Interests in Sixth Street, which will not occur in the Transaction. Dyal III is not transferring any Interests. The Transfer Restriction applies only when Dyal III is doing the transferring, so an upstairs sale of control over Dyal III GP cannot trigger it. Dyal III, the Subscriber, is not a party to the Transaction and its investment in Sixth Street is unchanged. The Transaction does not trigger the Transfer Restriction."[5]

In addition, the court found that there was no irreparable harm and the balance of the equities favored the defendants.

The Delaware Supreme Court later summarily affirmed the Court of Chancery's decision after judgment was entered against Sixth Street.

Symbiont: Future Affiliates Are Subject to Restrictions in Joint Venture Agreement

In 2016, Symbiont.io, Inc. (Symbiont) and Ipreo LTS, LLC (Ipreo) joined forces with a plan "to revolutionize the secondary market for syndicated loans." They formed a joint venture, which involved the creation of a new limited liability company, Synaps (JV). Symbiont committed to provide the JV a distributed ledger and smart contract technology, and Ipreo committed to provide, among other things, a management team with expertise in the syndicated loan industry. Symbiont and Ipreo entered into several agreements, including a joint venture agreement (JV Agreement).

The JV's primary competitor, IHS Markit Ltd. (Markit), had a 99% share of the market for intermediary services for syndicated loans through its technology ClearPar. Symbiont and Ipreo thought that they had a superior technology that could take market share from Markit.

In 2018, as the JV was struggling to gain traction, rumors spread that Markit was in talks to acquire Ipreo. Ultimately, Markit

[3] 233 A.3d 1 (Del. 2020).

[4] 2020 WL 2838575 (Del. Ch. May 29, 2020).

[5] 2021 WL 1553944.

acquired Ipreo in its entirety, including its interests in the JV, for $1.86 billion. After the acquisition closed, Markit decided against continuing the JV, and Markit continued to operate its ClearPar business.

In May 2019, Symbiont filed suit against Ipreo and Markit, bringing breach of contract and tortious interference claims. In its headline claim, Symbiont asserted that Ipreo breached the noncompetition provision in the JV Agreement. That provision prohibited Ipreo and any of its "affiliates" from engaging in any joint ventures except through the Synaps JV. Symbiont argued that Ipreo breached the noncompetition provision as soon as the acquisition closed because "(i) Markit became an Affiliate of Ipreo as a result of the Acquisition, (ii) Markit engaged in the Joint Venture Business by offering its ClearPar product, and (iii) Markit did not run its ClearPar business through [Synaps]."

In a post-trial opinion, the Court of Chancery found that Symbiont proved that Ipreo breached the noncompetition provision under this theory. The only disputed issue was whether Markit qualified as an affiliate of Ipreo after the acquisition.

The JV Agreement defined "affiliate" to mean include any entity that "directly or indirectly, controls, is controlled by, or is under common control with" a party. The term was used in several places throughout the JV Agreement in addition to the noncompetition provision, even in the definition of "Ipreo" at the beginning of the agreement, which was defined to include "its Affiliates."

Symbiont argued that the definition of affiliate called for "determining whether a party qualifies as an Affiliate at the time when contractual compliance with the JV Agreement is measured." In other words, according to Symbiont, the court needed to determine whether a party qualified as an affiliate at the time that the prohibited competition took place. Under this reasoning, once an entity qualified as an affiliate, that entity could not engage in a "Joint Venture Business" without causing a breach of the noncompetition provision.

Ipreo countered, arguing that the definition of affiliate only encompassed parties that qualified as affiliates on the date the JV Agreement became effective.

The court sided with Symbiont, saying that, "[f]or purposes of the Non-Competition Provision, there are other textual indications that compliance with the Affiliate Definition is determined when contractual compliance is measured." Those "textual indications" included, among other things, language in another restrictive covenant that showed that the parties knew how to limit the scope to events that occurred as of a specific date, while the noncompetition provision and the definition of affiliate failed to use similar language, thus indicating an intent that the affiliates should be determined as of the date contractual compliance is measured.

The court found that *Universal Studios Inc. v. Viacom Inc.*[6] was directly on point. That court did not limit the affiliate definition to companies that qualified as affiliates when the joint venture agreement was signed. The *Symbiont* court held, "[w]hen Symbiont and Ipreo entered into the JV Agreement in 2016, the Viacom case was settled precedent. It had been on the books for nineteen years. The decision not only illuminates the plain language of the JV Agreement, but it also shows that if the drafters wanted to achieve a different result, such as limiting the coverage of the Affiliate Definition to those Persons that qualified as affiliates on the effective date, then they needed to include additional language to achieve that result."

The court went on to conclude that, in addition to the plain language of the agreement and case law, the "real-world" commercial context also favored Symbiont's interpretation of the noncompetition provision and definition of affiliate. The court found that "[i]t would not make sense for the Non-Competition Provision to acknowledge

[6] 705 A.2d 579 (Del. Ch. 1997).

that the members' relationships with the Company could change over time, yet for the Affiliate Definition to treat those relationships as forever fixed at the time of signing." If that were the case, "either Symbiont or Ipreo could form a new entity immediately after executing the JV Agreement, then conduct Joint Venture Business through that entity. That outcome is absurd."

"Ipreo's interpretation of the Affiliate Definition seems like something dreamed up after the fact, for purposes of litigation," the court said. "It is not an interpretation that Ipreo held in real time, when negotiating and agreeing to the Transaction Agreements."

The court therefore held that Ipreo was liable for breach of the noncompetition provision in the JV Agreement when Markit became Ipreo's affiliate and operated its ClearPar business outside the JV.[7]

[7] *Symbiont* is currently on appeal to the Delaware Supreme Court.

Takeaways

- *Sixth Street* emphasizes that the court will carefully examine the contract at issue and enforce its plain meaning when determining whether nonparty upstream entities are bound. Ultimately, *Sixth Street* concluded that upstream entities that were not a party to the agreement were not bound by the agreement's anti-transfer provisions. *Symbiont* further reinforces that the court will look to the plain language of the agreement to interpret what entities are "affiliates," examining how that term is defined and used throughout the document, as well as the commercial intent of the parties.
- Given Delaware's strong respect for corporate separateness and freedom of contract, the plain language of a contractual provision, and, particularly, which entity is named as the subject of the provision at issue, will guide the court's determination of which entities are bound to its terms.
- Drafters of a contract should state explicitly which entities are being bound by and subject to the terms of the provision. Among other things, parties should carefully consider how "affiliates" are defined and how that term is used throughout the contract so as to encompass only those parties the parties intend to bind.
- A nonparty to a contract may still be bound when the contract contains "textual indications" that demonstrate the parties did not intend to limit the scope of the restrictive provision as they did in other provisions.
- The court may also look to the real world commercial context surrounding the agreement to determine if a party's interpretation is reasonable.

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