Delaware Corporate Law: Recent Trends and Developments

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On March 22, 2022, Skadden hosted a webinar on recent developments in Delaware corporate law. Litigation partners Edward Micheletti and Jenness Parker and litigation associate Lauren Rosenello led the discussion, which covered a range of issues that will bear on Delaware companies in 2022, and may affect future litigation, including:

i. the increasing number of books and records demands under 8 Del. C. §220, and related litigation;
ii. recent merger litigation trends involving *Corwin* and de facto controllers;
iii. significant developments in derivative litigation;
iv. trends in disputes involving material adverse effects (MAEs) and “ordinary course covenants” in the wake of the COVID-19 pandemic and the Ukraine conflict; and
v. recent decisions in the emerging area of SPAC litigation.

Below are high-level takeaways.

Books and Records Demands

Demands for books and records pursuant to Section 220 have been on the rise. Traditionally, books and records demands were precursors to derivative litigation, but now stockholders are also using Section 220 to lay the groundwork for class action M&A damages suits. Stockholders will use books and records to bolster post-closing actions against defenses, including that a deal was approved by a fully informed, uncoerced vote of disinterested stockholders.

Litigation over Section 220 demands has also been on the rise. Recent decisions have curtailed a company’s ability to reject demands outright. For example, companies may no longer argue that the wrongdoing a stockholder purports to investigate through the demand would not survive a motion to dismiss. However, courts have remained willing to entertain arguments about technical compliance with Section 220 and restrictions on the scope of documents that stockholders may access. Delaware courts have also recently shown a willingness to limit the scope to formal board materials that provide the necessary and essential information related to the demand, stopping short of ordering production of emails or other non-traditional documents that would turn the books and records procedure into something more akin to civil discovery.

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Key Takeaways
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Recent decisions:

***Employees' Ret. Sys. of R.I. v. Facebook, Inc.*, C.A. No. 2020-0085-JRS (Del. Ch. Feb. 10, 2021)**

- Electronic communications were necessary and essential to evaluate the board's process because traditional board materials already produced were "bereft" of relevant information.

***Durham v. Grapetree, LLC*, 246 A.3d 566 (Del. 2021)**

- Denial of inspection of informal records was affirmed where board presentations and minutes concerning the matters for inspection were deemed sufficient to satisfy the stockholders' demand.

Corwin

The *Corwin* doctrine applies when a fully-informed, non-coerced majority of disinterested and independent stockholders approves a transaction (providing it does not involve a conflicted controller). In 2021, the courts saw an uptick in merger litigation, including the application of the *Corwin* doctrine. We expect this trend to continue in 2022 with Delaware courts scrutinizing the adequacy of disclosures to ensure a vote was fully informed, and that the vote of a majority of independent and disinterested stockholders was obtained in favor of a transaction, in order to obtain a dismissal under *Corwin* and avoid costly discovery.

Recent decisions:

***Galindo v. Stover*, C.A. No. 2021-0031-SG (Del. Ch. Jan. 26, 2022)**

- Proxy's omission of information concerning a prior proposal was not material where neither board of directors nor management seriously considered the proposal, and circumstances surrounding the merger and prior proposal vastly differed. The case was dismissed on *Corwin* grounds.

De Facto Controllers and 'Entire Fairness'

"Control" in the merger context is not just limited to numerical stockholder control, but may also be found in situations where a stockholder has effective or de facto control below a numerical majority. These issues are case-specific, and the case law has developed as courts have analyzed what constitutes a de facto controlling stockholder in different factual settings. If a transaction involves a controller and lacks sufficient procedural protections, then the rigorous "entire fairness" standard of review may apply. Recently, the Court of Chancery noted that a controller does not even have to hold stock and can be a creditor with certain "control" rights.

Recent decisions:

***Blue v. Fireman*, C.A. No. 2021-0268-MTZ (Del. Ch. Feb 28, 2022)**

- Stock ownership is not prerequisite to being a controller. Creditor was target's controller by virtue of its voting power.

***In re MPM Holdings Inc. Appraisal & Stockholder Litig.*, C.A. No. 2019-0519 (Del. Ch. Jan. 13, 2022) (Transcript)**

- Determining whether a stockholder is a de facto controller involves a "holistic analysis." The court concluded that a 41% stockholder was a controller, citing factors including: board meetings held at stockholder's offices; an amended services agreement between the company and a controller-controlled entity; and other parties treating stockholder as the de facto controller.

Recent Delaware case law has also reiterated that "entire fairness" is an extremely difficult standard of review to satisfy. The decisions highlight the importance of structuring a transaction that will protect minority stockholders in order to benefit from a less demanding standard of review if the transaction is challenged.

Recent decision:

***In re Cellular Tel. P'ship Litig.*, Coordinated C.A. No. 6885-VCL (Del. Ch. Mar. 9, 2022)**

- Controller of a partnership on both sides of a freeze-out transaction failed to prove entire fairness and breached its duty of loyalty where no special committee or majority of minority vote was employed. The court, using its own discounted cash flow model, determined that the fair value of the partnership for purposes of a remedial award was roughly $500 million more than the $219 million controller paid.

Derivative Litigation

Prior to 2019, an oversight (or *Caremark*) claim almost never survived a motion to dismiss but, with the help of books and records, oversight claims have recently gained traction. Where stockholder plaintiffs have been successful with oversight claims at the pleadings stage, the courts appeared to be focused on the fact that the lack of oversight related to "mission critical" operations.

Thus boards should implement and actively enforce reporting systems that continuously monitor mission critical operations, including protocols for management reports to the board and regularly scheduled board meetings to evaluate key business risks and whether the company's oversight procedures are func-

tioning properly. Boards also should carefully document their oversight efforts in formal minutes.

Recent decisions:

***In re The Boeing Company Deriv. Litig.*, C.A. No. 2019-0907-MTZ (Del. Ch. Sept. 7, 2021)**

- Despite the high pleading bar under *Caremark*, allegations that the company failed to implement a reporting system for airplane safety and disregarded red flags survived a motion to dismiss.

***In re Camping World Holdings, Inc. S'holder Derivative Litig.*, CONSOLIDATED C.A. No. 2019-0179-LWW (Del. Ch. Jan. 31, 2022)**

- Reiterating that oversight liability "is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment," the court found that plaintiffs failed to plead a *Caremark* claim. The court criticized the plaintiffs' attempt to use the same set of facts to plead both a *Caremark* claim (lack of knowledge) and insider trading *Brophy* claim (based on knowledge of non-public facts), two theories of liability the court deemed "fundamentally inconsistent."

MAEs and 'Ordinary Course Covenants'

Delaware courts saw an uptick in material adverse effect litigation with the COVID-19 pandemic. Despite the pandemic, an MAE remains extremely difficult to establish and, to date, no Delaware court has excused a buyer from closing because the pandemic constituted a MAE.

In 2021 and 2022, Delaware courts also provided guidance on "ordinary course covenants" and the sources of information a court can consider when determining whether a seller acted in the ordinary course. Regardless of the situation, recent case law has reaffirmed that the court's analysis will always start with the contractual language and the court will apply strict contract interpretation.

Recent decisions:

***AB Stable VIII LLC v. MAPS Hotels and Resorts One LLC*, C.A. No. 2020-0310 (Del. 2021)**

- Affirmed that the seller breached the ordinary course covenant in a sale agreement when, without notifying the buyer in advance or securing its consent, the seller undertook significant business changes in response to the pandemic that were not consistent with the seller's past practices. The buyer was excused from closing.
- According to the merger agreement, "the business of the [c]ompany and its [s]ubsidiaries shall be conducted only in the ordinary course of business consistent with past practice in all material respectsm … ."
- The court held that the relevant inquiry was not whether the seller's response to COVID-19 was reasonable or consistent with others in the industry (including the buyer), but whether it deviated from the seller's past practice.

***Level 4 Yoga, LLC v. CorePower Yoga, LLC*, C.A. No. 2020-0249-JRS (Del. Ch. Mar. 1, 2022)**

- Franchisor CorePower Yoga argued that the COVID-19 pandemic was a MAE that excused it from acquiring its franchisee's yoga studios. The court held that the contract was structured as a "one way gate, without any conditions to closing and without any right to terminate," in part because the franchisor exercised a precontractual call option to require the franchisee to sell, and thus, the franchisee was not a voluntary seller. As a result, the parties were required to close. The court also determined the pandemic did not constitute an MAE.

SPAC Litigation

SPAC and de-SPAC transactions exploded in 2021, leading inevitably to related litigation. The Delaware Court of Chancery first had an opportunity to weigh in on SPACs in January 2022, holding that, although this area of the law is novel because of the transaction structure, established fiduciary duty principles apply. We expect that in 2022 Delaware courts will be called on to rule on a range of SPAC-related issues, including disclosures, conflicts and fairness issues.

Recent decision:

***In re MultiPlan Corp. Shareholders Litig.*, C.A. No. 2021-0300-LWW (Del. Ch. Jan. 3, 2022)**

- Applying "well-worn fiduciary principles" under Delaware law to the claims raised by stockholder plaintiffs, the court denied a motion to dismiss, allowing direct claims to proceed against a SPAC's sponsor and its directors, as well as an aiding and abetting claim against its financial advisor.
- The court's decision largely turned on what it determined at the motion-to-dismiss stage to be a disclosure claim. Courts will parse proxy statements issued in connection with SPAC transactions, and this case demonstrates the importance of robust disclosures given that a court could apply an "entire fairness" standard of review. Parties should give careful consideration to disclosures and risk factors issued in connection with any SPAC transaction.