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# Update | Delaware Corporate Law

April 2023

## Early 2023 Delaware Corporate and M&A Law Review

Corporate and M&A litigation in Delaware has started 2023 at an incredible pace. The Delaware Court of Chancery in particular has addressed numerous important, novel, and practice-moving issues mentioned below with some practical takeaways informed by attorneys from GT's other offices and related practices.

### CORPORATE

**Officer Oversight Obligations.** Officers of corporations owe fiduciary duties, and under recent Court of Chancery decisions those duties include an obligation to oversee the corporation similar to the board's oversight obligation under the *Caremark* line of case law. The exact parameters of an officer's oversight obligation will be determined by future case law, but recent judicial guidance suggests that it will be context-specific, and that related claims for failed oversight will be subject to both the onerous *Caremark* standard, and the typical demand requirements of a potential plaintiff-stockholder bringing derivative claims. Indeed, certain oversight claims against officers so far in 2023 were dismissed on demand futility grounds because a majority of the board was disinterested and independent. As noted in our previous GT Update, the practical implications of this development may be far-reaching. For instance, it will be important to identify employees who may and/or are intended to qualify as officers for various Delaware corporate law purposes, especially at large corporations like banks and financial institutions with multi-level reporting structures and for C-suite and compliance officers. Similarly, smaller companies that may utilize officer titles in an unofficial capacity for recruiting or advancement purposes (but are not intended to confer officer status) should review such practices to limit potential arguments that those persons inadvertently qualified as officers for Delaware corporate law purposes. Corporations also should consider potential changes to training and recordkeeping related to oversight at all levels, while considering which employees are fairly considered to qualify as officers.[1]

**DGCL Class Vote not Required for Officer Exculpation Charter Amendments.** Charter amendments adversely affecting the rights, powers, and preferences of a class of stock entitle that class to separate class voting rights under Section 242(b)(2) of the Delaware General Corporation Law (DGCL). Per a recent decision, which is being appealed, a charter amendment providing for limitation of officers' personal liability for breach of fiduciary duty under Section 102(b)(7) of the DGCL (as amended in 2022) does not trigger those class voting rights. The court explained that well-established Delaware case law led to an interpretation that the phrase "rights, powers and preferences" in Section 242(b)(2) refers only to the rights, powers and preferences of a class of stock expressly set forth in the certificate of incorporation. While acknowledging some receptiveness to the plaintiff-stockholders' argument, the court in this litigation also noted the benefits of such charter amendments to

corporations. This decision is a valuable study in the scope of class voting rights and sources of stockholder rights.[2]

**Enforceability of Restrictive Covenants and Conditional Payment Scheme**. Delaware courts have seen an influx of employment-related litigation, and recently declared unenforceable under Delaware law restrictive covenants, including a one-year noncompete and two-year non-solicit, binding on former partners of a Delaware limited partnership, and a four-year conditional payment scheme that conditioned payments of otherwise earned benefits on the former partners not competing with the partnership or its affiliates. Both of the unenforceable provisions were contained in a limited partnership agreement; the restrictive covenants were facially overbroad and void against Delaware public policy, while the conditional payment scheme was unenforceable as unreasonable. Although this is noteworthy guidance, it is not necessarily applicable to employment agreements or restrictive covenants in the sale of a business.[3]

**Clear and Unambiguous Intent for Voting Proxies to Bind Subsequent Holder**. Delaware public policy disfavors separation of economic and voting interests in shares, and accordingly requires clear and unambiguous drafting for a voting proxy to run with the subject shares. The Delaware Supreme Court affirmed the Court of Chancery's decision that a voting proxy failing to meet this standard did not bind subsequent holders. The Court based its conclusion on the Delaware policy, narrow provisions defining the stockholder and shares subject to the proxy and appointing the proxyholder which did not evince an intent for the proxy to run with the shares, the existence of an addendum reflecting the parties' understanding that the proxy wouldn't run with the shares, and internal drafting differences between the uses of transfer and assign suggesting the proxy would bind assignees but not transferees. This decision confirms that ambiguities will be construed against broad restrictions on subsequent holders allegedly imposed by voting proxies. Companies with generalized proxy provisions in stockholder or other agreements applying to a broad set of stockholders should review those provisions and related assignment provisions with counsel in light of this decision.[4]

**Judicial Validation of Amendments Increasing Shares in Dual-Class Charters without DGCL Class Approval**. Section 205 of the DGCL permits judicial validation of defective corporate acts, which has been sought by a host of corporations after the Court of Chancery's *Boxed* decision in 2022 suggesting that class votes were required under Section 242(b)(2) for charter amendments increasing authorized shares in a dual-class stock structure (as many SPAC charters were drafted and for which class votes were generally not sought). The court has confirmed that only uncertainty (not an actually finding of invalidity) is required for validation, though relief will also be narrowly granted to the issues presented in the petition. These decisions reflect the availability of judicial validation in appropriate situations, suggest a close eye toward the drafting of charter provisions authorizing shares, classes, and series of stock, and may call for class votes under Section 242(b)(2) at companies with multi-class stock structures.[5]

**Insider Trading Claim Based on Financial Performance Disclosure and Size and Timing of Trade**. Delaware's *Brophy* insider trading case law focuses in large part on materiality of the information and scienter of the insider. Such a claim was recently allowed to proceed, with the court downplaying the notions that requisite material nonpublic information must contradict an expectation previously set by company disclosures (because materiality is context-specific under Delaware law) or that there was a strong inference to be drawn from the fact that the trade was the defendant's first (because the company had only been public for a few months). In determining materiality, the court focused instead on the company's statements that the alleged material nonpublic information—related to a financial performance metric—was an important indicator of the

business and that it incorporated public and nonpublic data. In determining scienter, the court focused on the size of the trade ($500 million), despite that amount representing only 1% of the insider's position, and the timing of the trade (outside of a trading window, after expiration of special approval, and before announcement of the alleged MNPI), despite coinciding with a similarly sized long-term charitable commitment.[6]

**Deference to Independent Special Litigation Committee Reasonably Recommending Claim Dismissal**. Special litigation committee (SLC) recommendations to dismiss litigation claims may receive judicial deference when their members are independent, their investigation is in good faith and reasonably scoped, and their conclusions reasonably supported. An SLC recommendation to dismiss fiduciary duty claims against directors and a controlling stockholder, with respect to a stock repurchase from the controller, recently received such deference after the single-member SLC conducted 17 minuted meetings over nine months and issued a written report. The court focused on the SLC's thorough investigation of the claims, potential diversion of corporate resources, and advisors' potential conflicts, though the court acknowledged it was unfortunate the SLC report was silent on the independence of advisors that had relationships with the controller. But the court expressed skepticism about another SLC where a controlling stockholder may have interfered with the process after replacing the SLC members. These decisions illustrate the potential benefits of an SLC, as well as the thoroughness expected from its process.[7]

**Nonconsenting Stockholder Claim based on Disclosures Made to Consenting Stockholders**. Stockholders may act by written consent in lieu of a meeting and, when such actions are taken by stockholders who already have all material information, approval by consent can obviate extensive disclosures required when soliciting stockholder approval at widely held corporations. Former stockholders of a VC-backed tech company would have had standing to bring breach of fiduciary duty claims based on allegedly inadequate disclosures to other stockholders whose consents to a preferred stock financing were solicited by the company. The company allegedly failed to disclose that, before the financing, management had received an expression of interest in a potential strategic transaction. The disclosure claims were dismissed, however, on the basis that a subsequent merger had extinguished the plaintiffs' standing, because the claims were not direct as is often the case with disclosure claims.

**Director Rights to Access Privileged Material and to Share with Affiliated Stockholder**. Directors generally have unfettered access to corporate records, due in part to their responsibility for management of the corporation and the Delaware view that they are joint clients of company counsel. This is subject to use of a board committee, director agreement, or assertion of adversity. Directors designated by a stockholder also generally have a right to share information with the designating stockholder. In one case, both the director and the affiliated stockholder were viewed as within the company's circle of confidentiality, and therefore permitted to access company information created during the director's tenure. In another case, however, the adversity exception to privilege was satisfied where contemporaneous documentation showed that a director was aware of adversity in draft deal documents and emailed himself related talking points, which showed that the director understood he was adverse as to the potential transactions. These cases demonstrate the importance of identifying and managing potential conflicts of directors to protect privileged and confidential corporate records. VC funds and other institutional investors who require certain information to comply with their duties to the limited partners should ensure that they have such information rights documented as stockholder rights and should not rely solely on their access to information through a designated director.[8]

## MERGERS & ACQUISITIONS

**Potential Conflicts in SPAC and Other M&A Transactions**. Multiple decisions addressing potential conflicts arising from transactions involving public and private companies including special purpose acquisition companies (SPACs) provided valuable guidance regarding the identification of potential conflicts and the structure of a corporate sale process. The court has emphasized that principles of Delaware law apply equally to all Delaware corporations and the importance of actively identifying, monitoring, managing, and disclosing potential conflicts. For instance, the different terms of equity held by SPAC directors, officers, and other stockholders created a divergence from the interests of public stockholders. The court also noted that rights, such as a redemption right, could be undermined by inadequate disclosure related to exercise of that right. In a private company financing, a director was not independent of an investor that had appointed that director to the boards of that company and three other companies and compensated that director for such service. In a deal approved by disinterested stockholders, fiduciary duty claims were not cleansed under *Corwin*, because the deal disclosures, soliciting approval of a merger, were read to only give stockholders a choice between the merger and a liquidation the board would pursue if the merger were not approved; stockholders were not viewed as having the option to retain the status quo and therefore the vote was coerced. Boards and buyers may use this as an opportunity to revisit their rules of the road for strategic transaction processes including practices for vetting potential conflicts.[9]

**Value of Litigation Claims as Part of Determination of Merger Consideration**. In several decisions, the Court of Chancery has addressed *Primedia* claims, in which a transaction is challenged based on the board's alleged failure to value litigation claims and factor that value into the deal consideration. These cases have involved claims existing pre-closing and those identified post-closing, and former stockholders have been allowed to pursue the litigation claim when its elimination was conceivably undervalued and a source of conflict for corporate fiduciaries. Deal planners should be aware, for purposes of process, diligence, agreements, and disclosure, that the *Primedia* analysis has been unusually active in recent Delaware litigation. Salient issues in valuing litigation claims include the nature of the claims, any potential board conflicts that may arise from such claims, the standard of review that may apply, and the value of a potential remedy.[10]

**Binding Non-Signatories to Dispute Resolution Provisions**. Non-signatories to a contract may be bound to forum selection or dispute resolution provisions based on their receipt of benefits from the agreement. In one case, an LLC was subject to an arbitration provision in the employment agreement between an affiliate entity and the affiliate's employee, contemplating that the employee would provide services to the LLC. Although the LLC agreement was subsequently adopted and contained a Delaware court selection provision and an integration clause, ambiguity in overlapping provisions and principles of estoppel called for the LLC to be bound by the employment agreement's arbitration provision. In another case, however, officers of a non-surviving constituent company to a merger agreement, who signed the agreement on behalf of the company and continued as officers in the surviving entity, were not intended third-party beneficiaries. Nor did the officers benefit under or by way of the agreement when the agreement did not name them to their surviving-entity positions. These cases highlight the interplay of dispute resolution provisions across related transaction and governance documents, as well as provisions for non-signatory benefits, non-reliance, and integration.[11]

## RELATED TOPICS AND OUTLOOK

**Court Shuffling: Delaware CCLD Judges and Chancery Masters Assisting on Chancery Disputes; Nominations to Delaware Supreme Court**. Three important administrative developments will impact litigation in Delaware courts. First, judges from the Complex Commercial Litigation Division of the Superior Court will be hearing certain Chancery cases. Second, masters in the Court of Chancery will be hearing books and records disputes under Section 220 of the DGCL. Third, CCLD Judge Abigail LeGrow and N. Christopher Griffiths (attorney at Connolly Gallagher) have been nominated to the Delaware Supreme Court. Delaware courts have been resolving complex corporate and commercial disputes in historic volumes, so these measures are intended to allow the courts to maintain their reputation as the top business law court in the world.[12]

**Debut Season for Bylaws and Stockholder Meetings involving Universal Proxy Cards**. The SEC's universal proxy access rules have embarked on their first proxy season without widespread upheaval after only a handful of proxy contests under the new rules, which permit a few preliminary observations. First, the universal proxy rules allow shareholders to "pick and choose" by selecting individual candidates from the company and activist slates. As a result, proxy contestants under the new rules have focused on the qualifications of individual director nominees, suggesting that, going forward, it will be important for companies to pay close attention to individual directors, especially those who may be particularly vulnerable due to long tenure, overboarding, or other factors. Second, recommendations of the leading proxy advisory firms, Institutional Shareholder Services (ISS) and Glass Lewis, continue to have a significant impact on the outcomes of election contests. Indeed, ISS has retained its traditional two-prong framework for evaluating the merits of a dissident proxy campaign but increased its focus on the qualifications of individual nominees from both company and dissident slates. It appears that this new approach has resulted in a split-ticket ISS recommendation in at least one proxy contest under the universal proxy rules, which ultimately allowed the activist investor to elect one of its nominees to the board. Third, as mentioned in a previous GT Update, it remains important for companies to update their bylaws to account for the universal proxy rules, given that Delaware courts may apply established guidance from advance notice bylaw cases to provisions addressing universal proxy rules. However, proxy advisory firms and institutional investors are still formulating their views regarding universal proxy bylaw amendments.[13]

**Developments based on 2022 DGCL Amendments regarding Officer Exculpation and Corporate Conversions**. Since the 2022 DGCL amendments, some Delaware corporations have taken advantage of the increased authority and flexibility. Private corporations have been amending their charters to limit officers' personal liability for breaches of fiduciary duty, as now permitted by Section 102(b)(7), and largely without controversy. Only a handful of public corporations, however, have adopted such amendments in the face of headwinds from investor advisors. Private corporations in more limited numbers have also been incorporating amendments into their charters and contracts to account for the change in the stockholder approval, required for corporate conversions, from unanimous to majority.[14]

**California Allows Ratification and Validation of Noncompliant Corporate Actions and Conversion of California Corporations to Non-California Corporations**. Two pieces of California legislation that have importance for Delaware corporate practitioners became effective in January 2023. First, California has adopted a statute permitting ratification and validation of noncompliant corporate actions, which adopts a concept that began with Sections 204 and 205 of the DGCL and provides important remedies beyond what is available at common law. Second, California now permits conversion of California corporations to corporations of other states, which will simplify the process for

converting to a Delaware corporation. These legislative updates are important to general corporate practitioners, including those working with Delaware corporations, because of the large number of startups that begin their corporate existence in California and migrate to Delaware.

**Preparation for Reporting under the Corporate Transparency Act in 2024**. Regulations detailing the beneficial ownership reporting requirements under the Corporate Transparency Act have been adopted by FinCEN and will become effective on January 1, 2024. This will have significant impact on the reporting obligations of public and private trustees, corporate service providers, and other entities engaged in the formation and administration of legal entities. In light of the substantive obligations imposed by these rules, subject companies should begin preparations during 2023.[15]

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[1] C.A. No. 2021-0324-JTL (Del. Ch. Jan. 25 & Mar. 1, 2023) & (Mar. 1, 2023) (ORDER); *see also* Frank Placenti, Emily Ladd-Kravitz, Marina Olman-Pal, Kyle Freeny, Dmitriy Tartakovskiy, Nathan Emeritz, Justin Mann, et al., *GT Alert: Delaware Court of Chancery Determines that Corporate Officers Owe Duty of Oversight: Practical Considerations* (Feb. 6, 2023). Since that decision, oversight claims against officers have survived dismissal in other litigation. *See, e.g., Ontario Provincial Council of Carpenters' Pension Trust Fund v. Walton*, C.A. No. 2021-0827-JTL (Del. Ch. Apr. 12 & 26, 2023).

[2] *Electrical Workers Pension Fund, Local 103, IBEW v. Fox Corp.*, C.A. No. 2022-1007-JTL (Del. Ch. Mar. 29, 2023) (TRANSCRIPT) citing *Hartford Accident & Indem. Co. v. W. S. Dickey Clay Mfg. Co.*, 21 A.2d 178, 184 (Del. Ch. 1941), aff'd, 24 A.2d 315 (Del. 1942); *Orban v. Field*, C.A. No. 12820 (Del. Ch. Apr. 1, 1997). This decision alludes to more than a century of legislative history related to the stockholder rights and powers protected by the class voting provision that is now located in Section 242(b)(2) of the DGCL. The provisions for rights and powers of stock and stockholders were established in the original 1899 version of the DGCL, and the class voting provision was subsequently established in the early part of the 20th century, and that framework has largely remained intact. Specifically, the DGCL provides that stockholders have powers under the DGCL, the certificate of incorporation, and any other law; the DGCL is part of the charter and certificate of incorporation; the rights, powers, and preferences of stock are stated or expressed in the certificate of incorporation; and the class voting provision applies to certain changes to the rights, powers, and preferences given by the certificate of incorporation. As the court recently discussed, although this framework is broadly empowering of stockholders, the class voting provision has been interpreted as only applying to amendments affecting a narrow subset of the rights and powers of stock expressly stated or described in the certificate of incorporation.

[3] *Ainslie v. Cantor Fitzgerald LP*, Consol. C.A. No. 9436-VCZ (Del. Ch. Jan. 4, 2022). When it comes to restrictive covenants, the focus is more on Washington, D.C., specifically, the Federal Trade Commission (FTC), which received more than 25,000 public comments on its proposal to ban non-competition clauses earlier this year and closed the public comment period on April 26. The US Chamber of Commerce and various business industry trade groups were generally against the proposal, while unions, employee advocacy groups and some blue state attorneys general were in support. Employers are concerned because due to the proposed ban's broad language, non-solicitation clauses and even confidentiality clauses in routine employment-related documents could be at risk. Several states have passed their own limitations on restrictive covenants in the past few years, creating a patchwork of laws for employers that are difficult to comply with when employees are located around the country. *See, e.g.,* Kurt Kappes and Magaly Zagal, *GT Alert: Noncompete Provisions in Employment Agreements: Pending CA Legislation Further Limits Use* (April 17, 2023). Should the FTC move to implement the ban, industry trade groups have threatened to sue. Employers are particularly wary of the FTC's proposal, given that the National Labor Relations Board recently ruled that companies cannot require their departing employees to broadly waive their rights under the National Labor Relations Act when asked to sign severance or separation agreements as part of a release of claims.

[4] *Daniel v. Hawkins*, No. 184, 2022 (Del. Jan. 6, 2023).

[5] *In re Lordstown Motors Corp.*, C.A. No. 2023-0083-LWW (Del. Ch. Feb. 21, 2023). Similar cases were heard on combined bases and involved variations on common factual contexts, including corporations that obtained but had not solicited class approval, that never issued the additional authorized shares, and that had objections to the validation petition.

[6] *In re Rocket Companies, Inc. Stockholder Deriv. Litig.*, C.A. No. 2021-1021-KSJM (Del. Ch. Mar. 1, 2023) (TRANSCRIPT).

[7] *In re Baker Hughes, A GE Company, Derivative Litg.*, C.A. No. 2019-0201-LWW (Del. Ch. Apr. 17, 2023); *Harris v. Junger*, C.A. No. 2021-0511-NAC (Apr. 5, 2023) (TRANSCRIPT). In light of previous Delaware case law suggesting that a one-director committee may raise additional questions regarding independence and disinterestedness, the court's recent deference is noteworthy.

[8] *Hyde Park Venture Partners Fund III, L.P. v. FairXchange, LLC*, C.A. No. 2022-0344-JTL (Del. Ch. Mar. 9, 2023); *Cervieri v. Curadel Surgical Innovations, Inc.*, C.A. No. 2020-0926-NAC (Del. Ch. Mar. 24, 2023) (ORDER). As the court has recently reconfirmed, the three methods of excluding a director from privileged company information is by board committee, agreement, or adversity.

[9] *Delman v. GigAcquisitions3 LLC*, C.A. No. 2021-0679-LWW (Del. Ch. Jan. 4, 2023); *Laidlaw v. GigAcquisitions2, LLC*, C.A. No. 2021-0821-LWW (Del. Ch. Mar. 1, 2023); *Entrepology, LLC v. Palladium Equity Partners, LLC*, C.A. No. 2022-0063-MTZ (Del. Ch. Mar. 24, 2023) (TRANSCRIPT); *JB and Margaret Blaugrund Foundation v. Guggenheim Funds Investment Advisors, LLC*, C.A. No. 2021-1094-NAC (Del. Ch. Feb. 22, 2023) (TRANSCRIPT).

[10] *JB and Margaret Blaugrund Foundation*; *In re Orbit/FR, Inc. Stockholders Litig.*, C.A. No. 2018-0340-SG (Del. Ch. Jan. 9, 2023); *Harris v. Harris*, C.A. No. 2019-0736-JTL (Del. Ch. Jan. 6, 2023).

[11] *Fairstead Capital Management LLC v. Blodgett*, C.A. No. 2022-0673-JTL (Del. Ch. Jan. 6, 2023); *Golden v. ShootProof Holdings, LP,* C.A. No. 2022-0434-MTZ (Del. Ch. Feb. 28, 2023).

[12] *In re Designation of Actions Filed Pursuant to 8 Del. C. § 111* (Del. Feb. 23, 2023) (ORDER).

[13] Frank Placenti, Doron Lipshitz, Nathan Emeritz, and Justin Mann, *GT Alert: Considerations for Public Company Bylaw Amendments in View of the New SEC Universal Proxy Rules* (Dec. 13, 2022).

[14] Nathan Emeritz and Justin Mann, *GT Alert: Preparation of Corporate and M&A Documents for Proposed 2022 Delaware Corporate Law Amendments* (May 23, 2022).

[15] Marina Olman-Pal, Kyle Freeny et al., *GT Alert: Beneficial Ownership Reporting Requirements: FinCEN Issues Final Rule for Implementation of Corporate Transparency Act* (Oct. 26, 2022). Another notable provision of the CTA, applicable to pooled investment vehicles such as PE and VC funds, which may be exempt when advised by a registered advisor, is that their subsidiaries will not be eligible for the subsidiary exemption that is available to the subsidiaries of other types of exempt entities.