

Update | Delaware Corporate Law

October 2024

Mid 2024 Delaware Corporate and M&A Law Update

The courts and legislature in Delaware directed significant attention during the middle of this year to interpreting and revising the Delaware General Corporation Law. The Delaware Supreme Court, Court of Chancery, and Complex Commercial Litigation Division of the Delaware Superior Court (CCLD) have also continued providing important guidance regarding fiduciary duties and judicial standards of review applicable to alleged breaches of fiduciary duty. These updates are discussed in this GT Update.

CORPORATE

Advance Notice Bylaws and Nomination Periods Tested for Technical Validity, Equitable Enforceability, and Fundamental Shift in Corporate

Direction. Advance notice bylaws can bring order to stockholder meetings but also limit stockholders' ability to nominate director candidates and propose other business. Delaware courts have recently reviewed these bylaws for facial validity (compliance with the DGCL, the certificate of incorporation, and applicable law) and equitable enforceability (reasonable, proportional, and narrowly tailored to a cognizable threat). In one recent case, the Court of Chancery considered whether compelling circumstances existed to reopen the nomination period, based on whether those circumstances: (1) were caused by the board; (2) occurred after the advance notice deadline; (3) were fundamental; and (4) substantially altered the company's direction. The court declined to find that post-nomination period changes by the

board to the CFO position, the disclosure of regulatory inquiries, the initiation of class litigation, and other board-directed events signaled a radical shift in position or fundamental change in the board or its strategy. Further, the plaintiff-stockholder unreasonably delayed filing its complaint for approximately two months. The court declined to compel the board to reopen the nomination window. Separately, the Supreme Court affirmed a Court of Chancery decision that the ownership provision of an advance notice bylaw was indecipherable, unintelligible, nonsensical, and therefore invalid. The Court of Chancery struck down a 1,099-word, 13-subsection sentence requiring disclosures related to equity ownership in the company, competitors, and broadly defined stockholder-affiliated persons (SAPs). Although other advance notice bylaw provisions regarding (1) disclosure of extensive information about SAPs including those acting in concert and pursuant to an agreement, arrangement, or understanding, (2) consultation and nomination activities with SAPs over a decade, and (3) proposal supporters were facially valid, the Supreme Court affirmed their unenforceability because the board may have adopted them for the primary inequitable purpose of rejecting the plaintiff-stockholder's nominations. The Supreme Court agreed with the Court of Chancery's view of those provisions as a tripwire – a draconian license to reject a notice based on a subjective interpretation of its imprecise terms, and an ill-defined daisy chain of persons, respectively.¹

Contractual Governance Arrangements regarding Significant Corporate Actions.

In the highly publicized *Moelis* decision, the Court of Chancery stated that a contract could not meaningfully infringe on the managerial authority granted to the board under Section 141(a) of the DGCL. In a subsequent case, the court interpreted other sections of the DGCL as preventing a contractual limit on the board's primary authority and responsibility. For instance, a contract could not require stockholder consent before the board could approve a charter amendment under Section 242.²

Default Fiduciary Duties Not Dictated by Stockholders' Portfolio of External Interests.

Corporate fiduciary duties are owed to the corporation and its stockholders, who own a substantial amount of public company stock in diversified portfolios. Such a stockholder asserted that the board had not been acting in the best interests of those stockholders' diversified portfolios when it increased the company's value at the expense of the broader economy. The Court of Chancery dismissed the claim on the basis that default fiduciary duties are "firm-specific." The court noted, however, that fiduciary duties could be realigned by a charter provision directing that the company be managed for the interests of diversified stockholders or to prevent externalities harmful to such investors.³

Judicial Concern about Mootness Fees for "Gotcha" Lawsuits.

Delaware courts award fees to stockholders for corporate benefits produced by identifying to the company potential defects that might cause harm if unaddressed. The courts also award mootness fees when those defects are resolved, thereby mooted any claim that the stockholder might have had otherwise. Although Delaware courts recognize the value of corporate benefits, the Court of Chancery recently noted that it was "increasingly concerned about litigation that calls out technical foot faults and errors," referring to them as "gotcha" lawsuits that it viewed as trending upwards. In that case, potentially deficient disclosures identified by a

stockholder were unremarkable and their impact was blunted by otherwise accurate disclosures, and the court awarded \$75,000 instead of the \$275,000 requested by the stockholder.⁴

MERGERS & ACQUISITIONS

Fraudulent Inducement Claims Against Earnout Buyer under Integrated Contract without Anti-Reliance Language.

Parties to an integrated contract can use anti-reliance provisions to prevent fraud claims based on extracontractual statements, though prior Delaware case law has suggested that fraudulent inducement claims can be prevented even without anti-reliance language. The Court of Chancery recently clarified that, because fraudulent inducement is simply a subspecies of fraud, claims based on extracontractual statements can only be prevented by clear anti-reliance language in the contract. In two cases, the seller negotiated an earnout and sued the buyer for fraudulent inducement based on the buyer's pre-signing statements touting the benefits of a transaction. The court sifted through the alleged statements, finding some to be vague, non-actionable puffery, while others were sufficiently specific statements of market presence and experience to support a claim. In the later of those cases, the court awarded more than \$1 billion in damages for fraud and breaches of the buyer's contractual efforts obligations related to integration of the acquired business.⁵

Entire Fairness Claims Involving SPAC and Controlling Stockholders. Although application of the entire fairness standard of review often precludes dismissal of breach of fiduciary duty claims at early stages of litigation, the plaintiff must plead facts supporting the reasonable conceivability of a breach of fiduciary duty. In two cases, claims implicating the entire fairness standard of review were dismissed because the alleged breaches were not reasonably conceivable: in one, a SPAC board allegedly knew of information that was not disclosed in connection with a de-SPAC transaction, while in the other, a controlling stockholder allegedly received a unique benefit

in a transaction in the form of continuation of a commercial agreement. The SPAC case is notable because, despite similarities to underlying conflicts that triggered entire fairness review in other SPAC cases that were not dismissed, the Court of Chancery dismissed the claim. The controlling stockholder case emphasized that a controlling stockholder's conflict, as required to invoke entire fairness review of a conflicted controlling stockholder transaction, is not created by continuation of an existing contract but requires a new, incremental, and unique benefit for the controller. That point was further emphasized in a third case, where a private equity sponsor caused a portfolio company to pursue a sale when tax-law changes resulted in a reduction in the value of a tax receivable agreement between the sponsor and company. Although the court noted that the sponsor was entitled to change-of-control benefits arising from the TRA in the sale transaction (because no new incremental benefit was created in the sale), the decision to pursue a sale was subject to entire fairness review (because it constituted a new, incremental, unique benefit for the sponsor) and was not dismissed (because breaches of fiduciary duty were adequately pled).⁶

Fiduciary Duties and Fair Value in Cash Out by Reverse-Forward Split. Delaware corporations may pay fair value in cash instead of issuing fractions of stock, such as when shares are combined in a reverse stock split reclassification. In that situation, it is possible to cash out stockholders before effecting a subdivision by forward stock split reclassification to effectively return the remaining stockholders to their original numbers of shares. Directors must, however, act in accordance with their fiduciary duties when exercising discretion in such a transaction. For

example, the Court of Chancery recently found that a company may not have paid fair value in accordance with the DGCL and the directors may not have acted in accordance with their fiduciary duties, when shares were cashed out, without a third-party valuation, for de minimis cash amounts paid shortly after positive operational results and before a significantly valued financing. The only explanation for the reverse-forward split—*i.e.*, to simplify the capital structure—may not have been a good faith basis for the transaction. In addition, the de minimis fair value attributed to the cashed-out shares also may not have been within the realm of a rational fiduciary decision.⁷

RELATED TOPICS AND OUTLOOK

DGCL Amendments Responsive to Delaware Cases. The 2024 amendments to the DGCL, drafted in response to issues that arose in decisions by the Court of Chancery, became effective August 1, 2024, with general retroactive effectiveness subject to certain exceptions. Those amendments relate to important corporate and M&A legal issues, and we have addressed related drafting issues in a separate GT Update.⁸

Litigants Begin Petitioning Texas Business Courts in Commercial Disputes. The new Texas business courts (analogous to Delaware's CCLD) have opened, judges are being appointed to two-year terms, and petitions are being filed. Based on the initial petitions, many of the litigants are Delaware entities with an operational connection to Texas, and the complaints have generally related to contractual and property disputes, and at least one has specifically demanded a jury trial.

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¹ *Starboard Value LP v. Autodesk, Inc.*, C.A. No. 2024-0659-PAF (Del. Ch. June 20, 2024) (TRANSCRIPT); *Kellner v. AIM Immunotech Inc.*, No. 3, 2024 (Del. July 11, 2024).

² *Wagner v. BRP Group, Inc.*, C.A. No. 2023-0150-JTL (Del. Ch. May 28, 2024).

³ *McRitchie v. Zuckerberg*, C.A. No. 2022-0890-JTL (Del. Ch. Apr. 30, 2024).

⁴ *Kahan v. Rouhana*, C.A. No. 2023-0593-LWW (Del. Ch. May 13, 2024) (TRANSCRIPT).

⁵ *Trifecta Multimedia Holdings Inc. v. WCG Clinical Services LLC*, C.A. No. 2023-0699-JTL (Del. Ch. June 10, 2024); *Fortis Advisors LLC v. Johnson & Johnson*, C.A. No. 2020-0881-LWW (Del. Ch. Sept. 4, 2024).

⁶ *In re Hennessy Capital Acquisition Corp. IV Stockholder Litig.*, C.A. No. 2022-0571-LWW (Del. Ch. May 31, 2024); *In re Qualtrics International Inc. Stockholders Litig.*, Consol. C.A. 2023-1050-JTL (Del. Ch. July 23, 2024) (TRANSCRIPT); *Firefighters' Pension System of the City of Kansas City, Missouri Trust v. Foundation Building Materials Inc.*, C.A. No. 2022-0466-JTL (Del. Ch. May 31, 2024).

⁷ *Moline v. Bioventrix, Inc.*, C.A. No. 2023-0883-PAF (Del. Ch. May 1, 2024) (TRANSCRIPT).

⁸ Diane N. Ibrahim, Nathan P. Emeritz, and Justin E. Mann, *GT Alert: Drafting of Corporate and M&A Documents for 2024 Delaware General Corporation Law Amendments* (July 30, 2024).