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Key Developments in Delaware Corporation Law

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Consistent with trends in recent years, in 2019 Delaware corporation law largely was shaped by post-closing suits for money damages against directors who had approved mergers and acquisitions. Two Delaware Supreme Court decisions — *Kahn v. M & F Worldwide Corporation* (*MFW*) and *Corwin v. KKR Financial Holdings LLC* (*Corwin*) — and their progeny dominated those lawsuits.

Beyond the transactional context, the Delaware courts provided valuable insight to directors charged with monitoring risk and illuminated the standards by which director independence will be measured. Finally, stockholder inspection rights continued to evolve under Section 220 of the Delaware General Corporation Law (DGCL).

Directors and other transaction participants should take note of these developments and their impact on transaction structure, corporate disclosures, oversight responsibility, independence and companies' obligations to produce books and records.

Deal Litigation Developments Under *MFW*

Transactions involving controlling stockholders were a major target by plaintiffs in 2019. As a result, important rulings applied the Delaware Supreme Court's 2014 seminal decision in *MFW*. Under *MFW*, a transaction involving a controlling stockholder will be reviewed under the deferential business judgment rule (as opposed to the far more stringent entire fairness standard) if it is conditioned "*ab initio*" (from the beginning) on the "dual protections" of approval by both a well-functioning committee of independent and disinterested directors and a majority of the minority stockholders in an uncoerced, fully informed vote.

In *Olenik v. Lodzinski*, the Delaware Supreme Court clarified the meaning of *ab initio*. According to the court, the dual protections must be expressly put in place before "substantive economic negotiation[s]" begin, and *MFW* is satisfied only if a controlling stockholder has agreed that a transaction will not go forward without "the special committee and disinterested stockholder approval early in the process and before there has been any economic horse trading." Court rulings in 2020 likely will further illuminate the contours of the *ab initio* requirement and provide additional clarity as to the other requirements of *MFW*, such as director independence and committee effectiveness.

In *Tornetta v. Musk*, the Court of Chancery expanded *MFW*'s scope beyond "transformational" transactions to apply to other corporate decisions involving controlling stockholders, explaining that non-extraordinary transactions such as compensation decisions could be subject to business judgment review by following the procedures set forth in *MFW*. According to the ruling, where *MFW* is employed, "[T]he Court's suspicions regarding the controller's influence would [be] assuaged and deference to the Board and stockholder decisions would [be] justified."

Transaction participants should consider this valuable guidance when structuring transactions in 2020.

Deal Litigation Developments Under *Corwin*

The Delaware Supreme Court's 2015 decision in *Corwin* also remained a focus of recent cases. Under *Corwin*, in the absence of a conflicted stockholder, the fully informed vote of disinterested, uncoerced stockholders will extinguish

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breach of fiduciary duty claims, leaving only claims for waste. Two notable 2019 cases addressed — with differing outcomes — whether disclosures created a fully informed vote.

In *English v. Narang*, the Court of Chancery applied the *Corwin* doctrine to dismiss a fiduciary challenge to a merger following what the court ultimately held to be a fully informed stockholder vote. The court rejected a plethora of disclosure challenges concerning the company's financial outlook, discussions of post-merger employment and financial advisor conflicts, holding that the disclosure claims failed as a matter of law, and defendants met their burden to show that the vote was fully informed. By contrast, in *Chester County Employees' Retirement Fund v. KCG Holdings, Inc.*, the Court of Chancery denied motions to dismiss, holding that the defendants were not protected by *Corwin* because the plaintiffs had identified "significant deficiencies" in the proxy statement — including omitted details about an alleged financial advisor conflict, the CEO's role in negotiating a management compensation and retention pool, and revised projections late in the process — that rendered the stockholder vote uninformed.

In 2020, Delaware disclosure law may develop further in the context of the *Corwin* doctrine and less common disclosure-based requests for injunctive relief.

Caremark and Director Independence in Derivative Litigation

The Delaware courts provided valuable guidance outside the transactional context in 2019 as well. For example, in *Marchand v. Barnhill*, the Delaware Supreme Court reversed the Court of Chancery's dismissal of so-called *Caremark* duty of oversight claims arising out of the alleged failure by the directors of Blue Bell Creamery USA Inc. to adequately monitor whether its ice cream was safe to eat. The case arose after a listeria outbreak in Blue Bell's ice cream that sickened many consumers, caused three deaths and resulted in a total product recall. The court explained that "[w]hen a plaintiff can plead an inference that a board has undertaken no efforts to make sure it is informed of a compliance issue intrinsically critical to the company's business operation, then that supports an inference that the board has not made the good faith effort that *Caremark* requires."

A few months later, the Court of Chancery relied on the *Marchand* ruling to deny a similar *Caremark* claim in *In re Clovis Oncology, Inc. Derivative Litigation*. In that case, stockholders of Clovis Oncology, Inc., a clinical-stage biopharmaceutical company, alleged that the board ignored red flags that the company was not adhering to clinical trial protocols in developing its "most promising" drug, which, once disclosed, allegedly resulted in a 70% decline in the company's stock price. The court explained that "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." It remains to be seen in 2020 whether these decisions lead to an increase in duty of oversight litigation.

The *Marchand* decision also provided valuable insight into the sufficiency of allegations challenging director independence in derivative litigation. In *Marchand*, the Delaware Supreme Court held that the complaint adequately alleged that a majority of the members of the board of directors were interested and/or lacked independence for purposes of a demand futility analysis. The Supreme Court's ruling hinged on whether the complaint adequately alleged that one outside director, who previously was employed by the company, was conflicted. The court held that although the director was retired, a "longstanding business affiliation and personal relationship" between the director and the family of the company's CEO, as well as charitable donations made by the family on the director's behalf, were sufficient to plead "very warm and thick ties of personal loyalty and affection" between the director and the CEO.

Following *Marchand*, the Court of Chancery denied motions to dismiss derivative claims in *In re BGC Partners, Inc. Derivative Litigation*, concluding that stockholder plaintiffs adequately pleaded that members of a special committee lacked independence from an alleged controller due to, among other things, director fees they had earned from companies affiliated with the controller, the directors' attendance at social events where the controller was present and the controller's donations to charities affiliated with the directors.

In the coming year, the court's approach to these types of independence analyses will be of significance to companies and their directors, as stockholder plaintiffs continue to expand the manner in which they plead personal relationships and charitable connections, such as with the use of social media postings and other types of prelitigation discovery.

Trends in Books and Records Litigation

This past year stockholders increasingly implemented Section 220 of the DGCL to obtain corporate documents before commencing litigation. Section 220 permits stockholders of Delaware corporations to inspect books and records where they have identified a "proper purpose" for doing so. Traditionally, Section 220 was utilized by plaintiffs to draft and file detailed derivative complaints. Given the recent decrease in M&A injunction requests, and the corresponding decrease in discovery records created for that purpose, stockholder plaintiffs turned to Section 220 to access documents and communications that might assist them in similarly crafting a post-closing class action complaint that could survive *MFW* or *Corwin*. In addition, stockholder plaintiffs continue to expand the scope of documents they

seek under Section 220, frequently requesting not only board-level materials, such as minutes and presentations, but also electronic documents, such as personal emails and text messages. In 2019, Delaware courts helped clarify when such electronic documents should be made available to a stockholder in a Section 220 demand.

For example, in *Schnatter v. Papa John's International, Inc*., the Court of Chancery ordered the production of correspondence from personal email accounts and text messages from personal devices, rejecting a bright-line rule that such electronic communications are not subject to production under Section 220. Weeks later, in *KT4 Partners LLC v. Palantir Technologies Inc*., the Delaware Supreme Court ordered the production of electronic communications because the plaintiff had presented sufficient evidence that the company did not honor traditional corporate formalities and instead acted informally through email rather than at formal board meetings, in connection with the alleged wrongdoing that the plaintiff sought to investigate. In so ruling, the court explained that a corporation should not be required to produce electronic communications if other materials, such as board meeting minutes, exist and would accomplish the petitioner's proper purpose. In 2020, practitioners and Delaware courts may continue to grapple with whether and in what circumstances requests for electronic communications are proper under Section 220.

In *High River Limited Partnership v. Occidental Petroleum Corporation*, the Court of Chancery refused to permit affiliates of activist investor Carl Icahn to inspect corporate documents for use in a proxy contest to replace members of Occidental's board. The court declined to "recognize a new rule entitling stockholders to inspect documents under Section 220 if they can show a credible basis that the information sought would be material in the prosecution of a proxy contest," as opposed to another proper purpose, such as the investigation of corporate wrongdoing or mismanagement. The decision is currently on appeal, and the Delaware Supreme Court is likely to provide clarity in this area, which the Court of Chancery described as "murky" in its *Occidental* decision.