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In this issue, we explore ongoing corporate law issues involving controlling stockholders, with significant decisions anticipated from the Delaware Supreme Court in 2025; the rise in litigation over earnout provisions in merger agreements; and the Court of Chancery's dismissal of a "hybrid" of *Malone* false disclosure and *Caremark* oversight fiduciary duty claims.

2025 Outlook: Key Delaware Court Appeals and Their Impact on Corporate Law

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In 2024, Delaware courts continued to address important areas of corporate law, particularly regarding controlling stockholders. Several of those high-profile decisions were decided at the trial level and are now on appeal. In 2025, we will be watching as the Delaware Supreme Court addresses issues including aiding and abetting, nominal damages, non-ratable benefits for controlling stockholders, executive compensation, ratification and attorney's fees.

Aiding and Abetting and Nominal Damages

In 2023, the Court of Chancery, in a post-trial opinion, held an officer of a target company personally liable for breach of fiduciary duties.[1] The court found that the CEO improperly skewed the sales process in favor of the third-party buyer and that the company failed to disclose those interactions to its stockholders. The court awarded $1 per share in damages for each of the sales process and disclosure claims, though the class was limited to a total of $1 per share in damages. The Court of Chancery

[1] *In re Mindbody, Inc. S'holder Litig.*, 2023 WL 2518149 (Del. Ch. Mar. 15, 2023), *aff'd in part, rev'd in part*, — A.3d —, 2024 WL 4926910 (Del. Dec. 2, 2024). See "Court Finds Mindbody CEO Liable Under Revlon and That Buyer Aided and Abetted Disclosure Violations."

characterized the $1 per share in damages as "nominal" damages for the disclosure claims. Additionally, the court found the third-party buyer liable for aiding and abetting the CEO's disclosure violations — but not the sales process violations — and imposed joint and several liability on the third-party buyer for the nominal damages award.

In December 2024, the Delaware Supreme Court reversed the Court of Chancery's aiding and abetting holding and declined to reach the issue of nominal damages.

The court stated that an aiding and abetting claim brought against a buyer in this context is among the hardest to prove, and that it has never held a third-party arm's-length buyer liable for aiding and abetting a breach of fiduciary duty. However, the court also acknowledged that its decision could be different under "different facts or legal arguments," and noted that an appeal in the *Columbia Pipeline*[2] case as an example of a matter that "addresses similar issues with different facts."

What we're watching: Further development of aiding and abetting claims after *Mindbody*, including the Delaware Supreme Court's decision in *Columbia Pipeline* and whether the court addresses nominal damages.

Non-Ratable Benefits for Controlling Stockholders

In 2024, the Court of Chancery denied a motion to dismiss and held that entire fairness applied to a conversion of a Delaware corporation (TripAdvisor) to a Nevada corporation.[3] The plaintiffs alleged that the directors and controlling stockholder received a non-ratable benefit because (i) minority stockholders have "fewer litigation rights" under Nevada law, (ii) the conversion was not fair to the minority and (iii) the conversion was not subject to *MFW* protections.

The Court of Chancery found it reasonably conceivable that the conversion conferred a non-ratable benefit on the controller under a theory that stockholders of Nevada corporations have less litigation rights than those of a Delaware corporation. As a result, it held that the plaintiff had adequately alleged that the conversion was not entirely fair because it was "reasonably conceivable that the stockholders do not possess at least the substantial equivalent of what they possessed before." The Court of Chancery stated that litigation rights are "first-class rights" and noted that the role of equity in protecting these rights "has become more important" after the Delaware Supreme Court's decision in *In re Fox Corporation/Snap Inc.*[4] held that the Delaware corporation statute did not require a class voting right where a similar argument was made about loss of litigation rights for a certain group of stockholders. In a rare move, the Delaware Supreme Court accepted interlocutory appeal of this decision.

What we're watching: The upcoming decision from the Delaware Supreme Court, including its views of scope of potential non-ratable benefits for controlling stockholders and the interplay, if any, between this case and *Fox/Snap*.

Executive Compensation, Ratification and Attorney's Fees

This year, the Court of Chancery, in a series of opinions, resolved litigation challenging Elon Musk's 2018 equity compensation plan for his work at Tesla. The plan was approved by Tesla's stockholders, and although Musk achieved the plan's performance milestones, the equity grant remained "unexercised

[2] *In re Columbia Pipeline Group, Inc. Merger Litig.*, 299 A.3d 393 (Del. Ch. 2023). See "Real World Examples Where Conflicts Tainted a Deal Process, and Other Deals That Were Insulated From Conflicts."

[3] *Palkon v. Maffei*, 311 A.3d 255 (Del. Ch. 2024). See "Under Control: Recent Delaware Decisions on Controller Transactions, Standards of Review and Disclosure Obligations."

[4] *In re Fox Corp./Snap Inc.*, 312 A.3d 636 (Del. 2024).

and undisturbed." In a post-trial opinion, the Court of Chancery ruled in favor of the plaintiffs after finding that Musk exercised transaction-specific control over the negotiation of the plan and the entire fairness standard of review applied.[5] As a remedy, the Court of Chancery ordered the rescission of the entire compensation plan.

Following the post-trial opinion, Tesla held a second vote on the compensation plan. The company's stockholders overwhelmingly approved the same plan. The defendant moved to revise the post-trial opinion based on the second vote. Separately, class counsel filed a $5.6 billion fee petition.

In a separate opinion, the Court of Chancery denied the motion to revise.[6] It held, among other things, that common-law ratification cannot be raised after a post-trial opinion, and such ratification alone cannot reduce the relevant standard of review in this context to business judgment.

In the same opinion, the Court of Chancery denied the class counsel's $5.6 billion fee request and instead awarded $345 million. It stated that the original fee request generated an "insurmountable windfall problem." To avoid this problem, the Court of Chancery valued the recission by using the grant date fair value of the compensation plan.

What we're watching: We expect these decisions to be appealed and are closely watching the Delaware Supreme Court's analysis of both the post-trial opinion and the rulings on ratification and the award of attorney's fees.

[5] *Tornetta v. Musk*, 310 A.3d 430 (Del. Ch. 2023).

[6] *Tornetta v. Musk*, — A.3d —, 2024 WL 4930635 (Del. Ch. Dec. 2, 2024).

Key Points

- The Delaware Supreme Court reversed a Court of Chancery decision that held a third-party buyer liable for aiding and abetting, reinforcing that an aiding and abetting claim is among the hardest claims to bring under Delaware law. This ruling comes as another Court of Chancery decision finding aiding and abetting liability is currently on appeal to the Delaware Supreme Court.
- The Court of Chancery denied a motion to dismiss and held that a controlled company's reincorporation from Nevada to Delaware was subject to the entire fairness standard of review. That decision is currently on appeal to the Delaware Supreme Court in a rare grant of interlocutory appeal.
- The litigation regarding Tesla's compensation plan for Elon Musk is now resolved at the trial level. The Court of Chancery applied entire fairness and, following trial, rescinded the compensation plan. Following a second vote by stockholders approving the plan, the court declined to revise its post-trial opinion and awarded $345 million in attorney's fees.

Earnout Eruption: Delaware Courts Interpret 'Best Efforts' Clauses Amid Surging Earnout Provisions

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Over the last several years, Delaware courts — especially the Court of Chancery — have seen an increase in litigation involving earnout provisions in merger agreements. Each of these cases presents unique facts reflecting the individual circumstances of the parties, but the focus of disputes involving earnout provisions usually remains the same. Specifically, "[i]n what is an all-too-predictable pattern in these transactions, the parties later [become] embroiled in a seeming intractable dispute regarding whether the earn-out targets were satisfied."[1] The increase in earnout disputes has allowed the Delaware courts to develop an expertise in this area, resulting in significant precedent interpreting what standards parties must meet to comply with these provisions.

The main issue in these cases is whether the buyer complied with its responsibilities under a "best efforts" provision, which provides the buyer with discretion to run the surviving entity so long as the buyer's efforts are, for example, "reasonable," "commercially reasonable" or in "good faith." In the broader M&A context, Delaware courts have determined that these variations of best efforts provisions have roughly the same meaning — *i.e.*, "to take reasonable steps" to comply with the provision — and Delaware courts have used the same approach to interpret best efforts provisions related to earnouts.[2] With this in mind, the parties in an earnout transaction need to thoughtfully consider the language of best efforts provisions so the expectations of both the seller and buyer are met.

Background

Under an earnout provision, the seller pays an upfront amount and promises to pay additional consideration if the surviving entity exceeds targets set forth in the merger agreement. When drafting these agreements, the parties have different goals in mind — the buyer wants to maintain its discretion to run the surviving entity, but the seller wants to ensure that the buyer's performance will meet or exceed the earnout targets.[3] The parties often include best efforts and integration provisions that require the surviving entity to take certain steps to meet the required goals.[4] In most instances, the best efforts provision will be tailored to the buyer's business, as well as its own internal standards and industry standards. Depending on the industry, these business practices and standards will vary. There are also provisions defining key terms that are used to mark progress towards achieving the earnout. The buyer or surviving entity's compliance with these terms and standards, and how the parties interpret and measure success, often lead to disputes resulting in litigation.

[1] *Fortis Advisors, LLC v. Dematic Corp.*, 2022 WL 18359410, at *1 (Del. Super. Dec. 29, 2022) (LeGrow, J.), *aff'd*, 319 A.3d 305 (Del. 2024) (TABLE).

[2] *Fortis Advisors LLC v. Johnson & Johnson*, 2024 WL 4048060, at *22 (Del. Ch. Sept. 4, 2024).

[3] *Id.*

[4] *Id.*

Recent Examples of Earnout Disputes

STX Business Solutions, LLC v. Financial-Information-Technologies, LLC

In *STX*, the merger agreement contained a buyer-friendly best efforts provision, which gave the buyer broad discretion to run the business "so long [as] the Buyer did not take action in bad faith or with the specific intention of causing a reduction in the Earnout."[5] The surviving entity, using its business judgment, decided not to pursue a transaction that could have met an earnout target because the transaction could have "cause[d] complications" for its business.[6] The seller, in opposition to the defendants' motion to dismiss, posited that the defendants' inaction was done in bad faith to avoid hitting the earnout target.[7] But the court rejected this argument stating that "[a] party does not act in bad faith by relying on contract provisions for which that party bargained where doing so simply limits advantages to another party."[8] For these reasons, the Court of Chancery granted the defendants' motion to dismiss.[9]

Fortis Advisors LLC v. Johnson & Johnson

In *Fortis Advisors LLC v. Johnson & Johnson* (*Johnson & Johnson*), the parties entered into a merger agreement that allowed the surviving entity to use its "commercially reasonable efforts" and "usual practice" for obtaining regulatory approvals for two medical devices — *i.e.*, iPlatform and Monarch.[10] These regulatory approvals also served as the earnout targets.[11] Ultimately, the defendants missed several earnout targets, and the plaintiff sued alleging that the defendants failed to use its commercially reasonable efforts.[12] After trial, the court found that Johnson & Johnson (J&J) deviated from its usual practice by impairing iPlatform's development.[13] Specifically, the Court of Chancery stated that "[i]t is obvious from the record that J&J's efforts toward the iPlatform regulatory milestones were not commercially reasonable, as defined in the Merger Agreement."[14] In relation to Monarch, the Court of Chancery concluded that J&J's "actions, or lack thereof, were flawed and may [have] prompted unintended delays, but they [were] not commercially unreasonable[.]"[15] In its post-trial opinion, the court held that the defendants breached the merger agreement.[16]

Himawan v. Cephalon, Inc.

In *Himawan*, the merger agreement provided that the surviving entity had "complete discretion" to run the business, except that the surviving entity had to develop a product using the "commercially reasonable efforts" of "a company with substantially the same resources and expertise[.]"[17] Later, the surviving entity decided to stop developing the product, which was the basis for the earnout targets, after the surviving entity determined that further development was not feasible.[18] The surviving entity was then purchased by another buyer, which assumed the surviving entity's earnout

[5] *STX Bus. Sols., LLC v. Fin.-Info.-Techs., LLC*, 2024 WL 4645104, at *3 (Del. Ch. Oct. 31, 2024).

[6] *Id.* at *4.

[7] *Id.*

[8] *Id.* (quoting *Nemec v. Shrader*, 991 A.2d 1120, 1128 (Del. 2010)).

[9] *Id.*

[10] *Johnson & Johnson*, 2024 WL 4048060, at *14.

[11] *Id.* at *12–14.

[12] *Id.* at *17–19.

[13] *Id.* at *24–34.

[14] *Id.* at *26.

[15] *Id.* at *33.

[16] *Id.* at *56.

[17] *Himawan v. Cephalon, Inc.*, 2024 WL 1885560, at *3–4 (Del. Ch. Apr. 30, 2024); *see also S'holder Representative Servs. LLC v. Alexion Pharms., Inc.*, 2024 WL 4052343, at *36–47 (Del. Ch. Sept. 5, 2024) (analyzing a similarly worded best efforts provision).

[18] *Himawan*, 2024 WL 1885560, at *4–7.

obligations, and the new buyer also determined that developing the product was not feasible.[19] The Court of Chancery, in a post-trial opinion, found that the commercially reasonable efforts provision applied an objective standard based on a hypothetical company of similar resources and expertise.[20] Employing this standard, the court determined that the defendants did not breach the merger agreement because the defendants' actions were consistent with "pharmaceutical companies that faced similar circumstances[.]"[21]

Fortis Advisors, LLC v. Dematic Corp.

In *Dematic*, the parties used earnout targets based on the sale of "Company Products," which was defined "very generally" in a schedule containing one- or two-word terms.[22] The parties disputed whether "Company Products" included the seller's final versions of software, or whether "Company Products" included the seller's pieces of code that were integrated into the buyer's software.[23] Then-Judge Abigail LeGrow wrote a post-trial opinion — later affirmed by the Delaware Supreme Court — explaining that the term "Company Products" was ambiguous. After considering the extrinsic evidence and the contract structure, the court concluded that "Company Products" was intended to include the pieces of code for purposes of calculating the earnout.[24] In particular, the court stated that "[t]he extrinsic evidence offered at trial supports Fortis's interpretation of Company Products as including [pieces of] code integrated into other products[.]"[25]

[19] *Id.*

[20] *Id.* at *12–15.

[21] *Id.* at *13.

[22] *Dematic Corp.*, 2022 WL 18359410, at *3.

[23] *Id.* at *12–13.

[24] *Id.* at *17–21; *see also S'holder Representative Servs. LLC v. HPI Hldgs.*, LLC, 2023 WL 3092895, at *4–6 (Del. Ch. Apr. 26, 2023) (interpreting an earnout provision).

[25] *Dematic Corp.*, 2022 WL 18359410, at *19.

Key Points

- Vice Chancellor Lori Will, in *Johnson & Johnson*, emphasized the importance of "carefully drafting language that delineates the efforts expected of the buyer relative to the achievement of the milestones."[26] Parties need to be aware of the different types of best efforts formulations because these provisions can have a substantial impact on a case's outcome.
- That said, Delaware courts will seek to enforce the plain language of the merger agreement to determine what level of discretion is afforded to the surviving entity, and how this discretion is cabined or limited by the best efforts provisions.
- Parties have the option of drafting a best efforts provision that states the buyer should use "reasonable efforts," "commercially reasonable efforts" or "good faith efforts." "But there is no agreement in case law over whether they create different standards. Delaware courts have viewed variations of efforts clauses — particularly those using the term 'reasonable' — as largely interchangeable."[27] Hence, parties might consider other ways to expand or limit the buyer's discretion to run the surviving entity.
- Delaware courts may find a breach when the buyer causes the surviving entity to take actions inconsistent with the buyer's commercially reasonable efforts as defined in the merger agreement.
- When interpreting ambiguous contract terms in an earnout provision, a Delaware court will consider extrinsic evidence and the structure of the agreement to determine the intent of the parties. During drafting, the parties should consider defining terms clearly within the earnout provision to avoid a "glaring lack of clarity" when interpreting the provision.[28] Additionally, clearly defining the term "company products" can avoid issues when calculating whether a financial-based earnout target has been met.
- Interestingly, several of these decisions are post-trial opinions interpreting the agreement or making factual findings on a party's bad faith or best efforts.[29] Parties, along with counsel, should try to proactively address the terms and conditions of earnout provisions before executing the merger agreement.

[26] *Johnson & Johnson*, 2024 WL 4048060, at *23.

[27] *Id.* at *22.

[28] *Dematic Corp.*, 2022 WL 18359410, at *18.

[29] Edward P. Welch et al., *Mergers & Acquisitions Deal Litigation Under Delaware Corporation Law* § 6.01[B] (1st ed. Supp. 2024).

Court of Chancery Applies Well-Settled Principles To Dismiss *Malone/Caremark* 'Hybrid' Claims

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Introduction

The Delaware Court of Chancery recently dismissed a "hybrid" of *Malone*[1] false disclosures and *Caremark* oversight claims brought by two stockholder plaintiffs. In *In re FibroGen, Inc. Derivative Litigation*,[2] Vice Chancellor Sam Glasscock III analyzed what were essentially securities fraud claims repurposed as claims for breach of fiduciary duty under two theories: (i) knowingly misleading stockholders in disclosures (*Malone* claims) and (ii) failure of oversight (*Caremark* claims). The court, applying well-settled principles, dismissed the plaintiffs' claims due to their failure to plead any facts from which the court could reasonably infer that any director acted in bad faith.

Background

FibroGen, Inc. is a biopharmaceutical company involved in developing Roxadustat, a drug to treat anemia. FibroGen had an agreement with a commercial partner to develop the drug, and its revenue was primarily derived from this agreement. The drug development and clinical trials ran for several years. The U.S. Food and Drug Administration (FDA), however, ultimately did not approve the drug for any patient population, and FibroGen's commercial partner ceased funding and development.

On April 12, 2021, FibroGen stockholders brought a securities class action claim against FibroGen and certain members of its management. The securities plaintiffs alleged that the defendants previously had made false and misleading disclosures regarding the drug and FibroGen's FDA approval process. After a motion to dismiss those claims was denied in part, the parties agreed to settle the litigation for $28.5 million.

Subsequently, the plaintiffs brought a derivative action in the Court of Chancery against FibroGen's directors and officers for, among other things, breaches of fiduciary duty under *Malone* and *Caremark* theories.

The plaintiffs took issue with three types of communications. First, the plaintiffs alleged that members of FibroGen's management made false statements in conference calls and press releases regarding Roxadustat's safety results and the FDA's approval process (the management claims). The plaintiffs alleged that FibroGen board members were aware — or could have been aware — of facts contrary to management's statements, and that these statements misled investors into believing that the FDA would approve Roxadustat without special warnings.

Second, the plaintiffs claimed that FibroGen issued Forms 10-Q containing allegedly misleading statements about contents of its new drug application to the FDA (the 10-Q claims), and the plaintiffs alleged that FibroGen's directors were aware of facts indicating the filings were misleading.

[1] *Malone v. Brincat*, 722 A.2d 5 (Del. 1998). A *Malone* claim alleges that a fiduciary knowingly disseminated false information "that results in corporate injury or damage to an individual stockholder" outside the context of a stockholder vote. *Id.* at 9.

[2] *In re FibroGen, Inc. Deriv. Litig.*, C.A. No. 2022-0331-SG (Del. Ch. Oct. 2, 2024).

Finally, the plaintiffs alleged that FibroGen's 2019 and 2020 Forms 10-K — which were signed by a majority of the board — contained misleading, post hoc manipulated data about Roxadustat and the approval process (the 10-K claims). The defendants moved to dismiss for failure to plead demand futility as required under Court of Chancery Rule of Civil Procedure 23.1 and for failure to state a claim.

The Court's Analysis

Under Delaware law, a *Malone* claim arises when a fiduciary knowingly disseminates false information in the absence of a request for stockholder action "that results in corporate injury or damage to an individual stockholder."[3] A so-called "prong-two" *Caremark* oversight claim arises where directors, "having implemented [oversight] system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[4] Here, the court stated that the plaintiffs, "[p]erhaps sensing the weakness of the [*Malone*] disclosure allegations," presented a "hybrid" claim that asked the court to "consider the facts under the lens of a *Caremark* oversight claim." As the court explained, the plaintiffs' "syllogism ran thus: Management communicated false and misleading statements to investors and the FDA; even if Plaintiffs have not adequately alleged that a majority of the Director Defendants participated in that dissemination knowingly or intentionally, these Director Defendants' failure to investigate and intervene, in the face of 'red flags' indicating management wrongdoing, amounts to bad faith under a *Caremark* analysis." The court referred to this hybrid *Malone*/*Caremark* claim as a "*FibroGen*" claim.

In dismissing the complaint, the court first noted that the plaintiffs' claims required them to plead with particularity facts from which the court could reasonably infer that asking the FibroGen's board to consider whether any wrongdoing had occurred — a so-called "demand" on the board — would have been futile. The plaintiffs argued that such a demand would have been futile because a majority of the board faced a substantial likelihood of liability for breaching their fiduciary duties under the plaintiffs' allegations. The court held that the particularized pleading standard "differ[s] substantially from . . . permissive notice pleadings" and places a higher pleading burden on the plaintiffs. The court then separately analyzed the *Malone* and *Caremark* aspects of the hybrid claim, treating them as separate claims.

Analyzing the *Malone* claims, the court emphasized that the plaintiffs had to plead "specific facts indicating that [each] director 'prepared' the challenged language or was 'directly responsible for the misstatements or omissions,' that the statements were false or misleading, and that the director knew that the statements were false or misleading, or intended that they be so."

The court first analyzed the management claims. The court found that the plaintiffs had failed to allege with particularity that any member of the board had approved, prepared, caused or were otherwise involved with the purportedly false underlying statements. The court also rejected the plaintiffs' alternative argument that the board failed to correct the statements because the plaintiffs failed to plead with particularity that any director reviewed or even knew about the allegedly false statements.

Next, the court analyzed the 10-Q claims. Here, too, the court found that the plaintiffs had failed to plead particularized facts that any director knew about the statements included in the Forms 10-Q, let alone that any director had played any role in issuing the statements.

[3] *Malone*, 722 A.2d at 9.

[4] *Stone v. Ritter*, 911 A.3d 362, 370 (Del. 2006).

Finally, the court analyzed the 10-K claims. Unlike the Forms 10-Q, a majority of the board signed the Forms 10-K at issue. However, the court found that the plaintiffs again failed to plead facts from which the court could reasonably infer that a majority of directors were involved in preparing the Forms 10-K or that they knew that the facts regarding Roxadustat differed from those stated in the Forms 10-K. Simply signing the 10-K was not grounds for director liability.

Analyzing the *Caremark* claims next, the court held that the plaintiffs failed to plead with particularity facts from which the court could reasonably infer that a majority of directors consciously ignored red flags identifying management's alleged misconduct in issuing misleading disclosures.

The plaintiffs identified what they believed were the two most prominent red flags: (i) a July 2020 board meeting in which the board learned that a black box warning would likely be required for Roxadustat, and (ii) the FDA's extension of the review period and requests for additional safety analyses. As to the black box warning claim, the court found that such a warning would signal to the board at most that the FDA viewed Roxadustat as comparable to a competitor drug, which itself had a black box warning. Such information was therefore not clear enough to put the board on notice that management was issuing false or misleading public disclosures. Regarding the FDA's requests and extension, the court stated that although it might have been prudent for the board to investigate more fully after the FDA's actions, those actions did not give rise to red flags because they did not provide clear evidence that FibroGen management was disseminating allegedly false or misleading information.

The court also held that the plaintiffs had failed to clearly identify a corporate trauma — in other words, even if the board had been presented with "red flags," "none of the wrongdoing alleged against FibroGen itself caused the FDA's rejection of [Roxadustat] — that is, a failure of oversight did not lead to a 'mission critical' corporate trauma." The lack of any "mission critical" corporate trauma further undercut a reasonable inference that the board allegedly acted in bad faith by ignoring red flags of purported misconduct.

Key Points

- Although the plaintiffs' argument was framed as a hybrid of *Malone* and *Caremark* claims, the Court of Chancery treated the respective *Malone* and *Caremark* aspects as separate claims, and applied settled Delaware law to dismiss them.
- *FibroGen* reaffirms that board members cannot be held liable for public statements simply because they signed a public filing or an employee they oversee made the statements. To survive a motion to dismiss, a plaintiff must plead particularized facts making it reasonable to infer that a director either (i) knew about the falsity or misleading nature of the statements and did not act, or (ii) approved, prepared, caused or were otherwise involved with the false or misleading statements.
- Both directors and officers should regularly consult with counsel to ensure the accuracy of public statements issued outside the context of a stockholder vote, and to understand any litigation risks related to a corporation's public statements.

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