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RECENT DEVELOPMENTS IN

DELAWARE LAW

2025

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OVER 125 YEARS OF HELPING CLIENTS NAVIGATE THE INTRICACIES OF DELAWARE CORPORATE LAW

Richards, Layton & Finger has been defining Delaware law since 1899. Continuing our long tradition of providing insight into the evolution of our state's influential laws, this publication highlights recent Delaware corporate and alternative entity cases as well as statutory developments in our state.

Our corporate and alternative entities teams, the largest and most recognized in the state, play crucial roles in Delaware. For decades we have contributed to the development of key statutes, litigated influential decisions, and provided counsel on complex transactions—making us uniquely skilled at delivering the outstanding results our clients count on.

Richards Layton has been involved with many of the cases highlighted in this publication, and we have handled, as Delaware counsel, the most M&A transactions valued at or above $100 million for 32 years running, as reported in *Corporate Control Alert.* We welcome the opportunity to discuss with you the practical implications of the recent developments in Delaware law.

—Richards, Layton & Finger

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CORPORATIONS

Controlling Stockholder Issues

Palkon v. Maffei: **Entire Fairness Standard Applied to Controller-Led Corporate Conversion from a Delaware Corporation to a Nevada Corporation**

In *Palkon v. Maffei,* 311 A.3d 255 (Del. Ch. 2024), the Court of Chancery held that the plaintiffs adequately alleged that TripAdvisor Inc. and Liberty TripAdvisor Holdings, Inc.'s conversions from Delaware corporations to Nevada corporations were self-interested transactions effectuated by a controlling stockholder and that such conversions conferred a material non-ratable benefit on the company's fiduciaries. Therefore, the court held that entire fairness was the appropriate standard for reviewing the conversions. Applying entire fairness, the court held that the plaintiffs sufficiently pled facts that supported a reasonable inference that the conversions were not entirely fair because the post-conversion stockholders would not receive the substantial equivalent of what they held pre-conversion because their litigation rights as stockholders would be reduced by virtue of Nevada's greater liability protections for officers and directors.

TripAdvisor runs the world's largest publicly traded travel guidance platform. Liberty TripAdvisor Holdings owns high-vote shares in TripAdvisor, giving it a majority of TripAdvisor's outstanding voting power. Gregory Maffei is the CEO and chairman of the board of Holdings and owns high-vote shares in Holdings, giving him 43% of the outstanding voting power in Holdings. For purposes of the motion to dismiss,

the defendants conceded that Maffei is the controller of both Holdings and TripAdvisor.

In November 2022, the TripAdvisor board considered reincorporating to Nevada by converting into a Nevada corporation. In March 2023, the Holdings board considered reincorporating to Nevada by converting into a Nevada corporation. In each case, the proposed benefits of reincorporation were described to each board as including increased protections against liability for fiduciaries as well as lower franchise taxes and fees. By April 2023, each board unanimously approved such reincorporation. Each of TripAdvisor and Holdings sought stockholder approval of its respective conversion and recommended that its stockholders vote in favor of such conversion. Each corporation's proxy disclosed that the protections against unmeritorious litigation available to directors and officers would be greater under Nevada law than under Delaware law. At the stockholder meetings, the stockholders approved the conversions. Maffei delivered most of the vote in favor at the Holdings level, and Holdings delivered the majority vote in favor at the TripAdvisor level.

Prior to TripAdvisor and Holdings effecting the conversions, the plaintiffs sued seeking injunctive relief. The plaintiffs alleged that the defendants were self-interested in the conversions and that the conversions were not entirely fair. The defendants moved to dismiss, arguing, in part, that the transactions complied with Section 266 of the Delaware General Corporation Law (DGCL), which authorizes a corporation to convert to a foreign corporation upon board approval and approval from holders of a majority in voting power of the corporation's stock.

The court rejected the defendants' argument and explained that in every case, corporate action must be twice tested: first, to confirm proper exercise of corporate power under the DGCL and second, by equity to ensure that the fiduciary has acted in accordance with its fiduciary duties. The court held that no one disputed whether the defendants satisfied the first test (i.e., complied with Section 266 of the DGCL in properly authorizing the conversions); rather, the dispute was whether the defendants satisfied the second test. Therefore, on a motion to dismiss, the court had to determine the standard of review applicable to the conversions.

Plaintiffs sufficiently alleged that post-conversion stockholders would not receive the substantial equivalent of what they held pre-conversion because their litigation rights would be reduced by virtue of Nevada's greater liability protections.

The defendants argued that the business judgment rule protected the conversions. The court noted, however, that Delaware law deems the business judgment rule rebutted if a controlling stockholder receives a non-ratable benefit in the transaction. The defendants conceded for purposes of the motion that Maffei controlled both corporations. Therefore, the court examined whether the complaint sufficiently pled that the controller would receive a non-ratable benefit as a result of the conversions.

The court held that it was reasonably conceivable that a conversion from a Delaware corporation to a Nevada corporation would result in a reduction in the litigation rights of

stockholders because, as the plaintiffs alleged, Nevada law provided greater protections to directors and officers against liability, including those who approved the conversions, resulting in a non-ratable benefit to the controller. Therefore, the court held that entire fairness was the appropriate standard of review.

Reviewing the conversions under the entire fairness standard, the court held that the plaintiffs sufficiently pled facts that supported a reasonable inference that the conversions were not entirely fair. In particular, the court noted that the plaintiffs sufficiently alleged that post-conversion stockholders would not receive the substantial equivalent of what they held pre-conversion because their litigation rights would be reduced by virtue of Nevada's greater liability protections for officers and directors. The court also noted that no procedural protections had been implemented by the defendants, such as use of an independent board committee or a vote of the unaffiliated stockholders. Furthermore, the court suggested that the lack of support from unaffiliated stockholders in this instance provided further evidence of unfairness.

The Court of Chancery, however, denied the plaintiffs' request for injunctive relief to halt the conversions because the court reasoned that it would not be appropriate to award such equitable relief given that there would be an adequate remedy at law. The court concluded that compensatory damages, measured by the change in value of the plaintiffs' shares resulting from the conversion from a Delaware corporation to a Nevada corporation, would be an adequate remedy at law to compensate stockholders for any lost value attributable to a reduction in litigation rights.

The Court of Chancery's opinion was appealed, and on February 4, 2025, the Delaware Supreme Court reversed, finding that the business judgment rule applied.

In re Match Group, Inc. Derivative Litigation: Delaware Supreme Court Holds Entire Fairness Applies Where Controller Receives a Non-Ratable Benefit Unless *MFW* Criteria Are Satisfied

In *In re Match Grp., Inc. Deriv. Litig.,* 315 A.3d 446 (Del. 2024), the Delaware Supreme Court held that in any transaction with a controlled corporation in which a controlling stockholder is on both sides and receives a non-ratable benefit, entire fairness is the presumptive standard of review. Properly employing a special committee or subjecting the transaction to a majority of the minority vote shifts the burden of proof to the plaintiffs but does not lower the standard of review to the business judgment rule; instead, each of *MFW's* requirements must be satisfied to secure business judgment review. Notably, the court also held that all members of the special committee must be independent of the controlling stockholder to satisfy the committee independence criterion of the *MFW* framework.

In June 2020, IAC/InterActiveCorp separated its internet and media businesses from its online dating businesses through a reverse spin off. The separation was challenged by stockholder plaintiffs claiming that the reverse spin off was unfair because IAC, the controlling stockholder of Match, allegedly received benefits in the transaction at the expense of the Match minority stockholders. In particular, the plaintiffs alleged that the separation left Match public stockholders holding equity in a company that had taken on additional debt over the course of the separation to the benefit of IAC. The Court of Chancery dismissed the suit, holding, among other things, that the defendants satisfied all of *MFW's* requirements—(i) the controlling stockholder conditioned the transaction from the start on the approval of both a special committee and a majority

of the minority stockholders; (ii) the special committee was independent; (iii) the special committee was fully empowered; (iv) the special committee met its duty of care; (v) the vote of the minority was informed; and (vi) there was no coercion of the minority—leading to business judgment review. Applying the business judgment rule, the court dismissed the case. The plaintiff stockholders appealed.

The court held that because one member of the special committee was not independent, the committee failed to satisfy the independence requirement of *MFW* irrespective of how the process unfolded.

On appeal, the Delaware Supreme Court answered two pivotal corporate law questions. First, the court addressed whether the entire fairness standard or business judgment standard of review applies in a controlling stockholder transaction that does not involve a freeze-out merger when the defendants prove either (i) approval by an independent committee or (ii) approval by a majority of the uncoerced, fully informed, unaffiliated stockholders. On this issue, the court held that properly employing a special committee or subjecting the transaction to a majority of the minority vote changes the burden of proof to the plaintiffs but does not change the standard of review to business judgment. Instead, entire fairness applies. The court held that to trigger business judgment review, all of *MFW's* requirements must be satisfied.

Second, the court addressed whether a special committee must be composed of all independent directors in order to satisfy *MFW's* independent committee requirement. The court held that in the *MFW* setting, in order to replicate arm's-length bargaining, all special committee members must be independent of the controller.

Applying these rulings to the facts of the case, the Delaware Supreme Court agreed with the Court of Chancery that one of the individuals on the special committee representing Match, Thomas McInerney, was not independent of IAC. The court held that he lacked independence because he had previously been employed as the CFO of IAC and had strong, longstanding business ties to the controlling stockholder. Notwithstanding McInerney's conflict, the Court of Chancery had concluded that the plaintiffs failed to establish that the special committee lacked independence because they failed to demonstrate either that half of the committee members were not independent or that McInerney dominated or infected the special committee's independent decision-making process. The Delaware Supreme Court viewed the legal effect of such conflict differently.

The court held that because one member of the special committee was not independent, the committee failed to satisfy the independence requirement of *MFW* irrespective of how the actual negotiations and committee process unfolded. In other words, the mere fact that one member of the committee was not independent of the controller foreclosed the possibility of satisfying *MFW's* requirements and securing business judgment review. Because one of *MFW's* requirements was not satisfied, the court held that entire fairness was the applicable standard of review. Consequently, the court reversed and remanded the case to the Court of Chancery for further proceedings consistent with its holdings.

In re Sears Hometown & Outlet Stores, Inc. S'holder Litig.: **The Court of Chancery Establishes Enhanced Scrutiny as Standard of Review for Controller's Unilateral Action to Amend Bylaws and Replace Directors**

In *In re Sears Hometown & Outlet Stores, Inc. S'holder Litig.*, 309 A.3d 474 (Del. Ch. 2024), the Court of Chancery established that enhanced scrutiny is the applicable standard of review to apply to a challenged decision by a controlling stockholder to unilaterally amend bylaws and remove and replace directors. Reviewing the controller's actions under enhanced scrutiny, the Court of Chancery held that the controller's actions were taken in order to prevent a liquidation of assets and in an attempt to preserve long-term stockholder value, and the controller's actions were a reasonable response to achieve a legitimate end. The court did find, however, that the controlling stockholder failed to prove entire fairness of the subsequent transactions he engaged in to acquire the company that owned the would-be liquidated business segment. The court reasoned that the controller's bylaw amendments and actions to remove and replace the directors had such an influence over the subsequent negotiations that the subsequent transactions were not entirely fair.

In 2012, Sears Holding Corporation spun off Sears Hometown and Outlet Stores (the "Company") as its own publicly traded company. The two entities continued to do business together on favorable terms through a number of related-party agreements. Edward S. Lampert owned the majority of the shares in both companies. In 2016, Lampert indirectly purchased more shares of Company common stock and was exploring strategic alternatives for the Sears flagship brands. In response, the board of the Company formed a special committee and empowered it with the exclusive authority to address any potential transaction that Lampert might propose.

On October 11, 2018, news broke that creditors were pushing for a liquidation of Sears Holdings. On October 15, 2018, Sears Holdings filed for bankruptcy under Chapter 11 of the bankruptcy code. Around this time, Company management began to consider what options were available to the Company in the event of a liquidation of Sears Holdings. The Company's board and management considered that it could sell the Company to Lampert, liquidate a number of retail stores and try to run the remaining company profitably, or liquidate one poorly performing segment—Sears Hometown and Hardware—and continue to operate the better performing segment—Sears Outlet.

In January 2019, a fund associated with Lampert acquired all of Sears Holdings' assets, ending the possibility of a Sears Holdings liquidation. The Hometown segment of the Company, however, was performing poorly, and Company management continued working towards a plan to either sell or liquidate Hometown, use the proceeds to pay down debt, and then operate Outlet as a standalone company. The special committee authorized management to inquire whether Lampert was interested in purchasing Hometown or the Company. During management's discussions with Lampert, management explained to Lampert that without a deal, the Company was planning to liquidate Hometown. Lampert staunchly opposed the selective liquidation of Hometown because he believed it would be a value-destroying transaction. The board offered to give Lampert until April 15, 2019 to make an offer to acquire the Company or Hometown alone. After April 15, the board planned to begin liquidating Hometown.

At the special committee's direction, its financial advisor informed Lampert that the committee believed a per share valuation in the mid to high single digits was warranted. Lampert made an offer to buy the Company for $2.25 per share. Ultimately, while interested in acquiring the Company, Lampert could not come to an agreement with the special committee on price. In order to stave off the liquidation of Hometown, Lampert used his power as a controlling stockholder to amend the Company's bylaws to require that a Hometown liquidation receive approval from 90% of the board at two separate board meetings at least thirty business days apart, removed two of the three directors from the board (and thereby removed them from the special committee as well), and filled the board vacancies with two new members. Lampert removed the two directors he believed were most opposed to coming to a favorable agreement.

After Lampert's intervention, negotiations resumed between Lampert and the one remaining member of the special committee. After much back and forth, the committee and Lampert reached an agreement to enter into a merger agreement whereby (i) Lampert agreed to pay $2.25 per share to acquire the remaining minority interests; (ii) the parties agreed to an 84-day go-shop period for the Company to market Outlet, with a $97.5 million threshold price above which any additional consideration that a third party paid would increase the amount paid to stockholders; and (iii) a ceiling price of $120 million at which Lampert would no longer have a match right if a third party offered to acquire Outlet. The special committee recommended the transaction, and the board approved the deal. The merger agreement did not condition the transaction on a majority-of-the-minority vote. During the go-shop period, the Company managed to find a higher bidder and agreed to sell Outlet to the higher bidder for $121 million. Both transactions closed on October 23, 2019, and the stockholders received total consideration of $3.21 per share.

Several stockholders sued, challenging Lampert's conduct as a controlling stockholder and the resulting transactions. The plaintiffs alleged that Lampert breached his fiduciary duties when he removed and replaced two directors and amended the bylaws to make a liquidation of Hometown impracticable. The plaintiffs also alleged that Lampert breached his fiduciary duties by forcing the Company into the transactions.

After reviewing the history of Delaware's jurisprudence with respect to the fiduciary duties owed by a controlling stockholder, the court held that enhanced scrutiny was the appropriate standard for reviewing a controller's unilateral action to amend bylaws and remove directors.

In its post-trial opinion, the court held that Lampert had not breached his fiduciary duties with respect to his removal and replacement of directors and the amendment of the bylaws. The court first concluded that the appropriate standard of review for Lampert's conduct was enhanced scrutiny. After reviewing the history of Delaware's jurisprudence with respect to the fiduciary duties owed by a controlling stockholder, the court held that although there was no decision directly on point, enhanced scrutiny was the appropriate standard for reviewing a controller's unilateral action to amend bylaws and remove directors. The court reasoned that because enhanced

scrutiny applied in challenges to board action to "amend bylaws or otherwise intervene in elections or voting contexts touching on corporate control ... [e]nhanced scrutiny should also apply when a controller does something comparable." Therefore, Lampert was required to show that he acted in good faith for a legitimate objective and had a reasonable basis for believing that action was necessary, as well as that he chose reasonable means to achieve his legitimate objective.

Applying enhanced scrutiny, the court held that Lampert's interventions to remove and replace directors and amend the bylaws were not a breach of fiduciary duties. The court concluded that Lampert had acted properly to prevent the destruction of value to the Company that he reasonably believed would result if the Hometown liquidation was allowed to proceed absent his intervention. The court reasoned that the Company's estimates of value it could receive through a liquidation of Hometown were unrealistic because of potential liabilities and risks that the court believed were not adequately factored into the Company's analysis. Because Lampert's goal was the promotion of long-term stockholder value, Lampert had a legitimate objective. Further, Lampert had a reasonable basis for his belief because he had previously been involved in multiple bankruptcies and was familiar with the risks of liquidation, and the court found that his testimony at trial was credible. Lastly, the court held that Lampert's means of seeking to protect the Company's long-term value were reasonable—he did not take over the board, did not appoint himself to the board, only took unilateral action after negotiations failed, and took such action when he believed there were no other acceptable alternatives. Therefore, the court held that Lampert's conduct was a reasonable means to achieve the end of stopping the Hometown

liquidation. Thus, the court held that Lampert did not breach his fiduciary duties when he amended the bylaws and removed and replaced two directors.

Because the transactions involved Lampert acquiring the Company and eliminating the minority stockholders, the court analyzed the transactions under the entire fairness standard of review. With respect to process, the court noted that although Lampert's interventions were not a breach of his fiduciary duties, his actions "cast a shadow over the balance of the negotiations." The transactions were not subject to a majority-of-the-minority vote, and the court never determined whether the special committee was, in fact, fully independent. Further, although the special committee negotiated aggressively prior to the removal of two of its members from the board, after their removal, the court found that after Lampert's bylaw amendments and director removals, Lampert had effectively "boxed in" the committee and "eliminated the Company's principal alternative" to a transaction with Lampert. Additionally, the court concluded that the remaining special committee member negotiated effectively with Lampert, resulting in a go-shop that ultimately resulted in additional value for stockholders, but the playing field had already been set, and such substantive negotiations were effectively limited to the Outlet segment. In contrast, the court reasoned that the process with respect to the Hometown segment was "desultory and incomplete." The court found that, while negotiations over the Outlet segment had continued in earnest after Lampert's interventions, the negotiations over the Hometown segment had not. The negotiations over Hometown did not move beyond where Lampert and the committee had left them before the controller intervention. Accordingly, the court held that, on balance, the process weighed towards unfairness.

On price, the court reviewed valuation expert testimony, valuation methodologies, deal price with respect to Outlet, liquidation valuations with respect to Hometown, and the value of the Company's net operating losses to calculate a fair value for the transactions. The court concluded that Lampert underpaid for the Company, holding that a fair price would have been $4.99 per share. Therefore, the court held that on balance the transactions were not entirely fair and Lampert was liable to pay to the minority stockholders the difference between $4.99 per share and $3.21 per share (the amount stockholders received in the transactions), which equaled $1.78 per share.

Tornetta v. Musk: **Court of Chancery Holds that Tesla's Equity Compensation Package to Elon Musk Was Not Entirely Fair and Rescinds the Entire Compensation Package**

In *Tornetta v. Musk,* 310 A.3d 430 (Del. Ch. 2024), the Court of Chancery held that the equity compensation package that Tesla, Inc. had awarded to its CEO Elon Musk in 2018 was not entirely fair and therefore rescinded the entire compensation package. Just 10 months later, in *Tornetta v. Musk,* --- A.3d --- (Del Ch. Dec. 2, 2024), the same court rejected Tesla's subsequent efforts to ratify the rescinded 2018 compensation package via stockholder vote and awarded $345 million in attorneys' fees to plaintiff's counsel.

In April 2017, as Musk was nearing the completion of his previous Tesla executive compensation package (a 10-tranche package

representing a cumulative 5% stake in the company's outstanding common stock), discussions about a new compensation package for Musk commenced between him and other members of the board of directors. Musk proposed the initial terms of his compensation package. The board appointed an independent compensation committee to negotiate the compensation package with Musk. During negotiations, Musk exerted significant influence over the process, slowing it down or speeding it up at various points, proposing key terms, and even negotiating against himself. Through an extended process, several iterations of key compensation terms, and considerable back and forth among Musk and various board and committee members and officers, in January 2018 Tesla's board approved the 2018 compensation package.

Like his prior pay packages, the 2018 compensation package consisted solely of significant equity awards (roughly 6% of Tesla's outstanding stock) divided into 12 tranches of options that would vest upon Tesla's completion of certain market capitalization and operational milestones. All of the equity compensation was contingent on achieving the milestones. Among other things, to obtain the full equity award contemplated by the 2018 compensation package, Musk would have to grow Tesla from a $50 billion company to a $650 billion company. The 2018 compensation package was also conditioned on receipt of approval from a majority of the disinterested stockholders of Tesla. Though there was significant pushback from proxy advisors and certain stockholders, in March 2018 the stockholders of Tesla approved the 2018 compensation package, with 73% of the voting shares (excluding Musk and his brother's shares) voting in favor.

Just a few months later, in June 2018, a stockholder plaintiff brought a derivative action on behalf of Tesla. The plaintiff asserted two primary claims. First, the plaintiff claimed that the 2018 compensation package constituted a breach of Musk's fiduciary duties in his capacity as a controlling stockholder of Tesla. Second, the plaintiff claimed that Musk and other members of the Tesla board breached their fiduciary duties in authorizing the 2018 compensation package.

In its post-trial opinion, the court first determined that the entire fairness standard of review applied because the 2018 compensation package constituted a conflicted-controller transaction. Although Musk was only a holder of slightly less than 22% of Tesla's outstanding stock at the time the 2018 compensation package was awarded, the court found that Musk still qualified as a controller because he exercised transaction-specific control. In support, the court reasoned that although a 22% share was not automatically controlling, it was significant enough to functionally give Musk a sizeable leg-up in stockholder votes and the ability to block specific categories of bylaw amendments. Additionally, the court concluded that Musk exercised managerial supremacy over the rest of the board as a "Superstar CEO." The court found that Musk's superstar status "shift[ed] the balance of power between management, the board, and the stockholders" and created a "distortion field" that "weaken[ed] mechanisms by which stockholders hold fiduciaries accountable." Third, the court considered the relationships Musk had with other members of the board. Excluding one member of the board who departed the board, the court found that three of the eight directors were beholden to Musk based on

their personal relationships with him and/or the individual board member's financial dependence on Musk-controlled companies, including Tesla. Together with Musk, they constituted half of the eight-member board. Several of the other directors had extensive relationships with Musk, suggesting that they may have been beholden to Musk during his compensation negotiations.

The court found that Musk's superstar status "shifted the balance of power between management, the board, and the stockholders" and created a "distortion field" that "weakened mechanisms by which stockholders hold fiduciaries accountable."

Finally, the court considered the negotiation process. On this point, the court found that Musk controlled the timing and significant terms of the 2018 compensation package. Further, because the board's compensation committee took a cooperative approach to negotiating the 2018 compensation package, the court concluded that there was no meaningful negotiation or push-back against Musk. Most compelling to the court were the defendants' own testimonies suggesting that the decision making with respect to Musk's compensation package was a collaborative effort with Musk; no defendant described the process as an arm's-length negotiation. In addition, the court held that there was no benchmark analysis performed to compare the 2018 compensation package to other compensation awards given to executives at similar companies. The defendants argued that benchmarking was inapplicable because of the size and uniqueness of Tesla, but the court held that the compensation committee could have and should have performed this analysis. Ultimately, the court concluded that Musk

exercised strong transaction-specific control over the 2018 compensation package such that the compensation package constituted a conflicted-controller transaction, thereby triggering the entire fairness standard of review.

Next, the court rejected the defendants' arguments that the stockholder vote affirming the 2018 compensation package shifted the burden of proof to the plaintiffs. Under Delaware law, even when reviewing a transaction for entire fairness, a fully informed vote of the stockholders may shift the burden of proof to plaintiffs. To obtain burden shifting, the defendants had to show that the stockholders' approval of the 2018 compensation package was fully informed. That is, the defendants had to demonstrate that the proxy materials related to the 2018 compensation package contained all material information and did not omit or misconstrue any facts that would significantly alter the total mix of information available for a stockholder to consider.

The court found two defects in the proxy disclosures that defeated burden shifting. First, the court concluded that the proxy statement failed to adequately inform stockholders of the conflicts of interest with respect to Musk. Specifically, the court found that the proxy statement did not adequately inform stockholders of the personal relationships that the members of the board had with Musk or their level of financial dependence on Musk-controlled entities. Second, the proxy statement failed to adequately inform stockholders of several process-related facts surrounding the negotiation of the 2018 compensation package. In particular, the proxy statement failed to disclose that Musk first proposed the material terms of the 2018 compensation package, Musk asserted control over the timing of the negotiations, and the compensation committee failed to get a benchmark analysis.

The court also rejected the defendants' argument that there was no material omission because the key terms of the 2018 compensation package—the economic terms—were disclosed. The court held that Delaware law does not apply such a narrow reading of the materiality standard, stating that "materiality extends beyond economics to information regarding process, conflicts, incentives, and more."

Having rejected the burden-shifting argument, the court found that the defendants failed to meet their burden in showing that the 2018 compensation package was entirely fair. In analyzing entire fairness, the court considered two aspects of the 2018 compensation package: process and price. In evaluating the procedural aspects of the 2018 compensation package, the court considered the *Weinberger* factors that review the initiation and timing of a transaction, the structure and negotiation of a transaction, and the approval of a transaction.

As to the first factor, the court found that the 2018 compensation package was not a product of fair price. The court held that although Musk did not manipulate the initiation of the discussions, he did significantly manipulate the timing of the negotiations by accelerating and decelerating the negotiations at various times. The court found that members of the compensation committee were conflicted and that such conflicts prevented arm's-length bargaining. In support of this conclusion, the court pointed to the lack of evidence showing that there was adversarial negotiation with

Musk concerning the overall size of the 2018 compensation package. When key terms of the compensation package did change, the court found that it was solely because Musk changed his proposal. Further, the court noted that aspects of the 2018 compensation package that the board touted as concessions were not actually the product of negotiation. Ultimately, the court found that the compensation committee operated under a "controlled mindset" by engaging in a collaborative negotiation rather than engaging in an arm's-length bargaining process.

The court also found that the 2018 compensation package did not satisfy the fair price prong of the entire fairness test. The defendants argued that giving Musk up to 6% of Tesla's equity was a good deal for stockholders because it would only be realized if incredible gains in stockholder value were achieved—indeed, the full 6% of equity compensation would only be realized by Musk if Tesla's market capitalization increased by $600 billion. Therefore, the defendants argued that Musk bore all of the risk, and the stockholders had only upside in the 2018 compensation package. The court rejected the defendants' arguments. The court noted that Musk's compensation plan was the largest compensation plan the compensation committee's compensation advisor had ever seen by more than 30 times its nearest comparable plan. The court also found persuasive the argument that because Musk had a significant equity position in Tesla, his interests were already aligned with Tesla and there was no demonstrated need to continue awarding him more equity to maximize stockholder value. The court concluded that, although the goal of obtaining such a significant return for investors might be meritorious, the board and the compensation committee had never considered whether they could obtain such a goal with a smaller compensation award. The court further found that the board's concerns that Musk might walk away from Tesla were unfounded and the milestones were not as difficult to achieve as the board touted them to be. At bottom, the court held that the evidence at trial revealed that the 2018 compensation package was not entirely fair.

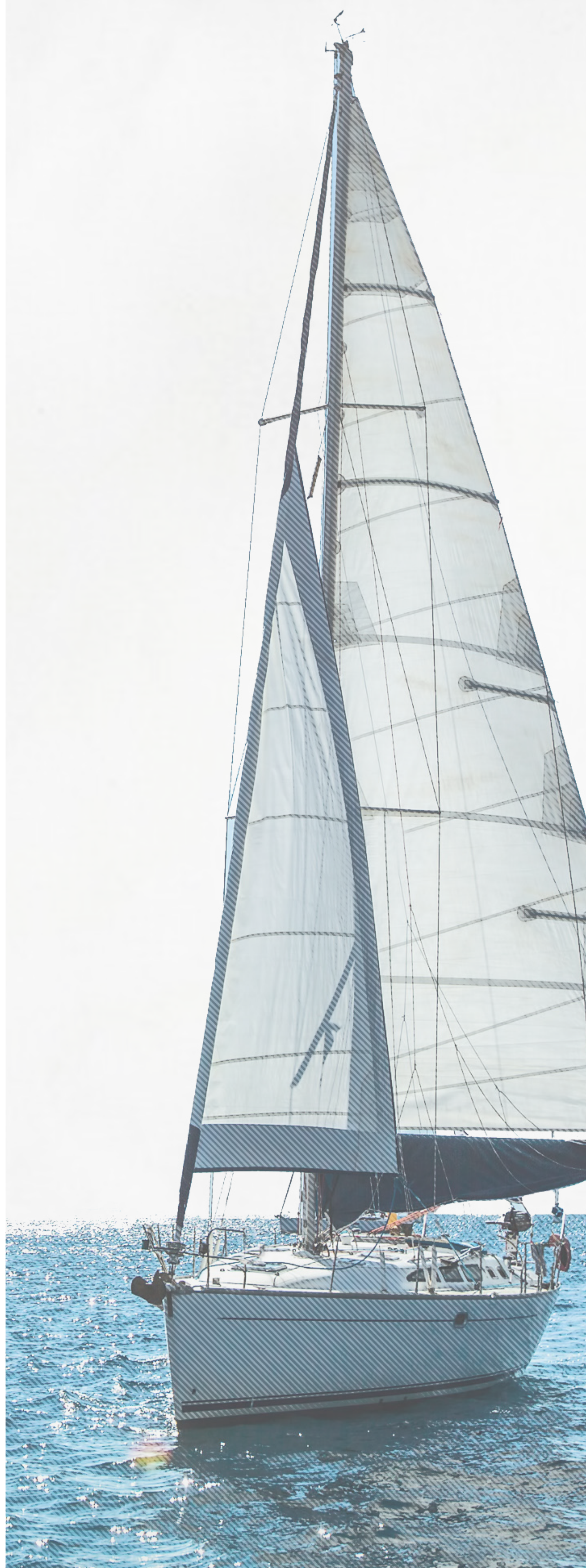
Having found that the 2018 compensation package was not entirely fair, the court held that rescission was a reasonable and appropriate remedy. While noting that this outcome was not mandated as an automatic remedy in light of Tesla's disclosure violations, the court found that rescission in this instance was the preferred remedy. The court noted that rescission would not impact any third-party interests, the grants had not been exercised, and even if they had been exercised, the shares would be subject to a previously negotiated five-year hold period. The court rejected the defendants' argument that rescission would leave Musk uncompensated for years of service at the helm of Tesla and suggested instead that he'd been adequately compensated via the appreciation in the equity Musk already owned in Tesla. Further, the court held that because the defendants had failed to identify a defensible delta between the 2018 compensation package and what was fairly owed to Musk for his service, the entire award should be rescinded.

Approximately 10 months later, in *Tornetta v. Musk,* --- A.3d --- (Del Ch. Dec. 2, 2024), the court rejected the defendants' motion to revise the court's previous judgment and awarded $345 million in attorneys' fees to plaintiff's counsel. After the post-trial judgment, the defendants attempted to ratify the 2018 compensation package via

stockholder vote, which the stockholders approved by overwhelming numbers. Upon receiving the successful ratification vote, the defendants asked the court to revise the post-trial judgment and recognize that the 2018 compensation package had been ratified by the stockholders.

The court denied the defendants' motion for several reasons. First, the court held that its ability to consider the stockholder ratification was procedurally barred because it was based on evidence produced after trial. Second, the court held that, as an affirmative defense, common-law ratification was inappropriately brought in a post-trial setting. Third, the court held that there was no basis in common law for a stockholder vote on its own to ratify a conflicted-controller transaction. And finally, even if Tesla stockholders could ratify the 2018 compensation package, the court held that there had been disclosure defects in the proxy statement soliciting stockholder support of the ratification that would defeat successful ratification.

The court then considered the fee petition brought by plaintiff's counsel. The court held that although the plaintiff's methodology was sound, the requested $5.6 billion award in freely tradeable Tesla shares based on a market value of the 2018 compensation package of $55.8 billion was a windfall that the court could not allow. Instead, the court granted a fee award of $345 million for the plaintiff's "total victory," calculated by taking 15% of the $2.3 billion grant-date fair value of the 2018 compensation package. The court did not mandate that the award be paid in Tesla shares, but gave Tesla the option to pay the award in cash or in the form of Tesla stock.

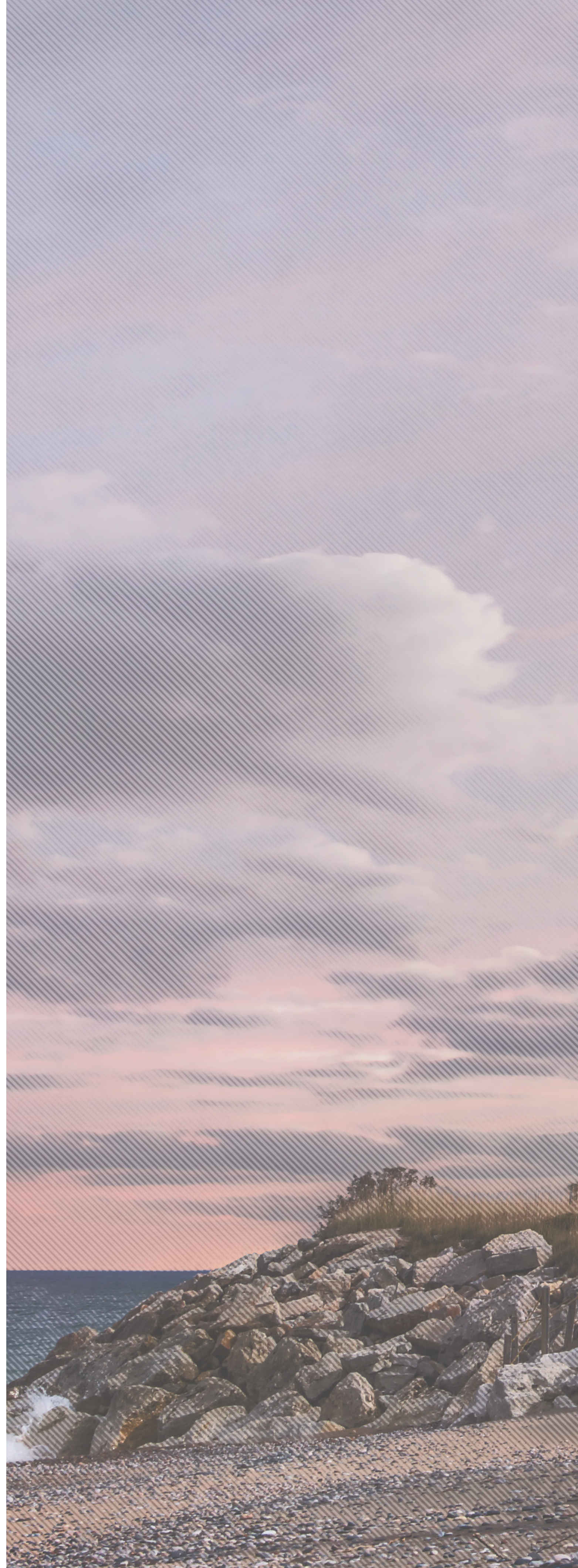


MFW Transactions

City of Dearborn Police and Fire Revised Retirement System v. Brookfield Asset Management, Inc.: **Inadequate Disclosure of Special Committee's Financial and Legal Advisors' Conflicts of Interest in Proxy Statement Rendered Stockholder Vote Not Fully Informed**

In *City of Dearborn Police and Fire Revised Retirement System v. Brookfield Asset Management, Inc.*, 314 A.3d 1108 (Del. 2024), the Delaware Supreme Court reversed the Court of Chancery's dismissal of a lawsuit, holding that inadequate proxy statement disclosures rendered the business judgment rule protections under *MFW* unavailable to defendants in the context of a squeeze-out merger. Namely, the proxy statement failed to include details about the independent special committee's financial and legal advisors' conflicts of interest with respect to the company's controlling stockholder who bought out the minority interests—conflicts that the Delaware Supreme Court held would have been material to a reasonable stockholder.

TerraForm Power, Inc. was an operator of solar and wind facilities in North America and parts of Europe. In early 2020, TerraForm's majority stockholder, Brookfield Asset Management, offered to acquire all of TerraForm's remaining outstanding stock via a squeeze-out merger. In order to address its own conflict of interest and position any legal challenge to Brookfield's proposed acquisition for review under the business judgment rule, Brookfield conditioned any transaction on both the approval of an independent special committee and a majority vote of disinterested stockholders.



In response, TerraForm's board of directors formed a special committee consisting of independent directors and empowered the special committee to review, discuss, and negotiate with Brookfield the proposed transaction and any alternatives thereto, and recommend or reject any such potential transaction. The special committee was also empowered to retain its own financial and legal advisors. The special committee retained two financial advisors—Greentech and Morgan Stanley. The special committee retained Kirkland & Ellis, LLP, and Richards, Layton & Finger, P.A., as its legal advisors.

After a robust evaluation and negotiation process, the special committee negotiated a merger whereby Brookfield would buy out the remaining outstanding shares of stock of TerraForm. The merger valued TerraForm at approximately $3.3 billion. The special committee recommended that the board approve Brookfield's offer, and the board approved the merger. The transaction was then submitted for a stockholder vote on June 29, 2020. The proxy statement disclosed that:

- Morgan Stanley had previously done work for each of TerraForm and Brookfield, as well as the fees paid by each to Morgan Stanley in connection with such representations over the past two years;
- the transaction would "likely provide a number of significant benefits to the Brookfield Renewable group," including by simplifying Brookfield's ownership structure, eliminating public company costs, expanding Brookfield's geographic portfolio, and increasing Brookfield's $20 million annual management fee; and
- the merger would be accretive to Brookfield's cash flows.

The plaintiffs, former stockholders of TerraForm, brought suit alleging that (i) Brookfield, as a controlling stockholder, breached its fiduciary duties in connection with the merger, (ii) directors of TerraForm breached their fiduciary duties in approving the merger and issuing a misleading proxy, and (iii) TerraForm's CEO breached his fiduciary duties in preparing and disseminating the proxy. The defendants moved to dismiss the complaint, arguing that all six elements of *MFW* were satisfied, such that the claims were subject to dismissal under the business judgment rule.

Under *MFW*, the business judgment standard of review is applicable to controller buyouts if, and only if:

> (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.

The plaintiffs alleged that the elements of *MFW* were not satisfied because the special committee was coerced. As evidence, the plaintiffs proffered that Brookfield had shared a financial model with TerraForm that did not include growth for TerraForm. The plaintiffs argued that because Brookfield was the primary funder of Brookfield's growth opportunities, the financial model was sent as a threat that Brookfield would stop supporting TerraForm if the special committee recommended against a transaction with Brookfield. The Delaware Supreme Court agreed with the Court of Chancery and rejected the plaintiffs' argument, holding that such an inference was a "stretch." Instead, the Delaware Supreme Court agreed with the Court of Chancery that nothing in the complaint approached the level of conduct that the Delaware courts had previously found as evidence of coercion.

Although the size of Morgan Stanley's investment may not have been material in terms of creating a conflict for Morgan Stanley, such an investment would be material in the eyes of a reasonable stockholder.

Second, the plaintiffs argued that the stockholder vote was not fully informed because it failed to disclose material information concerning the special committee's advisors' conflicts of interest. The court agreed and held that several advisor conflicts existed that were not adequately disclosed in the proxy statement. In particular, the court found that the proxy statement failed to disclose that Morgan Stanley had $470 million invested in Brookfield. The court explained that although the size of Morgan Stanley's investment may not have been material in terms of creating a conflict for Morgan Stanley, such an investment would be material in the eyes of a reasonable stockholder and therefore such investment should have been disclosed, enabling the stockholder to evaluate the information and make its own determination about the potential impact of such investment on Morgan Stanley's advice. In particular, the

court found compelling the fact that Morgan Stanley was holding interests in Brookfield for its own financial benefit, as opposed to holding those interests on behalf of a client or other entity.

The plaintiffs also argued that Kirkland's conflicts were not adequately disclosed in the proxy statement. Again, the court agreed. The court explained that the test for materiality is whether a reasonable stockholder would consider the information important in deciding how to vote. Kirkland had represented Brookfield and its affiliates on prior occasions, and Kirkland was concurrently representing Brookfield on an unrelated transaction at the time it was advising the special committee. The proxy statement said nothing about such prior and concurrent conflicts of interest. The court held:

> Even though, standing alone, Kirkland's prior conflicts with Brookfield may not have been sufficient to state a claim, we hold that it is reasonably conceivable that the details of Kirkland's conflicts, and particularly, the concurrent conflict, were material facts for stockholders that required disclosure. Kirkland's ongoing relationship with Brookfield raises the legitimate concern that Kirkland might not want to push Brookfield too hard given the nature of their ongoing lawyer-client relationship which includes the ethical duty of zealous advocacy.

Third, the plaintiffs argued that the proxy statement failed to adequately disclose how the special committee handled its advisors' conflicts of interests. The plaintiffs alleged that the special committee accepted the representations of Morgan Stanley and Kirkland that neither had a conflict of interest with representing the committee without proper follow-up, and that the proxy statement should have disclosed the committee's failure to dig deeper and take appropriate action with respect to such conflicts of interest. While the court was sympathetic to the plaintiffs' argument that, as alleged, the special committee's process in retaining advisors was flawed, the court held that Delaware's disclosure law does not require "self-flagellation." Furthermore, the court noted that on appeal the plaintiffs dropped their claims that TerraForm's board members violated their duty of care in connection with the merger, and the court had already held that Morgan Stanley and Kirkland's conflicts were inadequately disclosed, so no further ruling was needed on this particular allegation.

Fourth, the plaintiffs argued that the merger would lead to Brookfield earning $130 million from increased management fees payable by TerraForm to Brookfield. The plaintiffs argued that such an increase in management fees payable to Brookfield was inadequately disclosed in the proxy statement. The court agreed, holding that the proxy disclosures failed to set forth, with sufficient clarity, how Brookfield's management fees would be calculated post-closing. While Brookfield's fee structure and certain aspects thereof were disclosed, the court reasoned that in this instance, there was an absence of information for a stockholder to determine what the ultimate amount of fees assessed would be, and the proxy lacked certain variables that would enable a stockholder to adequately calculate the management fee assessed. The court did find certain disclosures adequate, including potential benefits that could inure

to the benefit of Brookfield as the result of potentially restructuring TerraForm's debt post-closing. The proxy statement disclosed that Brookfield could receive significant expense savings by refinancing TerraForm's debt. The plaintiffs argued that the proxy statement should have been more specific and disclosed that Brookfield could save $1 billion on interest expenses by refinancing. The court rejected this argument, holding that the $1 billion amount was speculative and dependent on several variables outside the parties' control, and therefore the exact amount of potential interest savings was not a material fact required to be disclosed.

However, because the Delaware Supreme Court held that certain conflicts and management fees were inadequately disclosed or omitted from the proxy statement, the court held that the stockholder vote was not fully informed such that *MFW's* protections were unavailable to the defendants and reversed the Court of Chancery's dismissal of the complaint.

City of Sarasota Firefighters' Pension Fund v. Inovalon Holdings, Inc.: Clarifying the Breadth of Disclosures Required Regarding Financial Advisors' Conflicts

In *City of Sarasota Firefighters' Pension Fund v. Inovalon Holdings, Inc.*, 319 A.3d 271 (Del. 2024), the Delaware Supreme Court considered the degree to which facts pertinent to financial advisors' alleged conflicts of interest must be disclosed in order for a disinterested stockholder vote to benefit from the effects set forth in *Kahn v. M&F Worldwide Corp*. In *Inovalon,* the Supreme Court emphasized the importance of making sufficient disclosures in a company's proxy statement to ensure that the stockholder vote to approve the transaction is fully informed.

Inovalon was a provider of cloud-based healthcare platforms. During 2021, Inovalon and its board of directors launched a process to evaluate strategic alternatives and retained J.P. Morgan as its financial advisor to conduct outreach to potentially interested parties. The transaction ultimately challenged was a take-private of Inovalon by a third-party private equity consortium led by Nordic Capital. In its initial outreach letter, Nordic recognized that it may, in the future, ask that certain members of management (who at the time collectively controlled approximately 86% of Inovalon's outstanding voting power) roll over some or all of their equity into the post-transaction entity. Nordic's outreach letter stated that were such a rollover to occur, the transaction would be conditioned on approval by the dual *MFW* protections: approval by a special committee and by disinterested stockholders.

A special committee was formed to evaluate strategic alternatives, including Nordic's offer. The special committee retained Evercore as its independent financial advisor. Ultimately, the special committee approved the transaction, which was also approved by a majority of Inovalon's disinterested shareholders. An Inovalon stockholder filed suit in the Court of Chancery, challenging the transaction as a breach of fiduciary duty. The defendants moved to dismiss. The Court of Chancery granted the defendants' motion and, in so doing, found that the disclosures in the proxy statement regarding the transaction were adequate and, accordingly, that the Inovalon defendants had successfully followed the *MFW* roadmap such that the business judgment rule applied to the court's review of the transaction. The plaintiff appealed.

In the appeal, the plaintiff claimed that the stockholder vote was not fully informed and focused on three alleged disclosure defects: (i) the disclosure regarding equity incentive plan payouts for Inovalon's management team, (ii) the disclosure of the financial advisors' concurrent and prior representations, and (iii) the disclosure of the financial advisor's outreach to potential bidders. The Supreme Court found the equity incentive disclosures sufficient, declined to rule on the outreach to bidders, and focused its decision on the sufficiency of disclosures concerning advisors' financial incentives.

The Supreme Court ultimately held that the proxy statement contained three categories of material misstatements or omissions:

- First, the court held that the proxy statement failed to adequately disclose Evercore's concurrent conflicts. While the proxy statement indicated that Evercore "may provide" advisory and other services to buy- and sell-side entities in the future, the plaintiff had alleged that Evercore in fact represented both Nordic and another consortium member in unrelated transactions. Thus, the court reasoned, use of the word "may" was misleading.

- Second, the court held that the proxy statement failed to adequately disclose J.P. Morgan's concurrent conflicts. It reasoned that the proxy statement failed to disclose that (per the plaintiff's allegations) J.P. Morgan represented both Nordic and another buy-side consortium member on several contemporaneous transactions, including Nordic's sale of a ~$3 billion asset.

- Third, the court held that the proxy statement failed to adequately disclose J.P. Morgan's past representations.

> The plaintiff alleged that J.P. Morgan had earned some $400 million in fees from consortium members during the prior two years, whereas the proxy statement disclosed $15.2 million in fees from Nordic during that time.

While the Supreme Court did acknowledge that there is "no hard and fast rule that requires financial advisors to always disclose the specific amount of their fees from a counter party," in the fact-specific context of Inovalon, the court found that the disclosures made were inadequate.

"Partial disclosure, in which some material facts are not disclosed or are presented in an ambiguous, incomplete, or misleading manner, is not sufficient to meet a fiduciary's disclosure obligations."

In reaching this conclusion, the court noted that materiality is "assessed from the viewpoint of a 'reasonable' stockholder," not the subjective viewpoint of a director, and reasoned that the central role of financial advisors in advising the special committee would be significant to a stockholder in deciding how to vote. To make this point, the court pointed to its previous decisions to illustrate the significance of the disclosure regime:

> When a board chooses to disclose a course of events or to discuss a specific subject, it has long been understood that it cannot do so in a materially misleading way, by disclosing only part of the story, and leaving the reader with a distorted impression. Rather, disclosures must provide a balanced, truthful account of all matters they disclosed. And partial disclosure, in which some material facts are not disclosed or are presented in an ambiguous, incomplete, or misleading manner, is not sufficient to meet a fiduciary's disclosure obligations.

Having determined that the stockholder vote was not fully informed, the Supreme Court concluded that *MFW* would not operate to restore application of the business judgment rule to the challenged transaction. It accordingly reversed the Court of Chancery's dismissal of the action and remanded for further proceedings.

Stockholders Agreements

West Palm Beach Firefighters' Pension Fund v. Moelis & Company: Consent Rights in Stockholder Agreement Held Facially Invalid

In *West Palm Beach Firefighters' Pension Fund v. Moelis & Company*, 311 A.3d 809 (Del. Ch. 2024), the Court of Chancery held that provisions in a stockholder agreement giving Ken Moelis, the founder and largest stockholder of Moelis & Company, certain consent and board composition rights violated Section 141(a) of the DGCL and were facially invalid.

Moelis & Company is an investment bank that, in connection with its 2014 IPO, entered into a stockholder agreement with founder Ken Moelis and his affiliates. Rather than governing how stockholder-signatories voted or exercised rights attendant to the shares, the stockholder agreement purported to impose obligations and restrictions on the company itself.

The stockholder agreement required Mr. Moelis to consent to 18 categories of corporate acts (the "Pre-Approval Requirements") before Moelis's board of directors could take them. The court stated that the Pre-Approval Requirements required "[Mr. Moelis's] signoff in advance for virtually any action the directors might want to take," including hiring and firing key officers; amending the governing documents or any material contract; issuing debt or equity above certain thresholds; adopting a stockholder rights plan, annual budget, or business plan; entering into new lines of business; initiating or settling material litigation; paying dividends; and entering into fundamental transactions like mergers, consolidations, recapitalizations, sales of all or substantially all of the assets, liquidation, and dissolution. The stockholder agreement also contained seven "Board Composition Provisions" (together with the Pre-Approval Requirements, the "Challenged Provisions"), governing the board's size, Mr. Moelis's right to designate and nominate directors, the company's obligation to use reasonable efforts to see that Mr. Moelis's designees were elected, and Mr. Moelis's rights concerning vacancies and the composition of board committees.

A Moelis stockholder sued to invalidate the stockholder agreement on grounds that the Challenged Provisions violated the DGCL by violating Section 141(a), which charges the board of directors (not stockholders) with managing the corporation's business and affairs unless the certificate of incorporation otherwise provides. The parties cross-moved for summary judgment. In an initial, separate opinion, the court held that neither laches nor acquiescence applied because acts that are void by virtue of violating the DGCL are not subject to equitable defenses. The court further reasoned that neither laches nor ripeness applied because the Section 141(a) violation was a "continuing" wrong rather than a discrete one for which claims accrued in 2014 when the stockholder agreement was originally entered into.

The merits opinion in *Moelis* found most of the Challenged Provisions facially invalid, which occurs if a provision cannot "operate lawfully in the face of Section 141(a) under any circumstances." In so holding, the court fashioned a novel test for Section 141(a) violations in which the court must first assess whether a given provision is part of an "internal governance arrangement" and next, if so, whether the provision violates Section 141(a).

The first prong asks "whether the challenged provision constitutes part of the corporation's internal governance arrangement" rather than an "external commercial agreement." If the agreement is not an internal governance agreement, the inquiry ends and the Section 141(a) challenge fails, but if it is an internal governance agreement, the court must assess whether the challenged provision removes "in a very substantial way" the directors' "duty to use their own best judgment on management matters" or "freedom ... on matters of management policy." By creating this test, the court declined to eliminate Section 141(a) review for corporate contracts, as had been proposed in prior cases.

Applying the new test, the court invalidated most of the Challenged Provisions. First, the court concluded that they were "prototypical governance provisions in a prototypical governance agreement." In particular, the court noted that the stockholder agreement was grounded in Section 218 of the DGCL, that all counterparties were intra-corporate actors, and that the Challenged Provisions constrained board action, featured no

underlying commercial bargain, could not be terminated by the company, and would likely support an injunction remedy rather than money damages in the event the parties to the contract violated the Challenged Provisions.

"When market practice meets a statute, the statute prevails. Of course, the General Assembly could enact a provision stating what stockholder agreements can do. Unless and until it does, the statute controls."

Analysis of the second prong comprised two parts. First, the court held that all Pre-Approval Requirements in the aggregate violated Section 141(a) by restricting the board's ability to manage the company. In so holding, the court reasoned that the provisions are dormant where the board and Mr. Moelis agreed on given decisions such that mutual agreement is not a basis to validate them. Relatedly, the court reasoned that the board could not operate freely while the provisions were in force because knowledge of the Mr. Moelis's blocking right would affect decision making on the front end.

Second, the court analyzed the Board Composition Provisions one by one. It ultimately concluded that provisions concerning the board's recommendations, vacancies, board size, and committee composition were invalid because each prevented the board from controlling key management matters. However, the provisions governing designations, nominations, and the company's reasonable efforts did not violate Section 141(a) because they at most required the board to take ministerial steps that fell short of a core managerial prerogative.

In invalidating most Challenged Provisions over the defendants' objection that doing so would invalidate many outstanding agreements, the court observed that "market practice is not law." The court further stated that, "[w]hen market practice meets a statute, the statute prevails.... Of course, the General Assembly could enact a provision stating what stockholder agreements can do. Unless and until it does, the statute controls." The Delaware General Assembly ultimately accepted that invitation by adopting new Section 122(18) of the DGCL, which legislatively overturned the new *Moelis* test and confirmed that consent rights of the sort invalidated in *Moelis* do not violate Section 141(a). However, Section 122(18) did not disturb the Court of Chancery's holding with respect to the stockholder agreement, and the defendants in *Moelis* have appealed the decision to the Delaware Supreme Court.

Wagner v. BRP Grp., Inc.: Court of Chancery Invalidates Stockholders Agreement Provisions Under Both the *Moelis* Test and DGCL

In *Wagner v. BRP Grp., Inc.*, 316 A.3d 826 (Del. Ch. 2024), the Delaware Court of Chancery applied not only the two-part test established in *West Palm Beach Firefighters' Pension Fund v. Moelis & Co*. to determine whether contractual provisions violate Section 141(a) of the DGCL, but also other DGCL provisions, to invalidate certain pre-approval rights in a stockholders agreement between the company and its founder. The court held that while a post-litigation consent agreement cured the Section 141(a) defects, certain provisions of the stockholders agreement still violated Sections 142 and 242 of the DGCL.

In connection with the IPO of BRP Group, Inc., Lowry Baldwin entered into a stockholders agreement with the company

that provided, among other things, that so long as Baldwin and his affiliates beneficially owned at least 10% of the outstanding shares, the company was required to obtain Baldwin's prior written approval before the company's board of directors was permitted to take certain actions.

A BRP stockholder challenged the facial validity of three provisions in the stockholders agreement, each of which required the company to obtain Baldwin's written approval before the company board was permitted to (i) hire, terminate, or make any other significant decision regarding any senior officer of the company; (ii) amend the company's certificate of incorporation; and (iii) agree to or otherwise consummate a significant transaction involving the company. In response to the litigation, the company and Baldwin entered into a consent agreement whereby Baldwin committed to approve any matter requiring consent under the stockholders agreement if a committee of the company's independent directors unanimously determined in good faith that the matter was in the best interests of the company and its stockholders. The parties cross-moved for judgment on the pleadings.

First, the court rejected the defendants' equitable defenses. The defendants argued that the plaintiff's years-long delay in suing supported a laches defense and further asserted that the plaintiff had acquiesced to the provisions it challenged because it purchased shares after those provisions were adopted and made public in connection with BRP's IPO. The court held that neither defense applied because equitable defenses cannot cure provisions that are void by virtue of violating the DGCL. The court further reasoned that the same arguments had been litigated and lost in *Moelis*.

The court then addressed the company's contention that the consent agreement mooted the plaintiff's claims because Baldwin effectively agreed to waive his rights under the challenged provisions if the matter was unanimously approved by a committee of the company's independent directors. The court disagreed and held that because the consent agreement merely modified the circumstances under which Baldwin could exercise his pre-approval rights without eliminating his right to invoke them, the plaintiff's claims were not moot.

Next, the court analyzed the plaintiff's Section 141(a) challenges under the two-prong test set forth in *Moelis*. First, the court held that the challenged provisions were part of an internal governance arrangement under *Moelis*'s first prong. In particular, the court reasoned that (i) the stockholders agreement is grounded in the DGCL (in particular, Section 218); (ii) the parties to the stockholders agreement consisted of intra-corporate actors (as opposed to service providers, customers, or other commercial parties); (iii) Baldwin's pre-approval rights sought to constrain how the board could exercise its corporate power; (iv) the challenged provisions resembled provisions that would appear in the DGCL or typically would need to be in the charter or bylaws of a Delaware corporation; (v) there was no underlying commercial exchange; (vi) the company was not permitted to unilaterally terminate the stockholders agreement; and (vii) the presumptive remedy for breaching the stockholders agreement was likely to be equitable relief (as opposed to money damages).

Under the second prong, the court assessed whether the challenged provisions improperly restricted the board's ability to manage the company's business and affairs in violation of Section 141(a) of the DGCL. The court began its analysis by concluding that because the officer pre-approval requirement limited the board's authority over the core management matter of hiring, firing, and making any other significant decision regarding senior officers, it violated Section 141(a). In so holding, the court rejected the company's argument that the provision principally empowered the board to make such decisions subject to Baldwin's veto. Instead, the court found that because the provision required Baldwin's *prior* written approval, it gave Baldwin effective control because "the power to review is the power to decide."

Because the charter pre-approval requirement purported to effectively flip the two-step statutory sequence—of board followed by stockholder approval—required to effect charter amendments, it violated Section 242 of the DGCL as well.

The court also rejected the company's arguments that the *board* remained free to exercise its decision-making authority because the nominal party to the stockholders agreement was the *company*. It reasoned that Baldwin could likely obtain equitable relief enforcing his rights if the company violated the challenged provisions. The court also emphasized that neither the severability provision in the stockholders agreement nor directors' fiduciary duties gave the board a basis to avoid compliance with the challenged provisions. The court further highlighted (i) the company's likely inability to invoke the implied covenant of good faith

and fair dealing to prevent Baldwin from exercising his contractual rights, and (ii) the fact that Baldwin's own fiduciary duties as a controlling stockholder would not limit his ability to exercise his contractual rights. Thus, the court held that the officer pre-approval requirement violated Section 141(a).

The court also held that the officer pre-approval requirement violated Sections 142(b) and (e) of the DGCL. The court explained that these statutes require the charter or bylaws to dictate decisions regarding the hiring and firing of officers such that stockholders agreement provisions purporting to do so are void.

Next, the court addressed the plaintiff's challenges to the charter pre-approval requirement. Having previously determined that the stockholders agreement was an internal governance arrangement, the court's Section 141(a) inquiry focused on the prong-two inquiry of the extent to which the provision limited directors' managerial authority. The court observed that Section 242 of the DGCL empowers solely the board to initiate the charter amendment process and held that the charter pre-approval requirement violated Section 141(a) by purporting to give a stockholder that managerial authority. The court also held that because the provision purported to effectively flip the two-step statutory sequence—of board followed by stockholder approval—required to effect charter amendments, it violated Section 242 of the DGCL as well.

The court further held that the transaction pre-approval requirement violated Section 141(a) by improperly restricting the board's ability to make decisions with respect to a broad range of transactions involving the company.

However, the court then concluded that the consent agreement effectively mitigated all foregoing Section 141(a) defects by empowering the board to exercise its statutory authority for all managerial decisions affected by the challenged provisions. It further held, however, that the consent agreement only addressed Section 141(a) issues, not other statutory violations, such that the officer pre-approval requirement and charter pre-approval requirement remained void for violating Sections 142 and 242, respectively. As a result, the plaintiff's motion for judgment on the pleadings was granted in part and denied in part.

Seavitt v. N-Able, Inc.: Court of Chancery Finds Limitations on Ability to Incorporate by Reference Substantive Provisions of Outside Contracts into Corporate Charter

In *Seavitt v. N-Able, Inc.,* 321 A.3d 516 (Del. Ch. 2024), the Delaware Court of Chancery held that a charter cannot incorporate provisions of a private contract by reference before holding that many provisions in a stockholders agreement were facially invalid under Section 141(a) of the DGCL—a decision largely paralleling results in two other recent cases: *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.* and *Wagner v. BRP Group*.

In July 2021, SolarWinds Corporation spun off its wholly owned subsidiary, N-able, Inc. In anticipation of the spinoff, SolarWinds' controlling stockholders (the "Lead Investors") entered into a stockholders agreement that granted the Lead Investors various governance rights, including provisions (i) requiring N-able to seek the prior approval of the Lead Investors before N-able or any of its subsidiaries could take a wide range of board-level actions (the "Pre-Approval

Requirements"), (ii) entitling the Lead Investors to control the size and composition of the N-able board of directors (the "Board Composition Covenants"), (iii) ensuring that the Lead Investors have representation on committees of the N-able board (the "Committee Composition Provisions"), and (iv) granting the Lead Investors the power to remove directors from N-able's classified board without cause (the "Removal Provision"). The plaintiff, a stockholder of N-able, challenged the facial validity of these provisions under Section 141(a) of the DGCL. The parties cross-moved for summary judgment.

The court began its analysis by clarifying that the first step in analyzing a Section 141(a) challenge is to determine whether the challenged provisions constitute part of the corporation's internal governance arrangement. The court determined that the seven factors set forth in *Moelis* suggested that the stockholders agreement at issue was an internal governance arrangement. In particular, the court reasoned that (i) stockholders agreements are grounded in the DGCL and the challenged provisions appeared in the Leading Investors' stockholders agreement; (ii) the stockholders agreement involved intra-corporate actors and was effectively a bilateral agreement between the Lead Investors and N-able; (iii) the challenged provisions sought to direct how the N-able board could exercise its corporate power; (iv) there was no underlying bargain that caused N-able to grant the Lead Investors their respective rights under the stockholders agreement; (v) the N-able board was not permitted to unilaterally terminate the stockholders agreement; (vi) the remedy for breach was specific performance (as opposed to damages tied to the commercial bargain); and (vii) the stockholders agreement

contained a variety of governance provisions that typically would need to appear in the certificate of incorporation or bylaws of a Delaware corporation. As a result, the court found that the Lead Investors' stockholders agreement was a part of N-able's entity-specific governance arrangement and moved to the second prong of the *Moelis* test.

That second prong directs the court to assess whether the stockholders agreement had "the effect of removing from [the] directors in a very substantial way their duty to use their own best judgment on management matters" or "tend[ed] to limit in a substantial way the freedom of director[s'] decisions on matters of management policy." In this regard, the court first addressed the plaintiff's challenges to the Pre-Approval Requirements individually, which, among other things, required N-able to obtain prior written approval from the Lead Investors before it could approve a change of control transaction, dissolve, approve certain transactions over $150 million, fire or hire a new chief executive officer of N-able, or change of the size of the N-able board. The court found that, from a practical perspective, the individual Pre-Approval Requirements operated as "direct, board-level restrictions" on the N-able directors' ability to discharge their board-level authority. Accordingly, the court held that each of the individual Pre-Approval Requirements were facially invalid under Section 141(a).

The court next addressed the plaintiff's challenge to the Pre-Approval Requirements collectively. The court observed that, in the aggregate, the Pre-Approval Requirements effectively gave the Lead Investors decision-making authority because the board knew *ex ante* that major decisions would require their approval (much like the board effectively controls officer decisions through the same dynamic). Therefore, the court held that the Pre-Approval Requirements, in their totality, were facially invalid under Section 141(a). In reaching this determination, the court rejected the defendants' counterarguments that (i) the Pre-Approval Requirements were merely "consent rights" that did not constrain the N-able board because they did "not compel the [N-able board] to take any particular action" and were "structured in such a way that board members are not restricted from discharging their fiduciary duties," and (ii) the Pre-Approval Requirements could operate lawfully where the Lead Investors declined to exercise them. The court reasoned that these arguments had been litigated and lost in *Moelis* and *Wagner*.

The court addressed, as a matter of first impression, whether a charter can incorporate substantive governance provisions of an outside contract by reference. The court held that it cannot.

The court then turned to the plaintiff's facial challenges to the Board Composition Covenants, which, among other things, provided the Lead Investors with nomination and veto rights for nominees for election as directors to the N-able board and obligated N-able to use reasonable best efforts to secure the election of the Lead Investors' nominees. However, because corresponding board composition provisions in N-able's certificate of incorporation and bylaws provided that such provisions were "subject to" the Lead Investors' rights in the stockholders agreement (including certain of the Board Composition Covenants), the court addressed, as a matter of first impression, whether a charter can incorporate substantive governance provisions of an outside contract by reference. The court held that it cannot for two reasons.

First, the court clarified that Section 102(d) of the DGCL "distinguishes between 'facts' external to the charter and 'provisions' internal to the charter," and found that because the DGCL does not contemplate that a charter could include "provisions ascertainable" outside the charter, the DGCL forecloses incorporating substantive provisions by reference. Second, the court invoked various policy reasons demonstrating the potential dangers of permitting incorporation by reference. In this regard, the court observed that incorporating provisions by reference from a private agreement inhibits Delaware public policy in favor of providing public access to all provisions of the certificates of incorporation (particularly for private companies not subject to SEC rules requiring public disclosure of governing documents), disrupts the "certainty and stability of the corporation's foundational firm-specific document," and permits the contracting parties to amend the charter by amending the stockholders agreement, thereby circumventing the amendment process required under Section 242 of the DGCL. The court also emphasized the General Assembly's inability to delegate its legislative powers. For these reasons, the court held that a charter cannot incorporate substantive provisions in a private agreement by reference.

After rejecting the incorporation by reference construct, and for largely the same reasons cited in *Moelis* and *Wagner*, the court held that many of the Board Composition Covenants were facially invalid under Section 141(a) of the DGCL, the Committee Composition Provisions were facially invalid under Sections 141(a) and 141(c)(2) of the DGCL, and the Removal Provision was facially invalid under Section 141(k) of the DGCL. In doing so, the court rejected the defendants' argument that the dangers of private agreements in the corporate governance context should be mitigated by the fact that stockholders agreements would be publicly filed as material agreements or available through Section 220 demands, explaining that private companies are not required to disclose governance agreements and, in any event, "publicizing a statutory violation does not cure a statutory violation."

As a result, the plaintiff's motion was granted with respect to the facial invalidity of the Pre-Approval Requirements, many of the Board Composition Covenants, the Committee Composition Provisions, and the Removal Provision.

Statutory Interpretation

In re Fox Corp./Snap Inc. Section 242 Litigation: Supreme Court Finds Separate Class Votes Not Required to Implement Officer Exculpation in Companies with Multi-Class Capital Structures

In re Fox Corp./Snap Inc. Section 242 Litigation, 312 A.3d 636 (Del. 2024), the Delaware Supreme Court addressed whether Fox Corporation and Snap Inc., each of which had multi-class capital structures, had to secure individual class votes when amending their respective certificates of incorporation to add officer exculpation provisions. The court ultimately held that they did not.

As part of a 2019 spin-off, Fox became a standalone, publicly traded company with a dual-class stock structure. Fox's Class A stockholders had no voting rights, but Fox's Class B stockholders were entitled to

one vote per share. At Fox's 2022 annual meeting, the company's board of directors recommended a charter amendment providing that officers would be exculpated from monetary liability for breaches of the fiduciary duty of care under DGCL Section 102(b)(7). Fox's Class B stockholders voted to approve the amendment. Fox did not solicit a vote from its Class A stockholders.

Snap Inc. featured a three-class stock structure since its IPO in March 2017. Under the terms of Snap's certificate of incorporation, Snap's Class A stockholders had no power to vote, Snap's Class B stockholders were entitled to one vote per share, and Snap's Class C stockholders were entitled to ten votes per share. Snap's board, like Fox's, recommended a charter amendment contemplating officer exculpation. Snap's Class C stockholders executed a written consent in favor of the amendment. Snap did not solicit a vote from its Class A stockholders, which was Snap's only class of outstanding publicly traded shares.

In November 2022, Class A stockholders of Fox and Snap filed class action complaints in the Court of Chancery against each company seeking, among other things, a declaration that each company's respective charter amendment violated Section 242(b)(2) of the DGCL. The cases were consolidated into a single civil action in which the parties cross-moved for summary judgment. The Court of Chancery entered summary judgment for the defendants. The plaintiffs appealed.

The plaintiffs principally argued that the exculpation amendment triggered Section 242(b)(2)'s requirement to obtain a separate class vote of any class whose "powers, preferences, or special rights" would be adversely affected by the proposed charter amendment. According to the plaintiffs, the word "powers" in Section 242(b)(2) included the right to sue, which was "adversely" affected by the officer exculpation amendment by limiting the remedies stockholders could pursue for breaches of fiduciary duty. The plaintiffs further maintained that stockholders have three fundamental "powers," which are to vote, sell, and sue.

The Delaware Supreme Court rejected these arguments and held that Section 242(b)(2) did not require a class vote. It began its analysis by reasoning that Sections 102(a)(4), 151(a), and 242(b)(2) of the DGCL—each of which refers in some manner to the "rights," "powers," and "preferences" of shares—form an interconnected statutory framework such that the rights, powers, and preferences of a given class of stock must refer to the same set of attributes in all three statutes. Thus, Sections 102(a)(4) and 151(a) of the DGCL provide that the rights, powers, and preferences of a given class or series of stock must be set forth in the certificate of incorporation, and Section 242(b)(2) provides that amendments that adversely affect *those same rights, powers, and preferences* require a separate vote by the adversely affected class.

The Supreme Court next reasoned that this reading was supported by two "seminal precedents": *Hartford Acc. & Indem. Co. v. W. S. Dickey Clay Mfg. Co.* and *Orban v. Field*. In *Dickey Clay,* the Supreme Court held that a charter amendment increasing the authorized shares of one class but not another was not an "adverse" effect triggering a class vote because it did not impact the "peculiar" or "special" qualities distinguishing one class from another. Likewise, in *Orban,* the Court of Chancery

held that creating a new class of preferred stock did not trigger a class vote under the prior rule established in *Dickey Clay*. The *Fox/Snap* court reasoned that the "peculiar" or "special" qualities referred to in these precedents were the rights, powers, and preferences referenced in Sections 102(a)(4), 151(a), and 242(b)(2) of the DGCL.

The right to sue is nowhere set forth in the DGCL. Instead, the right to sue is a default "attribute" of the shares rather than a "right," "power," or "preference."

Pulling these two strands of statutory and common law authority together, the Supreme Court held that the "powers," "preferences," and "rights" of a class of stock under Section 242(b)(2) refers to those qualities of the shares that are either (i) expressed in the certificate of incorporation as directed by Sections 102(a)(4) and 151(a) of the DGCL, or (ii) set forth in the default provisions of the DGCL, which are read into every charter by operation of Section 394 of the DGCL.

The Supreme Court then concluded that the right to sue fell into neither of those two categories: neither Fox nor Snap's charters expressly entitled the Class A stockholders to sue for breach of fiduciary duty. And the right to sue is nowhere set forth in the DGCL. Instead, the right to sue is a default "attribute" of the shares rather than a "right," "power," or "preference." Accordingly, the Supreme Court held, amendments that adversely affected one class's right to sue did not trigger a class vote under Section 242(b)(2).

The Supreme Court spent the remainder of the opinion dispensing with the plaintiffs' counterarguments. In particular, the court rejected the argument that because the word "power" was used in Sections 122, 123, 279, and 291 of the DGCL to refer to the right to sue or bring a petition in the Court of Chancery, the word "power" in reference to the rights, powers, and preferences of capital stock must also include the right to sue. The Supreme Court reasoned that the foregoing discrepancy in usage merely showed that the meaning of the word "power" as used in the DGCL varies depending on the context in which it is used. The court further noted that whereas Sections 122, 123, 279, and 291 of the DGCL clearly specified that "power" includes the right to sue, Sections 102(a)(4), 151(a), and 242(b)(2) of the DGCL do not, which suggests that a different meaning may have been intended in the latter three statutes.

Finally, the Supreme Court observed that history and practitioner understanding supported its result because when Section 102(b)(7) of the DGCL was enacted, corporations adopting it generally did not seek class votes.

Accordingly, the Supreme Court held that no class votes were required for either company and affirmed the result below.

Sjunde AP-fonden v. Activision Blizzard, Inc.: Court of Chancery Finds Plaintiff Adequately Alleged a Multibillion-Dollar Merger was Invalid under Section 251

In Sjunde AP-fonden v. Activision Blizzard, Inc., 2024 WL 863290 (Del. Ch. Feb. 29, 2024 *corrected* Mar. 19, 2024), the Court of Chancery refused to dismiss most claims alleging that the $69 billion merger between Microsoft Corporation and Activision Blizzard, Inc. was not duly approved and

adopted in accordance with various provisions of the DGCL.

Microsoft Corporation was one of Activision's largest customers for over two decades, and in 2021, Microsoft approached Activision about a potential strategic combination. On January 17, 2022, the board of directors of Activision met to approve a merger of the two parties and received a then-current draft of the merger agreement prior to the meeting.

The merger agreement reviewed by the Activision board did not include: (i) a company disclosure letter, (ii) disclosure schedules, (iii) the surviving corporation's charter, (iv) the name of Activision as the target in the merger (the merger agreement used "[Denali]" instead), (v) the amount of consideration (the merger agreement used "[●]" instead), and (vi) a provision addressing whether the Activision board could declare dividends between signing and closing, which the Activision board instead delegated to an ad hoc committee of the board.

The Activision board did not review or approve any version of the merger agreement after the January 17, 2022 meeting. Despite this, the parties executed the final version of the merger agreement the following day. Shortly thereafter, Activision filed a proxy statement seeking stockholder approval and attached the merger agreement to such proxy, but the attached merger agreement did not contain the disclosure letter, the disclosure schedules, or the surviving corporation's charter.

Activision's stockholders subsequently approved the merger, but because anti-trust issues delayed closing, the parties entered into a letter agreement that extended the closing period to October 2023 and permitted Activision to pay another dividend.

The merger closed on October 13, 2023. The plaintiff, a former Activision stockholder, filed suit against the board of directors of Activision, Microsoft, the board of directors of Microsoft, and the merger subsidiary alleging violations of DGCL Sections 251(b), 251(c), 251(d), and 141. The plaintiff also alleged that its shares were unlawfully converted due to statutory violations. The defendants moved to dismiss these claims.

The plaintiff alleged that for a merger agreement to be duly approved under Section 251(b), it needs to be an execution version and include all final key terms and provisions. The defendants responded that "'while Section 251(b) identifies the information that must be in the agreement,' it does not require that such information be included in the version approved by board resolutions." The court assumed, without deciding, that a board does not need to approve an execution version of the merger agreement. However, the court then held that at a minimum, Section 251(b) requires a board to approve an "essentially complete version of the merger agreement." Because the merger agreement approved by the Activision board failed to include key terms such as the consideration, target company name, disclosure schedules, and disclosure letter, the court held that it was reasonably conceivable that the merger agreement approved by the Activision board was not "essentially complete." Therefore, the court denied the motion to dismiss the plaintiff's Section 251(b) claim.

For the Section 251(c) claim, the plaintiff alleged that the notice of the Activision stockholder meeting did not contain a copy of the merger agreement required by Section 251(b) or a brief summary of the merger agreement, and therefore Activision violated Section 251(c).

The court held that Section 251(c) requires that a notice of a stockholder meeting being held for the purpose of acting on a merger agreement contain either (i) the merger agreement for consideration by the stockholders, or (ii) a brief summary thereof. The court held that the merger agreement attached to the notice did not satisfy the requirements of Section 251(b) because it did not include the surviving corporation's charter, and as a result Section 251(c)'s requirement that a copy of the merger agreement be attached to the notice could not have been satisfied. The court also held that the summary of the merger agreement in the proxy statement did not satisfy the other option under Section 251(c) of providing a summary of the merger agreement because the proxy statement is not the notice of the stockholder meeting. The court suggested that Section 251 could be amended such that a summary of a merger agreement contained in a proxy could be sufficient, but that was not the current law. Therefore, the court refused to dismiss the plaintiff's Section 251(c) claim.

The court held that at a minimum, Section 251(b) requires a board to approve an "essentially complete version of the merger agreement."

The plaintiff alleged that the defendants violated Section 251(d), "which prohibits any amendment of any term or condition of the agreement if that alteration or change has an adverse effect on a class of stockholders, by agreeing to extend the termination date in the Merger Agreement without stockholder approval." The plaintiff made this claim, however, in January 2023, prior to the Activision board extending the merger agreement end date. Even after the extension of the merger agreement end date, however, the plaintiff did not amend its complaint. Therefore, the court held that the plaintiff's allegations as of January 2023 pled no facts to support the claim that the defendants, in fact, agreed to extend the end date. While the court held that the plaintiff could have amended its complaint, the plaintiff failed to do so. Therefore, the court dismissed the Section 251(d) claim.

In addition to the alleged violations of the merger statute provisions, the plaintiff alleged that the defendants violated Section 141(c) by delegating negotiations over the dividend provision to an ad hoc board committee. According to the court, Section 251(b) imposes a statutory duty on the board of directors to approve the terms of a merger agreement, and therefore the board of directors cannot delegate that duty to a committee unless Section 141(c) permits it to do so.

Section 141(c) does not permit a board of directors to delegate to a committee the power to approve an agreement of merger or its terms. Given that the dividend provision was a term of the merger agreement, the court held that the Activision board could not delegate the ability to negotiate such term to an ad hoc committee. Further, because the Activision board allegedly did not approve the dividend provision, the court inferred that the ad hoc committee approved the dividend provision, again in violation of Section 141(c). Therefore, the court refused to dismiss the plaintiff's Section 141(c) claim.

The plaintiff also alleged that the statutory violations resulted in the unlawful conversion of the plaintiff's shares. Because the plaintiff successfully alleged that the defendants violated Section 251 and converted the

plaintiff's stock in the merger, the court held that the complaint adequately pled that the defendants committed the tort of conversion. Therefore, the court refused to dismiss the conversion claim.

The court did note that Section 204 and Section 205 of the DGCL, which relate to the ratification of defective corporate acts, provide "solutions for missteps." The defendants subsequently applied for validation of the merger agreement under Section 205, which the court granted.

The 2024 amendments to the DGCL also addressed several of the technical issues presented in this case. New Section 147 was added to provide, among other things, that where the DGCL requires the board of directors to approve an agreement, document, or other instrument, the board may approve the document in final form or substantially final form. Section 232 was amended to provide that any materials included with, or appended to, a notice to stockholders are deemed to be part of the notice for purposes of compliance with the DGCL's notice procedures. New Section 268(a) was added to provide limited circumstances under which the certificate of incorporation of the surviving corporation need not be attached to the merger agreement or approved by stockholders—principally in a typical reverse triangular merger where all of the target's stockholders are cashed out in the merger. Lastly, new Section 268(b) was added to provide that, unless otherwise expressly provided in the merger agreement, disclosure letters, disclosure schedules, and similar documents are not deemed part of the merger agreement (and thus need not be submitted to or approved by the board or stockholders as a statutory matter) but have the effects provided in the agreement.

Gunderson v. Trade Desk, Inc.: Court of Chancery Holds Charter-Based Supermajority Voting Standard Inapplicable to Charter Amendment Enacted via Statutory Conversion

In *Gunderson v. Trade Desk, Inc.*, 2024 WL 4692207 (Del. Ch. Nov. 6, 2024 *corrected* Nov. 8, 2024), the Delaware Court of Chancery held that a charter-based supermajority voting requirement for amendments to The Trade Desk, Inc.'s certificate of incorporation did not apply to a conversion under Section 266 of the DGCL.

The certificate of incorporation contained a supermajority voting requirement providing that "to amend or repeal, or adopt" certain enumerated provisions within the certificate, approval by holders of 66⅔% of the outstanding voting power was required. On September 20, 2024, Trade Desk's board of directors adopted resolutions to reincorporate as a Nevada corporation through a conversion conducted under Section 266 of the DGCL. On October 3, 2024, Trade Desk filed a notice of a special meeting of the stockholders of Trade Desk and, in the accompanying proxy statement, disclosed that the conversion required approval by the holders of a majority of the outstanding voting power.

The plaintiff sued Trade Desk seeking to enjoin the conversion on grounds that the supermajority requirement applied to the vote on the conversion because (as defendants later conceded) the conversion would result in the post-conversion entity having a certificate of incorporation with provisions different from those protected by the supermajority requirement. The parties cross-moved for summary judgment on a pure question of law: whether the supermajority requirement applied to the conversion. The Court of Chancery held that it did not and entered partial summary judgment for the defendants.

> **"Corporate drafters seeking to exalt substance over form, or otherwise displace the doctrine of independent legal significance and expand certificate language across sections of the DGCL, must do so with clear, express language."**

In reaching its decision, the court discussed a long line of Delaware cases bearing on the scope of charter-based enhanced voting requirements. The court explained that in the seminal case in this area, *Elliot Associates, L.P. v. Avatex Corp.*, the Delaware Supreme Court established the following general rule: where an enhanced voting standard applies to charter amendments and the provision specifies that the standard applies where the amendment is enacted "by merger, consolidation, or otherwise," the enhanced voting standard will apply to charter amendments enacted via statutory mergers; but if that language is absent, mergers effecting charter amendments will not trigger the enhanced voting standard. The court discussed over a half-dozen cases both preceding the *Avatex* rule and applying it in various contexts. It then reasoned that because the certificate of incorporation lacked the specific language required by *Avatex*—that is, it did not refer to amendments effected via conversions—the supermajority requirement did not apply.

The court then rejected several counter-arguments. First, the court reasoned in a footnote that the Nevada charter did not

"amend" or "alter" the Delaware charter under Section 104 of the DGCL, which defines the "certificate of incorporation" as including several instruments filed with the Delaware Secretary of State (including under Sections 151, 251, etc., of the DGCL) but not instruments filed in connection with statutory conversions. Thus, the Nevada charter was not an iteration of the Delaware charter and as such could not have amended or altered it.

Next, the court rejected the notion that the *Avatex* rule only applies to preferred stock protective provisions. It relied on the general rule that "high vote requirements" must generally be clear and unambiguous and reasoned that at least one prior case applied the *Avatex* rule to common stock protective provisions.

The court further rejected the plaintiff's arguments that the supermajority requirement's plain terms required a different result. The court reasoned that it must read the certificate of incorporation as a whole, a task that itself requires considering all provisions of the DGCL, which are read into every certificate of incorporation by operation of Section 394 of the DGCL. And because Section 242 of the DGCL contained language strongly resembling that of the supermajority requirement, the supermajority requirement should be read to apply to charter amendments enacted under Section 242—not to other statutory provisions. The court further observed that other certificate provisions specifically applied to mergers, consolidations, and other transactions, demonstrating that the drafters knew how to expressly reference specific transactions but chose not to in the supermajority requirement.

Second, the court further rejected the plaintiff's argument that the court should consider substance—that is, whether the transaction resulted in an amendment—over form. The court held that "formality play[s] a critical role in the interpretation of certificates and corporate law writ large," resulting in the "doctrine of independent legal significance [being] a bedrock of Delaware Corporate Law." It further reasoned that where corporate drafters labor under decades of case law establishing a specific rule (here, the *Avatex* line of cases) and decline to follow that precedent's legal directives, that fact is probative of the drafters' intent.

Finally, the court rejected the plaintiff's appeal to the doctrine of *contra proferentem*. The court held that the doctrine of *contra proferentem,* which is occasionally invoked to resolve ambiguities against the drafter, was inapplicable here because there was no ambiguity.

Ultimately, the court held that "corporate drafters seeking to exalt substance over form, or otherwise displace the doctrine of independent legal significance and expand certificate language across sections of the DGCL, must do so with clear, express language." It accordingly held that the supermajority requirement did not apply to the conversion and entered partial summary judgment for defendants.

Advance Notice Bylaws

Kellner v. AIM ImmunoTech Inc.: **Supreme Court Distinguishes Standards for Determining the Validity and Enforceability of Bylaw Provisions**

In *Kellner v. AIM ImmunoTech Inc.*, 320 A.3d 239 (Del. 2024), the Delaware Supreme Court affirmed in part and reversed in part the Court of Chancery's holding as to the invalidity of AIM ImmunoTech Inc.'s advance notice bylaws. Finding that the Court of Chancery erred in conflating the applicable standards for reviewing challenges to the validity and equitable enforceability of bylaws, the Supreme Court distinguished the two standards and applied each to establish that three of the four challenged provisions were facially valid but inequitable and unenforceable under the circumstances and one of the four challenged provisions was facially invalid.

For three years in a row, a group of stockholders of AIM attempted to nominate directors for election at AIM's annual meeting. The stockholders included two felons convicted of various crimes, including wire fraud and insider trading. After rejecting the stockholders' nominations in the first year for noncompliance with federal securities laws and in the second year for noncompliance with AIM's advance notice bylaws, the board amended its advance notice bylaws to create additional disclosure requirements for nominating stockholders. In the third year and third attempt to nominate directors for election at the annual meeting, the board again rejected the stockholders' nomination notice for failing to comply with the corporation's bylaws, including the newly adopted amendments.

In response, the stockholders filed suit against the corporation and its directors seeking a mandatory injunction requiring the company to put forth the stockholders' nominees and an order invalidating the amended advance notice bylaws in their entirety.

The Court of Chancery analyzed the stockholders' claims through the enhanced scrutiny standard of review, which required defendants to prove that (i) the board faced a threat to an important corporate interest, and (ii) the board's response was reasonable and proportionate in relation to the threat posed. Applying this standard, the Court of Chancery held that the defendants satisfied the first element because the board proved it faced a legitimate threat: the risk that stockholders could face potentially abusive and deceptive tactics in the upcoming director election. The board appropriately concluded that this threat existed following consideration of advice from counsel, the 2022 proxy contest campaign that itself featured deceptive nomination tactics, and the apparent likelihood that the 2023 contest was spurred by the same dissidents. However, the court found that the defendants failed to satisfy the second element because the board's response to that legitimate corporate objective—adopting the amended advance notice bylaws—was not reasonable and proportionate.

The court undertook a thorough review of six bylaw provisions, determining that four provisions unreasonably restricted stockholders' nomination rights or were

an otherwise disproportionate response and declaring those bylaw provisions invalid. The four bylaw provisions that the court invalidated were as follows:

- An "AAU" provision requiring disclosure of all agreements, arrangements, or understandings that a nominating stockholder or any "Stockholder Associated Person" had with any holder, nominee (or immediate family member, affiliate, or associate thereof), person acting in concert with any Stockholder Associated Person, holder, nominee (or immediate family member, affiliate, or associate thereof), or "other person or entity." "Stockholder Associated Person" was defined to include (at a high level) (i) persons acting in concert with the nominating holder, (ii) affiliates and associates of the nominating holder, and (iii) immediate family members of the nominating holder or its affiliates and associates. The court held that while this bylaw served the legitimate end of helping the board and stockholders learn the identity and motivations of nominees' proponents, it went "off the rails" by being vague and overbroad. The court observed that the "interplay of the various terms" "acting in concert," "Associate," "Affiliate," and "immediate family" within the Stockholder Associated Person definition "cause[d] them to multiply, forming an ill-defined web of disclosure requirements" that led to absurd results. However, the court declined to invalidate a term within the AAU provision requiring disclosure of all AAUs within the prior 24 months on grounds that it appropriately sought to thwart the same sort of gamesmanship that the dissidents had attempted during their 2022 campaign.

- A provision requiring disclosure of all AAUs between the proponent or a Stockholder Associated Person, on the one hand, and any stockholder nominee, on the other hand, "regarding consulting, investment advice, or a previous nomination for a publicly traded company within the last ten years." The court held that this bylaw was unreasonable because it suffered from the same vagueness and overbreadth flaws as the AAU provision and "impose[d] ambiguous requirements across a lengthy term."

- A provision requiring disclosure of all known supporters of the nomination. The court determined that this provision was unreasonable because its limitations were so ambiguous that the board could reject a good faith response on grounds that would be difficult to predict. The court noted, however, that limiting such a provision to known *financial* supporters would correct this shortcoming as per *Rosenbaum v. CytoDyn Inc.*

- An "ownership provision" requiring disclosure of the nominating stockholder's ownership of all stock and "beneficial, synthetic, derivative, and short positions" of the corporation, as well as those of all Stockholder Associated Persons, immediate family members, and persons acting in concert with a nominee. The court reasoned that although provisions requiring disclosure of synthetic equity positions are generally "perfectly legitimate" because they close loopholes created by federal securities laws, AIM's provision—which contained over 1,099 words and 13 subparts—was

"indecipherable" and "sprawl[ed] wildly beyond this purpose" by requiring, among other things, "disclosure of 'legal, economic, or financial' interests 'in any principal competitor'" of the corporation.

Two challenged bylaw provisions were deemed reasonable and proportionate to the threat. The first required disclosure of the dates of first contact among those involved in the nomination effort, which proved reasonable because it was easy to satisfy and furthered the legitimate end of enabling the board to make an informed recommendation to stockholders. The second required nominees to submit a completed questionnaire within five business days of the proponent's request for the questionnaire's form from the corporation. The court held that this was a "common" provision and rejected the dissidents' argument that the five-business-day period would enable the board to make unreasonable revisions, noting that those types of challenges would be better asserted as challenges to the board's enforcement of the bylaw.

Next, the court turned to the stockholders' claim that the board had wrongfully applied the advance notice bylaws to reject the stockholders' nominees. The court rejected this claim on grounds that the stockholder notice violated AIM's advance notice bylaws and the board's decision to enforce them was equitable. The court determined that the nomination notice violated, among other provisions, AIM's AAU bylaw because it falsely stated that before July 2023, no decision had been made for the stockholders' three nominees to work together to advance nominations, when in fact the effort had begun long before then. And the court found the board's enforcement of the bylaw equitable given, among other factors, the board's diligent evaluation of the issue with assistance from counsel in order to promote

the legitimate ends of evaluating nominees and enabling stockholders to cast informed votes. The court also cited the dissidents' history of deploying deceptive tactics to shield nominees' true proponents as supporting this result.

On appeal, the Supreme Court explained that the Court of Chancery conflated the "validity" and "enforceability" challenges. The Supreme Court explained that the Court of Chancery incorrectly engaged in an enhanced scrutiny analysis to assess the validity of the challenged bylaws rather than applying the standard for determining facial validity. To eliminate confusion surrounding these similar yet distinct analyses, the Supreme Court assessed both the validity and enforceability of the amended bylaws under the applicable standards of review.

The Supreme Court held that a bylaw is facially valid if it is "authorized by the Delaware General Corporation Law, consistent with the corporation's certificate of incorporation, and not otherwise prohibited." To establish a bylaw as facially invalid, the Supreme Court noted that plaintiffs must prove that the bylaw cannot operate lawfully or equitably under any circumstances.

To establish a bylaw as facially invalid, the Supreme Court noted that plaintiffs must prove that the bylaw cannot operate lawfully or equitably under any circumstances.

Applying this standard, the Supreme Court had "no trouble" finding all but one of the four amended bylaws at issue on appeal to be valid. All but one of the bylaws were valid because they were authorized by the DGCL, consistent with the corporation's certificate of incorporation, and not otherwise prohibited. The only bylaw the Supreme Court declared as invalid was the excessively long and vague ownership provision that it found "indecipherable" and therefore "invalid under 'any circumstances.'" The Supreme Court noted that AIM's chairman had stated that "the bylaw was written in such a way that 'no one would read it'" and "if the directors had started reading it 'line by line' during their March 2023 board meeting, they 'would still be in the meeting.'" Accordingly, the Supreme Court held that the ownership provision was invalid.

Next, the court explained that even if facially valid, bylaws may nonetheless be unenforceable as a matter of equity. Because of the fiduciary obligations binding corporate actors, when a board adopts, amends, or enforces advance notice bylaws during a proxy contest, for the bylaws to be enforceable, the board's conduct must survive enhanced scrutiny review. As the Supreme Court provided in *Coster v. UIP Companies, Inc.*, this enhanced scrutiny review assesses (i) whether the board acted in response to a "real and not pretextual" threat, with motives that were "proper and not selfish or disloyal," and (ii) whether the response was "reasonable in relation to the threat" and "not preclusive or coercive to the stockholder franchise." Recognizing the insurgent stockholders' "troubling history" as a potential impediment to the board's stated purpose of obtaining transparency from the nominating stockholders, the Supreme Court agreed with the Court of Chancery's conclusion that the board's alleged motive in adopting the bylaws stemmed from a legitimate threat.

Despite this legitimate threat, the Supreme Court found that the board's alleged motive could not be reconciled with the

unreasonableness of the contested bylaws. The Supreme Court concluded that the AAU provision required disclosure about AAUs between "any members of a potentially limitless class of third parties and individuals unknown to the nominator," functioning as a tripwire rather than an information-gathering tool. The Supreme Court held that the consulting/nomination provision required disclosures of AAUs spanning a 10-year period, which the Supreme Court found unreasonable and ambiguous and only marginally useful, giving the board a "'license to reject a notice' based on a subjective interpretation of its imprecise terms." Further, the Supreme Court held that the known supporter provision was too expansive, requiring a nominating stockholder not only to provide information based on personal knowledge, but also information about an "ill-defined daisy chain of persons," which impeded the stockholder franchise. Therefore, the Supreme Court agreed with the Court of Chancery's finding that the throughline of the amended bylaws did not exhibit a desire to promote transparency, but rather implied an intent to thwart stockholder activism and maintain control by precluding stockholders from nominating new board candidates. Consequently, the Supreme Court held that the board's conduct failed under the enhanced scrutiny standard and the challenged bylaw provisions at issue on appeal were inequitable and unenforceable.

Stockholder Primacy

McRitchie v. Zuckerberg: The Court of Chancery Formally Rejects Stakeholder Primacy

In *McRitchie v. Zuckerberg,* 315 A.3d 518 (Del. Ch. 2024), the Court of Chancery granted a motion to dismiss a stockholder's claims for breach of fiduciary duty against Meta Platforms Inc. and its directors, officers, and significant stockholder (Mark Zuckerberg) for managing the company in a manner that generates firm-specific value to the detriment of Meta stockholders' diversified investments. The court ultimately rejected the plaintiff's claims, holding that Delaware follows the "single-firm" or "stockholder" model of corporate governance, under which directors' fiduciary duties obligate them to maximize the value of the specific corporation they serve for the benefit of its stockholders. In so holding, the court rejected the "diversified investor" or "stakeholder" model positing that directors must maximize the value of all enterprises in the economy writ large (and all stakeholders the corporation affects).

Meta is the world's largest social media company, with over 3.59 billion monthly active users across its platforms (Facebook, Instagram, Messenger, and WhatsApp). Under Meta's stock ownership guidelines, directors were required to own Meta stock. Employee directors were required to own shares with a value of at least $4 million and non-employee directors were required to own shares with a value of at least $750,000. Zuckerberg's holdings included 350 million shares of Class B stock, which the plaintiff alleged aligned his interests with those of Meta. The plaintiff argued that Meta's public stockholders, by contrast, included broadly diversified investors. Diversified institutional investors owned 75% of Meta's publicly traded Class A common stock, with the top five institutional holders owning 28%. The plaintiff alleged that many of these institutions were legally required to diversify their investments by holding shares in various other public companies.

The plaintiff argued that the defendants violated their fiduciary duties by managing the company in a way that harmed the financial interests of its diversified stockholders. He alleged that certain decisions, particularly related to the company's content moderation policies, created negative externalities and cited news reports concerning Meta's alleged role in allowing the spread of misinformation during Covid-19, exploitation by criminal organizations, and negative mental health effects for teenagers using Instagram. The plaintiff argued that these managerial decisions negatively affected the overall value of diversified investment portfolios.

The plaintiff brought claims for breach of fiduciary duty against: (i) the board for breaching its fiduciary duty by managing Meta in a way adverse to investors' interests, even as the company's stock price and overall profitability increased; (ii) Zuckerberg and Sheryl Sandberg (Meta's former COO), in their capacities as officers, for allegedly causing Meta to engage in practices that depressed the value of diversified stockholders' investments, particularly by allowing harmful content and activities to proliferate on the company's platforms; and (iii) Zuckerberg in his capacity as a controlling stockholder for the same general alleged misconduct.

Fiduciary duties always obligate directors to maximize firm-specific value for the benefit of stockholders.

The plaintiff further claimed that because the director defendants owned significant blocks of Meta stock, these decisions were self-interested and therefore Delaware's most rigorous standard of review—the entire fairness standard—should apply. The defendants moved to dismiss the complaint under Rule 12(b)(6), asserting that the plaintiff failed to state a claim for breach of fiduciary duty. The Court of Chancery, in evaluating the motion, took the allegations in the complaint as true and considered them in the light most favorable to the plaintiff.

The court began its analysis by undertaking a thorough review of Delaware case law addressing—directly or indirectly—whether fiduciary duties run to stockholders or some broader class of stakeholders. The court concluded that a vast array of cases arising in different contexts uniformly provide that fiduciary duties only require fiduciaries to maximize the value of the corporation for the benefit of its residual claimants. It observed, for example, that in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.,* the Delaware Supreme Court held that it was improper for directors to consider the interests of noteholders when determining whether to accept one takeover offer versus another. It further pointed to lines of precedent holding that (i) directors do not owe fiduciary duties to creditors even when the corporation is insolvent or in the zone of insolvency; (ii) directors do not owe fiduciary duties to preferred stockholders in their capacity as contractual claimants; (iii) directors do not owe fiduciary duties to employees in their capacity as employees; (iv) where directors agree to sell the corporation, Delaware courts ask only whether firm-specific value was maximized and uniformly disregard the interests of other stakeholders in that analysis; and (v) directors' stock ownership aligns their interests with those of the corporation, a concept inconsistent with a "diversified investor" model positing that concentrated ownership creates a conflict of interest. Thus, the court continued, the weight of Delaware precedent supported the

stockholder model, not the stakeholder model.

Next, the court held that the stockholder model is consistent with the historical development of fiduciary duties under Delaware law. It explained that in historical cases creating and defining fiduciary duties, courts have reasoned that the duty springs from the fact that the fiduciary manages assets it does not own. And because in the corporate context stockholders invest only cash and other assets—not their "hopes and dreams"—directors are only obligated to maximize the former (by maximizing the value of the corporation), not the latter (by catering to other non-corporate interests investors may have). The court further explained that even during the era in which corporate law commentators declared that "managerialism"—the notion that corporations should serve stakeholders—reached its height, Delaware courts consistently published opinions reaffirming stockholder primacy. The court added that Delaware courts maintained this orientation through the takeover era of the 1980s. Thus, the court reasoned, fiduciary duties always, and continue to, obligate directors to maximize firm-specific value for the benefit of stockholders.

Finally, the court addressed public policy arguments. The court noted that the plaintiff's concerns about negative externalities were valid from a policy perspective, but asserted that the proper avenue for addressing these matters would be to opt-in to corporate governance structures reflecting these values on a firm-by-firm basis. For example, corporations could convert to benefit corporations (as is permitted by the DGCL) or include provisions in their charters that explicitly constrain directors to consider the welfare of diversified investors or to limit the externalities generated by their business practices. The court noted that it would not, however, impose such a duty under existing Delaware law absent express language in the certificate of incorporation.

Accordingly, the Court of Chancery granted the defendants' motion and dismissed the complaint in its entirety.

Mergers to Circumvent Amendment Approval Requirements under LLC Act

Campus Eye Management Holdings, LLC v. DiDonato: **Court of Chancery Validates Merger Done for Purposes of Circumventing Amendment Approval Requirements Pursuant to Delaware Limited Liability Company Act**

In *Campus Eye Management Holdings, LLC v. DiDonato,* 2024 WL 4024230 (Del. Ch. Aug. 30, 2024), the court approved a motion for judgment on the pleadings filed by Campus Eye Management Holdings, LLC ("CE Holdings"), confirming the amendment by merger of the limited liability company agreement (the "Original CE Management Agreement") of CE Holding's wholly owned subsidiary, Campus Eye Management, LLC ("CE Management"), where such amendment by merger was effected in such manner to circumvent the Original CE Management Agreement's amendment approval requirements.

The defendant, E. Bruce DiDonato, OD, is an optometrist who in 2021 sold a majority interest in his New Jersey practice to a private equity firm, The Beekman Group. Following the sale, CE Management was the operating company of the optometry practice and CE Holdings was the sole member of CE Management. DiDonato maintained a 35% equity interest in CE Holdings, and Beekman received a 65% equity interest therein. CE Management was managed by DiDonato, and CE Holdings was managed by a board of three managers, with DiDonato appointing one manager and Beekman appointing two. The CE Holdings board was authorized to act by majority action.

The divergence of equity interests and management power in CE Management soon caused friction between DiDonato and Beekman. Seeking to curb DiDonato's power to manage CE Management, the Beekman-appointed managers of CE Holdings attempted to amend the Original CE Management Agreement to make CE Management managed by its sole member—CE Holdings—rather than its manager—prior to such amendment, DiDonato. This attempted amendment prompted litigation resulting in the rejection of the attempted amendment because, under the Original CE Management Agreement, the approval of CE Management's manager, DiDonato, was required to amend the Original CE Management Agreement.

The very day that the court rejected this attempted amendment, the Beekman-appointed managers of CE Holdings approved via written consent (i) the formation of a new subsidiary of CE Holdings, (ii) the merger of such subsidiary into CE Management, and (iii) by virtue of such merger, the amendment and restatement by merger of the Original CE Management Agreement in the form of an amended and restated limited liability company agreement of CE Management (the "A&R CE Management Agreement"). The newly adopted A&R CE Management Agreement provided that CE Management would be managed by its sole member, CE Holdings, rather than a manager, effectively eliminating DiDonato's direct management rights over CE Management. After approving these matters, CE Holdings sought from the court a declaratory judgment that the merger and the A&R CE Management Agreement were valid. After some parliamentary jostling, CE Holdings moved for a judgment on the pleadings related to such declaratory judgment.

Analyzing the merger approval requirements for a Delaware limited liability company under Section 18-209(d) of the LLC Act, the court determined that CE Holdings, as the sole member of CE Management, could unilaterally approve CE Management's merger, notwithstanding CE Management's contemporaneous management by a manager, DiDonato. While the court expressly noted that Section 18-209(d) of the LLC Act provides that a majority of an entity's members can approve a merger unless "otherwise provided" in its limited liability company agreement, the court did not find that the Original CE Management Agreement's vesting primary management authority of CE Management in DiDonato, as manager, gave him an approval right regarding CE Management's merger. It is not clear from the court's opinion whether DiDonato proffered this argument or whether the court considered it. Similarly, the court did not analyze the impact of CE Management's merger approval coming from the board of managers of CE Holdings, its sole member, rather than from CE Holdings directly in its capacity as sole member of CE Management.

Having concluded that CE Holdings could unilaterally approve CE Management's merger, the court synthesized Section 18-209(f) of the LLC Act and the Original CE Management Agreement, noting that the Original CE Management Agreement's amendment provisions did not expressly apply to amendments by merger and that, as a result, such amendment provisions do not apply to amendments by merger. As a result, only CE Holdings' approval of the merger was required to amend by merger the Original CE Management Agreement. In so finding, and rejecting DiDonato's arguments, the court held that by operation of Sections 18-209(f) and 18-302(e) of the LLC Act, a valid amendment by merger does not require an "actual transaction of some kind" rather than one with the "sole purpose" of effecting "an otherwise impossible amendment."

By operation of Sections 18-209(f) and 18-302(e) of the LLC Act, a valid amendment by merger does not require an "actual transaction of some kind" rather than one with the "sole purpose" of effecting "an otherwise impossible amendment."

The court further dispensed with DiDonato's argument that the gap-filling effects of the implied contractual covenant of good faith and fair dealing entitled him to an approval right over an amendment by merger of CE Management, holding that no gap exists because of the very presence of Section 18-209(f) of the LLC Act. Because an existing provision of the LLC Act expressly sanctions the amendment of a, or adoption of a new, limited liability company agreement notwithstanding any provision of the limited liability company agreement relating to amendment (unless such provision expressly restricts amendments by merger), the court reasoned that there was no gap to be filled via the implied covenant.

While the court quickly dispatched with DiDonato's allegations of breaches of fiduciary duty on the basis that the CE Holdings managers had no fiduciary duties under the limited liability company agreement of CE Holdings and that CE Holdings owes no fiduciary duties to its wholly owned subsidiary, CE Management, it is notable that the court undertook

such analysis after determining that the amendment by merger was legally permitted under the LLC Act.

Restrictive Covenants in LP and LLC Agreements

Cantor Fitzgerald, L.P. v. Ainslie:
Delaware Supreme Court Enforces Forfeiture-for-Competition Provisions in Limited Patnership Agreement Given Strong Public Policy for Freedom of Contract in Limited Partnership Context

An interesting scenario arises when a limited partnership agreement contains forfeiture-for-competition provisions in the context of employee limited partners. Typically, non-competition provisions or restrictive non-competition covenants are subject to reasonableness review under Delaware law, but the question arises whether forfeiture-for-competition provisions in a limited partnership agreement are subject to this same standard.

In *Ainslie v. Cantor Fitzgerald, L.P.*, 2023 WL 106924 (Del. Ch. Jan. 4, 2023), *rev'd and remanded*, 312 A.3d 674 (Del. 2024), the Delaware Court of Chancery considered cross-motions for summary judgment in an action brought by six former limited partners and employees of Cantor Fitzgerald, L.P. or its affiliates ("Cantor Fitzgerald") to resolve disputes relating to certain restrictive covenants and related provisions in the partnership agreement of Cantor Fitzgerald (the "CF LP Agreement"). The court determined, among other things, that certain restrictive covenants and related forfeiture provisions in the CF LP Agreement were unenforceable and that Cantor Fitzgerald breached the CF LP Agreement when it failed to make certain payments owed to the former employees.

The CF LP Agreement contains two provisions to discourage and ban competition after a partner withdraws from Cantor Fitzgerald. First, the CF LP Agreement contains restrictive covenants prohibiting, among other things, a partner of Cantor Fitzgerald from engaging in competitive activities for a one- to two-year period after its withdrawal from Cantor Fitzgerald, including a non-compete covenant with no geographic limitation during the first year after withdrawal and a non-solicit covenant during the second year after withdrawal. These covenants are breached when Cantor Fitzgerald's managing general partner makes a good faith determination that a partner has engaged in a competitive activity during the restricted period. Second, the CF LP Agreement contains provisions permitting Cantor Fitzgerald to withhold payments owed to a partner of Cantor Fitzgerald from its capital account and other earned compensation ("CF Capital Account") that is repaid to a partner in annual installments over a four-year period after such partner's withdrawal from Cantor Fitzgerald unless such partner engages in competitive activities with Cantor Fitzgerald at any time during the four-year period.

The plaintiffs voluntarily withdrew from Cantor Fitzgerald between 2010 and 2011. Within a year of each of their withdrawals, Cantor Fitzgerald determined to withhold CF Capital Account payments from each of the plaintiffs based on determinations by the managing general partner that each plaintiff had accepted employment or otherwise performed services on behalf of a competing business within a year of each of their respective withdrawals from

Cantor Fitzgerald. The plaintiffs sought claims for, among other things, breach of contract against Cantor Fitzgerald seeking enforcement of their respective CF Capital Account payments and seeking a declaration that the non-compete provisions were unenforceable. Cantor Fitzgerald argued that (i) each of the plaintiffs engaged in competitive activities, and (ii) restrictive covenants should be enforceable as a matter of public policy. Cantor Fitzgerald also argued that the provisions permitting it to withhold CF Capital Account payments if a former partner engages in a competitive activity during a four-year period following withdrawal are not non-compete agreements because Cantor Fitzgerald is not seeking to prohibit the competition, but rather only to withhold the obligation to make payments. The plaintiffs countered that the restrictive covenants and the withholding of payments are both restraints of trade and should be evaluated accordingly.

The court first considered whether the restricted covenant provisions are penalties or conditions precedent to Cantor Fitzgerald's duty to make the CF Capital Account payments. The court determined that the covenants are conditions precedent to Cantor Fitzgerald's duty to pay based on the plain language of the CF LP Agreement and a determination that an agreement can create a condition that is triggered by a failure to perform a duty under a contract. The court then analyzed the restrictive covenants for reasonableness and determined that they were unreasonable because (i) the worldwide geographic scope was not narrowly tailored to serve Cantor Fitzgerald's interests; (ii) the scope of protection extended to any affiliated entity of Cantor Fitzgerald and included any activity that is or could be considered a competitive activity; (iii) Cantor Fitzgerald's managing general partner was afforded the discretion to determine if a competitive activity has taken place; and (iv) the restricted period was too long in light of each of the CF Partners having withdrawn from Cantor Fitzgerald. Despite the foregoing, the court considered that Cantor Fitzgerald was not prohibiting the former partners from obtaining employment and that the former partners had in fact entered into the CF LP Agreement that contained the restrictive covenants. The court then considered that the plaintiffs would lose an extraordinary amount of compensation by Cantor Fitzgerald withholding the CF Capital Account payments. In its balancing of the equities, the court determined that the restrictive covenants were unreasonable and unenforceable.

The court then analyzed the four-year competitive activity condition as a basis to discharge Cantor Fitzgerald's duty to make the CF Capital Account payments. The court noted that it is not clear under Delaware law whether a forfeiture-for-competition provision is a restraint of trade requiring the court to evaluate it for reasonableness. The court considered precedent regarding treatment of liquidated damages provisions enforcing non-compete and non-solicit agreements and determined that, similar to liquidated damages provisions, forfeitures are not favored because of the potential to result in unjust outcomes. Additionally, the court noted that the plaintiffs could engage in a competitive activity accidentally or unknowingly, were not able to negotiate the CF LP Agreement, and could experience an extraordinary loss as a result of the forfeiture. The court then determined that forfeiture-for-competition provisions should be analyzed for reasonableness as restraints

on trade, but under an employer-friendly review in light of the former partners' ability to compete. The court noted that the same reasoning for concluding that the restrictive covenants are unreasonable also applies to the four-year competitive activity condition, but that this condition is more reasonable because the scope of prohibited activities is narrower and the determination of whether a competitive activity has been engaged in is not left up to the Cantor Fitzgerald managing general partner. The court then determined that because Cantor Fitzgerald could not advance a compelling reason for the four-year period of the competitive activity condition, this condition was also unenforceable, and Cantor Fitzgerald could not rely on it to withhold the CF Capital Account Payments.

The court determined that forfeiture-for-competition provisions should be analyzed for reasonableness as restraints on trade, but under an employer-friendly review in light of the former partners' ability to compete.

On appeal, in *Cantor Fitzgerald, L.P. v. Ainslie,* 312 A.3d 674 (Del. 2024), the Delaware Supreme Court reversed the decision below by the Delaware Court of Chancery and found that the forfeiture-for-competition provisions are enforceable. The Supreme Court distinguished forfeiture-for-competition provisions in a partnership agreement from restrictive non-competition covenants and liquidated damages provisions used to enforce such covenants. While restrictive non-competition covenants and related liquidated damages provisions are generally subject to scrutiny for reasonableness

under Delaware law, the court held that absent unconscionability, bad faith, or other extraordinary circumstances, forfeiture-for-competition provisions in a partnership agreement are not subject to reasonableness review. Instead, the court found that the express and stated public policy of the LP Act of giving effect to the principle of freedom of contract and the enforceability of partnership agreements supported enforcing a forfeiture-for-competition provision without regard to reasonableness.

In its analysis, the Delaware Supreme Court reviewed the public policy considerations associated with non-competition provisions and related liquidated damages provisions and compared them to the public policy considerations associated with forfeiture-for-competition provisions. In analyzing whether to enforce the forfeiture-for-competition provisions, the court distinguished between a restrictive non-competition covenant that prevents an individual from working in a specific field (which may be subject to injunctive relief) and a forfeiture-for-competition provision that allows an individual to work but imposes a cost for doing so (which is not subject to injunctive relief). The court also noted that Section 17-306 permits partnership agreements to contain consequences that are not available in other commercial contracts, such as penalties and forfeitures, and that the LP Act has a stated policy "to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements." While recognizing that freedom of contract is not unbounded, the Supreme Court found that the public policy interest that is present when a court reviews the reasonableness of a restriction on working in a specific field is much stronger than the public policy interest in preventing employees from forfeiting benefits for choosing to compete. As a result, the court found that the forfeiture-for-competition provisions in this case are not subject to review for reasonableness.

The Delaware Supreme Court's opinion in *Cantor Fitzgerald* highlights that, in the context of Delaware limited partnerships, Delaware courts (i) recognize a strong public policy of freedom of contract, and (ii) absent some form of bad faith or unconscionability, will generally preserve contractual flexibility and hold parties to their bargained-for agreements.

Sunder Energy, LLC v. Jackson: Court of Chancery Notes Problematic Nature of Incorporating Restrictive Covenants into Entity's Governing Agreement

In *Sunder Energy, LLC v. Jackson,* 305 A.3d 723 (Del. Ch. 2023), *aff'd in part, rev'd in part*, --- A.3d ---- (Del. 2024), the Delaware Court of Chancery, in part, considered and subsequently denied an application for a preliminary injunction brought by Sunder Energy, LLC against Tyler Jackson to enjoin Jackson from taking actions in breach of restrictive covenants (the "Sunder Covenants").

Sunder sells residential solar power systems and had an exclusive dealer agreement with Freedom Forever LLC, which installed the solar power systems. Jackson was a co-founder of Sunder Energy and Sunder's head of sales. At its formation in 2019, Sunder Energy operated under an oral agreement that provided for all co-founders, including Jackson, owning a single class of units as members with two of the members, Max Britton and Eric Nielson, owning a majority of the units. Thereafter, Britton and Nielson engaged a law firm to prepare an LLC

agreement (the "2019 LLC Agreement") that materially changed the ownership structure of Sunder, altered its internal governance, and added the Sunder Covenants. The Sunder Covenants included restrictions on, among other things, engaging in competitive activities and soliciting Sunder's employees and independent contractors. Britton and Nielson sent a copy of the 2019 LLC Agreement to the other co-founders on New Year's Eve, encouraging them to sign it by the end of the night, without an explanation of the terms of the incentive units that they were to receive, which drastically differed from the members' rights as co-owners of a single class of units. In 2021, Britton and Nielson informed the other members that the 2019 LLC Agreement was being amended (the "2021 LLC Agreement") to add a member and that no substantive changes were being made. However, the 2021 LLC Agreement also expanded the geographic scope of the Sunder Covenants. The other members did not receive a copy of the 2021 LLC Agreement at the time it was adopted. The relationship between Sunder and Jackson deteriorated over time, which prompted Jackson to seek employment with a rising Freedom Forever dealer. Several of Sunder's high-level managers and sales personnel joined Jackson.

In seeking a preliminary injunction against Jackson, Sunder argued that Jackson breached certain of the Sunder Covenants. The court first had to consider choice of law issues. The court noted that jurisdictions outside of Delaware have a significant interest in how businesses compensate employees and the extent to which restrictive covenants can be attached to such arrangements. The court described the problematic nature of including restrictive covenants in internal governance documents for Delaware entities because they call on the court to adjudicate post-employment disputes for Delaware entities operating around the world. The court expressed concern for jeopardizing the deference provided by other states deferring to Delaware law to govern the internal affairs of Delaware entities and suggested that a potential solution could involve policy-makers beyond the courts.

The court described the problematic nature of including restrictive covenants in internal governance documents for Delaware entities because they call on the court to adjudicate post-employment disputes for Delaware entities operating around the world.

Here, the court analyzed whether to apply laws of Delaware (the choice of law specified in the 2021 Sunder LLC agreements), Utah (where Sunder is headquartered), or Texas (where Jackson lives and works). The court noted that Sunder asked the court to apply Delaware law, not Texas law, even though Sunder would fare better under Texas law. The court next observed that although Jackson would have a stronger case for invalidity of the covenants under Utah law, this is a false conflict given that the Sunder Covenants are invalid under Delaware law. For these reasons, the court analyzed the substantive issues under Delaware law.

The court determined that Sunder could not obtain a preliminary injunction against Jackson to enforce the Sunder Covenants because the 2019 LLC Agreement and the 2021 LLC Agreement, which contained the Sunder Covenants, were not validly

approved. The court found that Britton and Nielson breached their fiduciary duty of disclosure when they sought member approval for the 2019 LLC Agreement and the 2021 LLC Agreement, and that it would be inequitable to permit Britton and Nielson to enforce the Sunder Covenants in light of the circumstances surrounding their approval. The court noted that the one-sided nature of the 2019 LLC Agreement should have been disclosed by Britton and Nielson to the other members, and that providing a copy of the 2019 LLC Agreement was not enough to fulfill their fiduciary duty of disclosure. The court also focused on the language in the email in which Britton and Nielson sought the approval of the other members for the 2019 LLC Agreement. Further, the court noted that the adoption of the 2021 LLC Agreement also did not fulfill Britton and Nielson's fiduciary duty of disclosure because a copy of the 2021 LLC Agreement was not circulated to the other members, and Britton and Nielson inaccurately stated that no material changes were being made.

The court then analyzed the reasonableness of the Sunder Covenants under the assumption that the Sunder Covenants could be enforced under general principles of contract law. The court generally found the Sunder Covenants to be overly broad and particularly egregious in their terms.

Void vs. Voidable Under LLC Agreement

XRI Inv. Holdings LLC v. Holifield: **Court of Chancery and Delaware Supreme Court Address Void vs. Voidable Acts Under LLC Agreement**

In *XRI Inv. Holdings LLC v. Holifield,* 283 A.3d 581 (Del. Ch. 2022), *aff'd in part, rev'd in part and remanded,* 304 A.3d 896 (Del. 2023), the Delaware Court of Chancery provided clarification as to void and voidable acts in LLC agreements, and when the defense of acquiescence can be utilized in this regard. The court ultimately held that, when an LLC agreement expressly prohibits a particular transaction or act, any violation is void and not subject to ratification or acquiescence. Thus, the prohibited act or transaction is considered void, not voidable. However, the court also noted *in dicta* that such results are inequitable and recommended that the controlling precedent be reconsidered.

XRI Investment Holdings LLC was formed in 2013 by Matthew Gabriel and Gregory Holifield. Through various transactions, Morgan Stanley came to hold all Class A units, while Gabriel and Holifield held all the Class B units. Additionally, Morgan Stanley designated three of the five members of the board of representatives. Gabriel, who also served as CEO, and Holifield held the other two seats on the board. XRI's LLC agreement included a provision that prohibits members from transferring their member interests, making any such transfer void (the "XRI Transfer Provision"). The LLC agreement also included a related provision that enables members to transfer their interest to an entity that is owned solely by the transferring member, so long as that transfer is made for no consideration (the "XRI Transfer Exception").

In addition to XRI, Holifield also had large stakes in several other entities, including Entia, LLC. In 2018, Holifield sought to raise capital for Entia and created Blue Holdings, LLC as a special purpose vehicle to do so. Holifield's ultimate plan was to transfer ownership of his XRI units (the "XRI Disputed Units") to Blue Holdings, and

then use those units as collateral to obtain a loan that would help finance Entia (the "Blue Transfer"). Holifield notified Gabriel of this financing arrangement, and Gabriel subsequently discussed the arrangement with the board, as well as attorneys for XRI. After receiving no objections, Gabriel informed Holifield that board approval was not required. Entia's loan agreement was executed in June 2018. In December 2020, XRI informed Holifield that: (i) the 2018 transaction was in violation of the XRI Transfer Provision, (ii) Holifield still had sole possession of the disputed units, and (iii) XRI was initiating a strict foreclosure on those units. Holifield countered that the foreclosure action was invalid because the board had acquiesced to the transfers, and therefore Blue Holdings was the rightful owner of the disputed units.

Citing recent Delaware Supreme Court precedent interpreting Section 18-106(e) of the LLC Act, XRI argued that because the LLC agreement used the word "void" to specify the consequences of breaching the XRI Transfer Provision, the noncompliant act by Holifield was void and thus could not be subsequently acquiesced to. The court reluctantly agreed with this argument, finding that if a particular transaction is a "restricted activity" under the LLC agreement, then it is void and, in contrast to being voidable, could never be ratified. In essence, any transaction that is void is incurably void, and equitable defenses cannot be invoked that would validate the prohibited transaction.

Applying precedent to the facts at hand, the court determined that the XRI Transfer Provision explicitly prohibited any transfers of units by members for consideration, even with acquiescence by the necessary parties (in this case, the board). The court found that, although Holifield had transferred the disputed units to a solely owned entity (Blue) and therefore appeared to satisfy the XRI Permitted Transfer Exception, he had actually received consideration for the transfer because the Blue transaction was used to secure a $3.5 million loan for Entia. Thus, the XRI Permitted Transfer Exception could not apply. The court also dismissed Holifield's argument based on the equitable defense of acquiescence. Although Holifield followed the proper procedures in asking Gabriel for board approval, the transaction was not voidable, but rather void on its face. As a result, the disputed units still belonged to Holifield, and the foreclosure was proper.

While the court noted that contracting parties' use of the word "void" does not necessarily render the relevant act incurably void in every case, it held that the particular language of the LLC agreement was a clear expression of the parties' intent that any noncompliant transfers would be incurably void.

Although the court concluded that the Blue Transfer was indeed void, the opinion also noted, *in dicta*, that the result was inequitable and suggested that the controlling precedent be reconsidered. The opinion went so far as to find that if the court were able to consider equitable remedies, Holifield would likely be successful in asserting an acquiescence defense. According to the court, equity enables courts to "ameliorate the sometimes harsh consequences that can result from the blanket application of a generally sound rule of law." The current structure, therefore, enabled XRI to basically contract out of

equity—an undesirable result that should be addressed. In sum, the decision was correct under the legal precedent, but contrary to equitable principles.

On appeal, the Delaware Supreme Court affirmed in relevant part the Court of Chancery's holding that (i) the transfer was rendered incurably void by the plain language of the XRI LLC agreement, and (ii) the Court of Chancery lacked the power to consider equitable defenses to breach of the XRI LLC agreement, such as acquiescence. Noting that Delaware limited liability companies are creatures of contract, the court stated that it would use longstanding principles of contractual interpretation to examine the provisions of the XRI LLC agreement at issue; absent a finding of ambiguity, the court would not need to look beyond that agreement to the default rules in the LLC Act or to apply equitable principles. While the court noted that contracting parties' use of the word "void" does not necessarily render the relevant act incurably void in every case, it held that the particular language of the XRI LLC agreement ("the use of the word 'void,' the language prohibiting XRI from recording a noncompliant transfer on its books and the language prohibiting XRI from recognizing a transferee of a noncompliant transfer as the owner of units, in addition to the contractual context [a transfer restriction in a private, closely held LLC, with sophisticated members]") was a clear expression of the parties' intent that any noncompliant transfers would be incurably void.

The Delaware Supreme Court went on to discuss the import of Section 18-106(e) of the LLC Act in this case, which provides, in relevant part:

(e) Any act or transaction that may be taken by or in respect of a limited liability company under this chapter or a limited liability company agreement, but that is void or voidable when taken, may be ratified (or the failure to comply with any requirements of the limited liability company agreement making such act or transaction void or voidable may be waived) by the members, managers or other persons whose approval would be required under the limited liability company agreement:

(1) For such act or transaction to be validly taken; or

(2) To amend the limited liability company agreement in a manner that would permit such act or transaction to be validly taken, in each case at the time of such ratification or waiver....

The court held that this provision extended only to ratification of breaching acts taken by the limited liability company itself, and not to acts taken by its members, as was the case in *Holifield*. In its discussion of Section 18-106(e), the court expressed its view that the legislature had intentionally chosen to limit the circumstances in which Section 18-106(e) could be used in certain respects and declined to effectively expand Section 18-106(e) by judicial decision. The court further determined that considerations of *stare decisis* weighed against overturning precedent in the present case.

The court therefore held that, because the transfer at issue was incurably void, XRI was entitled to recover damages for breach of contract, and remanded the case for additional proceedings regarding the amount of these damages and the extent to which XRI was entitled to recover amounts advanced to Holifield under the XRI LLC agreement, noting that the Court of Chancery's potential finding *in dicta* of acquiescence did not preclude recovery.

Powers of Estate to Administrate LLC Interests

Gurney-Goldman v. Goldman: Court of Chancery Addresses Scope of Powers of Administrator of Estate Pursuant to Section 18-705 of the LLC Act

In *Gurney-Goldman v. Goldman,* 321 A.3d 559 (Del. Ch. 2024), the Court of Chancery addressed an issue of first impression regarding the scope of powers under Section 18-705 of the LLC Act. For decades, each of four siblings, Jane, Allan, Diane, and Amy, owned an equal 25% share of a New York-based real estate empire comprised of hundreds of entities. The entity at issue, SG Windsor LLC, is a Delaware limited liability company that lacked a written LLC agreement. Historically, Jane and Allan managed the day-to-day operations of the empire and the other siblings pursued other interests. In 2022, Allan passed away and his 25% member interest in SG Windsor LLC passed to his estate.

In this action, the parties sought declaratory judgment regarding the governance of SG Windsor LLC and asked the Court of Chancery to determine whether (i) SG

Windsor LLC is member-managed, (ii) Allan's estate is a member in SG Windsor LLC or only holds an assignee interest, (iii) the executor of Allan's estate may exercise any member right associated with the LLC interest in SG Windsor LLC to administer and settle the estate, (iv) any of Jane's affirmative defenses were valid, and (v) the court may issue any injunctive relief preventing Jane from taking any unilateral action on behalf of SG Windsor LLC as its sole remaining manager.

In determining whether SG Windsor LLC is member-managed, the court reasoned that by default, under the LLC Act, an LLC is member-managed. To create a manager-managed structure, the LLC agreement must expressly vest authority in one or more managers. In the instant case, SG Windsor LLC had no LLC agreement; therefore, there is no express authority vested in any manager.

Under the LLC Act, an LLC agreement may be oral or implied through conduct. The LLC Act defines the term "Manager" as "a person who is named as a manager of a limited liability company in, or designated as a manager of a limited liability company pursuant to, a limited liability company agreement or similar instrument under which the limited liability company is formed." The court noted colloquially that "Manager" means the person running things. In this case, the record showed that Jane and Allan acted as colloquial managers, but the record did not support any implied LLC agreement that Jane or Allan were managers under the definition in the LLC Act.

In determining whether Allan's estate is a member of SG Windsor LLC, the court found that the estate is not a member. The court noted that, under the LLC Act, when a member of an LLC transfers its LLC interests to another person, the recipient of the LLC interest does not automatically become a member. The recipient of the LLC interest only holds the rights of an assignee, which consists of the economic rights associated with the LLC interest, plus the power to sue derivatively. The assignee does not receive any governance rights. To gain all of the rights of a member, the estate must seek the approval of all the members of the LLC or be admitted as a member in accordance with the LLC agreement. Here, there was no evidence that the estate achieved the status of a member under either approach.

The court agreed with the broader interpretation of Section 18-705 and sided with the executor because handling an estate requires not only settling the estate but also estate administration.

The court then discussed, under Section 18-705 of the LLC Act, whether the executor of Allan's estate may exercise any governance rights Allan could have exercised as a member of SG Windsor LLC, for the purposes of administering and settling his estate. The court noted that rights under Section 18-705 are not a well-developed area of Delaware law, and the scope of Section 18-705 presents an issue of first impression. The executor of Allan's estate argued that under Section 18-705, a personal representative can exercise all of the member's rights to settle the deceased member's estate or administer the deceased member's property and that all of the rights include all governance rights in addition to economic rights. Jane argued that under Section 18-705, settling

a member's estate solely applies to when a member who is an individual dies, whereas administering the member's property correlates solely to when a court determines a member to be incompetent to manage the member's person or property. Therefore, Jane argued, Allan's executor only has the power to exercise member rights for the purpose of settling the member's estate and not for administering Allan's property. The court agreed with the broader interpretation of Section 18-705 and sided with the executor because handling an estate requires not only settling the estate but also estate administration. Therefore, the court found an executor must have the ability to do both. The court was clear, however, that these rights are limited; they may only be exercised for a proper purpose of either settling an estate or administering the former member's property. The court noted that so long as the executor subjectively believes that the exercise of governance rights serves the proper purpose of settling the estate and administering the property, the court will not second guess the exercise.

Lastly, the court addressed the defendant's affirmative defenses and whether an injunctive relief could be implemented. The court found that the affirmative defenses of acquiescence, ratification, estoppel, laches, consent, and waiver to block the plaintiffs from obtaining any relief required the siblings to have waited too long to assert a claim. That was not the case here, as when Jane asserted her claim that she was a manager of SG Winsor LLC and therefore could act unilaterally without member approval, Allan's executor and one of her other siblings sued promptly. The court found that here, there is no concrete act the plaintiffs seek to enjoin because Jane was not currently threatening any particular unilateral action; therefore, injunctive relief would be inappropriate.

Inspection Rights to Books and Records

Bruckel v. TAUC Holdings, LLC: **Delaware Court of Chancery Confirms Essentially Ongoing Unfettered Right of Access of Managers to Limited Liability Company's Documents**

In *Bruckel v. TAUC Holdings, LLC,* 2023 WL 116483 (Del. Ch. Jan. 6, 2023), the Delaware Court of Chancery clarified a previous decision regarding a manager's right to inspect the books and records of an LLC under Section 18-305 of the LLC Act and under the relevant LLC agreement. The court held that the plaintiff manager had continuous contractual and statutory rights to inspect the meeting minutes, emails, and other documents related to informal meetings between other managers.

Bruckel arose out of a dispute between the managers of TAUC Holdings, LLC, a Delaware limited liability company. Matthew Bruckel, a founding member and manager of TAUC, fell out of favor with the other four managers on TAUC's board of managers (the "Favored TAUC Managers"). At a previous trial, the court held that Bruckel had both a contractual right to TAUC's books and records, because TAUC's LLC agreement granted Bruckel unrestricted access to books and records, and a statutory right to books and records under Section 18-305, which states that a manager of an LLC has a right to inspect the books and records of a company that are reasonably related to their role as a manager. After trial, in an effort to avoid the court's ruling, the Favored TAUC Managers largely ceased having formal meetings and

instead held dozens of informal "weekly group updates," each involving only a few of the Favored TAUC Managers at a time. The Favored TAUC Managers argued that they were not obligated to produce all emails and meeting minutes surrounding these and other meetings because those documents were outside the substantive and temporal scope of the court's previous holding. The court ultimately sided with Bruckel and required that he be allowed to inspect all documents and communications in question.

The plaintiff manager had continuous contractual and statutory rights to inspect the meeting minutes, emails, and other documents related to informal meetings between other managers.

First, the court clarified the substantive extent of Bruckel's right to review books and records. The court held that "what the other managers are being given and documents that reflect how the other managers meet and act collectively" are the best proxies for what is reasonably related to a manager's status as manager. The court also noted that the way in which managers conduct their business is important to determining which records and communications must be disclosed. If business is sometimes conducted informally, then even supposedly informal communications are books and records that managers are entitled to inspect. Even though the weekly group updates were supposedly informal, the court held that the "managers acted as managers in settings other than Board meetings," and, as a result, Bruckel was entitled to minutes of those meetings and to related communications under Section 18-305.

Second, the court clarified the temporal scope of Bruckel's inspection rights. The Favored TAUC Managers argued that they were only obligated to produce books and records up to the date of the trial. The court rejected this assertion and held that Bruckel had a continuing right to inspect books and records both under Section 18-305 and TAUC's LLC agreement. Regarding Section 18-305, the court stated that managers need to inspect books and records to fulfil their fiduciary duties, and that "[a]s long as a sitting manager owes fiduciary duties, she is entitled to receive whatever the other managers are given." Regarding TAUC's LLC agreement, the court noted that Bruckel had an unrestricted and ongoing contractual right to books and records, which was not limited to the scope or timing of Bruckel's lawsuit.

Implied Covenant Relating to Indemnification Determination

Baldwin v. New Wood Resources LLC: Delaware Supreme Court Reverses Trial Court and Holds Implied Covenant of Good Faith and Fair Dealing Applies to Whether Former Manager Was Entitled to Indemnification

In *Baldwin v. New Wood Resources LLC,* 283 A.3d 1099 (Del. 2022), the Delaware Supreme Court reversed a trial court decision and held that the covenant of good faith and fair dealing was implied where an individual's right to indemnification under an operating agreement was to be determined by the majority interest holder of the limited liability company. Richard Baldwin, the initial plaintiff, served as a manager of New Wood Resources LLC, a Delaware limited liability company. ACR Winston Preferred Holdings LLC held approximately 85.52% of New Wood's then-

outstanding units, making it the majority holder of New Wood.

There was a dispute as to whether Baldwin was entitled to indemnification for certain costs pursuant to the New Wood operating agreement. Section 8.2 of the New Wood operating agreement entitled Baldwin to indemnification only if he had acted in good faith. The operating agreement also provided that ACR Winston, as the majority interest holder, was entitled to determine whether Baldwin adhered to the good faith standard for purposes of being entitled to indemnification.

Drafters of LLC agreements are not expected to include "obvious and provocative" conditions in agreements, such as one stating that a manager would not mislead members.

ACR Winston executed a written consent stating that Baldwin had not acted in good faith for purposes of indemnification. The written consent did not explain the rationale for the determination, nor did it provide evidence of bad faith by Baldwin. Baldwin challenged the determination by ACR Winston on behalf of New Wood denying him indemnification. The trial court denied Baldwin's challenge and held that the implied covenant of good faith and fair dealing was not applicable with respect to the good faith determination contemplated by Section 8.2 of the New Wood operating agreement. The trial court reasoned that imposing an additional "free-floating" good faith covenant would result in subjecting every provision to "fact-intensive and unyielding judicial review" inconsistent with Delaware law.

On appeal to the Delaware Supreme Court, Baldwin asserted, among other things, that the implied covenant of good faith and fair dealing was applicable to the good faith determination required under Section 8.2. The Supreme Court agreed with Baldwin and held that the implied covenant was applicable and acted as a "gap-filler," because a determination of entitlement to indemnification may not be made in bad faith. The court noted that although Delaware gives maximum effect to the principle of freedom of contract, the Delaware LLC Act specifically prohibits the elimination of the implied covenant in Section 18-1101(c). The court noted that drafters of LLC agreements are not expected to include "obvious and provocative" conditions in agreements, such as one stating that a manager would not mislead members. The court held that it would be "too obvious" to demand the express inclusion of the implied covenant that a determination under the LLC agreement be reached in good faith. The court also noted precedents reinforcing the underlying principle that if one party is given discretion in determining whether a condition has occurred, that party must use good faith in making that determination.

Ultimately, the New Wood operating agreement required ACR Winston to make a "subjective discretionary determination as to whether an indemnitee has met a specific standard of conduct." The court reasoned that, as the operating agreement did not expressly state whether the determination must be made in good faith, if indemnification could be denied for any reason, including in bad faith, the good faith determination would be rendered meaningless. The court reversed and remanded the trial court's judgment, intending to give Baldwin an opportunity to prove whether New Wood did in fact breach

the implied covenant that the court held to be implied in Section 8.2 of the operating agreement.

Scope of Who Is a "Manager" of LLC for Purposes of Personal Jurisdiction

Next Level Ventures, LLC v. AVID USA Techs. LLC: **Court of Chancery Finds de facto Managers of Delaware Limited Liability Company Subject to Personal Jurisdiction in Delaware**

In *Next Level Ventures, LLC v. AVID USA Technologies LLC,* 2023 WL 3141054 (Del. Ch. Mar. 16, 2023), the Delaware Court of Chancery considered, *inter alia,* whether it could exercise personal jurisdiction over two defendants alleged to be de facto managers of a Delaware limited liability company under Section 18-109 of the LLC Act. The plaintiff in *Next Level* sought to enforce a preliminary injunction against AVID USA Technologies LLC (f/k/a AVD Technologies USA LLC), a Delaware limited liability company, and its alleged managers, Jonathan and Hanna Carfield, for violations of the Delaware Deceptive Trade Practices Act. Ultimately, the court found, *inter alia,* that the Carfields were de facto managers of AVID USA Technologies and subject to personal jurisdiction in Delaware under Section 18-109 of the LLC Act.

The court explained that to exercise personal jurisdiction over a defendant, a "plaintiff must first show there is a statutory basis for service, and then that the exercise of personal jurisdiction comports with due process." *Id.* at *19. After determining that the Carfields materially participated in the management of AVID USA Technologies and were de facto managers under Section 18-109 of the LLC Act, the court analyzed whether the defendant's claim fell within the scope of Section 18-109 of the LLC Act. Consistent with analogous corporate precedent, the court, relying on the plain language of the statute, noted that for claims to fall within Section 18-109, such claims must relate to (i) the business of the limited liability company, or (ii) a violation by the manager of a duty to the limited liability company. Further, the court highlighted that while earlier Delaware decisions had collapsed the Section 18-109 analysis with the due process analysis, the court would, looking to corporate precedent, conduct a separate due process analysis. Ultimately, the court found that the defendant's claims fell within the scope of Section 18-109 and noted that the Carfields had conceded that due process would be satisfied if they were found to be managers of AVID USA Technologies. As such, the court found, *inter alia,* that it could exercise personal jurisdiction over the Carfields.

The court, relying on the plain language of the statute, noted that for claims to fall within Section 18-109, such claims must relate to the business of the limited liability company or a violation by the manager of a duty to the limited liability company.

In re P3 Health Group Holdings, LLC: Court of Chancery Finds Chief Legal Officer of LLC and Person Who Had No Official Role with LLC but Made Decisions Regarding Management of LLC Were Both "Managers" Under the LLC Act for Purposes of Personal Jurisdiction

In *In re P3 Health Group Holdings, LLC,* 282 A.3d 1054 (Del. Ch. 2022), the Delaware Court of Chancery dismissed a motion for lack of personal jurisdiction. The court held that an LLC's chief legal officer was a manager within the meaning of 6 *Del. C.* § 18-109(a) and implicitly consented to service of process. Ultimately, the court reasoned that the chief legal officer materially participated in the LLC's management, qualifying her as a manager under Section 18-109(a).

P3 Health Group Holdings, LLC, a Delaware LLC, was managed by a board of managers. Hudson Vegas Investment SPV, LLC, a minority unit holder, brought a breach of fiduciary duty claim against P3's general counsel and chief legal officer, Jessica Puathasnanon. Puathasnanon moved for dismissal for lack of personal jurisdiction, arguing that there was improper service of process under Section 18-109(a) of the LLC Act. Specifically, Puathasnanon argued that she was not a company manager and did not consent to service of process.

Section 18-109(a) states that an LLC manager consents to the service of process through the LLC's registered agent by agreeing to serve as a manager for the LLC. Section 18-109(a) defines a "manager" as either (i) a person officially named as a manager in the company's governing documents ("formal manager"), or (ii) a person, not formally named, who materially participates in the management of the LLC ("acting manager").

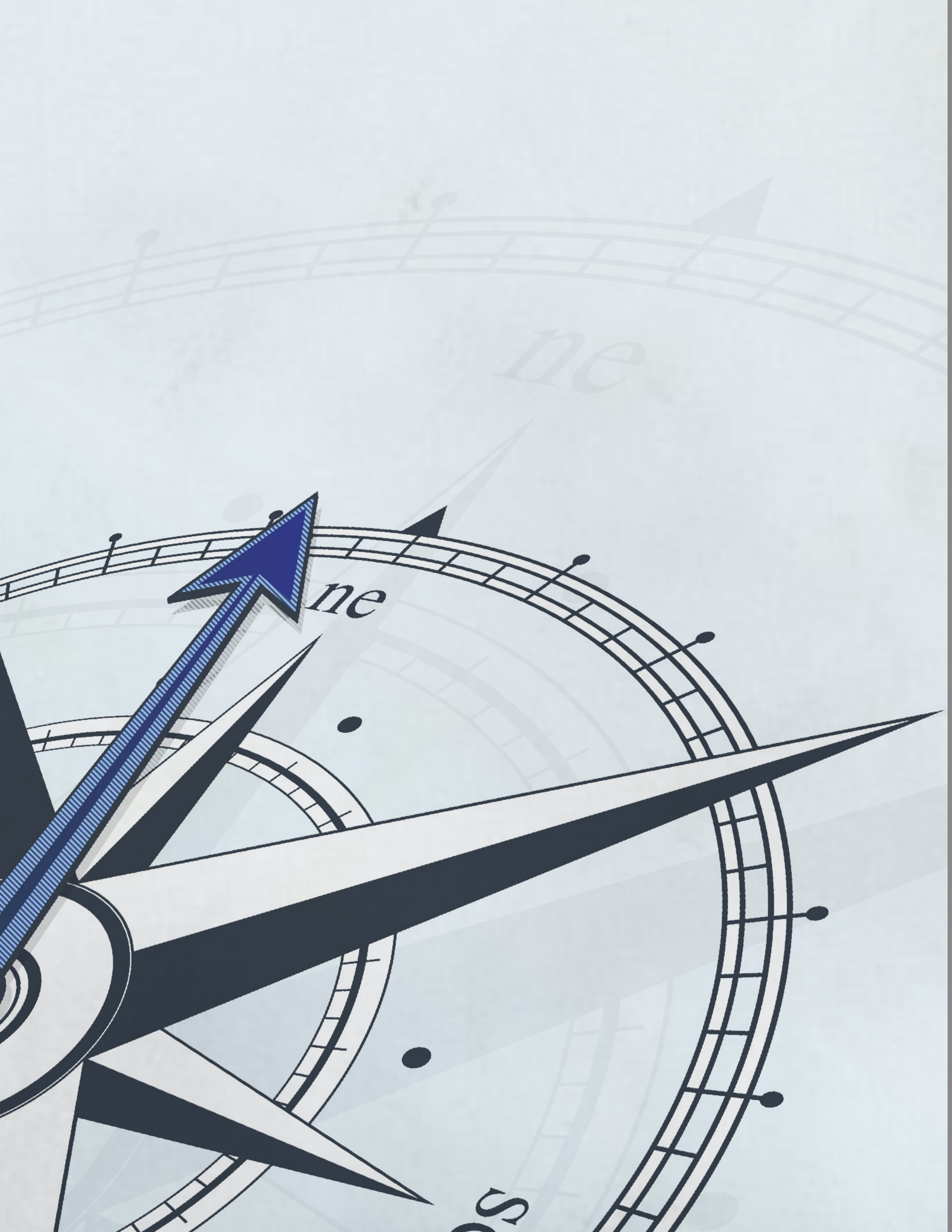
The court found that Puathasnanon was an acting manager and consented to service of process for three reasons. First, the court interpreted the plain meaning of "material participation" to include personnel in senior roles who perform functions consistent with those roles. Here, Puathasnanon was named the chief legal officer and general counsel.

An individual who has a significant role in managing an LLC or who plays a significant part in an activity or an event that constitutes part of the management of such LLC "participates materially" in the company's management and is a "manager" under Section 18-109(a).

Further, Puathasnanon performed functions consistent with those roles, including working with outside counsel to shape P3's merger strategy and guide the board in effectuating the merger. Second, the court applied the technical meaning of "material participation" as interpreted under the tax code. The court noted that one such test to determine if a taxpayer materially participated in a business is whether the taxpayer worked more than 500 hours a year in the role. Using this test to inform its analysis, the court found that, as chief legal counsel and general counsel, Puathasnanon materially participated in P3's management by working more than 500 hours a year in a senior management position. Third, the court analogized Section 18-109(a) to 10 *Del. C.* § 3114(b), which states that a corporate officer implicitly consents to service of process by voluntarily accepting the appointment. Section 3114(b) specifically names, among other officers, the chief legal officer as a role

consenting to service. The court found that Section 3114(b) was analogous to Section 18-109(a), despite Section 18-109(a) not listing specific officers. Ultimately, the court found that Puathasnanon consented to service of process by accepting a role as a chief legal counsel.

In the same decision, the court also denied a motion to dismiss for lack of personal jurisdiction filed by Sameer Mathur, a principal of Chicago Pacific Founders Fund, L.P., a Delaware limited partnership private equity fund that controls P3 through control of a majority of the P3 board of managers. Mathur argued that his purported service of process under Section 18-109(a) of the LLC Act was ineffective because he was not a "manager" of P3 within the meaning of Section 18-109(a). Mathur never held any official role with P3, as a manager, officer, employee, or otherwise, and was never designated as a manager by P3. Nevertheless, the court noted that an individual who has a significant role in managing a limited liability company or who plays a significant part in an activity or an event that constitutes part of the management of such limited liability company "participates materially" in the management of the limited liability company and is a "manager" under Section 18-109(a). While Mathur had no official role with P3, facts and documents presented to the court demonstrated that in connection with the year-long negotiation and ultimate consummation of the de-SPAC merger that led to this litigation, Mathur made decisions on behalf of P3, directed P3's management to take actions, instructed P3's advisors to perform work without authorization from P3's management, berated P3's legal counsel for not sending documents to him before circulating them to the wider group, and received materials for and attended P3's board meetings (despite his not being on P3's board). The court held that taking these actions on behalf of P3 and in connection with the de-SPAC merger constituted a significant role in the management of P3. As a result, the court found that Mathur was a "manager" within the meaning of Section 18-109(a) and could be validly served with process pursuant to that section.
In making this finding, the court rejected Mathur's arguments based on the "control overlay test"—that an individual cannot effectively control an entity if a different party is designated as the "sole manager" of such entity, and such individual therefore cannot be subject to personal jurisdiction in Delaware. The court concluded that the control overlay test conflicts with the plain language of Section 18-109(a).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2024 AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW

Legislation amending the DGCL was signed into law on July 17, 2024. It made several important changes to the statute as summarized below. Unless otherwise noted, the amendments became effective on August 1, 2024.

Section 122: Agreements with Stockholders and Beneficial Owners

The amendments to Section 122 were proposed in response to the opinion of the Delaware Court of Chancery in *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.*, 311 A.3d 809 (Del. Ch. 2024). In that case, the plaintiff, a stockholder of Moelis & Company, challenged the facial validity of various provisions in a stockholders' agreement between the company and its founder, Ken Moelis. The stockholders' agreement was adopted before the company's initial public offering, at which time Mr. Moelis owned more than 90% of the company's outstanding stock. While it undoubtedly was envisioned that Mr. Moelis would gradually reduce his position in the company's stock over time, it was apparently deemed important that he nevertheless retain some control over the company—which bore his name and presumably owed a substantial measure of its success to his involvement and efforts. Accordingly, the stockholders' agreement provided Mr. Moelis veto rights with respect to various corporate actions as well as rights in respect of the composition of the company's board of directors and board committees.

The court agreed with the plaintiff's argument that most of the provisions in the stockholders' agreement violated Section 141(a) of the DGCL, which provides that the business and affairs of the corporation shall be managed by or under the direction of the board of directors, except as otherwise provided in the DGCL or the certificate of incorporation. In reaching this conclusion, the court distinguished between "internal governance arrangements" and third-party agreements, finding that corporations have a greater degree of latitude in imposing restrictions on the board's managerial authority in third-party agreements than they do in the context of internal governance arrangements. In the case of the stockholders' agreement between the company and Mr. Moelis, the court held that the veto rights—which covered 18 different categories of actions, including the hiring and firing of the chief executive officer, mergers and acquisitions, and financings—were overbroad in combination, having the "effect of removing from the directors in a very substantial way their duty to use their own best judgment on management matters." The court likewise invalidated the provisions of the stockholders' agreement obligating the board to recommend to stockholders that they vote to elect Mr. Moelis' nominees as well as the provisions providing Mr. Moelis rights to fix the size of the board, to dictate the composition of board committees, and to fill board vacancies.

The court observed that certain provisions of the stockholders' agreement could have been validly implemented by alternative means, including through the adoption of provisions of the certificate of incorporation providing for charter-based veto rights or an affirmative delegation of the powers otherwise reserved by default to the board. Thus, the court's holding should be read to mean that there is no public policy prohibiting the types of governance arrangements set forth in the stockholders' agreement. Rather, the court's opinion should be read to mean that the provisions were invalid solely because they had not been implemented in one of the manners that the statute expressly permits.

Anticipating the effect its opinion would have on commercial practice, the court opened its opinion with the following: "What happens when the seemingly irresistible force of market practice meets the traditionally immovable object of statutory law? A court must uphold the law, so the statute prevails." In recognition of the effect on market practice, the court seemed to invite a legislative change, stating that the "expansive use of stockholder agreements suggests that greater statutory guidance may be beneficial" and that it "would welcome additional statutory guidance."

The amendments to Section 122 of the DGCL attempt to provide such additional statutory guidance. Section 122 is the provision of the DGCL that enumerates specific powers that are conferred upon a corporation, largely to negate any implication that the enumerated powers are not otherwise available to the corporation. To this end, the amendments added new Section 122(18), which expressly authorizes a corporation to enter into contracts with its stockholders and beneficial owners of its stock in exchange for minimum consideration determined by the board of directors. The statutory requirement for "minimum consideration" need not be expressly fixed by the board; rather, based on the language of the statute, the board's approval of an agreement from which it is clear that some form of consideration is flowing to the corporation

will satisfy the statutory requirement that the board make a determination as to the minimum consideration. The "minimum consideration" requirement is designed principally to distinguish between contracts, such as the stockholders' agreement at issue in *Moelis,* involving bargained-for rights and benefits, on the one hand, and governance arrangements, such as rights plans, where the counterparty is a rights agent (rather than one or more stockholders, despite the fact that they may be the ultimate beneficiaries of the plan), or stockholder-adopted bylaws. Nothing in new Section 122(18), however, should disturb the well-settled law surrounding stockholder-adopted bylaws or the adoption and maintenance of rights plans, or otherwise cast doubt on the sufficiency of the consideration supporting the validity of rights plans at common law.

Section 122(18) includes a nonexclusive list of the types of contracts that may be made with stockholders and beneficial owners, including agreements (i) pursuant to which the corporation agrees to restrict or prohibit itself from taking actions specified in the contract, whether or not the taking of such action would require approval of the board of directors under the DGCL; (ii) pursuant to which the approval or consent of one or more persons or bodies is required before the corporation may take actions specified in the contract; and (iii) in which the corporation covenants that it or one or more persons or bodies will take, or refrain from taking, actions specified in the contract. The amendments recognize that, unlike a charter-based provision adopted pursuant to Section 141(a), an agreement-based provision under Section 122(18) may not have the effect of ensuring that a stockholder or beneficial owner, in and of itself and without further corporate action on the part of the board or one or more other parties, can implement corporate action. But such an agreement-based provision may give rise to a remedy for breach of contract or attempted breach of contract. Broadly speaking, the amendments to Section 122(18) would insulate an agreement pursuant to which a corporation provides one or more of its stockholders or beneficial owners broad-based veto rights against a finding of statutory invalidity. It would similarly insulate against a finding of statutory invalidity of contract-based provisions that, for example, require the board (or some future board) to appoint specified directors to committees of the board, authorize corporate actions (including stock issuances), or take or refrain from taking any number of other corporate actions.

While the plain language of the new subsection would appear to give the board the power to bind the corporation to take fundamental action, such as approving a merger, at the direction of a stockholder, the real-world operation of any provision included in a stockholders' agreement will be much more limited. Although an agreement adopted pursuant to new Section 122(18) may require a corporation to cause fundamental action to be taken, nothing in the statute expressly provides that individual directors may be parties to the agreement and expressly bound thereto in their directorial capacities. Moreover, nothing in Section 122(18) enables a corporation to deliver any vote or consent of stockholders required by the DGCL or the certificate of incorporation. While new Section 122(18) recognizes that a stockholder may receive damages if the corporation fails to cause a contractually specified event to occur, the amount of any such damages will be constrained, in most cases involving fundamental corporate actions, by equitable principles. For example, fashioning a remedy

for a corporation's failure to cause a merger to occur as required by a stockholders' agreement due to the failure of stockholders to adopt the merger agreement likely would involve consideration of the principles of preclusion and coercion applicable to termination fees.

In connection with the addition of Section 122(18), Section 122(5), which relates to the corporation's power to appoint officers and agents and provide them suitable compensation, is being amended to clarify that any contract delegating power to an officer or agent is subject to Section 141(a), to the extent applicable. Thus, the amendments make clear that a board may not, for example, delegate fundamental board-level functions to officers and agents, absent a charter provision allowing such a delegation of power.

Section 147: Approval of Agreements, Documents, and Instruments

New Section 147 was added in response to the Delaware Court of Chancery's opinion in *Sjunde AP-fonden v. Activision Blizzard, Inc.,* 2024 WL 863290 (Del. Ch. Feb. 29, 2024), in which the court declined to grant a motion to dismiss the plaintiff's claims that a board failed to adequately authorize a merger agreement in accordance with Section 251. Among other things, the *Activision* court observed that there are competing views under Delaware law as to whether the board must approve the final merger agreement or an "essentially complete" form of the merger agreement. The court seemed to suggest that it would be sufficient for a board to approve an "essentially complete" form of agreement. Nevertheless, the court found, based on the allegations in the plaintiff's complaint, that the merger agreement as approved by the target company's board was not in essentially final form due to the omission of several terms that it regarded as essential.

New Section 147 enables a board of directors to approve, in either final form or "substantially final" form, any agreement, instrument, or document that requires board approval under the DGCL. Although new Section 147 does not expressly define what constitutes "substantially final," the synopsis to the proposed legislation makes clear that an agreement, document, or other instrument should be deemed to be in substantially final form if, at the time of board approval, all of the material terms are either set forth in the agreement, instrument, or document or are determinable through other information or materials presented to or known by the board.

Although new Section 147 was adopted in response to *Activision,* which related to the authorization of a merger agreement, it applies more broadly to other types of agreements, documents, or instruments requiring board approval under the DGCL, such as amendments to the certificate of incorporation, including certificates of designation. The new section applies to all relevant provisions of the DGCL, not just those relating to mergers; it thereby avoids creating a trap for the unwary by prescribing a more restrictive regime for one class of agreements, documents, and instruments than another. Section 147 should not be used to create an implication that any such agreement, document, or instrument requiring board approval may only be approved in final form or substantially final form; whether any such agreement is duly authorized is a function of the corporation's

certificate of incorporation and bylaws and common law principles governing corporate authorization. For example, the board's authorization of a term sheet summarizing the key terms, including the principal amount, interest rate, and maturity date, of a short-term note may serve as sufficient authorization of the note, even if the form of note was not presented to or reviewed by the board. Notably, since Section 271 of the DGCL, which requires a vote of stockholders to authorize a sale, lease, or exchange of all or substantially all of a corporation's assets, does not expressly require approval of an agreement, the new statute should not be viewed as creating an implication that a board must approve, pursuant to Section 271, an agreement in final form or substantially final form, nor should it create an implication that a board may not seek authorization for a sale, lease, or exchange of assets in the absence of a specific agreement.

New Section 147 also provides that if the board of directors has acted to approve or take other action with respect to an agreement, instrument, or document that is required to be filed with the Secretary of State or referenced in a certificate so filed (e.g., a certificate of merger), the board may, after providing such approval or taking such action and before the effectiveness of such filing, ratify the agreement, instrument, or document at any time before such filing becomes effective, and such ratification will satisfy any requirement under the statute relating to the board's authorization, whether in terms of the manner or sequence in which it is provided. The ratification provision is available as an option to provide greater certainty in circumstances where there may be a question as to whether the agreement, document, or instrument as initially approved was in substantially final form at the time of its approval. Although a board may elect to use Section 147's procedure to ratify an agreement, document, or instrument that it had previously approved in substantially final form, no such ratification is required for the valid authorization of any such agreement, document, or instrument. The fact that the statute offers a ratification as a failsafe should not be viewed as undermining the prior due authorization of any agreement, document, or other instrument subject to the statute if it was in fact approved in final form or substantially final form. Ratification under Section 147's procedure, where available, is an alternative to ratification under Section 204 of the DGCL, which provides corporations with a "self-help" procedure for ratifying defective acts, and Section 205 of the DGCL, which gives corporations and others the right to seek an order of the Court of Chancery validating a corporate act. Ratification under Section 147 dispenses with the formalities applicable to a ratification under Section 204 and, more important, dispenses with any need for a determination that the underlying act is or may be defective due to some failure in its authorization. As with ratification under Sections 204 and 205, however, the board's ratification of its original approval of an agreement, document, or other instrument under Section 147 relates back to the time of the original board approval. Moreover, ratification under Section 147 operates solely to eliminate doubt as to whether an agreement, document, or instrument subject to the statute was duly authorized; it does not, of itself, render moot any otherwise viable equitable challenge to the underlying business decision.

New Section 147 does not undercut any public policy in favor of ensuring that the terms expressly required by statute to be included in

a merger agreement have largely come to rest by the time the board takes action to approve the merger agreement. By statute, the only matters required to be included in a merger agreement are the terms and conditions of the merger, the mode of carrying it into effect, the amendments or changes of the certificate of incorporation of the surviving corporation to be effected by the merger, and the manner of converting shares into merger consideration or cancelling some or all of the shares. Any of the terms of the merger agreement, including those required by statute to be set forth therein, can be made dependent upon the operation of extrinsic facts. Moreover, before 1983, when the statute was amended to provide express authority for amendments to a merger agreement to be made, it was customary to negotiate the material terms of a transaction in a reorganization agreement, which had attached to it as an exhibit a bare-bones, short-form merger agreement that formally implemented the merger. These features of the statute and historical practice may provide some gloss on which terms of a merger agreement will be most critical in connection with any assessment as to whether the board had approved a "substantially final" form of the agreement.

Section 261: Remedies for Breach of a Merger Agreement; Stockholders' Representatives

Remedies for Breach of a Merger Agreement

The amendments to Section 261(a)(1) were proposed principally to address the Delaware Court of Chancery's opinion in *Crispo v. Musk,* 304 A.3d 567 (Del. Ch. 2023), in which a former Twitter stockholder, Luigi Crispo, brought suit against Elon Musk and his affiliates seeking specific performance and damages after they attempted to terminate a merger agreement with Twitter. After Musk and his affiliates dropped their suit against Twitter and closed the acquisition, Crispo sought a fee award based on the assertion that his claims contributed to the buyer group's decision to change course and close the deal. The *Crispo* court ruled that the plaintiff was not entitled to a mootness fee, finding that his claims were not meritorious since he either lacked status as a third-party beneficiary to bring the claims or, to the extent he was a third-party beneficiary, his ability to exercise his rights as such had not vested.

In reaching this conclusion, however, the court followed the reasoning in the Second Circuit Court of Appeals' decision in *Consolidated Edison, Inc. v. Northeast Utilities,* 426 F.3d 524 (2d Cir. 2005), to the effect that a target corporation in a proposed merger could not seek on behalf of its stockholders the loss of any premium the stockholders would have enjoyed had the buyer not breached the merger agreement beyond the damages incurred by the target itself. In the nearly two decades between *ConEd* and *Crispo*, many practitioners believed that the Delaware courts would not follow the reasoning in *ConEd,* and Delaware M&A practice evolved around that basic premise, with many public company M&A agreements either including provisions stating expressly that the target corporation would be entitled to seek from the buyer damages in the form of the stockholders' lost premium if the buyer's breach caused a closing failure, or remaining entirely silent on the question with the expectation that Delaware was an "anti-*ConEd*" state.

While the *Crispo* court recognized that M&A agreements may confer third-party beneficiary status on stockholders allowing

them to seek damages for any lost premium, it suggested, contrary to the expectations of many practitioners, that Delaware law aligns with *ConEd*. The opinion thus called into question the enforceability of provisions in M&A agreements purporting to vest in the target company the exclusive right to recover damages for the stockholders' lost premium. The *Crispo* court noted that, if the acquiror performed its obligations under the merger agreement, payment of the premium would flow to the stockholders, not the target company. On that basis, the court suggested that a damages award of the stockholders' lost premium, if recovered by the corporation itself, would function as an unlawful penalty. Despite recognizing the efficiency of allowing the target corporation to recover the stockholders' lost premium, the court indicated that a corporation could not appoint itself as the stockholders' agent for that purpose. (In a footnote, the court did raise the question as to whether a charter provision could be used to appoint the corporation as agent on behalf of the stockholders to seek damages based on the stockholders' lost premium.) The court's opinion appeared to provide stockholders greater protection in the form of a direct right to pursue claims for damages against buyers if the target failed to seek or obtain an award of specific performance. In practice, though, it significantly diminished the negotiating leverage of target corporations and decreased the overall protection available to their stockholders in that it supplied buyers with a strong rationale for resisting any effort to name the target company's stockholders as third-party beneficiaries or to include a lost damages premium as a potential measure of damages (i.e., that the buyer refused to expose itself to damages claims from a gaggle of disaggregated plaintiffs).

The amendments to Section 261(a)(1) allow commercial parties to contract for an outcome different from that contemplated by *ConEd*. The new subsection provides that parties to a merger agreement may include provisions for penalties or consequences (including a requirement to pay lost premium damages) upon a party's failure to perform or consummate the merger, regardless of any otherwise applicable provisions of contract law, such as those addressing liquidated damages and unenforceable penalties. Consistent with the DGCL's role as an enabling statute, the new subsection provides that constituent corporations may, through express provision in the merger agreement, allocate the risk of non-performance. Thus, a target corporation may, acting on behalf of the stockholders generally, seek a damages award from a buyer in the form of the stockholders' lost premium. Moreover, the target corporation may retain any such damages award it collects—and need not distribute the proceeds to stockholders or to any group of stockholders.

The new subsection, in and of itself, does not exclude remedies that might otherwise be available to a party at law or in equity, nor does it alter the fiduciary duties of directors in determining whether to approve or enforce any provision of a merger agreement. Thus, the new subsection does not displace the well-developed common law governing the circumstances under which a target's termination fee may operate lawfully, or when it may be struck down as preclusive of other bids or coercive of a stockholder vote.

Appointment of Stockholders' Representatives

In light of the statements in *Crispo* regarding agency appointments, to eliminate any

doubt regarding the validity of a typical arrangement in a private company merger agreement providing for the appointment of a stockholders' representative, new Section 261(a)(2) was adopted to provide that parties to a merger agreement may, through express provision in the agreement, appoint one or more persons to serve as the representative of stockholders of any constituent corporation, including stockholders whose shares shall be cancelled, converted, or exchanged in the merger or consolidation, and to delegate to such person(s) the exclusive authority to enforce the rights of such stockholders, such as rights to receive payments and enforce stockholders' rights under earn-out, escrow, or indemnification provisions, and to enter into settlements with respect thereto. The stockholders' representative may be appointed at or after the stockholders' adoption of the merger agreement and will thereafter be binding on all stockholders.

Section 261(a)(2) codifies the key aspects of existing Delaware law regarding the appointment and functions of stockholders' representatives in merger transactions. The provisions of subchapter IX of the DGCL governing mergers have for decades included provisions allowing provisions in merger agreements to be made dependent on facts ascertainable outside of the agreement. *See Aveta Inc. v. Cavallieri,* 23 A.3d 157 (Del. Ch. 2010). The "facts ascertainable" provisions set forth in several sections of subchapter IX already provide a corporation broad authorization to include in an agreement of merger or consolidation one or more provisions making the consideration received by stockholders subject to any future determinations made by, or documents entered into in the future by, a stockholder representative. It has become market practice, however, to refer to a stockholders' representative appointed in an agreement of merger or consolidation as an agent of the stockholders of the constituent corporation whose shares are cancelled and converted in the merger into the right to receive cash or other property. Accordingly, new Section 261(a)(2) provides express authorization for these representative provisions, avoiding any implication that such an arrangement is an impermissible agency appointment. It further provides that a stockholders' representative appointed pursuant to the terms of a merger agreement may be delegated powers, exercisable after the effectiveness of the merger, in addition to the power to make adjustments in respect of the nature or amount of merger consideration. As indicated above, the amendments should not be construed to limit the broad authority permitted under the DGCL and recognized in opinions of the Delaware courts, including *Aveta*, for constituent entities to make provisions in agreements or other instruments dependent on facts ascertainable outside of the agreement or instrument.

The amendments to Section 261(a)(2) do not allow for a provision of an agreement of merger or consolidation empowering a stockholders' representative to exercise powers beyond those related to the enforcement of the rights of stockholders under the agreement. Thus, for example, the amendments do not empower a stockholders' representative, acting solely pursuant to a provision adopted under new Section 261(a)(2), to waive, compromise, or settle, in the name of any stockholder, any rights to appraisal under Section 262 or any direct claim for breach of fiduciary duty that such stockholder is entitled to assert following a merger or consolidation, nor do the amendments empower the stockholders' representative to consent, in the name of any

stockholder, to restrictive covenants, such as a covenant not to compete or a non-solicitation covenant. An individual stockholder or group of stockholders, however, would still be entitled in their own capacity to grant any such powers to a stockholders' representative or other agent, whether through execution of a joinder to a merger agreement, consent or support agreement, or other instrument evidencing assent to the grant of such power.

Section 268: Amendments to Surviving Corporation Certificate of Incorporation; Disclosure Schedules

Amendments to the Surviving Corporation Certificate of Incorporation

New Section 268(a) provides that, if an agreement of merger (other than a holding company reorganization under Section 251(g) (i.e., a holding company reorganization not requiring a stockholder vote)) entered into pursuant to subchapter IX provides, with respect to a constituent corporation, that all of the shares of capital stock of the constituent corporation issued and outstanding immediately before the effective time of the merger are converted into or exchanged for cash, property, rights, or securities (other than stock of the surviving corporation), then the merger agreement approved by the board need not include any provision relating to the certificate of incorporation of the surviving corporation. Rather, under new Section 268(a), the board of directors of the target or buyer that will be the sole stockholder of the surviving corporation following the merger, or any person acting at either of their direction, may approve any amendment or amendment and restatement of the certificate of incorporation of the surviving corporation. Additionally, no alteration or change to the certificate of incorporation of the surviving corporation will be deemed to constitute an

amendment to a merger agreement within the scope of Section 268(a).

New Section 268(a) was adopted in light of the *Activision* opinion discussed above, in which the plaintiff also alleged that the board of directors did not approve the post-merger certificate of incorporation of the surviving corporation. Among other things, the amendment provides flexibility to a buyer in a typical "reverse triangular merger" to adopt the terms of the certificate of incorporation of the surviving corporation that, following the effectiveness of the merger, will be wholly owned and controlled by the buyer. Despite the additional statutory flexibility, a target corporation may insist, however, that the merger agreement expressly provide that the certificate of incorporation of the surviving corporation be adopted in a specified form or contain specified provisions, such as those relating to exculpation, indemnification, and advancement of expenses of directors, officers, and others, as applicable.

Disclosure Schedules, Disclosure Letters, and Similar Documents

The 2024 amendments also add new Section 268(b), which provides that a disclosure letter or disclosure schedules or any similar documents or instruments delivered in connection with an agreement of merger or consolidation that modify, qualify, supplement, or make exceptions to representations, warranties, covenants, or conditions in the merger agreement will not, unless otherwise provided by the agreement, be deemed part of the agreement for purposes of the DGCL. New Section 268(b) was adopted to avoid any implication from the court's decision in *Activision* that, in order for a merger agreement to have been duly authorized, the board of directors must have

approved final or substantially final disclosure schedules (or similar documents), or that the disclosure schedules (or similar documents) must be submitted to or adopted by the stockholders. New Section 268(b) reflects the fact that disclosure schedules and similar documents frequently operate as extrinsic facts incorporated by reference into the agreement but are not themselves part of the agreement and, as such, may be negotiated and prepared by officers and agents at the direction of the board of directors without the need, as a statutory matter, for formal approval by the board of directors or the stockholders.

Effective Date of Amendments

The amendments became effective on August 1, 2024 and apply to all contracts made by a corporation; all agreements, instruments, or documents approved by the board of directors; and all agreements of merger or consolidation entered into by a corporation, in each case whether made or approved before or after August 1, 2024. Consistent with Section 393 of the DGCL, which provides that "[a]ll rights, privileges and immunities vested or accrued by and under any laws enacted prior to the adoption or amendment of [the DGCL], all suits pending, all rights of action conferred, and all duties, restrictions, liabilities and penalties imposed or required by and under laws enacted prior to the adoption or amendment of [the DGCL], shall not be impaired, diminished or affected by [the DGCL]," the legislation states that the amendments do not apply to or affect any civil action or proceeding completed or pending before August 1, 2024.

2024 AMENDMENTS TO THE DELAWARE LLC AND PARTNERSHIP ACTS

Delaware has recently adopted legislation amending the Delaware Limited Liability Company Act (LLC Act), the Delaware Revised Uniform Limited Partnership Act (LP Act), and the Delaware Revised Uniform Partnership Act (GP Act) (collectively, the LLC and Partnership Acts). The following is a brief summary of some of the more significant amendments that affect Delaware limited liability companies, Delaware limited partnerships, and Delaware general partnerships, including amendments that will (i) expand the ability of a certificate of merger to amend a surviving entity's formation documents, and (ii) confirm and clarify the approval required to revoke dissolution or termination. The amendments became effective on August 1, 2024.

Amendments Effected by Certificates of Merger

Prior to the adoption of the recent amendments, the LLC and Partnership Acts expressly provided that a certificate of merger may amend (i) a surviving entity's certificate of limited partnership, certificate of formation, statement of partnership existence, or statement of qualification, as applicable, to change such surviving entity's name, registered office, or registered agent; and (ii) the certificate of registered series of a registered series surviving a merger, to change the name of such surviving registered series. The amendments to the LLC and Partnership Acts will permit a certificate of merger to amend a surviving entity's (or surviving registered series') certificate of limited partnership, certificate of formation, statement of partnership existence, statement of qualification, or certificate of registered series, as applicable, for any desired purpose in connection with a merger. This new mechanism will provide for greater efficiency by eliminating the need to file separate post-merger amendments to filed organizational documents. For example, if the general partner of a surviving Delaware limited partnership changes in connection with a merger, the amendments will permit a certificate of merger to amend the certificate of limited partnership to reflect such change. If a certificate of merger amends a certificate of limited partnership to reflect the admission of a new general partner, then the new general partner must sign the certificate of merger.

Further, to streamline the process of amending certificates of limited partnership, certificates of formation, statements of partnership existence, and certificates of registered series in connection with a merger, the amendments will also provide greater flexibility by permitting certificates of merger to fully amend and restate certificates of limited partnership, certificates of formation, statements of partnership existence, and certificates of registered series in their entirety. This approach is consistent with how certificates of merger may amend and restate certificates of incorporation of Delaware corporations under the Delaware General Corporation Law.

Revocation of Dissolution Approval

As a general matter, the LLC Act and the LP Act provide that if a Delaware limited partnership, limited liability company, or registered series thereof is dissolved, or a protected series thereof is terminated, by a vote or consent, then that same vote or

consent is needed to revoke such dissolution or termination. In this context, the amendments will confirm and clarify that the vote or consent of "other persons" to revoke dissolution or termination is determined by reference to the vote to dissolve or terminate in the partnership agreement or limited liability company agreement, as applicable, rather than by reference to any non-organizational document.

The amendments reflect Delaware's continuing commitment to maintaining statutes governing Delaware LLCs, LPs, and GPs that effectively serve the business needs of the national and international business communities. The amendments to the LLC Act, the LP Act, and the GP Act are contained in House Bill Nos. 336, 337, and 339, respectively.

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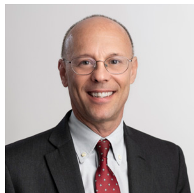

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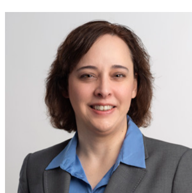

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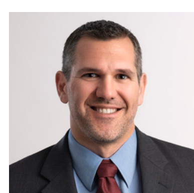

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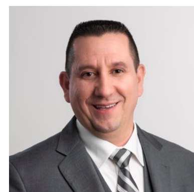

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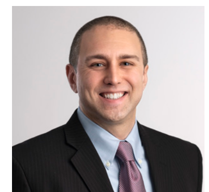

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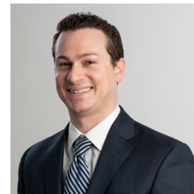

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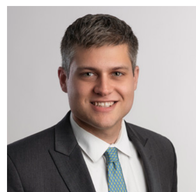

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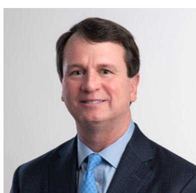

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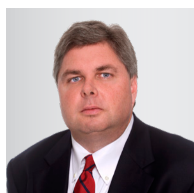

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