KEY DECISIONS OF 2014 IN DELAWARE CORPORATE AND ALTERNATIVE ENTITY LAW

Kathaleen S. McCormick, Tammy L. Mercer, and Daniel M. Kirshenbaum*

I. CORPORATE LAW

A. Clarifying Controlling Stockholder Issues

1. *MFW* Defines The Legal Standard Applicable To Negotiated Mergers With Controlling Stockholders

In *Kahn v. M&F Worldwide Corp.*,[1] the Delaware Supreme Court considered the standard of review applicable to a going-private merger with a controlling stockholder, holding that the business judgment standard can apply to transactions preconditioned on the approval of an independent and well-functioning special committee and the affirmative vote of a majority of the minority stockholders.

MFW involved a public offer by a 43% stockholder, MacAndrews & Forbes ("MacAndrews"), to acquire the remaining shares of M&F Worldwide ("MFW") for $24 per share. MacAndrews' proposal was contingent upon the conditions that: (1) the "Merger be negotiated and approved by a special committee of independent MFW directors"; and (2) the "Merger be approved by a majority of stockholders unaffiliated with" MacAndrews.[2] MFW's board of directors empowered a special committee of independent directors to review and evaluate the proposal, negotiate with MacAndrews, report its recommendation on the fairness of the proposal to the board, and/or elect not to pursue the offer.[3] The special committee retained its own independent legal counsel and financial advisor, and met eight times over the course of three months to negotiate with MacAndrews.[4] The special committee ultimately succeeded in raising the per-share deal price by $1, to $25 per share.[5]

The plaintiffs initially sought to enjoin the transaction in the Court of Chancery, but withdrew the request after taking expedited discovery.[6] The defendants then moved for summary judgment. The Court of Chancery held that

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* Ms. McCormick is a partner in and Ms. Mercer and Mr. Kirshenbaum are associated with the Corporate Counseling and Litigation Section of Young Conaway Stargatt & Taylor, LLP. While the authors and their firm represented parties in some of the decisions discussed in this article, the views expressed herein are those of the authors alone and do not necessarily represent the views of their firm or its clients. The authors express their gratitude to members of their firm who assisted with this article, including Meryem Dede, as well as Louis G. Hering of the law firm Morris Nichols Arsht & Tunnell for his thoughtful comments.

1. 88 A.3d 635 (Del. 2014).

2. *Id*. at 638.

3. *Id*. at 641.

4. *Id*. at 650-51.

5. *Id*. at 652.

6. *Id*. at 638.

business judgment review, rather than entire fairness, applied to its evaluation of the transaction because MacAndrews had, as a practical matter, relinquished its control by conditioning its offer on the special committee and stockholder approval processes.[7] The Court of Chancery granted summary judgment to the defendants, and the plaintiffs appealed.[8]

In affirming the Court of Chancery's decision, the Supreme Court acknowledged that, in the typical transaction between a corporation and its controlling stockholder, the applicable standard of judicial review is entire fairness, with defendants bearing the burden of proving that the transaction was entirely fair to the corporation and its minority stockholders.[9] The Court further recognized that, even where the transaction is approved by a well-functioning committee of independent directors *or* by an informed vote of a majority of the minority stockholders, entire fairness still applies, although the burden of persuasion shifts to the plaintiff.[10]

The Supreme Court concluded, however, that where *both* procedural protections are in place, business judgment review is appropriate. More specifically, the Court found that business judgment review applies if, and only if, the following six factors are satisfied:

> (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.[11]

The Court explained that the "simultaneous deployment of the[se] procedural protections … create a countervailing, offsetting influence of equal – if not greater – force" than the threat of entire fairness.[12] In other words, "where the controller irrevocably and publicly disables itself from using its control to dictate the outcome of the negotiations and the shareholder vote, the controlled merger then acquires the shareholder-protective characteristics of third-party, arm's-length mergers, which are reviewed under the business judgment standard."[13] The Court noted that business judgment scrutiny of such transactions also was justified because, among other things, it "optimally protects the minority stockholders" and is consistent with the traditional notion of Delaware law that courts should respect the informed decisions of directors and stockholders.[14]

The Court warned, however, that if a plaintiff could "plead a reasonably conceivable set of facts showing that any or all of these enumerated conditions did not exist," the complaint would state a claim for relief and would entitle the

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7. *Id*. at 639.

8. *Id*.

9. *Id*. at 642.

10. *Id*.

11. *Id*. at 645.

12. *Id*. at 644.

13. *Id*.

14. *Id*. at 644-45.

plaintiff to discovery.[15] If triable issues of fact about either dual procedural protections remained after discovery, the Court continued, the "case will proceed to a trial in which the court will conduct an entire fairness review."[16]

The Supreme Court then reviewed the record before it and affirmed the Court of Chancery's conclusions that MFW's special committee was independent and fully empowered and had acted with due care, and that the majority-of-the-minority vote was fully informed and uncoerced.[17] Because it could not "be credibly argued (let alone concluded) that no rational person would find the Merger favorable to MFW's minority stockholders[,]" the Supreme Court concluded that summary judgment had been appropriately granted in the defendants' favor.[18]

Two unreported 2014 bench rulings issued subsequent to *MFW* applied its holdings: *Swomley v. Schlecht*[19] and *ACP Master, LTD v. Sprint Corporation*.[20]

In the first, *Swomley*, the Court dismissed a complaint challenging a cash-out merger of a privately-held company by a 46-percent stockholder where the merger met the six-factor *MFW* test. As a threshold matter, the Court determined that the *MFW* test may be applied in the "private company context."[21] The Court reasoned that, historically, Delaware courts have not made distinctions between public companies and private companies. Then, the Court held that the stockholder-plaintiffs failed to plead facts sufficient to question the satisfaction of any of the six factors and granted the defendants' motion to dismiss the plaintiffs' complaint.

In the second, *Sprint*, the Court of Chancery denied a motion to dismiss claims challenging a controlling-stockholder buyout conditioned on the approval of both a special committee and a majority of the minority stockholders pursuant to *MFW*. Because the plaintiffs had adequately pled allegations that the majority-of-the-minority vote in favor of the merger had been coerced, the Court determined that it could not apply the business judgment standard of review. In light of the heightened scrutiny to be applied under the entire fairness standard, the Court denied the defendants' motions to dismiss the stockholder-plaintiffs' complaint alleging breach of loyalty claims against the acquirer and the target's board of directors, among others.

Further, because the Court determined that it was reasonably conceivable that *MFW* would not apply, and that the merger would be subject to entire fairness review, the Court declined to grant the dismissal motions of the company and the director defendants. The Court also declined to grant the acquirer's motion to dismiss for lack of personal jurisdiction and on the merits. In so doing, the Court held that the plaintiffs had adequately pled that the Court of Chancery had personal jurisdiction over SoftBank with respect to Clearwire's acquisition, because SoftBank's "jurisdictional act of forming Delaware subsidiaries for the purpose of acquiring Sprint" was "part of a single plan on behalf of Softbank

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15. *Id*. at 646.

16. *Id*.

17. *Id*. at 647-54.

18. *Id*. at 654.

19. C.A. No. 8355-VCL (Del. Ch. Sept. 10, 2014) (TRANSCRIPT) (applying *MFW* in the private company context), *aff'd*, No. 180, 2015 (Del. Nov. 19, 2015).

20. C.A. No. 8508-VCL (Del. Ch. Jul. 23, 2014) (TRANSCRIPT) (denying defendants' motion to dismiss under *MFW* where the plaintiffs argued that the majority-of-the-minority vote had been coerced).

21. *Id*. at 66.

to acquire Sprint and acquire Clearwire."[22] The Court further held that the plaintiffs had adequately pled that SoftBank aided and abetted Sprint "to squeeze out the stockholders of Clearwire for a below-market price."[23] The Court based this holding on its finding that the plaintiffs' allegations that SoftBank, among other things, participated in merger negotiations "create[d] an inference that SoftBank knowingly participated in that ongoing course of conduct."[24]

2. Dismissal Decisions Lend Guidance On Allegations Sufficient To Support A Finding Of Control

In several cases in 2014, the Court of Chancery discussed the circumstances under which a stockholder owning less than 50% of a corporation's outstanding shares can be considered a controlling stockholder. In three of these cases, the Court of Chancery dismissed complaints where allegations of control were insufficient, making clear that a non-majority stockholder will only be considered a controller if the stockholder controls the corporation's board of directors with respect to the challenged transaction.[25]

In *KKR*, the Court of Chancery considered on a motion to dismiss whether a stockholder who owned only 1% of a corporation's outstanding shares, but managed the corporation's day-to-day operations, was a controlling stockholder.[26] *KKR* involved the acquisition of KKR Financial Holdings LLC ("Holdings") by KKR & Co. L.P.'s ("KKR") in a stock-for-stock merger.[27] The merger was valued at $2.6 billion and represented a 35% premium to Holdings' trading price on the day of closing.[28] It was the product of a sound process, having been negotiated for Holdings by an independent transaction committee, which was advised by independent financial advisors and legal counsel, effective in raising the exchange ratio, and informed by a fairness opinion.[29] Also, the merger was conditioned on the approval of a majority of Holdings' stockholders other than KKR and its affiliates, which was obtained.[30]

Nevertheless, stockholder plaintiffs filed suit challenging the merger, alleging, among other things, that KKR was a controlling stockholder of Holdings and that it breached its duty of loyalty to other Holdings stockholders by causing Holdings to enter into the merger agreement. Although KKR owned less than 1% of Holdings' shares, the plaintiffs argued

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22. *Id.* at 107.

23. *Id.* at 108.

24. *Id.* at 109.

25. *See* In re KKR Fin. Hldgs. LLC S'holder Litig., 101 A.3d 980 (Del. Ch. 2014), *aff'd*, No. 629, 2015 (Del. Oct. 2, 2015); In re Crimson Exploration Inc. S'holder Litig., 2014 Del. Ch. LEXIS 213 (Del. Ch. Oct. 24, 2014); and In re Sanchez Energy Deriv. Litig., 2014 Del. Ch. LEXIS 239 (Del. Ch. Nov. 25, 2014). *But see* In re Zhongpin S'holders Litig., 2014 Del. Ch. LEXIS 252 (Del. Ch. Nov. 26, 2014), *rev'd on other grounds* 115 A.3d 1173 (Del. 2015).

26. 101 A.3d 980.

27. *Id.* at 983.

28. *Id.* at 988.

29. *Id.* at 987-88.

30. *Id.* at 988-89.

that KKR held actual control of Holdings' corporate conduct through a management agreement between Holdings and an affiliate of KKR, KKR Financial Advisors LLC ("Advisors").[31] The management agreement "delegated responsibility for its day-to-day operations," including, among other things, the power to implement and execute Holdings' business, investments, and risk management practices.[32] The management agreement also explicitly subjected Advisors to the supervision of the Holdings' board and limited the Advisors' "functions and authority" as Holdings delegated to it.[33]

The Court rejected the plaintiffs' argument that KKR was a controlling stockholder of Holdings with concomitant fiduciary duties. The Court explained that "[t]o survive a motion to dismiss … plaintiffs must allege facts demonstrating actual control with regard to the particular transaction that is being challenged."[34] Relying on its prior decisions in *Superior Vision Services, Inc. v. ReliaStar Life Insurance Co.*[35] and *In re Morton's Restaurant Group, Inc. Stockholders Litigation*,[36] the Court held that a minority stockholder will not be considered a controlling stockholder that owes a duty of loyalty to the other stockholders "unless it exercises such formidable voting and managerial power that it, as a practical matter, is no differently situated than if it had majority voting control."[37] The Court concluded that although the management agreement demonstrated that KKR controlled the day-to-day operations of Holdings, the complaint did not contain sufficient facts to support a reasonable inference that KKR controlled the Holdings board and was able to prevent the Holdings board from exercising its independent judgment when deciding whether or not to approve the merger agreement.[38] Specifically, the Court reasoned that the plaintiffs' claim was "devoid of any allegation that KKR had a contractual right to appoint any (much less a majority) of the members of the Holdings board, to dictate any action by the board, to veto any action of the board or to prevent the board from hiring advisors and gathering information in order to be fully-informed."[39] The Court also noted that there was nothing in the pleaded facts to suggest that the Holdings directors had reason to fear being replaced if they voted against the merger.[40]

On appeal, the Delaware Supreme Court affirmed and commended the Court of Chancery's "well-reasoned opinion,"[41] observing that "the Chancellor correctly applied the law and we see no reason to repeat his lucid analysis of the question."[42]

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31. *Id.* at 993.

32. *Id.* at 985.

33. *Id.*

34. *Id.* at 991.

35. 2006 Del. Ch. LEXIS 160 (Del. Ch. Aug. 25, 2006).

36. 74 A.3d 656 (Del. Ch. 2013).

37. *In re KKR*, 101 A.3d at 992 (citing *In re Morton's,* 74 A.3d at 664-65).

38. *Id.* at 993.

39. *Id.* at 994.

40. *Id.*

41. Corwin v. KKR Fin. Hldgs. LLC, No. 629, 2015, at 2 (Del. Oct. 2, 2015).

42. *Id.* at 4.

Next, in *Crimson*,[43] the Court of Chancery considered on a motion to dismiss whether a stockholder who owned 33.7% of a corporation's outstanding shares was a controlling stockholder. *Crimson* involved a stock-for-stock merger of Crimson Exploration, Inc. ("Crimson") and Contango Oil & Gas Co. ("Contango") in which Contango acquired Crimson in consideration for 0.08288 shares of Contango for each share of Crimson.[44] The exchange ratio represented a 7.7% premium to the trading price of Contango and Crimson common stock on the day prior to the announcement of the Merger.[45] The merger contained several deal protection devices, including a $7 million termination fee, which represented approximately 1.8% of Crimson's enterprise value, an expense fee, a no-solicitation provision and a matching-rights provision.[46]

Stockholder plaintiffs alleged that the merger undervalued Crimson. They further alleged that Oaktree Capital Management L.P. ("Oaktree"), the owner of 33.7% of Crimson's common stock, was a controlling stockholder that caused Crimson to be sold for an inadequate price in exchange for benefits not shared with the minority common stockholders.[47] The plaintiffs also alleged that both Crimson management and its board lacked independence because they were interested in the merger and were also dominated by Oaktree.[48] The plaintiffs thus argued that entire fairness was the proper standard of review and that defendants could not satisfy this standard.[49] The defendants moved to dismiss the complaint, arguing that Oaktree was not a controlling stockholder and that the plaintiffs had not pled sufficient facts to rebut the business judgment rule.[50]

The Court began its analysis by discussing the "two different contested issues related to the law of controlling stockholders": "(1) when is a stockholder a controlling stockholder?; and (2) which transactions involving a controlling stockholder implicate entire fairness?"[51] The Court first addressed the issue of when a stockholder will be considered a controlling stockholder. The Court explained that even a stockholder owning less than 50% of a corporation's shares can be considered a controlling stockholder if it is determined that the stockholder "exercises control over the business affairs of the corporation."[52] The Court proceeded to make a "non-exhaustive list of significant cases" where there was a dispute about whether a non-majority stockholder satisfied the "control" test and noted the lack of correlation in those cases between the percentage of shares owned by the non-majority stockholder and the likelihood of the Court to find the stockholder to be a controlling stockholder.[53] After examining several of the listed cases, the Court concluded that "a

43. 2014 Del. Ch. LEXIS 213 (Del. Ch. Oct. 24, 2014).

44. *Id.* at *19.

45. *Id.*

46. *Id.* at *20.

47. *Id.* at *23-24.

48. *Id.* at *24.

49. *Id.* at *23.

50. *Id.* at *25.

51. *Id.* at *31.

52. *Id.* at *32.

53. *Id.* at *34.

large blockholder will not be considered a controlling stockholder unless they actually control the board's decisions about the challenged transaction."[54]

The Court then addressed the second issue—which transactions involving a controlling stockholder implicate entire fairness review—holding that entire fairness review will be implicated in the following two categories of cases: "(a) transactions where the controller stands on both sides; and (b) transactions where the controller competes with the common stockholders for consideration."[55] The Court explained that in the latter category, entire fairness is deemed appropriate because the controller is presumed to be competing with the minority stockholders for a larger portion of the total consideration the acquirer is willing to pay."[56] The Court identified three cases in which the controlling stockholder will be considered to be competing with the minority stockholders: "(1) the controller receives disparate consideration, which the board approves; (2) the controller receives a continuing stake in the surviving entity, whereas the minority is cashed out; and (3) the controller receives a unique benefit, despite nominal pro rata treatment of all stockholders."[57]

In applying these standards, the Court found that while the plaintiffs did not plead any facts from which the Court could reasonably infer that Oaktree actually controlled the Crimson board, the Court was "hesitant to conclude that [p]laintiffs could not conceivably make that showing," which would be sufficient to survive a motion to dismiss.[58] Nevertheless, the Court held that entire fairness review was inappropriate because the plaintiffs did not plead sufficient facts from which they could conceivably show that Oaktree stood on both sides of the Merger or that it received some benefit not shared with the minority stockholders.[59]

The third case, *Sanchez*,[60] involved two family members whose collective ownership of 21.5% of the corporation's stock and control of two of five board seats were deemed insufficient to constitute control.[61] *Sanchez* involved a transaction in which Sanchez Energy Corporation ("Sanchez Energy") purchased a partial working interest in 40,000 acres of undeveloped land from Sanchez Resources, LLC ("Sanchez Resources").[62] A third-party, Altpoint Capital Partners ("Altpoint"), held a stake in the acreage.[63] When Altpoint refused to make any additional investments to fund development, Sanchez Energy acquired Altpoint's interest in the acreage.[64] Sanchez Energy paid approximately $77 million in cash and stock—$62 million to Altpoint and $15 million to Sanchez Resources.[65]

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54. *Id.* at *38.

55. *Id.* at *40.

56. *Id.* at *46-47.

57. *Id.* at *47.

58. *Id.* at *56.

59. *Id.* at *57-68.

60. 2014 Del. Ch. LEXIS 239 (Del. Ch. Nov. 25, 2014) *rev'd* 2015 Del. LEXIS 472 (Del. 2015).

61. *Id.* at *32.

62. *Id.* at *6.

63. *Id.* at *5.

64. *Id.*

65. *Id.* at *6.

Members of the Sanchez family stood on both sides of the transaction—owning Sanchez Resources outright, and having a significant 21.5% stake in Sanchez Energy. Two Sanchez family members also sat on the Sanchez Energy board.[66] The other three board members acted as the audit committee, which was created for the purpose of evaluating and approving interested-party transactions between Sanchez Energy and Sanchez family members.[67] The independent audit committee members, assisted by a financial advisor, approved the transaction with Sanchez Resources.[68]

Stockholder plaintiffs filed a derivative action alleging a breach of fiduciary duty claim against all of the directors for approving the transaction. The plaintiffs did not make a pre-suit demand, arguing that such a demand was futile under the test set forth in *Aronson v. Lewis*[69] and was therefore excused.[70] In *Aronson*, the Supreme Court held that a plaintiff who has not made a demand on the board must plead allegations raising a reasonable doubt that "(1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment."[71]

Relevant to the control analysis, the Court rejected the plaintiffs' argument under the second prong of *Aronson*: that even if the audit committee was found to be disinterested and independent, demand was futile under the second prong of the *Aronson* test because the Sanchez family were controlling stockholders, thereby triggering entire fairness standard of review.[72] The Court explained that "to establish that a defendant is a controlling stockholder when that stockholder owns less than 50% of the corporation's outstanding stock, a plaintiff must allege domination by a minority shareholder through actual control of corporate conduct," which the Court held means actual control over the board of directors.[73] According to the Court, "Vice Chancellor Parson's survey [in *Crimson*] confirms that, while the controller analysis is highly fact specific, actual board control is undoubtedly the defining and necessary feature of a minority controlling stockholder."[74] The Court held that the plaintiffs failed to plead facts to support a reasonable inference that the Sanchez family actually controlled Sanchez Energy's board.[75] In so concluding, the Court relied in part on the plaintiffs' own admission at oral argument that the Sanchez family could not exert power to remove a dissenting director.[76]

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66. *Id*. at *3.

67. *Id*. at *7.

68. *Id*.

69. 473 A.2d 805 (Del. 1984).

70. *Sanchez*, 2014 Del. Ch. LEXIS 239, at *2-3.

71. 473 A.2d at 814.

72. *Sanchez*, 2014 Del. Ch. LEXIS 239, at *21-22.

73. *Id*. at *25.

74. *Id*. at *27.

75. *Id*. at *31-32.

76. *Id*. at *32.

The Court also rejected the plaintiffs' argument that demand was futile under the first prong of the *Aronson* test because two of the three members of the audit committee lacked independence from the Sanchez family.[77] The plaintiffs based this argument on allegations that one of the audit committee members, Jackson, had donated to a Sanchez family member's political campaign and maintained a close friendship with the Sanchez patriarch "for more than five decades."[78] The other board member, Garcia, was also alleged to have personal ties to the Sanchez family that were "conceded at oral argument" to be "even weaker," than those alleged about Jackson.[79] The plaintiffs further pointed to long-term business relationships between Garcia and the Sanchez family, but failed to explain in briefing or at argument "the significance of these business relationships" or how they would cause Garcia to "abandon his fiduciary duties."[80] The Court found the plaintiffs' allegations wholly insufficient bases upon which to reasonably infer that either Jackson or Garcia lacked independence from the Sanchez family.[81]

One 2014 decision deemed allegations of a non-majority stockholders' control sufficient to support a finding of control if true. In *Zhongpin*,[82] the Court considered on a motion to dismiss whether a CEO and chairman of the board who owned 17.3% of a corporation's common stock was considered a controlling stockholder. *Zhongpin* involved a going-private merger in which Xianfu Zhu ("Zhu"), the CEO and chairman of the board of Zhongpin Inc. ("Zhongpin") and the owner of 17.3% of Zhongpin's common stock, purchased Zhongpin's outstanding shares for $13.50 per share. In March 2012, Zhu submitted a preliminary, non-binding proposal to purchase all of Zhongpin's outstanding shares for $13.50 per share.[83] In response to Zhu's proposal, Zhongpin's board established a three-member special committee comprising three directors from Zhongpin's board.[84] The special committee was charged to evaluate and negotiate, and recommend to the board whether to accept or reject, the terms of Zhu's proposal or any alternative transaction.[85]

The special committee engaged Barclays Bank PLC ("Barclays") as its independent financial advisor in connection with evaluating Zhu's proposal and any alternative transaction.[86] Although Barclays attempted to negotiate with Zhu to raise his $13.50 bid, Zhu remained steadfast in his price.[87] On November 21, 2012, Zhu informed the special committee that any further delay in signing a merger agreement would jeopardize his financing.[88] Shortly thereafter, Barclays informed

77. *Id.* at *8.

78. *Id.* at *16.

79. *Id.* at *19.

80. *Id.* at *20.

81. *Id.* at *21.

82. 2014 Del. Ch. LEXIS 252 (Del. Ch. Nov. 26, 2014).

83. *Id.* at *3.

84. *Id.* at *4.

85. *Id.*

86. *Id.* at *7.

87. *Id.* at *9.

88. *Id.* at *10.

the special committee that it could not render a fairness opinion on Zhu's proposal and terminated its engagement as the special committee's financial advisor.[89] Fearing that Zhu would lose his financing, the special committee determined at its November 23, 2012 meeting that Zhu's proposal was fair to Zhongpin's stockholders and advised the board to approve the transaction and recommend it to Zhongpin's stockholders, notwithstanding Barclays' refusal to render a fairness opinion.[90] In reaching this conclusion, the special committee noted the favorable deal provisions, including (i) a non-waiveable "majority of the minority" voting requirement, (ii) a 60–day go-shop provision that allowed Zhongpin to actively solicit proposals from third parties after entering into the Merger Agreement, and (iii) Zhongpin's right to terminate the merger agreement at any time and for any reason during the go-shop period with no termination fee.[91]

Zhongpin received no superior offers during the go-shop period.[92] On February 8, 2013, the special committee's new financial advisor rendered a fairness opinion on Zhu's proposal, concluding that it was fair from a financial standpoint.[93] On the same date, Zhongpin's special committee and board approved certain amendments to the merger agreement, including the removal of both the go-shop provision and Zhongpin's right to terminate the merger agreement for any reason and a reduction of Zhongpin's termination fee.[94] On June 27, 2013, a slim majority—51.3%—of Zhongpin's unaffiliated stockholders approved the merger agreement.[95]

Stockholder plaintiffs asserted fiduciary claims against both Zhongpin's board, for engaging in a sales process that advantaged Zhu at the expense of the other stockholders, and Zhu, for completing a self-dealing transaction at the expense of the other stockholders. The plaintiffs argued that Zhu was a controlling stockholder and thus the Court should apply the entire fairness standard.[96] The plaintiffs claimed that the merger was not entirely fair to the other stockholders because the special committee was beholden to Zhu, its process was flawed, and the merger consideration was inadequate.[97] Defendants moved to dismiss the complaint, arguing that the business judgment rule applied and that the plaintiffs could not rebut the business judgment rule's presumptions.[98]

The Court concluded that the complaint asserted facts that, if accepted as true, established that Zhu was a controlling stockholder. To reach this result, the Court concluded that the complaint supported inferences that Zhu possessed both latent control—the ability to exercise significant influence over stockholder votes on the election of directors, mergers and acquisitions, and amendments to Zhongpin's bylaws—and active control—the ability to materially impact

89. *Id.* at *11.

90. *Id.*

91. *Id.* at *12.

92. *Id.* at *13-14.

93. *Id.* at 14.

94. *Id.*

95. *Id.*

96. *Id.* at *16.

97. *Id.*

98. *Id.* at *15.

Zhongpin's day-to-day operations.[99] With respect to the "active control" issues, the Court noted that Zhongpin's 10-K explicitly stated that Zhu had "significant influence over [Zhongpin's] management and affairs," and that the loss of Zhu "would have a material adverse effect on [Zhongpin's] business and operations."[100] While the Court acknowledged that the 10-K did not "conclusively demonstrate Zhu's status as a controller under Delaware law," it did "along with the other allegations in the Complaint, support the inference that Zhu exercised significantly more power than would be expected of a CEO and 17% stockholder."[101]

Because Zhu was a controlling stockholder who stood on both sides of the transaction, the Court held that entire fairness review was appropriate. In so holding, the Court explained that because Zhu did not condition his proposal at the outset on the approval of a majority of the minority and that provision was only included at the "tail-end of the sales process" after the parties had already negotiated and agreed to the $13.50 per share price, the transactional structure did not satisfy the criteria set forth in *Kahn v. M & F Worldwide Corp.* to warrant the application of the business judgment standard of review.[102] The Court concluded that the plaintiffs adequately alleged facts that the merger "was not characterized by fair dealing and fair price" to meet the "reasonably conceivable" standard necessary to survive a motion to dismiss.[103]

3. *Nine Systems* Applies The Entire Fairness Standard To Find That A Control Group Breached Its Fiduciary Duties

In *In re Nine Systems Corp. Stockholders Litig.*, the Court held that defendants breached their duties of loyalty by engaging in a self-interested transaction through an unfair process, but at a fair price, awarding no damages, but inviting a petition for attorneys' fees.[104]

This entire fairness action arose from a 2002 recapitalization of Streaming Media Corporation, which later changed its name to Nine Systems Corporation ("Nine Systems").[105] The recapitalization caused the equity stake of defendants—three entities known as "Wren," "Javva," and "Catalyst," that collectively held 90% of Nine Systems' secured debt—to increase significantly, while the equity stake of plaintiffs, who were minority stockholders, was correspondingly diluted.[106] Four years later, in 2006, after marked improvement in Nine Systems' financial health, Nine Systems sold itself

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99. *Id.* at *25-26.

100. *Id.* at *22-23.

101. *Id.* at *24.

102. *Id.* at *28-31.

103. *Id.* at *32-33.

104. 2014 Del. Ch. LEXIS 171 (Del. Ch. Sept. 4, 2014).

105. *Id.* at *3.

106. The first step in the recapitalization involved the conversion of the Nine Systems' secured debt to newly issued Preferred A stock. That conversion increased Nine Systems' total equity outstanding by 23%. Nine Systems then issued new Preferred B-1 stock, representing 51% of Nine Systems's total equity, to Wren and Javva. As a result of the recapitalization, Wren, Javva, and Catalyst together increased their ownership interest from 54% to 80% of the Company's stock, and the plaintiff-stockholders' ownership was diluted from approximately 26% to 2% of the Company's stock. *Id.* at 49.

to Akamai Technologies ("Akamai") for $175 million.[107] The plaintiffs, who received $3 million in the merger,[108] sued and argued, *inter alia*, that the recapitalization: (1) was a conflicted transaction that was not entirely fair to the minority; and (2) resulted in the minority receiving far less than their fair share of the consideration from the Akamai merger.[109] The overarching theory behind the plaintiffs' claims was that, "through the Recapitalization, the Defendants unfairly expropriated the economic and voting rights of the Company's stockholders who did not participate in it."[110]

The Court rejected the defendants' argument that the Akamai merger extinguished plaintiffs' standing to pursue a derivative claim, finding that the plaintiffs could pursue their claims as direct claims against the defendants under *Gentile v. Rossette*,[111] because the defendants constituted a control group and "use[d] the levers of corporate control to benefit themselves" to the minority's detriment.[112] The Court reached this conclusion, in part, based on an internal Catalyst memo reflecting Catalyst's plan to "control the purse strings" of the Company to give "Catalyst (and to a lesser extent, [Wren] and Javva) control over the Company."[113] The Court also placed weight upon evidence that Catalyst was provided an option to invest that was not extended to other stockholders.[114]

The Court further concluded that the plaintiffs had standing to challenge the recapitalization directly because the majority of the board was conflicted with respect to the challenged transactions. The Court reasoned that:

> it makes little sense to hold a controlling stockholder to account to the minority for improper expropriation after a merger but to deny standing for stockholders to challenge a similar expropriation by a board of directors after a merger. After all, Delaware law endows the board—not a controller—with the exclusive authority to manage and direct the corporation's business affairs, the foremost example of which is the power to issue stock. Why, then, should Delaware law hold a controlling stockholder to a higher standard than the board of directors?[115]

The Court then undertook the fair dealing/fair price inquiry and found that the defendant directors had engaged in unfair dealing because, *inter alia*, they: (1) utterly failed to understand the nature of their fiduciary relationships to the Nine Systems minority stockholders; (2) were not adequately informed about the Company's valuation in connection with the recapitalization; (3) failed to adequately disclose material information about the recapitalization's terms and participants; and (4) inexplicably changed the terms of the recapitalization (after board approval had occurred) to increase the benefit to Wren and Javva, thereby increasing the harm to the minority stockholders.[116]

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107. *Id.*

108. *Id.* at *59.

109. *Id.* at *60.

110. *Id.* at *59.

111. 906 A.2d 91 (Del. 2006).

112. 2014 Del. Ch. LEXIS 171, at *85.

113. *Id.* at *72.

114. *Id.* at *74.

115. *Id.* at *82 (internal footnotes omitted).

116. *Id.* at *108-14.

Despite the finding of unfair dealing, the Court found that the plaintiffs received a more than fair price in the Akamai merger because, as of the recapitalization, the Company had a negative implied equity value and thus the value of the plaintiffs' shares as of the recapitalization was zero.[117] "[B]ecause their common stock had no value that could have been diluted, the Plaintiffs necessarily received the substantial equivalent in value of what they had before."[118] In what the Court labeled its "unitary conclusion on entire fairness," the Court held that "a grossly unfair process can render an otherwise fair price, even when a company's common stock has no value, not entirely fair."[119] Because the defendants' process in connection with the recapitalization was grossly unfair, the Court found that the defendants had breached their fiduciary duties.[120] Although the Court declined to award damages, it stated its willingness to exercise its "inherent equitable power to shift attorneys' fees and its statutory authority to shift costs," and invited the plaintiffs to "petition the Court for an award of attorneys' fees and costs if they so choose."[121]

B. Imposing Liability Against Financial Advisors

In *In re Rural/Metro Corp. Stockholders Litigation*,[122] the Court of Chancery held an acquired corporation's primary financial advisor liable for $74 million for aiding and abetting breaches of fiduciary duty by the corporation's directors, even though the directors' loyalty was not challenged and they were exculpated from monetary liability for breaches of the duty of care.

Rural/Metro Corporation ("Rural") merged with an affiliate of Warburg Pincus LLC ("Warburg") in June 2011.[123] Warburg paid $17.25 per share.[124] Dissenting stockholders of Rural sued, alleging that the Rural board breached its fiduciary duties by (i) failing to conduct a reasonable sales process (the "Sales Process Claim"), and (ii) failing to disclose material information in the Company's definitive proxy statement (the "Disclosure Claim").[125] The plaintiffs also alleged that the Rural board's financial advisors, RBC Capital Markets, LLC ("RBC"), and Moelis & Company LLC ("Moelis"), aided and abetted the Rural board's breaches of fiduciary duties. Both the Rural directors and Moelis settled before trial.[126] A trial was held solely against RBC on the aiding and abetting claims. [127]

117. *Id.* at *141.

118. *Id.* (internal quotation marks omitted).

119. *Id.* at *145-46.

120. *Id.* at *147.

121. *Id.* at *161 (internal footnote omitted).

122. 88 A.3d 54 (Del. Ch. 2014) (post-trial opinion concerning liability), 102 A.3d 205 (Del. Ch. 2014) (damages opinion), *aff'd sub nom.*, RBC Cap. Mkts., LLC v. Jervis, No. 140, 2015 (Del. Nov. 30, 2015).

123. 88 A.3d at 64.

124. *Id.*

125. *Id.*

126. *Id.*

127. *Id.*

At trial, the plaintiffs proved the following: In December 2010, RBC was aware that both Rural and Emergency Medical Services Corporation ("EMS"), Rural's largest competitor, were interested in being acquired.[128] RBC saw an opportunity whereby, "if Rural engaged in a sale process led by RBC, then RBC could use its position as sell-side advisor to secure buy-side roles with the private equity firms bidding for EMS."[129] RBC pursued this opportunity and became Rural's sell-side financial advisor, but "RBC did not disclose that it planned to use its engagement as Rural's advisor to capture financing work from the bidders for EMS."[130]

RBC commenced the sales process on the instructions of one Rural director and without the full Rural board's approval.[131] Soon after the sales process began, it ran into "readily foreseeable problems."[132] Because RBC had timed the Rural sales process to run in parallel with the EMS sales process, many of the "financial sponsors who participated in the EMS process [were] limited in their ability to consider Rural simultaneously because they [were] constrained by confidentiality agreements they signed as part of the EMS process and because EMS would fear that any participants in both processes would share EMS's confidential information with its closest competitor," Rural.[133] The confidentiality concerns ultimately resulted in Warburg being the only bidder for Rural.[134] RBC lobbied hard to convince Warburg to include RBC on its buy-side "financing tree" for the Rural merger, but Warburg refused. [135]

The Court of Chancery issued two primary post-trial opinions. The first, addressing RBC's liability for aiding and abetting the Rural directors' breaches of fiduciary duties, was issued on March 7, 2014 (the "Liability Opinion").[136] The second, quantifying the amount of damages for which RBC was responsible, was issued on October 10, 2014 (the "Damages Opinion").[137]

In its Liability Opinion, the Court of Chancery applied Delaware's intermediate standard of review, "enhanced scrutiny,"[138] to the Rural directors' decisions regarding the sale process.[139] The Court explained that the intermediate standard "applies to 'specific, recurring, and readily identifiable situations involving potential conflicts of interest where the realities of the decisionmaking context can subtly undermine the decisions of even independent and disinterested directors.'"[140]

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128. *Id.* at 66.

129. *Id.*

130. *Id.* at 68.

131. *Id.* at 67.

132. *Id.* at 70.

133. *Id.*

134. *Id.* at 74.

135. *Id.* at 77-78.

136. 88 A.3d 54.

137. 102 A.3d 205 (Del. Ch. 2014).

138. In the context of a challenged merger, this standard is sometimes referred to as the *Revlon* standard in reference to Revlon, Inc. v. MacAndrews & Forbes Hldgs., Inc., 506 A.2d 173, 182 (Del. 1986).

139. 88 A.3d at 81.

140. *Id.* at 82 (quoting In re Trados Inc. S'holder Litig., 73 A.3d 17, 43 (Del. Ch. 2013)).

On the burden of proof, the Court observed that had the Rural directors not settled with the plaintiffs, they would have been required to "establish both (i) the reasonableness of the decision making process … including the information on which the directors based their decision, and (ii) the reasonableness of the directors' action in light of the circumstances then existing."[141] But, since the plaintiffs settled with the defendant directors, the plaintiffs "took up the burden of proof on each of the elements of aiding and abetting, including the existence of a fiduciary breach."[142]

The Court then found that the plaintiffs had carried their burden on the sales process claims demonstrating the unreasonableness of several aspects of the defendant directors' decision-making process, including: (i) the decision to run the Rural sales process in parallel with the EMS process; (ii) the decision to maintain the parallel process despite its preventing many potential acquirers from considering Rural; and (iii) the decision to approve Warburg's $17.25 bid without adequate information.[143]

The Court also found that RBC aided and abetted the directors' breaches of duties because "RBC *created* the unreasonable process and informational gaps that led to the Board's breach of duty."[144] Thus, RBC's conduct easily satisfied the "knowing participation" prong of the standard for aiding and abetting a breach of fiduciary duty.[145]

Concerning the disclosure claims, the Court found that RBC provided false information to the Rural board in connection with its precedent transaction analyses. "RBC told the directors that it used 'Wall Street research analyst consensus projections' to derive Rural's EBITDA for 2010," but those data "were neither analyst projections, nor did they represent a Wall Street consensus."[146] The inclusion of that false information in Rural's proxy statement was a breach of duty in which RBC knowingly participated. Moreover, the proxy statement failed to disclose "how RBC used the initiation of the Rural sales process to seek a role in the EMS acquisition financing," and it also omitted "RBC's receipt of more than $10 million for its part in financing the acquisition of EMS."[147] Because "RBC knowingly participated in both of the disclosure violations," the Court held RBC liable for aiding and abetting the breaches of fiduciary duties in connection with those violations.[148]

In the subsequent Damages Opinion, the Court of Chancery engaged in a lengthy analysis to conclude that RBC was responsible for 83% of the total damages suffered by the plaintiffs.[149] The Court began by analyzing the Delaware Uniform Contribution Among Tortfeasors Act ("DUCATA") and concluded that DUCATA did not bar RBC from claiming a settlement credit or from seeking contribution from the settling defendants as joint tortfeasors.[150] But the Court also

141. 88 A.3d at 83 (internal quotation marks omitted).

142. *Id.* at 85.

143. *Id.* at 89-96.

144. *Id.* at 99 (emphasis in original).

145. *Id.* at 96-97.

146. *Id.* at 104.

147. *Id.* at 106.

148. *Id.* at 107.

149. 102 A.3d 205.

150. *Id.* at 222-224.

held that the equitable doctrine of unclean hands barred RBC from claiming either a settlement credit or contribution "to the extent that the breaches of duty [were] related to the Board's final approval of the Merger" because RBC "forfeited its right to have a Court consider contribution for these matters by committing fraud against the very directors from whom RBC would seek contribution."[151] Where breaches of duty were *not* related to the board's final approval of the merger, the Court apportioned liability between RBC and those director defendants who had committed non-exculpated breaches—i.e., breaches of the duty of loyalty—and thus would have been liable to plaintiffs but for the settlement. [152]

The Court weighted equally the damages associated with each of the two sets of claims—i.e., the (i) Sales Process Claim, and (ii) the Disclosure Claim. The Court then found that RBC was "solely responsible for the Disclosure Claim" and thus apportioned 50% of total damages to RBC based on that claim.[153] Next, the Court found that 50% of the fault for the Sales Process Claim related to the Rural board's final approval of the merger, and thus apportioned 50% of the damages for the Sales Process Claim (25% of the total damages) to RBC based on the "unclean hands" analysis. Lastly, the Court apportioned the final 50% of the fault for the Sales Process Claim (*i.e.*, the remaining 25% of total damages) between RBC and the two directors who had breached their duties of loyalty, assigning 8% of the remaining total damages to RBC. [154] In sum, RBC was liable for 83% of the total damages suffered by the plaintiff class.[155] The Court entered judgment against RBC in accordance with that conclusion.[156]

C. Proscribing Stockholder Litigation: Unenforceable Fee-Shifting Bylaws And Enforceable Delaware Forum Selection Clauses

In 2015, Delaware law-makers amended the Delaware General Corporation Law to prohibit certificates of incorporation and bylaws from including fee-shifting provisions for internal governance disputes, and to permit certificates of incorporation and bylaws to include provisions requiring that internal corporate claims be brought exclusively in Delaware courts.[157] The amendments, codified at 8 *Del. C.* §§ 102(f), 109(b), and 115, were signed into law by Delaware Governor Jack Markell on June 24, 2015, and became effective on August 1, 2015.

These amendments effectively prohibit the extension of the 2014 decision in *ATP Tour, Inc. v. Deutscher Tennis Bund* to stock corporations. In *ATP*, the Delaware Supreme Court held that fee-shifting bylaws were both theoretically permissible and enforceable under Delaware law, but the corporation at issue in the case was a non-stock membership corporation.[158] The amendments also codified the 2013 ruling in *Boilermakers Local 154 Retirement Fund v. Chevron*

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151. *Id.* at 237, 239.

152. *Id.* at 239.

153. *Id.* at 262.

154. *Id.* at 263.

155. *Id.*

156. *Id.*

157. Del. S. Res. 75, 148th Gen. Assem. (2015).

158. 91 A.3d 554 (Del. 2014).

Corporation,[159] which deemed enforceable a bylaw amendment unilaterally adopted by a board that selected Delaware as an exclusive forum for lawsuits brought by stockholders, either directly or on behalf of the corporation derivatively, to obtain redress for fiduciary breach.

The 2015 amendments, however, made clear that the Court of Chancery's 2014 decision in *City of Providence v. First Citizens BancShares, Inc.*,[160] in which the Court of Chancery held that forum selection bylaws were permissible even if they designated an exclusive forum other than Delaware, is no longer good law.

D. Clarifying Stockholder Inspection Rights

1. Scope Of Inspection: Ability To Inspect Privileged Information

In *Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Trust Fund IBEW*,[161] the Supreme Court considered on appeal the scope of production ordered by the Court of Chancery, which included the production of e-mails. The Supreme Court also considered whether the Court of Chancery properly applied the Fifth Circuit's holding in *Garner v. Wolfinbarger*[162] in ruling that certain attorney-client privileged documents should be produced. The Supreme Court affirmed both the scope of production ordered and the Court of Chancery's adoption and application of *Garner*.

Wal-Mart involved a request by Indiana Electrical Workers Pension Trust Fund IBEW ("IBEW") to inspect a broad category of documents of Wal-Mart Stores, Inc. ("Wal-Mart") pursuant to 8 *Del. C.* § 220. The request was in response to allegations that Wal-Mart de Mexico ("WalMex"), a Wal-Mart subsidiary, engaged in a scheme of illegal bribery payments to Mexican officials at the direction of WalMex's CEO in exchange for benefits ranging from zoning changes to rapid and favorable processing of permits and licenses for new stores.[163] IBEW's stated purpose in requesting the documents was "to investigate: (1) mismanagement in connection with the WalMex Allegations; (2) the possibility of breaches of fiduciary duty by Wal–Mart or WalMex executives in connection with the bribery allegations; and (3) whether a pre-suit demand on the board would be futile as part of a derivative suit."[164] Although Wal-Mart produced certain documents, IBEW believed that the document production was deficient and too narrow in scope.[165] Wal-Mart also declined to produce to IBEW documents that were protected by the attorney-client privilege and attorney work-product doctrine.[166] As a result, IBEW brought an action in the Court of Chancery pursuant to Section 220.

IBEW also noticed depositions of certain Wal-Mart records custodians to gain information about documents that it believed should have been disclosed.[167] In response, Walmart moved for a protective order, arguing that the deposition

159. 73 A.3d 934 (Del. Ch. 2013).

160. 99 A.3d 229 (Del. Ch. 2014).

161. 95 A.3d 1264 (Del. 2014).

162. 430 F.2d 1093 (5th Cir.1970).

163. *Wal-Mart*, 95 A.3d at 1268.

164. *Id*.

165. *Id*. at 1269.

166. *Id*.

167. *Id*.

notices were overly broad.[168] After an October 2012 Court of Chancery hearing failed to resolve the parties' issues, the parties agreed to conduct a Section 220 trial on the basis of a paper record to determine whether Wal-Mart had produced all of the documents that were responsive to IBEW's demand.[169]

On October 15, 2013, the Court of Chancery entered a Final Order and Judgment ordering Wal-Mart to produce: "(1) officer (and lower)-level documents regardless of whether they were ever provided to Wal–Mart's Board of Directors or any committee thereof; (2) documents spanning a seven-year period and extending well after the timeframe at issue; (3) documents from disaster recovery tapes; and (4) any additional responsive documents 'known to exist' by the undefined 'Office of the General Counsel.'"[170]

Additionally, the Court of Chancery ordered Wal-Mart to produce documents protected by the attorney-client privilege. In doing so, the Court of Chancery relied on *Garner v. Wolfinbarger*, in which the Fifth Circuit recognized a stockholder's right to inspect attorney-client privileged documents in order to prove fiduciary breaches by those in control of the corporation upon showing good cause.[171] The Court of Chancery also ordered Wal-Mart to produce documents protected by the attorney work-product doctrine.[172]

Wal-Mart appealed the Court of Chancery's final order, arguing that it was ordered to produce documents that "far exceed the proper scope of a Section 220 action," and that IBEW failed to meet its burden of showing that the scope of production was "necessary and essential" to its proper purposes.[173] Wal-Mart also argued that the *Garner* doctrine had never been accepted by the Supreme Court in any plenary proceeding, much less in the context of a Section 220 action.[174] Finally, Wal-Mart argued that the Court of Chancery erroneously relied on the *Garner* doctrine in requiring Wal-Mart to produce work-product documents because the *Garner* doctrine is only applicable to attorney-client privileged documents.[175]

The Supreme Court first affirmed the scope of the production ordered by the Court of Chancery. The Supreme Court explained that the plain language of Section 220(c) gives the Court of Chancery discretion to determine the scope of any document production and it thus only reviews the Court of Chancery's determinations for abuse of discretion.[176] The Supreme Court concluded that the Court of Chancery properly used its discretion in concluding that the documents ordered to be produced were "necessary and essential" to IBEW's proper purposes.[177]

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168. *Id.*

169. *Id.*

170. *Id.* at 1270.

171. *Id.*

172. *Id.*

173. *Id.* at 1270-71.

174. *Id.* at 1271.

175. *Id.*

176. *Id.* at 1271-72.

177. *Id.* at 1272.

Next, the Supreme Court affirmed the Court of Chancery's ruling that IBEW was entitled to certain attorney-client privileged documents. In doing so, the Supreme Court concluded that the Court of Chancery properly adopted the *Garner* doctrine in a Section 220 action. The Supreme Court explained that the *Garner* doctrine "is narrow, exacting, and intended to be very difficult to satisfy," and that the doctrine "achieves a proper balance between legitimate competing interests."[178] The Court made clear, however, that "the necessary and essential inquiry must precede any privilege inquiry because the necessary and essential inquiry is dispositive of the threshold question—the scope of document production to which the plaintiff is entitled under Section 220."[179]

The Supreme Court also affirmed the Court of Chancery's application of the *Garner* doctrine. The Supreme Court relied on the following factors in determining that IBEW had satisfied the "good cause" standard required by *Garner*: (1) IBEW had a colorable claim; (2) the information sought was unavailable from non-privileged sources; (3) the information sought was particularized and not just "a broad fishing expedition"; (4) disclosure of the material would not risk the revelation of trade secrets; (5) the allegations at issue implicated criminal conduct under the Foreign Corrupt Practices Act; and (6) IBEW was a legitimate stockholder as a pension fund.[180]

Finally, the Supreme Court affirmed the Court of Chancery's ruling that IBEW was entitled to certain work-product documents. The Supreme Court rejected Wal-Mart's contention that the Court of Chancery improperly conflated these two standards, explaining that "[a] careful reading of the Garner factors demonstrates that they overlap with the required showing under the Rule 26(b)(3) work-product doctrine" and that the Court of Chancery "only referred to the privilege rationale of Garner as overlapping with its own separate work product analysis."[181]

2. Conditions On Inspection: Agreements To Forum Selection And Trading Restrictions

In *United Technologies Corp. v. Treppel*,[182] the Supreme Court considered on appeal whether the Court of Chancery had authority under 8 *Del. C.* § 220 to impose a restriction requiring a stockholder to bring any legal action resulting from a books and records inspection in Delaware. At the time Treppel brought his lawsuit, United Technologies did not have a forum selection clause in its bylaws requiring all litigation to be brought in Delaware courts.[183] However, the board adopted such a provision while the lawsuit was pending.[184] The Supreme Court reversed the Court of Chancery's ruling, holding that the Court of Chancery does have such authority under the broad powers of Section 220.[185] The Supreme

178. *Id*. at 1278.

179. *Id*.

180. *Id*. at 1279-80.

181. *Id*. at 1281.

182. 109 A.3d 553 (Del. 2014).

183. *Id*. at 556.

184. *Id*.

185. *Id*. at 559.

Court remanded the action so the Court of Chancery could consider in the first instance whether it should exercise its authority and impose this restriction based on the specific facts of the case.[186]

Conversely, in *Ravenswood Inv. Co., L.P. v. Winmill & Co. Inc.*,[187] the Court of Chancery held that a corporation could not condition a production in response to a books and records demand on an agreement to indemnify the corporation against any legal claims arising as a result of the stockholder's use of the information received.

Ravenswood involved a demand by Ravenswood Investment Company, L.P. ("Ravenswood) to inspect the books and records of Winmill & Company Incorporated ("Winmill") pursuant to Section 220 for the purpose of "determining the value of its investment in and the economic performance of Winmill."[188] Winmill provided Ravenswood with all of its requested documents except for Winmill's financial statements.[189] Winmill had concerns regarding potential "tipper liability" under the federal securities law for disclosing material, nonpublic information to a recipient who then trades on that information.[190] Winmill also argued that Ravenswood's true purpose for requesting the financial statements could only have been to trade on the non-public, material information that it would learn from the financial statements, which did not qualify as a "proper purpose" under Section 220(b).[191] Thus, Winmill refused to provide Ravenswood with its financial statements unless Ravenswood agreed to be bound by a restriction forbidding it to trade in Winmill's stock for one year after receiving the financial statements.[192]

The Court began its analysis by noting that "Delaware law has long recognized that valuing stock is a proper purpose to support a stockholder's request for financial information from a corporation under 8 *Del. C.* § 220."[193] The Court thus concluded that Ravenswood's purpose for requesting Winmill's financial statements was "clearly proper," and that "any secondary purpose or ulterior motive of the stockholder becomes irrelevant."[194]

Having determined the purpose of Ravenswood's request to be proper, the Court next addressed the restriction that Winmill sought to impose on Ravenswood as a condition to producing the financial statements. The Court held that such a restriction "would inappropriately frustrate" the "fundamental stockholder right" of valuing stock.[195] The Court explained that "the whole point of valuing stock is so that a stockholder can determine what to do with it: to buy, to sell, or to use the value for some other appropriate purpose."[196] The Court was thus "unwilling to incorporate such an inequitable notion into Delaware's Section 220 jurisprudence," concluding that such a restriction "is contrary to Delaware law."[197]

186. *Id.* at 560.

187. 2014 Del. Ch. LEXIS 93 (Del. Ch. May 30, 2014) (Noble, V.C.).

188. *Id.* at *7.

189. *Id.*

190. *Id.*

191. *Id.*

192. *Id.*

193. *Id.* at *11.

194. *Id.* at *12.

195. *Id.*

196. *Id.* at *12-13.

197. *Id.* at *13.

3. Proper Purpose For Inspection: Ulterior Purposes And Desire To Investigate Time-Barred Claims

In *Caspian Select Credit Master Fund Ltd. v. Key Plastics Corp.*,[198] the Court of Chancery considered whether a stockholder had improper ulterior motives in requesting to inspect a corporation's books and records other than its stated purpose, which the Court had determined was a "proper purpose" under 8 *Del. C.* § 220(b). The Court granted the stockholder's request to inspect the corporation's books and records, holding that the corporation could not prove that the stockholder's stated purpose for inspecting the books and records was not genuine and that the potential existence of an ulterior motive was not a basis to reject the stockholder's request.

Caspian involved a request by Caspian Select Credit Master Fund Ltd. ("Caspian"), the owner of approximately 8.5% of Key Plastics Corporation's ("Key Plastics") outstanding shares, to inspect Key Plastics' books and records pursuant to Section 220. Key Plastics had filed a prepackaged bankruptcy plan under Chapter 11. Caspian served a demand letter upon Key Plastics requesting to inspect Key Plastics' books and records.[199] The letter explained that Caspian wished to inspect Key Plastics' books and records for the purpose of, among other things, (i) investigating potential waste and mismanagement with respect to a loan provided to Key Plastics by Wayzata Investment Partners LLC, the manager of two funds that together owned the other 91.5% of Key Plastics outstanding shares; (ii) investigating whether the controlling stockholders engaged in any self-dealing; and (iii) valuing Caspian's equity stake.[200] Key Plastics agreed to allow Caspian to inspect a limited number of documents on condition that Caspian sign a confidentiality agreement.[201] Caspian refused to sign the confidentiality agreement and instead brought a books and records action.

The parties disagreed about whether Caspian's purpose for inspecting the books and records was proper. Caspian argued that both its desire to investigate potential waste and mismanagement and its desire to value its equity stake were proper purposes under Section 220(b).[202] Key Plastics argued that Caspian's true purpose for requesting to inspect the books and records was to use the litigation as a means to force Key Plastics to buy Caspian's equity stake.[203]

The Court began its analysis by noting that the valuation of one's equity stake and the investigation of potential waste, mismanagement, self-dealing or other improper transactions are proper purposes under Section 220(b).[204] Accordingly, the Court explained that "[b]ecause the analysis of a stockholder's secondary purpose or ulterior motive is unnecessary once a proper primary purpose is established, the Court's analysis is limited to determining whether the alleged secondary purposes are the stockholder's primary purposes and the stated primary purpose is false."[205] In other words, the Court held

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198. 2014 Del. Ch. LEXIS 26 (Del. Ch. Feb. 24, 2014) (Noble, V.C.).

199. *Id.* at *5.

200. *Id.*

201. *Id.* at *6.

202. *Id.* at *7.

203. *Id.*

204. *Id.* at *9-11.

205. *Id.* at *9.

that for a defendant to rebut an established proper primary purpose "[t]he defendant must demonstrate that the plaintiff's stated purpose was offered under false pretenses and thus the primary purpose is improper."[206]

The Court found no evidence that Caspian's stated purposes were offered under false pretenses. The Court explained that Caspian had demonstrated an interest in selling its equity stake, which justified Caspian's desire to value that stake, and produced sufficient evidence to support a credible basis for its concerns regarding waste, mismanagement and self-dealing, etc.[207] The Court rejected Key Plastics' assertions that the evidence did not support a credible basis to infer wrongdoing as "attempts to engage in a merits defense," explaining that "a stockholder need not prove actual wrongdoing as a Section 220 action is not a full trial on the merits."[208]

In *Wolst v. Monster Beverage Corp.*,[209] the Court of Chancery considered whether a stockholder seeking to inspect a corporation's books and records to evaluate the corporation's rejection of the stockholder's litigation demand can demonstrate a "proper purpose" under Section 220(b) when the claims the stockholder sought to bring are now time-barred. The Court held that, in such a case, the inspection request would be improper.

Wolst involved a request by Anastasia Wolst, a stockholder of Monster Beverage Corporation ("Monster"), to inspect Monster's books and records pursuant to Section 220. In 2012, Wolst made a demand on Monster's board to bring litigation related to potential federal securities violations by certain Monster insiders.[210] In response, Monster's board appointed a special committee, which rejected Wolst's demand.[211] In 2013, Wolst requested from Monster to inspect certain of its books and records for the purpose of evaluating the board's refusal to act on her litigation demand and the process by which the board decided to reject her demand.[212] Wolst conceded that her ultimate goal was "to determine whether there is a basis to bring a derivative suit based on the wrongs alleged in the earlier derivative action."[213] Monster thus argued that Wolst's request was not for a "proper purpose," as required by Section 220(b), because the derivative suit that Wolst wanted to bring was time-barred.[214]

The Court began its analysis by noting that while the derivative suit that Wolst wanted to bring was time-barred, it is possible that "conduct that cannot be challenged because of a time-bar defense can, nevertheless, inform consideration of other potentially wrongful conduct that is not yet time-barred."[215] Nevertheless, the Court acknowledged "the possibility that, in a specific factual setting, a time bar defense … would eviscerate any showing that might otherwise

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206. *Id.* at *12-13.

207. *Id.* at *9-12.

208. *Id.* at *12.

209. 2014 Del. Ch. LEXIS 198 (Del. Ch. Oct. 3, 2014) (Noble, V.C.).

210. *Id.* at *2.

211. *Id.*

212. *Id.*

213. *Id.*

214. *Id.*

215. *Id.* at *4.

be made in an effort to establish a proper shareholder purpose."[216] The Court explained that in this case, the challenged trading activities occurred in 2006 and 2007 and Wolst had not identified any more recent wrongful conduct that could serve as a basis for litigation. The Court thus concluded that "[w]ithout some elaboration upon what [Wolst] would do with the requested books and records in her capacity as a stockholder, the burden of producing books and records that Section 220 imposes upon the corporation should be avoided in this instance."[217] The Court emphasized, however, that its holding was limited to "this specific factual setting."[218]

E. Dismissing Directors Pre-Trial On The Basis Of Exculpatory Charter Provisions

In *In re Cornerstone Therapeutics, Inc. S'holder Litig.*, the Supreme Court put an end to a long-standing debate concerning the procedural implications of exculpatory charter provisions.[219] Overruling the Court of Chancery,[220] the Supreme Court held that even when the challenged transaction is subject to entire fairness review, exculpated claims against directors protected by exculpatory charter provisions may be resolved before trial, saving the directors the burden of litigation.[221]

In February 2013, Chiesi Farmaceutici S.p.A. ("Chiesi"), a privately-held Italian drug manufacturer and holder of 65.4% of the stock in Cornerstone Therapeutics Inc. ("Cornerstone") sent a letter to Cornerstone's board offering to acquire all of Cornerstone's remaining stock for between $6.40 and $6.70 per share.[222] At the time, Cornerstone's board consisted of nine directors, including two who were current Chiesi employees.[223] Cornerstone formed a special committee to consider Chiesi's offer. The special committee consisted of five Cornerstone directors, all of whom were unaffiliated with Chiesi.[224] The special committee hired Clifford Chance U.S. LLP as its legal advisor and Lazard as its financial advisor.[225]

Upon reviewing management's forecasts and Lazard's financial analysis, the special committee concluded that the fair value of Cornerstone's stock was in the range of $11.00 to $12.00 per share. The special committee communicated to Chiesi that it would consider a deal at $12.00 per share.

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216. *Id.*

217. *Id.*

218. *Id.*

219. 115 A.3d 1173 (Del. 2015).

220. 2014 Del. Ch. LEXIS 170 (Del. Ch. Sept. 10, 2014) (Glasscock, V.C.).

221. *Cornerstone*, 115 A.3d at 1176.

222. *Cornerstone*, 2014 Del. Ch. LEXIS 170, at *3-4.

223. A third director was a former Chiesi employee. *Id.*

224. Plaintiffs, however, questioned the special committee's independence, noting that some of its members were involved in a company that had previously done a deal with Chiesi and that the other members were handpicked by Cornerstone's CEO, who had previously sold Cornerstone stock to Chiesi. *Id.* at *6.

225. *Id.* at *4-6.

In May 2013, Cornerstone released first quarter financial results that fell below its projections. Based on management's updated financial forecast and certain negative adjustments that the special committee instructed Lazard to make to its financial analysis, the special committee informed Chiesi that it would accept a deal at $10.25 per share.[226]

A few weeks later, Cornerstone received a letter from one of its competitors advising that it was seeking regulatory approval for a new drug that would compete directly with one of Cornerstone's products; but, the competitor claimed, that would not infringe on any of Cornerstone's patents. In light of this threat, the special committee further revised its demand to Chiesi downward, to $9.75 per share.[227]

The special committee ultimately recommended to the board a merger at $9.50 per share, conditioned upon the approval of the majority of Cornerstone's minority stockholders. The Cornerstone board approved the merger and filed its definitive proxy in December 2013. The merger was approved by more than 80% of Cornerstone's minority stockholders at a special stockholder meeting in February 2014.[228]

The plaintiffs filed suit to challenge the merger, asserting a breach of fiduciary duty claim against members of the special committee and the other four Cornerstone directors, a breach of fiduciary duty claim against Chiesi as the controlling stockholder, and an aiding and abetting a breach of fiduciary duty claim against Cornerstone.[229]

All defendants moved to dismiss the claims against them. Both plaintiffs and defendants agreed that entire fairness was the appropriate standard of review for the claims against Chiesi as the controlling stockholder and against the two interested directors employed by Chiesi. The seven director defendants who were not employed by Chiesi at the time of the merger, however, contended that they were entitled to dismissal of plaintiffs' claims because they were disinterested in the merger and plaintiffs had failed to allege with specificity that the director defendants breached a non-exculpated fiduciary duty.[230]

Plaintiffs opposed dismissal. Relying on *Emerald Partners v. Berlin*,[231] plaintiffs argued that in a case governed by *Kahn v. Lynch*,[232] the Court may not dismiss claims against disinterested and independent directors at the pre-trial stage, even where a plaintiff fails to allege a breach of non-exculpated fiduciary duty with specificity. Plaintiffs reasoned that one of the purposes of entire fairness review is to allow for thorough discovery and fact-finding at trial to uncover possible breaches of the duty of loyalty by disinterested directors who might have been influenced by a controlling stockholder.[233]

On the motion to dismiss, the Court of Chancery noted the advantages of both plaintiffs' and the independent directors' arguments regarding the appropriate pleading standard to be applied to claims against disinterested directors in a transaction involving a controlling stockholder. According to the Court, plaintiffs' proposed standard would "undoubtedly

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226. *Id.* at *9-10. Plaintiffs asserted that the special committee's decision was partially motivated by the fear that Chiesi would terminate discussions unless the special committee lowered its proposal.

227. *Id.* at *10-11.

228. *Id.* at *11-12.

229. *Id.* at *12-13.

230. *Id.* at *14-16.

231. 787 A.2d 85 (Del. 2001).

232. 638 A.2d 1110 (Del. 1994).

233. *Cornerstone*, 2014 Del. Ch. LEXIS 170, at *16-17.

result in justice being done in cases where, under the [Director] Defendants' pleading rule, faithless directors would not be called to account."[234] Conversely, the Court noted, the disinterested and independent director defendants' proposed standard "is consistent with our treatment of directors alleged to have breached duties in non-controller-dominated transactions," "allows management of the corporation to proceed unaffected by frivolous litigation [,] and protects the directors' ability to pursue appropriate levels of risk without fear of liability, so long as their actions are consistent with the duty of loyalty."[235] In the end, however, the Court of Chancery concluded that it was bound by controlling precedent to deny the motion to dismiss.

On appeal, the Supreme Court reversed the Court of Chancery's decision, but acknowledged that "the body of law relevant to these disputes presents a debate between two competing but colorable views of the law."[236] The Supreme Court observed, however, that denying dismissal to independent directors that had not committed duty of loyalty or good faith violations incentivizes such directors to avoid serving on special committees altogether or to reject transactions simply from fear of litigation.[237]

The Supreme Court further observed that to deny dismissal to directors with only exculpatory claims pled against them would undermine a purpose of 102(b)(7),[238]—to allow directors to take business risks without fear of personal liability.[239]

In reaching this result, the Supreme Court cabined its ruling in *Emerald Partners*, instructing that it should be read only in its "case-specific context."[240]

The Supreme Court also mentioned previous Court of Chancery opinions that supported its *Cornerstone* holding. In *In re Southern Peru Copper Corp. Shareholder Derivative Litigation*,[241] the Court of Chancery granted—albeit in a bench ruling[242]—summary judgment for special committee defendants prior to trial based upon an exculpatory charter provision. Likewise, in *Dirienzo v. Lichtenstein*,[243] the Court of Chancery granted special committee defendants' motion

234. *Id.* at *40.

235. *Id.* at *35.

236. *Cornerstone*, 115 A.3d at 1179.

237. *Id.* at 1184.

238. *Id.* at 1185.

239. *Id.*

240. *Id.* at 1185.

241. In re S. Peru Copper Corp. S'holder Deriv. Litig., C.A. No. 961-VCS, Transcript of Oral Argument at 40, 43, (Del. Ch. Dec. 21, 2010) (Strine, V.C.) ("[F]or about seven to ten good and sufficient reasons, . . . [it] really couldn't be the law" that "pre-trial dismissal on 102(b)(7) grounds in an entire fairness case is not appropriate," because "the whole idea of the 102(b)(7) clause is if all you can fault [directors] for is some lapse in care, then they are out.").

242. Note, however, that the Delaware Court of Chancery has cautioned practitioners about relying on transcripts of bench rulings as precedent. In re NYSE Euronext S'holders Litig., C.A. No. 8236-CS, Transcript at 4-6, (Del. Ch. May 10, 2013) (Strine, C.).

243. 2013 Del. Ch. LEXIS 242, at *34-60 (Del. Ch. Sept. 30, 2013) ("[The plaintiff] seeks to bootstrap his entire fairness claim against Lichtenstein into an entire fairness claim against the Special Committee. This he cannot do. To burden the Special Committee with proving entire fairness, [the plaintiff] must allege sufficient that the committee members breached a non-exculpated fiduciary duty.").

to dismiss prior to discovery pursuant to a § 102(b)(7) provision. In both cases, the challenged transactions were subject to entire fairness review. The *Cornerstone* Court discussed *DiRienzo* at length and approved *DiRienzo*'s interpretation that *Emerald Partners* stood only "for the mundane proposition that a defendant cannot obtain dismissal on the basis of an exculpatory provision when there is evidence that he committed a non-exculpated breach of fiduciary duty."[244]

F. Adopting And Applying Section 204 And 205 Of The DGCL

Sections 204 and 205 of the Delaware General Corporation Law became effective on April 1, 2014.[245] Section 204 creates a statutory method of retroactively ratifying any void or voidable corporate act that is within the power of the corporation under subchapter II of the DGCL. Section 205 establishes a new type of proceeding in the Delaware Court of Chancery to determine or affect the validity of corporate acts.

Two 2014 cases gave rise to decisions applying Section 205: *In re Trupanion, Inc.*,[246] and *In re Cheniere Energy, Inc. Stockholders Litigation*.[247]

The petitioners in *Trupanion* sought to cure uncertainty arising from a series of invalid corporate conversions of Trupanion, Inc. ("Trupanion"). Specifically, in 2008, a Trupanion employee filed documents purportedly effecting a conversion of Trupanion from a Delaware corporation to an Arizona corporation with the Delaware Secretary of State and the Arizona Corporation Commission.[248] The employee filed these documents without first obtaining the necessary approval from either Trupanion's board or stockholders.[249] Three months later, the same employee filed documents purportedly undoing the prior transaction, converting Trupanion from an Arizona corporation to a Delaware corporation.[250] Thereafter, Trupanion purported to issue additional stock, amend its certificate of incorporation, and hold annual meetings to elect new directors.[251] By 2014, due to the purported conversions in 2008, it was unclear whether Trupanion existed as a Delaware corporation, what of its outstanding stock was valid, and whether its board was validly elected.[252]

Because Trupanion could not identify its directors or stockholders with certainty, it was unable to ratify its defective conversions and subsequent corporate acts through Section 204. Nonetheless, Trupanion sent each of its stockholders and putative stockholders, with the exception of one former stockholder running a competing business, an information sheet, which informed them of the defective corporate acts and asked each stockholder or putative stockholder to indicate

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244. *Cornerstone*, 115 A.3d at 1186.

245. 8 Del. C. §§ 204, 205.

246. C.A. No. 9496-VCP (Del. Ch. Apr. 28, 2014) (ORDER and TRANSCRIPT) (Parsons, V.C.).

247. C.A. No. 9710-VCL (Del. Ch. Jul. 10, 2014) (TRANSCRIPT) (Laster, V.C.).

248. Verified Petition for Relief Under 8 Del. C. § 205, C.A. No. 9496-VCP, at ¶¶ 1-2 (Del. Ch. Apr. 28, 2014).

249. *Id.* at ¶ 2.

250. *Id.*

251. *Id.*

252. *Id.* at ¶ 3.

whether they supported ratification of each defective corporate act.[253] Stockholders representing 99.26% of Trupanion's valid stock responded in support of ratification.[254]

Trupanion then filed a petition under Section 205 in the Delaware Court of Chancery, detailing the events leading to the defects in its corporate structure as well as its efforts to confirm its stockholders' approval of ratification. Along with the significant issues caused by the purported conversions, Trupanion also noted other potentially defective corporate acts in its history.[255] Finally Trupanion noted that it could not ratify the defects in its corporate structure through Section 204 with confidence.[256]

Less than a month after Trupanion's petition under Section 205 was filed, the Court held a hearing on Trupanion's petition.[257] At the start of the hearing, the Court confirmed that there were no objectors to Trupanion's petition at the hearing.[258] The Court also confirmed that Section 204 was not a viable alternative for Trupanion.[259] Nonetheless, the Court noted that the course that Trupanion had followed was akin to a Section 204 action, in that it had provided notice and sought stockholder approval.[260] The Court then clarified that although it was willing to confirm the validity of Trupanion's stock and stock options, it was only doing so with respect to the defects identified in the information statement sent to Trupanion's stockholders and putative stockholders: "I don't mean for this to be, you know, sanitizing everything that possibly ever could have been challenged about any of those transactions."[261]

At the hearing, the Court granted Trupanion's proposed form of order ratifying the defective corporate acts for which Trupanion sought ratification. The Court noted that in granting the proposed order, it was important that "we, through this order, not be granting something more than you would have gotten if you went through the procedures of 204."[262] The Court directed Trupanion to file multiple certificates of validation with the Secretary of State to address the multiple potentially invalid actions taken by Trupanion and the Court directed the Secretary of State to accept the Certificates.[263] The Court also validated Trupanion's proposed stock ledger, a statement of outstanding options, and a roster for Trupanion's board, each as set forth in an exhibit provided by Trupanion.[264]

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253. *Id.* at ¶ 79.

254. C.A. No. 9496-VCP, at 29 (Del. Ch. Apr. 28, 2014) (TRANSCRIPT) (Parsons, V.C.).

255. Verified Petition for Relief Under 8 Del. C. § 205, C.A. No. 9496-VCP, at ¶¶ 44-48 (Del. Ch. Apr. 28, 2014).

256. *Id.* at ¶ 53.

257. C.A. No. 9496-VCP (Del. Ch. Apr. 28, 2014) (TRANSCRIPT) (Parsons, V.C.).

258. *Id*.

259. *Id.* at 6.

260. *Id.* at 21-22.

261. *Id.* at 21, 38.

262. *Id.* at 37.

263. *Id.* at 23.

264. 2014 Del. Ch. LEXIS 176 (Del. Ch. Apr. 28, 2014) (Parsons, V.C.).

The second Section 205 decision of 2014, *In re Cheniere Energy, Inc. Stockholders Litigation,*[265] addressed the procedural interplay between Section 205 actions and traditional stockholder litigation challenging corporate acts.

At its 2013 stockholders' meeting, Cheniere held a stockholder vote to approve an amendment (the "Amendment") to a plan that governed the issuance of stock options to Cheniere's directors, officers, and employees, to permit the issuance of additional options.[266] The NYSE, on which Cheniere's stock trades, required a stockholder vote to approve the Amendment.[267] In counting the stockholder vote on the Amendment, Cheniere omitted abstentions, as Cheniere contended was permitted by the NYSE rules, and determined that the stockholders had approved the Amendment.[268]

Cheniere stockholders brought multiple derivative and direct lawsuits alleging, *inter alia*, that the Amendment was not validly approved because stockholder abstentions from the vote to approve the Amendment should have been treated as "no" votes under Delaware law.[269] Shortly thereafter, Cheniere filed an action pursuant to Section 205 seeking: (1) a determination that the Amendment was validly approved as a matter of law and (2) if the Amendment was not validly approved, judicial ratification of the Amendment (the "Section 205 Action").[270]

At oral argument on the schedule for the Section 205 Action and the stockholder actions, Cheniere argued that the Section 205 Action should proceed first because the Section 205 Action afforded the Court more flexibility with respect to remedies.[271] Cheniere further argued that the Court should bifurcate the Section 205 Action to address the question of validity first as a matter of law, and then, if necessary, to permit the plaintiff stockholders to take discovery in advance of a trial on ratification.[272] The stockholders argued, among other things, that it was improper for Cheniere to bring the Section 205 Action in response to the stockholder actions and that the Section 205 Action should be viewed as "a tag-along case," to be addressed if anything remained after a resolution of the stockholder actions.[273]

The Court agreed with Cheniere that, in the scheduling context, "the Section 205 action logically takes precedence and is designed to take precedence. The idea of fixing things through ratification and the idea that you could moot challenges by engaging in ratification is something that is long-standing."[274] The Court also noted that equity acts where there is no other remedy, but Section 205 provided a remedy at law to many of the issues raised by the plaintiffs.[275] The

265. C.A. No. 9710-VCL (Del. Ch. Jul. 10, 2014) (TRANSCRIPT) (Laster, V.C.).

266. Verified Application Pursuant to 8 Del. C. § 205, C.A. No. 9710-VCL, at ¶¶ 32-49 (Del. Ch. July 10, 2014).

267. *Id.*

268. *Id.* at ¶¶ 5-6.

269. Jones v. Souki, C.A. No. 9710-VCL (Del. Ch. filed May 29, 2014), Macguire v. Souki, C.A. No. 9746-VCL (Del. Ch. filed June 6, 2014), and Shenker v. Souki, C.A. No. 9763 (Del. Ch. filed June 13, 2014).

270. Verified Application Pursuant to 8 *Del. C.* § 205, C.A. No. 9710-VCL, at ¶¶ 81-90 (Del. Ch. July 10, 2014) (Laster, V.C.)

271. C.A. No. 9710-VCL, at 6-7 (Del. Ch. July 10, 2014) (TRANSCRIPT) (Laster, V.C.).

272. *Id.* at 16-17.

273. *Id.* at 28.

274. *Id.* at 38-39.

275. *Id.* at 39.

Court further observed that the stockholders were not worse off as a result of the stay of the consolidated action, because the consolidated action was also subject to a motion for judgment on the pleadings as to the validity of the Amendment, which would have a similar effect to the stay in favor of the Section 205 Action. Finally, the Court held that Cheniere's proposed bifurcated approach was sensible. Thus, the Court ordered the parties to submit briefing on the validity of the Amendment and stayed discovery pending a ruling on validity.

While addressing scheduling, the Court observed that the Section 205 Action would not necessarily resolve the consolidated action:

> What is clear from 205 and what is clear from 204 is that it addresses legal validity …. Let's assume that these shares are validated, but they're validated at great expense and cost to the company. There is still a potential wrong out there. It doesn't necessarily mean that that wrong is moot. That wrong might be *de minimis*, such that nobody feels that it's worth pursuing, but it may or may not be that there is, nevertheless, a claim against the humans who caused the corporation to engage in particular behavior or who acted contrary, it is alleged, to potential contract rights as part of the constitutive agreement between the corporation and stockholders. That would still remain live.[276]

In the course of ruling on the litigation schedule, the Court made several helpful observations about Section 205 actions generally. First, the Court observed that "it seems to me that if a company is going to come forward and say, 'Court, bless this,' you have something of an obligation to come forward and inform the Court about everything that one is blessing."[277] Second, the Court noted that the grant of validation can be "conditioned on things[,]" in order to balance the equities where ratification is sought in a context in which the board was found to have engaged in misconduct but third-parties would be harmed in the absence of ratification.[278]

G. Challenging A Sales Process Under *Revlon*

The Delaware Supreme Court in *C&J Energy Services, Inc. v. City of Miami General Employees and Sanitation Employees' Retirement Trust*,[279] reversed the Court of Chancery's November 24, 2014 bench ruling enjoining a business combination for 30 days to permit the target company to shop itself during that period.

In *C&J*, the stockholder plaintiffs sued to enjoin a merger between C&J and a division of a competitor, Nabors Industries Ltd. ("Nabors").[280] Through the proposed merger, C&J, a U.S. corporation, would acquire a subsidiary of Nabors, domiciled in Bermuda.[281] The merger was structured to effect a "corporate inversion" whereby the combined entity would be re-domiciled as a Bermuda entity to obtain significant corporate tax savings.[282] Importantly, Nabors would retain

276. *Id.* at 40-41.

277. *Id.* at 12.

278. *Id.* at 48.

279. 107 A.3d 1049 (Del. 2014).

280. *Id.* at 1052.

281. *Id.*

282. *Id.* at 1057.

the majority of the equity of the surviving entity.[283] The merger was negotiated by C&J's chairman and founder, Joshua Comstock, who held a 10% stake in C&J.[284]

In light of the proposed restructuring (and corresponding transfer of majority control to Nabors), the seven-member board of C&J considered whether to actively shop C&J to potential buyers, but it elected not to do so.[285] To temper Nabors' majority voting control of the surviving entity, C&J's board negotiated certain protections for C&J's stockholders, including a by-law guaranteeing that all stockholders would share *pro rata* in any future sale of the new entity.[286] The board also bargained for a "fiduciary out" if a superior proposal emerged during a lengthy market check, but the merger agreement prohibited C&J from soliciting competing bids.[287] As part of the final deal, Comstock would receive a more generous compensation package from the new entity than the compensation he would receive in his current position at C&J.[288]

The Court of Chancery faulted the board for failing to actively shop C&J and determined that there was a plausible violation of the board's *Revlon* duties. The Court of Chancery enjoined the stockholder vote for 30 days and required C&J to shop itself.[289] To address the fact that this mandatory injunction otherwise conflicted with the terms of the merger agreement, the Court of Chancery ruled that "[t]he solicitation of proposals consistent with this Order and any subsequent negotiations of any alternative proposal that emerges will not constitute a breach of the Merger Agreement in any respect."[290] The defendants filed an expedited appeal.

In reversing this decision, the Delaware Supreme Court described the Court of Chancery's ruling as "an unusual preliminary injunction."[291] The Supreme Court agreed with the Court of Chancery's determination that "*Revlon* made clear that when a board engages in a change of control transaction, it must not take actions inconsistent with achieving the highest immediate value reasonably attainable."[292] But the Supreme Court clarified that *Revlon* did not require the board to conduct an active solicitation process in order to satisfy its contextual fiduciary duties:

> *Revlon* does not require a board to set aside its own view of what is best for the corporation's stockholders and run an auction whenever the board approves a change of control transaction …. "[T]here is no single blueprint that a board must follow to fulfill its duties," and a court applying *Revlon*'s enhanced scrutiny must decide "whether the directors made a *reasonable* decision, not a *perfect* decision."[293]

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283. *Id.* at 1052.

284. *Id.* at 1055.

285. *Id.* at 1061.

286. *Id.* at 1062.

287. *Id.*

288. *Id.* at 1064.

289. *Id.* at 1052.

290. *C&J Energy Servs.,* C.A. No. 9980-VCN, Order Granting Preliminary Injunction, Certifying Interlocutory Appeal, & Staying the Injunction Pending Appeal, (Del. Ch. Nov. 26, 2014) (Noble, V.C.).

291. 107 A.3d at 1052.

292. *Id.* at 1067 (citation omitted).

293. *Id.* (quoting Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1385-86 (Del. 1995)).

The Court clarified that an "effective" market check need not be an "active" one, but rather, a process through which "interested bidders have a fair opportunity to present a higher-value alternative, and the board has the flexibility to eschew the original transaction and accept the higher-value deal."[294] Thus, the Supreme Court held that the Court of Chancery had misapplied the *Revlon* standard by requiring an active solicitation process.[295]

The Supreme Court also ruled that the Court of Chancery erred by entering a mandatory injunction based on a preliminary record.[296] The Supreme Court first noted that the traditional use of a preliminary injunction is to preserve "the status quo," not to require a party to take affirmative action.[297] The standard of review for a preliminary injunction requires a plaintiff to demonstrate (1) a reasonable probability of success on the merits, (2) that they will suffer irreparable injury without an injunction, and (3) that its harm without an injunction outweighs the harm to defendant that will result from the injunction.[298] The Supreme Court determined that the Court of Chancery misapplied the first factor:

> In this case, although the Court of Chancery correctly identified the standard of review for a preliminary injunction, it misapplied that standard when it found that there was "a *plausible* showing of a likelihood of success on the merits as to a breach of the duty of care, and that goes to an absence of an effort to sell." … A party showing a "reasonable probability" of success must demonstrate "that it will prove that it is more likely than not entitled to relief."[299]

Further, the Court observed that "[t]o issue a mandatory injunction requiring a party to take affirmative action—such as to engage in the go-shop process the Court of Chancery required—the Court of Chancery must either hold a trial and make findings of fact, or base an injunction solely on undisputed facts."[300] The Supreme Court observed that here, "the Court of Chancery issued a mandatory injunction on a paper record that surfaced a number of important factual disputes and that was only sufficient to convince the Court of Chancery that the plaintiffs had a plausible merits case. This was error."[301] The Supreme Court concluded by noting that "[a]lthough the equitable authority of our Court [of Chancery] is broad, it is not uncabined and must be exercised with care and respect for the rights of litigants."[302]

In addition, the Court observed that where, as in C&J, there is no finding that the acquirer aided and abetted in any fiduciary breach, it is inappropriate to "blue-pencil" a contract through a mandatory injunction and thereby "strip an innocent third part of its contractual rights while simultaneously binding that party to consummate the transaction."[303]

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294. 107 A.3d. at 1068.

295. *Id*. at 1071.

296. *Id*.

297. *Id*. at 1072.

298. *Id*. at 1066.

299. *Id*. (quoting *C&J Energy Services,* C.A. No. 9980-VCN (Del. Ch. Nov. 24, 2014) and Mitchell Lan Publishers, Inc. v. Rasemas, 2014 Del. Ch. LEXIS 194 (Del. Ch. 2014)).

300. *Id*. at 1071.

301. *Id*.

302. *Id*.

303. *Id*. at 1054.

H. Endorsement Of Lower Poison Pill Threshold To Activist Stockholder Under *Unocal*

In *Third Point LLC v. Ruprecht*,[304] the Court held that activist stockholders may constitute a threat justifying the imposition of a poison pill with a lower trigger level (10%) than that applicable to passive investors (20%).

Third Point involved Sotheby's, a publicly traded Delaware corporation, led by an independent, non-staggered board.[305] Between May and July of 2013, three hedge funds—Trian Fund Management, L.P. ("Trian"), Third Point, LLC ("Third Point") and Marcato Capital Management LLC ("Marcato")—disclosed stockholdings in Sotheby's.[306] Sotheby's board became concerned about the possibility of a proxy contest being mounted by the hedge funds either separately or as a group.[307] The board met repeatedly with its legal advisor, Wachtell, Lipton, Rosen & Katz ("Wachtell") and financial advisor, Goldman Sachs Group, Inc. ("Goldman") to discuss both a possible proxy contest and a project to return capital to stockholders.[308]

By October 2, 2013, Third Point filed an amended Schedule 13D, revealing that it had increased its stake in Sotheby's to 9.4%, making it Sotheby's largest stockholder.[309] Third Point included a letter with its Schedule 13D filing criticizing Sotheby's management, board, and competitive position.[310] The next day, the board met with Wachtell and Goldman.[311] Wachtell recommended that the board adopt a poison pill to ensure the board's involvement in the timing and outcome of a takeover or creeping accumulation of control.[312] The board tabled the poison pill proposal at the close of the October 3 meeting, but met again on October 4 and approved the poison pill.[313] At the October 4 board meeting at which the board approved the poison pill, the board did not make any explicit finding that the hedge funds presented a threat to Sotheby's.[314]

By its terms, the poison pill expired in one year unless approved by a stockholder vote, did not apply to certain "any-and-all" shares offers for 100% of the company, and had a two-tier structure.[315] Under the poison pill, a stockholder

304. 2014 Del. Ch. LEXIS 64 (Del. Ch. May 2, 2014) (Parsons, V.C.).

305. *Id.* at *8-9.

306. *Id.* at *9-12.

307. *Id.* at *15-17.

308. *Id.* at *10.

309. *Id.* at *28.

310. *Id.*

311. *Id.*

312. *Id.* at *30-31.

313. *Id.* at *31-32.

314. *Id.* at *32.

315. *Id.* at *32-33.

who reported its ownership pursuant to Schedule 13G, indicating its status as a passive investor, was able to acquire up to a 20% interest in Sotheby's, but all other stockholders, including Third Point, were limited to 10% ownership.[316]

Throughout late 2013 and early 2014, the board attempted unsuccessfully to negotiate an agreement with Third Point's CEO Daniel Loeb to forestall a proxy fight.[317] Third Point also continued to increase its stockholdings.[318] Then, in March 2014, in advance of Sotheby's annual meeting, Third Point requested a waiver of the poison pill to allow it to buy up to 20% of Sotheby's stock. Sotheby's board refused.[319]

Third Point then sought a preliminary injunction to delay Sotheby's upcoming annual meeting until the Court had an opportunity to rule on the validity of the poison pill.[320]

Applying *Unocal*'s two prong analysis, the Court first assessed whether the board reasonably perceived a threat to corporate effectiveness. The Court found a *prima facie* showing of reasonableness based on the board's composition of a majority of outside, independent directors and reliance on the advice of legal counsel.[321] Thereafter, the Court noted that, when Sotheby's adopted the poison pill, several hedge funds were increasing their Sotheby's holdings and Third Point was doing so rapidly.[322] Thus, the Court concluded that

> Based on these facts and the profiles of Third Point and Marcato, presented to the Board in materials prepared by its financial and legal advisors, I cannot conclude that there is a reasonable probability that the Board did not make an objectively reasonable determination that Third Point posed a threat of forming a control block for Sotheby's with other hedge funds without paying a control premium.[323]

Third Point argued that the Court should apply the stringent *Blasius* standard when reviewing the poison pill because (1) the record showed that the board was concerned about the upcoming proxy contest when it adopted the poison pill and (2) certain emails showed animus towards Loeb.[324] The Court rejected this argument on the grounds that (1) the board was composed of independent, outside directors, with the sole exception of its CEO, (2) the board had a reasonable basis to believe that Third Point was trying to acquire control without paying a control premium, (3) the record was nearly devoid of any evidence of an entrenchment motive by any director, and (4) the emails referring to Loeb pejoratively came primarily from Sotheby's CEO and followed public statements by Loeb disparaging the CEO.[325] As such, the Court

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316. *Id.* at *33.

317. *Id.* at *36-37.

318. *Id.* at *39-40.

319. *Id.* at *40-45.

320. *Id.* at *45.

321. *Id.* at *57.

322. *Id.* at *58.

323. *Id.* at *58-59.

324. *Id.* at *60-62.

325. *Id.* at *61-63.

found that Third Point was unlikely to be able to show that the poison pill was adopted either for the primary purpose of interfering with the stockholder franchise or out of animus toward Third Point.[326]

In the course of reaching this conclusion, the Court noted that Delaware law is somewhat unresolved with respect to the role of the *Blasius* standard, without attempting to clarify the issue.[327]

With respect to the second prong of *Unocal*, whether the poison pill was a proportionate response, the Court found that the board would likely prevail. In support of that holding, the Court noted that the entire board owned less than 1% of Sotheby's stock collectively, that a 10% threshold allows activist investors to accumulate a substantial stake in the company, that Third Point was Sotheby's largest stockholder, and that "[a] trigger level much higher than 10% could make it easier for a relatively small group of activist investors to achieve control, without paying a premium, through conscious parallelism."[328]

With respect to the trigger, which limited activist stockholders that filed the Schedule 13D to 10% ownership while allowing passive Schedule 13G-filers to accumulate 20% ownership, the Court first noted that the discriminatory trigger was arguably more tailored to the threat identified than a flat 10% trigger would be.[329] Then, the Court held:

> In this case, Third Point is the Company's largest stockholder meaning that there are no Schedule 13G filers who own more than 10% of Sotheby's stock. Thus, while the question of whether Schedule 13G filers should be permitted under a rights plan to buy a larger interest in a company than activist stockholders is important in a general sense, I am not persuaded it can or should serve as a basis to enjoin the Sotheby's annual meeting when, as a practical matter, it is a complete non-issue in terms of the current composition of Sotheby's stockholders.[330]

The Court also analyzed Third Point's request that the board waive the 10% trigger under *Unocal*.[331] For the purposes of that analysis, the Court observed that the "wolf pack" concern was not as pressing.[332] Nonetheless, the Court found that

> The evidence currently available indicates that Sotheby's may have had legitimate real-world concerns that enabling individuals or entities, such as Loeb and Third Point, to obtain 20% as opposed to 10% ownership interests in the Company could effectively allow those persons to exercise disproportionate control and influence over major corporate decisions, even if they do not have an explicit veto power.[333]

The Court held that this threat could satisfy the first prong of *Unocal*.[334]

326. *Id*. at *64.

327. *Id*. at *59.

328. *Id*. at *68.

329. *Id*. at *70.

330. *Id*. at *71-72.

331. *Id*. at *72-76.

332. *Id*. at *74.

333. *Id*. at *74-75.

334. *Id*.

I. Creditor Standing To Pursue Derivative Claims

The Court of Chancery, in *Quadrant Structured Products Co. v. Vertin*,[335] clarified, on a motion to dismiss, creditor standing to bring derivative litigation and the standards applicable to the decisions of the board of a controlled and insolvent company.

The plaintiff, Quadrant Structured Products Company, Ltd. ("Quadrant"), was a creditor of Athilon Capital Corp. ("Athilon").[336] Athilon was controlled by EBF & Associates ("EBF"), which employed its affiliate Athilon Structured Investment Advisors, LLC ("ASIA") to manage Athilon's investments.[337] Athilon allegedly became insolvent sometime in 2008 due to its heavy investment in credit swaps for residential mortgage-backed securities.[338] Though insolvent, Athilon (1) continued to pay interest on the subordinated debt held by EBF, although it allegedly had a contractual right to discontinue such interest payments, and (2) also allegedly overpaid ASIA for management services, which Quadrant offered to perform for Athilon at substantially lower cost.[339] Athilon's board also adopted a riskier business strategy after May 2011.[340] Quadrant filed derivative claims for fiduciary breach against Athilon's board, EBF, and ASIA, for the payments made to EBF and ASIA, as well as the board's decision to embark on a risker investment strategy.[341] Quardant also alleged fraudulent transfer claims against EBF and ASIA.[342]

The defendants moved to dismiss Quadrant's complaint on the grounds that Quadrant was not a creditor of Athilon at the time of each of the challenged decisions and thus lacked standing under 8 *Del. C.* § 327 or analogous principals.[343] The Court rejected this argument.

The Court began its opinion on the defendants' dismissal motion with a summary of Delaware law concerning the fiduciary duties owed by directors of troubled or insolvent corporations.[344] The Court noted that under Delaware law, directors owe fiduciary duties to the corporation.[345] As the residual claimants in a solvent corporation, stockholders have standing to assert derivative claims to enforce the directors' fiduciary duties.[346] But when a corporation becomes insolvent,

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335. 102 A.3d 155 (Del. Ch. 2014).

336. *Id*. at 166.

337. *Id*. at 168.

338. *Id*. at 168-169.

339. *Id*. at 169.

340. *Id*. at 167-168.

341. *Id*. at 166.

342. *Id*.

343. *Id*.

344. *Id*. at 171-76.

345. *Id*.

346. *Id*.

creditors gain standing to assert derivative claims.[347] The Court then elaborated that in order to plead derivative standing, a creditor must plead facts supporting a reasonable inference that the corporation was insolvent—either through the "balance sheet" test or the "cash flow" test.[348] The Court further held that Quadrant's complaint establishes a reasonable inference that Athilon was insolvent as of 2008.

The Court further analyzed whether statutory standing requirements applicable to stockholders pleading derivative claims apply to creditors by analogy.[349] Specifically, Section 327 requires a stockholder to hold stock at the time of the wrongs complained of (the contemporaneous ownership requirement) and courts have required that stockholders hold stock continuously since that time (the continuous ownership requirement) to maintain standing to bring a derivative action.[350]

The Court rejected the defendants' arguments that the contemporaneous and continuous ownership requirements apply to creditors, explaining that both creditors' and stockholders' standing to bring derivative litigation arose at common law.[351] The common law did not include either a contemporaneous or a continuous ownership requirement.[352] The Court noted that Section 327 was a statutory limitation on these common law principals.[353] Because "[b]y its terms, Section 327 applies only to stockholders[,]" the Court concluded that Section 327's contemporaneous ownership requirement does not apply to a creditor's standing to bring derivative litigation.[354] Moreover, the Court held that Court of Chancery Rule 23.1 cannot impose a contemporaneous standing requirement on creditors, because the Court's rules are not permitted to modify substantive law.[355]

The Court also held, following the rationale in *Production Resources Group, L.L.C. v. NCT Group, Inc.*,[356] that creditors of an insolvent corporation have standing to bring derivative actions challenging fiduciary conduct that occurred before the corporation became insolvent. The Court noted that "[i]t is entirely possible, perhaps even likely, that breaches of fiduciary duty that cause, hasten, or otherwise contribute to insolvency will have occurred before the point of insolvency in fact.[357] If creditors lack standing to assert claims that pre-dated the point of insolvency, then the number of potential plaintiffs will be few: stockholders will lack the incentive, and creditors will lack the ability."[358]

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347. *Id.*

348. *Id.* at 176 (citations omitted).

349. *Id.* at 177-182.

350. *Id.* at 177-178.

351. *Id.* at 178.

352. *Id.*

353. *Id.* at 178-179.

354. *Id.* at 179.

355. *Id.* at 178.

356. 863 A.2d 727 (Del. Ch. 2004).

357. *Quadrant*, 102 A.3d at 180.

358. *Id.*

The Court further accepted Quadrant's arguments that the challenged payments to EBF and ASIA should be reviewed under the entire fairness standard, because each decision allegedly benefited Athilon's controlling stockholder to the detriment of Athilon's residual interest holders.[359] Although the board was permitted to manage Athilon (a wholly owned subsidiary) solely for the benefit of its parent corporation when Athilon was solvent, the Court held that the board of an insolvent corporation cannot sacrifice the interests of the corporation for the benefit of its parent.[360]

The Court, however, dismissed Quadrant's claims challenging the board's adoption of a riskier investment strategy, holding that such a decision would be subject to review under the business judgment standard.[361] The Court reasoned that

> "Even when the firm is insolvent, directors are free to pursue value maximizing strategies, while recognizing that the firm's creditors have become its residual claimants." … If a creditor-plaintiff could sue derivatively and establish a lack of director independence and disinterestedness by alleging that the director who owned equity or who owed duties to a large stockholder adopted a risky business strategy to benefit the common stock, the directors of an insolvent corporation would face precisely the same type of fiduciary conflict that *Gheewalla* sought to avoid.[362]

Consequently, the Court held that where a board of an insolvent corporation acts to the benefit of all stockholders, its decision remains protected by the business judgment rule.

II. ALTERNATIVE ENTITY LAW

In 2014, the concept of good faith and the scope of the implied covenant of good faith and fair dealing played an important role in the decisions concerning alternative entities. In two opinions involving the same master limited partnership, the Court of Chancery refused to find any breach of the contractual standard of good faith and refused to use the implied covenant of good faith and fair dealing to sustain claims that were specifically precluded by the terms of the parties' negotiated agreements, even though such claims would have been viable under a traditional fiduciary duty analysis. In a post-trial opinion involving a limited liability company, the Court of Chancery held that the defendants had not eliminated or modified the traditional default fiduciary duties and that the defendants had breached those duties. Finally, in a rare post-trial opinion, the Court held that a defendant had breached the implied covenant of good faith and fair dealing.

A. *El Paso* MLP Decisions

In two separate opinions, the Court of Chancery addressed the concept of contractual good faith and the implied covenant of good faith and fair dealing in the context of transactions undertaken by a publicly traded master limited partnership. These opinions all involved so called "drop down transactions," *i.e.*, transactions in which a parent entity or an affiliated entity sells certain assets to the publicly traded limited partnership. These transactions typically involve

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359. *Id.* at 182-184, 185.

360. *Id.* at 184-185.

361. 102 A.3d at 192.

362. *Id.* at 186 (quoting Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P., 906 A.2d 168, (Del. Ch. 2006)).

conflicts of interest because the parent or the affiliate holds an interest in the limited partnership. The limited partnership agreement for the master limited partnership (the "LP Agreement") in these cases followed a typical form. The LP Agreement eliminated all fiduciary duties and replaced those duties with a contractually defined duty of good faith. The LP Agreement also created a conclusive presumption of good faith if certain procedural devices were used (*e.g.* special approval by a conflicts committee). In each case, on a summary judgment record, the Court refused to allow the plaintiffs' claims to proceed.

1. *El Paso I*

In the first opinion, *In re El Paso Pipeline Partners, L.P. Derivative Litigation* ("*El Paso I*"),[363] the Court decided on summary judgment that the general partner had not breached its implied duty of good faith and fair dealing by failing to disclose certain information to a conflicts committee and that the conflicts committee's failure to consider such information did not result in an ineffective special approval process.

In *El Paso I*, the plaintiffs challenged two separate transactions.[364] The first involved the sale of a 51% interest in Southern LNG ("Southern LNG") and a 51% interest in El Paso Elba Express Company, LLC ("Elba Express") by El Paso Corporation ("El Paso Parent") to El Paso Pipeline Partners, L.P. ("El Paso MLP") in March 2010 (the "March Transaction").[365] The second involved the sale of the remaining 49% interest in Southern LNG and Elba Express by El Paso Parent to El Paso MLP in November 2010 (the "November Transaction" and with the March Transaction the "Transactions").[366] Southern LNG and Elba Express each owned facilities for the storage and transport of liquid natural gas ("LNG").[367] Between 2006 and 2010 the demand for LNG was strong. In 2010, however, about the time El Paso Parent proposed the Transactions, demand for LNG was much lower due to higher levels of domestic production and lower gas prices.[368]

Because the March Transaction involved a conflict, the general partner sought to obtain Special Approval, as defined by the LP Agreement.[369] It created a conflicts committee to consider and approve the Transactions.[370] The conflicts committee hired Tudor, Pickering, Holt & Co. ("Tudor") to act as its financial advisor and Akin Gump Strauss Hauer &

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363. 2014 Del. Ch. LEXIS 101 (Del. Ch. June 12, 2014) (Laster, V.C.), *aff'd sub nom.*, Allen v. El Paso Pipeline GP Co., L.L.C., 2015 Del. LEXIS 107 (Del. Feb. 26, 2015).

364. 2014 Del. Ch. LEXIS 101, at *1-2.

365. *Id.* at *1.

366. *Id.* at *1-2. Only the March Transaction is the subject of *El Paso I*. The November Transaction is the subject of a separate post-trial opinion dated April 20, 2015. In that opinion, the Court of Chancery held that the Conflicts Committee had not acted with subjective good faith in connection with approving the November Transaction. Accordingly, the Court awarded the plaintiffs $171 million in damages.

367. *Id.* at *6-7.

368. *Id.* at *7.

369. *Id.* at *9-10.

370. *Id.* at *10.

Feld LLP ("Akin Gump") to act as its legal advisor.[371] The conflicts committee met five times over a one and a half month time period and approved the March Transaction.[372] At the same time that the conflicts committee was deciding whether to approve the March Transaction, El Paso Parent was considering whether to purchase additional LNG assets for itself.[373] El Paso Parent had a right of first refusal as to certain other LNG assets.[374] El Paso Parent refused to exercise the right of first refusal at a price that represented a lower implied EBITDA multiple than was being applied to the Southern LNG and Elba Express assets being sold by El Paso Parent to El Paso MLP.[375] Certain directors were involved in El Paso Parent's decision not to purchase additional LNG assets, but did not disclose those negotiations to the conflicts committee.[376]

The plaintiffs alleged that the failure by El Paso Parent and the directors involved with El Paso Parent's decision not to purchase LNG assets to disclose this information to the conflicts committee created an inference of bad faith.[377] The plaintiffs further alleged that because the conflicts committee did not know this information, the Special Approval was ineffective.[378]

As to the contractual good faith inquiry, the plaintiffs argued that Special Approval was not properly obtained because the conflicts committee could not have approved the March Transaction in good faith.[379] Plaintiffs argued that the conflicts committee lacked information about El Paso Parent's decision not to acquire LNG assets.[380] The Court rejected this argument and held that subjective good faith is determined solely based on the information possessed by the conflicts committee at the time they made the decision to approve the March Transaction.[381] If the conflicts committee had known about the LNG assets offered to El Paso Parent at the time they were considering the March Transaction, the pricing disparity between the two might have supported an inference of bad faith. However, because the plaintiffs admitted that the onflicts committee lacked this knowledge, there could be no such inference.[382] The Court also observed that any claim that the Special Approval was ineffective as a result of El Paso Parent's decision to withhold information from the conflicts committee would arise under an implied covenant analysis because the LP Agreement was silent on the issue.[383]

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371. *Id.* at *12.

372. *Id.* at *14.

373. *Id.* at *20.

374. *Id.* at *21.

375. *Id.*

376. *Id.*

377. *Id.* at *22.

378. *Id.*

379. *Id.* at *46.

380. *Id.*

381. *Id.*

382. *Id.* at *47.

383. *Id.* at *46.

As to the implied covenant of good faith and fair dealing, the plaintiffs argued that the implied covenant of good faith and fair dealing required that El Paso Parent disclose to the conflicts committee the fact that it was considering purchasing LNG assets at the time it was selling Southern LNG and Elba Express to El Paso MLP.[384] On this claim, the Court held that a contractual gap existed because the LP Agreement was silent on whether, absent a request from the conflicts committee, El Paso Parent was required to disclose this information.[385] The Court observed that if the LP Agreement had not eliminated all default fiduciary duties, Delaware law would require El Paso Pipeline GP Company ("El Paso GP") and El Paso Parent to voluntarily disclose to the conflicts committee the material information they possessed.[386] Because the LP Agreement eliminated all such duties, however, no such disclosure requirement existed.[387]

In so holding, the Court rejected the notion that the Delaware Supreme Court in *Gerber v. Enterprise Products Holdings, LLC*[388] held otherwise.[389] The Court noted that while the Delaware Supreme Court in *Gerber* observed that the intentional concealment of material information by a controller from a financial advisor would be an act that would breach the implied covenant of good faith and fair dealing, these comments were dictum because they did not impact the outcome of the case.[390] The Court refused to read *Gerber* as holding that the failure of a controller to volunteer information is always a breach of the implied covenant of good faith and fair dealing.[391]

Instead, the Court looked at the LP Agreement to discern what the parties would have agreed had they considered the disclosure issue.[392] The Court held that the parties would not have required El Paso Parent to voluntarily disclose the details of its refusal to purchase the LNG assets and thus there was no breach of the implied covenant of good faith and fair dealing by failing to do so.[393] The Court found five facts important: (1) the parties general approach to the LP Agreement was to use the freedom of contract granted to them to provide El Paso GP with broad freedom to act; (2) the LP Agreement eliminated all fiduciary duties and, instead, left the parties with their contractual relationship—a relationship in which counterparties typically have no duty to disclose private information to the other; (3) because the LP Agreement eliminated all fiduciary duties, including the duty of disclosure, it seems unlikely the drafters would impose an implicit contractual obligation of disclosure; (4) the LP Agreement eliminated El Paso Parent's and El Paso GP's common law obligation to disclose business opportunities to El Paso MLP; and (5) other agreements in precedent cases show that where parties sought to impose a duty to disclose information to a conflicts committee, specific language (absent here) was used to require such disclosure.[394]

384. *Id.* at *57.

385. *Id.* at *63-64.

386. *Id.*

387. *Id.*

388. 67 A.3d 400 (Del. 2013).

389. 2014 Del. Ch. LEXIS 101, at *69-70.

390. *Id.* at *69.

391. *Id.* at *69-70.

392. *Id.* at *70.

393. *Id.* at *76-77.

394. *Id.* at *70-76.

2. *El Paso II*

In a later opinion involving the same El Paso entity and another drop-down transaction, *Allen v. El Paso Pipeline GP Co.* ("*El Paso II*"),[395] the Court again granted summary judgment to the defendants and in doing so held that the general partner had not breached any contractual duties or the implied covenant of good faith and fair dealing.

In *El Paso II*, the general partner sought to obtain Special Approval of another drop-down transaction.[396] Again the conflicts committee hired Tudor to act as its financial advisor and Akin Gump to act as its legal advisor.[397] The conflicts committee met six times over a period of almost two months and conducted due diligence.[398] At the sixth and final meeting Tudor formally opined that the transaction was "fair from a financial point of view to holders of El Paso MLP common units other than the holders affiliated with El Paso Parent."[399] Based on this opinion, the conflicts committee approved the Transaction and the board of the general partner followed suit.[400] The transaction closed thereafter.[401]

The plaintiffs argued that the defendants had breached the LP Agreement because the transaction was not approved by the conflicts committee in good faith.[402] They asserted that the conflicts committee could not have acted in good faith in approving the transaction because it failed to consider the impact of the IDRs (incentive distribution rights held by the general partner) on the partnership.[403]

As to the express breach claim, the Court observed that the general partner chose to comply with the Special Approval provision.[404] As such, the relevant contractual standard required that the transaction be approved by a majority of the members of the conflicts committee acting in "good faith."[405] Good faith was defined as a belief that the conflict-of-interest transaction was in the "best interests of El Paso MLP."[406] The Court observed that "[t]wo aspects of the resulting contractual test warrant emphasis: (i) subjective belief and (ii) best interests of the Partnership."[407] The Court observed that this contractual standard "departs from the fiduciary standard of conduct that applies in the corporate arena" as follows:

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395. 113 A.3d 167 (Del. Ch. 2014), *aff'd*, 2015 Del. LEXIS 107 (Del. Feb. 26, 2015).

396. 113 A.3d at 174.

397. *Id*. at 175.

398. *Id*. at 175-76.

399. *Id*. at 176.

400. *Id*.

401. *Id*.

402. *Id*.

403. *Id*.

404. *Id*. at 178.

405. *Id*.

406. *Id*.

407. *Id*.

> When considering that issue the Conflicts Committee has discretion to consider the full range of entity constituencies, including but not limited to employees, creditors, suppliers, customers, the general partner, the IDR holders … and of course limited partners. In place of a single beneficiary of fiduciary duties, the LP Agreement confers contractual discretion on the Conflicts Committee to balance the competing interests of the Partnership's various entity constituencies when determining whether a conflict-of-interest transaction is in the best interests of the Partnership.[408]

Applying this standard, the Court held that certain facts were fatal to the plaintiff's claim.[409] The plaintiff had made no claim that the partnership had paid an excessive price for the assets and no claim that the transaction harmed the partnership.[410] Moreover, the conflicts committee members testified that they believed the transaction benefitted the partnership.[411] It was not enough to assert that the transaction was more beneficial to the general partner than to the unaffiliated limited partners.[412] Such a claim might have survived summary judgment under a traditional fiduciary duty analysis, but did not survive summary judgment under the pertinent contract standard.[413]

Finally, as to the implied covenant claim, the plaintiff asserted a *Gerber*-type claim, *i.e.* that the financial advisor opinion failed to address some element of the transaction in its opinion—in this case the dilution the limited partners would suffer as a result of the transaction.[414] The Court refused to read the Special Approval provision of the LP Agreement as to require the conflicts committee to obtain any opinion from a financial advisor, let alone one that addressed the effects of the transaction on the limited partners.[415] The Court held that it would:

> [C]onflict fundamentally with the plain language and structure of Section 7.9(a) to invoke the implied covenant to require that the Conflicts Committee follow a particular course by obtaining an opinion from a financial advisor that addressed the fairness of the [Transaction] to the limited partners in a judicially proscribed manner. Deploying the implied covenant in this fashion would rewrite Section 7.9(a) by changing both the nature of the Conflicts Committee inquiry (from the best interests of the Partnership to fairness to the limited partners) and the scope of judicial review (from the subjective good faith of a majority of the committee to compliance with an obligation to obtain an opinion that analyzed the fairness with a sufficient level of methodological rigor to satisfy a court after the fact).[416]

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408. *Id.* at 181.

409. *Id.*

410. *Id.*

411. *Id.*

412. *Id.*

413. *Id.*

414. *Id.* at 182.

415. *Id.* at 190.

416. *Id.* at 191.

Interestingly, the Court limited *Gerber*.[417] The Court held that the plaintiff could not rely on *Gerber* to state an implied covenant claim because "that decision turned on the Conclusive Presumption Provision and its gaps."[418] Because the Court's decision focused on the Special Approval provision, *Gerber* did not apply.[419]

Finally, as to the aiding and abetting claims, the Court held that because the parties had eliminated all fiduciary duties and replaced them with contractual duties, an aiding and abetting theory was not available.[420] "Because the LP Agreement establishes a purely contractual relationship, a theory of aiding and abetting a breach of contract claim is unavailable in this case."[421] The Court distinguished between contractual "fiduciary duties" and a contractual standard that turned on a "requisite mental state" such as subjective good faith.[422] The former could support an aiding and abetting claim while the latter could not.[423]

B. Consequence Of Failing To Eliminate Default Fiduciary Duties

In *Ross Holding & Management Co. v. Advance Realty Group, LLC*,[424] the Court of Chancery held that the operative limited liability company agreement had not eliminated default fiduciary duties and that defendants had breached the fiduciary duties they owed to the company's minority unitholders by agreeing to a reorganization without adequately considering the impact it would have on the minority unitholders. However, because the plaintiffs failed to show how they had been harmed, the Court could not award damages.

Plaintiffs, minority unitholders of Advance Realty Group, LLC ("ARG"), brought an action against the members of ARG's Board of Managers (the "Board") claiming that the Board breached its fiduciary duties to the minority unitholders by agreeing to a reorganization (the "Reorganization").[425] The plaintiffs claimed that the Reorganization caused a diminution in value of their ARG units.[426]

In 2001, ARG was looking for an infusion of capital to grow its business and, as a result, partnered with Five Arrows Realty Securities, III ("FARS"), an investor that provided growth capital to private and public real estate operating companies in return for both a steady return and the opportunity to participate in the increase in the companies' equity value.[427] Pursuant to a credit agreement, FARS gave ARG a $60 million loan with a maturity date of August 6, 2008

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417. *Id.* at 190.

418. *Id.*

419. *Id.*

420. *Id.* at 194.

421. *Id.*

422. *Id.*

423. *Id.*

424. 2014 Del. Ch. LEXIS 173 (Del. Ch. Sept. 4, 2014) (Noble, V.C.).

425. *Id.* at *2-3.

426. *Id.* at *3.

427. *Id.* at *5.

(the "Maturity Date").[428] The interest on the loan was 6%, but would increase to 15% if ARG did not repay the loan by the Maturity Date.[429] The promissory note FARS received also allowed it to convert all or a portion of its debt into ARG Class A units at a conversion price of $16.65 per unit.[430]

ARG also amended its operating agreement and expanded the Board from two members to four members, with ARG's majority owner Advance Capital Partners ("ACP") being granted two designees and FARS being granted two designees.[431] Additionally, according to the terms of the loan, if ARG defaulted on the loan the Board would expand to add a fifth FARS-controlled board seat.[432]

Beginning in 2005, ARG began exploring options to assist FARS in liquidating its investment in ARG. The Board explored several possibilities, including a Rule 144A private placement, a recapitalization, and a sale of its operating portfolio.[433] Ultimately, ARG decided against any of these transactions and instead pursued the Reorganization.[434] The purpose of the Reorganization was to create one easily-capitalized and readily-saleable company while allowing FARS to satisfy its investment.[435] To accomplish this, ARG spun off its development subsidiary, Advance Realty Development ("ARD"), to ACP, allowing it to own and develop $45 million worth of capital-intensive properties.[436] FARS also converted approximately $10 million of its debt at a strike price of $16.65 into approximately 600,000 units of ARG thereby giving FARS a majority equity interest in the reorganized ARG, which would keep its revenue-generating properties in order to sell them to satisfy FARS' investment.[437] After the conversion of $10 million of its debt into Class A units, the remaining balance of FARS' $60 million debt was converted into $80 million worth of notes in the reorganized ARG.[438] FARS was also given the right to be paid before the minority unitholders.[439] The minority unitholders were offered two options: (1) to exchange their Class A Units for common units in ARD on the same terms as those accepted by ACP, or (2) to receive $21.68 per unit payable in $5.84 in cash and a promissory note of $15.84 with an interest rate of 6%.[440] The plaintiffs refused both options and instead retained their units.[441]

428. *Id.* at *6.

429. *Id.* at *6-7.

430. *Id.* at *7.

431. *Id.* at *7-8.

432. *Id.* at *8.

433. *Id.* at *14-18.

434. *Id.* at *24.

435. *Id.*

436. *Id.* at *25.

437. *Id.*

438. *Id.*

439. *Id.* at *26.

440. *Id.* at *37.

441. *Id.* at *38.

Ultimately, ARG defaulted on its Class A unitholders' notes and many other of its loans.[442] The plaintiffs' units thus became valueless.[443] The plaintiffs brought a claim against members of the Board for breach of fiduciary duty.[444]

The Court began its analysis by assessing what duties were owed by defendants. To make this determination, the Court began with ARG's operating agreement.[445] The Court held that traditional fiduciary duties apply to limited liability companies unless those duties "have been clearly supplanted or modified" by the operating agreement.[446] After analyzing ARG's operating agreement, the Court concluded that the operating agreement did not eliminate or modify the default fiduciary duties the Board owed to the minority unitholders.[447] Moreover, the Court held that the Reorganization was an interested transaction and the entire fairness standard of review applied.[448]

The Court then examined the Reorganization under the entire fairness standard. In applying the standard, the Court held that while the price that the minority received for redeeming their units was fair, the Reorganization was procedurally unfair.[449] Specifically, the Court held that,

> The process employed by ARG's board left much to be desired and was motivated by its members' self-interest. The process did not empower ARG's minority to negotiate with the Board, to seek interim injunctive relief, or to ratify the transaction. The Board failed to provide information to the minority which could help them in evaluating the value of their units and sent inadequate notice only after the Regorganization was complete. No fairness opinion guided the Board's valuation efforts. In sum, the Court was not convinced that the Board was adequately representing the minority interests.[450]

Thus, the Court concluded that the poor process prevented a finding that "the price *and* process, assessed as a unitary standard was fair."[451] The Court discussed the various types of damages awards that might have been available, but concluded that because the plaintiffs had failed to explain how they were harmed it had no basis to make a "responsible estimate of damages."[452]

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442. *Id*. at *39.

443. *Id*.

444. *Id*.

445. *Id*. at *41.

446. *Id*. at *42.

447. *Id*. at *46.

448. *Id*. at *59.

449. *Id*. at *72.

450. *Id*. at *114-15.

451. *Id*. at *119.

452. *Id*. at *121.

C. Post-Trial Damages Awarded As Result Of A Breach Of The Implied Covenant Of Good Faith And Fair Dealing

Finally, in *NAMA Holdings, LLC v. Related WMC LLC*,[453] the Court of Chancery held, after trial, that that an escrow agent had breached the implied covenant of good faith and fair dealing by failing to remain neutral in its role. The facts showed that the escrow agent held monies in escrow. Following a dispute in 2006 regarding those monies, the Court approved an order outlining the escrow agent's duties related to the escrow pending an arbitration of the parties' disputes (the "Segregation Order").[454] The Segregation Order required the escrow agent to hold any disputed amounts in a segregated, interest-bearing account until either (i) the parties to the disputes authorized the release of the disputed amounts by joint written instructions or (ii) the escrow agent received a copy of the decision of the one arbitrating the disputes.[455] Following arbitration, the escrow agent refused to release certain disputed amounts pursuant to the ruling of the arbitral panel.[456] Instead, the escrow agent released the funds to another related party who distributed the amounts in a manner not contemplated by the arbitrators' decision.[457] As a result, the plaintiff filed an action against the escrow agent and its parent company for breach of the implied covenant of good faith and fair dealing.[458] The parties proceeded to trial and the Court issued its post-trial opinion finding that the escrow agent had breached the implied covenant of good faith and fair dealing.[459] In so holding the Court provided a roadmap for analyzing such claims.

The Court began its analysis by noting that the implied covenant will only "fill gaps" in a contract and will not apply to issues that the language of the contract expressly covers.[460] Furthermore, the Court explained that even if it determines that a contractual gap exists, the Court will only "fill the gap" when "it is clear from what was expressly agreed upon that the parties who negotiated the express terms of the contract would have agreed to proscribe the act later complained of as a breach of the implied covenant of good faith—had they thought to negotiate with respect to that matter."[461]

The Court next discussed how it should go about determining how to fill the gaps. To do so, the Court observed that it does not "introduce its own notions of what would be fair or reasonable under the circumstances" because the implied covenant of good faith and fair dealing is not a "free-floating requirement that a party act in some morally commendable sense." Likewise, to find a breach of the implied covenant the court need not determine that a party acted in bad faith.

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453. 2014 Del. Ch. LEXIS 232 (Del. Ch. Nov. 17, 2014) (Laster, V.C.).

454. *Id.* at *18.

455. *Id.*

456. *Id.* at *31.

457. *Id.* at *33.

458. *Id.* at *43.

459. *Id.* at *45.

460. *Id.* at *47.

461. *Id.* at *51.

Instead, the implied covenant contemplates "faithfulness to the scope, purpose and terms of the parties' contract."[462] This determination is based on whether the party's actions comport with the contract itself and what the parties would have agreed upon had the issue arisen when they were bargaining originally.[463]

Applying this test, the Court assessed the language of the Segregation Order, which reflected the most recent stipulation between the parties.[464] The Court held that while the Segregation Order did not contain any language requiring the escrow agent to act as a neutral custodian for the funds, "this expectation was so fundamental that [the parties] did not need to negotiate about [it]."[465] According to the Court, "[i]t was a core term that the parties would have agreed to themselves and made explicit if they had considered the issue in their original bargaining positions at the time of contracting."[466] The Court relied on what it considered to be the widely-held proposition that a custodian for property in dispute is expected to act neutrally with respect to the parties in dispute.[467] The Court concluded that the escrow agent did not act neutrally when it refused to release the amount after the arbitrator's decision.[468] The Court awarded damages in the amount of $5,894,391, which represented the amount the plaintiff was unable to recover as a result of the escrow agent's conduct.[469]

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462. *Id.* at *50 (citation omitted).

463. *Id.* at *51.

464. *Id.* at *53.

465. *Id.* (citation omitted).

466. *Id.* at *53-54.

467. *Id.*

468. *Id.* at *65.

469. *Id.* at *78.