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Delaware Law Developments in 2020, and Looking Forward to 2021

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There is no doubt that the COVID-19 pandemic will dominate the story of 2020. Delaware corporate law is no different, as seen by the flood of busted deal litigation. But the year also saw developments in Delaware law unrelated to the pandemic that will shape merger litigation and governance considerations in the years to come. Below, we highlight some of these developments, and considerations for the future. [1]

MAE and Ordinary Course Covenants Confront the Pandemic.

One of the early consequences of the COVID-19 pandemic to corporate law was an uptick in renegotiated deals, cancelled mergers, and busted deal litigation. At the heart of these cases was whether either (1) the effects of the pandemic could constitute a material adverse effect ("MAE") or (2) the response to the pandemic constituted a deviation from the ordinary course of business.

In late 2020, Vice Chancellor Laster provided an answer in *AB Stable VII LLC v. Maps Hotels and Resorts One LLC*, 2020 WL 7024929 (Del. Ch. Nov. 30, 2020). Subject to the facts and arguments of the case, the Vice Chancellor held that the pandemic was carved out from the parties' definition of a MAE in their agreement. Nonetheless, the Vice Chancellor held that the target's "routine" response to the pandemic, which included employee layoffs and the cancelling of customer services, breached its contractual obligation to operate in the ordinary course consistent with past practices.

As we previously wrote, the *AB Stable* opinion highlights a number of considerations for buyers and sellers in future merger transactions, including defining what is "ordinary course", whether to apply customary MAE exceptions to an ordinary course covenant, and whether to address the interaction of an ordinary course covenant with other contractual covenants.

A Revival in Appraisal Arbitrage?

In recent years, both Delaware courts and the Delaware legislature have confronted the problem of "appraisal arbitrage," or investment strategies designed to exploit the value of statutory appraisal claims. One development that looked to curtail such abuses was the trifecta of Delaware Supreme Court cases in *DFC Glob. Corp. v. Muirfield Value P'rs, L.P.*, 172 A.3d 346 (Del. 2017), *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd.*, 177 A.3d 1 (Del. 2017), and *Verition P'rs Master Fund Ltd. V. Aruba Networks, Inc.*, 210 A.3d 128 (Del. 2019). In *DFC*, *Dell*, and *Aruba*, the Court recognized that deal price, less synergies, reflects the best evidence of the fair value of a public company. Combined with the ability of a respondent corporation to pre-pay what it believes to be the fair value of the appraised shares so as to avoid pre-judgment statutory interest, it appeared that public company appraisal arbitrage was on its last legs.

A recent Delaware Supreme Court decision, however, may upend these developments. In *In re Solera Ins. Coverage Appeals*, 2017 WL 57839 (Del. Oct. 23, 2020), the Court held that an appraisal claim is not covered as a "Securities Violation" pursuant to a typical D&O insurance policy, leaving the surviving company to cover the extraordinary costs of defending an appraisal claim. Based on anecdotal evidence, plaintiffs counsel has been invoking the *Solera* decision to threaten litigation costs so as to extract additional value from appraisal claims. If this trend continues, we will have to see how the insurance market responds, including if carriers will underwrite cost-effective policies covering appraisal defense. If not, then another solution may be to amend the Delaware General Corporation Law to permit fee-shifting provisions in corporate charters and bylaws for appraisal claims, even if such fee shifting is limited to when the respondent corporation exercises its statutory right to prepayment and any final appraisal award does not exceed that prepayment.

Disclosures Return to the Forefront?

Through a series of decisions from the second half of 2020, Delaware Courts have raised the stakes for disclosures in proxy materials seeking stockholder approval of merger transactions.

The decision in *City of Warren Gen. Emps. Ret. Sys. v. Roche*, No. 2019-0740-PAF (Del. Ch. Nov. 30, 2020), provides a stark example. In *Roche*, the Court of Chancery allowed disclosure claims to proceed against the CEO of the target in a merger where the proxy materials allegedly (1) failed to disclose projections showing an additional $20 million in EBITDA from acquisitions in 2018, which projections defendants contended were speculative and unreliable, and when the company had already disclosed various EBITDA projections ranging from $240 million to $275 million for 2018 and (2) misstated the ability of the target to solicit an alternative transaction during the go-shop period. In reaching this result, the Court rejected plaintiff's other allegations that the CEO had acted disloyally. Thus, the surviving disclosure claim was based entirely on a breach of the duty of care—even though common sense would suggest that the relevant proxy disclosures would not have been drafted by the CEO, but rather by the attorneys and other professionals who penned the proxy. As a result, the CEO (and the surviving corporation through the CEO's indemnification rights) now must defend a class seeking a quasi-appraisal remedy.

Pointedly, the disclosure claim in *Roche* would not have survived against a member of the board of directors acting as a director. With rare exceptions, the charters of Delaware companies exculpate directors from monetary liability for a breach of the duty of care. Such protection does not extend to officers.

Time will tell if post-closing merger litigation in Delaware shifts its focus to executive officers for technical footfalls in proxy disclosures. If that shift does happen, then a legislative response may be needed. One solution could be to permit corporate charters to exculpate senior officers from a breach of the duty of care, even if such exculpation is limited only to proxy disclosures

Federal Forum Provisions Are Approved.

In 2018, the United States Supreme Court issued its decision in *Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061 (2018), finding that plaintiffs could elect to pursue violations of the Securities Act of 1933 in either state or federal court. The *Cyan* decision accelerated the trend of state court filings of

Securities Act claims, with plaintiffs viewing state courts as more favorable than federal courts because of the relatively lax pleading standards and looser discovery standards in state court.

In early 2020, the Delaware Supreme Court approved a private solution to the *Cyan* problem. In *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. 2020), the Court upheld a federal forum charter provision requiring that Securities Act claims be brought in federal court. A number of state court decisions outside of Delaware have since applied *Sciabacucchi* to dismiss Securities Act claims barred by such charter provisions. Nonetheless, one can expect that the full implications of the *Sciabacucchi* decision will continue to be tested, including whether federal forum provisions may be included in corporate bylaws or if a charter or bylaw could require the arbitration of stockholder claims.

Oversight Claims Remain Difficult to Plead.

A critical governance question left over from 2019 was whether Delaware Courts were going to be more solicitous of oversight claims in 2020. After the Delaware Supreme Court's decision in *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019), many thought pieces were authored suggesting Delaware's oversight jurisprudence had dramatically expanded.

The past year has not borne out this concern. Indeed, decisions from the Court of Chancery in *Owens v. Mayleben*, 2020 WL 748023 (Del. Ch. Feb. 13, 2020), *In re GoPro, Inc. S'holder Deriv. Litig.*, 2020 WL 2036602 (Del. Ch. Apr. 28, 2020), *In re TrueCar, Inc. S'holder Deriv. Litig.*, 2020 WL 5816761 (Del. Ch. Sept. 30, 2020), *In re MetLife Inc. Deriv. Litig.*, 2020 WL 4746635 (Del. Ch. Aug. 17, 2020), and *Richardson v. Clark*, 2020 WL 7861335 (Del. Ch. Dec. 31, 2020), confirm both that an oversight claim remains one of the most difficult claims in corporate law to plead successfully, and the core finding from *Marchand* that directors must at least try to implement an effective oversight system for the corporation's mission critical risks. Thus, in *Owens*, *GoPro*, *True Car*, *MetLife*, and *Richardson*, the Court dismissed oversight claims where the plaintiffs failed to plead facts that the directors did not at least try to institute internal controls, or where the complaints' factual allegations demonstrated the directors made good faith efforts to ensure their organizations' legal compliance.

While *Marchand* demonstrates that a properly pled oversight claim has teeth, the past year should give comfort to engaged directors that they should not expect to defend specious oversight claims as a matter of course. Such comfort is especially important after a year of extraordinary challenges that directors and their companies have confronted.

ESG to Continue to Gain Prominence in 2021.

One current governance trend that has yet to find its way to the Delaware courts is the greater prevalence of environmental, social, and governance ("ESG") considerations in the C-Suite and boardroom. That may change in 2021.

In many ways, 2020 offered a perfect environment for ESG considerations. From the COVID-19 pandemic, to the Black Lives Matter movement, to the fallout from the 2020 United States presidential election, companies have increasingly weighed stakeholder interests in their decision making. As we previously wrote, Delaware law recognizes and encourages the consideration by directors of such stakeholder interests in managing Delaware corporations for the benefit of their stockholders.

While directors are given broad discretion in how they fulfill their duties, the weaponization of ESG by plaintiff firms has already begun. In the past half year, plaintiff firms have filed litigation in courts outside of Delaware alleging that corporate boards failed to live up to their organizations' stated ideals of diversity and inclusion. In 2021, one may see this litigation strategy expand to other areas where companies have expressed their commitment to certain values, such as how the corporation addresses climate change.

Even without the risk of litigation related to ESG issues, we expect to see greater focus on how directors further their organization's ESG goals. Both California and NASDAQ have expanded requirements related to board diversity and disclosure. In addition, activist shareholders, institutional investors, and proxy advisors are increasingly raising ESG themes in their campaigns or communications with companies and their shareholders. And as the pandemic recedes and directors can shift their focus to the future, we also expect to see climate change become more important in corporate governance. Lastly, we would not be surprised to see greater attention given to whether companies should be incorporated as public benefit corporations, which would formalize in their constitutional documents the societal, cultural, or environmental goals of the organization.

With the law of corporate governance continuing to evolve, corporations, their directors, and their investors have much to look forward to in 2021. Ultimately, a core strength of Delaware law remains the freedom it grants independent directors to address the coming opportunities.

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