Delaware Corporate Law

2024 Year in Review

Potter Anderson

Your Delaware Advantage

2024: DELAWARE CORPORATE JURISPRUDENCE IN REVIEW

2024 proved to be another monumental year in Delaware corporate law and for the Delaware courts. The Court of Chancery had one of its busiest years ever, with 1,357 cases filed, and it underwent significant changes to its bench. Meanwhile, the Delaware legislature passed sweeping revisions to the Delaware General Corporation Law, including amendments regarding stockholders' agreements, the use of stockholder representatives, contractual provisions concerning penalties for breaches of merger agreements and lost-premium damages, and approvals of merger agreements. The amendments exemplify Delaware's unique ability to respond swiftly to address matters perceived to be of potential concern to Delaware corporations and their constituents.

Vice Chancellor Sam Glasscock, III retired in January 2025 after serving in that capacity since his appointment to the Court in 2011. Vice Chancellor Glasscock had previously served as a Magistrate from 1999 to 2011. Potter Anderson thanks Vice Chancellor Glasscock for his many years of exemplary service, and we will remember fondly his wisdom and humor from the bench. Thank you.

Magistrate Bonnie David filled the vacancy Vice Chancellor Glasscock's retirement created. Vice Chancellor David, who clerked for Vice Chancellor Glasscock, became a Magistrate on the Court in 2023 after working at Skadden, Arps, Slate, Meagher & Flom LLP's Wilmington office. Vice Chancellor David has already hit the ground running, and we are delighted to see her step into the role previously held by perhaps her greatest mentor. She is a superb addition to the already deep Chancery bench.

The Court of Chancery made major changes to the Magistrate in Chancery position. First, Christian Douglas Wright, Danielle Gibbs, and David Hume, IV joined as Magistrates in Chancery, bringing the number of Magistrates to five and the total number of members of the bench to twelve. Magistrate Wright previously served as Director of Impact Litigation at the Delaware Department of Justice, Magistrate Gibbs previously served as Chief Legal Counsel to Governor John Carney, and Magistrate Hume served as Chief Legal Ethics Officer for the Delaware Department of Justice and a member of its Appellate Unit. Second, the Court created a new position, Senior Magistrate in Chancery, elevating Magistrate Selina Molina to the role after six years as Magistrate. In her new role, Senior Magistrate Molina will assist Chancellor McCormick with administrative tasks related to the Magistrates' docket, including their important role in hearing books and records disputes pursuant to 8 *Del. C. § 220*.

The Court of Chancery also continued its efforts to update and modernize its rules, making significant changes to, among other things, the rules regarding service of

public versions of documents and filing of certificates of services. The Court also made changes to rules about pleadings, defenses, counterclaims, and third-parties to match the equivalent rules in the Federal Rules of Civil Procedure and previous Court of Chancery guidance. These rule changes have already streamlined practice in Chancery and have been much appreciated by practitioners. The Court expects to make additional rules changes in 2025 as it completes its modernization campaign.

On February 17, 2025, proposed amendments to the DGCL were introduced to the Delaware General Assembly. If enacted, this legislation would amend Section 144 of the DGCL, providing, among other things, safe harbors with respect to certain acts or transactions involving directors, officers, controlling stockholders or members of control groups, and Section 220 of the DGCL, amending or clarifying certain provisions with respect to books and records demands. The Delaware Senate also introduced legislation that would request that the Corporation Law Section of the Delaware State Bar Association prepare a report and recommendations regarding the award of attorneys fees in certain corporate litigation cases. The amendments to Section 144 are intended to address recent case law regarding director independence and specific (and relatively infrequent) circumstances involving stockholder-controlled corporations that have been seen by many as problematic. The Section 220 amendments are designed to reduce the burden of stockholder demands for books and records on Delaware corporations by, among other things, more narrowly defining the types of documents that constitute "books and records." In Potter Anderson's view, the proposed amendments, if enacted, will help ensure that good faith business judgments of independent directors are given appropriate weight when challenged in stockholder litigation, even in circumstances involving controlling stockholder conflicts of interest, and will restore balance to the books and records demand process.

The events of 2024 show that Delaware continues a thriving and robust market prepared to adapt to whatever challenges it faces for years to come.

The Market Practice Amendments

In July of 2024, in response to certain significant developments in case law, the Delaware legislature passed several amendments (the "Market Practice Amendments") to the General Corporation Law of the State of Delaware (the "DGCL"). Targeting Sections 122, 147, 232, 261, and 268 of the DGCL, the Market Practice Amendments became effective on August 1, 2024. The Market Practice Amendments, framed within the context of the case law developments to which the Delaware legislature responded, are summarized below.

Moelis, Wagner, N-able and Section 122

In *W. Palm Beach Firefighters' Pension Fund v. Moelis & Co*., C.A. No. 2023-0309-JTL (Feb. 23, 2024) (Vice Chancellor Laster), Moelis & Company (the "Company"), its CEO, Ken Moelis ("Moelis"), and three of Moelis's affiliates entered into a stockholders agreement prior to the Company's IPO. The stockholders agreement contained three sets of provisions that the plaintiff challenged as violating Section 141(a) of the DGCL: (i) the Pre-Approval Requirements, (ii) the Board Composition Provisions, and (iii) the Committee Composition Provision.

The Pre-Approval Requirements required the board of directors (the "Board") to secure the pre-approval of Moelis, in his capacity as a stockholder, before it could exercise essentially any of its authority to act on behalf of the Company. The Board Composition Provisions, which significantly impacted the Board's ability to select new directors, were comprised of the following: (i) a Nomination Requirement; (ii) a Designation Right; (iii) an Efforts Requirement; (iv) a Recommendation Requirement; (v) a Size Requirement; and (vi) a Vacancy Requirement. The Committee Composition Provision required the Board to appoint a number of Moelis designees to each committee that was proportionate to the number of Moelis designees sitting on the Board.

The Court derived from case law a two-part analysis, asking, first, whether the stockholders agreement constituted part of the corporation's internal governance arrangement, and, if so, whether, under the *Abercrombie* test, certain provisions in such agreement imposed restrictions on the board of director's authority in violation of Section 141 of the DGCL. Section 141(a) provides, in relevant part, that "[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation." Under the *Abercrombie* test, provisions that are part of a corporation's internal affairs will violate Section 141(a) when they "have the effect of removing from directors in a very substantial way their duty to use their own best judgment on management matters" or "tend[] to limit in a substantial way the freedom of director decisions on matters of management policy[.]" In short, if a provision

deprives a board of independent action or of the ability to exercise discretion in its decision making, the provision is likely to violate Section 141(a) under *Abercrombie*.

The Court found that the challenged provisions in the stockholders agreement were "part of the corporation's internal governance arrangement" and that the Pre-Approval Requirements, the Recommendation Requirement, the Size Requirement, the Vacancy Requirement, and the Committee Composition Provision were facially invalid under Section 141(a). The Court also concluded that the Committee Composition Provision was facially invalid under Section 141(c). The Court found, however, that the Nomination Requirement, the Designation Right, and the Efforts Requirement were facially valid.

The Delaware legislature directly addressed *Moelis* by adding subsection 18 to Section 122 of the DGCL. New Section 122(18) expressly permits corporations to enter into restrictive agreements with stockholders, contingent upon the corporation's receipt of board-determined "minimum consideration." As noted in the new subsection, the corporation is now permitted to, among other things: (i) "restrict or prohibit itself from taking actions specified in the contract"; (ii) "require the approval or consent of 1 or more persons or bodies before the corporation may take actions specified in the contract (which persons or bodies may include the board of directors or 1 or more current or future directors, stockholders or beneficial owners of stock of the corporation)"; and (iii) "covenant that [it] or 1 or more persons or bodies will take, or refrain from taking, actions specified in the contract (which persons or bodies may include the board of directors or 1 or more current or future directors, stockholders or beneficial owners of stock of the corporation)." The newly created subsection also states that "the corporation shall be subject to the remedies available under the law governing the contract, including for any failure to perform or comply with its agreements under such contract."

Although new Section 122(18) now permits restrictions on a board of director's authority in a stockholders agreement, two post-*Moelis* cases, which were decided prior to the Market Practice Amendments taking effect, warrant further analysis: *Wagner v. BRP Grp., Inc.*, C.A. No. 2023-0150-JTL (Del. Ch. May 28, 2024) (Vice Chancellor Laster), and *Seavitt v. N-able, Inc.*, C.A. No. 2023-0326-JTL (Del. Ch. July 25, 2024) (Vice Chancellor Laster). The fact patterns in *Wagner* and *N-able* largely resembled that in *Moelis*, with both cases analyzing governance agreements that contained provisions such as pre-approval requirements, board and committee composition provisions, and director removal provisions which restricted their respective boards' abilities to act in the best interests of their corporations pursuant to Section 141(a) of the DGCL.

As in *Moelis*, the Court concluded that many of the provisions in *Wagner* and *N-able* violated Section 141(a). In *Wagner*, the Court additionally found that pre-approval requirements with respect to officers and charter amendments violated Sections 142 and 242, respectively, of the DGCL. In *N-able*, in addition to the Section 141(a)

violations, the Court found that the committee composition provision, director removal provision, and vacancy covenant in the stockholders agreement violated Sections 141(c)(2), 141(k), and 223(a), respectively, of the DGCL. The *N-able* court further found that certain of these provisions violated the corporation's certificate of incorporation and/or bylaws.

N-able also included an additional aspect not presented in *Moelis* or *Wagner*: some of the provisions in the company's certificate of incorporation and bylaws had stated that they were "subject to" the governance agreement at issue. The Court found that "[t]he DGCL does not permit the wholesale inclusion of provisions from private agreements into charters through incorporation by reference." In addition to matters of public policy, the Court noted that such incorporation by reference would violate Section 102 of the DGCL, which permits a charter to rely on "facts ascertainable" external to the certificate of incorporation but does not permit a certificate of incorporation to include "'agreements ascertainable' or 'provisions ascertainable,'" and Section 242 of the DGCL, which requires stockholder approval of any charter amendments.

Takeaways

Stockholders agreements may place restrictions on a board of directors' authority; however, certain provisions in such agreements remain subject to challenge: While new Section 122(18) places stockholders agreements on equal footing with certificates of incorporation with respect to their ability to restrict a board of director's authority, *Wagner* and *N-able* demonstrate that certain provisions in such agreements are still subject challenge under other provisions of the DGCL, a corporation's certificate of incorporation and/or a corporation's bylaws. In preparing stockholders agreements, drafters are urged to engage in a careful review of provisions for compliance more broadly with provisions of the DGCL outside of Section 141(a), in addition to the corporation's certificate of incorporation and bylaws.

"Facts ascertainable" do not include "agreements ascertainable" or "provisions ascertainable": The Court in *N-able* found that a certificate of incorporation may not incorporate a stockholders agreement by reference. As such, provisions in a private agreement, such as a stockholders agreement, that are referenced and intended to have operative effect in a certificate of incorporation should be substantively included in the certificate of incorporation rather than incorporated by reference. The *N-able* Court left open the question of whether incorporation of a private agreement by reference in a corporation's bylaws is similarly impermissible.

Activision Blizzard and Sections 147, 232 and 268

In *Sjunde AP-Fonden v. Activision Blizzard, Inc., et al.*, C.A. No. 2022-1001-KSJM (Del. Ch. Mar. 19, 2024) (Chancellor McCormick), Activision Blizzard's board of directors (the "Board") met to discuss, and approve, a merger. At this meeting, the Board approved a previously received draft of the merger agreement. What the Board approved, however, did not include a disclosure letter, disclosure schedules, the certificate of incorporation of the surviving corporation, amount of consideration, or the name of the target, and did not address a key open issue regarding dividends. The Board never received, analyzed, or approved a subsequent draft of the merger agreement, and the finalized copy of the merger agreement differed from the Board-approved draft in several respects.

As the transaction proceeded, Activision Blizzard filed its proxy statement, which contained a copy of the merger agreement but did not include copies of the disclosure letter, disclosure schedules, or the certificate of incorporation of the surviving corporation. The stockholders approved the merger. The plaintiff, a stockholder of Activision Blizzard, asserted several claims, including alleged violations of Sections 251 and 141 of the DGCL. The Court first concluded that, at least at the motion to dismiss stage, there was enough evidence for the Court to infer that the Board did not meet the requirements under Section 251(b), which requires a board of directors to adopt an agreement of merger. The Court noted that "[a]t bare minimum, Section 251(b) requires a board of directors to approve an essentially complete version of the merger agreement." Given that the merger agreement that the Board approved lacked key features such as the consideration and the certificate of incorporation of the surviving corporation, the latter of which is expressly referenced in Section 251(b) as a "statutorily mandated item[]," it could not be considered an "essentially complete version."

The Court also analyzed whether the defendants had violated Section 251(c) of the DGCL. Section 251(c) provides that a notice of a stockholder meeting set with the intention of voting on a merger agreement must either include: (i) the merger agreement itself or (ii) "a brief summary thereof." The plaintiff argued that the defendants failed to meet either option. The Court agreed, first explaining that while a copy of the merger agreement was attached to the proxy in an attempt to satisfy the first option, the lack of inclusion of the certificate of incorporation of the surviving corporation, which is expressly mandated by Section 251(b), invalidated this attempt. Second, the Court explained that although a brief summary of the merger agreement was provided, it was contained in the proxy statement rather than the notice, and Section 251(c) required such summary to be provided in the notice.

In response to *Activision Blizzard*, the amendments to Section 147 now provide that, if board approval of an agreement or other document is required, the board may approve of such document either: (i) in its final form or (ii) in its substantially final form. Section 147 also now provides that if a board has approved a document that

is required to be filed with the Secretary of State or "referenced in any certificate so filed," it may "adopt a resolution ratifying" that document prior to the filing, with the ratification applying retroactively to the time of the initial approval.

The Delaware legislature further responded to *Activision Blizzard* by altering Section 232 to clarify that when notice is given pursuant to either subsection (a)(1) or (a)(2) of Section 232, each document that is submitted in conjunction with that notice is considered part of the notice. The amendment made clear, however, that such documents are only construed as part of the notice "for purposes of determining whether notice was duly given under this title, the certificate of incorporation or bylaws."

Finally, the Delaware legislature responded to *Activision Blizzard* by amending Section 268 of the DGCL. Subsection (a) of 268 now provides that merger agreements, except those executed under Section 251(g) of the DGCL, need not contain any reference to the certificate of incorporation of the surviving corporation in the merger agreement for that agreement "to be considered in final form or substantially final form." Further, the constituent corporation's board may adopt "any amendment or amendment and restatement of the certificate of incorporation of the surviving corporation" and if the certificate of incorporation is modified, it will not be considered a revision of the merger agreement. Subsection (b) states that "any disclosure letter, disclosure schedules or similar documents or instruments" filed to correct or explain "representations, warranties, covenants or conditions" in a merger agreement are not considered a part of the agreement unless said agreement provides otherwise.

Takeaways

Boards of directors are permitted to approve a "substantially final form" of merger agreement: Amended Section 147 now allows boards of directors to approve a "substantially final" form of merger agreement. If a board of directors does approve a "substantially final" form of merger agreement, following such approval and prior to the effectiveness of the filing of the certificate of merger, the board of directors can ratify the final merger agreement.

Drafters should carefully review boiler provisions in merger agreements: Amended Section 268 clarifies that disclosure letters, schedules and similar documents will not be considered part of a merger agreement unless otherwise provided therein. This means, among other things, that the copy of the merger agreement (or brief summary thereof) to be submitted to the stockholders for the purpose of acting on the merger agreement will not include disclosure schedules and similar documents *unless* the merger agreement so provides. Drafters should carefully review boiler provisions in a merger agreement, such as the integration clause, that may otherwise ordinarily incorporate disclosure schedules and similar documents by reference in the merger agreement and determine whether to exclude such documents from constituting part of the merger agreement for purposes of Section 268(b).

Crispo and Section 261

In *Crispo v. Musk, et al.,* C.A. No. 2022-0666-KSJM (Del. Ch. Oct. 31, 2023) (Chancellor McCormick), in a petition for mootness fees, the Court addressed whether a plaintiff-stockholder of a target company had third-party beneficiary status to sue for lost-premium damages under a merger agreement, finding that the stockholder's claim was not meritorious when filed because the stockholder was either not a third-party beneficiary or such stockholder's third-party beneficiary status had not yet vested under the merger agreement. The merger agreement contained a damages-definition variant of a *"Con Ed"* provision expressly providing for lost stockholder premiums by defining the target company's damages to include lost-premium damages. The merger agreement further contained a no-third party beneficiaries provision, with limited exceptions not applicable to the stockholder's claim. The Court explained that "[a] target company has no right or expectation to receive merger consideration, including the premium," under agreements operating like the merger agreement at issue, and, therefore, only a stockholder of the target company would expect to receive payment of a premium under the merger agreement. "Where a target company has no entitlement to a premium in the event the deal is consummated," the Court further explained, "it has no entitlement to lost-premium damages in the event of a busted deal." The Court called into question *Con Ed* provisions taking a damages-definition approach, noting that "a provision purporting to define a target company's damages to include lost-premium damages cannot be enforced by the target company. To the extent that a damages-definition provision purports to define lost-premium damages as exclusive to the target, therefore, it is unenforceable." A damages-definition provision, the Court stated, would only be enforceable if stockholders were granted third-party beneficiary status.

In response to *Crispo*, new Section 261(a)(1) of the DGCL expressly provides that all agreements or merger or consolidation, except for those accomplished under Section 251(g), may include specific "penalties or consequences" that apply to any party to the agreement that fails to either fulfill its contractual obligations or otherwise hinders or obstructs the consummation of the merger or consolidation. Such penalties or consequences "may include an obligation to pay to the other party or parties to such agreement an amount representing, or based on the loss of, any premium or other economic entitlement the stockholders of such other party would be entitled to receive pursuant to the terms of such agreement if the merger or consolidation were consummated in accordance with the terms of such agreement." Additionally, subsection (a)(1) explains that if such a penalty or consequence is designed as an obligation to pay the other party to the agreement, that party "shall be entitled to enforce the other party's payment obligation and, upon receipt of any such payment, shall be entitled to retain the amount of such payment so received."

New Section 261(a)(2) also now provides that: (i) a stockholder representative may be appointed and bestowed with the "sole and exclusive authority" to act on behalf of the constituent corporation's stockholders in upholding their rights under a merger

agreement; (ii) this appointment is "irrevocable and binding" from the time the merger agreement or consolidation is adopted; and (iii) any such provision cannot be amended after the merger or consolidation's effective time unless it is amended "with the consent or approval of persons specified in the agreement of merger or consolidation." Subsection (a)(2) concludes by noting that provisions created in accordance with Section 261(a) "may be made dependent upon facts . . . ascertainable outside of such agreement, provided that the manner in which such facts shall operate upon the terms of the agreement is clearly and expressly set forth in the agreement of merger or consolidation."

Takeaways

Target corporations may enforce claims for, and retain the payment of, lost-premium damages if so provided in the merger agreement: Amended Section 261(a)(1) permits merger agreements to provide for penalties or consequences, including lost-premium damages, and explains that if a merger agreement provides that a corporation is entitled to payment from another party representing a penalty or consequence, such corporation is entitled to enforce the other party's payment obligations and to retain such payment.

Merger agreements may provide for the appointment of a stockholders' representative, with certain limitations on such representative's power thereunder: New Section 261(a)(2) clarifies that parties to a merger agreement may appoint a stockholders' representative in the merger agreement, which representative may be vested with "sole and exclusive authority" to act on behalf of a constituent corporation's stockholders. This authority, as granted in a merger agreement, remains subject to certain limitations, however, as the synopsis to this amendment notes that this amendment "do[es] not allow for a provision of an agreement of merger or consolidation empowering a stockholders' representative to exercise powers beyond those related to the enforcement of the rights of stockholders under the agreement." As examples of powers outside the scope of the stockholders' representative's authority pursuant to a merger agreement, the synopsis lists the ability "to waive, compromise or settle, in the name of any stockholder, any rights to appraisal under [Section] 262 or any direct claim for breach of fiduciary duty that such stockholder is entitled to assert following a merger or consolidation, or to consent, in the name of a stockholder, to restrictive covenants, such as a covenant not to compete or a non-solicitation covenant."

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Earnouts

Fortis Advisors LLC v. Johnson & Johnson

C.A. No. 2020-0881-LWW
(Vice Chancellor Will)

Background

In 2012, Johnson & Johnson ("J&J") identified a growing market for robotically assisted surgical devices and began taking steps to increase its market share. J&J began by forming a joint venture that worked on a new surgical robot, Verb. But over the years, Verb ran into delays, and J&J became worried about meeting the expected 2020 commercial release for Verb. J&J had previously invested in Auris Health, Inc. ("Auris") and believed it would be an attractive acquisition target. Auris was also developing a new surgical robot, iPlatform. J&J believed that an investment in iPlatform would be beneficial. Although unsure exactly how it would use iPlatform, J&J believed that it could be a back-up for Verb, become integrated with Verb, or get released into the market with Verb. In negotiations with Auris, J&J emphasized that iPlatform would survive and continue with more resources towards regulatory approval. In February 2019, J&J signed a deal to acquire Auris for $3.4 billion upfront and another $2.35 billion as a potential earnout based on ten milestones. The merger agreement included a clause requiring J&J to use "commercially reasonable efforts" to achieve the earnout milestones and a one-way anti-reliance clause favoring Auris.

Immediately following closing, J&J began "Project Manhattan," a competition between iPlatform and Verb. Project Manhattan resulted in J&J buying out the Verb joint venture partner and combining the two development teams to integrate Verb into iPlatform. In April 2020, J&J wrote down the value of certain regulatory and sales milestones to zero. Litigation commenced in October 2020. By the end of 2021, J&J scrapped iPlatform for parts to integrate with Verb, ending any expectation of achieving the earnout.

Following trial, the Court determined that J&J had breached its efforts obligations in the merger agreement, the implied covenant of good faith and fair dealing, and committed fraud in its statements regarding the certainty of a milestone. The Court also found that plaintiff had not upheld its burden to prove repudiation of the contract or fraud regarding J&J's intentions for Auris at the time of contracting.

Efforts to Achieve Earnout Milestones

The merger agreement contained a commercially reasonable efforts provision directed at achieving the earnout milestones. The Court emphasized three key protections for Auris in that provision. First, it contained a directive that J&J direct its efforts towards

achieving the regulatory milestones rather than J&J's other priorities. Second, J&J's efforts had to be "consistent with its 'usual practice' for a 'priority medical device.'" Third, J&J could not act based on "the cost of making any Earnout Payment(s)."

The Court reviewed J&J's efforts to meet the milestones, distinguishing between those that J&J chose not to achieve and those that J&J failed to achieve through a losing strategy. The Court found J&J liable only for the former. The Court compared J&J's treatment of its other surgical robot products with its treatment of iPlatform. The Court found that J&J had not acted in accordance with its past practices for developing surgical robots when it required iPlatform to compete with Verb in Project Manhattan, required a more complicated development process for iPlatform, and shelved iPlatform. Ultimately, the Court found that J&J had breached the commercially reasonable efforts obligations of the merger agreement.

One particular milestone required FDA approval through a specific method. At the time of the merger agreement, the parties assumed that this was the only logical pathway for iPlatform to get approved. The FDA, however, prevented approval in that manner, but an alternate and more onerous pathway was available. J&J argued that once the specific pathway for regulatory approval closed, it could abandon its efforts towards that milestone. The Court found instead that the implied covenant of good faith and fair dealing required J&J to have pursued the alternate pathway to regulatory approval based on the assumptions of the parties at the time of contracting and the intention—to get regulatory approval—behind the milestone. The Court found that because J&J had not done so, it breached its obligations under the implied covenant.

Fraud in Statements about the Milestones

The Court rejected arguments that the integration and anti-reliance clauses in the merger agreement would foreclose fraud claims when the statements were not in the contract and the anti-reliance clause was one sided in favor of Auris. The Court found statements amounting to general puffery, forward-looking statements, or true statements could not as a matter of law be considered fraud, even where J&J, after contracting, chose to take a different path that breached the agreement.

On the other hand, the Court found J&J's statements to Auris regarding the "high certainty" of achieving a specific milestone relating to Soft Tissue Ablation and its views that the milestone was an "'effective' up front" payment constituted fraud. J&J, at the time it made those statements, was actively concealing material facts concerning the death of a patient in a clinical study that made it uncertain that J&J would meet that milestone post-merger. Ultimately J&J did not reach that milestone. The Court determined that Auris relied on those statements in agreeing to the merger and suffered damages resulting from the fraud because Auris would have demanded a higher upfront payment rather than accept the true uncertainty of meeting the milestone.

Damages

The Court awarded a total of $960,865,748 in damages, plus pre-judgment interest. That total included $900 million in lost milestone payments, based on the Court's probability weighting of the likelihood that J&J would have achieved the targets had it used Commercially Reasonable Efforts, and approximately $60 million in expectation damages for the fraud claim.

The case is currently on appeal before the Delaware Supreme Court.

Takeaways

When drafting efforts provisions, consider whether the provision focuses outward or inward rather than focusing just on different iterations of "reasonable best efforts": There are many iterations of efforts provisions, which in the transactional realm are hierarchical. In Delaware, however, efforts provisions using the term "reasonable" are largely interchangeable. Instead, the courts focus on the delineation of "the efforts expected of the buyer relative to the achievement of the milestones." In other words, the courts look to the measure used, whether it is outward-facing—focused on the industry practice or standard—or inward-facing—focused on the past efforts of the buyer—and then judge the conduct based on the comparison to the measure rather than the hierarchy of the language used.

The implied covenant of good faith and fair dealing can modify earnout obligations where the parties had not previously considered an alternative approach: The implied covenant of good faith and fair dealing acts as a gap filler in contracts to deal with issues not considered by the parties at the time of contracting. The courts can find a gap in seemingly specific contractual language. Where there are third-party changes, such as regulatory shifts, the implied covenant may require a party to modify its understanding of the contractual language and focus on the intent of a clause, rather than the literal contract language. Failure to do so may result in breach.

Acquiror Aiding and Abetting Disclosure Violations

In re Mindbody, Inc. Stockholder Litigation
No. 484, 2023
(Justice Valihura)

In this decision, the Delaware Supreme Court affirmed in part and reversed in part a post-trial decision by the Court of Chancery. The Supreme Court affirmed the Court of Chancery's rulings that a CEO breached his fiduciary duties of loyalty (by tilting the sale process in a specific buyer's favor out of his own self-interest) and disclosure (by failing to disclose material aspects of his participation in, and his motivations for, the sale). The Supreme Court reversed, however, the Court of Chancery's ruling that the private equity acquirer had aided and abetted the CEO's disclosure breach, disagreeing with the Court of Chancery's holding that the acquirer's contractual right to review SEC filings provided a sufficient basis to conclude the acquirer had substantially participated in the breach. In doing so, the Supreme Court provided guidance for the first time as to the applicability of the Restatement (Second) of Torts factors in examining the "substantial assistance" portion of an aiding and abetting claim.

In 2018, three years after taking Mindbody, Inc. ("Mindbody" or the "Company") public, Richard Stollmeyer—the CEO and founder of the Company—decided to consider a sale. At the time, Stollmeyer had a need for liquidity and was aware that the controlling stockholder venture capital firm desired a near-term sale.

By August 2018, Stollmeyer commenced an informal sale process without the board's consent or knowledge, which the trial court found ultimately allowed Vista Equity Partners Management, LLC ("Vista") to obtain a competitive advantage over other potential acquirers. During the fall of 2018, Stollmeyer met with Vista representatives on numerous occasions informing Vista of his desire to "find a good home for his company" and Vista's founder that he intended to explore a sale of Mindbody, something he admitted to not having board authorization to say and information that was not otherwise available to the market. Even though Stollmeyer told the board of his discussions with Vista, he withheld the fact that he disclosed his desire to sell. In addition, after a November earnings call, Stollmeyer's investment banker (who was later hired by the Company) told Vista's representative that Stollmeyer wanted $40 per share minimum. By mid-November, Stollmeyer informed Vista of the upcoming sales process. The Company planned to solicit strategic bidders on November 29 and financial sponsors on November 30. Yet, the investment banker "formally" contacted Vista on November 30 then waited until December 3 and 4 to contact other financial sponsors. Vista received its final market study two days before other financial sponsors

had access to Mindbody's data room. At this point, Stollmeyer still had not informed the board of key information regarding the process: the VC firm's desire to sell, Vista viewing Mindbody's stock downturn as a buying opportunity, Vista's intent to make an offer on a premium over its trading price, that Stollmeyer had already met with Vista more than once, his conversation with a Vista portfolio company CEO, and that he planned on stepping down in two or three years.

Vista submitted an offer to acquire Mindbody for $35 per share, with a 24-hour deadline, three days after the data room opened to the remaining bidders on December 18. However, the other bidders were further behind in diligence and unprepared to make an offer. After one counteroffer, Vista provided its best and final of $36.50. With all other bidders out, the entire board convened and directed management to accept the bid.

The merger agreement provided for a 30-day go-shop and gave Vista the contractual right to review Mindbody's proxy materials. Under the merger agreement, if Vista became aware of material facts that were omitted from the proxy information, Vista had an obligation to inform Mindbody. That obligation was a key component of the Court of Chancery's conclusion that Vista provided substantial assistance and thus aided and abetted the CEO's disclosure breaches.

On January 4, 2019, Mindbody determined it had beaten Wall Street consensus estimates for Q4 revenue, information it did not include in its January 9 preliminary merger proxy. After discussing whether to disclose the Q4 earnings while stockholders deliberated over approving the deal, Mindbody's audit committee voted against disclosure. Mindbody's initial proxy also omitted references to some of Stollmeyer's meetings with Vista and Vista's expression of interest in mid-October. The definitive proxy and supplemental disclosures told stockholders about Stollmeyer's additional meetings with Vista representatives and attendance at the summit but failed to include the substance of his conversations.

Litigation ensued. After trial, the Court of Chancery found Stollmeyer liable for damages of $1 per share for breaching his duty of loyalty under Revlon. Also, it awarded damages of $1 per share against Vista and Stollmeyer jointly and severally for the disclosure violations, finding Vista aided and abetted Stollmeyer's breach.

On appeal, the defendants challenged the Court of Chancery's holdings (1) that Stollmeyer breached his fiduciary duty of loyalty under Revlon, (2) that Stollmeyer breached his fiduciary duty of disclosure, (3) that Vista aided and abetted Stollmeyer's disclosure breach, (4) awarding $1 of damages for Stollmeyer's Revlon breach, and (5) refusing to apply a settlement credit under DUCATA.

In analyzing Stollmeyer's liability for breaches of the duty of loyalty and disclosure, the Court affirmed the Chancellor's findings that he suffered from disabling conflicts, which presented a "paradigmatic" Revlon claim and that his omissions, in the aggregate,

were material, with the strongest claims concerning his tips to Vista concerning pricing and process timing that violated transaction committee guidelines. The evidence also supported the $1 per share in damages for Stollmeyer's duty of loyalty breach.

The Court then analyzed the various novel issues implicated by the Chancellor's holding that Vista aided and abetted Stollmeyer's disclosure breach, noting "how thin the case law" was on the issues. In total, for the reasons discussed below, the Court concluded that Vista had not substantially assisted the disclosure breaches.

The Court reaffirmed that the knowledge (scienter) prong for an aiding and abetting contains two distinct concepts: the plaintiff must prove that the aider and abettor knew that "the primary party's conduct constitute[d] a breach" and "that its own conduct regarding the breach was legally improper," which is distinct from knowledge of the primary party's conduct. The Court also acknowledged that participation should "be the most difficult to prove" against a potential acquirer who negotiated at arm's-length. The Court stated that an acquirer is protected in its attempt to reduce the sale price through arms'-length negotiations so long as it is not exploiting conflicts, and a different rule might deter third parties from deals altogether.

The Court adopted the Restatement (Second) of Torts § 876(b) factors to determine whether conduct amounts to "substantial assistance." Under those factors, an aider and abettor must actively participate in the breach, rather than have "mere passive awareness." In reviewing the Restatement factors, the Court held that Stollmeyer's November tips supported the trial court's conclusion that Vista likely knew that Stollmeyer's conduct constituted a breach but reversed the Chancellor's finding that Vista knew of the wrongfulness of its own conduct. Considering Vista's awareness of its own misconduct, the Court stated that the Chancellor's finding that Vista participated in the drafting of the proxy materials was not supported by the record evidence, and the trial court did not find Vista actively contributed to drafting or editing the proxy materials. The Court held that passive awareness of a fiduciary's disclosure breach that would come from reviewing draft proxy materials did not amount to taking actions to facilitate or assist Stollmeyer's breach. Rather, Vista stood by passively while Stollmeyer breached his duty of disclosure.

During this analysis, the Supreme Court considered what obligations Vista undertook by negotiating for a contractual obligation in the merger agreement to review and comment on public disclosures for the merger. Factually, the Supreme Court concluded that the Court of Chancery's finding that Vista had participated in drafting the proxy lacked support in the record. Legally, the Supreme Court found that the contractual obligation in the merger agreement did not impose an independent duty of disclosure on Vista. Therefore, the Supreme Court rejected the Court of Chancery's ruling that Vista had "withheld information from the stockholders." The Supreme Court considered "compelling public policy reasons" for not collapsing the arms'-length distance between the third-party buyer and target to make the buyer consider duties

to target stockholders, which could potentially force buyers to "second-guess the materiality determinations and legal judgment of the target's board," which does owe fiduciary duties to the target stockholders.

Finally, the Supreme Court analyzed the Restatement's "state of mind" factor. To the Supreme Court, the evidence that the Court of Chancery relied upon—scrubbing of "incriminating" information from investment committee materials that related to communications with the CEO—was insufficient given that it occurred almost a month before the drafting of the proxy and that it supported a finding that Stollmeyer may have violated his Revlon duties, not his disclosure duties. Because the aiding and abetting claim focused on the disclosure breaches, the plaintiffs needed to show that Vista knew its own conduct was wrongfully assisting Stollmeyer in those specific breaches. Thus, the Supreme Court held that the record did "not support a determination that Vista's conduct [rose] to the level of 'substantial assistance' or 'participation' in" Stollmeyer's breach, and it reversed the holding that Vista aided and abetted Stollmeyer's disclosure violation. Because the plaintiffs were only entitled to one recovery of $1 per share, and with the Revlon damages award affirmed, the ruling also meant that the Court did not need to analyze damages for the disclosure violation.

Takeaways

The bar for showing a third-party acquirer aided and abetted a fiduciary's disclosure breach is high: In analyzing Vista's participation, the Court made clear that notwithstanding the factual record supporting a finding of Vista's knowledge of Stollmeyer's breach, passive awareness of a fiduciary's disclosure breach that would come from reviewing draft proxy materials did not amount to taking actions to facilitate or assist the primary party's breach. This statement highlights the high burden that must be met in order to prove an acquiror's knowledge in an aiding and abetting disclosure claim. To meet this burden, a plaintiff must show some affirmative act on the part of the acquiror, e.g., drafting, revising, commenting, that evidences awareness to meet the second prong of the scienter element.

Contractual obligations to review proxy materials do not give rise to an independent duty of disclosure on acquirors to target stockholders: Buyers, especially those negotiating terms that provide final say on proxy materials, should take comfort in the Court's holding that such obligations alone do not give rise to independent fiduciary duties. The Court pointed to the public policy against having acquirors "second-guess the materiality determinations and legal judgment of the target's board[.]" Acquirors should still consider, however, potential breach of contract claims that may arise from obligations arising from language in a merger agreement.

Reincorporation

***Palkon, et al. v. Maffei, et al.*[1]**
C.A. No. 2023-0449-JTL
(Vice Chancellor Laster)

Rev'd sub nom.

Maffei, et al. v. Palkon, et al.
C.A. No. 125, 2024
(Justice Valihura)

Beginning in late 2022, the Board of Directors (the "Tripadvisor Board") of Tripadvisor, Inc. ("Tripadvisor") began exploring the possibility of converting Tripadvisor from a Delaware corporation into a Nevada corporation. In connection therewith, in early 2023, the Board of Directors (the "Holdings Board") of Tripadvisor's largest stockholder, Liberty TripAdvisor Holdings, Inc. ("Holdings" and together with Tripadvisor, the "companies"), a Delaware corporation existing primarily to hold shares representing 56% of the voting power of Tripadvisor, also began to consider converting Holdings into a Nevada corporation. Over the course of several months, the Tripadvisor Board and the Holdings Board received multiple presentations regarding the benefits of becoming a Nevada corporation. Ultimately, the Tripadvisor Board and the Company Board each unanimously approved the conversions of Tripadvisor and Holdings to Nevada corporations.

Tripadvisor and Holdings then sought stockholder approval for the conversions. The companies each issued proxy statements in support of the conversions that similarly extoled the virtues of Nevada, as compared with Delaware, law, including providing for greater protection for directors and officers from litigation and eliminating liability of directors and officers for certain breaches of fiduciary duties, including the duty of loyalty, absent intentional misconduct, fraud or a knowing violation of law. At separate stockholder meetings in June 2023, stockholders of each company voted to approve the conversions. Holdings, however, controlled a large block of Tripadvisor's voting power, and Mr. Maffei controlled a large block of the Holdings voting power. Excluding Mr. Maffei's respective voting blocks of each of Tripadvisor and Holdings, only 5.4% of voting power of the Tripadvisor shares held by the unaffiliated Tripadvisor stockholders, and only 30.4% of the voting power of the Holdings shares held by unaffiliated Holdings stockholders, were voted in favor of the conversions.

[1] Potter Anderson represents the defendants in this litigation and in the appeal before the Supreme Court of Delaware. Nothing in this summary is intended to express agreement or disagreement with the Court of Chancery's or the Supreme Court's factual findings or its or their analyses or holdings.

Stockholder litigation ensued, seeking to enjoin the conversions from closing. Plaintiff-stockholders alleged that the directors of Tripadvisor and Holdings and Mr. Maffei, as the stipulated controlling stockholder and chief executive officer and chair of the Holdings Board, and member of the Tripadvisor Board, received a non-ratable benefit from the conversions by virtue of the reduction in the unaffiliated stockholders' litigation rights. Thus, plaintiff-stockholders argued, defendants were self-interested in approving the conversions and the entire fairness standard of review applied.

Defendants explained that the conversions were approved in accordance with Section 266 of the DGCL, including board approval and approval from the holders of a majority of each company's outstanding voting power. Plaintiff-stockholders did not argue that the conversions violated Section 266, however, and the Court found Defendants' technical argument to be "beside the point," given that actions are twice-tested, in law and in equity, by the Court.

Focusing on the breach of fiduciary duty claim, the Court agreed with plaintiff-stockholders that the applicable standard of review was entire fairness. The Court found that the entire fairness standard of review applied because, at the pleading stage, it was reasonably conceivable to infer from the complaint that Nevada law provided greater protection to fiduciaries and conferred a material benefit on defendants. The Court also declined to adopt defendants' assertion that the reduction of liability could only constitute a benefit if such a reduction addressed "existing potential liability," focusing the question of whether the plaintiff-stockholders rebutted the business judgment rule instead on whether the conversions conferred a material benefit on the fiduciary defendants, without regard to any temporal component.

In its decision, the Court emphasized that stockholders' litigation rights are first-class rights and cannot be relegated to second-class rights if investor protections are "to be meaningful." Instead, the Court explained that the three fundamental rights stockholders possess – "to sell, vote, and sue" – each represent a category of stockholder entitlements: "economic rights, governance rights, and litigation rights." The Court viewed litigation rights as foundational in protecting stockholders' other rights. The Court also did not address the question of whether Delaware or Nevada law was actually more favorable to stockholders.

Ultimately, however, the Court declined the plaintiff-stockholders' request to enjoin the conversions. Despite clarifying that Delaware courts could, in certain circumstances, prevent a corporation from leaving the state, the Court determined that, in the case of a publicly traded company such as Tripadvisor or Holdings where only the domicile of the company was changing in connection with a conversion, a change in the trading price of such company's stock could serve to quantify any loss in value resulting from the conversions.[2] Additionally, the Court explained, this case would continue to move forward regardless of the conversions, as Section 266

[2] In a footnote in its opinion reversing the Court on appeal, the Supreme Court of the State of Delaware appeared to cast doubt on this proposed analysis.

provides that, even following a conversion to a foreign entity, a corporation remains subject to the jurisdiction of the Delaware courts and the liability of the company's fiduciaries is not be impacted by the conversion.

Defendants then sought interlocutory appeal of the determination that entire fairness was the proper standard of review. Though the Court of Chancery denied the application to certify the appeal, the Supreme Court of the State of Delaware accepted the appeal on the basis that "[c]ertainty regarding the standard of review applicable to a decision to reincorporate in another jurisdiction would be beneficial," among other reasons. Following oral arguments on appeal, the defendants announced a transaction whereby Tripadvisor would purchase Holdings, resulting in Tripadvisor no longer having a controlling stockholder. Plaintiffs moved to dismiss the appeal, arguing that the case was mooted by the pending transaction. The Supreme Court denied the motion to dismiss, explaining that the proposed transaction was not finalized, and therefore Mr. Maffei, the stipulated controller that existed at the time of plaintiff-stockholders' complaint, still remained a controller, and the plaintiff-stockholders had maintained the position that they had independently stated a claim with respect to the director defendants.

Turning to the merits of the appeal, the Supreme Court held that the Court of Chancery erred in finding that the conversions bestowed a non-ratable benefit on the directors or the controlling stockholder. Noting that "the mere fact that a controller may be better positioned after a transaction does not necessarily mean that the controller received a non-ratable benefit," the Supreme Court analyzed the potential benefit to the directors and controller through the lens of materiality. Specifically, the Supreme Court recognized that "temporality weighs heavily in determining materiality" and the materiality of the alleged benefit was dispositive to the question of whether a transaction resulted in a non-ratable benefit. Because plaintiffs could not point to any existing or threatened litigation that would have motivated the directors and controlling stockholder to seek liability protection through the contemplated conversions, the Supreme Court declined to find that the conversions provided the defendants with a material, non-ratable benefit and held that the business judgment standard of review applied.

Additionally, the Supreme Court noted that Delaware courts had found that a reduction of litigation liability was sufficient to trigger entire fairness review, but only in circumstances where such reduction was focused on addressing *past*, rather than future, conduct. The Supreme Court explained that if Delaware law were to subject such prospective litigation risk reduction to entire fairness review, then market-standard actions by Delaware companies such as adopting indemnification provisions, 102(b)(7) exculpatory provisions, or even purchasing D&O insurance would trigger entire fairness.

The Supreme Court also noted that, although it did not represent separate grounds for overturning the Court of Chancery's decision, subjecting the conversion of a

Delaware entity to another jurisdiction to arduous entire fairness review raises significant concerns with comity and Delaware public policy. The Supreme Court recognized that "courts are ill-equipped to quantify the costs and benefits of one state's corporate regime over another's" and that any such attempt by the judiciary would "risk[] intruding on the value judgments of state legislators and directors of corporations." Given Delaware's public policy in favor of "flexibility and private ordering," the Supreme Court found that without a concrete allegation of defendants receiving a material, non-ratable benefit, Delaware public policy and principles of comity support deferring to the business judgment of directors in evaluating and weighing the comparative costs and benefits of different states' corporate governance regimes.

Takeaways

Temporality weighs heavily on whether a non-ratable benefit realized by a controller is "material" such that the entire fairness standard of review applies: The hypothetical and contingent impact of a reincorporation, undertaken on a "clear day" where no litigation is existing or threatened, is not a material, non-ratable benefit that would trigger the entire fairness standard of review. The Supreme Court left open, however, the possibility that a conversion involving a more concretely material reduction of litigation risk could subject such conversion to entire fairness review. Controlling stockholders should exercise caution when considering undertaking any transaction that could result in their realization of a material, non-ratable benefit. Despite its initial establishment in the context of a controller freeze-out transaction, plaintiffs continue their push to expand the scope of *MFW*'s applicability, and Delaware courts have shown a willingness to consider the *MFW* framework in a broad range of transactions. Employing a special committee and conditioning a transaction involving a controller realizing a material, non-ratable benefit on a majority-of-the-minority vote in accordance with *MFW* and its progeny can significantly reduce litigation exposure.

Litigation rights of stockholders in Delaware are part of a stockholder's bundle of rights: The Court of Chancery in *Palkon* recognized the role of litigation rights in protecting all other rights, noting that "[v]alue ultimately depends on legal rights," and treated stockholders' litigation rights as "first-class rights." While reversing the ruling below on whether the purported benefit to the controller actually represented a material, non-ratable benefit, the Supreme Court acknowledged that litigation rights are part of the bundle of rights that stockholders have.

A core tenet of Delaware corporate law involves balancing stockholder protections with national comity: The Supreme Court recognized that the judiciary is ill-equipped to assess the differences between state corporate law structures. Corporate boards have wide latitude to make decisions for the benefit of the corporations that they serve, and the stockholders of those corporations. Because corporate law differs in a variety of aspects as between states, Delaware courts cannot reasonably expect to substitute their judgment on which corporate franchise best serves the needs of a corporation's board of directors and stockholders.

Gunderson v. The Trade Desk, Inc., et al.
C.A. No. 2024-1029-PAF
(Vice Chancellor Fioravanti)

The board of directors of The Trade Desk, Inc., a Delaware corporation ("Trade Desk"), approved a resolution to convert the company into a Nevada corporation pursuant to Section 266 of the DGCL. A conversion of a Delaware corporation pursuant to Section 266 requires the "approval of a majority of the voting power of the outstanding stock entitled to vote[.]" Because Trade Desk's co-founder, director, and Chief Executive Officer's ownership of Trade Desk's stock gave him 49% of Trade Desk's voting power, approval of Trade Desk's conversion under Section 266 was a near certainty.

On October 4, 2024, prior to the scheduled stockholder vote on the conversion, plaintiff Stephen Gunderson brought suit in the Court of Chancery, alleging that, under Trade Desk's certificate of incorporation (the "Certificate"), the conversion must be approved by holders of two thirds of the voting power of outstanding stock entitled to vote. Gunderson argued that the conversion would amend and repeal the Certificate, therefore triggering the vote set forth in Article X of the Certificate, which required "the affirmative vote of the holders of at least sixty-six and two-thirds percent (66 2/3%) of the voting power of the outstanding shares of stock" "to amend or repeal, or adopt any provision" of the restated certificate inconsistent with certain provisions in the Certificate. The proxy filed in connection with the stockholder vote on the conversion disclosed that the required vote for the conversion was "a majority of the voting power of the shares outstanding and entitled to vote." Gunderson alleged that Trade Desk and its board of directors breached the Certificate and, therefore also, the board of director's fiduciary duties, by failing to disclose that the conversion required a supermajority vote.

Trade Desk argued that the supermajority vote requirement in Article X of the Certificate only applied to actions taken under Section 242 of the DGCL, specifically relating to amendments to the certificate of incorporation. Because Section 266 governed the conversion, Trade Desk argued, the doctrine of independent legal significance applied and the supermajority vote requirement in the Certificate would only apply to the conversion if such requirement "contained specific language extending its reach to mergers, consolidations, conversions, or similar transactions."

The Court of Chancery granted Trade Desk's, and denied Gunderson's, motion for summary of judgment. The Court of Chancery reviewed Section 266 and its legislative history before determining the meaning of Article X of the Certificate under well-settled principles of contract interpretation. Following a long line of cases starting with *Warner Communications Inc. v. Chris-Craft Industries, Inc.* and including, among others, *Elliott Associates, L.P. v. Avatex Corp.*, declining to apply voting requirements under Section 242 to mergers and consolidations absent clear language in a certificate of incorporation, the Court of Chancery agreed with Trade Desk that *Warner* and

its progeny applied and controlled in this case and declined to adopt Gunderson's argument that such case law did not extend beyond the preferred stock context. Construing the plain language of Article X, read as a whole, the Court of Chancery found that Article X applied to amendments to the Certificate and was limited to actions taken under Section 242 of the DGCL. In support of this finding, among other things, the Court of Chancery observed that the drafters of the Certificate included special voting rights elsewhere in the Certificate, concerning "[a]ny merger or consolidation . . . or any other transaction having" a certain "effect on stockholders." Absent language akin to that in *Avatex*, "whether by merger, consolidation or otherwise," the Court of Chancery found, Article X only applied to certificate amendments under Section 242. The Court of Chancery declined to adopt Gunderson's substance over form argument that would have required the Court of Chancery to reject *Warner*, *Avatex*, and related cases and further declined to adopt Gunderson's argument that a conversion is a "repeal" that would require a supermajority vote pursuant to Article X of the Certificate, noting from *Avatex* that the key language in *Warner* is the phrase "whether by merger, consolidation or otherwise," which language was absent from Article X of the Certificate. The Court of Chancery applied the *Warner* doctrine to conversions and found that Article X of the Certificate, from which the critical *Avatex* language was missing, did not extend beyond actions covered by Section 242 to conversions under Section 266. And because Article X of the Certificate was not ambiguous, the Court of Chancery also declined to apply the doctrine of *contra proferentem*.

Takeaways

Drafters of certificates of incorporation desiring to alter the vote required for a conversion "must do so with clear, express language": The Court's opinion in *Trade Desk* serves as a refresher on the general contract interpretation principles as applied to the required vote under a certificate of incorporation and cautions transactional lawyers to take care in crafting protective provisions that would alter the vote otherwise required with respect to a particular transaction governed by the DGCL.

SUMMARY OF AMENDMENTS TO COURT OF CHANCERY RULES

I. Fee Schedule (Revised Rules 3 and 174)

The revisions to Rule 3 remove the fee schedule for items such as issuing summonses, subpoenas, rules to show cause, and other demands, and making a request for expedited proceedings. Going forward, the Register in Chancery will assess fees and charges, and publish them on a fee schedule that will be made available on the Court's website and periodically updated. In addition to removing the fee schedule from Rule 3, the Court has increased the fee for mediation under Court of Chancery 174 from $5,000 to $15,000 for the first day to "conform to market prices."

II. Process and Service (Revised Rules 4 and 5)

Process (Rule 4)

The Amendments effectuate several minor relevant changes to Rule 4. Of note, Rule 4(dc) was removed and folded into Rule 4(e). Rule 4 was modified to address service under 6 *Del. C.* § 15-114, 6 *Del. C.* § 17-109, 6 *Del. C.* § 18-109, and 10 *Del. C.* § 3114. The comments to the Amendments explain that the only substantive changes intended to Rule 4(dc) and 4(e) were to rely expressly on the language of the pertinent statute and to avoid any mismatch between the provisions of the Rule and the provisions of the pertinent statute.

Furthermore, Rule 4(h) was added to clarify that service may be effectuated by any authorized means—in particular, 10 *Del. C.* § 3104(d), which is not referenced in the Rule.

Service (Rule 5)

A certificate of service is no longer needed for a paper served electronically, under Revised Rule 5(f). However, this does not include service of discovery and all papers served through non-electronic methods.

Delaware attorneys may now withdraw without filing a notice and without Court approval, so long as another Delaware attorney from the same firm continues to represent the party, under new Rule 5(i)(C).

Revised Rule 5(c)(4) adds requirements for the filing of demonstratives used at hearing or trial, providing that (i) a party must file any presentation or demonstrative

used at a hearing within 10 days after the hearing or trial, and (ii) testifying expert reports and demonstrative exhibits must be filed within 10 days after the conclusion of the trial or hearing. The Court may issue an order to the contrary.

Among certain other changes to Rule 5:

- Electronic service is officially now a recognized method of service, under Revised Rule 5(b)(2)(A);
- Briefs and letters must be served on every party, under the Revised Rule 5(a)(1)(D); and
- When a party submits a document to the Court for in camera review, it must be accompanied by a letter noting the submission, under Revised Rule 5(g).

III. Public Access to Confidential Filings (Revised Rule 5.1)

Key revisions include: (i) parties are no longer required to obtain a confidentiality order before filing documents under seal; (ii) the deadlines for providing Rule 5.1 notices have been extended by a full day; and (iii) public versions now are due to be filed the day *after* receiving the redactions from other parties, rather than the same afternoon. Some of the more noteworthy changes are summarized in more detail below.

A. Confidential Filings

Rule 5.1 no longer requires the entry of a confidentiality order before parties can file documents confidentially with the Court. Instead, Rule 5.1(d) now authorizes confidential filings, so long as the parties comply with its terms. Specifically, a confidential filing can (or should) now be made whenever (i) "a person believes that the paper contains confidential information"; or (ii) "the person believes that another person would contend that the paper contains confidential information". Please note, though, that Rule 5.1 does not apply to documents that are not filed with the Court, namely, discovery. Parties should still enter into agreements or seek Court order to govern confidentiality of non-filed documents.

Rule 5.1(b) now clarifies the definition of Confidential Information and provides that to qualify as such for confidential filings under Rule 5.1(d), certain requirements must be met. The Comment to the Amendments provides additional details, noting that "sensitive proprietary information" or "sensitive financial, business, or personal information" will generally qualify. The Comment further explains that other types of information that generally meet the broader requirements of Rule 5.1(b)(2)(A) and (B)—in that the information is maintained confidentially and is not otherwise publicly available, such as information subject to a confidentiality agreement or potentially embarrassing information—must also meet the requirements of Rule 5.1(b)(2)(C) and (D) to qualify for confidential filing. This is not a substantive change, but rather, a clarification.

While the Amendments modify slightly the procedure, confidential treatment can still be challenged by any person. The Amendments require that any challenge be filed with the Register in Chancery and specify the challenged filing; and that any motion to maintain confidential treatment be served on the person challenging confidential treatment.

Lastly, the obligation to “file” a deposition transcript, or excerpt of such transcript, now contemplates filing in accordance with Rule 5.1. This is distinct from a lodged deposition as contemplated by Rule 5.1(f)(1).

B. Rule 5.1 Notice and Public Versions

Among other things, Rule 5.1(e) has been significantly revised as to the procedures for providing notice of confidential filings. This includes revisions to the persons who must receive notice, the timing of Rule 5.1 notices, and the timing of public version filings.

The timing of Rule 5.1 notices has been revised accordingly:

- **FOR CONFIDENTIAL ORIGINAL COMPLAINTS:**
  - The deadline for the filing party to propose redactions is now 3:00 p.m. **the day after the filing**, rather than the prior rule which required sending a 5.1 notice on the same day as filing.
  - The deadline for the recipient to propose redactions is still three days after the filing of the Complaint.
  - Please note that the Rule now clarifies that this tighter deadline applies only to **original, not amended**, Complaints.

- **FOR ALL OTHER CONFIDENTIAL FILINGS:**
  - The deadline for the filing party to propose redactions is now 3:00 p.m. **two days after the filing**, rather than the prior rule, which required sending a 5.1 notice the next day.
  - The deadline for the recipient to propose redactions is five days after the filing.
  - Please note, for 5.1 notice purposes, that the deadline for the other side propose redactions will now be one day *before* the public version is to be filed with the Court.

The Amendments now require that a Public Version of a Confidential Filing subject to a Rule 5.1(e) notice be filed the day after the deadline for designating additional information for redaction, under Revised Rule 5.1(f). Please also note that the Amendments now clarify that the filed Public Version must contain the redactions in the proposed public version and any additional designated information in response to the notice, unless the parties agree to reduce redactions. If no party files a public version, the Amendments clarify that the Register in Chancery may file a public version.

IV. Pleadings, Defenses, Counterclaims, and Third-Parties (Rules 8; 13-15)

Several noteworthy changes were made to Rules 8, and 13-15, largely to either conform with or codify prior Delaware law and best practice, as well as the FRCP.

Regarding, complaints, Revised Rule 8(a)(1) now requires that a pleading must include a short and plain statement of the grounds for subject matter jurisdiction. The Revised Rule does not alter Delaware law, under which a pleading need not state a basis for personal jurisdiction. Regarding answers, the Amendments now provide that all parties may not assert a general denial to all allegations of a pleading. Revised Rule 8(b)(3) requires that only nominal parties and relief parties can assert general denials. Revised Rule 8(b)(3) also now conforms with existing case law and provides that for each affirmative defense, the party must include a short statement setting forth the basis of the affirmative defense.

Rule 13(b) was revised to delete the phrase "not arising out of the transaction or occurrence that is the subject matter of the opposing party's claim," as a party may state a permissive counterclaim that arises out of the same transaction or occurrence even if the claim is not a compulsory counterclaim. Moreover, Rule 13(f) was abrogated, and an amendment to add a counterclaim is now governed only by Rule 15.

Rule 14(b) was revised to clarify that a plaintiff may assert a third-party claim when any type of claim is brought against it.

Rule 15 contains changes largely clarifying or conforming to prior caselaw. Specifically, the Rule regarding the allotted time to amend (under former Rule 15(aaa), and now Rule 15(a)(5)) was revised in response to *Otto Candies, LLC v. KPMG, LLP*, 2019 WL 1856766 (Del. Ch. Apr. 25, 2019), to now allow 30 days after transfer from another court for a party to determine whether to amend or to stand on their pleading. Rule 15(a)(4) was added to clarify certain effects (mootness or waiver) resulting from amended pleadings, regarding the effect of an amended pleading.

Other Noteworthy Changes

The Amendments contain a variety of other changes, both substantive and non-substantive, which includes certain of the Rules referenced above. The other Rules revised in the Amendments are referenced below, with relevant changes highlighted.

Rule 6 was revised to align its language with FRCP 6 and current practice. This includes the Revised Rule 6(a), which now provides that the rules for calculating time periods apply to statutes which address the timing of events in this Court; and the addition of a computation for hours. But importantly, when calculating a

period of less than 11 days, Rule 6(a)(1) retains the current method of excluding intermediate Saturdays, Sundays, and legal holidays from the computation, and does *not* adopt the current federal approach of counting every day.

Rule 79 was amended to reflect current administrative practice. Rules 79.1 and 79.2 were eliminated accordingly.

Rules 23 and 23.1 were only amended to update certain cross-references.

Rules 1-2, 9, 11, and 12 contain no substantive changes.

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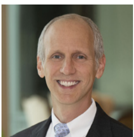

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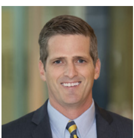

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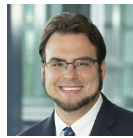

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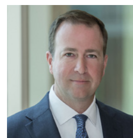

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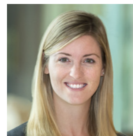

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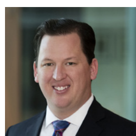

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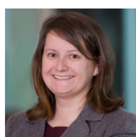

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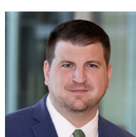

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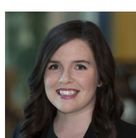

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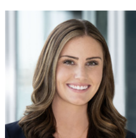

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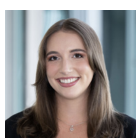

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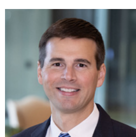

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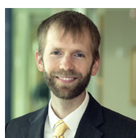

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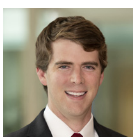

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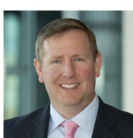

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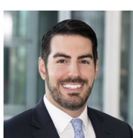

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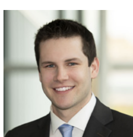

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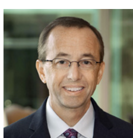

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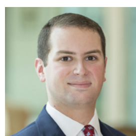

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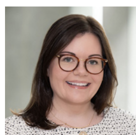

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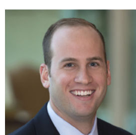

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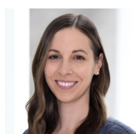

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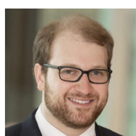

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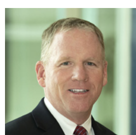

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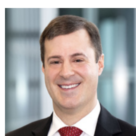

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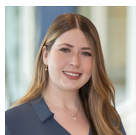

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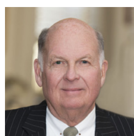

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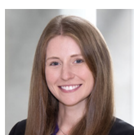

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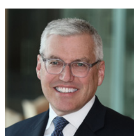

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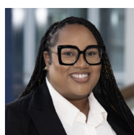

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