Summer 2023 Update For

CLOSELY HELD BUSINESS ORGANIZATIONS

Cases, Materials, and Problems

Third Edition

compiled by

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CHAPTER II – AGENCY

A. THE CREATION OF AN AGENCY RELATIONSHIP

3. AGENCY VS. CONTRACT RELATIONSHIP

Insert on p. 32 following Note 6:

7. In Boozer v. Fischer, 2023 WL 4278510, at *9 n.18 (Tex. June 30, 2023), the court noted that an escrow holder is not an agent of the parties to the escrow contract because the escrow holder is not under their control.

8. The principal case may be compared to the situation in which a customer purchases an insurance policy from an independent insurance agent (i.e., an agent offering policies from multiple insurance companies). As a recent case noted: "It has long been the common law of this state that, when an insurance policy is facilitated by an independent insurance agent or broker, the independent insurance agent or broker is considered an agent of the insured rather than an agent of the insurer." Al-Hajjaj v. Hartford Accident and Indemnity Co., 2023 WL 436653, at *3 (Mich. Ct. App. Jan. 26, 2023) (internal quotations omitted).

B. LIABILITY IN CONTRACT

1. THE PRINCIPAL'S LIABILITY TO THIRD PARTIES

d. Ratification

Insert on p. 58 following Note 5:

6. In GreatAmerica Financial Services Corp. v. Natalya Rodionova Medical Care, P.C., 956 N.W.2d 148, 156 (Iowa 2021), the court held that the receipt and installation of office equipment subject to a finance agreement and the payment of numerous installments over a seven-month period pursuant to the finance agreement amounted to ratification of the underlying contract.

C. LIABILITY IN TORT

2. SCOPE OF EMPLOYMENT

Insert on p. 88 following Note 4:

5. In Tammen v. Tranvold, 965 N.W.2d 161 (S.D. 2021), the court applied the "coming and going rule" – i.e., the rule that an employee who has an accident traveling to or from work is not acting within the scope of his employment.

3. THE TORTS OF INDEPENDENT CONTRACTORS

Insert on p. 104 following Note 3:

4. In Popovich v. Allina Heath System, 946 N.W.2d 885 (Minn. 2020), the plaintiff sued on behalf of her husband for injuries he allegedly suffered as the result of negligence by doctors and radiologists who worked as independent contractors in the emergency room of a hospital. The court of appeals affirmed the dismissal of the medical malpractice action on the ground that a hospital can be vicariously liable for a physician's negligence only if the physician is an employee of the hospital. The Minnesota Supreme Court reversed:

> . . . . Under the doctrine of respondeat superior, an employer is vicariously liable for the torts of an employee committed within the course and scope of employment. A business or individual—a principal—is vicariously liable under the doctrine of apparent authority where they hold an agent out as having authority or knowingly permit the agent to act on their behalf, and the agent is negligent. The proof of the agent's apparent authority is found in the conduct of the principal, not the agent.
>
> We have previously held that respondeat superior applies to hospitals to impose vicarious liability on hospitals for the negligence of employees, including physicians and other medical personnel. . . . [W]e [have] explained that a hospital is vicariously liable for the negligence of its employees where the hospital has control over the actions of the employees. If there is a break in the chain of control between employer and employee, the hospital cannot be vicariously liable under the doctrine of respondeat superior. . . .
>
> . . . . Although the theories of respondeat superior and apparent authority are closely related concepts within the law of agency, they are theoretically distinct. Notably, respondeat superior requires the element of control, while apparent authority does not. Thus, a business may be vicariously liable for the negligence of a non-employee even if the business does not have control over the non-employee, as long as the business held the non-employee out as having authority or knowingly permitted the non-employee to assume authority.
>
> . . . .
>
> . . . . Allina also makes several policy arguments as to why hospitals should be exempt from vicarious liability based on apparent authority. For example, Allina argues that patients already have sufficient remedies for medical malpractice, such as direct actions against physicians for negligence and direct actions against hospitals for negligent credentialing. Allina also claims that the rule of law proposed by Popovich will increase costs without an improvement in patient care.
>
> The existence of other remedies does not justify granting a hospitals-only exemption from the general rule of vicarious liability based on apparent authority. We have long allowed plaintiffs to hold individuals and businesses vicariously liable for the acts and

omissions of apparent agents, and have done so despite the existence of other remedies. Furthermore, the majority of courts considering the same issue have held that hospitals may be vicariously liable for the negligence of independent contractors under a theory of apparent authority. Allina cites no evidence from these jurisdictions to support its argument that failing to exempt hospitals from apparent authority as a theory of vicarious liability will have deleterious effects on hospital systems. Hospitals have a variety of methods to address these risks, should they arise. Hospitals can establish policies and monitor the quality of care administered within their facilities. Hospitals can also allocate risk through the agreements they have with the independent contractors providing care to patients in the emergency room. In contrast, the typical emergency room patient has significantly less bargaining power and little ability to predict or manage the risks of negligent medical care.

Nor are we persuaded by the dissent's argument that the regulation of hospitals through state and federal laws means that hospitals should be exempt from vicarious liability based on apparent authority. The same could be said of many industries. For example, the food service industry is subject to a variety of health and safety regulations, including licensing requirements and regular inspections. Nothing about such regulation justifies an exemption from the doctrine of apparent authority.

There is also a strong public policy argument in favor of applying apparent authority to hold hospitals vicariously liable for the negligence of independent contractors, as [plaintiff] correctly observes. We have long recognized that the doctrine of apparent authority prevents businesses and individuals alike from placing secret limitations on their liability to third persons for the acts or omissions of their agents. Here, Allina acknowledges that many members of the public are unaware of the arrangements it has with the physicians that provide services for the emergency rooms located within Allina-owned hospitals. It would be contrary to the fundamental purpose of the apparent authority doctrine to allow hospital systems to escape vicarious liability for the negligence of independent contractors working in emergency rooms through these little-known contractual relationships, even as hospitals reap both reputational and financial benefits from operation of their emergency rooms. We therefore see no reason to grant to hospitals a categorical exemption from vicarious liability based on apparent authority.

For these reasons, we hold that a plaintiff may assert a claim against a hospital to hold the hospital vicariously liable for the negligence of a non-employee based on a theory of apparent authority.

. . . .

We therefore hold that a plaintiff states a vicarious liability claim against a hospital for the professional negligence of independent contractors in the hospital's emergency room based on a theory of apparent authority if (1) the hospital held itself out as a provider of emergency medical care; and (2) the patient looked to the hospital, rather than a specific doctor, for care and relied on the hospital to select the personnel to provide services.

Id. at 890-95, 898; *see also* Williams v. Dimensions Health Corp., 279 A.3d 954 (Md. 2022) (affirming a judgment finding a hospital liable for the negligence of an emergency room physician who was an independent contractor based on the doctrine of ostensible agency); *but cf*. Sneed v. University of Louisville Hospital, 600 S.W.3d 221, 233 (Ky. 2020) (hospital was not vicariously liable for the negligence of independent contractor physicians where the hospital "clearly attempted to alert its patients that the physicians who provided treatment at the Hospital were not employees" through its consent forms).

In *Popovich*, were the doctors and radiologists agents of the hospital? Did they have actual or apparent authority to act on the hospital's behalf? Is apparent authority the best explanation for the court's imposition of vicarious liability on the hospital for the negligent torts of its independent contractors?

CHAPTER III – THE PARTNERSHIP

A. FORMATION

1. PARTNERSHIPS VS. OTHER RELATIONSHIPS

Insert on p. 158 at the end of Note 4:

4. In Northeast Natural Energy LLC v. Pachira Energy LLC, 844 S.E.2d 133 (W. Va. 2020), the court adopted the traditional view, in opposition to *Energy Transfer Partners*, that "people operating a business together for profit may inadvertently create a partnership despite their expressed subjective intention not to do so." *Id*. at 138 (internal quotation omitted).

3. AGGREGATE VS. ENTITY STATUS

Insert on p. 174 following Note 8:

9. In United States of America v. Sanofi-Aventis U.S. LLC, 226 A.3d 1117 (Del. 2020), the court held that the Delaware version of RUPA allows parties to change the entity status of a partnership by contract and that a term stating "the Partnership shall not be a separate legal entity distinct from its Partners" made the partnership merely an aggregate of its partners. Should the result be the same under RUPA generally?

C. FINANCIAL RIGHTS AND OBLIGATIONS

2. SHARING PROFITS AND LOSSES

Insert on p. 189 at the end of Note 1:

1. Schaffer v. Haler, 2023 WL 2467902 (Minn. Ct. App. Mar. 13, 2023), illustrates the importance of having a written partnership agreement. As the trial court found:

> This case presents an unusual legal challenge of the highest order of complexity. The parties through their actions, and more importantly inaction, have created what can be charitably described as a legal "mess." They engaged in a long running relationship over approximately 7½ years, involving the farming of 10,000 acres of land, generating millions of dollars, with countless transactions involving the sale and lease of land, the purchase, sale, and acquisition of personal property, as well as distributions themselves, all without any agreement or writing as to the terms of what they were doing.

Id. at *2. A jury found that four parties had impliedly agreed to form a partnership. In a second phase of the case that was tried to the court, the court found that the partners had agreed to alter the typical partnership rule that profits are shared pro rata. In the court's view, for almost eight years the partnership had distributed $72,000 per year to two partners regardless of the partnership's actual profit or loss and that this course of conduct constituted an implied agreement that partnership profits would be distributed in this fashion. The Court of Appeals affirmed. *See id.* at *5.

F. DISSOLUTION

2. RUPA

b. Partnership Dissolution

Insert on p. 309 following the first full paragraph:

In United States v. Sanofi-Aventis U.S. LLC, 226 A.3d 1117 (Del. 2020), the court held that a partnership could not continue to prosecute an action as part of its winding up process where the action was in its beginning stages and pursuing the action was the sole purpose for which the partnership was established. In the court's view, such conduct would have constituted continuing the business of the partnership rather than winding up the partnership's business.

c. Buying out Dissociated Partners

Insert on p. 310 following the first full paragraph:

It is the obligation of the partnership, rather than any individual partner, to buy out any partners who have dissociated from the partnership. *See* Bedoyan v. Samra, 352 So. 3d 361, 366-67 (Fla. Dist. Ct. App. 2022); *see also* RUPA § 701(a).

CHAPTER IV – THE CORPORATION

B. FORMATION

6. THE ULTRA VIRES DOCTRINE

Insert on p. 349 at the end of Note 7:

7. DGCL § 363 has been amended to lower from two-thirds to a majority the stockholder vote required for (1) amendments to a certificate of incorporation that convert a conventional corporation into a public benefit corporation or convert a public benefit corporation into a conventional corporation and (2) mergers that convert shares of conventional corporations into shares of public benefit corporations or shares of public benefit corporations into shares of conventional corporations. Those amendments also eliminate appraisal rights for such amendments or mergers.

C. MANAGEMENT AND OPERATION

1. ALLOCATION OF POWER

Insert on p. 352 following Note 6:

7. California law requires public corporations to have at least one female director on the board, at least two female directors on any board with five members, and at least three female directors on any board with six or more members. *See* CAL. CORP. CODE § 301.3(a), (b). California also requires that a public corporation's board have at least one director from an underrepresented community, at least two directors from an underrepresented community on any board with more than four and fewer than nine members, and at least three directors from an underrepresented community on any board with nine or more members. *See* CAL. CORP. CODE § 301.4(a), (b). A "director from an underrepresented community" means "an individual who self-identifies as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native, or who self-identifies as gay, lesbian, bisexual, or transgender." CAL. CORP. CODE § 301.4(e)(1). These requirements cover California corporations and foreign corporations that have their principal executive offices in California as described in their annual reports filed with the SEC under the Securities Exchange Act. *See* CAL. CORP. CODE §§ 301.3(a), 301.4(a), 2115.5. One recent decision upheld the gender-based requirements under the Equal Protection Clause of the Fourteenth Amendment. *See* Meland v. Weber, 2021 WL 65118651 (E.D. Cal. Dec. 27 2021). Another granted a preliminary injunction against the race-based requirements on federal equal protection grounds. *See* Alliance for Fair Board Recruitment v. Weber, 2023 WL 3481146 (E.D. Cal. May 15, 2023). A third case held that California's gender- and raced-based board requirements violated the Equal Protection Clause of the California Constitution. *See* Crest v. Padilla, 20 STCV 37513 (Cal. Super. Ct. Apr. 1, 2022). This issue will, no doubt, be the subject of future litigation in light of the Supreme Court's holding that race-based affirmative action in university admissions constitutes an equal protection

violation. *See* Students for Fair Admissions, Inc. v. President and Fellows of Harvard College, 143 S. Ct. 2141 (2023).

It should also be noted that the state of Washington requires that every public company have at least 25% women on its board or disclose to its shareholders a "board diversity discussion and analysis" explaining the measures the board took to obtain appropriate diversity in its membership. *See* WASH. REV. CODE § 23B.08.120.

2. INTERFERENCE WITH THE SHAREHOLDER FRANCHISE

Insert on p. 362 at the end of Note 3:

3. In Rosenbaum v. CytoDyn Inc., 2021 WL 4775140 (Del. Ch. 2021), the Delaware Chancery Court upheld the application of an advance notice bylaw that required 90-days' notice of any stockholders' nominees to the board, the identities of those proposing the nominees, and whether the nominees had financial interests in any potential transactions involving the company. The court declined to apply *Blasius* because the bylaw had been in existence for many years, long before the contested election in question.

Insert on p. 363 following Note 6:

7. The Delaware Supreme Court's embrace of *Blasius* continued in Coster v. UIP Cos., 255 A.3d 952 (Del. 2021). In this case, a shareholder deadlock existed due to the existence of two equal stockholders, and new directors could not be elected. The existing board consisted of three directors, including one of the 50% stockholders (who was also the board chair) and two of his allies. The 50% stockholder who was not a director sued for the appointment of a custodian pursuant to DGCL § 226. In response, the board issued new shares to one of the director-allies of the board chair to dilute the other 50% stockholder and remove the deadlock. The Chancery Court held that the entire fairness test applied because the transaction was self-interested and found that this test was satisfied where the price was based on a valuation by an independent financial advisor. As a result, the Chancery Court saw no need to appoint a custodian. The Supreme Court accepted the Chancery Court's finding on entire fairness but held that the court erred by not applying *Blasius's* compelling justification test. The Supreme Court reasoned that, whatever the board's underlying motives, the board intended to interfere with the veto power of a 50% shareholder. On remand, the Chancery Court upheld the stock sale under the *Blasius* standard. The court found that defeating the action for the appointment of a custodian, as well as facilitating a succession plan that existed before the deadlock occurred, constituted compelling justifications for the stock sale. The Delaware Supreme Court affirmed. *See* Coster v. UIP Cos., 2022 WL 1299127 (Del. Ch. May 2, 2022), *aff'd*, 2023 WL 4239581 (Del. June 28, 2023).

3. FORMALITIES REQUIRED FOR BOARD ACTION

Insert on p. 368 following Note 4:

5. In Backer v. Palisades Growth Capital II, L.P., 246 A.3d 81 (Del. 2021), a corporation had five authorized board seats. Two of the seats were held by a majority stockholder and his father. The Series A Preferred Shares and the Series A-1 Preferred Shares each had the right to elect one director. The fifth director was elected by the combined voting of the common and preferred shares. There was a vacancy in the seat held by the Series A-1 shareholders. The board determined to fire the majority shareholder as CEO and appoint his replacement to fill the vacancy on the board. The majority shareholder indicated a willingness to accept these actions. On the eve of the board meeting, the fifth director unexpectedly resigned. The majority shareholder made statements suggesting that he was still willing to accept his replacement as CEO and the appointment of his successor to the board. As a result, the Series A director attended the meeting, without whom a quorum would not have existed. At the meeting, the majority shareholder and his father acted to continue the majority shareholder as CEO and also made him CFO. In addition, they expanded the size of the board so that they could appoint an ally to the board and stipulated that a quorum would be three directors so that the Series A director could no longer prevent action by failing to attend a board meeting. Although notice is not required to hold a regular board meeting in Delaware, the court held that the board's actions were nevertheless invalid for deceiving the Series A director and causing him to attend the meeting.

6. DGCL § 110(i) has been added to the statute to provide that "[d]uring any emergency condition . . . the board of directors (or, if a quorum cannot be readily convened for a meeting, a majority of the directors present) may . . . take any action that it determines to be practical and necessary to address the circumstances of such emergency condition with respect to a meeting of stockholders of the corporation notwithstanding anything to the contrary in this chapter or in Chapter 7 of Title 5 or in the certificate of incorporation or bylaws."

5. SHAREHOLDER ACTION

c. Informational Rights

Insert on p. 388 at the end of Note 1:

1. In Oklahoma Firefighters Pension & Retirement System v. Amazon, Inc., 2022 WL 1760618 (Del. Ch. 2022), the court held that the mere fact that a corporation is the subject of government investigations or lawsuits does not entitle a stockholder to corporate records under DGCL § 220 to conduct its own investigation into the board's oversight of the corporation's legal compliance.

In Simeone v. Walt Disney Co., 2023 WL 4208481 (Del. Ch. June 27, 2023), a Disney shareholder sought books and records in connection with Disney's opposition to Florida legislation that proposed limiting instruction on sexual orientation or gender identity in Florida classrooms, as a consequence of which Florida's legislature voted to dissolve a special tax district encompassing the Walt Disney World Resort. The Chancery Court held that the plaintiff had not made a sufficient allegation of wrong doing to justify a books and records request:

> This suit concerns such a business decision by the Disney board—a decision that cannot provide a credible basis to suspect potential mismanagement irrespective of its outcome. There is no indication that the directors suffered from disabling conflicts. Nor is there any evidence that the directors were grossly negligent or acted in bad faith. Rather, the board held a special meeting to discuss Disney's approach to the legislation and the employees' negative response. Disney's public rebuke . . . followed.

Id. at *1.

Insert on p. 390 following Note 11:

12. In Pettry v. Gilead Sciences, Inc., 2020 WL 6870461 (Del. Ch. 2020), plaintiffs sought to inspect the books and records of Gilead Sciences, Inc. to investigate possible wrongdoing in connection with the company's development, marketing, and sale of HIV drugs. The court noted that "[w]hen a stockholder seeks inspection for the purpose of investigating wrongdoing, the stockholder must demonstrate a credible basis to suspect possible wrongdoing" and held that the plaintiffs had satisfied this standard where: (a) Gilead received FDA approval for tenofovir disoproxil fumarate ("TDF"), a life-saving medication for persons living with HIV; (b) TDF had generated billions in revenue for Gilead year after year; (c) these revenues incentivized Gilead to protect the market for TDF by forestalling the market entry of generic TDF and delaying the development of Gilead's safer TDF-substitute drug called tenofovir alafenamide; (d) the plaintiffs showed that there was a credible basis to suspect that Gilead violated antitrust laws, committed mass torts, infringed on government patents, and defrauded government programs in its efforts to protect the TDF market; and (e) the plaintiffs were joined by a host of other accusers, including persons living with HIV, activists, regulatory agencies, the Department of Justice, and Congress. *See id*. at *1. The court emphasized that "Delaware courts have urged stockholders to use the tools at hand and pursue Section 220 inspections before filing derivative lawsuits for decades." *Id.* at *29. Concerned that "defendants like Gilead think that there are no real downsides to overly aggressive defense campaigns at the Section 220 phase," the court granted the plaintiffs leave to move for attorney's fees. *Id.* at *30. In Seidman v. Blue Foundry Bancorp, 2023 WL 4503948 (Del. Ch. July 7, 2023), the Chancery Court applied *Gilead* and required a defendant to pay over $223.000 in attorneys' fees and expenses.

13. In Hauppage Digital, Inc. v. Rivest, 2023 WL 4440279 (Del. July 10, 2023), a shareholder sought disclosure of a corporation's financial statements for the years 2016 to 2018 for the purpose of valuing his shares. The corporation asked that any disclosure be subject to two-year confidentiality agreement. The Chancery Court ordered disclosure and declined to impose any confidentiality agreement. The Supreme Court held that restrictions on the use of information disclosed under Section 220 are within the sound discretion of the Chancery Court and affirmed the Chancery Court's ruling.

D. ALTERING CORPORATE NORMS BY CONTRACT

1. VOTING AGREEMENTS

Insert on p. 400 following the first full paragraph:

In Daniel v. Hawkins, 289 A.3d 631 (Del. 2023), the Delaware Supreme Court considered whether an irrevocable proxy bound a purchaser of certain corporate shares and held that the irrevocable proxy did not run with the shares. The court explained that "because of the concerns arising from a decoupling of the voting and economic interest in shares, [h]istorically, proxies have been interpreted narrowly and when there is an ambiguity, read as not restricting the right to vote the shares." *Id*. at 848 (citation omitted). The contract in question contained the following provision:

> The Stockholder agrees that such Irrevocable Proxy is coupled with an interest sufficient in law to support an irrevocable power and shall not be terminated by any act of the Stockholder (other than in connection with the termination provisions of Section 4 hereof), by death or disability of the Stockholder, by lack of appropriate power or authority or by the occurrence of any other event or events other than as provided in Section 4 hereof.

Id. at 653. The court noted:

> [The defendant] argues that the words “by any act of the Stockholder” and “or by the occurrence of any other event or events” include the sale of the . . . Shares by the Stockholder. Therefore, a sale of the . . . Shares by the Stockholder would not terminate the Irrevocable Proxy. Under [the defendant's] reading, the provision “communicates that only the circumstances of Section 4 may result in termination of the Irrevocable Proxy.”
>
> The Court of Chancery rejected [the defendant's] reading of the Non-Termination Provision. It found that “the more natural reading is that the Non-Termination Provision confirms that the Stockholder cannot terminate the Irrevocable Proxy while owning the . . . Shares” but “does not say anything about whether the Irrevocable Proxy binds a subsequent owner.”

Id. at 653-54. The Supreme Court held that the Chancery Court's reading was at least plausible and, therefore, affirmed the Chancery Court's ruling that the irrevocable proxy did not run with the shares. *See id*. at 661.

The relevant contract also contained the following provision:

> This Irrevocable Proxy and the rights of the Holders under this Irrevocable Proxy may not be assigned except that (a) any Holder may, with the consent of the remaining Holders, transfer such Holder's rights to any person who is, or is affiliated with, a limited partner of the Partnership, and (b) the Holders may act pursuant to this Irrevocable Proxy, in voting the Proxy Shares or otherwise, through any duly authorized officer or employee

> of [the corporation]. This Irrevocable Proxy shall be binding upon and inure to the benefit of Stockholder and the Holders and their respective heirs, devises, legatees, personal representatives, agents and permitted assigns.

Id. at 661-62. The court commented:

> The Assignment Provision begins with a blanket prohibition on assignment by the Holders in the first sentence (the "No-Assignment Clause"), followed by two exceptions to the blanket prohibition in clauses (a) and (b) (the "Holder Exceptions"). The final sentence identifies the beneficiaries of the Irrevocable Proxy and those who will be bound by the Irrevocable Proxy (the "Bound Parties Clause").
>
> [The defendant] argues that the Bound Parties Clause causes the Irrevocable Proxy to bind the Stockholder and his permitted assigns, which includes purchasers of the . . . Shares. Rejecting this argument, the Court of Chancery first held that the phrase "permitted assigns" does not include purchasers of the . . . Shares. It then held that, even if [the defendant] is correct that the phrase "permitted assigns" included subsequent purchasers, the "only reasonable" reading of the Bound Parties Clause is that it binds only the "permitted assigns" of the Holders, not those of the Stockholder. The Court of Chancery explained that this reading was the "only reasonable" one because it applies the rule of the last antecedent, accords with the "more natural reading" of the sentence, and "better fits the structure of the Assignment Provision, which starts with the No-Assignment Clause, continues with the Holder Exceptions, and finishes with the Bound Parties Clause and its specific reference to 'permitted assigns."

Id. at 662. Once again, the Delaware Supreme Court affirmed the Chancery Court because the no-assignment clause was at least ambiguous. *See id*. at 667.

E. LIMITED LIABILITY AND PIERCING THE CORPORATE VEIL

2. TORT CASES

Insert on p. 446 at the end of Note 2:

2. In Mortimer v. McCool, 255 A.3d 261 (Pa. 2021), the court refused to engage in horizontal veil piercing among sister corporations, which it labeled veil piercing according to an "enterprise liability" theory, where common ownership was lacking among the supposed sister entities.

5. REVERSE PIERCING

Insert on p. 467 at the end of carryover paragraph:

In Manichaean Capital, LLC v. Exela Technologies, Inc., 251 A.3d 694, 714 (Del. Ch. 2021), the court accepted "there is a place for carefully circumscribed reverse veil-piercing within

Delaware law." The court noted that prior to engaging in reverse veil piercing, a court should first consider the basic alter ego factors to determine whether an entity's veil should be pierced. A court should then consider whether the interests of innocent creditors or shareholders are affected and make an equitable decision.

F. THE TRADITIONAL ROLE OF FIDUCIARY DUTY

1. THE DUTY OF CARE

a. The Oversight Context

Insert on p. 494 at the end of Note 9:

9. In Hughes v. Hu, 2020 WL 1987029 (Del. Ch. 2020), the court denied a Rule 12(b)(6) motion to dismiss a *Caremark* claim in the following circumstances:

> Kandi Technologies Group, Inc. (the "Company") is a publicly traded Delaware corporation based in China. The Company has struggled persistently with its financial reporting and internal controls, encountering particular difficulties with related-party transactions. The complaint describes problems dating back to 2010. In March 2014, the Company publicly announced the existence of material weaknesses in its financial reporting and oversight system, including a lack of oversight by the Audit Committee and a lack of internal controls for related-party transactions. The Company pledged to remediate these problems. Instead, in March 2017, the Company disclosed that its preceding three years of financial statements needed to be restated. In connection with the restatement, the Company disclosed that it lacked:
>
> > • Sufficient expertise relating to technical knowledge of US GAAP requirements and SEC disclosure regulations;
> >
> > • Sufficient expertise to ensure the completeness of the disclosure of financial statements for equity investments;
> >
> > • Sufficient expertise to ensure the proper disclosure of related-party transactions;
> >
> > • Effective controls to ensure the proper classification and reporting of certain cash and non-cash activities related to accounts receivable, accounts payable, and notes payable; and
> >
> > • Sufficient expertise to ensure the accuracy of the accounting and reporting of income taxes and related disclosures.
>
> Despite having pledged three years earlier to get its house in order, the Company had none of these necessary competencies.

> The plaintiff is a stockholder in the Company. The plaintiff filed this suit on the Company's behalf to recover damages from (i) the three directors who comprised the Audit Committee during the Company's period of persistent problems, (ii) the Company's CEO, and (iii) the three CFOs who served in quick succession during the years leading up to the March 2017 restatement. The plaintiff contends that the director defendants consciously failed to establish a board-level system of oversight for the Company's financial statements and related-party transactions, choosing instead to rely blindly on management while devoting patently inadequate time to the necessary tasks. The plaintiff contends that the director defendants' failures led to the March 2017 restatement, which caused the Company harm. . . .

Id. at *1. *See* In re Boeing Co. Derivative Litig., 2021 WL 4059934 (Del. Ch. 2021) (refusing to dismiss a derivative suit alleging that Boeing had no board-level process for ensuring the safety of its aircraft); *cf*. City of Detroit Police and Fire Retirement System v. Hamrock, 2022 WL 2387653 (Del. Ch. 2022) (dismissing a derivative claim based on *Caremark* where the board of a natural gas company had a well-functioning committee charged with addressing the risks posed by its business even though the board's process did not prevent a serious explosion).

In In re McDonald's Corp. Stockholder Derivative Litigation, 289 A.3d 343 (Del. Ch. 2023), the Delaware Chancery Court extended the *Caremark* duty of oversight to officers. Previously, the doctrine had been applied only to directors. In *McDonald's*, stockholders brought a derivative suit against the McDonald's officer responsible for ensuring a safe and respectable workplace. They alleged that he failed to respond adequately to acts of sexual harassment at the company. The court denied the defendant's motion to dismiss for failure to state a claim and noted:

> This decision clarifies that corporate officers owe a duty of oversight. The same policies that motivated Chancellor Allen to recognize the duty of oversight for directors apply equally, if not to a greater degree, to officers. The Delaware Supreme Court has held that under Delaware law, corporate officers owe the same fiduciary duties as corporate directors, which logically include a duty of oversight. Academic authorities and federal decisions have concluded that officers have a duty of oversight.

Id. at 349-50. The court then held that the plaintiffs had adequately pled a *Caremark* claim against the officer. The court found that the allegations of the complaint established that the officer was aware of a large number of "red flags" regarding the existence of sexual harassment and had failed to take appropriate action in response. *See id*. at 377-80.

In a later decision, the Court of Chancery dismissed a similar *Caremark* claim against certain directors of McDonald's. *See* In In re McDonald's Corp. Stockholder Derivative Litigation, 291 A.3d 652 (Del. Ch. 2023). The court held that the plaintiffs had pled sufficient "facts supporting an inference that the Director Defendants knew about a problem with sexual harassment and misconduct at the Company." *Id*. at 662. Nevertheless, the court dismissed the complaint:

> What the complaint does not support is an inference that the Director Defendants failed to respond. The confluence of events during 2018, including the revelations about the Global Chief People Officer, led to action. Throughout 2019, the Director Defendants engaged with the problem of sexual harassment and misconduct at the Company. They worked with Company management on a response that included (i) hiring outside consultants, (ii) revising the Company's policies, (iii) implementing new training programs, (iv) providing new levels of support to franchisees, and (v) taking other steps to establish a renewed commitment to a safe and respectful workplace.
>
> Given that response, it is not possible to draw a pleading-stage inference that the Director Defendants acted in bad faith. The pled facts do not support a reasonably conceivable claim against them for breach of the duty of oversight.

Id.

2. THE DUTY OF LOYALTY

a. Conflict of Interest Transactions

Insert on p. 539 at the end of Note 7:

7. In re Tesla Motors, Inc. Stockholder Litigation, 2023 WL 3854008 (Del. June 6, 2023), involved a challenge to Tesla's purchase of SolarCity Corporation. Elon Musk was Tesla's chief executive officer, board chairman, and largest shareholder (at 22%). He was also SolarCity's board chairman and largest shareholder (at 21.9%). The Chancery Court assumed that the entire fairness test applied to the transaction. The Chancery Court found that the transaction was the product of fair dealing despite the Tesla board's failure to establish an independent special committee because the Tesla board: (a) actively negotiated with Musk; (b) retained independent legal and financial advisors; and (c) conditioned the transaction on approval of a majority of the shares that Musk did not own. The Chancery Court also found that the transaction occurred at a fair price. The Chancery Court did not rely on a discounted cash flow analysis to value SolarCity and instead relied upon: (a) other value analyses performed by the board's financial advisor (including a sum-of-the-parts analysis and a premiums paid analysis); (b) the fact that Tesla's acquisition of SolarCity created synergy; and (c) the market price of SolarCity's stock, given that SolarCity was a public company whose stock traded on an efficient market. The Supreme Court noted that the failure to appoint an independent special committee meant that Musk retained the burden of proof on entire fairness and affirmed the Chancery Court's findings as supported by the record. The *Tesla* case demonstrates that the high burden the entire fairness test imposes on a self-dealing party is not insurmountable.

4. EXCULPATION STATUTES

Insert on p. 610 at the end of Note 1:

1. DGCL § 102(b)(7) has been amended to provide that exculpation provisions in the certificate of incorporation may cover officers to the same extent as directors.

Insert on p. 610 at the end of Note 3:

3. In Meade v. Christie, 974 N.W.2d 770 (Iowa 2022), the court highlighted differences between the exculpation statutes contained in the DGCL and MBCA:

> Delaware's director shield exclusions do not match the MBCA's (and thus Iowa's) director shield exclusions in an important way that enlightens our analysis of the "intentional infliction of harm on the corporation or the shareholders" exclusion in [MBCA § 2.02(b)(4)(ii)]. Delaware's exclusion will not preclude liability for "acts or omissions not in good faith or which involve intentional misconduct." [DGCL § 102(b)(7)]. Delaware's precedent applying its director shield statute makes it clear that the shield forecloses claims against directors for gross negligence but does not apply to conduct motivated by an actual intent to do harm (subjective bad faith) or to lesser forms of bad faith, like a director's conscious disregard for . . . responsibilities or intentional dereliction of duty. Under Delaware law, actions that amount to conscious disregard for responsibilities or intentional dereliction of duty fall under Delaware's "bad faith" exception to the director shield—not under the statute's "actual intent to do harm" exception. In contrast to Delaware's statute, Iowa's director shield statute includes no exception enabling liability for "acts not in good faith."

Id. at 778.

Insert on p. 612 following Note 7:

8. In New Enterprise Associates 14, L.P. v. Rich, 295 A.3d 520 (Del. Ch. 2023), the court upheld a contract that restricted fiduciary duties to a greater extent than allowed by Section 102(b)(7). In that case certain investment funds granted another investor a contract right to engage in three types of transactions that qualified as a sale of the company. The investment funds promised not to sue the investor or its affiliates and associates if the investor exercised that right. This promise extended to breach of fiduciary duty claims. The investor committed capital to the corporation in reliance on this promise. The investor then became a controlling shareholder, took control of the board of directors, and effected a sale of the company. The investment funds brought claims against the investor, including a claim for breach of fiduciary duty. The court upheld the waiver of the breach of fiduciary duty claim because it was narrowly tailored to address a specific kind of transaction and because the court deemed the waiver reasonable. However, the court refused to dismiss tort claims seeking relief for intentional harm.

By contrast, in CCSB Financial Corp. v. Totta, 2023 WL 4628822 (Del. July 19, 2023), the court invalidated a charter provision that it viewed as impermissibly waiving aspects of a board's fiduciary duties. In that case, the corporate charter of a bank holding company capped at 10% the stock that could be voted by a person in any stockholder vote and aggregated the votes of any shareholders acting in concert for the purpose of applying this threshold. The certificate provided that the board's determination of whether shareholders were acting in concert was conclusive and binding as long as the determination was made in good faith based on reasonably available information. The board relied on this provision to invalidate votes that would otherwise have elected three directors to a staggered board. The Chancery Court invalidated the charter provision that made the board's determination of whether shareholders were acting in concert conclusive and binding. The Chancery Court then found that the shareholders in question were not acting in concert and that their votes should not have been invalidated. The Supreme Court affirmed and relied on a passage from an older Chancery Court case:

> The Court of Chancery held that, "[i]f the meaning of the above provision were as the defendants suggest, it would effectively eviscerate the duty of loyalty for corporate directors as it is generally understood under Delaware law." According to the court, "[w]hile such a provision is permissible under the Delaware Limited Liability Company Act and the Delaware Revised Uniform Limited Partnership Act, where freedom of contract is the guiding and overriding principle, it is expressly forbidden by the DGCL." The court relied on Section 102(b)(7) and held that "[t]he effect of the provision at issue would be to do exactly what is forbidden. It would render any breach of the duty of loyalty relating to a self-dealing transaction beyond the reach of a court to remedy by way of damages." The charter provision was therefore determined to be "void as 'contrary to the laws of this State' and against public policy."

Id. at *10 (quoting Sutherland v. Sutherland, 2009 WL 857468, at *4 (Del. Ch. Mar. 23, 2009)).

5. INDEMNIFICATION AND INSURANCE

Insert on p. 626 at the end of Note 4:

4. DGCL § 145(c) has been amended to define the group of officers who are entitled to the statutory right of indemnification as the officers who are deemed to have consented to the jurisdiction of the State for acts relating to breach of officer duties pursuant to Section 3114(b) of title 10. Section 3114(b) of title 10 does not apply to residents of the State, but amended Section 145(c) treats residents as if they were non-residents to ensure that persons who hold the officer positions identified in Section 3114(b) are entitled to indemnification, whether or not they are residents of the State.

Insert on p. 626 at the end of Note 5:

5. In InterMune, Inc. v. Harkonen, 2023 WL 3337212 (Del. Ch. May 10, 2023), the court held that a corporate officer who has been convicted of federal wire fraud may not relitigate the

issue of “good faith” under Section 145(a) when the guilty verdict necessarily determined that the officer acted in bad faith and the officer had a full and fair opportunity to challenge the verdict.

Insert on p. 627 at the end of Note 9:

9. In InterMune, Inc. v. Harkonen, 2023 WL 3337212 (Del. Ch. May 10, 2023), the court held that a presidential pardon does not render an officer “successful on the merits or otherwise” under Section 145(c).

DGCL § 145(c) has been amended to add a new subsection (2) that permits (but does not require) a corporation to indemnify other persons who are not current or former directors or officers if they are successful in defense of a proceeding referenced in subsections (a) and (b) of Section 145.

Insert on p. 630 following Note on Insurance:

In RSUI Indemnity Co. v. Murdock, 248 A.3d 887, 930 (Del. 2021), the Delaware Supreme Court applied DGCL § 145(g) in holding that a D&O carrier could insure against liabilities arising from bad faith misconduct without violating the public policy of Delaware.

DGCL § 145(g) permits Delaware corporations to purchase D&O insurance to protect directors and officers from liability for breach of fiduciary duty. This insurance has typically been purchased from insurance companies who are not affiliated with the purchasing corporation. Purchasing D&O insurance from independent providers has become problematic as these companies have increased premiums and restricted coverage. To remedy this problem, DGCL § 145(g) has been amended to make clear that corporations may purchase D&O insurance from a "captive insurance company" – i.e., an insurance company that is owned, controlled, or funded by the purchasing corporation.

G. DISSENSION IN THE CLOSELY HELD CORPORATION

3. SHAREHOLDER OPPRESSION

c. Fixing the Buyout Price: Determining "Fair Value"

Insert on p. 692 at the end of Note 6:

6. In Bohac v. Benes Service Co., 969 N.W.2d 103 (Neb. 2022), the court held that determining fair value in a buyout proceeding does not include a minority discount.

Insert on p. 693 at the end of Note 10:

10. In Bohac v. Benes Service Co., 969 N.W.2d 103 (Neb. 2022), the court held that determining fair value in a buyout proceeding does not include a marketability discount.

H. SECURITIES FRAUD

Insert on p. 735 at the end of Note 7:

7. In In re Volkswagen "Clean Diesel" Marketing, Sales Practices, and Products Liability Litig., 2 F.4th 1199 (9th Cir. 2021), the court stated that the *Affiliated Ute* "presumption should not be applied to cases that allege both misstatements and omissions unless the case can be characterized as one that primarily alleges omissions." *Id.* at 1204 (internal quotation omitted).

Insert on p. 735 at the end of Note 8:

8. In Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System, 141 S. Ct. 1951 (2021), the Supreme Court held that: (a) the courts must consider the generic nature of certain misrepresentations (e.g., an allegedly false representation that the defendant has extensive procedures and controls that are designed to identify and address conflicts of interest) because "the generic nature of a misrepresentation often will be important evidence of a lack of price impact;" and (b) the defendant bears the burden of demonstrating lack of price impact to prevent class certification. *Id*. at 1961, 1963.

In MachPhee v. MiMedx Group, Inc., 2023 WL 4418636 (11th Cir. July 10, 2023), the court outlined what a plaintiff must prove to establish loss causation in a fraud-on-the-market case:

> [T]he plaintiff must: (1) identify a "corrective disclosure," i.e., a release of information that reveals to the market the pertinent truth that was previously concealed or obscured by the company's fraud; (2) show that the stock's price dropped soon after that corrective disclosure; and (3) eliminate other possible explanations for the price drop, such that the factfinder can infer that it is more probable than not that it was the corrective disclosure—as opposed to other possible depressive factors—that caused at least a substantial amount of the price drop. Additionally, the plaintiff need not rely on a single, complete corrective disclosure; rather, it is possible to show that the truth gradually leaked out into the marketplace through a series of partial disclosures. Corrective disclosure can come from any source and take any form from which the market can absorb the information and react, so long as the disclosures revealed to the market the falsity of the prior misstatements. . . .

Id. at *12 (internal quotations omitted).

Insert on p. 736 at the end of Note 9:

9. In Liu v. SEC, 140 S. Ct. 1936 (2020), the Supreme Court held that a disgorgement award to victims in an SEC enforcement action that does not exceed a wrongdoer's net profits constitutes permissible equitable relief under 15 U.S.C.A. § 78u(d)(5).

6. Dissolution for Deadlock

Insert on p. 723 following the carryover paragraph:

Pursuant to DGCL § 226, the Delaware Chancery Court will not appoint a custodian to resolve a board deadlock "if one side sought to manufacture it" or if the alleged deadlock is "based on a specious premise." Bighorn Ventures Nevada, LLC v. Solis, 2022 WL 17948659, at *6 (Del. Ch. Dec. 23, 2022). The court will also not appoint a custodian if the shareholders have the ability to break the deadlock. *See id*. As a result, the Solis court refused to appoint a custodian even though a board was deadlocked 2-2 because the corporation's governing documents provided for five board seats and the shareholders had the ability to break the deadlock by electing a fifth director.

I. FUNDAMENTAL TRANSACTIONS

1. CERTIFICATE AMENDMENTS

Insert on p. 743 following Note 5:

6. A corporation may divide its stock into classes, and it may divide classes of stock into series. *See, e.g.*, DGCL § 151(a); MBCA § 601(a). The distinction between a class and a series is hardly clear. Under Delaware law, the difference matters because a special class vote is required for certificate amendments that increase the amount of authorized stock within any class but not for certificate amendments that increase the amount of authorized stock within any series. A particular series receives a class vote only if the rights of the series are affected in a way that is not applicable to the class as a whole. *See* DGCL § 242(b)(2).

This problem was addressed in Garfield v. Boxed, Inc., 2022 WL 17959766 (Del. Ch. Dec. 27, 2022). A corporation that was an SPAC (i.e., a special purpose acquisition corporation) had outstanding Class A and Class B common stock. The corporation entered into a plan of merger, one component of which required amending the corporation's certificate to allow for an increase in the number of authorized Class A shares. The corporation believed that the common shares constituted a single class and that the division into Class A and Class B established two different common series (despite the fact that they were denominated as "Classes"). As a result, the corporation obtained legal advice that the certificate amendment could be approved by a majority of all the outstanding common shares entitled to vote and that a separate vote of the Class A shares was not required. The court disagreed and "conclude[d] that Class A and Class B are each a class of common stock, not series." *Id*. at *9. As a result, the certificate amendment could not be approved without a separate vote of the Class A shares.

The *Garfield* decision created a firestorm. Prior to *Garfield*, many Delaware SPACs had assumed that separate class votes were not required to accomplish similar mergers. And an enormous amount of stock was issued pursuant to such certificate amendments. All of these companies were now faced with the prospect that these stock issuances were defective because the certificate amendments permitting them had not been properly approved. These corporations scrambled to have these potentially defective issuances remedied pursuant to DGCL § 205. In In re Lordstown Motors Corp., 290 A.3d 1 (Del. Ch. 2023), the Delaware Court of Chancery applied Section 205 to approve one attempt to remedy a potentially defective stock issuance. The court viewed its opinion as a model for how such potentially defective issuances could be remedied in other cases.

It should be noted that the same problem does not arise under the Model Act. The Model Act provides symmetrical provisions defining when class votes are required for certificate amendments affecting particular classes or series of stock. *See* MBCA § 10.04(a), (b).

2. BYLAW AMENDMENTS

Insert on p. 747 following Note 7:

8. DGCL § 110(a) has been amended to provide that emergency bylaws (i.e., bylaws that will be operative during an emergency) may be adopted by "the board of directors or, if a quorum cannot be readily convened for a meeting, by a majority of the directors present."

3. SALES OF ASSETS

a. Transactions Triggering Shareholder Rights

Insert on p. 756 at the end of Note 9:

9. In Stream TV Networks, Inc. v. SeeCubic, Inc., 279 A.3d 323 (Del. 2022), a corporation's certificate of incorporation gave a separate class vote to its Class B stockholders in connection with "a sale, lease or other disposition of all or substantially all of the assets or intellectual property of [the corporation]." *Id*. at 333. The Delaware Supreme Court held that this provision was entitled to enforcement even if it gave shareholders greater voting rights than DGCL § 271. *See id*. at 337. The Supreme Court also refused to create an insolvency exception to DGCL § 271, which would have allowed a corporation's board to sell the assets of an insolvent or failing firm without stockholder approval. The Supreme Court noted that, although this exception had found some favor in other states, it was precluded by the adoption of the predecessor of DGCL § 271, which does not include an insolvency exception. *See id*. at 343-54.

b. Appraisal

Insert on p. 769 following Note 6:

7. In Manti Holdings, LLC v. Authentix Acquisition Co., 261 A.3d 1199 (Del. 2021), the Delaware Supreme Court held that, at least where sophisticated shareholders are involved, Delaware law permits the contractual waiver of appraisal rights.

J. DERIVATIVE SUITS

1. DIRECT VS. DERIVATIVE SUITS

Insert on p. 794 following the carryover paragraph:

In Brookfield Asset Management, Inc. v. Rosson, 261 A.3d 1251 (Del. 2021), a corporation issued stock to a controlling shareholder. The plaintiffs brought direct claims contending that the stock issue was underpriced and caused dilution of their interests. In 2006, the Delaware Supreme Court had held that this type of claim involved a dual harm to shareholders and the corporation and, therefore, could be prosecuted as direct claims. *See* Gentile v. Rossette, 906 A.2d 91 (Del. 2006). In *Rosson*, the Delaware Supreme Court found that this result was inconsistent with the *Tooley* standard, overruled *Gentile*, and held that the claims were derivative.

According to the internal affairs doctrine, compliance with the procedural requirements for derivative suits are governed by the jurisdiction of incorporation. *See, e.g.*, TEX. BUS. ORGS. CODE § 21.562(a). In Haussmann v. Baumann, 2023 WL 4110493 (N.Y. App. Div. June 22, 2023), plaintiffs asserted derivative claims for breach of fiduciary duty against officers and directors of Bayer AG, a German corporation, in connection with Bayer's purchase of another company. The plaintiffs concededly did not satisfy the German standards for commencing a derivative suit. They sought to maintain the suit by alleging compliance with New York's standards. The court held that failure to satisfy the standards of the jurisdiction of incorporation required dismissal of the suit. *Accord* Sagarra Inversiones, S.L. v. Cementos Portland Valderrivas, S.A., 34 A.3d 1074 (Del. 2011).

2. DEMAND ON THE BOARD OF DIRECTORS

Insert on p. 805 following Note 9:

UNITED FOOD AND COMMERCIAL WORKERS UNION AND PARTICIPATING FOOD INDUSTRY EMPLOYERS TRI-STATE PENSION FUND v. ZUCKERBERG

Supreme Court of Delaware
262 A.3d 1034 (2021)

MONTGOMERY-REEVES, Justice:

In 2016, the board of directors of Facebook, Inc. ("Facebook") voted in favor of a stock reclassification (the "Reclassification") that would allow Mark Zuckerberg—Facebook's controller, chairman, and chief executive officer—to sell most of his Facebook stock while maintaining voting control of the company. Zuckerberg proposed the Reclassification to allow him and his wife to fulfill a pledge to donate most of their wealth to philanthropic causes. With Zuckerberg casting the deciding votes, Facebook's stockholders approved the Reclassification.

Not long after, numerous stockholders filed lawsuits in the Court of Chancery, alleging that Facebook's board of directors violated their fiduciary duties by negotiating and approving a purportedly one-sided deal that put Zuckerberg's interests ahead of the company's interests. The trial court consolidated more than a dozen of these lawsuits into a single class action. At Zuckerberg's request and shortly before trial, Facebook withdrew the Reclassification and mooted the fiduciary-duty class action. Facebook spent more than $20 million defending against the class action and paid plaintiffs' counsel more than $68 million in attorneys' fees under the corporate benefit doctrine.

Following the settlement, another Facebook stockholder—the United Food and Commercial Workers Union and Participating Food Industry Employers Tri-State Pension Fund ("Tri-State")—filed a derivative complaint in the Court of Chancery. This new action rehashed many of the allegations made in the prior class action but sought compensation for the money Facebook spent in connection with the prior class action.

Tri-State did not make a litigation demand on Facebook's board. Instead, Tri-State pleaded that demand was futile because the board's negotiation and approval of the Reclassification was not a valid exercise of its business judgment and because a majority of the directors were beholden to Zuckerberg. Facebook and the other defendants moved to dismiss Tri-State's complaint under Court of Chancery Rule 23.1, arguing that Tri-State did not make demand or prove that demand was futile. . . .

. . . [T]he Court of Chancery dismissed Tri-State's complaint under Rule 23.1.

. . . .

A cardinal precept of Delaware law is that directors, rather than shareholders, manage the business and affairs of the corporation. This precept is reflected in Section 141(a) of the Delaware General Corporation Law ("DGCL"), which provides 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 [a corporation's] certificate of incorporation." The board's authority to govern corporate affairs extends to decisions about what remedial actions a corporation should take after being harmed, including whether the corporation should file a lawsuit against its directors, its officers, its controller, or an outsider.

In a derivative suit, a stockholder seeks to displace the board's decision-making authority over a litigation asset and assert the corporation's claim. Thus, by its very nature, the derivative action encroaches on the managerial freedom of directors by seeking to deprive the board of control over a corporation's litigation asset. In order for a stockholder to divest the directors of their authority to control the litigation asset and bring a derivative action on behalf of the corporation, the stockholder must (1) make a demand on the company's board of directors or (2) show that demand would be futile. The demand requirement is a substantive requirement that ensures that a stockholder exhausts his intracorporate remedies, provides a safeguard against strike suits, and assures that the stockholder affords the corporation the opportunity to address an alleged wrong without litigation and to control any litigation which does occur.

. . . .

The plaintiff in this action did not make a pre-suit demand. Thus, the question before the Court is whether demand is excused as futile. This Court has articulated two tests to determine whether the demand requirement should be excused as futile: the *Aronson* test and the *Rales* [v. *Blasband*, 624 A.2d 927 (Del. 1993)] test. The *Aronson* test applies where the complaint challenges a decision made by the same board that would consider a litigation demand. Under *Aronson*, demand is excused as futile if the complaint alleges particularized facts that raise a reasonable doubt that "(1) the directors are disinterested and independent[,] [or] (2) the challenged transaction was otherwise the product of a valid business judgment." This reflects the "rule . . . that where officers and directors are under an influence which sterilizes their discretion, they cannot be considered proper persons to conduct litigation on behalf of the corporation. Thus, demand would be futile."

The *Rales* test applies in all other circumstances. Under *Rales*, demand is excused as futile if the complaint alleges particularized facts creating a "reasonable doubt that, as of the time the complaint is filed," a majority of the demand board "could have properly exercised its independent and disinterested business judgment in responding to a demand." "Fundamentally, *Aronson* and *Rales* both address the same question of whether the board can exercise its business judgment on the corporation's behalf' in considering demand. For this reason, the Court of Chancery has recognized that the broader reasoning of *Rales* encompasses *Aronson*, and therefore the *Aronson* test is best understood as a special application of the *Rales* test.

. . . .

The directors and officers of a Delaware corporation owe two overarching fiduciary duties—the duty of care and the duty of loyalty. Predicated upon concepts of gross negligence, the duty of care requires that fiduciaries inform themselves of material information before making a business decision and act prudently in carrying out their duties. The duty of loyalty requires an undivided and unselfish loyalty to the corporation and demands that there shall be no conflict between duty and self-interest.

Tri-State alleges that the Director Defendants breached their duty of care in negotiating and approving the Reclassification. Section 102(b)(7) of the DGCL authorizes corporations to adopt a charter provision insulating directors from liability for breaching their duty of care: "[T]he certificate of incorporation may ... contain any or all of the following matters: (7) A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; . . . or (iv) for any transaction from which the director derived an improper personal benefit.

Facebook's charter contains a Section 102(b)(7) clause; as such, the Director Defendants face no risk of personal liability from the allegations asserted in this action. Thus, Tri-State's demand-futility allegations raise the question whether a derivative plaintiff can rely on exculpated care violations to establish that demand is futile under the second prong of the *Aronson* test. . . .

. . . .

Tri-State's argument hinges on the plain language of *Aronson's* second prong, which focuses on whether "the challenged transaction was . . . the product of a valid business judgment"[.] . . .

Later opinions issued by this Court contain similar language that can be read to suggest that *Aronson's* second prong focuses on the propriety of the challenged transaction. These passages do not address, however, why *Aronson* used the standard of review as a proxy for whether the board could impartially consider a litigation demand. The likely answer is that, before the General Assembly adopted Section 102(b)(7) in 1986, rebutting the business judgment rule through allegations of care violations exposed directors to a substantial likelihood of liability. Thus, even if the demand board was independent and disinterested with respect to the challenged transaction, the litigation presented a threat that would "sterilize [the board's] discretion" with respect to a demand.

. . . .

Although not unanimous, the weight of Delaware authority since the enactment of Section 102(b)(7) supports holding that exculpated care violations do not excuse demand under *Aronson's* second prong. . . .

. . . .

Accordingly, this Court affirms the Court of Chancery's holding that exculpated care claims do not satisfy *Aronson's* second prong. This Court's decisions construing *Aronson* have consistently focused on whether the demand board has a connection to the challenged transaction that would render it incapable of impartially considering a litigation demand. When *Aronson* was decided, raising a reasonable doubt that directors breached their duty of care exposed them to a substantial likelihood of liability and protracted litigation, raising doubt as to their ability to impartially consider demand. The ground has since shifted, and exculpated breach of care claims no longer pose a threat that neutralizes director discretion. These developments must be factored into demand-futility analysis, and Tri-State has failed to provide a reasoned explanation of why rebutting the business judgment rule should automatically render directors incapable of impartially considering a litigation demand given the current landscape. For these reasons, the Court of Chancery's judgment is affirmed.

. . . .

. . . Tri-State's argument collapses the distinction between the board's capacity to consider a litigation demand and the propriety of the challenged transaction. It is entirely possible that an independent and disinterested board, exercising its impartial business judgment, could decide that it is not in the corporation's best interest to spend the time and money to pursue a claim that is likely to succeed. Yet, Tri-State asks the Court to deprive directors and officers of the power to make such a decision, at least where the derivative action would challenge a conflicted-controller transaction. This rule may have its benefits, but it runs counter to the cardinal precept of Delaware law that independent and disinterested directors are generally in the best position to manage a corporation's affairs, including whether the corporation should exercise its legal rights.

. . . .

. . . . The Court of Chancery noted that turnover on Facebook's board, along with a director's decision to abstain from voting on the Reclassification, made it difficult to apply the Aronson test to the facts of this case:

> The composition of the Board in this case exemplifies the difficulties that the *Aronson* test struggles to overcome. The Board has nine members, six of whom served on the Board when it approved the Reclassification. Under a strict reading of *Rales*, because the Board does not have a new majority of directors, *Aronson* provides the governing test. But one of those six directors abstained from the vote on the Reclassification, meaning that the *Aronson* analysis only has traction for five of the nine. *Aronson* does not provide guidance about what to do with either the director who abstained or the two directors who joined the Board later. The director who abstained from voting on the Reclassification suffers from other conflicts that renders her incapable of considering a demand, yet a strict reading of *Aronson* only focuses on the challenged decision and therefore would not account for those conflicts. Similarly, the plaintiff alleges that one of the directors who subsequently joined

> the Board has conflicts that render him incapable of considering a demand, but a strict reading of *Aronson* would not account for that either. Precedent thus calls for applying *Aronson*, but its analytical framework is not up to the task. The *Rales* test, by contrast, can accommodate all of these considerations.

. . . .

. . . [T]he Court of Chancery applied the following three-part test on a director-by-director basis to determine whether demand should be excused as futile: (i) whether the director received a material personal benefit from the alleged misconduct that is the subject of the litigation demand; (ii) whether the director would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand; and (iii) whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct that is the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand. . . .

This Court adopts the Court of Chancery's three-part test as the universal test for assessing whether demand should be excused as futile. . . .

. . . [T]he refined test "refocuses the inquiry on the decision regarding the litigation demand, rather than the decision being challenged." Notwithstanding text focusing on the propriety of the challenged transaction, this approach is consistent with the overarching concern that *Aronson* identified: whether the directors on the demand board "cannot be considered proper persons to conduct litigation on behalf of the corporation" because they "are under an influence which sterilizes their discretion." The purpose of the demand-futility analysis is to assess whether the board should be deprived of its decision-making authority because there is reason to doubt that the directors would be able to bring their impartial business judgment to bear on a litigation demand. That is a different consideration than whether the derivative claim is strong or weak because the challenged transaction is likely to pass or fail the applicable standard of review. It is helpful to keep those inquiries separate. And the Court of Chancery's three-part test is particularly helpful where, like here, board turnover and director abstention make it difficult to apply the *Aronson* test as written.

Finally, because the three-part test is consistent with and enhances *Aronson*, *Rales*, and their progeny, the Court need not overrule *Aronson* to adopt this refined test, and cases properly construing *Aronson*, *Rales*, and their progeny remain good law.

. . . .

The second issue on appeal is whether Tri-State's complaint pleaded with particularity facts establishing that a litigation demand on Facebook's board would be futile. The Court resolves this issue by applying the three-part test adopted above on a director-by-director basis.

The Demand Board was composed of nine directors. Tri-State concedes on appeal that two of those directors, Chenault and Zients, could have impartially considered a litigation demand.

And Facebook does not argue on appeal that Zuckerberg, Sandberg, or Andreessen could have impartially considered a litigation demand. Thus, in order to show that demand is futile, Tri-State must sufficiently allege that two of the following directors could not impartially consider demand: Thiel, Hastings, Bowles, and Desmond-Hellmann.

Tri-State concedes on appeal that neither Thiel, Hastings, Bowles, nor Desmond-Hellmann had a personal interest in the Reclassification. This eliminates the possibility that demand could be excused under the first prong of the demand-futility test, as none of the remaining four directors obtained a material personal benefit from the alleged misconduct that is the subject of the litigation demand.

Similarly, there is no dispute that Facebook has a broad Section 102(b)(7) provision; and Tri-State concedes on appeal that the complaint does not plead with particularity that Thiel, Hastings, Bowles, or Desmond-Hellmann committed a non-exculpated breach of their fiduciary duties with respect to the Reclassification. This eliminates the possibility that demand could be excused under the second prong of the demand-futility test, as none of the remaining four directors would face a substantial likelihood of liability on any of the claims that would be the subject of the litigation demand.

This leaves one unanswered question: whether the complaint pleaded with particularity facts establishing that two of the four remaining directors lacked independence from Zuckerberg.

The primary basis upon which a director's independence must be measured is whether the director's decision is based on the corporate merits of the subject before the board, rather than extraneous considerations or influences. Whether a director is independent is a fact-specific determination that depends upon the context of a particular case. To show a lack of independence, a derivative complaint must plead with particularity facts creating a reasonable doubt that a director is . . . so beholden' to an interested director . . . that his or her discretion would be sterilized.

A plaintiff seeking to show that a director was not independent must satisfy a materiality standard. The plaintiff must allege that the director in question had ties to the person whose proposal or actions he or she is evaluating that are sufficiently substantial that he or she could not objectively discharge his or her fiduciary duties. In other words, the question is whether, applying a subjective standard, those ties were material, in the sense that the alleged ties could have affected the impartiality of the individual director. Our law requires that all the pled facts regarding a director's relationship to the interested party be considered in full context in making the, admittedly imprecise, pleading stage determination of independence. And while the plaintiff is bound to plead particularized facts in . . . a derivative complaint, so too is the court bound to draw all inferences from those particularized facts in favor of the plaintiff, not the defendant, when dismissal of a derivative complaint is sought.

A variety of motivations, including friendship, may influence the demand futility inquiry. But, to render a director unable to consider demand, a relationship must be of a bias-producing nature. Alleging that a director had a personal friendship with someone else, or that a director had an outside business relationship, are insufficient to raise a reasonable doubt that the director lacked independence. Consistent with the predicate materiality requirement, the existence of some financial ties between the interested party and the director, without more, is not disqualifying.

. . . .

The complaint does not raise a reasonable doubt that Hastings lacked independence from Zuckerberg. According to the complaint, Hastings was not independent because:

• "Netflix purchased advertisements from Facebook at relevant times," and maintains "ongoing and potential future business relationships with" Facebook.

• According to an article published by The New York Times, Facebook gave to Netflix and several other technology companies "more intrusive access to users' personal data than it ha[d] disclosed, effectively exempting those partners from privacy rules."

• "Hastings (as a Netflix founder) is biased in favor of founders maintaining control of their companies."

• "Hastings has . . . publicly supported large philanthropic donations by founders during their lifetimes. Indeed, both Hastings and Zuckerberg have been significant contributors . . . [to] a well-known foundation known for soliciting and obtaining large contributions from company founders and which manages donor funds for both Hastings . . . and Zuckerberg . . . ."

These allegations do not raise a reasonable doubt that Hastings was beholden to Zuckerberg. Even if Netflix purchased advertisements from Facebook, the complaint does not allege that those purchases were material to Netflix or that Netflix received anything other than arm's length terms under those agreements. Similarly, the complaint does not make any particularized allegations explaining how obtaining special access to Facebook user data was material to Netflix's business interests, or that Netflix used its special access to user data to obtain any concrete benefits in its own business.

Further, having a bias in favor of founder-control does not mean that Hastings lacks independence from Zuckerberg. Hastings might have a good-faith belief that founder control maximizes a corporation's value over the long-haul. If so, that good-faith belief would play a valid role in Hasting's exercise of his impartial business judgment.

Finally, alleging that Hastings and Zuckerberg have a track record of donating to similar causes falls short of showing that Hastings is beholden to Zuckerberg. As the Court of Chancery noted below, "[t]here is no logical reason to think that a shared interest in philanthropy would undercut Hastings' independence. Nor is it apparent how donating to the same charitable fund would result in Hastings feeling obligated to serve Zuckerberg's interests." . . .

. . . .

According to the complaint, Thiel was not independent because:

• "Thiel was one of the early investors in Facebook," is "its longest-tenured board member besides Zuckerberg," and "has . . . been instrumental to Facebook's business strategy and direction over the years."

• "Thiel has a personal bias in favor of keeping founders in control of the companies they created . . . ."

• The venture capital firm at which Thiel is a partner, Founders Fund, "gets 'good deal flow' " from its "high-profile association with Facebook."

• "According to Facebook's 2018 Proxy Statement, the Facebook shares owned by the Founders Fund (i.e., by Thiel and Andreessen) will be released from escrow in connection with" an acquisition.

• "Thiel is Zuckerberg's close friend and mentor."

• In October 2016, Thiel made a $1 million donation to an "organization that paid [a substantial sum to] Cambridge Analytica" and "cofounded the Cambridge Analytica-linked data firm Palantir." Even though "[t]he Cambridge Analytica scandal has exposed Facebook to regulatory investigations"201 and litigation, Zuckerberg did not try to remove Thiel from the board.

• Similarly, Thiel's "acknowledge[ment] that he secretly funded various lawsuits aimed at bankrupting [the] news website Gawker Media" lead to "widespread calls for Zuckerberg to remove Thiel from Facebook's Board given Thiel's apparent antagonism toward a free press." Zuckerberg ignored those calls and did not seek to remove Thiel from Facebook's board.

These allegations do not raise a reasonable doubt that Thiel is beholden to Zuckerberg. The complaint does not explain why Thiel's status as a long-serving board member, early investor, or his contributions to Facebook's business strategy make him beholden to Zuckerberg. And for the same reasons provided above, a director's good faith belief that founder controller maximizes value does not raise a reasonable doubt that the director lacks independence from a corporation's founder.

While the complaint alleges that Founders Fund "gets 'good deal flow' "from Thiel's "high-profile association with Facebook," the complaint does not identify a single deal that flowed to—or is expected to flow to—Founders Fund through this association, let alone any deals that would be material to Thiel's interests. The complaint also fails to draw any connection between Thiel's continued status as a director and the vesting of Facebook stock related to the acquisition. And alleging that Thiel is a personal friend of Zuckerberg is insufficient to establish a lack of independence.

The final pair of allegations suggest that because "Zuckerberg stood by Thiel" in the face of public scandals, "Thiel feels a sense of obligation to Zuckerberg." These allegations can only raise a reasonable doubt about Thiel's independence if remaining a Facebook director was financially or personally material to Thiel. As the Court of Chancery noted below, given Thiel's wealth and stature, "[t]he complaint does not support an inference that Thiel's service on the Board is financially material to him. Nor does the complaint sufficiently allege that serving as a Facebook director confers such cachet that Thiel's independence is compromised." . . .

. . . . According to the complaint, Bowles was not independent because:

• "Bowles is beholden to the entire board" because it granted "a waiver of the mandatory retirement age for directors set forth in Facebook's Corporate Governance Guidelines," allowing "Bowles to stand for reelection despite having reached 70 years old before" the May 2018 annual meeting.

• "Morgan Stanley—a company for which [Bowles] ... served as a longstanding board member at the time (2005-2017)—directly benefited by receiving over $2 million in fees for its work . . . in connection with the Reclassification . . ."

• Bowles "ensured that Evercore and his close friend Altman financially benefitted from the Special Committee's engagement" without properly vetting Evercore's competency or considering alternatives.

These allegations do not raise a reasonable doubt that Bowles is beholden to Zuckerberg or the other members of the Demand Board. The complaint does not make any particularized allegation explaining why the board's decision to grant Bowles a waiver from the mandatory retirement age would compromise his ability to impartially consider a litigation demand or engender a sense of debt to the other directors. For example, the complaint does not allege that Bowles was expected to do anything in exchange for the waiver, or that remaining a director was financially or personally material to Bowles.

The complaint's allegations regarding Bowles's links to financial advisors are similarly ill-supported. None of these allegations suggest that Bowles received a personal benefit from the Reclassification, or that Bowles's ties to these advisors made him beholden to Zuckerberg as a condition of sending business to Morgan Stanley, Evercore, or his "close friend Altman." . . .

. . . .

For the reasons provided above, the Court of Chancery's judgment is affirmed.

Notes & Questions

1. To what extent is *Aronson* consistent with *Rales*?

2. Does the *Zuckerberg* court overrule *Aronson*?

3. Should a demand be required where a derivative complaint plausibly alleges that directors have violated their duty of care if that violation is unlikely to subject the directors to

liability due to an exculpation provision in the corporation's certificate of incorporation adopted pursuant to DGCL § 102(b)(7)?

4. Was a majority of the Facebook board sufficiently independent from Zuckerberg to keep a demand from being futile?

6. PAYMENT OF THE PLAINTIFF'S EXPENSES

Insert on p. 821 following the second full paragraph:

In Knott Partners, L.P. v. Boudett, 2023 WL 4276912 (Del. Ch. June 29, 2023), a plaintiff sued a corporation and forced it to ratify certain defective corporate acts. Because this action resulted in a benefit to the corporation and its shareholders, the court required the corporation to pay $300,000 in attorneys' fees. *See also* Garfield v. Boxed, Inc., 2022 WL 17959766 (Del. Ch. Dec. 27, 2022) (granting attorneys' fees to a plaintiff who convinced a corporation to have a special class vote in connection with a merger where the court found that the class vote was legally required).

Insert on p. 821 following the last paragraph:

In In re Dell Technologies Inc. Class V Stockholders Litigation, 2023 WL 4864861 (Del. Ch. July 31, 2023), the Delaware Chancery Court approved attorneys' fees of $266.7 million in connection with the settlement of a class action. The class action lawyers litigated the case to the pre-trial stage and achieved a settlement of $1 billion, the largest settlement ever achieved in a Chancery Court action. The court noted that the Delaware Supreme Court generally follows the percentage method rather than the lodestar method. Delaware gives special attention to the stage at which the settlement is achieved. The late pre-trial settlement indicated an award of 26.7% of the settlement. The court noted that no special factors suggested that the award should be adjusted upward or downward. It declined to apply the declining percentage method, pursuant to which courts reduce the percentage of the benefit awarded as the size of the common fund increases.

CHAPTER V – THE LIMITED PARTNERSHIP

B. FORMATION

2. FORMATION DEFECTS

Insert on p. 833 at the end of Note 2:

2. In O'Neal v. Burley, 884 S.E.2d 462, 467 (N.C. Ct. App. 2023), the court held that the failure to file a certificate of limited partnership with the Secretary of State precluded a finding that there had been substantial statutory compliance. As a result, the court held that the parties had formed a general partnership.

C. MANAGEMENT AND OPERATION

Insert on p. 839 at the end of Note 6:

6. DRULPA § 17-305 has been amended to provide that when a limited partner is entitled to obtain information for a stated purpose (whether pursuant to Section 17-305 or a partnership agreement), the limited partner's right shall be to obtain such information as is necessary and essential to achieving that purpose, unless such right has been expanded or restricted in the partnership agreement. This amendment is intended to overrule existing case law.

Insert on p. 839 following Note 8:

9. DRULPA § 17-106 has been amended to add subsection (e) to provide a non-exclusive safe harbor procedure for ratifying acts or transactions that may be taken by or in respect of a limited partnership under the DRULPA or a limited partnership agreement that are void or voidable and waiving failures to comply with requirements of a partnership agreement that make such acts and transactions void or voidable. New subsection (e) is intended to overrule existing case law.

2. DISSOLUTION

Insert on p. 928 following Note 7:

WITTINGHAM, LLC v. TNE LIMITED PARTNERSHIP

Supreme Court of Utah
469 P.3d 1035 (2020)

Chief Justice Durrant.

Introduction

We are asked to determine whether a contract entered into by a dissolved partnership is void or merely voidable. . . .

Two years after the Muir Second Family Limited Partnership (the Muir Partnership or Partnership) was administratively dissolved, Nicholas Muir—the former general partner of the Muir Partnership—obtained a loan from the TNE Limited Partnership (TNE). Mr. Muir obtained the loan, which he secured through a trust deed, ostensibly to remove an encumbrance on apartments owned by the dissolved Partnership. But the encumbrance was, in fact, part of a fraudulent scheme to obtain title to the apartments.

Once the scheme was discovered, Wittingham, LLC, a successor-in-interest to the Muir Partnership, brought suit to declare the trust deed void and recover damages for the fraudulent scheme. The district court held that the trust deed was void because the Muir Partnership had been dissolved prior to the time Mr. Muir signed the trust deed . . . .

. . . . TNE appeals the district court's determination that the TNE trust deed is void . . . .

Background

The Muir Partnership was organized on December 30, 1993, and continued until it was administratively dissolved on May 3, 2007. Two years after dissolution, Nicholas Muir, the former general partner of the defunct Partnership, obtained a loan for $435,000 from TNE. To secure the loan, Mr. Muir issued a promissory note to TNE, which was secured by a trust deed on a pair of apartment buildings owned by the Partnership. Prior to the execution of the TNE trust deed, Mr. Muir did not disclose to TNE that the Muir Partnership had been administratively dissolved. Instead, he created and registered a second entity: "Muir Second Family Limited Partnership" (second partnership). The only difference between the names of the two partnerships is that the name of the second partnership is missing the definite article "the."

In his negotiations with TNE, Mr. Muir asserted that the loan was necessary to remove an existing encumbrance on the apartments. That existing encumbrance was another trust deed, which secured a promissory note payable to Trump Security LLC. In fact, the purported purpose of the TNE transaction was a sham. There was no promissory note payable to Trump Security nor was there a valid trust deed. And the sole member of Trump Security was Gavin Dickson, who assisted Mr. Muir in his scheme. Mr. Muir apparently agreed to the sham encumbrance in order to obtain funds to repair the apartments.

After TNE disbursed the funds, the sham encumbrance was released. Mr. Dickson, acting on behalf of Trump Security, then directed that the TNE funds be used for purposes that did not benefit the Partnership. When Mr. Muir's family discovered the sham encumbrance and misappropriation of the TNE funds, Wittingham, LLC, the Muir Partnership, and Dorothy Jeanne Muir (collectively, Wittingham) commenced this action, seeking to have the TNE trust deed declared void.

Wittingham asserted that the TNE trust deed was void because the transaction was not for the purpose of winding up Partnership affairs . . . . Wittingham also sought to recover damages from TNE, Trump Security, and Mr. Dickson for civil conspiracy due to their roles in the fraudulent scheme. Wittingham obtained a default judgment against Mr. Muir, who transferred his partnership interest to plaintiff Jeanne Muir to satisfy the judgment. After the transfer of Mr. Muir's partnership interest, the Muir family made a series of transactions transferring title to the apartment buildings among successive business entities, the last being Wittingham, LLC.

. . . .

After a bench trial, the district court . . . concluded that the TNE trust deed was void *ab initio,* rather than voidable. The district court reasoned that, because Mr. Muir's dealings with TNE were not acts performed for the purpose of winding up Muir Partnership affairs, the TNE trust deed was an illegal contract and thus void. . . .

. . . .

Analysis

. . . . TNE argues that, under the test we recently established in *Ockey v. Lehmer*, [189 P.3d 51 (Utah 2008),] the district court erred in determining that the trust deed was void, and not voidable. We agree. Under the rule we established in *Ockey*, the trust deed is presumed voidable—a presumption that can be rebutted only through a showing free from doubt that the contract is against public policy. Because we hold that the TNE trust deed is voidable, we reverse and remand to the district court for further proceedings.

. . . .

. . . . The distinction between void and voidable is critical. Although a void contract cannot be ratified or accepted, a voidable contract may either be ratified or set aside at the election of the injured party. . . .

In *Ockey*, we determined that the conveyance of trust property was voidable even though the trustees who conveyed the property lacked authority (because the trust had terminated eight years before). We held that in determining whether contracts are void or voidable, we start with the presumption that they are *voidable* unless they clearly violate public policy. This presumption arises from the principle that parties have the freedom to contract. Consistent with this principle, courts must employ any reasonable construction to declare contracts lawful and not in contravention of public welfare. For this reason, it is only where a party has made a showing free from doubt that the contract is against public policy that courts should hold contracts to be void.

To help courts in determining whether a contract clearly violates public policy, we identified two factors: (1) whether the law or legal precedent has declared that the type of contract at issue is unlawful and absolutely void, and (2) whether the contract harmed the public as a whole—not just an individual. In applying these factors in *Ockey*, we concluded that the unauthorized conveyance of the trust property was not void but merely voidable because the trustee's actions were not contrary to public policy and did not injure anyone other than the plaintiff himself.

So, under our decision in *Ockey* there is a rebuttable presumption that defective contracts are voidable rather than void. This presumption can be rebutted only through a showing, free from doubt, that the contract violates public policy. And, in considering whether a contract clearly violates public policy, courts should consider the two *Ockey* factors. Based on these rules, we conclude that the TNE transaction is voidable, not void.

. . . .

With the presumption of voidability in mind, we first consider whether the legislature has declared by statute that the type of contract at issue is unlawful and absolutely void. In reviewing a statute to determine whether it provides that a contract is void, we apply the traditional rules of statutory construction, relying first on the statute's plain language. If the plain language of the statute is ambiguous, we read the statute in harmony with other statutes under the same and related chapters.

Because the Muir Partnership is a "limited partnership" formed under the General and Limited Liability Partnerships Act (the Act), we review the Act to determine whether it provides a well-defined and dominant public policy supporting the conclusion that the type of contract at issue in this case is void. Under the Act, a limited partnership can act only through its agent, typically the general partner. And the general partner has authority to bind the partnership by entering into agreements on the partnership's behalf.

As with any agent, a general partner's authority to bind the partnership can be actual (as provided by statute or the partnership agreement) or apparent (as provided by statute and common-law agency principles). The Act specifically identifies the scope of a general partner's actual authority by defining circumstances under which a general partner's actions will bind a partnership. And it grants a general partner apparent authority by incorporating common-law principles of agency—such as the apparent authority" principle and the principle of partner by estoppel—which may apply to render a general partner's acts enforceable even when those acts fall outside the scope of the general partner's actual authority.

And, importantly for this case, the Act specifically addresses the nature of a general partner's authority after a limited partnership has been dissolved. Under section 48-1-30 of the Act, when a limited partnership has been dissolved, the general partner's authority to act on behalf of the limited partnership is limited to "wind[ing] up" the partnership's affairs.

Relying on this section, the district court concluded that the Act provides a clear policy that partners may bind the partnership only in limited circumstances after dissolution. According to the court, Mr. Muir did not enter into the TNE transaction for the purpose of winding up the Partnership, so the transaction fell outside Mr. Muir's authority to act as the dissolved Partnership's general partner. For that reason it determined that the trust deed was an illegal contract and was therefore absolutely void. But unlike the district court, we are not convinced that section 48-1-30 leads to a conclusion free from doubt that the contract is against public policy.

Although the district court concluded that there was a clear public policy against allowing the type of contract at issue in this case to be formed, there are at least three places in the Act suggesting the existence of a public policy that is in direct conflict with the court's policy finding. First, section 48-1-32(1)(b) suggests the existence of a general public policy in favor of protecting third parties who unknowingly enter into contracts with dissolved partnerships. This section allows a general partner to bind the dissolved partnership to acts performed outside the course of winding up the partnership's business in certain situations where the other party to the transaction did not have notice of dissolution. Although the district court determined, for unspecified reasons, that this provision did not bind the Partnership in this case, the existence of this provision cuts against, and therefore casts doubt on, the public policy determination underlying the court's conclusion that the TNE transaction was void.

Second, section 48-1-13 of the Act incorporates the common-law principle of partner by estoppel, a principle that also aims to protect third parties. Under this principle, a partnership may be held liable when a person represents himself or herself as an agent of an "actual or apparent partnership" to a third party, and the third party extends credit as a result of the representation.

And third, section 48-1-11 provides that a partnership may be bound under the common-law agency principle known as apparent authority. That section provides that a "partnership is bound to make good the loss" when a "partner act[s] within the scope of his apparent authority [and] receives money or property of a third person and misapplies it." So, when a general partner's transaction is not within the general partner's actual authority, the limited partnership may still be bound under the doctrine of apparent authority.

Although the court did not discuss whether the principles of partner by estoppel or apparent authority could have applied in this case, the Act's incorporation of those principles, together with the exception the Act creates in section 48-1-32(1)(b), suggests the existence of a general public policy in favor of protecting third parties who enter into a transaction with a dissolved partnership without knowledge of the dissolution. Because these provisions cut against the public policy identified by the district court, we conclude that the district court erred in determining that section 48-1-32 served as a legislative declaration that the type of contract at issue in this case was unlawful and absolutely void. Instead, we conclude that the first *Ockey* factor weighs in favor of a finding that the contract at issue is voidable, rather than void.

. . . .

We also conclude that the second *Ockey* factor—whether the contract harmed the public as a whole—weighs against a finding that the contract is void. In so doing, we note that the district court did not consider the second *Ockey* factor as part of its analysis. But, on appeal, TNE argues that the type of transaction at issue in this case does not harm the public as a whole because, as a typical business transaction, it does not implicate public health, morality, or welfare. We agree with TNE.

Although, under the Act, Mr. Muir may not have had authority to enter into the TNE transaction, it was not the type of transaction that harms the public as a whole. Typically, contracts that harm the public as a whole, are those that, by their terms, harm more than the parties involved in the transaction. For example, we have determined that contracts that control prices and limit competition between the bids given to contractors create an unreasonable restraint on trade and, as a result, harm the public as a whole. We have also determined that contracts for an illegal purpose harm the public as whole. But the TNE transaction was not a contract for an illegal purpose nor does it harm parties outside the transaction. Accordingly, we conclude that the second *Ockey* factor—whether the contract harms the public as a whole—does not weigh in favor of a finding that the TNE transaction is void.

In sum, the district court erroneously held that the Act sets forth a well-defined and dominant public policy that renders the TNE transaction void. Even though Mr. Muir did not enter into the TNE transaction for the purpose of winding up partnership affairs, and therefore may have lacked authority to enter into that transaction, the Act as a whole does not clearly demonstrate that this type of transaction violates a well-defined and dominant public policy. Additionally, the transaction did not harm the public as a whole. Accordingly, we conclude that the TNE transaction is presumptively voidable, not void—a presumption Wittingham has failed to rebut. For this reason, we reverse the district court's decision in this regard and remand for further proceedings consistent with this opinion.

. . . .

Notes & Questions

1. Section 48-1-30 of Utah's General and Limited Liability Partnerships Act has analogues in RULPA (1985) § 801 and ULPA (2001) § 803(a).

2. Why was it improper for Muir to obtain a secured loan for his limited partnership?

3. Why was the loan transaction voidable rather than void?

4. Who has the power to ratify the loan if it is merely a voidable transaction?

5. What must the district court determine on remand?

CHAPTER VI – THE LIMITED LIABILITY COMPANY

C. THE ROLE OF CONTRACT

Insert on p. 958 following Note 5:

6. A recent decision contrasted the greater freedom of contract that LLCs have as compared to corporations under Delaware law:

> Decisions frequently observe that LLCs are creatures of contract, which they primarily are. The Delaware Limited Liability Company Act (the "LLC Act") provides that "[i]t is the policy of this chapter to give maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements." Because of this freedom, virtually any management structure may be implemented through the company's governing instrument. Using the contractual freedom that the LLC Act confers, the drafters of an LLC agreement can create a manager-managed entity, label the managers a "board of directors," refer to the LLC interests as "shares," and provide that the LLC will be governed by the DGCL and operate as if it were a Delaware corporation.
>
> . . . . Regardless of what investors might agree to in investor-level agreements, there are fundamental differences between what a certificate of formation must contain (virtually nothing) and what a certificate of incorporation must contain (six enumerated items including the number and types of shares the corporation can issue and any special rights, powers, privileges, qualifications, and limitations on those shares). And there are fundamental differences between what an LLC can achieve through its constitutive document (minimally constrained) and what a corporation can achieve (moderately constrained). Most notably, the constitutive document of an LLC (the LLC agreement) can (i) fully eliminate any duties existing at law or in equity, including fiduciary duties, (ii) provide indemnification and advancement unconstrained by any statutory standards, and (iii) fully eliminate any and all liabilities, except for bad faith breaches of the implied covenant of good faith and fair dealing. By contrast, the constitutive document of a corporation (the charter and bylaws) (i) can shape fiduciary duties but cannot eliminate them, (ii) cannot eliminate monetary liability for breach of fiduciary duty except for breaches of the duty of care, (iii) cannot provide indemnification or advancement that goes beyond statutory standards, and (iv) cannot constrain liability for breach of the implied covenant of good faith and fair dealing.

New Enterprise Associates 14, L.P. v. Rich, 295 A.3d 520, 579-82 (Del. Ch. 2023) (internal quotations and citations omitted).

D. MANAGEMENT AND OPERATION

1. GENERAL GOVERNANCE

Insert on p. 959 at the end of Note 6:

6. DLLCA § 18-305 has been amended to provide that when a member is entitled to obtain information for a stated purpose (whether pursuant to Section 18-305 or a limited liability company agreement), the member's right shall be to obtain such information as is necessary and essential to achieving that purpose, unless such right has been expanded or restricted in the limited liability company agreement. This amendment is intended to overrule existing case law to the extent such law is to the contrary.

Insert on p. 959 following Note 6:

7. DLLCA § 18-106 has been amended to add subsection (e) to provide a non-exclusive safe harbor procedure for ratifying acts or transactions that may be taken by or in respect of a limited liability company under the DLLCA or a limited liability company agreement that are void or voidable and waiving failures to comply with requirements of a limited liability company agreement that make such acts and transactions void or voidable. New subsection (e) is intended to overrule existing case law.

F. THE NATURE OF THE LLC: REGULATORY ISSUES

Insert on p. 981 at the end of Note 5:

5. In Foxfield Villa Associates, LLC v. Robben, 967 F.3d 1082, 1100 (10th Cir. 2020), *cert. denied*, 141 S. Ct. 1385 (2021), the court held that interests in a member-managed LLC were not investment contracts or securities.

H. LIMITED LIABILITY

1. THE SCOPE OF LIMITED LIABILITY

Insert on p. 994 at the end of Note 4:

4. In Adelsperger v. Elkside Development LLC, 529 P.3d 230, 235 (Or. 2023), the court noted: "[M]embers and managers remain personally liable for the actions that they take on behalf of an LLC to the same extent that they would be liable if [they] were acting in an individual capacity." (Citation omitted).

Insert on p. 994 following Note 4:

5. In Kinzua Resources, LLC v. Oregon Department of Environmental Quality, 468 P.3d 410 (Or. 2020) (en banc), the court held that, under statutes that imposed certain obligations on

each person controlling a landfill, liability for the person's own failure to satisfy those obligations is direct liability and such liability is not prevented by the Oregon statute that limits the liability of LLC members and managers.

I. FIDUCIARY DUTIES

Insert on p. 1009 at the end of Note 4:

4. In Plank v. Cherneski, 231 A.3d 436 (Md. 2020), the court held that the President, CEO, and majority-interest member in an LLC owed a fiduciary duty to the minority members:

> Despite the statutory silence concerning fiduciary duties in the LLC Act, managing members are clearly agents for the LLC and each of the members, which is a fiduciary position under common law. Accordingly, managing members of an LLC owe fiduciary duties to the LLC and the minority members arising under traditional common law agency principles.

Id. at 450-51.

Insert on p. 1009 at the end of Note 6:

6. In Meridian Medical Systems, LLC v. Epix Therapeutics, Inc., 250 A.3d 122, 132 (Me. 2021), the court applied the business judgment rule to decisions made by co-managers of an LLC.

Insert on p. 1031 following Note 4:

5. In Wilson v. Gandis, 844 S.E.2d 631 (S.C. 2020), South Carolina had a dissolution for oppression statute that applied to LLC's. The court held that the freezeout of a minority member constituted oppression and ordered a fair value buyout of the minority's interest. However, the court required the majority members to buy the minority member's interest only if the LLC failed to do so.

6. In Bearce v. Yellowstone Energy Development, LLC, 963 N.W.2d 299, 302 (N.D. 2021), the court took a position contrary to *Anderson*:

> We have recognized that [North Dakota statutory law] provides significant protection for minority shareholders in a close corporation. We have said [North Dakota statutory law] imposes a duty upon officers, directors, and those in control of a corporation to act in good faith, and affords remedies to minority shareholders if those in control act fraudulently, illegally, or in a manner unfairly prejudicial toward any shareholder. The [plaintiffs] provide no authority, and we can find none, where a court has extended the duties that directors of a corporation owe to minority shareholders in a close corporation to the managing members or board of a limited liability company under the Uniform Limited Liability Company Act. In the absence of a statutory directive, we decline to extend the

> duties under law applicable to close corporations to closely held limited liability companies.

Id. at 302. Do you agree with *Anderson* or *Bearce*?

K. EXIT RIGHTS: DISSOCIATION AND DISSOLUTION

Insert on p. 1060 at the end of Note 4:

4. In Furrer v. Siegel & Rouhana, LLC, 2022 WL 9834101, at *16 (Md. Ct. Spec. App. Oct. 17, 2022), the court held that, in valuing a member's interest as part of a statutory buyout proceeding after the member's withdrawal from an LLC, the member's economic interest should be cut off as of the date of withdrawal.

CHAPTER VII – PUBLIC CORPORATION SUPPLEMENT

A. INSIDER TRADING

2. FEDERAL REGULATION

a. True Insiders

Insert on p. 1102 following Note 9:

10. The SEC promulgated Rule 10b5-1, 17 C.F.R. § 240.10b5-1, to allow an insider to trade his corporation's securities according to written plans that were adopted prior to the insider's receipt of material non-public information about the issuer or its securities. Concerned that this privilege was being abused, the SEC recently amended Rule 10b5-1 to require: (a) insiders to observe a 30-day cooling off period from the time a plan is adopted to the commencement of trading; (b) directors and officers to observe an extended cooling off period equal to the greater of 90 days from the time a plan is adopted or 2 days following the disclosure of the corporation's financial results in a Form 10K or Form 10Q (but not to exceed 120 days); and (c) directors and officers adopting a trading plan to certify that they are not in possession any material non-public information about the issuer or its securities and that they are acting in good faith and not as part of any plan or scheme to avoid the prohibitions of Rule 10b-5. In addition to requiring that a trading plan be adopted in good faith, the amended rule requires that adopting persons act in good faith with respect to a trading plan. Finally, the SEC prohibited multiple overlapping trading plans and limited single-trade plans (i.e., plans that are designed to protect a single transaction) to one use in any 12-month period. *See* Rel. No. 34-96492, 87 Fed. Reg. 80362 (2022).

B. FEDERAL PROXY REGULATION

Insert on p. 1159 at the end of the carryover paragraph:

The increased influence of institutional shareholders in public corporations has led to growth of proxy advisory firms, who make recommendations on how shareholders in such corporations should vote on particular issues. The two most important proxy advisory firms are Institutional Shareholder Services, Inc. and Glass, Lewis & Co. In 2020, the Securities and Exchange Commission amended the proxy rules to cover the activities of proxy advisory firms. 17 C.F.R. § 240.14a-1(l)(1)(iii) was amended to add paragraph (A) to make clear that the terms "solicit" and "solicitation" include any proxy voting advice that makes a recommendation to a shareholder as to its vote, consent, or authorization on a specific matter for which shareholder approval is solicited, and that is furnished by a person who markets its expertise as a provider of such advice, separately from other forms of investment advice, and sells such advice for a fee. 17 C.F.R. § 240.14a-1(l)(2) has been amended to make clear that the terms "solicit" and "solicitation" do not include any proxy voting advice provided by a person who furnishes such advice only in response to an unprompted request.

Insert on p. 1159 at the end of the first full paragraph:

In 2020, 17 C.F.R. § 240.14a-2(b)(9)(ii) was adopted to require, as a separate condition to the availability of the exemptions from the solicitation rules, a proxy voting advice business adopt and publicly disclose written policies and procedures reasonably designed to ensure that: (a) the proxy voting advice business identify any material conflicts of interest in connection with the giving of proxy voting advice; (b) registrants that are the subject of proxy voting advice have such advice made available to them at or prior to the time when such advice is disseminated to the proxy voting advice business's clients; and (c) the proxy voting advice business provides its clients with a mechanism by which they can reasonably be expected to become aware of any written statements regarding its proxy voting advice by registrants that are the subject of such advice, in a timely manner before the shareholder meeting (or, if no meeting, before the votes, consents, or authorizations may be used to effect the proposed action).

The proxy advisory firms and their clients, who are principally institutional investors, lobbied the SEC to modify the rules. In 2022, the SEC retained the requirement relating to disclosing conflicts of interest but eliminated the other requirements for providing an exemption from the proxy solicitation rules.

Insert on p. 1160 following the second full paragraph:

The SEC has promulgated Rule 14a-19, 17 C.F.R. § 240.14a-19, to require universal proxy cards in connection with the election of directors. The SEC now requires that the corporation's proxy card, and any proxy card distributed by dissident shareholders, include all nominees for the board, whether or not supported by the corporation or the dissidents. As a result, shareholders may vote for any combination of candidates on any proxy card. Dissidents must solicit at least 67% of the shares entitled to vote, and provide notice at least 60 days in advance of the election of the intent to solicit proxies and the identities of their nominees. Corporations must provide 50-days' notice of their nominees to dissidents. In addition, Rule 14a-4, 17 C.F.R. § 240.14a-4, has been amended to require proxy cards to have "against" or "abstain" options where such choices have a legal effect.

1. PROXY FRAUD

Insert on p. 1166 at the end of Note 10:

10. On remand, the District Court in *Mills* assumed that, where a merger was accomplished by means of a materially false and misleading proxy, the proper damage model in a Rule 14a-9 action was the difference between a fair merger price and the actual merger price. Since the Supreme Court found that the merger price was fair, it had no need to review the District Court's damage model. However, in Karp v. First Connecticut Bancorp, Inc., 69 F.4th 223 (4th Cir. 2023), the court came to a different conclusion. In that case, the plaintiff challenged a proxy statement issued in connection with a stock-for-stock merger that valued the plaintiff's shares at $32.33. The plaintiff alleged that the proxy statement violated Rule 14a-9 because it failed to contain certain cash flow projections that the corporation's investment banker possessed when

rendering its fairness opinion. The District Court granted the defendant's motion for summary judgment because, in light of all the other information contained in the proxy statement, the omitted projections were not material. The Court of Appeals affirmed this holding. *See id*. at 234. The Court of Appeals also held that summary judgment was properly granted for the defendant because the plaintiff had not advanced sufficient proof of loss causation. The plaintiff contended that a fair merger price would have valued his stock at $35.51 and, therefore, that the allegedly misleading proxy had cost him $3.18 per share. The Court of Appeals disagreed:

> [The plainitff] contends that "loss causation is satisfied because the deficient proxy [was] a proximate cause of the damages"—that is, the proxy statement was an "essential link in a financially unfair merger." [The defendant] says that more is needed: [the plaintiff] "must tie the misleading proxy statements directly to the economic harm" by showing that omission of the projections "prevented [the corporation's] shareholders from receiving $35.51 per share for their stock." [The defendant] argues that [the plaintiff] failed to show that disclosure of the projections would have either (1) caused another buyer to pay more than $32.33 per share, or (2) caused shareholders to reject the merger, and (in that case) that the share price on the day of the merger would have been $35.51. We . . . agree with [the defendant].
>
> As the district court explained, [the plaintiff] hasn't shown that the omission of the . . . cash-flow projections caused a $3.18 per share loss. For one, [the corporation's] stock was trading at $26 per share the day before the merger was announced, well below the merger consideration of $32.33. And [the plaintiff] doesn't suggest that the shareholders missed out on "a viable superior offer" by approving the merger. On the contrary, [the corporation's merger partner] was "willing to walk" if [the corporation] rejected the $32.33 offer, and no other offer was on the table. So it's unclear how the shareholders would have realized the $35.51 price had the proxy statement included the cash-flow projections—or whether they even would have rejected the merger in that case. . . .

Id. at 234-35.

Insert on p. 1183 at the end of Note 5:

5. The federal courts have applied the *Omnicare* standard to proxy fraud cases. *See* Golub v. Gigamon, Inc., 994 F.3d 1102, 1106 (9th Cir. 2021); Jaroslawicz v. M & T Bank Corp., 962 F.3d 701, 717-18 (3d Cir. 2020), cert. denied, 141 S. Ct. 1284 (2021).

Insert on p. 1183 following Note 9:

10. In 2020, 17 C.F.R. § 240.14a-9 was amended to add to the examples of what may be misleading within the meaning of the rule. The Note to this rule included new paragraph (e) to provide that the failure to disclose material information regarding proxy voting advice, "such as the proxy voting advice business's methodology, sources of information, or conflicts of interest" could, depending upon particular facts and circumstances, be misleading within the meaning of the rule. In 2022, the SEC eliminated Note e to Rule 14a-9. The SEC emphasized that proxy

advisory firms can still violate Rule 14a-9 if they make material misrepresentations or omissions in connection with a proxy solicitation.

2. SHAREHOLDER PROPOSALS

Insert on p. 1188 at the end of the first paragraph under subsection 2:

17 C.F.R. § 240.14a-8(b) has been amended to provide that a shareholder will be eligible to submit a proposal if the shareholder demonstrates continuous ownership of at least:

• $2,000 of the company's securities entitled to vote on the proposal for at least three years;

• $15,000 of the company's securities entitled to vote on the proposal for at least two years; or

• $25,000 of the company's securities entitled to vote on the proposal for at least one year.

The amended rule will not include a component based on a percentage of shares owned. Aggregation of holdings for purposes of meeting the ownership requirements is not permitted. The amended rule requires shareholders that use a representative to submit a proposal for inclusion in a company's proxy statement to provide certain documentation. Under the amended rule, shareholder proponents will be required to provide the company with a written statement that they are able to meet with the company in person or via teleconference at specified dates and times that are no less than 10 calendar days, nor more than 30 calendar days, after submission of the proposal. The amended rule states that each person may submit no more than one proposal, directly or indirectly, to a company for a particular shareholders' meeting.

Insert on p. 1188 at the end of the second paragraph under subsection 2:

17 C.F.R. § 240.14a-8(i)(12) has been amended to provide that a shareholder proposal will be excludable from a company's proxy materials if it addresses substantially the same subject matter as a proposal, or proposals, previously included in the company's proxy materials within the preceding five calendar years if the most recent vote occurred within the preceding three calendar years and the most recent vote was:

• Less than 5 percent of the votes cast if previously voted on once;

• Less than 15 percent of the votes cast if previously voted on twice; or

• Less than 25 percent of the votes cast if previously voted on three or more times.

Insert on p. 1198 at the end of Note 2:

2. The SEC's staff recently indicated that it was narrowing the grounds on which it would issue no-action letters relating to the "economic relevance" exclusion, *see* 17 C.F.R. §

240.14a-8(i)(5), and the "ordinary business operations" exclusion, *see* 17 C.F.R. § 240.14a-8(i)(7). *See* Division of Corporation Finance, Securities and Exchange Commission, Shareholder Proposals: Staff Legal Bulletin No. 14L (Nov. 3, 2021).

With regard to Rule 14a-8(i)(5), companies are allowed to exclude a proposal that "relates to operations which account for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business." The staff now takes the view that "proposals that raise issues of broad social or ethical concern related to the company's business may not be excluded, even if the relevant business falls below the economic thresholds of Rule 14a-8(i)(5)."

With regard to Rule 14a-8(i)(7), companies are allowed to exclude a proposal that "deals with a matter relating to the company's ordinary business operations." The staff noted that it would "realign its approach for determining whether a proposal relates to "ordinary business" with the standard the Commission initially articulated in 1976, which provided an exception for certain proposals that raise significant social policy issues, and which the Commission subsequently reaffirmed in the 1998 Release." The staff further noted that it would "no longer focus on determining the nexus between a policy issue and the company, but will instead focus on the social policy significance of the issue that is the subject of the shareholder proposal. In making this determination, the staff will consider whether the proposal raises issues with a broad societal impact, such that they transcend the ordinary business of the company." The staff gave the following example: "[P]roposals squarely raising human capital management issues with a broad societal impact would not be subject to exclusion solely because the proponent did not demonstrate that the human capital management issue was significant to the company."

Rule 14a-8(i)(7) has also allowed the exclusion of proposals that involve micromanagement of the board's business. The staff noted that it would "take a measured approach to evaluating companies' micromanagement arguments – recognizing that proposals seeking detail or seeking to promote timeframes or methods do not per se constitute micromanagement. Instead, we will focus on the level of granularity sought in the proposal and whether and to what extent it inappropriately limits discretion of the board or management. We would expect the level of detail included in a shareholder proposal to be consistent with that needed to enable investors to assess an issuer's impacts, progress towards goals, risks or other strategic matters appropriate for shareholder input." The staff gave as an example its recent denial of a no-action letter with respect to "a proposal requesting that the company set targets covering the greenhouse gas emissions of the company's operations and products. The proposal requested that the company set emission reduction targets and it did not impose a specific method for doing so."

C. CONTESTS FOR CORPORATE CONTROL

2. TENDER OFFERS

b. State Law

Insert on p. 1249 after Problem 7-16:

WILLIAMS COMPANIES STOCKHOLDER LITIGATION

Court of Chancery of Delaware
2021 WL 754593 (2021)

MEMORANDUM OPINION

McCORMICK, V.C.

This litigation concerns the validity of a stockholder rights plan, or so-called "poison pill," a device that came to popularity in the 1980s as a response to front-end loaded, two-tiered tender offers. Coercive tender offers of the 1980s were to takeovers what the forward pass was to Notre Dame football in the days of Knute Rockne, and a powerful offense required a powerful defense. Of all the defenses developed to fend off hostile takeovers, the poison pill was among the most muscular. These bulwarks gained judicial imprimatur in 1985 when the Delaware Supreme Court upheld a poison pill as an antitakeover device in *Moran v. Household International, Inc.*[,500 A.2d 1346 (Del. 1985).] *Moran* also established intermediate scrutiny under *Unocal* [*Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985),] as the legal framework for reviewing stockholder challenges to poison pills.

Poison pills metamorphosed post-*Moran*. The flip-over feature of the *Moran* pill was augmented by a flip-in feature. After the adoption of state anti-takeover statutes, trigger thresholds crept down from the 20% threshold of *Moran* to 15% and then to 10% in some instances. The pill's initial success engendered mission creep. Originally conceived as anti-takeover armaments, poison pills were redirected to address other corporate purposes such as protecting net operating loss assets. Recently, pills have been deployed to defend against stockholder activism.

The plaintiffs in this litigation challenge an anti-activist pill adopted by the board of directors of The Williams Companies, Inc. ("Williams" or the "Company") at the outset of the COVID-19 pandemic and amid a global oil price war. The Williams pill is unprecedented in that it contains a more extreme combination of features than any pill previously evaluated by this court—a 5% trigger threshold, an expansive definition of "acting in concert," and a narrow definition of "passive investor."

Unocal calls for a two-part inquiry, asking first whether the board had reasonable grounds for identifying a threat to the corporate enterprise and second whether the response was reasonable in relation to the threat posed. The defendants identify three supposed threats: first, the desire to prevent stockholder activism during a time of market uncertainty and a low stock price, although the Williams board was not aware of any specific activist plays afoot; second, the apprehension that hypothetical activists might pursue "short-term" agendas or distract management from guiding Williams through uncertain times; and third, the concern that activists might stealthily and rapidly accumulate over 5% of Williams stock.

Of these three threats, the first two run contrary the tenet of Delaware law that directors cannot justify their actions by arguing that, without board intervention, the stockholders would vote erroneously out of ignorance or mistaken belief. This decision assumes for the sake of analysis that the third threat presents a legitimate corporate objective but concludes that the Company's response was not proportional and enjoins the Williams pill.

. . . .

The Plan will expire at the end of one year and has four key features: (i) a 5% trigger; (ii) a definition of "acquiring person" that captures beneficial ownership as well as ownership of certain derivative interests, such as warrants and options; (iii) an "acting in concert" provision that extends to parallel conduct and includes a "daisy chain" concept (the "AIC Provision"); and (iv) a limited "passive investor" exemption.

. . . .

The Plan operates in conjunction with regulatory requirements established by federal and state law. Understanding the Plan's features requires a quick refresher of certain of those requirements.

- Section 13(d) of the Securities Exchange Act (the "Exchange Act") requires that non-passive investors report "beneficial ownership" of more than 5% of a class of stock but gives investors a ten-day window to report ownership levels using a Schedule 13D form. During that window, the investor is permitted to continue accumulating stock.

- Section 13(d) does not include derivative securities in the definition of "beneficial ownership."

- Section 13(d) aggregates the beneficial ownership of investors who are acting in concert, which under the Exchange Act occurs where "two or more persons agree to act together for the purpose of acquiring, holding, voting or disposing of equity securities of an issuer." Section 13(d)'s definition of "acting in concert" does not capture "parallel conduct" (discussed below) nor a "daisy chain" concept (discussed below).

- Section 13(d) excludes "passive investors," defined as persons who acquired "securities in the ordinary course of [their] business and not with the purpose nor with the effect of changing or influence the control of the issuer."

The Plan established a trigger threshold of "5% or more." The Plan is triggered, and the rights distributed, on "the close of business on the tenth Business Day after" a "Person" (defined as an individual, firm, or entity) acquires "beneficial ownership" of 5% or more of Williams stock or commences "a tender or exchange offer" that would result in their ownership reaching that threshold. Given Williams' market capitalization in March 2020, triggering the 5% threshold at the time the Plan was adopted would have required an economic investment (sometimes referred to as a "toehold") of approximately $650 million.

The Plan's definition of "beneficial ownership" starts with the definition found in Rule 13d–3 of the Exchange Act, then extends more broadly to include "[c]ertain synthetic interests in securities created by derivative positions," such as warrants and options.

The AIC Provision deems a Person to be "Acting in Concert" with another Person if:

> such Person knowingly acts (whether or not pursuant to an express agreement, arrangement or understanding) at any time after the first public announcement of the adoption of this Right Agreement, in concert or in parallel with such other Person, or towards a common goal with such other Person, relating to changing or influencing the control of the Company or in connection with or as a participant in any transaction having that purpose or effect, where (i) each Person is conscious of the other Person's conduct and this awareness is an element in their respective decision-making processes and (ii) at least one additional factor supports a determination by the Board that such Persons intended to act in concert or in parallel, which additional factors may include exchanging information, attending meetings, conducting discussions, or making or soliciting invitations to act in concert or in parallel.

. . . .

The "parallel-conduct" dimension of the "acting in concert" provision (sometimes referred to as a "wolfpack" provision) is a feature of modern pills . . . . [P]oison pills have always included an acting-in-concert concept. Early poison pills required express agreements, using language that tracked the definitions of a "group," "affiliate," and "associate" under Section 13(d) and Rule 12b-2 of the Exchange Act. Express agreement provisions do not capture so-called wolfpack activism achieved through "conscious parallelism that deliberately stop[s] short of an explicit agreement."

The AIC Provision includes a "daisy chain" concept, providing that "[a] Person who is Acting in Concert with another Person shall be deemed to be Acting in Concert with any third party who is also Acting in Concert with such other Person." Put differently, stockholders act in concert with one another by separately and independently "Acting in Concert" with the same third party.

The AIC Provision does not apply to a public proxy solicitation or tender offer. Persons are not deemed to be "Acting in Concert" solely as a result of soliciting proxies in connection with a "public proxy or consent solicitation made to more than 10 holders of shares of a class of stock" or when soliciting tenders pursuant to a "public tender or exchange offer." While this provision allows stockholders to initiate a proxy contest and solicit proxies without triggering the Plan, it does not exempt routine communications among stockholder before the launch of a proxy contest or tender offer.

The AIC Provision is also asymmetrical. It excludes "actions by an officer or director of the Company acting in such capacities," such that incumbents can act in concert without suffering the consequences of the Plan.

The Plan carves out "Passive Investors" from the definition of "Acquiring Persons." The Plan defines "Passive Investor" to mean:

> [A] Person who (i) is the Beneficial Owner of Common Shares of the Company and either (a) has a Schedule 13G on file with the Securities and Exchange Commission pursuant to the requirements of Rule 13d-1(b) or (c) under the Exchange Act with respect to such holdings (and does not subsequently convert such filing to a Schedule 13D) or (b) has a Schedule 13D on file with the Securities and Exchange Commission and either has stated in its filing that it has no plan or proposal that relates to or would result in any of the actions or events set forth in Item 4 of Schedule 13D or otherwise has no intent to seek control of the Company or has certified to the Company that it has no such plan, proposal or intent (other than by voting the shares of the Common Shares of the Company over which such Person has voting power), (ii) acquires Beneficial Ownership of Common Shares of the Company pursuant to trading activities undertaken in the ordinary course of such Person's business and not with the purpose nor the effect, either alone or in concert with any Person, of exercising the power to direct or cause the direction of the management and policies of the Company or of otherwise changing or influencing the control of the Company, nor in connection with or as a participant in any transaction having such purpose or effect, including any transaction subject to Rule 13d-3(b) of the Exchange Act, and (iii) in the case of clause (i)(b) only, does not amend either its Schedule 13D on file or its certification to the Company in a manner inconsistent with its representation that it has no plan or proposal that relates to or would result in any of the actions or events set forth in Item 4 of Schedule 13D or otherwise has no intent to seek control of the Company (other than by voting the Common Shares of the Company over which such Person has voting power).

This carve-out was intended to ensure that truly passive investors would be exempt from the definition of Acquiring Person under the Plan. Director Defendants testified as to their belief that the definition excludes Schedule 13G filers, defined under the Exchange Act as an investor that "acquired such securities in the ordinary course of his business and not with the purpose nor with the effect of changing or influencing the control of the issuer."

As drafted, however, the carve-out is far more exclusive. The definition uses "and" before romanette (iii), which makes the three requirements of the provision conjunctive. Thus, a stockholder must meet all three conditions to qualify as an exempt "Passive Investor." Consequently, the definition excludes *any* investor that seeks to "*direct or cause the direction of the management and policies of the Company*" as provided in romanette (ii) of the definition. The "management and policies" qualifier of the AIC Provision captures a broader range of activity other than the "changing or influencing . . . control" language applicable to Schedule 13G filers.

. . . .

The Board has the authority to redeem or amend the Plan, but it remains in place.

In fact, outside of the context of privileged discussions concerning this litigation, the Board never considered redeeming the Plan. . . .

. . . .

The parties . . . dispute the applicable standard of review. Plaintiffs contend that *Unocal* governs the court's analysis. Defendants argue that the more deferential business judgment standard applies.

Since the Delaware Supreme Court's decision in *Moran*, this court and the Supreme Court have used *Unocal* exclusively as the lens through which the validity of a contested rights plan is analyzed.

Defendants nevertheless argue that the Board's adoption and maintenance of the Plan should be subject to business judgment review. Defendants say that the sole justification for *Unocal's* enhanced standard is "the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders." Defendants argue that this specter is not present where a poison pill is designed to address stockholder activism as opposed to hostile takeover attempts.

Defendants' contention runs contrary to the Delaware Supreme Court's decision in [Versata Enters., Inc. v. Selectica, Inc., 5 A.3d 586 (Del. 2010)]. There, the poison pill was adopted for the purpose of preserving [net operating loss] assets and not warding off hostile takeover attempts. The court held that the *Unocal* standard nevertheless applied because all poisons pills, "by . . . nature, have a potentially entrenching "effect." It is therefore settled law that the Board's compliance with their fiduciary duties in adopting and then failing to redeem the Plan must be assessed under *Unocal*.

The Director Defendants' actual and articulated reason for taking action figures prominently in the *Unocal* analysis. In the traditional language of *Unocal*, the directors must have identified and responded to a legitimate corporate threat. They cannot justify their conduct based on threats that they never identified or beliefs they did not hold. Before turning to the question of whether the threat is legitimate, the court must determine why the Director Defendants acted. This decision therefore starts by making factual findings concerning the threat or corporate objective to which the Board was responding when adopting the Plan.

. . . .

A few themes emerge from the Director Defendants' testimony. First, they all expressed the sentiment that the Plan was intended to deter stockholder activism. Second, they desired to insulate the board from activists pursuing "short-term" agendas and from distraction and disruption generally. Third, they were concerned that a stockholder might stealthily and rapidly accumulate large amounts of stock.

The first prong of *Unocal* requires evaluating whether the Board has demonstrated that it conducted a good faith reasonable investigation and had "grounds for concluding that a threat to the corporate enterprise existed." Defendants have demonstrated that the Board conducted a good faith, reasonable investigation when adopting the Plan. The Director Defendants are nearly all independent, outside directors. They considered the Plan over the course of two meetings. . . .

The real problem is not the process that Defendants followed, but the threats they identified. The first threat was quite general—the desire to prevent stockholder activism during a time of market uncertainty and a low stock price. The second threat was only slightly more specific—the concern that activists might pursue "short-term" agendas or distract management. The third threat was just a hair more particularized—the concern that activists might rapidly accumulate over 5% of the stock and the possibility that the Plan could serve as an early detection device to plug the gaps in the federal disclosure regime. Each of the three threats were purely hypothetical; the Board was not aware of any specific activist plays afoot. The question presented is whether these hypothetical threats present legitimate corporate objectives under Delaware law.

"Stockholder activism" is a broad concept that refers to a range of stockholder activities intended to change or influence a corporation's direction. Activists may pressure a corporation to make management changes, implement operational improvements, or pursue a sale transaction. They may seek to catalyze or halt a merger or acquisition. More recently, "ESG activism" has come to the fore, and stockholders have begun pressuring corporations to adopt or modify policies to accomplish environmental, social, and governance goals. Many forms of stockholder activism can be beneficial to a corporation, as Defendants themselves recognize.

Under Delaware law, the board of directors manages the business and affairs of the corporation. Thus, stockholder activism is directed to the board. And activists' ability to replace directors through the stockholder franchise is the reason why boards listen to activists. Most activists hold far less than a hard majority of a corporation's stock, making the main lever at an activist's disposal a proxy fight. In this way, stockholder activism is intertwined with the stockholder franchise.

Under Delaware law, directors cannot justify their actions by arguing that without their intervention, the stockholders would vote erroneously out of ignorance or mistaken belief in an uncoerced, fully informed election. The notion that directors know better than the stockholders about who should be on the board is no justification at all.

Viewing all stockholder activism as a threat is an extreme manifestation of the proscribed we-know-better justification for interfering with the franchise. That is, categorically concluding that *all* stockholder efforts to change or influence corporate direction constitute a threat to the corporation runs directly contrary to the ideological underpinnings of Delaware law. The broad category of conduct referred to as stockholder activism, therefore, cannot constitute a cognizable threat under the first prong of *Unocal*.

. . . .

The Board's second concern was that activists might pursue short-term agendas or disrupt or distract management. The "short-termism" justification refers to the concern that "a particular activist seeks short-term profit without regard to the impact on the company's long-term prospects." The "disruption" justification typically refers to the concern that the actions of the activists might cause operational disruption . . . Here, the Director Defendants instead frame this concern as a desire to insulate the management team from distraction.

. . . .

Reasonable minds can dispute whether short-termism or distraction could be deemed cognizable threats under Delaware law. These sorts of justifications, particularly short-termism, are conspicuous in the policy debate but they become nebulous when viewed through a doctrinal lens. The central criticism of short-termism is that shareholders who favor short-termism . . . are hurting themselves as much as they are hurting their fellow shareholders. This is a valid policy argument, but . . . the short-termism argument just particularizes the concern that shareholders will cast votes in a mistaken assessment of their own best interests. That is, short-termism and distraction concerns boil down to the sort of we-know-better justification that Delaware law eschews in the voting context.

Although there is room to disagree as to whether short-termism or distraction could be deemed cognizable threats under Delaware law, this decision does not resolve that issue. Even if justifications of short-termism or disruption could rise to the level of a cognizable threat, hypothetical versions of these justifications cannot. The concerns in this case are raised in the abstract—there is no specific, immediate activist play seeking short-term profit or threatening disruption. When used in the hypothetical sense untethered to any concrete event, the phrases "short-termism" and "disruption" amount to mere euphemisms for stereotypes of stockholder activism generally and thus are not cognizable threats.

The third justification for the Plan is the concern that activists might rapidly accumulate over 5% of the stock and the belief that the Plan could serve as an early-detection devise to plug the gaps in the federal disclosure regime.

. . . .

Lightning strikes [i.e., rapid, undetected accumulation of stock in a short period of time] go undetected under the federal disclosure regime, which requires stockholders to disclose their ownership position after crossing the 5% threshold but gives stockholders ten days to do so. The federal disclosure regime does not prohibit stockholders from continuing to acquire stock during that ten-day period and does not capture "wolf pack" activity.

. . . .

This decision need not address whether a true gap-filling pill would be permissible. As discussed below, the features of the Plan are more extreme than any of the gap-filling pills . . . . At this stage of the analysis, the question is whether the desire to fill gaps in federal disclosure laws through private ordering constitutes a legitimate corporate objective under *Unocal*. A related question is whether the gap-filling objective becomes more viable in the face of market uncertainty or a precipitous stock drop resulting in a stock price that undervalues the corporation.

Reasonable minds can dispute whether a gap-filling purpose standing alone is a legitimate corporate purpose under *Unocal*. The main concern is that if gap filling were a legitimate corporate objective that justified the adoption of a poison pill, then all Delaware corporations subject to the federal disclosure regime would have a ready-made basis for adopting a pill. These policy concerns are only slightly mitigated by a precipitous stock drop, which is not an uncommon occurrence.

Recognizing an omnipresent justification for poison pills would constitute a dramatic turn in Delaware law, which has consistently held that a pill's adoption and maintenance raises concerns sufficient to give rise to enhanced scrutiny. This court routinely views poison pills as situationally specific defenses and has conducted fact intensive inquiries to determine whether the action is justifiable under the unique circumstances of the case. Put differently, Delaware law has handled these nuclear weapons of corporate governance with the delicacy they deserve. . . .

Just as this decision need not decide in the abstract whether a gap-filling pill is permissible, this decision also need not address whether gap-filling represents a legitimate corporate objective. This decision instead assumes for the purposes of analysis that gap filling to detect lightning strikes at a time when stock price undervalues the corporation is a legitimate corporate purpose under the first prong of *Unocal*. The question becomes whether the adoption of the Plan was a proportional response to that assumedly valid threat.

Because Plaintiffs do not claim that the Plan is coercive or preclusive, the second prong of the *Unocal* inquiry requires the court to evaluate whether Defendants proved that adopting the Plan fell within a range of reasonable responses to the lightning-strike threat posed.

The thirty-thousand-foot view looks bad for Defendants. As Morgan Stanley advised the Board at the March 19 Meeting, the 5% trigger alone distinguished the Plan; only 2% of all plans identified by Morgan Stanley had a trigger lower than 10%. Even among pills with 5% triggers, the Plan ranked as one of only nine pills to ever utilize a 5% trigger outside the [net operating loss] context. Among Delaware corporations, it was one of only two. The other Delaware corporation to adopt a 5% trigger for a non-NOL pill did so in distinguishable circumstances—in the face of a campaign launched by an activist who held 7% of the company's outstanding shares at the time the pill was adopted. Of the twenty-one pills adopted between March 13 and April 6, 2020, only the Plan had a 5% triggering threshold. Of the twenty-one companies that adopted pills during that time, thirteen faced ongoing activist campaigns when adopting their pill.

The Plan's other key features are also extreme. The Plan's "beneficial ownership" definition goes beyond the default federal definitions to capture synthetic equity, such as options. The Plan's definition of "acting in concert" goes beyond the express-agreement default of federal law to capture "parallel conduct" and add the daisy-chain concept. The Plan's "passive investor" definition goes beyond the influence-control default of federal law to exclude persons who seek to direct corporate policies. In sum, the Plan increases the range of Williams' nuclear missile range by a considerable distance beyond the ordinary poison pill.

. . . .

Had the Board desired to close some of the gaps in the federal disclosure regime, the Board might have considered one of the less extreme options aimed at detection and designed to compel stockholder disclosure. Instead, the Board selected a Plan with features that went beyond those of gap-filling pills. Regardless of whether the Board intended to gap fill federal disclosure regulations—and whether that intent is permissible—the Plan's combination of features created a response that was disproportionate to its stated hypothetical threat.

. . . .

In the end, Defendants bear the burden to show their actions were reasonable. They have failed to show that this extreme, unprecedented collection of features bears a reasonable relationship to their stated corporate objective. Because Defendants failed to prove that the Plan falls within the range of reasonable responses, the Plan is invalid.

For the foregoing reasons, judgment is entered in favor of the certified class declaring the Plan unenforceable and permanently enjoining the continued operation of the Plan. Having concluded that the Plan is unenforceable because the Director Defendants breached their fiduciary duties under *Unocal* when adopting it, this decision need not resolve whether the Director Defendants independently breached their fiduciary duties by failing to redeem the Plan.

Notes & Questions

1. Was the *Williams* court correct to use *Unocal* rather than the business judgment standard of review?

2. Is shareholder activism a cognizable threat under *Unocal*?

3. Are "short-termism" and "disruption" cognizable threats under *Unocal*?

4. May boards adopt a poison pill to prevent "lightning strikes" that would otherwise be permissible under federal law?

5. Was the poison pill adopted in *Williams* proportionate to the threats of identified by the board?

6. Does it matter that the poison pill in *Williams* was adopted as a prophylactic measure in response to hypothetical concerns of the board?