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Reopening of Advance Notice Window Requires Activists to Show "Radical Shift" at Company

In *Sternlicht v. Hernandez*, the Delaware Court of Chancery, in an opinion by Vice Chancellor Fioravanti, clarified the high standard that activists must overcome to reopen the director nomination window of an otherwise valid advance notice bylaw—namely, they must show that there has been a "radical shift" in company position caused by the board after the deadline for director nominations had passed. The court held that the plaintiffs did not overcome this standard, despite numerous alleged "radical shifts" that occurred after the deadline. As a result, in a holding favorable for the company, the court enforced the deadline for nominations established by the company's advance notice bylaw and prevented the plaintiffs from nominating a competing slate of directors at the upcoming annual meeting. The opinion strengthens advance notice bylaws as a means of providing certainty around the annual meeting and election process for companies and protecting against activist attacks. For more on the *Sternlicht* opinion, see here.

Delaware Court of Chancery Determines That *Corwin* Cleansing Does Not Apply to Defensive Measures Subject to *Unocal*

In *In re Edgio, Inc. Stockholders Litigation*, the Delaware Court of Chancery, in an opinion by Vice Chancellor Zurn, denied a motion to dismiss claims seeking to enjoin alleged defensive measures contained in a stockholders' agreement entered into by Limelight Network, Inc. and a third party investor. Limelight acquired a portfolio company from the third party in exchange for a 35% interest in Limelight, which stock issuance was approved by Limelight's stockholders under Nasdaq listing rules. Limelight and the third party concurrently entered into a stockholders' agreement that restricted the third party's voting and transfer rights, including, among other provisions, a package of standstill provisions requiring that the third party (i) vote in favor of Limelight's board-recommended nominees and against any nominees not so recommended, (ii) vote in favor of the board recommendation (or pro rata with all other stockholders) in respect of any non-routine matters submitted for a stockholder vote and (iii) not transfer any stock without the consent of, or as recommended by, Limelight for two years and thereafter be restricted from transferring any stock to entities on a specified list of the 50 "most significant" activist investors for another year. Plaintiffs, two Limelight stockholders unaffiliated with the third party, sought to enjoin provisions of the stockholders' agreement that they argued were defensive measures designed to entrench the board and protect the company from stockholder activism. The court found that the plaintiffs pled facts supporting a reasonable inference that the board acted defensively in response to a perceived threat, thereby warranting enhanced scrutiny under *Unocal*. The court rejected the defendant's argument that stockholder approval of the stock issuance with full disclosure of the stockholders' agreement's terms cleansed the voting restrictions under the *Corwin*

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doctrine, noting that *Corwin*'s function is to apply to post-closing damages actions and was not intended to apply to claims seeking injunctive relief against unreasonable defensive measures under *Unocal*.

Delaware Court of Chancery Upholds Covenant Not to Sue for Breach of Fiduciary Duty

In *New Enterprise Associates 14, L.P.* v. *Rich*, the Delaware Court of Chancery, in an opinion by Vice Chancellor Laster, held that a contractual covenant by stockholders not to sue for breach of fiduciary duty in connection with a drag-along sale is enforceable under Delaware law if it is narrowly tailored and reasonable under the circumstances. In doing so, the court cautioned that the case under consideration presented an "optimal" circumstance for enforcement because it involved a clear, specific covenant bargained for by sophisticated parties, and that such provisions may not be enforceable in other contexts. To that end, the court indicated that such a covenant may not be enforced in the case of intentional breach of duty, and thus the court denied the defendants' motion to dismiss with respect to allegations that preferred stockholders acted intentionally and in bad faith to benefit themselves and harm the common stockholders during the lead-up to the challenged drag-along sale. For more on the *New Enterprise Associates 14* opinion, see here.

Delaware Supreme Court Holds That Dilutive Share Issuance Is Subject to Enhanced Review Under *Unocal* Rather Than Separate *Blasius* or *Schnell* Review

In *Coster* v. *UIP Companies, Inc.*, the Delaware Supreme Court, in an *en banc* opinion by Chief Justice Seitz, affirmed the Court of Chancery's holding that the board of directors had a "compelling justification" for authorizing a dilutive share issuance to resolve a stockholder deadlock. In so holding, the Supreme Court determined that the standards of review derived from *Schnell* v. *Chris-Craft Industries, Inc.* and *Blasius Industries, Inc.* v. *Atlas Corp.* that have historically governed board decisions affecting stockholder voting in director elections or touching on matters of corporate control should be folded into a *Unocal* review. *Coster* involved the deadlock of two equal stockholders, with one seeking the appointment of a custodian for the company. The board, comprised of the other stockholder and two directors aligned with him, approved the issuance of a one-third interest in the company to one of the directors. The stockholder who sought appointment of the custodian then filed an action alleging that the directors breached their fiduciary duties in approving the stock issuance and sought its cancelation. In an earlier opinion discussed here, the Delaware Supreme Court reversed and remanded the Court of Chancery's earlier determination that the transaction was entirely fair, ordering the lower court to consider the transaction under alternative standards of review, including *Blasius* and *Schnell*. On remand, the Court of Chancery found that the board acted in good faith and had a "compelling justification" for authorizing the share issuance to resolve the deadlock. The Supreme Court affirmed, holding that the standards from *Schnell* (i.e., that a board breaches its fiduciary duties when it "utilize[s] the corporate machinery" with the intent of "perpetuating itself in office" by interfering with a proxy contest) and *Blasius* (i.e., that even good faith actions by a board that interfere with stockholder voting in director elections or touching on matters of corporate control require a "compelling justification") "have been and can be folded into *Unocal* review to accomplish the same ends – enhanced judicial scrutiny of board action that interferes with a corporate election or a stockholder's voting rights in contests for control." Therefore, applying enhanced scrutiny under *Unocal*, the Supreme Court upheld the Court of Chancery's findings that the board was properly motivated in responding to the existential threat posed by the deadlock, and that its actions authorizing the share issuance were reasonable and proportionate to the threat posed by the potential deadlock and were not preclusive or coercive.

Delaware Supreme Court Affirms Holding That Tesla's Acquisition of SolarCity Was Entirely Fair

In a unanimous *en banc* decision in *In re Tesla Motors, Inc. Stockholder Litigation*, the Delaware Supreme Court, in an opinion by Justice Valihura, affirmed the Court of Chancery's earlier post-trial opinion (discussed here) holding that Tesla's 2016 acquisition of SolarCity Corporation was entirely fair. On appeal of the Court of Chancery's decision, the appellants did not challenge the lower court's factual findings, but rather the application of entire fairness, arguing that the court placed too great a degree of importance on market evidence in determining whether the price Tesla paid was fair. With limited exception, the Supreme Court rejected appellants' arguments and affirmed the Court of Chancery's opinion. The Supreme Court agreed that the acquisition resulted from a fair process, and despite the absence of an independent committee, was negotiated by a majority independent board and was approved by a fully informed stockholder vote. With regard to fair price, the Supreme Court held that the Court of Chancery erred in comparing the purchase price to the unaffected stock price as of the date Tesla announced the acquisition,

because the stock price on that date did not reflect material, nonpublic information concerning SolarCity's credit problems and downgrades. Nonetheless, the Supreme Court rejected the contention that the announcement date stock price was the sole basis of the Court of Chancery's fair price determination and, therefore, the lower court's analysis in this regard did not constitute reversible error.

Delaware Court of Chancery Finds *Caremark* Claims Timely; Allows a Subset of Claims to Advance in Pair of Opinions

Vice Chancellor Laster of the Delaware Court of Chancery recently issued back-to-back opinions in *Ontario Provincial Counsel of Carpenters' Pension Trust Fund* v. *Walton* that addressed duty of oversight claims—so-called *Caremark* claims—brought against the directors of Walmart Inc. in connection with the company's role in the opioid epidemic. In the first opinion, the court held that the claims were not time-barred, which holding is in line with the court's recent trend of increased receptivity to *Caremark* claims at the early stages of litigation. In the second opinion, the court denied the defendants' motion to dismiss certain of the *Caremark* claims, including those relating to allegations that the board knowingly caused Walmart to fail to comply with (i) a settlement between the company and the U.S. Drug Enforcement Agency and (ii) its obligations under the federal Controlled Substances Act when acting as a dispenser of opioids through its retail pharmacies. However, the court dismissed *Caremark* claims based on allegations that the directors knowingly caused Walmart to fail to comply with its obligations under the Controlled Substances Act when acting as a wholesale distributor for opioids for its retail pharmacies. The court dismissed the latter category of claims for failure to make a pre-suit demand on the board, as plaintiffs failed to show that the directors were so conflicted by the threat of liability that they could not objectively assess the merits of the claims against them.

2023 Amendments to the Delaware General Corporation Law

The 2023 amendments to the General Corporation Law of the State of Delaware ("DGCL") have been passed by the Delaware General Assembly. Assuming they are signed by the governor, which is likely, they will become effective on August 1, 2023. Key amendments include the following:

- Ratification of defective corporate acts under DGCL Section 204. To reduce review time of certificates of validation, the required contents of the certificates of validation have been simplified, and the filing requirement will be altogether eliminated in certain circumstances (e.g., if the defective act being ratified was the improper filing of a prior certificate, but no changes are needed to that prior certificate once ratified).

- Stockholder votes for certain charter amendments under DGCL Section 242. A stockholder vote will no longer be required for a forward stock split, and, in connection with that split, the charter also may be amended to increase the authorized shares up to a proportional amount, so long as there is only one outstanding class that is not divided into series. This is intended to be helpful in connection with IPOs, allowing the pre-IPO corporation to approve most aspects of its IPO charter in advance but wait until pricing to do a final forward split (and determine the correct authorized share count, so long as doing so is no more than proportional to the split) without an additional stockholder vote in the limited time remaining before the IPO.

  In addition, for public corporations, the vote to approve a reverse split or increase or decrease the authorized share count is reduced to a majority of the shares voted (instead of the default majority of the outstanding). This will be most useful for companies that struggle to approve reverse splits to maintain compliance with the minimum bid price rule, as well as companies that struggle to get approval to increase their authorized share count, due to broker nonvotes resulting from large blocs of nonvoting retail investors.

- Conversions to corporations under DGCL Section 265. Similar to amendments made last year for in-bound domestications, in connection with a conversion to a corporation, the prior entity can adopt a plan of conversion containing, among other things, "any corporate action to be taken by the converted corporation of this State in connection with the conversion of the other entity" without needing further authorization for those actions post-conversion. For example, in connection with an IPO or spin, the entity can stay a limited liability company as late as possible, with the approval of its conversion to a

corporation immediately pre-IPO/spin also authorizing issuing new shares, adoption of equity plans, etc. without requiring new board approvals for technical DGCL compliance.

- Pledging assets under Section 272. The amendments create a new express safe harbor allowing for the sale, lease or exchange of pledged property or assets to reduce or satisfy the underlying debt without stockholder approval if either (i) the transaction is being effected by the secured party's exercise of its rights under the terms of the mortgage or pledge or (ii) the secured party and the corporation agree to an alternative transaction, approved by the board, and the value of the secured assets being sold, leased or exchanged does not exceed the amount of the liabilities reduced or eliminated thereby and such transaction is not prohibited by the law governing the mortgage or pledge. The amended statute does not dictate a specific method for valuing such assets, but does provide that receipt by the corporation or its stockholders of additional consideration will not create a presumption that the asset values exceeded the value of the discharged liabilities for purposes of this statutory safe harbor.

- Stockholder notice under Section 228. The amendments simplify the determination of the record date for stockholders entitled to receive notice of action by written consent of stockholders, and permit corporations entitled to use a notice of internet availability of proxy materials under federal securities laws to use such notice to satisfy the requirements of DGCL Section 228(e).

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M&A Markets

The following issues of *M&A at a Glance*, our monthly newsletter on trends in the M&A marketplace and the structural and legal issues that arise in M&A transactions, were published this quarter. Each issue can be accessed by clicking on the date of each publication below.

April 2023 May 2023 June 2023

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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