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Delaware Court of Chancery Questions Enforceability of *Con Ed* Provisions

In *Crispo* v. *Musk*, the Delaware Court of Chancery, in an opinion by Chancellor McCormick, addressed the enforceability of merger agreement provisions related to the recovery of lost-premium damages by the target. Such "*Con Ed* provisions"—named after the Second Circuit's opinion in *Consolidated Edison, Inc.* v. *Northeast Utilities*—attempt to clarify that damages for lost merger premiums are recoverable from a wrongfully terminating buyer by the target or stockholders in certain circumstances. *Crispo* suggests that while Delaware courts will likely not permit the target to recover lost-premium damages for itself or on behalf of stockholders, target stockholders themselves would have that right in certain circumstances. For more, see here.

Delaware Court of Chancery Again Declines to Enforce or Blue-Pencil Restrictive Covenants

In *Sunder Energy, LLC* v. *Jackson*, the Delaware Court of Chancery, in an opinion by Vice Chancellor Laster, declined to enforce or "blue-pencil" (i.e., modify) restrictive covenants contained in a limited liability company agreement (an "LLCA"). The decision continues a recent series of decisions (discussed here and here) where Delaware courts have addressed non-competes in various contexts, and in each case have declined to enforce the provisions due to their overbreadth. In *Sunder*, applying Delaware law, the court held that restrictive covenants in the company's LLCA, which included a non-compete and a restriction on soliciting employees, were unenforceable due to their overbreadth as to duration, geography and scope of restricted activity. In addition, the court found that the company's managing members breached their fiduciary duties by failing to disclose adequately the contents of the LLCA, including the covenants, to the minority members. The opinion serves as a helpful reminder of important drafting and disclosure considerations for parties seeking to enter into and enforce restrictive covenants purporting to be governed by Delaware law, particularly in limited liability company agreements. For more, see here.

Delaware Court of Chancery Addresses Advance Notice Bylaws in Two Decisions

This quarter the Delaware Court of Chancery, in opinions by Vice Chancellor Will, upheld two boards' enforcement of advance notice bylaws to exclude activist nominees. In one case, however, the court held that certain advance notice bylaws were invalid because they were overly broad and therefore unreasonable under the enhanced scrutiny standard set forth in *Coster* v. *UIP Companies, Inc.* These decisions reflect the Delaware courts' general position to uphold reasonable advance notice bylaws and defensive measures, but also their willingness to scrutinize bylaws or

defensive measures that are overly broad or facially entrenching. Boards should keep this in mind when evaluating such provisions for adoption.

First, in *Paragon Technologies, Inc. v. Cryan*, the court declined to require the board of directors of Ocean Powers Technology, Inc. ("OPT") to permit an activist's candidates to stand for election and to exempt the activist from OPT's net operating loss ("NOL") rights plan. The court held that under the high standard applicable to requests for mandatory relief, and based on the limited preliminary record, the activist's nomination notice did not comply with OPT's advance notice bylaw. In addition, the court held that the board's enforcement of the advance notice bylaw survived *Coster*'s enhanced scrutiny review and the board's decision not to exempt the shareholder from the NOL rights plan survived *Unocal* review.

Second, in *Kellner v. AIM Immunotech Inc.*, the court similarly declined to require the board to permit an activist's nominees to stand for election, but found certain of the company's advance notice bylaws to be invalid. The plaintiff in this case had aligned with other stockholders of the company to nominate directors twice. After the first attempt failed, the board amended the company's advance notice bylaw to make changes to require additional, more expansive disclosure. This decision comes up in the context of the second attempted nomination. Applying enhanced scrutiny, the court concluded that certain of the amended bylaws were invalid, as they were not proportional in relation to the board's proper corporate objective of obtaining transparency from a stockholder seeking to nominate directors. Among other things, the court found such bylaws to be problematic because they required disclosure covering overly broad categories of persons or overly long time periods or were overly vague. Nevertheless, the court held that the plaintiff failed to make all of the required disclosures even without the invalid amendments, including information on agreements, arrangements or understandings relating to the nomination. Again applying *Coster* enhanced scrutiny review, the court concluded that the board's rejection of the nomination notice was equitable, as it was a proportionate response to the proper corporate objective of full and fair disclosure to enable the board to evaluate the nomination notice and to assist stockholders in casting informed votes.

Delaware Courts Issue Series of *Caremark* Decisions

Delaware courts addressed a series of *Caremark* breach of the duty of oversight cases this quarter. In all three cases, the Court of Chancery dismissed such claims, but, in one case, that decision was reversed and remanded by the Delaware Supreme Court based on the Court of Chancery's interpretation of a rule of evidence.

In *Lebanon County Employees' Retirement Fund v. Collis*, the Delaware Supreme Court, sitting en banc, reversed and remanded the Court of Chancery's earlier dismissal of claims relating to AmerisourceBergen Corporation's alleged noncompliance with regulations addressing suspicious orders for opioids. Plaintiffs asserted "Red-Flags Claims" (i.e., *Caremark* breach of oversight claims alleging that the directors consciously failed to address known problems under existing reporting systems) and "*Massey* Claims" (i.e., claims that a fiduciary knowingly caused the corporation to seek profit by violating the law). The earlier decision by Vice Chancellor Laster dismissed the claims in reliance on a federal court decision holding that the company had complied with federal law to ensure that suspicious opioid orders would not be diverted into improper channels. Based on this decision, the Court of Chancery held that it would be impossible to infer that the company had failed to comply with such law. On appeal, the Delaware Supreme Court, in an opinion by Justice Traynor, reversed, holding that the Court of Chancery erred by effectively adopting the federal court's decision. Among other things, the Supreme Court held that the question of whether the defendants in the federal litigation engaged in wrongful conduct was a question of fact, and Delaware courts cannot take adjudicative notice of factual findings of another court when the underlying fact is reasonably disputed.

In *In re ProAssurance Corp. Stockholder Derivative Litigation*, the Court of Chancery, in an opinion by Vice Chancellor Will, dismissed *Caremark* claims brought against the board for its decision to underwrite a policy with a large healthcare institution without sufficient loss reserves. The board's decision was a departure from the company's traditional business of insuring small accounts. The plaintiffs sued, alleging breach of the duties of oversight and disclosure. The court dismissed for failure to plead demand futility, as it was not substantially likely that the company's independent and disinterested board faced liability for either claim. The court noted, "[o]versight claims should be reserved for extreme events," and for liability to arise, the oversight failures must be so egregious that they amount to bad faith. Here, the allegations were "hindsight second-guessing of a business

decision that turned out poorly" and could not reasonably support an inference of bad faith. The plaintiffs' disclosure claim was similarly dismissed, as the complaint lacked particularized allegations that the directors issued disclosures knowing that they were false.

Finally, in *Segway, Inc.* v. *Cai*, the Court of Chancery, in an opinion by Vice Chancellor Will, dismissed a *Caremark* claim against a former officer in part due to the company's failure to adequately plead bad faith, which is necessary for a successful *Caremark* claim. After the company terminated defendant's employment, the company discovered discrepancies in the records maintained by the defendant that the company could not reconcile. The company sued, alleging that the defendant "was aware of serious issues" with customers that "led to significant increases" in accounts receivable and "willfully ignored" problems within her areas of responsibility, and should be liable for failing to address these matters and advise the board about them. The Court of Chancery disagreed and dismissed the claims. The company merely asserted that the defendant learned about "issues" with unspecified customers, revenue decreases and increases in accounts receivable. According to the court, "[s]uch generic financial matters are far from the sort of red flags that could give rise to *Caremark* liability if deliberately ignored." Moreover, the complaint did not adequately allege that the defendant acted in bad faith. Oversight duties are not "designed to subject [fiduciaries] to personal liability for failure to predict the future and properly evaluate business risk." The court continued, "[b]ad things can happen to corporations despite fiduciaries exercising the utmost good faith." Therefore, the court dismissed the claims against the defendant.

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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.

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