Securities
Regulation Daily

Wolters Kluwer

January 8, 2020

Corporate law in 2019: ESG is in, WeWork is out, and the state to watch is... Wyoming?

By Mark S. Nelson, J.D., and Anne Sherry, J.D.

Last year saw changes in the state corporate world on several fronts. The attention on ESG issues—environmental, social, and governance—increased dramatically in the year to mirror growing public concern over climate change and other factors. Evincing investor fatigue with unicorn startups and founder-friendly corporate governance structures, WeWork saw its valuation drop dramatically after it scrapped a planned IPO. While the saga does not indicate that unicorns are now extinct, it marks a sharp change in power away from startup founders who were until recently able to essentially dictate terms to investors.

Another ESG topic on people's minds in 2019 was board diversity. The developments this year are mixed, perhaps reflecting the broader debate around diversity mandates specifically and legislative interference in governance more broadly. An Illinois law that was initially inspired by California's board-diversity mandate scrapped a quota system in favor of disclosure, which could indicate increased hesitation given criticism of and challenges to the California law. Finally, retiring Delaware Supreme Court Justice Leo Strine entered the debate about ESG with a sweeping proposal for governance reform. Strine's plan adds an extra "E" to the initialism, emphasizing the treatment of employees.

Strine's retirement is the end of one era, and the beginning of another, for Delaware corporate jurisprudence. He had been an outspoken and influential jurist since 1998, when he became a vice chancellor on the Chancery Court, and he earned increasingly prominent standing within the state court system, becoming Chief Justice in 2014. His impact is apparent in several significant 2019 decisions involving the *MFW* framework by which controllers can secure business judgment review of transactions, as well as an increasing emphasis on a transaction's deal price in appraisal proceedings. Replacing Strine as Chief Justice is Collins J. Seitz, Jr., who was elevated from an associate justice position on the court. Tamika Montgomery-Reeves left the Chancery Court to fill the resulting vacancy and become the first African American, and third woman, on the court.

Delaware will also have to answer for its judicial selection process in 2020, when the U.S. Supreme Court will hear a challenge to a requirement that considers candidates' political party. Meanwhile, it faces friendly competition from Wyoming, which for several years has worked to attract fintech businesses by enacting various laws allowing for the use of distributed ledger technology and other advances in corporate governance. Wyoming's gambit culminated this year with the establishment of a chancery court to provide a specific forum for resolving business disputes.

©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

I. Environmental, social, governance—and employees

Attention to environmental, social, and governance issues has escalated in recent years, mirroring political and social concerns as a whole. That ESG continues to be a significant topic of debate is demonstrated most clearly in 2019 by state legislative action on board diversity and well as the headline-grabbing rise and fall of WeWork. And while this paper as a whole focuses on state-law developments, a discussion of ESG would be incomplete without mentioning the increasing scrutiny that legislators and regulators are taking at the federal level, particularly with respect to environmental risks.

The We Company: A case study. The controversy around dual-class share structures came to a head with Snap Inc.'s 2017 IPO and has waned since then—notably, Uber went public in 2019 with a one-share, one-vote structure—but it and similar governance questions persist. The We Company's overtures toward a 2019 IPO provide a cautionary tale about valuations and shareholder pushback against supervoting shares. Even more, the story reflects a growing cynicism about so-called unicorn startups.

The We Company (WeWork) filed an initial registration statement on August 14 and quickly came under fire for its $47 billion valuation and for the control it ceded to then-CEO Adam Neumann. Neumann's shares would have carried 20 votes each, and his successor would have been chosen by a special committee appointed by his wife.

The company walked back these changes one month later by amending its IPO registration to reduce the voting power of Neumann's shares by half and to have the board, rather than special committee, select his successor. Even these changes ultimately failed to salvage the IPO. The WeWork bubble popped, the IPO fizzled, and the company's main investor, Softbank, took control. Softbank paid Neumann $1.7 billion to step down as CEO; by the third quarter of 2019, it valued the company below $5 billion. In November, WeWork confirmed that it would lay off 2400 employees.

Neumann is also being sued by a shareholder (and former employee) who claimed he obtained effective control over the company, which he then used to the company's and shareholders' detriment by engaging in self-dealing and other activities in breach of fiduciary duties he owed to shareholders of the private company.

According to the complaint, Neumann obtained his $1.7 billion golden parachute through a pattern of self-dealing. Among the examples of questionable transactions cited by the complaint are: (1) causing We Company to lease space at Neumann-owned buildings; (2) obtaining a $6 million payment from the company after Neumann trademarked "We" and "The We Company"; (3) hiring his wife and other family members to work at We Company; (4) receiving large loans from the company at low interest rates; (5) engaging in activities without business purposes that resulted in losses to the company; and (6) cashing out $700 million in We Company stock ahead of the planned IPO. The complaint also cites allegedly wasteful spending and conflicted transactions with banks that also were to be underwriters of We Company's IPO.

 ©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

WeWork can be seen as an isolated case, its outsized valuation enabled by the unusual investment style and objectives of Softbank. Although its specific lessons may not apply to other companies, the initial optimism of its IPO followed by a dramatic reversal suggest that the unicorn bubble itself may have burst. Investors are increasingly skeptical of young startups and are pushing back more strongly against uneven governance features like supervoting stock. While the SEC in recent years has discussed dual-class shares and other control features, regulatory involvement may not be necessary if investors keep the pressure on companies themselves.

Strine's swan song. On the eve of his retirement as Delaware Chief Justice, Leo Strine released a sweeping proposal for corporate governance reform that would prioritize employees, hold institutional investors accountable, and tax financial transactions. In an interview with the *Financial Times*, Strine explained that he has been trying to forge common ground between business and labor for a long time, and as the country heads into the 2020 election cycle, some people had asked him to put his ideas into a solid form. "My entire reason for being a public servant is because I believe in the idea that self-governing societies can make things better for their entire citizenry," he told the newspaper. Strine opined that change will come about through elections, leadership, and focus.

The "fair and sustainable capitalism proposal" emphasizes corporations' responsibility to treat employees fairly, as well as the role of institutional investors in effecting this change. Strine would also impose a tax on financial transactions and reassess legal decisions that have privileged corporate elites. The jurist summarized the ideas in a *Financial Times* op-ed.

Strine's emphasis on corporate responsibility echoes the recent statement by the Business Round table that corporate stakeholders include not just shareholders but also employees, suppliers, customers, and communities. But he said in his op-ed that "skepticism rightly exists over whether this woke talk will be backed up by real action." Although he credited Business Round table with "put[ting] down a marker" and is optimistic that the group's statement is a step forward, Strine goes further by laying out specific steps in his proposal.

The proposal starts from the premise that incentives underlying corporate governance have failed to encourage long-term investment, sustainable business practices, and "fair gainsharing" between shareholders and workers. Strine takes aim at institutional investors, which wield 75 percent of shareholder voting power but tend to escape the criticism that falls on CEOs and boards. Middle-class investors saving for retirement rely on mutual funds, but those fund companies, not the individual investors, get the vote. Strine believes that corporations will not prioritize social responsibility or the treatment of employees unless institutional investors also support these goals.

Focusing on employees is critical as 99 percent of Americans owe most of their wealth to their job, Strine said. Since the early 1970s worker productivity has risen by about 70 percent while hourly pay has grown by only 12 percent, and corporate profits have reached record highs. The proposed reforms are aimed at giving workers a voice within the boardroom and greater access to collective bargaining. Strine gives some institutional investors credit for considering environmental, social, and governance (ESG) issues, but said that all of them must factor in EESG—the extra E standing for "employees."

 ©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

Strine would modify the fiduciary duties of institutional investors to require them to consider their ultimate beneficiaries' specific investment objections and horizons. They would no longer be allowed to rely on the recommendations of proxy advisory firms unless tailored to the fund's investment style and horizon. Strine also proposes a suite of measures that would complement the other reforms to promote long-term economic growth.

The proposal also includes some measures that corporations would welcome. First, Strine would reduce the frequency of say-on-pay votes on executive compensation, calling annual voting "insane." He would also raise the ownership threshold for shareholder proposals, requiring that shareholders making an economic proposal hold $2 million or 1 percent of the company's stock, whichever is less. Shareholders attempting to change a company's governance would have to disclose their net beneficial ownership interest in the company's stock.

The proposal sets out reforms to the tax system by establishing a financial transaction tax, revenues from which would go into a trust fund for investment in infrastructure and other projects. He would also close the carried-interest loophole and change the holding period for long-term capital gains from one year to five. A one-year long-term capital gain is an oxymoron, he told *FT*. Finally, Strine proposes measures to curb excessive corporate power, such as barring public companies from political spending without the consent of at least 75 percent of their shareholders. The proposal would limit the enforceability of certain forced arbitration clauses, restore state sovereignty over state-law claims, and recognize unions that can fairly show that they have majority support.

Board diversity remains in the spotlight. 2019 saw the continuation of efforts to increase the diversity of corporate boards. In August, following the lead of California's 2018 board-diversity law—but taking a compromise approach—the Illinois governor signed legislation requiring public companies headquartered in the state to disclose information about gender and minority representation on their boards. A major institutional shareholder also spoke up about board diversity: New York City Comptroller Scott Stringer said that his office will press companies to consider women and minorities for all open board seats and the CEO position, a hiring initiative modeled after the NFL's "Rooney Rule."

Under the Illinois law, no later than January 1, 2021, all public companies with their executive office in Illinois must include diversity information in their annual reports. The disclosure must include the self-identified gender of each board member and state whether each member self-identifies as a minority person. If a director self-identifies as a member of a minority group, the corporation must also disclose the director's race or ethnicity.

The enacted law completely replaces the draft as introduced, which would have required each corporation to have at least one female and one African American director by the end of 2020 and would have imposed penalties for noncompliance modeled after California's law.

The California law, which requires that each public company headquartered in California have at least one to three female directors, has faced criticism and a legal challenge to its constitutionality. SEC Commissioner Hester Peirce said that its requirements amount to "an improper federalization of corporate governance," increase costs to public companies, and may unintentionally signal that

 ©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

corporations will not recruit female directors unless required to do so. Institutional Shareholder Services, however, predicted that California's law could lead to a 22 percent increase of female directorships nationwide.

Illinois' lighter approach, which focuses on disclosure rather than quotas, may presage a trend towards pressuring companies to improve diversity through disclosure rather than outright mandates. Lawmakers believe that the bill will further efforts toward more diverse boards without imposing specific board-composition requirements. Senator Christopher Belt said that the law will help "pinpoint the corporations who aren't diversifying. Illinois is a very diverse state, and boards should reflect the diversity of its employees, consumers and community." Representative Chris Welch, who introduced the bill, said that he is also looking into similar legislation for "private companies that do public business."

Pressure to improve board diversity is also increasing from institutional shareholders. In October, New York Comptroller Scott Stringer announced that his office will urge companies to adopt a version of the NFL's Rooney Rule, which requires team management to interview diverse candidates for coaching and front-office positions. Stringer said companies should emulate this hiring policy by considering women and minorities for all open board seats and for the role of CEO.

In announcing the initiative, Stringer published a letter his office sent to 56 S&P 500 companies that have not disclosed Rooney Rule-compliant policies on gender and racial diversity. The letters, exemplified by one sent to The Kraft Heinz Company, call on public companies to include qualified women and racially/ethnically diverse candidates on lists of new management-backed nominees for director and CEO. The letters also urge companies to apply the comptroller's version of the Rooney Rule to their outside consultants who conduct searches for directors and executives.

Moreover, the letters ask companies to include director candidates with non-traditional backgrounds (e.g., government, non-profit, or academic). The letters said that too often companies abide by a policy of recruiting only directors with prior board or C-suite experience, a practice that can limit the pool of candidates from which a company can select new board members. A related issue, the letters noted, is the "over boarding" of the comparatively small number of women and minority director candidates who do possess prior board or C-suite experience. The letters also cited a report by Russell Reynolds suggesting that companies with boards that have women and minority members tend to have more women and minorities in their C-suites.

According to the letters, the purpose of a public-company Rooney Rule is to create opportunity. "It does not dictate who should be hired and does not mandate an outcome. It does[,] however, widen the talent pool and require the inclusion of a diverse set of candidates for consideration." The letters cited reports by McKinsey and MSCI that suggest diversity can drive public company performance while potentially lessening the risks posed by corporate activities that may involve criminal or fraudulent conduct. The letters also suggested that diversity in the boardroom and in the C-suite can lessen the risk of "groupthink," in which a group of people with like beliefs may overlook risks because of their inability to question their own assumptions.

©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

Moreover, business industry groups have advocated for board diversity. The NYC Comptroller's letters, for example, invoked the Principles of Corporate Governance published by the Business Roundtable. The BRT recently published another statement describing the purpose of a corporation as including "diversity and inclusion, dignity and respect" for employees as part of a shift away from shareholder primacy.

Federal attention to ESG issues. Federal regulators and lawmakers have likewise increased their presence in the ESG debate. Although many ESG issues are within state jurisdiction—a fact that critics such as SEC Commissioner Hester Peirce cite in opposition to federal involvement—the SEC and CFTC have a say in whether and how companies make disclosures. The ESG Disclosure Simplification Act (H.R. 4329; amended version), sponsored by Juan Vargas (D-Calif), would bring Congress into the debate over ESG disclosures by requiring reporting companies to describe how they view the link between ESG metrics and long-term business strategy, as well as disclosing their process for determining how ESG metrics impact strategy.

ESG issues have become increasingly commonplace in shareholder proposals and related litigation, especially regarding environmental issues (see, e.g., lawsuits involving Exxon in federal courts in New York and Texas and in New York state court), and in SEC rulemaking petitions (see, e.g., petitions submitted August 13, 2019, and February 27, 2019). Human capital, much like the environment, has garnered increasing attention (see, e.g., SEC commissioners' views on handling Regulation S-K changes, SEC Chairman Jay Clayton's statement; and a rulemaking petition).

CFTC Commissioner Rostin Behnam has taken the lead on climate risk among the federal financial regulators, recently creating a subcommittee of the agency's Market Risk Advisory Committee devoted to reporting on such risks. Behnam's focus on climate change is widely seen as a departure from an administration that is rolling back climate-focused initiatives. He said that the volume of applications to the subcommittee indicates that the "first-of-its-kind effort is well-timed to raise awareness" and emphasized his aim "to ensure that those who are most vulnerable to the physical and transition risks associated with climate change will benefit."

In contrast, SEC Commissioner Peirce has quipped that ESG could stand for "enabling shareholder graft" and particularly called out the use of ESG scorecards and similar ratings. "We see labeling based on incomplete information, public shaming, and shunning wrapped in moral rhetoric preached with cold-hearted, self-righteous oblivion to the consequences, which ultimately fall on real people," she said in prepared remarks at the American Enterprise Institute in June. Peirce allowed that ESG issues may be relevant to a company's long-term financial value if they are financially material, but said that "the ESG tent seems to house a shifting set of trendy issues of the day, many of which are not material to investors, even if they are the subject of popular discourse."

However, a panel of experts at a November meeting of the SEC's Investor Advisory Committee agreed that disclosing ESG-related matters can benefit all investors, even those that are not specifically seeking that information. Some of the panelists cited a need for standardization and consistency as a reason for SEC action on ESG disclosures. Panelist Jonathan Bailey, head of ESG Investing at Neuberger Berman, described the current state of ESG disclosures by public companies as "patchy

 ©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

and inconsistent" and added that some companies have collected data privately but are wary of sharing it with investors over liability and competition concerns.

A House Financial Services subcommittee hearing earlier in the year heard diverging viewpoints on the issue. Much of the testimony centered around the E in ESG and on climate change in particular. Mindy S. Lubber, president and CEO of Ceres, said that environmental risks are very real, pointing to PG&E's bankruptcy stemming from the California wildfires. But several Republican members of the subcommittee said that the ESG Disclosure Simplification Act of 2019 would harm an already faltering IPO market.

Finally, multinational companies will also be affected by an increasing focus by international regulators on ESG matters. The European Securities and Markets Authority released its annual report on the activities of accounting enforcement officials in the European Union, who for the first time in 2018 examined non-financial information on ESG matters. European companies were required to improve their ESG and other non-financial disclosure by the amended Accounting Directive and through principles set out in ESMA's guidelines on alternative performance measures. ESMA Chair Steven Maijoor emphasized in a news release the importance of ESG information in giving investors a complete picture of a company's performance and urged companies to improve their efforts to provide high quality disclosures in this area.

II. Delaware: *Caremark*, *MFW*, and a bit of appraisal drama

Key 2019 decisions out of the Delaware chancery and Supreme Courts spotlight a continuing focus on governance and procedure. The courts continue to explore and define the contours of the *MFW* framework, which offers a way to structure a controller transaction to earn the business judgment presumption. Process is also critical in a *Caremark* claim; while such claims are usually easily defeated by companies simply by showing a board-level system of oversight, the Delaware Supreme Court held that merely reporting on general operations to the board did not constitute such a system. Finally, sale process remains an utmost consideration in appraisal cases, and while a vice chancellor seems to have heeded the Supreme Court's message after several reversals, he could not resist setting the stage for what may become further sparring in this area.

Plaintiffs pass *Caremark* hurdles. A significant decision from the Delaware Supreme Court revived a derivative plaintiff's breach-of-loyalty claim against Blue Bell directors under the notoriously difficult—but not insurmountable—*Caremark* standard. A *Caremark* claim depends on allegations that a company's board either did not have oversight systems in place or that it consciously disregarded those systems. *Caremark* claims are usually dismissed because the plaintiff must concede the existence of some board-level oversight, but in this case the plaintiff adequately pleaded that there was no such system of monitoring or reporting on food safety, an essential consideration for an ice-cream company.

The high court noted that for as much discretion as directors have to exercise their disinterested business judgment, at a minimum the board must try to put in place a reasonable system of monitoring and reporting at the board level. The complaint fairly alleged that prior to a 2015 listeria outbreak in Blue Bell ice cream, there was no board committee addressing food safety; no regular process or

©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

protocols requiring management to keep the board apprised as to food safety; and no schedule for the board to consider safety on a regular basis.

Furthermore, management knew of red or at least yellow flags preceding three customer deaths in 2015, but the board minutes revealed no evidence that these warning signs were disclosed to the board. The minutes were devoid of any suggestion that the board regularly discussed food safety. The complaint also alleged that the FDA had identified systematic deficiencies in all of Blue Bell's plants that might have been rectified had there been a reporting system requiring management to relay this information to the board on an ongoing basis.

The court rejected the directors' counterargument that there was an oversight system by way of Blue Bell's compliance with FDA and state regulatory requirements for food safety, issuance of employee manuals addressing safety practices, and commissioning of occasional audits. The fact that Blue Bell as a company may have had these efforts in place did not imply that the board implemented a monitoring system at the board level.

The directors' argument that management reported to the board on operational issues was "telling." The court explained that *Caremark* claims are usually dismissed because the plaintiffs must concede the existence of board-level systems of oversight such as a relevant committee, a regular reporting protocol, or the use of third-party monitors. If the fact that management discussed general operations with the board were enough to thwart a *Caremark* claim, it would render the doctrine a "chimera," as management is likely to touch on an operational issue at any board meeting of any company. "If *Caremark* means anything, it is that a corporate board must make a good faith effort to exercise its duty of care," the court wrote. The plaintiff adequately pleaded that there was no board-level system of overseeing the "mission critical" issue of food safety. (*Marchand v. Barnhill*, June 19, 2019, Strine, L.).

Another *Caremark* claim survived a motion to dismiss later in the year. The Chancery Court held that, for purposes of a motion to dismiss, a shareholder derivative complaint sufficiently pleaded that Clovis Oncology, Inc.'s board consciously disregarded red flags about the conduct of a drug trial while also acquiescing in the company's public reporting of the inflated results of the drug trial.

With respect to the first *Caremark* prong, the court concluded that an allegation that Clovis lacked any oversight systems could not succeed. The court explained that Clovis did have relevant board committees that engaged in general oversight of the company.

But as to the second *Caremark* prong, the court said the complaint painted a picture of a board that consciously disregarded red flags about Clovis's conduct of the drug trial. Specifically, the court noted efforts by the company to repeatedly deviate from well-established drug trial procedures common in the industry as well as to flout FDA regulations. According to the court, the plaintiffs pleaded "serial non-compliance" with drug trial standards by Clovis that would result in the company's failure to obtain FDA approval of its drug and spark a stock sell-off that would harm its shareholders. (*In re Clovis Oncology, Inc. Derivative Litigation*, October 1, 2019, Slights, J.).

©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

Finally, the Chancery Court rejected Facebook's contention that the court should decide the merits of a *Caremark* claim before allowing the plaintiff access to the company's books and records. The shareholder requested the books to investigate wrongdoing by the Facebook board in connection with the Cambridge Analytica data breach. The preponderance of the evidence presented at trial provided a credible basis to infer the board and Facebook senior executives failed to oversee Facebook's compliance with an FTC consent decree and its broader efforts to protect the private data of its users. Furthermore, as a matter of law, the court need not adjudicate the merits of the plaintiff's *Caremark* claim before allowing an otherwise proper demand for inspection to stand. According to the court, a *Caremark* claim does not license the court to alter the minimum burden of proof governing a stockholder's qualified right to inspect books and records. (*In re Facebook, Inc. Section 220 Litigation*, May 30, 2019, Slights, J.).

Delaware courts continue to explore the features and pitfalls of *MFW*. Under the *MFW* framework, so called after the roadmap set forth by the Delaware Supreme Court in *Kahn v. M&F Worldwide Corp.* (2014), controlling stockholders can secure business judgment deference over a transaction by securing the approval of both a properly empowered, independent committee and an informed, uncoerced majority of minority stockholders. In *MFW*, a case of first impression, the Supreme Court likened this "dual protection" structure to an arm's-length transaction under Section 251 of the Delaware General Corporation Law.

The contours of *MFW* were tested in 2019, along with the pitfalls of failing to avail oneself of its benefits. First, in April the Supreme Court reversed in part a chancery decision based on an intervening opinion interpreting *MFW*. The Chancery Court had dismissed a complaint alleging that oil and gas companies and their executives caused stockholders to approve an unfair transaction based on a misleading proxy statement. According to the Chancery Court, the business judgment rule applied because the transaction between Bold Energy and Earthstone Energy was structured to comply with *MFW* once an offer was submitted.

However, while the matter was on appeal, the Delaware Supreme Court held in *Flood v. Synutra International, Inc.* that, to invoke the *MFW* protections in a controller-led transaction, the controller must "self-disable" using the *MFW* conditions prior to the start of "substantive economic negotiations." The court noted that *MFW* protections will not result in dismissal in connection with the business judgment rule when a complaint has adequately pleaded facts supporting a reasonable inference that the procedural protections were not put in place early and before the commencement of substantive economic negotiations. In the Bold/Earthstone transaction, the *MFW* protections and the involvement of the special committee were not in place until almost eight months into substantive economic dealings and negotiations, the court reasoned.

"MFW protections must be established 'up front' if they are to serve as a 'potent tool to extract good value for the minority,'" the court stated, and *Synutra* clarified that *MFW* is not satisfied if a controller has not accepted that a transaction will not move forward without special committee and disinterested stockholder approval "early in the process and before there has been any economic horse trading." (*Olenik v. Lodzinski*, April 5, 2019, Seitz, C.).

©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

Later in the year, a case involving Elon Musk's executive compensation package raised a what-if scenario involving the *MFW* framework. In a matter of first impression, the Chancery Court held that Musk's status as Tesla's controller subjected his compensation plan to entire fairness review rather than the deferential business judgment standard. The court did, albeit in dicta, also extend the rationale of *M&F Worldwide* as a framework for how a board can structure a controller's compensation package to earn the business judgment presumption.

Musk argued against extending the application of *MFW* beyond the context of a squeeze-out merger, observing that the framework mimics Section 251 and is irrelevant to transactions where approval is not required at both the board and stockholder levels. The court rejected this "statutory symmetry" argument. But the Chancery Court reasoned that, while nothing in *MFW* suggests the Supreme Court intended to hold that the dual protections are required in all controlling stockholder transactions to trigger business judgment review, the protections can still provide useful safeguards in other situations. If the Tesla board had, at the outset of the compensation negotiations, ensured that both an independent compensation committee and the minority stockholders were able to make an informed review of the award, followed by an uncoerced approval, this would have "abated the Court's reflexive suspicion of Musk's coercive influence over the outcome" and triggered business judgment review at the pleadings stage. (*Tornetta v. Musk*, September 20, 2019, Slights, J.).

Finally, in December, a company's failure to employ the *MFW* framework worked in favor of a shareholder seeking to inspect the company's books to investigate wrongdoing. The CBS shareholder was challenging the company's merger with Viacom, which closed soon after. One of the factors leading the Chancery Court to find a credible basis for the inspection was CBS's decision to pass up the opportunity for business judgment deference by allowing unaffiliated stockholders to vote on the merger. This choice looked "suspicious" in the context of an inspection demand proceeding. While the failure to follow *MFW* would not suggest a credible basis by itself, it can contribute to a showing of a credible basis. (*Bucks County Employees Retirement Fund v. CBS Corporation*, November 25, 2019, Slights, J.)

Chancery court heeds high court appraisal decisions. In recent years, the Delaware Supreme Court has stressed the importance of deal price as a factor in appraising a corporation in connection with a merger or other transaction. 2019 saw the third entry in a trilogy of such cases with the court's reversal of a Chancery Court appraisal opinion. In *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, April 16, 2019, the high court found that the Court of Chancery abused its discretion by valuing Aruba Networks by its stock price rather than the deal price minus synergies. Hewlett Packard acquired Aruba Networks in 2015.

In his appraisal opinion, Vice Chancellor Laster posited three valuation options: (1) the deal price ($24.67); (2) the deal price minus synergies ($18.20); or (3) the unaffected market price ($17.13). The court declined to rely on the DCF analysis, which pitted experts representing the dissenters ($32.57) against those for Aruba Networks ($19.77). Significantly, the court also rejected the deal price minus synergies standard because it is prone to human error and may include elements to which the dissenters would not be entitled. Ultimately, the vice chancellor decided that the best indicator of value was Aruba Networks' unaffected market price.

 ©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

In reaching this conclusion, the court emphasized that it was not saying that the Supreme Court's 2017 appraisal reversals—*Dell* and *DFC Global*—mean that market price is the standard for fair value; the court was merely saying the unaffected market price was the best indicator of fair value in this case.

On the contrary, however, the high court has repeatedly emphasized the importance of deal price in an appraisal action, and it did so again in reversing the Chancery Court's appraisal of Aruba Networks. In a valuation case, the Supreme Court wrote, a court must value a company "as an operating entity . . . but without regard to post-merger events." In cases where a court has used the price at which a company is sold in a third-party transaction, it has excised a reasonable estimate of whatever share of synergy or other value the buyer expects from changes it plans to make to the company's "going concern" business plan that has been included in the purchase price as an inducement to the sale.

Here, the Court of Chancery abused its discretion in using Aruba Networks' "unaffected market price" because it did so on the incorrect theory that it needed to make an additional deduction from the deal price for unspecified "reduced agency costs." According to the Supreme Court, the price that HP paid was a better assessment of Aruba Networks' going-concern value for reasons consistent with corporate finance theory. The Supreme Court opined that the lower court injected due process and fairness problems into the proceedings.

The high court in its *per curiam* opinion also took note of the overall tone of the Vice Chancellor's opinion and interpreted his desire not to award deal price minus synergies as a bid to generate an odd result compelled by his personal frustration at having been reversed in *Dell*.

Following the *Aruba Networks* reversal, Vice Chancellor Laster issued another appraisal opinion, this time ruling that the deal price was the best evidence of the fair value of Columbia Pipeline Group just before its 2016 acquisition by TransCanada Corporation (*In re Appraisal of Columbia Pipeline Group, Inc.*, August 12, 2019). And ten days later, he appraised Stillwater Mining Company at the deal price as well. The weighty *Columbia Pipeline* opinion goes to some lengths to shore up its analysis to withstand an appeal to the Supreme Court. In upholding the deal price, the Chancery Court cites heavily from the Supreme Court's appraisal trilogy of *Dell*, *DFC*, and *Aruba Networks*, comparing the facts in the Columbia transaction with the facts and factors set forth in those opinions.

First, the court examined the Supreme Court's findings that "objective indicia" of the fairness of the deal price outweighed shortcomings in the sale processes. This factor favored the deal price. The court next seriously considered, but ultimately rejected, the petitioners' attacks on the sale process. The court concluded that deal protections did not undermine the sales process according to the Supreme Court precedents because they would pass muster under enhanced-scrutiny review in a breach of fiduciary duty case. *Aruba Networks* involved a similar array of deal protections, and the Supreme Court found that potential buyers had an open chance to bid.

Finally, the sale process, while not perfect, was, on a whole, at least on par with the facts in *DFC*, *Dell*, and *Aruba Networks*. The Vice Chancellor said, however, that he does not read those cases as establishing minimum requirements for deal price to be afforded weight: "The decisions did not address when a sale process would be sufficiently bad that a trial court could give the deal price no weight. The

©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

decisions also did not address when a sale process that was not as good would still be good enough for a trial court to give the deal price weight. Technically, the holdings did not delineate when a sale process was sufficiently good that the trial court should give it heavy if not dispositive weight."

This last note could be seen as provocative given the tension between the Vice Chancellor and the high court on the topic of the appraisal reversals. The Chancery Court also left its opinion vulnerable by declining to adjust the deal price downward for synergies, finding that TransCanada failed to meet its burden of proving its assertion that the deal price included synergies worth $4.64 per share. *Aruba Networks* was issued *per curiam*, obscuring its authorship, and the high court recently saw personnel changes with the retirement of Delaware Chief Justice Strine and the appointment of Vice Chancellor Tamika Montgomery-Reeves to the court. It remains to be seen whether the sparring will continue or if the new court will let it fizzle out in the new year.

III. Delaware fills high court seats, but will federal case imperil centrist reputation?

The history of Delaware corporate law can be defined by the several periods in which significant developments are strongly associated with individual judges. This past year, judges associated with two of those periods generated sadness and surprise; the individuals were former Chancellor William T. Allen and Chief Justice Leo E. Strine, Jr. Both jurists broke new ground in Delaware corporate law, the former for explaining why it is so difficult to hold derelict boards accountable, the other for expanding use of the business judgment rule. This past October, the Delaware bar paused to remember Allen, who passed away at the age of 75. Meanwhile, Chief Justice Strine announced plans to retire from the state's Supreme Court by the end of October after holding the job of chief justice for five years; Strine had previously served on the Chancery Court for many years, including as chancellor.

Following Strine's departure, Delaware Governor John Carney nominated then-Associate Justice Collins J. Seitz, Jr. to be chief justice and, to fill the seat left open by Seitz's promotion, then-Vice Chancellor Tamika Montgomery-Reeves to be Delaware's first African American and third woman Supreme Court justice. Seitz and Montgomery-Reeves were confirmed by Delaware's Senate in early November. Seitz was sworn in on November 8, 2019; Montgomery-Reeves was sworn in on December 5, 2019. As of publication, Montgomery-Reeves's seat on the Chancery Court remained open.

Moreover, at a time of significant personnel changes, Delaware's method of selecting judges has come under renewed scrutiny. Delaware's governor recently directed the state to ask the U.S. Supreme Court to review a federal appeals court opinion holding that the state's judicial balancing method that focuses on a judge's political affiliation with one of two major political parties violated the First Amendment. The Supreme Court has since agreed to hear the case.

The passing of Chancellor Allen. Allen's time on the Delaware judiciary ended years ago, but his opinions for the Chancery Court live on in opinions written by his successors, who quote him at length, because often there is no better way to state or explain a key corporate law principle than to quote Allen. Allen will perhaps be remembered most for his adage that the *Caremark* claim is one of the hardest claims to plead.

©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

In *Caremark*, Chancellor Allen articulated a standard of board conduct, later enshrined in Delaware case law by the state's Supreme Court in *Stone v. Ritter*, centered around the notion that corporate directors may be held liable for egregious company conduct if either there were no internal controls for monitoring the company's behavior or the company's board ignored them. Writing in *Caremark*, Allen suggested the standard was "quite high" while explaining that a "demanding test" is needed to serve the twin goals of attracting qualified directors and holding them accountable. Delaware courts historically have routinely dismissed *Caremark* claims, but Delaware courts recently have experienced a revival of sorts, with the Delaware Supreme Court (*Marchand v. Barnhill*) and the Chancery Court (*In re Clovis Oncology Inc. Derivative Litigation*) both finding *Caremark* claims were adequately pleaded.

After leaving the bench, Allen had a lengthy second career in academia and private practice. Chancellor Allen was a graduate of the University of Texas Law School and was in private practice both before (at Morris, Nichols, Arsht & Tunnell) and after (at Wachtell, Lipton, Rosen & Katz) his service on the Chancery Court. He completed his undergraduate work at New York University and would return to NYU as a professor and as founding director of the NYU Pollack Center for Law & Business. Moreover, Allen, along with Reinier H. Kraakman of Harvard Law School, co-authored the Wolters Kluwer publication *Commentaries and Cases on the Law of Business Organization*, 5th Edition (2016).

Chief Justice Strine retires. Chief Justice Strine's retirement leaves an opening for a new public intellectual on the Delaware judiciary, an informal role beyond that of chief justice, although there are a few obvious candidates. Strine became a Vice Chancellor of the Delaware Court of Chancery in 1998, was elevated to Chancellor in 2011, and became Chief Justice in 2014. Strine has been the subject of controversy during his 21 years on the Delaware bench for his outspoken personal comments, his numerous non-judicial writings, and sometimes for his court opinions. Strine has also sat on both sides of disagreements between Chancery Court judges and the Delaware Supreme Court.

Governor Carney said Strine was "one of Delaware's top legal minds." Strine also drew praise from SEC Chairman Jay Clayton and SEC Commissioner Robert Jackson, the latter remarking on Strine's influence in the field of corporate law: "More than that, the Chief Justice is an intellectual leader, on the cutting edge of how best to protect the American families who rely upon our companies to build a sustainable future." That is a theme on which several of Strine's more recent extra-judicial writings focused, especially regarding the influence (or sometimes lack of influence) of the big four fund complexes on corporate governance and how those funds' decisions impact ordinary investors. Some of Strine's ideas also can be found in aspects of proposed federal legislation, for example, the Accountable Capitalism Act (H.R. 7294; S. 3348), originally sponsored in the last Congress by Sen. Elizabeth Warren (D-Mass), and the Shareholders United Act (H.R. 936), sponsored by Rep. Jamie Raskin (D-Md), which was included in the For The People Act (H.R. 1), which passed the House in March 2019 by a vote of 234-193. Business Roundtable also recently issued a statement that incorporates some themes Strine has written about.

Strine will be remembered for many of his opinions, but perhaps he will be best remembered for having set the stage for an expansion of the business judgment rule in cases where the entire fairness standard of review would typically apply. One can see Strine taking the first steps in this direction in his opinion in the *Southern Peru Copper* case, where he detailed the Delaware judiciary's

©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

long-running frustration with controlling stockholders. But it would be Strine's opinion in *M&F Worldwide*, and the Delaware Supreme Court's endorsement of that opinion, that set a new standard by which a controlling stockholder can disable herself before substantive economic negotiations begin and, thus, preserve the applicability of the business judgment rule if the transaction is later challenged in court.

The role of Delaware Chancellor and Vice Chancellor can occasionally pit lower court judges against the Delaware Supreme Court. Strine would find himself on both sides of such disputes during his tenure on the state judiciary. In one case, the Supreme Court would chide then-Vice Chancellor Strine in a *per curiam* opinion for his "excursus" on the existence of "default" fiduciary duties under Delaware's LLC statute. As Chief Justice, Strine would be part of a *per curiam* opinion chiding Vice Chancellor J. Travis Laster for having engaged in a similar adventure regarding valuation methods in an appraisal case.

Lastly, *Caremark* may be a fitting bridge between Allen, Strine, and Seitz because it provides an example of when Strine and Seitz found themselves on opposite sides of a case as members of the state Supreme Court (Strine, via footnote, would characterize it as a "good faith disagreement"). The case also suggests that the resurgence in *Caremark* claims still has serious limits. In *City of Birmingham Retirement and Relief System v. Good*, shareholders claimed that Duke Energy's board failed to oversee the company when the company allegedly polluted a river with toxic coal ash. Chief Justice Strine explained his dissent thus: "I do so because I find that the facts pled raise a pleading stage inference that it was the business strategy of Duke Energy, accepted and supported by its board of directors, to run the company in a manner that purposely skirted, and in many ways consciously violated, important environmental laws." Then-Justice Seitz, writing for the majority, emphasized in a pair of footnotes how the majority believed Strine had overlooked what was known (or not known) to Duke Energy's directors. Said Seitz: "As we have shown, based on the specific arguments raised on appeal, the plaintiffs have not demonstrated a pleading stage reasonable inference that those directors knew Duke Energy was violating the law *and* knew from the information presented to the board that the Company ignored the violations" (emphasis in the original).

In many other cases Strine and Seitz would find themselves on the same side, including as the dissenters in one of Delaware's more controversial non-corporate law cases in which a majority of the Delaware Supreme court held that state officials could not ban the possession of firearms in state parks and forests. In *Bridgeville Rifle & Pistol Club, Ltd. v. Small*, Justice Karen Valihura wrote for the majority and emphasized that Delaware's constitutional provision on firearms is broader than the U.S. Constitution's Second Amendment; the majority also emphasized the U.S. Supreme Court's opinions in *Heller* and *McDonald*. Meanwhile, the dissent, written by Strine and joined by Seitz, emphasized that Delaware's amended constitutional provision was not intended to reverse the state's existing regulations banning firearms in public areas. In another contentious case, *Rauf v. State*, Seitz joined a majority *per curiam* opinion answering five questions certified to it by the Delaware Superior Court and finding that the state's death penalty statute violated the Sixth Amendment to the U.S. Constitution regarding the role of juries. The opinion produced four separate opinions, including concurrences by Strine and former Justice Randy J. Holland, both of which Seitz joined.

 ©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

Seitz becomes chief justice. Chief Justice Seitz, perhaps in a nod to how he plans to conduct himself in his new role, opted for a small swearing-in ceremony in contrast to what a Delaware Supreme Court press release called "the usual, large investiture." As an associate justice, Seitz often wrote corporate law opinions for a unanimous court or for sizeable majorities in those cases requiring something more than a brief order or summary affirmance of the Chancery Court. A few cases provide some insight into Seitz's thinking on corporate law issues, in addition to the Duke Energy case discussed above.

In *Olenik v. Lodzinski*, for example, Seitz wrote for a unanimous court that partially reversed a Chancery Court opinion because a controller did not put into place the M&F Worldwide protections before substantive economic negotiations began per the *Synutra* opinion, which the Delaware Supreme Court had not yet decided when the vice chancellor dismissed the complaint. In other respects, the Chancery Court opinion still provides insight into how a court chooses between the entire fairness standard of review and the business judgement rule review allowed by *M&F Worldwide* and the *Corwin* cleansing approaches.

With respect to executive compensation, Seitz again wrote for a unanimous court in *In re Investors Bancorp, Inc. Stockholder Litigation*, reversing a Chancery Court opinion that had found shareholders ratified an award of company stock by the company's directors to themselves under an equity incentive plan. The equity incentive plan gave the directors discretion to award themselves up to 30 percent of eligible stock. The Supreme Court reversed because the complaint stated a pleading stage claim that the directors' excessive awards to themselves breached their fiduciary duties such that the directors could not assert the affirmative defense of shareholder ratification.

In the long-running *Shawe v. Elting* litigation over the fate of TransPerfect Global, Inc., the Supreme Court per Seitz's majority opinion upheld the Chancery Court's order appointing a custodian to sell the solvent and profitable company where a "lengthy and seriously dysfunctional relationship between the owners" resulted in deadlock (the court separately and unanimously upheld sanctions against one of the litigants). The majority emphasized that 8 Del. C. §226 interpretation issues had been raised for the first time on appeal and that the Chancery Court had carefully evaluated the matter before ordering the appointment of a custodian. Justice Valihura dissented because, in her view, the majority's interpretation of 8 Del. C. §226 was too expansive and gave too little weight to a property rights theory and due process concerns. Valihura also questioned whether there was any Delaware precedent for ordering the sale of a company over stockholders' objections. The Supreme Court later affirmed the Chancery Court's subsequent approval of the sale of the company, although Justice Valihura concurred in that order because the prior Supreme Court opinion was the law of the case while she continued to assert the objections stated in her prior dissent.

Seitz has also written for the court in a number of cases involving master limited partnerships and LLCs. In *Culverhouse v. Paulson & Co.*, for example, Seitz wrote an opinion answering in the negative the following question certified by the U.S. Court of Appeals for the Eleventh Circuit: "Does the diminution in the value of a limited liability company, which serves as a feeder fund in a limited partnership, provide a basis for an investor's direct suit against the general partners when the company and the partnership allocate losses to investors' individual capital accounts and do not issue transferrable shares and losses are shared by investors in proportion to their investments?" The

©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

question raised the possibility of tension between the Delaware Supreme Court's *Tooley* opinion and the Chancery Court's *Anglo American* opinion. Seitz wrote for the court that under the undisputed facts as gleaned by the court (the parties had not offered stipulated facts per Delaware Supreme Court rule), the plaintiff's claims were derivative because it had invested indirectly via a feeder fund and, thus, failed both prongs of *Tooley*. Seitz concluded that *Anglo American* was factually distinguishable because the plaintiff there had invested directly in a fund. Seitz's opinion also emphasized that Delaware courts take corporate form and related formalities seriously.

Seitz has not been a prolific author of dissenting opinions during his tenure on the Supreme Court, but one of them involving a merger suggests how he applies principles of contract interpretation. In *Shareholder Representative Services LLC v. Gilead Sciences, Inc.*, Seitz, joined by Justice Gary F. Traynor, dissented from a Supreme Court order affirming a Chancery Court determination that a milestone payment regarding a drug approval was not due. Seitz and Traynor would have found the milestone payment was due based on the plain meaning of "disease" as that word was used in a schedule to the merger agreement.

Seitz joined the Delaware Supreme Court as an associate justice in 2015 after spending decades in private practice at Connolly Bove Lodge & Hutz and, more recently, at the firm he co-founded, Seitz, Ross, Aronstam & Moritz LLP. He has an undergraduate degree from the University of Delaware and a law degree from Villanova University School of Law.

In 2008, while in private practice at Seitz, Ross, Aronstam & Moritz LLP, Seitz was part of a team of lawyers who successfully represented Delaware before the U.S. Supreme Court in an original jurisdiction case that resolved the disputed state boundaries for a portion of the Delaware River. Delaware believed that a proposed liquified natural gas terminal extending from the New Jersey shore would infringe on Delaware's waters as defined by a compact between the two states (See *New Jersey v. Delaware,* 552 U.S. 597 (2008).

The Delaware Supreme Court's announcement of Seitz's swearing in also noted that Seitz comes from a family with a long tradition of service on Delaware's state and federal judiciary. Seitz's father, Collins J. Seitz, Sr. (1914-1998), was Chancellor of the Court of Chancery and a "judge" of the Delaware Supreme Court when Chancery and Superior Court judges composed the state's Supreme Court. The elder Seitz also was Chief Judge of the U.S. Court of Appeals for the Third Circuit.

During his tenure as Chancellor, the elder Seitz would hold in two school segregation cases that school facilities for African American students were substantially inferior to those for white students. The elder Seitz also recognized the limits of the state court: "I believe the 'separate but equal' doctrine in education should be rejected, but I also believe its rejection must come from that court [i.e., the U.S. Supreme Court]," said Chancellor Seitz (See *Belton v. Gebhart*, 32 Del. Ch. 343 (1952). The Delaware Supreme court decision upholding Chancellor Seitz's ruling (see *Gebhart v. Belton*, 91 A.2d 137 (1952)) would become the only case upheld by the U.S. Supreme Court in the landmark opinion in *Brown v. Board of Education*, 347 U.S. 483 (1954). There, the U.S. Supreme Court explained that the Delaware Supreme Court had followed the "separate but equal" doctrine while

©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

simultaneously finding that African American students should be admitted to white schools because those schools were superior to the African American schools.

Montgomery-Reeves makes Delaware history. Associate Justice Montgomery-Reeves is the first African American and third woman to serve on the Delaware Supreme Court. Prior to becoming a vice chancellor in 2015, Montgomery-Reeves's private practice focused on corporate governance, business litigation, and securities litigation at Wilson Sonsini Goodrich & Rosati (Wilmington, Delaware) and at Weil Gotshal & Manages (New York City). Montgomery-Reeves completed her undergraduate work at the University of Mississippi and is a graduate of University of Georgia Law School.

Montgomery-Reeves addressed a range of corporate law issues in the roughly 340 opinions she wrote as a vice chancellor, including controlling shareholders, master limited partnerships, advancement of legal fees, books and records, LLC default fiduciary duties (citing opinions by then-Vice Chancellor Strine), and numerous cases asking whether demand was excused. From among these opinions, a few stand out.

In *In Re Hansen Medical, Inc. Stockholders' Litigation*, Montgomery-Reeves found that, for purposes of a motion to dismiss decided under the standard that a case is dismissed only if a plaintiff cannot show a reasonably conceivable basis for recovery, minority shareholders adequately alleged the presence of a control group and, thus, the merger must be reviewed under the entire fairness standard. The minority shareholders and the alleged control group urged opposing views of *Frank v. Elgamal* (Del. Ch. 2012); the alleged controllers argued that that case did not directly address the control issue while the minority shareholders said it adequately covered the topic. Montgomery-Reeves was persuaded that, at the early stages of *Hansen Medical*, a control group existed because multiple shareholders had a long history of investing together, only the controllers could negotiate directly with the acquiring company, the controllers had irrevocable proxies and voting agreements to support the merger, the acquiring company had stock purchase agreements with the controllers but not with the minority shareholders, and the controllers' shares of the acquired company would be converted to preferred stock in the acquiring company. Montgomery-Reeves also found the alleged breaches of fiduciary duty by the controllers were non-exculpated, although she dismissed an aiding and abetting claim against the acquiring company.

Montgomery-Reeves also addressed the issuance of stock in several opinions. In *Applied Energetics, Inc. v. Farley*, she granted a corporation's request for a preliminary injunction to stop a former director of a shell company from selling company stock the director had issued to himself as the lone remaining director after the other two directors had resigned, one of them in protest of the stock sale. The board had never been reduced from three to one and the director receiving the stock had valued the stock at a low price despite higher valuations suggested by others. In *Henry v. Phixios Holdings, Inc.*, Montgomery-Reeves found that a shareholder did not have actual knowledge of a stock transfer restriction, nor did the shareholder assent to the purported restriction after buying the company's stock. The shareholder had alleged wrongdoing as the basis for a related books and records demand, while the company had asserted that the shareholder violated the stock transfer restriction by competing with the company. Lastly, in *Williams v. Ji*, Montgomery-Reeves applied the entire fairness standard (i.e., fair dealing and fair price), at least at the motion to dismiss stage, to directors'

©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

self-interested grant of stock options to themselves from multiple subsidiaries following the transfer of assets from the parent company to the subsidiaries. Montgomery-Reeves cited an opinion written by former Chancellor Allen regarding her discussion of the excessive nature of one of the grants.

In the *Caremark* setting, in *In re Qualcomm Inc. FCPA Stockholder Derivative Litigation*, Montgomery-Reeves found demand was not excused regarding allegations that Qualcomm's board breached its fiduciary duties by engaging in bad faith by failing to respond to red flags about FCPA and federal securities violations. Montgomery-Reeves distinguished cases like *Massey Energy*, in which a company executive believed he was more knowledgeable about safety than government regulators. With respect to the role of the FCPA, Montgomery-Reeves added: "A corporation's violation of the FCPA alone is not enough for director liability under *Caremark*. ... Delaware law, not the FCPA, establishes the standard for director liability, and under Delaware law, Plaintiffs' Complaint does not allege bad faith."

U.S. Supreme Court to hear Delaware judge selection case. The U.S. Supreme Court agreed to hear a case later this term that calls into question the constitutionality of Delaware's judicial selection methods requiring political balance on the state's courts. Governor Carney explained the state's decision to appeal a decision by the Third Circuit finding these methods unconstitutional thus: "Delaware's judiciary has a longstanding reputation as objective, stable, and nonpartisan." Upon hearing of the certiorari grant, Carney said via press release: "I believe it's more important than ever to protect Delaware's appointment process from the partisan infighting that has come to characterize the federal appointment process."

The Supreme Court will address the two questions presented by Delaware's certiorari petition, plus a third question posed by the court upon granting certiorari regarding whether the respondent/appellee, James Adams, has Article III standing. Randy J. Holland, senior of counsel at Wilson Sonsini Goodrich & Rosati, PC and a former Delaware Supreme Court justice, was one of several lawyers who drafted Delaware's certiorari petition. The two substantive questions are:

- Does the First Amendment invalidate a longstanding state constitutional provision that limits judges affiliated with any one political party to no more than a "bare majority" on the State's three highest courts, with the other seats reserved for judges affiliated with the "other major political party"?

- Did the Third Circuit err in holding that a provision of the Delaware Constitution requiring that no more than a "bare majority" of three of the state courts may be made up of judges affiliated with any one political party is not severable from a provision that judges who are not members of the majority party on those courts must be members of the other "major political party," when the former requirement existed for more than fifty years without the latter, and the former requirement, without the latter, continues to govern appointments to two other courts?

Adams sued Governor Carney because he believed Delaware's constitutional requirement of political balance on its judiciary would prevent Adams, a self-described progressive who was upset with Democratic party "centrism" in Delaware and who recently became a "Bernie [Sanders] independent," from obtaining a judicial appointment. Adams previously sought and was not selected for a position as Family Court Commissioner. At other times, both when Adams was still a Democrat and after he became an Independent, Adams considered, but chose not to apply for, judicial positions

©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

because the only vacancies were for Republicans. Adams successfully argued in the district court and in the Third Circuit that the Delaware constitution's political balance provisions violated his associational rights under the First Amendment.

Several amici wrote in favor of a grant because they want the Supreme Court to clarify the anti-patronage or policymaking exception that applies to hiring for certain government jobs. A group of law professors, writing as amici, supported Delaware, in part, because American dual federal-state sovereignty means that Delaware should be free to act as a "laboratory" for ordering its government as provided under the U.S. Constitution's Guarantee Clause (Art. IV, §4) and the 10th Amendment. Former Delaware Chief Justices Myron T. Steele (Democrat) and E. Norman Veasey (Republican) also urged as amici that Delaware be allowed to retain its balancing provision, as did an amici brief submitted by former Delaware Governors Michael Castle, Dale Wolf, Thomas Carper, Ruth Ann Minner, and Jack Markell (two Republicans and three Democrats). Joel Edan Friedlander, of Friedlander & Goris, P.A., who authored the law review article that, at least in part, motivated Adams to sue Delaware, was the lone amicus supporting Adams in opposing the grant of certiorari.

With respect to standing, neither Delaware nor Adams addressed the issue at length in their certiorari-stage briefing, although a footnote in Delaware's petition for certiorari noted that the Third Circuit found Adams lacked Article III standing regarding his claims about Delaware's Family Court and Court of Common Pleas, which have a bare majority requirement but not a major political party requirement (i.e., Adams could have applied for a job on these courts as an Independent). The Third Circuit's opinion noted that Delaware did not contest whether Adams had Article III standing regarding the balancing provisions for the Delaware Supreme Court, Superior Court, and Chancery Court, which the Third Circuit found to be unconstitutional. Otherwise, the cert-stage briefing by Delaware, Adams, and amici focused on the policymaking exception applied by the U.S. Supreme Court in a trio of opinions addressing political patronage.

Generally, Article III standing exists where a party has suffered an injury in fact, that is fairly traceable to the challenged conduct of the defendant (as compared to the independent action of a non-party), and it is likely the injury will be redressed by a favorable decision. The Supreme Court also has explained that an injury must address a protected interest that is concrete and particularized and actual or imminent, and not conjectural or hypothetical. Likewise, the redress of an injury must be likely and not speculative (See *Lujan* and *Spokeo*).

The district court, on motion for reconsideration, described Delaware as arguing that Adams lacked standing because he asserted a generalized grievance, but rejected Delaware's attempts to belatedly raise the issue of prudential standing (i.e., plaintiff asserts his own rights, does not present a generalized grievance, and is within the zone of interests protected by the law). Adams had argued that, regardless of Article III standing, facial challenges based on the First Amendment allow for the relaxation of prudential standing requirements regarding all of Delaware's judge selection provisions, a point the district court said Delaware failed to address. The Third Circuit affirmed that Adams had standing to challenge parts of Delaware's judge selection process, although the appeals court clarified that the district court may not "substitute" prudential standing for Article III standing. With respect to the selection process for the Delaware Supreme Court, Superior Court, and Chancery Court, for

©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

which Adams had Article III standing, the Third Circuit went on to find that Adams also would have prudential standing "because of his desire to apply for a judicial position while refraining from associating with either the Democratic or Republican parties."

The standing question raises several possibilities. For one, the court could find standing exists and then decide the validity of Delaware's state constitutional judge selection provisions and, thus, clarify application of the policymaking exception. But does the addition of the standing question signal that the court may see other issues with the case or that it intends to deliver a broader message about Article III standing?

Moreover, the court's focus on standing may raise the question of what the court will do if it concludes that Adams lacks standing. For example, the court could do something akin to what it did in a recent gerrymandering case by concluding that standing does not exist under the facts alleged but then vacate the lower court decision and remand the case, but without instructing the lower court to dismiss the case (See, e.g., *Gil v. Whitford*) (noting the court would not direct dismissal because "[t]his is not the usual case" given the "unsettled" nature of the claim's justiciability). The court in *Gil* observed: "We caution, however, that 'standing is not dispensed in gross': A plaintiff's remedy must be tailored to redress the plaintiff's particular injury" (citation omitted). Justice Thomas, joined by Justice Gorsuch, would not have deviated from the court's practice of directing dismissal where Article III standing is absent. The court later held claims similar to those presented in *Gil* to be non-justiciable political questions about the allocation of political power between the two major political parties and noted the lack of authority in the U.S. Constitution for federal courts to hear such cases and the absence of a limiting standard for evaluating gerrymanders (See, *Rucho v. Common Cause*).

Perhaps the concurrence in the Third Circuit's opinion in the Delaware case suggests the path forward if the Supreme Court finds Delaware's judge selection provisions are unconstitutional. Judge McKee, joined by Judges Restrepo and Fuentes, said he wrote separately because of his experience with state partisan judicial elections. In a footnote, Judge McKee praised the elder Judge Seitz as an example of Delaware's "judicial excellence." Then, returning to the main text of the concurrence, Judge McKee said of the "bipartisan excellence" on Delaware's judiciary: "That culture appears to be so firmly woven into the fabric of Delaware's legal tradition that it will almost certainly endure in the absence of the political affiliation requirements that run afoul of the First Amendment."

The Supreme Court had distributed Delaware's certiorari petition for conference four times before deciding to hear the case. The parties will begin submitting their merits briefs in early 2020.

IV. With new Chancery Court, Wyoming hopes to further entice corporations to the state

Finally, another state to watch in 2020 in addition to Delaware: Wyoming. The state was one of the earliest adopters of the advantages of blockchain and distributed ledger technology, having proposed or enacted multiple pieces of legislation welcoming its use in the business realm. In March 2019, Wyoming's governor signed into law a bill establishing a chancery court in the state, offering a new enticement to businesses looking to home themselves in the West.

©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.

The court will have jurisdiction over certain actions for equitable or declaratory relief or seeking money damages in excess of $50,000. The list of actions over which the court will have jurisdiction includes breach of fiduciary duty, fraud, shareholder derivative actions, violations involving the sale of assets or securities, corporate restructurings, and commercial class actions. The court will conduct non-jury trials and "limited" motions practice and may make use of alternative dispute resolution.

A committee is currently considering issues related to the new court, such as how it can implement remote communication and a searchable electronic database (no word yet on whether that database will incorporate the distributed ledger technology that the state has championed).

In recent years, Wyoming has considered a series of bills designed to entice cryptocurrency and blockchain organizations to do business in the state. Of the bills signed into law, three relax Wyoming's regulations concerning cryptocurrency and two amend the state's corporation law to facilitate blockchain and cryptocurrency innovation and development.

In March 2018, Wyoming enacted legislation to update the state's Business Corporations Act to allow corporations to create, maintain, and store corporate records on a blockchain in order to minimize the resources expended on, and errors associated with, physical record maintenance. Specifically, the legislation authorizes corporations to use "distributed or electronic networks or databases" for records, to use data addresses associated with private keys to identify shareholders, and to accept shareholder votes if signed by a network signature corresponding with a data address. [H.B. 101, 64th Leg., Budg. Sess. (Wyo. 2018).]

In February 2019, the governor of Wyoming signed legislation establishing that open blockchain tokens with specified consumptive characteristics are intangible personal property and not subject to a securities exemption. The act also requires developers and sellers of open blockchain tokens to file notices of intent and fees with the secretary of state and makes certain specified violations unlawful trade practices. [S.B. 62, 65th Leg., 2019 Gen. Sess. (Wyo. 2019).] Under separately passed legislation, the Wyoming Secretary of State is authorized to develop and implement a blockchain filing system for required filings. The secretary of state may create a blockchain for this purpose or contract for the use of a privately created blockchain. [S.B. 70, 65th Leg., 2019 Gen. Sess. (Wyo. 2019).]

These overtures to corporations are now complemented by the establishment of the new chancery court, which will continue to take shape in 2020 and beyond. The state Supreme Court will establish the rules of the chancery court, and judge positions will initially be filled by retired Supreme Court or district court judges or by a panel of up to five active district court judges. Beginning in 2022, however, judgeships will be filled through Wyoming's judicial selection process. The court's location is yet to be determined.

©2020 CCH Incorporated and its affiliates. All rights reserved. Reprinted with permission from Securities Regulation Daily.