The Corporate Governance Review

Ninth Edition

Editor
Willem J L Calkoen

The Law Reviews

THE CORPORATE GOVERNANCE REVIEW

NINTH EDITION

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Willem J L Calkoen

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Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK

www.TheLawReviews.co.uk

ISBN 978-1-83862-015-8

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

A&L GOODBODY

ADVOKATFIRMAET BAHR AS

ALLEN & GLEDHILL

BHARUCHA & PARTNERS

BREDIN PRAT

THE DELAWARE COUNSEL GROUP LLC

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PREFACE

I am proud to present this new edition of *The Corporate Governance Review* to you.

In this ninth edition, we can see that corporate governance is becoming a more vital and all-encompassing topic with each year that passes. We all realise that the modern corporation is one of the most ingenious concepts ever devised. Our lives are dominated by corporations. We eat and breathe through them, we travel with them, we are entertained by them, most of us work for them. Most corporations aim to add value to society, and they very often do. Some, however, are exploiting, polluting, poisoning and impoverishing us. A lot depends on the commitment, direction and aims of a corporation's founders, shareholders, boards and management, and employees. Do they show commitment to all stakeholders and to long-term shareholders, or mainly to short-term shareholders? There are many variations on the structure of corporations and boards within each country and between countries. All will agree that much depends on the personalities and commitment of the persons of influence in the corporation.

We see that everyone wants to be involved in better corporate governance: parliaments, governments, the European Commission, the US Securities and Exchange Commission (SEC), the Organisation for Economic Co-operation and Development (OECD), the UN's Ruggie reports, the media, supervising national banks, more and more shareholder activists and other stakeholders. The business world is getting more complex and overregulated, and there are more black swans, while good strategies can quite quickly become outdated. Most directors are working diligently, many with even more diligence. Nevertheless, there have been failures in some sectors, so trust has to be regained. How can directors do all their increasingly complex work and communicate with all the parties mentioned above?

What should executive directors know? What should non-executive directors know? What systems should they set up for better enterprise risk management? How can chairs create a balance against imperial CEOs? Can lead or senior directors create sufficient balance? Should most non-executive directors understand the business? How much time should they spend on their function? How independent must they be? What about diversity? Should their pay be lower? What are the stewardship responsibilities of shareholders? What are the pros and cons of shareholder rights plans and takeover defences?

Governments, the European Commission and the SEC are all pressing for more formal inflexible legislative acts, especially in the area of remuneration. Acts set minimum standards, while codes of best practice set aspirational standards. We see a large influence on norms by codes and influential investor groups.

More international investors, voting advisory associations and shareholder activists want to be involved in dialogue with boards about strategy, succession and income. Indeed, far-sighted boards have 'selected engagements' with stewardship shareholders to create trust.

What more can they do to show all stakeholders that they are improving their enterprises other than through setting a better tone from the top? Should they put big signs on their buildings emphasising integrity, stewardship and respect?

Interest in corporate governance has been increasing since 1992, when shareholder activists forced out the CEO at General Motors and the first corporate governance code – the Cadbury Code – was written. The OECD produced a model code, and many countries produced national versions along the lines of the Cadbury comply or explain model. This has generally led to more transparency, accountability, fairness and responsibility. However, there have been instances where CEOs have gradually amassed too much power, or companies have not developed new strategies and have produced bad results – and sometimes even failure. More are failing since the global financial crisis than previously, hence the increased outside interest in legislation, further supervision and new corporate governance codes for boards, and stewardship codes for shareholders and shareholder activists. The European Commission is developing a regulation for this area as well. Recently, we see that governments want to involve themselves in defending national companies against takeovers by foreign enterprises. We also see a strong movement of green investors, which often is well appreciated by directors. There is a move to corporate citizenship.

This all implies that executive and non-executive directors should work harder and more as a team on long-term policy, strategy, entrepreneurship and investment in R&D. More money is lost through lax or poor directorship than through mistakes. On the other hand, corporate risk management with new risks entering such as a digitalised world and cybercrime is an essential part of directors' responsibilities, as is the tone from the top. How can directors do their important work well without being petrified of attacks from shareholders, regulations and the press?

Each country has its own measures; however, the chapters of this book also show a convergence. Understanding differences leads to harmony. The concept underlying the book is of a one-volume text containing a series of reasonably short, but sufficiently detailed, jurisdictional overviews that permit convenient comparisons, where a quick first look at key issues would be helpful to general counsel and their clients.

My aim as editor has been to achieve a high quality of content so that *The Corporate Governance Review* will be seen as an essential reference work in our field. To meet the all-important content quality objective, it was a condition *sine qua non* to attract as contributors colleagues who are among the recognised leaders in the field of corporate governance law from each jurisdiction.

I thank all the contributors who helped with this project. I hope that this book will give the reader food for thought; you always learn about your own law and best practice by reading about the laws and practices of others. Further editions of this work will obviously benefit from the thoughts and suggestions of our readers. We will be extremely grateful to receive comments and proposals on how we might improve the next edition.

Willem J L Calkoen
NautaDutilh
Rotterdam
March 2019

Chapter 27

UNITED STATES: DELAWARE

Ellisa O Habbart[1]

I OVERVIEW OF GOVERNANCE REGIME

i Sources of Delaware law

The position of Delaware law is illustrated by the fact that more than half of US public companies (including more than 66 per cent of the Fortune 500) are incorporated in the state. Delaware's corporate governance regime draws from two bodies of law. The first is the General Corporation Law of the State of Delaware (DGCL), a statutory framework adopted by the Delaware legislature in 1899, substantially revised in 1967 and regularly amended to date. Updates and revisions are made each year by the Delaware legislature based on the recommendations of the Council of the Corporation Law Section of the Delaware State Bar Association. As a result, the DGCL is constantly under review by the most knowledgeable members of the Delaware Bar.

Judicial decisions comprise the second source of corporate governance law in Delaware. The state's Court of Chancery (Chancery Court) is largely regarded as the nation's premier business court. The Chancery Court is a court of equity, which consists of five expert judges chosen to adjudicate corporate and commercial disputes. Appeals from the Chancery Court are heard by the Delaware Supreme Court.

ii Enforcement of Delaware's corporate governance regime

Derivative, direct, and class actions each provide a method for shareholders to seek redress against corporations and their directors and officers for alleged wrongdoing. Class actions are essentially an aggregation of direct claims being prosecuted by one or more persons as representatives of a group of shareholders. Direct claims involve an injury to the suing shareholder individually, as opposed to the corporation. Where there is an actual injury to the corporation to which any relief would flow, the cause of action must be brought by the corporation or by the shareholders derivatively if the corporation fails to act. In practice, the classification of a particular claim as derivative or direct may be challenging.

The classification of a claim is significant because a shareholder plaintiff may not proceed against a corporation with a derivative claim without first making a demand on the corporation to pursue the claim itself, unless the making of a demand would be futile. The Chancery Court will excuse the failure to make a demand based on futility if the complaint creates a reasonable doubt that the corporation's directors are disinterested and independent or the challenged action was otherwise the product of valid business judgement.[2] Under

1 Ellisa O Habbart is a partner at The Delaware Counsel Group LLC.

2 *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984).

the first prong of the well-known *Aronson* test, a director is interested if he or she sits on both sides of a transaction or derives a benefit from a transaction that is not shared by the corporation or all shareholders generally. Independence is lacking if the director's decision is based on extraneous influences rather than the merits. When addressing *Aronson's* second prong, the plaintiff must create a reasonable doubt that either the action was taken honestly and in good faith, or the board was adequately informed in making the decision. Demand also may be excused under the second prong of *Aronson* if a plaintiff properly pleads a waste claim.[3]

iii Nature of the corporate governance regime and recent developments

Delaware's corporate governance regime is founded on the fundamental principle set forth in Section 141(a) of the DGCL that, unless otherwise provided in a corporation's certificate of incorporation, the business and affairs of a corporation must be managed by or under the direction of its board of directors. Delaware decisional law reflects a constant tension between directors and shareholders over the shareholders' desire to exert influence over corporate management and potentially usurp the board's decision-making authority. Aside from the corporate electoral process and the reservation of the shareholders' right to vote on various fundamental corporate actions,[4] the board's power is limited only by certain well established fiduciary obligations.

Notably, in 2016, the Delaware Supreme Court determined that the statutory basis for finding jurisdiction over Delaware directors and officers was more expansive than it has been interpreted to be by Delaware courts for over 30 years.[5] Now, non-resident officers and directors of Delaware corporations are deemed to have consented to personal jurisdiction not only in any action against that director or officer for violation of a duty in that capacity, but also in all civil actions brought in Delaware by, on behalf of or against a Delaware corporation, in which the director or officer is a necessary or proper party.

II CORPORATE LEADERSHIP

i Board structure and practices

The board of directors must consist of at least one member, and all members must be natural persons.

Term of office

Under Section 141(b) of the DGCL, each director holds office until the director's successor is elected and qualified, or until the director's earlier resignation or removal. Typically, the term of each director is one year unless the board has been structured as classified. Pursuant to Section 141(d) of the DGCL, the certificate of incorporation, the initial by-laws of the company or a by-law adopted by the shareholders may divide the board into a maximum of three classes of directors who serve staggered terms. If three classes of directors are created, then only one class of directors stands for election each year.

3 See footnote 7.

4 These matters include amendments to the certificate of incorporation, certain mergers, sales of substantially all or all of the corporation's assets and dissolution.

5 *Hazout v. Tsang Mun Ting*, 134 A.3d 274 (Del. 2016).

Qualifications

The DGCL does not specify any qualifications for directors other than that they be natural persons. However, pursuant to Section 141(b) of the DGCL and the common law, the certificate of incorporation and by-laws may prescribe reasonable director qualifications. The Delaware courts are likely to enforce qualifications that are reasonably related to the corporation's business. Valid qualifications might include a minimum ownership requirement or experience in a certain field of business.

Board action

Directors act collectively, and all directors possess equivalent voting rights unless the certificate of incorporation otherwise provides. Any action may be taken by vote of a majority of the directors present at a meeting at which a quorum is present unless the certificate of incorporation or by-laws provide for a supermajority vote. Unless directors are restricted by the certificate of incorporation or by-laws, directors may act without a meeting by unanimous written or electronic consent, including email transmissions.

Committees

Certain managerial duties may be delegated by the board of directors to committees of the board consisting of one or more directors. Generally, a properly constituted board committee may exercise the full powers of the board of directors in the management of the business and affairs of the corporation with two significant exceptions:

a a board committee cannot approve, adopt or recommend to shareholders any action or matter expressly required by the DGCL to be submitted to shareholders for a vote (other than the election or removal of directors); and

b a board committee cannot adopt, amend or repeal any by-law.

Advisory committees of the corporation may include members who are not directors, but any such committee's function must be purely advisory in nature.

Officers

Corporations must have such officers as established by the by-laws or by resolution of the board of directors. A court will generally uphold a delegation of authority to officers by a corporation's board of directors unless the delegation is of a task specifically assigned by the DGCL to the board. However, if the delegation conflicts with some overriding public policy or provision of a corporation's certificate of incorporation, it will not be upheld. Unauthorised acts of officers may be validated by ratification by the board of directors unless the acts are beyond the authority of the corporation.

Compensation

The board of directors may fix director compensation in the absence of restrictions in the certificate of incorporation or by-laws. The directors' self-interested decision will be entitled to the protection afforded by the business judgement rule if the compensation plan has been approved by the corporation's shareholders and contains well-defined, specific limits on potential self-dealing. Otherwise, if challenged, the board will have to show that the compensation arrangements are fair to the corporation by demonstrating that services of value are actually being rendered, and that the level of compensation for these services is similar to either industry standards or compensation at corporations of similar size and profitability. Shareholders' approval may not guarantee judicial deference to business judgement when the shareholders only approve an upper limit and the directors are given discretion to determine compensation up to that limit.[6] The board should also approve the compensation of executive officers of the corporation. As a matter of customary practice, most corporations delegate the responsibility for fixing executive compensation to outside directors. At a minimum, directors do not participate in the discussion of, or vote upon, their own compensation as officers or employees to minimise the appearance of self-dealing. Executive compensation decisions made by disinterested directors are generally upheld in the absence of waste.[7]

Takeover practice

The responsibility for responding to takeovers is generally held to reside with the board of directors pursuant to the managerial authority provided in Section 141(a) of the DGCL. The board of directors has a fiduciary responsibility to advance the best interests of the corporation's shareholders in responding to takeovers.

ii Directors

Fiduciary duties

All directors of a Delaware corporation owe fiduciary duties of care and loyalty to the corporation and its shareholders. The courts have also recognised that directors have fiduciary duties of disclosure and good faith, which are not separate duties, but rather specific applications of the fiduciary duties of care and loyalty. These duties are owed by all directors to the corporation and shareholder body as a whole without regard to whether any director is an inside or outside director or was elected by a particular class of shareholders.

Duty of care

The duty of care requires that directors inform themselves using all material information reasonably available to them before making a business decision. This duty extends to the board's delegation functions. However, directors are not expected to oversee every detail of day-to-day corporate activities, and may rely in good faith upon the records of the corporation and upon information, reports, opinions and statements of corporate officers and employees.

Duty of loyalty

Directors also owe a duty of loyalty to the corporation. The duty of loyalty mandates that a director cannot consider or represent interests other than the best interests of the corporation and its shareholders in making a business decision. Where a director has an interest in a decision that is different from or in addition to the interests of the corporation

6 *In re Investors Bancorp, Inc Stockholder Litig*, 177 A.3d 1208, 1211 (Del. 2017) ('[W]hen stockholders have approved an equity incentive plan that gives the directors discretion to grant themselves awards within general parameters, and a stockholder properly alleges that the directors inequitably exercised that discretion, then the ratification defence is unavailable to dismiss the suit, and the directors will be required to prove the fairness of the awards to the corporation.')

7 See *Calma on Behalf of Citrix Systems, Inc. v. Templeton*, 114 A.3d 563, 590 (Del. Ch. 2015) ('To state a claim for waste, it must be reasonably conceivable that the directors authorize[d] an exchange that [was] so one sided that no business person of ordinary, sound judgement could conclude that the corporation has received adequate consideration.') (internal quotations and citations omitted).

and shareholders generally, the director is said to be an interested director. Interested directors should disclose the interest to the other members of the board and, if the interest is material, consider abstaining from any board vote on the matter.

The duty of loyalty also encompasses cases where the director fails to act in good faith.[8] Bad faith may be shown where the director's conduct is motivated by an actual intent to do harm, or where the director intentionally acts with a purpose other than that of advancing the best interests of the corporation or with the intent to violate applicable law. Bad faith is also demonstrated where the director intentionally fails to act in the face of a known duty to act, thereby demonstrating a conscious disregard for his or her duties.

Liability of directors

Directors may be found to be personally liable for monetary damages if they breach their fiduciary duties of loyalty and care. Directors may be exculpated from paying monetary damages for liability arising from breach of the fiduciary duty of care if the corporation's certificate of incorporation contains an exculpatory provision authorised by Section 102(b)(7) of the DGCL. Whether a director will be found liable for breach of fiduciary duty depends largely on the standard of review applicable to the challenged action or decision of the director. However, the Delaware Supreme Court recently clarified that regardless of what standard of review applies, a plaintiff seeking only monetary damages against a director protected by an exculpatory provision must plead claims for breach of the duty of loyalty to survive a motion to dismiss.[9]

Standards of review

Delaware has three standards of review for evaluating director decision-making: the business judgement rule, entire fairness and intermediate scrutiny.

The business judgement rule

The business judgement rule is the default standard of review. In general, the business judgement rule is a presumption that, in making a business decision on behalf of the corporation, the directors acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.[10] When a court finds that the business judgement rule applies, the business decisions of disinterested directors will not be disturbed if they can be attributed to any rational business purpose.

Entire fairness

If the business judgement rule's presumption is rebutted, the burden generally shifts to the defendant directors to show the entire fairness of the transaction. The entire fairness standard is the most exacting standard of review applied by Delaware courts when reviewing a challenged transaction and has two elements: fair price and fair dealing.[11] Fair price relates

8 *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

9 See *In re Cornerstone Therapeutics Inc. Stockholder Litig*, 115 A.3d 1173 (Del. 2015).

10 *In re MFW S'holders Litig*, 67 A.3d 496 (Del. Ch. 2013), aff'd sub nom., *Kahn v. M&F Worldwide Corp*, 88 A.3d 635 (Del. 2014).

11 *In re Riverstone Nat, Inc Stockholder Litig*, 2016 WL 4045411, at *15 (Del. Ch. 28 July 2016).

to the economic and financial considerations of a transaction. Fair dealing requires a review of when the transaction was timed, how it was initiated, structured, negotiated and disclosed to the directors, and how the approvals of the directors and the shareholders were obtained.

Intermediate scrutiny

Unocal

A Delaware court will apply an intermediate level of scrutiny in reviewing a board's responses to takeovers that are defensive in nature under the *Unocal* enhanced scrutiny test.[12] If this test applies, directors must show that they had 'reasonable grounds for believing that a danger to corporate policy and effectiveness existed'[13] and that their action was 'reasonable in relation to the threat posed'.[14] If the defensive action was neither preclusive nor coercive, the court will determine whether the directors have met their burden of showing that the response was within a range of reasonableness considering the threat posed.

Revlon

Intermediate scrutiny will also be applied to review a board's actions in the context of transactions involving a change in control or a break-up of the corporation under *Revlon*.[15] To meet this standard, the directors must focus on one primary objective – to secure the best value reasonably available for the shareholders. The Delaware courts have recognised that there is no single blueprint to follow in reaching the ultimate goal of maximising shareholder value. Thus, under *Revlon*, directors are generally free to select the path to value maximisation so long as they choose a reasonable route. For example, in *C&J Energy Services, Inc. v. City of Miami General Employees*, the Delaware Supreme Court reversed a Chancery Court decision that held that a board must conduct a pre-signing active solicitation process to satisfy its duties under *Revlon*.[16] The Court found that so long as any bidder interested in paying more for the target company had a reasonable opportunity to do so, the company was not required to actively shop itself.[17]

Procedural protections may modify the standard of review

In certain situations, the use of specific procedural protections will warrant the application of a more deferential standard of review. For example, transactions involving a conflicted controlling shareholder are generally subject to entire fairness. However, the business judgement standard of review will apply to such a transaction if, and only if, the transaction is conditioned on the approval of both an independent special committee of the board and a minority shareholder vote, and:

a the special committee is empowered to freely select its own advisers and to say no definitively;

b the special committee meets its duty of care in negotiating a fair price;

12 *Unocal Corp v. Mesa Petroleum Co*, 493 A.2d 946 (Del. 1985).

13 Id. at 954.

14 Id. at 955.

15 *Revlon v. MacAndrews & Forbes Holdings, Inc*, 506 A.2d 173, 182 (Del. 1986).

16 107 A.3d 1049, 1067-69 (Del. 2014).

17 Id. at 1069.

c the vote of the minority is informed; and
d there is no coercion of the minority.[18]

Additionally, the business judgement standard of review will irrebuttably apply to a post-closing challenge of a transaction generally subject to enhanced scrutiny if a majority of disinterested, uncoerced and fully informed shareholders approved the transaction.[19] Similarly, a transaction that involves a conflicted board of directors that would generally be subject to entire fairness will be subject to the irrebuttable application of the business judgement standard of review if a majority of disinterested, uncoerced and fully informed shareholders approved the transaction.[20] If the challenged transaction involves a conflicted controlling shareholder, however, the shareholder vote will not result in the irrebuttable application of the business judgement standard of review.[21] In transactions involving a conflicted controlling shareholder, the shareholder vote will merely shift the burden of persuasion from the controlling shareholder to the minority shareholders.[22]

Indemnification

Under Section 145 of the DGCL, a director may be indemnified for expenses incurred in defending derivative claims, and for expenses, judgements, fines and amounts paid in settlement incurred in connection with defending direct actions. However, if the director has been successful on the merits or otherwise in the defence of the proceeding, he or she is entitled to mandatory indemnification for expenses actually and reasonably incurred. To be indemnified in criminal actions or proceedings, the director must also have had no reason to believe that the challenged conduct was unlawful. Advancement of expenses to a director prior to the final disposition is also permitted if the director executes an undertaking to repay the monies advanced if it is ultimately determined that he or she is not entitled to indemnification. These rights cannot be eliminated by a corporation after a director's period of service ends unless the individual knows at the time he or she chooses to serve that his or her rights will terminate or can be eliminated at a later time.[23] Notably, indemnification and advancement rights apply only where the director has been sued 'by reason of the fact' that the director is or was a director of the corporation.[24] This standard cannot be modified by contract.[25]

Election of directors

An annual meeting of shareholders of a Delaware corporation is mandated to elect directors. To permit an orderly period of solicitation of shareholder nominations prior to a meeting,

18 *Kahn v. M&F Worldwide Corp*, 88 A.3d 635, 645 (Del. 2014); *Larkin v. Shah*, 2016 WL 4485447, at *9 (Del. Ch. 25 August 2016).

19 See *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304 (Del. 2015); *City of Miami General Employees v. Comstock*, 2016 WL 4464156 (Del. Ch. 24 August 2016); *Singh v. Attenborough*, 137 A.3d 151 (Del. 2016). See also, *In re Cyan, Inc Stockholders Litigation*, C.A. No. 11714-CB (Del. Ch. May 11, 2017) and *Matthew Sciabacucchi v. Liberty*, C.A. No. 11419-VCG (Del. Ch. May 31, 2017).

20 *Larkin v. Shah*, 2016 WL 4485447, at *13.

21 Id. at *9.

22 Id.

23 See *Marino v. Patriot Rail Co*, 131 A.3d 325, 342-43 (Del. Ch. 2016).

24 See, e.g., *Charney v. American Apparel, Inc*, 2015 WL 5313769, at *14 (Del. Ch. 11 September 2015).

25 Id.

many corporations have adopted provisions in their certificates of incorporation or by-laws to provide for advance notice of the nomination of directors by shareholders. Such provisions typically require that the shareholder making the nomination be a shareholder of record. The nominating shareholder must also submit specific information within a specified window to the corporation about himself or herself; the beneficial owner, if any, on whose behalf the nomination is being made; and about each of his or her director nominees. The information required typically includes all information about the nominee that would be required to be disclosed under federal securities laws and whether the nominating shareholder or the beneficial owner, if any, intends to solicit proxies from other shareholders. By-law provisions requiring advance notice of nominations have been found inequitable in specific factual circumstances.[26]

III DISCLOSURE

Under Delaware law, obligations relating to corporate disclosure are derived from common law fiduciary duties, not the DGCL. The duty of disclosure is a component of a director's fiduciary duties of care and loyalty, and its scope and requirements depend on context. Corporate fiduciaries can breach their duty of disclosure by making a materially false statement, by omitting a material fact or by making a partial disclosure that is materially misleading. The duty of disclosure applies in a number of situations, including when directors seek shareholder action such as the ratification of director compensation.[27]

IV CORPORATE RESPONSIBILITY

In contrast to US federal law, Delaware does not have a statutory regime addressing risk management, compliance policies, whistle-blowing or other issues of corporate responsibility. Rather, Delaware relies on fiduciary duty law to encourage and enforce ethical behaviour by directors and officers of Delaware corporations.

A claim of breach of fiduciary duty that seeks to hold directors of a Delaware corporation liable for either knowingly causing the corporation to violate the law or for failing to establish an effective system for monitoring the corporation's compliance with the law is rarely successful.[28] Plaintiffs are faced with the difficult burden of establishing the necessary linkage between illegal conduct and a conscious board decision. If plaintiffs cannot point to a particular board decision demonstrating the board's conscious decision to violate the law, the plaintiff must plead that the board deliberately failed to act after learning about incidents or occasions of possible illegality. Alternatively, plaintiffs could establish that the illegality occurred because the board abrogated its oversight function by failing to ensure that the corporation possessed an adequate compliance system. For example, a plaintiff might be successful if the board did not form an audit or other compliance committee.

26 See, e.g., *JANA Master Fund, Ltd v. CNET Networks, Inc*, 954 A.2d 335 (Del. Ch. 2008).

27 The failure to disclose material information in this context will negate any effect a shareholder vote otherwise might have on the validity of the transaction or the applicable standard of review.

28 This type of claim is known colloquially as a *Caremark* claim, after the seminal decision by the Chancery Court in *In re Caremark International Inc*. See *In re Caremark Int'l Inc Derivative Litig*, 698 A.2d 959 (Del. Ch. 1996).

Section 204 and Section 205 of the DGCL, which were adopted in 2014 and amended in 2015, act as powerful tools for current boards of Delaware corporations. These provisions grant boards the power to ratify, and the Chancery Court authority to validate, defective corporate acts that failed to comply with the DGCL or the corporation's organisational documents. The Section 204 ratification procedure involves adopting resolutions, obtaining shareholder approval if such approval is legally required, and filing a certificate of validation in accordance with Section 103 of the DGCL. Under Section 205, the Chancery Court can determine the validity of any defective corporate act that has not been ratified or has been ratified effectively under Section 204, regardless of whether the defective corporate act would have been capable of ratification pursuant to Section 204.

V SHAREHOLDERS

i Shareholder rights and powers

Equality of voting rights

Unless otherwise provided in the certificate of incorporation, shareholders are entitled to one vote for each share of capital stock held by the shareholders pursuant to Section 212 of the DGCL. A common type of variation from the one vote per share rule is the creation of preferred stock with contingent voting rights. Generally, all holders of the same class or series of stock must have equivalent voting, dividend and other rights under the common law doctrine of equal treatment. However, the Chancery Court has upheld scaled and tenured voting patterns where specifically authorised by the certificate of incorporation, as well as other types of discrimination among holders of the same class or series of stock where the discrimination was not inequitable.[29]

Shareholders' ability to influence the board

Generally, the shareholders' ability to influence the board is limited to the power to elect and remove directors, with or without cause,[30] and to approve or disapprove certain actions as required by the DGCL or as may be provided in the corporation's certificate of incorporation.

Shareholders may also exercise influence by dissolving the corporation without board approval if the written consent of all shareholders is obtained. A shareholder who owns 90 per cent or more of the outstanding shares of each class of capital stock of a Delaware corporation may force a short-form merger of the corporation without board or other shareholder approval under Section 253 of the DGCL. The only other significant power that shareholders may exercise without prior board action is the amendment of the corporation's by-laws pursuant to Section 109 of the DGCL. The board may be given concurrent power to amend the by-laws in the corporation's certificate of incorporation, and the certificate of incorporation or by-laws may impose supermajority voting requirements for shareholder amendments to the by-laws. However, in no case may the ability of the shareholders to amend the by-laws be completely eliminated.

29 See, e.g., *Lacos Land Co v. Arden Group, Inc*, 517 A.2d 271, 275 (Del. Ch. 1986).

30 Unless the corporation's certificate of incorporation otherwise provides, in the case of a corporation whose board is classified, shareholders may effect such a removal only for cause.

Rights of dissenting shareholders

Aside from the right to an appraisal of the fair value of their shares by the Chancery Court in connection with certain types of mergers, shareholders do not enjoy dissenters' rights under the DGCL. Generally, appraisal rights are triggered in connection with the merger of a listed company incorporated in Delaware if the shareholders of the corporation are required to accept in the merger consideration other than stock in the surviving corporation or publicly traded stock in another corporation. If the Chancery Court finds that the fair value of the shares is higher than the merger consideration and the petitioning shareholders have properly asserted their appraisal rights, then the shareholders are entitled to receive the difference between the merger price and the price determined by the Chancery Court to constitute fair value, plus interest.

In the past, Delaware courts have generally adopted the merger consideration as the best evidence of fair value of an entity's shares. However, in the Chancery Court's 2016 *In re Appraisal of Dell Inc* decision,[31] appraisal petitioners of Dell Inc were awarded fair value for their shares that was significantly higher than the merger consideration paid to the other public shareholders in the merger. This rare decision can most likely be attributed to the unique set of facts presented to the court, which included:

a the transaction at issue was a management buyout;

b extensive and compelling evidence of a 'valuation gap between the market's perception and the target company's operative reality';

c limited pre-signing competition for the target company;

d the only active bidders were financial, rather than strategic, buyers; and

e the special committee that negotiated the deal did not consider fair value – instead, it focused on the market price of the company's common stock, and 'negotiated without determining the value of its best alternative to a negotiated acquisition'.

Nevertheless, this decision makes clear that Delaware courts have broad discretion to determine share value based on the facts and circumstances of each individual appraisal action before deferring to the merger consideration as the best evidence of fair value. Consistent with earlier decisions, the Delaware Supreme Court reversed the Court of Chancery decision given, according to the Supreme Court, the Court of Chancery's reasons for ignoring the deal price did not agree with the Supreme Court's findings. As a result, but for situations where there is significant evidence to support a finding to the effect that there were defects in the market that justify a departure from deal price, it is still very relevant.

ii Shareholders' duties and responsibilities

A controlling shareholder owes fiduciary duties to the shareholders of the corporation he or she controls. A controlling shareholder may not exercise control over the management and affairs of the corporation to his or her benefit and to the detriment of the corporation and the minority shareholders.[32] Indeed, whenever a corporation enters into a transaction with, or at the behest of, its controlling shareholder, the applicable standard of review is normally entire

31 *In re Appraisal of Dell Inc*, 2016 WL 3186538 (Del. Ch. 2016).

32 Delaware does not impose fiduciary duties or other obligations upon shareholders who are not controlling shareholders. A controlling shareholder may possess less than a majority of the corporation's outstanding voting power and still be considered a controlling shareholder if the shareholder exercises actual domination and control of the corporation.

fairness, placing the burden of proof on the defendant to demonstrate the fair value and process of the transaction.[33] This burden of proof is shifted to the plaintiffs if the controlling shareholder transaction is approved either by an independent and well-functioning special committee or by a majority of the minority shareholders.[34]

iii Shareholder activism

Shareholder activism has increased significantly over the past decade, and Delaware has not been immune to its expanding influence.[35] A Delaware corporation will often regulate shareholder activism by including defensive provisions in its certificate of incorporation and by-laws. These include advance notice by-laws, staggered board provisions, supermajority requirements for by-law amendments, and prohibitions on the shareholders' ability to act by written consent and to fill vacancies on the board. These defences, often used in combination, allow corporations to effectively prevent or defeat hostile tender offers.[36]

iv Takeover defences

See Section V.iii.

v Contact with shareholders

Communications between the board and the shareholders mainly occur in connection with the solicitation of the shareholders' vote on matters in which the shareholders are required to act.

Under Delaware law, when directors communicate with shareholders outside the context of seeking shareholder action, the directors' fiduciary duty of disclosure still applies but on a more limited basis. In such circumstances, the directors must communicate with honesty. For example, if a director speaks 'through public statements made to the market, statements informing shareholders about the affairs of the corporation, or public filings required by the federal securities laws, he or she must not knowingly disseminate false information that results in injury to a shareholder'.[37]

VI OUTLOOK

The ongoing and active involvement of the members of the Delaware Bar in maintaining and recommending amendments to the DGCL, as well as the quality of Delaware's courts and Office of the Secretary of State, are likely to ensure that Delaware remains the jurisdiction of choice for incorporation and adjudication of business disputes in the United States.

33 *Kahn v. Lynch Communication Systems, Inc*, 638 A.2d 1110, 1117 (Del. 1994).

34 Id.

35 See *Third Point LLC v. Ruprecht*, 2014 WL 1922029 (Del. Ch. 2 May 2014).

36 In some cases, a board will employ a white-knight defence, which entails management of the target company recruiting a rival bidder that will save them from an initial, unfriendly offer or by offering a more attractive deal.

37 *In re Wayport, Inc Litig*, 76 A.3d 296, 315 (Del. Ch. 2013) (quotations and citations omitted).

Appendix 1

ABOUT THE AUTHORS

ELLISA O HABBART

The Delaware Counsel Group LLC

Ms Habbart leads The Delaware Counsel Group and assists lawyers globally on transactions and governance issues with a Delaware connection. Outside counsel and in-house counsel of Fortune 100 companies, major financial institutions and private equity firms worldwide rely on Ms Habbart as their guide on Delaware law. A significant portion of Ms Habbart's representations involve cross-border transactions. Typical representations include fund formations, mergers and acquisitions, joint ventures, recapitalisations, financings and new equity issuances. In addition to helping to implement such transactions and rendering legal opinions, Ms Habbart regularly advises management on governance issues relating to significant transactions and issues that arise during the life of a business entity.

Ms Habbart is top ranked in *Chambers USA* as one of America's leading business lawyers in the Delaware corporate and mergers and acquisitions law section, and by *Who's Who Legal: Corporate Governance*. According to *Chambers*, clients report that she 'has expert knowledge in the field but is still commercially sensitive to what the client aims to achieve', and is 'very plugged in to Delaware legal developments'. She is also rated 'AV' by Martindale-Hubbell.

Ms Habbart is one of only 26 lawyers appointed to the Council of the Section of Corporation Law of the Delaware State Bar Association, the group responsible for monitoring and recommending amendments to the Delaware General Corporation Law. She is also the Corporate and M&A Law Committee's representative on the Economic Sanctions working group of the International Bar Association's Legal Policy and Research Unit, which develops and implements innovative strategies and initiatives relevant to business and the law, the global legal profession and the broader global community. She is the former vice chair of the Corporate and M&A Committee Corporate Governance Subcommittee and holds significant leadership positions in the American Bar Association.

Ms Habbart's publications include a chapter on Delaware law in the *Partnerships, Joint Ventures and Strategic Alliances; Delaware Limited Liability Company Forms and Practice Manual*, which is updated annually; the US chapter of the *Treasury Shares Guide*; the Delaware chapter in *Private Fund Dispute Resolution*; the IBA's *Directors and Officers Checklist*; and the first in-depth analysis of the Uniform Law Commission Uniform Statutory Trust Act in the American Bar Association publication *The Business Lawyer*.

Prior to founding The Delaware Counsel Group LLC, Ms Habbart was an associate and partner with Prickett Jones & Elliott and was the partner in charge of the Delaware office of Stradley Ronon Stevens & Young. In addition to her Juris Doctor, Ms Habbart has a master's degree in taxation.

THE DELAWARE COUNSEL GROUP LLC

2 Mill Road, Suite 108
Wilmington, DE 19806
United States
Tel: +1 302 576 9600
Fax: +1 302 576 9608
ehabbart@decg.com
www.decg.com

Law
Business
Research

ISBN 978-1-83862-015-8