CLEARY GOTTLIEB

2021 Developments in Securities and M&A Litigation

January 2022

Overview

2021 was a significant year for developments in securities litigation. The Supreme Court issued its much anticipated decision in *Goldman Sachs Group Inc. v. Arkansas Teacher Retirement System*, holding that courts must consider all evidence concerning price impact at the class certification stage, including evidence regarding the generic nature of a misrepresentation, and must weigh that evidence in order to determine whether it is more likely than not that the alleged misrepresentations had price impact. The Supreme Court also granted *certiorari* in *Pivotal Software, Inc. v. Tran* to consider whether the Private Securities Litigation Reform Act's ("PSLRA") automatic stay of discovery applies to Securities Act cases brought in state court, but the parties subsequently settled the case before the Court could decide the issue.

The Circuit courts also issued several notable decisions concerning the securities laws, including deepening or creating several circuit splits that could be resolved by the Supreme Court. In *Cavello Bay Reinsurance Ltd. v. Stein*, the Second Circuit continued to follow its prior decision in *Parkland Global Hub Ltd. v. Porsche Automobile Holdings SE* that the presence of a domestic transaction is a necessary, but not sufficient, condition to invoke Section 10(b) for securities not listed on a domestic exchange. However, the First Circuit in *Securities and Exchange Commission v. Morrone* deepened the circuit split on this issue by joining the Ninth Circuit in rejecting *Parkcentral* as inconsistent with *Morrison*. In *Pirani v. Slack Technologies, Inc.*, the Ninth Circuit created another circuit split in holding that investors in a direct listing had standing to bring a Section 11 claim despite being unable to trace their purchases to registered shares. In *Aly v. Valeant Pharmaceuticals International Inc.*, the Third Circuit deepened another circuit split by holding that *American Pipe*'s tolling doctrine applies to opt-out actions filed while class certification is still pending.

In addition, district courts around the country began to issue decisions in response to several recent trends in the filing of securities class actions, including cases arising from the COVID-19 pandemic, claims concerning cyberattacks, and actions related to special purpose acquisition companies ("SPACs").

With respect to M&A and corporate governance litigation, the Delaware courts issued a number of important decisions. In *United Food and Commercial Workers Union v. Zuckerberg, et al.*, the Delaware Supreme Court reformulated and streamlined the demand futility test in shareholder derivative actions. In *Brookfield Asset Management., Inc. v. Rosson*, the Delaware Supreme Court overruled *Gentile v. Rossette*, establishing that all overpayment/dilution claims are exclusively derivative and cannot be brought by stockholders directly.

Other decisions by the Delaware courts addressed the standard for pleading a *Caremark* claim, material adverse effect claims, the enforceability of liability limitations in a contract procured by fraud, the effect of a merger agreement's termination provision, and the standard for granting an injunction in order to facilitate disclosures before a shareholder vote on a proposed merger, among other issues.

As in the securities context, the pandemic and the increasing number of SPACs continued to spur M&A and corporate governance litigation in Delaware courts. Notably, the Delaware Court of Chancery in *The Williams Companies Stockholder Litigation* enjoined a poison pill adopted, in part, because of the pandemic. In *AB Stable VIII LLC v. MAPS Hotels and Resorts One LLC*, the Delaware Supreme Court affirmed the Court of Chancery's finding that a seller's pandemic response breached an ordinary course covenant. Multiple stockholder lawsuits were filed challenging de-SPAC mergers, with the Delaware Court of Chancery issuing its first opinion in such cases (allowing the claims to proceed) in the first week of 2022.

Finally, federal courts dismissed a number of shareholder derivative suits seeking to hold directors and officers liable for perceived diversity failures at their companies.

Securities Litigation

Supreme Court Weighs in on Price Impact Inquiry at Class Certification Stage

In June, the Supreme Court handed down its decision in *Goldman Sachs Group Inc. v. Arkansas Teacher Retirement System* addressing how defendants in securities class actions can rebut the *Basic*[1] presumption of reliance at the class certification stage by showing that the alleged misrepresentations lacked price impact.[2] The Court's decision contained several notable holdings, which could significantly shape arguments made at both the class certification and merits stages.

First, the Court held that, even at the class certification stage, district courts "must take into account *all* record evidence relevant to price impact, regardless whether that evidence overlaps with materiality or any other merits issue,"[3] including the generic nature of a misrepresentation. This holding was significant because it forecloses arguments by plaintiffs, which had been adopted by several lower courts, that certain types of evidence could not be considered at the class certification stage under the Supreme Court's prior decisions in *Erica P. John Fund, Inc. v. Halliburton Co.*[4] and *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*[5] that loss causation and materiality, respectively, are merits issues that need not be proven at the class certification stage.

Second, the Court held that district courts must weigh all price impact evidence submitted by the parties in order to decide whether it was "more likely than not that the alleged misrepresentations had a price impact."[6] The Court also clarified that although defendants bear the burden of persuasion on that issue, "the allocation of the burden is unlikely to make much difference" and "will have bite only when the court finds the evidence in equipoise—a situation that should rarely arise."[7] These holdings are significant because they call into question, if not outright reject, the prior approach of certain lower courts that looked only at whether defendants' evidence was convincing enough to prove a complete absence of price impact.

1 *Basic Inc. v. Levison*, 485 U.S. 224, 108 S. Ct. 978, 99 L. Ed.2d 194 (1988).

2 *Goldman Sachs Grp., Inc. v. Arkansas Tchr. Ret. Sys.*, 141 S. Ct. 1951, 210 L. Ed. 2d 347 (2021).

3 *Goldman* at 1961.

4 *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804, 131 S. Ct. 2179, 180 L. Ed. 2d 24 (2011).

5 *Amgen Inc. v. Connecticut Ret. Plans & Tr. Funds*, 568 U.S. 455, 133 S. Ct. 1184, 185 L. Ed. 2d 308 (2013).

6 *Goldman* at 1963.

7 *Id*. at 1963.

Third, in holding that district courts must consider the generic nature of the alleged misrepresentation in its price impact analysis, the Court recognized that plaintiffs often try to prove the amount of price inflation caused by an alleged misrepresentation by arguing that such initial inflation equals the amount of the subsequent stock price drop associated with a disclosure that allegedly corrected the misrepresentation.[8] The Court further stated that "that final inference—that the back-end price drop equals front-end inflation—starts to break down when there is a mismatch between the contents of the misrepresentation and the corrective disclosure," including where the misrepresentation is generic and the corrective disclosure is more specific.[9] This reasoning may prove useful for defendants not only in opposing class certification, but also at the merits stage, in making arguments that the corrective disclosures identified by plaintiffs do not accurately measure damages caused by the alleged misrepresentation.

Supreme Court Grants Certiorari to Decide Applicability of PSLRA's Discovery Stay to Securities Act Cases in State Court

In July 2021, the Supreme Court granted a petition for writ of *certiorari* in *Pivotal Software, Inc. v Tran*, in order to decide whether the statutory stay of discovery contained in the PSLRA applies to Securities Act cases brought in state court.[10]

In recent years, lower courts have reached differing conclusions on whether the PSLRA discovery stay, which provides that "[i]n any private action arising under" the Securities Act, "all discovery . . . shall be stayed during the pendency of any motion to dismiss,"[11] applied in state court. On one side, a number of lower courts held that the language was broadly worded to apply in "any" private action asserting claims under the Securities Act, including those filed in state court. On the other hand, other courts, including the California state court in *Pivotal*, concluded that the PSLRA discovery stay did not apply to actions filed in state courts, including because the PSLRA discovery stay is procedural, making it applicable only to federal court actions.[12] In their petition, the *Pivotal* defendants argued that the Supreme Court should grant *certiorari* to resolve this inconsistency, and because the issue evades federal appellate review.[13]

However, after *certiorari* was granted,[14] the case was removed from the Court's argument calendar in September because the parties had agreed, in principle, to settle.[15] It remains to be seen whether the Supreme Court will grant another petition raising this question, as the issue of whether the PSLRA's discovery stay applies in state court remains important in light of the growth of Securities Act lawsuits filed in state courts since the Supreme Court's 2018 decision in *Cyan Inc. v. Beaver County Employees Retirement Fund*.[16]

8 *Id*. at 1961.

9 *Id*.

10 *See* Petition for Writ of Certiorari ("Petition"), *Pivotal Software, Inc. v. Tran*, No. 20-1541 (May 3, 2021).

11 15 U.S.C. § 77z-1(b)(1).

12 *See, e.g.,* Appendix A (Order Denying Defendants' Joint Motion to Stay Discovery) at 10a, *Pivotal Software, Inc. v. Tran*, No 20-1541 (May 3, 2021).

13 *See* Petition at 11-27.

14 *See* Docket, July 2, 2021, *Pivotal Software, Inc. v. Tran*, No. 20-1541.

15 *See* Docket, Sept. 2, 2021.

16 *Cyan Inc. v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061, 200 L. Ed. 2d 332 (2018).

New York's First Department Permits Federal Securities Act Claim to Survive Dismissal

On April 29, 2021, the New York Appellate Division, First Department issued a short opinion in *Chester County Employees Retirement Fund v. Alnylam Pharmaceuticals, Inc.*,[17] affirming, in large part, the trial court's decision to allow plaintiff's Securities Act claims to proceed past dismissal, after finding that the alleged misstatements were not "premised on nonactionable statements of opinion."[18]

This decision is notable because following the Supreme Court's decision in *Cyan*,[19] holding that state courts retain jurisdiction to hear Securities Act cases, the First Department had dismissed all such actions filed in New York state court.[20] Therefore, *Alnylam*'s departure from those earlier dismissals may encourage additional plaintiffs to file Securities Act class actions in New York state court even where similar actions have been filed in federal court.

Circuit Courts Deepen or Create Circuit Splits on a Number of Issues Under the Federal Securities Laws

The year was also notable in that it gave rise to a number of decisions in which circuit courts deepened existing circuit splits and created new ones, increasing the divergence in the application of the federal securities laws across the circuits, and giving rise to the possibility that the Supreme Court will grant petitions seeking to resolve these issues.

Extraterritoriality Issues

In January, the Second Circuit affirmed the dismissal of a claim under Section 10(b) of the Exchange Act in *Cavello Bay Reinsurance Ltd. v. Stein*,[21] holding that a private sale of restricted shares between two Bermudan companies was "so predominantly foreign" as to be impermissibly extraterritorial even if it constituted a domestic transaction.[22] Among other reasons, the decision was notable because the Second Circuit adhered to its prior decision in *Parkcentral Global Hub Ltd. v. Porsche Automobile Holdings SE*,[23] which held that the presence of a domestic transaction was a necessary but not sufficient basis to bring the transaction within the scope of the federal securities laws under the Supreme Court's extraterritoriality decision in *Morrison*,[24] notwithstanding that the *Parkcentral* decision was subsequently rejected by the Ninth Circuit in *Stoyas v. Toshiba Corp.*[25] In *Cavello Bay*, the Second Circuit further clarified that the "predominantly foreign" inquiry established in *Parkcentral* should focus on the structure of the transaction and the purposes of the federal securities laws, rather than on the location where the alleged fraud was committed, the location of the impact of that fraud, or acts evincing the formation of a contract. In this respect, *Cavello Bay* indicates that a critical factor in determining whether a transaction is "so predominantly foreign" is whether the investor is located in the United States, such that it intended to be protected by the federal securities laws, despite the presence of contacts with the United States. Further, the Second Circuit sought to respect the bargain between sophisticated institutional investors, who structured their transaction in a way "to avoid the bother and expense (and taxation) of U.S. law."[26]

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17 *Chester Cty. Emps. Ret. Fund v. Alnylam Pharms., Inc.*, 193 A.D.3d 638, 148 N.Y.S.3d 80 (1st Dep't 2021).

18 *Id.* at 639.

19 *Cyan*, 138 S. Ct. at 1061.

20 *See Lyu v. Ruhnn Holdings Ltd.*, 189 A.D.3d 441, 137 N.Y.S.3d 322 (1st Dep't 2020), leave to appeal denied sub nom. *Jianming Lyu v. Ruhnn Holdings Ltd.*, 36 N.Y.3d 912, 168 N.E.3d 855 (2021); *Matter of Dentsply Sirona, Inc. S'holders Litig.*, 191 A.D.3d 404, 141 N.Y.S.3d 462 (1st Dep't 2021); *Matter of Sundial Growers, Inc. Sec. Litig.*, 191 A.D.3d 543, 138 N.Y.S.3d 330 (1st Dep't 2021); *Labourers' Pension Fund of Cent. & E. Canada v. CVS Health Corp.*, 192 A.D.3d 424, 144 N.Y.S.3d 16 (1st Dep't 2021).

21 *Cavello Bay Reinsurance Ltd. v. Shubin Stein*, 986 F.3d 161 (2d Cir. 2021).

22 *Id.* at 165, 167-68.

23 *Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE*, 763 F.3d 198 (2d Cir. 2014).

24 *Morrison v. Nat'l Australia Bank Ltd.*, 561 U.S. 247, 130 S. Ct. 2869, 177 L. Ed. 2d 535 (2010).

25 *Stoyas v. Toshiba Corp.*, 896 F.3d 933 (9th Cir. 2018).

26 *Cavello Bay* at 167.

Subsequently, in May, the First Circuit further deepened this circuit split by issuing an opinion in *Securities and Exchange Commission v. Morrone*,[27] which joined the Ninth Circuit in rejecting *Parkcentral* as inconsistent with *Morrison*.[28] Instead, the First Circuit held that, under *Morrison*, the presence of a domestic transaction is sufficient to invoke the federal securities laws without further inquiry.[29] In *Morrone*, the First Circuit found that this requirement was satisfied based on evidence that irrevocable liability occurred in the United States because subscription agreements were executed in and shares were issued from Boston.[30]

Tracing Requirement for Section 11 Claims Regarding Direct Listings

In September, the Ninth Circuit in P*irani v. Slack Technologies, Inc.*[31] created another circuit split, affirming a district court's novel ruling that investors who bought stock in a direct listing had standing to bring Section 11 claims despite their inability to trace their purchases to the registration statement.[32] For decades, circuit courts (including the Ninth Circuit) had uniformly held that the statutory language of Section 11 only permitted suits by investors who could actually trace their shares to the registration statement that contained the alleged misrepresentations. It was thus widely assumed that Section 11 claims could not be brought by investors in direct listings, given that such offerings can involve the simultaneous sale of both registered and unregistered securities.

In *Pirani*, however, a divided panel of the Ninth Circuit adopted a broader reading of Section 11's tracing requirement, under which investors could bring claims about shares whose "public sale cannot occur without the only operative registration in existence," even if the specific shares they purchased were not issued under that registration statement.[33] In reaching its conclusion, the majority was animated by a concern that Section 11 liability could be extinguished altogether in the context of direct listings by adopting the traditional tracing requirement.[34]

The defendants in *Pirani* have since filed a petition for rehearing or rehearing en banc.[35] If not reversed and followed by other courts, *Pirani* may make it easier for plaintiffs to bring Section 11 claims in connection with direct listings and potentially other types of offering structures.

Application of American Pipe Tolling to Pre-Class Certification Opt Outs

In June, the Third Circuit, in *Aly v. Valeant Pharmaceuticals International Inc.*,[36] deepened another existing circuit split, holding that individual opt-out actions can benefit from class action tolling under *American Pipe*[37] even before a district court makes a class certification ruling.[38] In doing so, the Third Circuit joined the Second, Ninth, and Tenth Circuits in holding that *American Pipe* tolling applies to individual actions filed both before and after a district court rules on a class certification motion, which is a position that has been rejected in the Sixth Circuit.[39]

In *Aly*, the district court had reasoned that *American Pipe* and its progeny should only toll the limitations period for individual actions filed *after* a court's class certification ruling, explaining that judicial efficiency favors delaying pursuit of individual claims until after class certification is resolved.[40] However, the Third

[27] *Sec. & Exch. Comm'n v. Morrone*, 997 F.3d 52 (1st Cir. 2021).

[28] *Id.* at 60.

[29] *Id.*

[30] *Id.*

[31] *Pirani v. Slack Techs., Inc.*, 13 F.4th 940 (9th Cir. 2021).

[32] *See id.* at 943.

[33] *Id.* at 947.

[34] *See Pirani* at 947-948.

[35] Petition for Rehearing and Rehearing En Banc, No. 20-16419, Dkt. # 59 (9th Cir., Nov. 3, 2021).

[36] *Aly v. Valeant Pharms. Int'l Inc*, 1 F.4th 168 (3d Cir. 2021).

[37] *Am. Pipe & Const. Co. v. Utah*, 414 U.S. 538, 94 S. Ct. 756, 38 L. Ed. 2d 713 (1974).

[38] *See Aly* at 169.

[39] *Id.* at 174-175.

[40] *Id.* at 171.

Circuit rejected this reasoning, stating that *American Pipe* "makes clear that the filing of a class action is the operative event that tolls the limitations period, and that once the period is tolled, it remains tolled for all putative members until they are no longer part of the class."[41] The Third Circuit noted, among other things, that its conclusion harmonized with the function of statutes of limitation to avoid the "surprise" revival of old claims, a non-issue for defendants who are already aware of the claims against them through the class action.[42] The Third Circuit's ruling also reflected a concern with "lock[ing]" putative class members into the class until after class certification, and leaving "in limbo for an indefinite period of time" members who decide to bring an individual action after the expiration of the normal limitations period but before class certification.[43] Moreover, the Third Circuit found that the district court's rule could produce anomalous results, including in situations where individual actions brought before certification could be dismissed as untimely while individual actions filed much later after certification could proceed, and in situations where members may never be able to assert their individual claims because those claims are barred by the statute of repose, which is not subject to class action tolling, before the class certification motion is decided.[44]

Other Notable Circuit Court Decisions

In 2021, decisions by the Second and Ninth Circuits underscored the demands of the heightened pleading standard and the broad scope of forward-looking statements under the PSLRA.

In August, the Second Circuit affirmed the dismissal of a putative securities class action brought against Danske Bank and certain of its officers alleging that defendants made misstatements and omissions related to the involvement of the bank's Estonia branch in money-laundering.[45] Most significantly, the Second Circuit held that none of the challenged statements were actionable.[46] In particular, it concluded that the bank's release of financial statements without disclosing the Estonia branch's possible money laundering was not actionable because the information was accurate despite the fact that it reflected profits from the Estonia branch.[47] The court emphasized that the bank had no duty to disclose "uncharged, unadjudicated wrongdoing."[48] The court also rejected plaintiffs' argument that the financial statements were misleading for including revenue from unenforceable contracts with the Estonia branch's clients, finding that plaintiffs failed to plead with particularity the law or contractual provision that made the contracts unenforceable.[49] Plaintiffs also challenged statements about the bank's whistleblower system and a goodwill impairment they alleged resulted from the closing of the Estonia portfolio.[50] However, because those statements were made years before plaintiffs purchased their American Depository Receipts ("ADRs") and there had been intervening events, the court held that those statements were stale and immaterial to a reasonable investor.[51] Conversely, the court concluded that the plaintiffs could not challenge the bank's statement that it did not expect the money laundering scandal to materially affect its financial position because that statement was made after plaintiffs purchased their ADRs.[52] The court also held that the bank's statements about compliance with anti-money laundering and anticorruption protocols and standards were puffery and "too general to induce reliance."[53]

41 *Id.* at 175.

42 *Id.* at 176.

43 *Id.* at 177.

44 *Id.* at 178-79.

45 *Plumbers & Steamfitters Local 773 Pension Fund v. Danske Bank A/S*, 11 F.4th 90, 95, 98 (2d Cir. 2021).

46 *See id.* at 98.

47 *Id.* at 98-99.

48 *Id.* at 98 (quoting *City of Pontiac Policeman's and Fireman's Ret. Sys. V. UBS AG*, 752 F.3d 173, 184 (2d Cir. 2014)).

49 *See id.* at 99.

50 *Id.* at 100-03.

51 *Id.* at 102-03.

52 *Id.* at 104-05.

53 *Id.* at 103-04.

In January, the Ninth Circuit in *Wochos v. Tesla, Inc.*[54] likewise affirmed the district court's dismissal of a putative securities class action against Tesla, Inc., in a case alleging that Tesla and certain of its officers made false and misleading statements regarding production capacity for the company's first mass-market electric car.[55] The Ninth Circuit agreed with the district court's conclusion that Tesla's statements regarding its production goals were forward-looking statements, accompanied by meaningful cautionary statements that afforded it protection under the PSLRA's safe harbor.[56] Notably, this included certain forward-looking statements containing present sense components, such as that the company was "on track" to achieve its production goals and that "'there [were] no issues' that 'would prevent'" the company from reaching its goal.[57] With respect to these statements, the court reasoned that "any announced 'objective' for 'future operations' *necessarily* reflects an implicit assertion that the goal is achievable based on current circumstances," and, with respect to those few statements that "arguably contain[ed] representations about current facts," the court held that they were opinions that were not adequately alleged to be false.[58] Finally, the Ninth Circuit also affirmed the district court's denial of leave to amend, concluding that plaintiff could not plead loss causation because the "quick and sustained price recovery" after a modest stock price drop following disclosure of the fact plaintiff alleged had been misrepresented "refutes the inference that the alleged concealment of [that] particular fact caused any material drop in the stock price."[59]

[54] *Wochos v. Tesla, Inc.*, 985 F.3d 1180 (9th Cir. 2021).

[55] *Id.* at 1184-85.

[56] *See id.* at 1191-96.

[57] *Id.* at 1192.

[58] *Id.* at 1192, 1196.

[59] *Id.* at 1198.

Initial District Court Dismissal Decisions in Areas with Increased Filing Activity

In recent years, notable trends in the securities litigation area have included a significant increase in filings against companies that have faced challenges as a result of the COVID-19 pandemic, that have experienced data breaches or cyberattacks, and that have gone public through SPACs. District courts in 2021 began to issue motion-to-dismiss decisions in each of these areas, which may prove to be increasingly significant as litigation continues to be filed on these topics.

COVID-19 Pandemic

Over the course of the last two years, a long line of securities class actions have been filed related to the COVID-19 pandemic, including a number of early class actions against travel companies that allegedly misstated the impact of the then-developing pandemic on their business prospects, litigation against healthcare companies about allegedly misrepresenting the prospects of their COVID-19 treatments and production capacities, and cases concerning allegedly undisclosed volatility in the markets for various products as a result of the pandemic. More recently, several class actions have been filed alleging that companies made misstatements and omissions about supply chain issues that have resulted in part from the effects of COVID-19.

In 2021, district courts began to issue motion to dismiss decisions in these cases, several of which took a skeptical view of allegations that businesses could have predicted the impact of the pandemic in its early days or were required to disclose publicly-available information about the pandemic's impacts. For example, the Southern District of Florida dismissed securities claims in two separate cases involving cruise lines in April and May. In *Douglas v. Norwegian Cruise Lines*,[60] plaintiff alleged that defendants committed securities fraud because they engaged in deceptive sales practices despite knowing of the pandemic's

[60] *Douglas v. Norwegian Cruise Lines*, No. 20-21107-CIV, 2021 WL 1378296 (S.D. Fla. Apr. 12, 2021).

dangers and negative impacts.[61] The court granted defendants' motion to dismiss, finding, among other things, that defendants' allegedly false or misleading statements about marketing strategies, improvements to bookings, safety measures, and ethical business conduct were nothing more than corporate puffery and plaintiff failed to plead scienter.[62] In *In re Carnival Corp. Securities Lit.*,[63] the court likewise dismissed a complaint that alleged defendants' statements, including with respect to their commitment to health and safety and compliance with regulatory requirements, were false or misleading in light of the pandemic.[64] Notably, with regard to a March 2020 statement that Carnival had not "ha[d] a diagnosed case linked to [its] operation," the court found that the statement was false.[65] However, because that statement was made on the same day that Carnival suspended its voyages in response to the pandemic, the court concluded that the statement could not "reasonably mislead investors at that stage of the pandemic."[66]

Similarly, in January, the Central District of California dismissed a class action alleging violations of Sections 11 and 15 of the Securities Act in *Berg v. Velocity Financial, Inc.*[67] Plaintiff alleged, in part, that a real estate finance company's registration statement "distorted the real estate market's conditions and [the defendant's] ability to capitalize on it."[68] Notwithstanding plaintiff's contention that defendants "painted a 'rosy' picture" of the market when it was set to collapse due to the pandemic, the court found that statements in the offering materials were nonactionable puffery.[69] Although plaintiff alleged, among other things, that pursuant to Item 303, defendants should have disclosed "the uncertainty in the real estate market because of the coronavirus pandemic," the court pointed out that plaintiff failed to allege that defendants "would or could have known the extent of the coronavirus pandemic, or even the presence of the disease in America" at the time of the company's IPO such that disclosure about the pandemic was required.[70]

Together, these cases reinforce the challenges that securities plaintiffs are likely to face in establishing that companies were able to foresee unpredictable developments caused by the pandemic, and reinforce that securities complaints may not merely assert claims of fraud with the benefit of hindsight.

In contrast, district courts denied motions to dismiss in two securities cases against healthcare companies arising from the pandemic. In February, the Eastern District of Pennsylvania in *McDermid v. Inovio Pharmaceuticals, Inc.* found that plaintiffs adequately pled claims concerning defendants' statements about the company having "construct[ed]" a COVID vaccine in three hours and the company's progress in producing vaccine doses.[71] Among other things, the court found that plaintiffs had adequately alleged that defendants claimed to have accomplished something they did not accomplish and knew that their manufacturing partner lacked large-scale production capabilities.[72] Then, in June, the Southern District of New York in *Yannes v. SCWorx Corp.* held that plaintiffs plausibly pled that defendants had made misrepresentations about their deal to produce millions of COVID tests, including by rejecting defendants' argument that plaintiffs were trying to plead fraud-by- hindsight and rejecting the notion that defendants did not have to disclose the identity of their supplier.[73]

61 *Id*. at *2.

62 *See id*. at *4-*7,*9.

63 *In re Carnival Corp. Sec. Litig.*, No. 1:20-CV-22202, 2021 WL 2583113 (S.D. Fla. May 28, 2021).

64 *Id*. at *14-*18 (S.D. Fla. May 28, 2021).

65 *Id*. at *14.

66 *Id*. at *14.

67 *Berg v. Velocity Financial, Inc.*, No. 2:20-CV-06780 2021 WL 268250, at *1 (C.D. Cal. Jan. 25, 2021).

68 *Id*. at *3.

69 *Id*. at *8-*9.

70 *Id*. at *9-*10.

71 *McDermid v. Inovio Pharmaceuticals, Inc.*, 520 F. Supp, 3d 652, 663 (E.D. Pa. 2021).

72 *Id*. at 663, 667.

73 *See Yannes v. SCWorx, Corp.*, No. 29-CV-03349 2021 WL 2555437, at *2, *7-*8 (S.D.N.Y. June 21, 2021).

Data Breaches and Cyberattacks

Another continuing trend in securities litigation is the filing of securities class actions against companies that have experienced cyberattacks or data breaches, and a number of courts in 2021 addressed the requirements for pleading a claim in this area.

For example, in February, the Southern District of New York granted a motion to dismiss in a putative securities fraud class action filed against FedEx following numerous disclosures in 2017 and 2018 regarding the impact of a Russian cyberattack on its recently acquired subsidiary, TNT Express Services B.V. ("TNT").[74] FedEx's disclosures included that TNT's operations had been "significantly affected" due to the cyberattack and warned that the financial impact of the disruption "could be material."[75] In subsequent disclosures, FedEx reported progress in restoring TNT's systems and integrating it into FedEx, but repeatedly warned of negative impacts on FedEx's operations and future financial condition.[76] The company also made statements related to its commitment to a specific income target by 2020, but later disclosed that it would not achieve its targeted income increase by fiscal year 2020.[77] The complaint alleged that FedEx's disclosures were materially false in that they misrepresented the status of TNT's recovery from the cyberattack and the negative impact on the company's operations and future earnings.[78]

[74] *In re Fed Ex Corp. Sec. Litig.*, 517 F. Supp. 3d 216, 220-21 (S.D.N.Y. 2021).

[75] *Id.* at 222.

[76] *See id.* at 222-26.

[77] *Id.* at 224-26.

[78] *Id.* at 226-27.

However, the court held that plaintiff failed to adequately plead that FedEx had made any material misrepresentations or acted with the requisite scienter.[79] In particular, the court found that FedEx's disclosures contained language that warned investors about the potentially lingering negative effects of the cyberattack on the company's operations and financial condition.[80] The court also found that even optimistic statements did not meet the requisite pleading standard for materially misleading statements, in part, because Section 10(b) does not require companies to maintain a pessimistic outlook.[81] And, even if certain statements were false or misleading, the court found they would be protected as forward-looking statements.[82] The court further rejected plaintiff's allegations of scienter as conclusory.[83]

Similarly, in June, the Southern District of Maryland found plaintiff failed to adequately allege falsity, scienter or loss causation in *In re Marriott International, Inc., Customer Data Security Breach Litigation*.[84] This case arose out of a guest reservation data breach suffered by Starwood Hotels and Resorts, which Marriott had acquired in 2016.[85] Plaintiff brought claims under Section 10(b) and Rule 10b-5, alleging that Marriott made a series of misstatements related to due diligence and merger integration, the company's outlook, risk factors, customer data protection, and global privacy.[86]

The court found that statements regarding due diligence and integration were not false or misleading, including because none of the statements were specifically about *cybersecurity* due diligence or integration and none of plaintiff's allegations suggested that Marriot was not, in fact, conducting due diligence and spending time on integration.[87] The court also found that the company's

[79] *Id.* at 227.

[80] *Id.* at 230.

[81] *Id.* at 233-34.

[82] *Id.* at 232-33.

[83] *Id.* at 237.

[84] *In re Marriott Int'l, Inc., Customer Data Sec. Breach Litig.*, No. 19-MD-2879, 2021 WL 2407518, at *1 (D. Md. June 11, 2021).

[85] *Id.* at *2.

[86] *See id.* at *2, *6, *11, *19, *25, *28.

[87] *Id.* at *7.

statements regarding the anticipated future success of the merged companies and Marriott's commitment to protecting customer data were puffery, opinions, or forward-looking statements.[88] The court concluded that plaintiff's allegations fell short of demonstrating that a reasonable investor would find the risk factors disclosures or global privacy statements to be false or misleading.[89] The court also highlighted that Marriott updated its risk disclosures regarding cyberattacks in the wake of the breach.[90]

SPACs

A final filing trend in securities class actions that became increasingly prominent in 2021 were cases against companies that went public through SPACs. SPACs have become popular alternatives to traditional IPOs, and represented more than 50% of new public companies in the United States in recent years.[91] However, the increasing popularity of SPACs has been viewed skeptically by many regulators and members of the securities plaintiffs' bar, who have expressed concerns on a number of topics, including about the potential for conflicts of interest in the SPAC structure, the perception that SPACs do not have the same type of gatekeepers present in traditional IPOs, and the possibility that SPACs (many of which take public early-stage companies with products that remain in development) may issue overly optimistic projections about their future business prospects. As a result, a large number of securities class actions have been filed against companies that went public through SPACs, including several after short sellers had issued reports challenging statements made about the status and commercial viability of products in early stages of development.

While many of these SPAC suits have not yet reached a decision on a motion to dismiss, in one early case against a SPAC a motion to dismiss was denied. In particular, in April, the Southern District of Texas in *Camelot Event Driven Fund v. Alta Mesa Resources, Inc.* denied defendants' motions to dismiss and permitted the case to proceed to discovery, after finding that plaintiffs sufficiently pleaded their claims under sections 10(b), 14(a) and 20(a) of the Exchange Act.[92] The suit stemmed from the financial collapse of defendant Alta Mesa, a company created through a SPAC merger.[93] Plaintiffs alleged that defendants made materially false and misleading statements before and after the merger related to Alta Mesa's and the acquired companies' financial health and value.[94] In finding that plaintiffs' pleadings were adequate to support their claims, the court found it significant that Alta Mesa was unable to timely file its annual report because it "expect[ed] to report material weakness in its internal control over financial reporting."[95] The court also found significant, among other factors, Alta Mesa's $3.1 billion write-down—more than 80% of the company's value—less than a year after filing its first Form 10-K.[96]

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[88] *See id.* at *11-*19, *26-*28.

[89] *Id.* at *25, *32.

[90] *Id.* at *23.

[91] *See Max H. Bazerman & Paresh Patel, SPACs: What You Need to Know*, Harvard Business Review (July – August 2021), https://hbr.org/2021/07/spacs-what-you-need-to-know.

[92] *Camelot Event Driven Fund v. Alta Mesa Res., Inc.*, No. 4:19-CV-957, 2021 WL 1416025, at *11-*12 (S.D. Tex. Apr. 14, 2021).

[93] *See id.* at *2-*7.

[94] *Id.* at *1.

[95] *See id.* at *11-*12.

[96] *See id.* at *11-*12.

M&A and Corporate Governance Litigation

Delaware Supreme Court Streamlines the Demand Futility Test

In September, the Delaware Supreme Court decided *United Food and Commercial Workers Union v. Zuckerberg, et al.*,[97] in which it reformulated a demand futility test that applies in all circumstances. The case arose when Facebook shareholders filed a derivative suit in order to recover millions of dollars that the company had spent in defending a previous breach of fiduciary duty class action challenging the board's approval of a stock reclassification.[98]

While nominally new, the standard articulated in *Zuckerberg* blends the tests set forth in *Aronson v. Lewis*[99] and *Rales v. Blasband*[100] without overruling either.[101] Prior to *Zuckerberg*, Delaware courts assessed demand futility under one of two tests.[102] The two-prong *Aronson* test applied "where the complaint challeng[ed] a decision made by the same board that would consider a litigation demand," and excused litigation demands if (1) the board was not disinterested and independent or (2) the transaction at issue was not the result of the board's valid business judgment.[103] The *Rales* test, on the other hand, was applicable in all other situations and excused demand when a majority of the demand board (i.e., the board when the derivative suit was filed that would have considered the demand had one been made) could not "properly exercise[] its independent and disinterested business judgment in responding to a demand."[104] In choosing to adopt the new three-prong test for demand futility, the Delaware Supreme Court concluded that the focus of *Aronson*'s second prong on rebutting the business judgment rule was outdated given that a corporation's ability to insulate its directors from personal liability for duty of care breaches pursuant to DGCL 102(b)(7) "weakened the connection between rebutting the business judgment standard and exposing directors to a risk that would sterilize their judgment with respect to a litigation demand."[105]

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97 *United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg*, No. 404, 2020, 2021 WL 4344361 (Del. Sept. 23, 2021).

98 *See Zuckerberg* at *1.

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

100 *Rales v. Blasband*, 634 A.2d 927 (Del. 1993).

101 *See Zuckerberg* at *17.

102 *Id.* at *7.

103 *Id.*

104 *Id.*

105 *See id.* at *2, *10-*12, *16.

Moving forward, the Delaware Supreme Court held that, in all shareholder derivative suits, courts should consider the following questions with respect to each director on the demand board: "(i) whether the director received a material personal benefit from the alleged misconduct that is the subject of the litigation demand; (ii) whether the director would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand; and (iii) whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct that is the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand."[106] An affirmative answer to any of the three questions with respect to at least half of the demand board will excuse a demand as futile.[107] This test is intended to shift focus from the underlying decision plaintiffs seek to challenge to the litigation demand itself, and provides needed clarity in circumstances in which *Aronson* was difficult to apply.[108]

Delaware Supreme Court Overrules *Gentile*

Following 15 years of inconsistent precedent governing a stockholder plaintiff's standing to pursue direct, rather than derivative claims, the Delaware Supreme Court's September decision in *Brookfield Asset Management., Inc. v. Rosson*,[109] unanimously overruled *Gentile v. Rossette*.[110] *Gentile* provided a carve-out to the general rule that "overpayment" claims are derivative, allowing shareholders to bring both direct and derivative claims where a controlling shareholder caused a corporation to make an overpayment to the controlling shareholder, resulting in a corresponding dilution of minority shareholders' stock.[111] In *Brookfield*, former minority shareholders brought direct and derivative claims against the corporation's controlling shareholders and directors, alleging that the corporation's private placement of stock to the controlling shareholders was not supported by adequate consideration.[112] The trial court dismissed the derivative claims, as plaintiffs' derivative standing was extinguished in a merger that occurred subsequent to the filing of the complaint, but allowed the direct claims to proceed under *Gentile*.[113]

On appeal, the Delaware Supreme Court found good reason to overrule *Gentile*. It explained that *Gentile* was analytically in tension with *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*,[114] under which a claim is direct if (1) the shareholder, individually, "suffered the alleged harm" and (2) the shareholder, individually "would receive the benefit of any recovery."[115] Under *Tooley*, overpayment/dilution claims are solely derivative because the corporation suffers the harm (i.e., a decline in its value) and benefits from any recovery (i.e., a restoration of that value).[116] Any harm to individual shareholders is indirect and exists because of the corporation's injury.[117] The court explained that *Gentile* erred when it concluded that stockholders' economic and voting dilution was independent of the corporation's harm; relied on the "special injury" test, which *Tooley* rejected; and focused on the party who caused harm (i.e., the controller) rather than the party harmed.[118] In light of these considerations, the court held that *Tooley* alone controls whether a shareholder's claim should be considered direct or derivative and made clear that overpayment/dilution claims are exclusively derivative.[119]

The *Brookfield* decision is significant in removing a small, but influential niche doctrine that shareholders have used to bring claims directly that properly belong to their corporations. And, as the Delaware Supreme Court recognized, its holding that

[106] *Id*. at *17.

[107] *Id*.

[108] *See id*. at *2, *16.

[109] *Brookfield Asset Mgmt., Inc. v. Rosson*, No. 406, 2020, 2021 WL 4260639 (Del. Sept. 20, 2021).

[110] *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006).

[111] *See Brookfield Asset Mgmt.*, 2021 WL 4260639 at *10.

[112] *See id*. at *1-*2, *5.

[113] *See id*. at *6.

[114] *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004).

[115] *See Brookfield Asset Mgmt.*, 2021 WL 4260639 at *8.

[116] *See id*. at *10-*11.

[117] *See id*. at *11.

[118] *See id*. at *12-*19.

[119] *See id*. at *1, *22.

overpayment/dilution claims are solely derivative will be outcome determinative in instances where shareholders lose standing to assert derivative claims following a merger.[120]

Delaware Court of Chancery Highlights Factors that Call into Question Directors' Independence

In September, the Delaware Court of Chancery issued its decision in *In re BGC Partners, Inc. Derivative Litigation*,[121] finding that genuine issues of material fact existed as to whether (1) a majority of a board was independent of a controller's influence such that the board could impartially consider a litigation demand and (2) a particular director acted to advance the self-interest of a controller from whom he could not be presumed to act independently, such that he could be liable for a non-exculpated breach of the duty of loyalty.[122] The case arose out of a board's approval of an acquisition in which the seller and buyer both had the same controlling stockholder.[123] Plaintiffs alleged that the controller (who also sat on the board of the buyer company) caused the buyer to overpay for the target company because of his large financial interest in the target.[124] Without first making a demand on the board, plaintiffs brought claims against the seller, affiliates of the seller, the controller, and the outside directors of the buyer company who approved the acquisition, alleging breaches of fiduciary duty.[125] After denial of their motions to dismiss and discovery, defendants moved for summary judgment, arguing that plaintiffs could not establish demand futility or non-exculpated claims against the outside directors.[126]

Addressing demand excusal, the Court of Chancery found that there were genuine issues of material fact that two of the outside directors were not independent of the controller.[127] The court found it significant that one director's board seat had provided him more than half his income for seven years, which was a material financial tie in light of the controller's power to remove the director from the board.[128] The court also found significant that director's testimony that his board income was important and allowed him to support his family and continue his career in public radio.[129] While money was not material for the second director whose net worth was nearly $20 million, that director had an "exceptionally glowing admiration" for the controller because of his philanthropy following the September 11 attacks, and the director and controller shared a 20-year professional relationship.[130]

Delaware Court of Chancery Allows Some *Caremark* Claims to Proceed

As noted in our 2020 Developments in Securities and M&A Litigation, in several cases the Delaware Court of Chancery allowed *Caremark*[131] claims to survive motions to dismiss in 2020[132] despite the high pleading standard for such claims, following the Delaware Supreme Court's 2019 decision *Marchand v. Barnhill*[133] that allowed a *Caremark* duty-of-oversight claim to survive a pleading challenge. The Court of Chancery continued that trend in its September 2021 decision *In re Boeing Company Derivative Litigation*,[134] but in another case, *Firemen's Retirement System of St. Louis v. Sorenson*,[135] dismissed the case against the board of Marriott.

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[120] *See id.* at *8.

[121] *In re BGC Partners, Inc. Derivative Litigation*, C.A. No. 2018-0722-LWW, 2021 WL 4271788 (Del. Ch. 2021).

[122] *See id.* at *9, *13.

[123] *Id.* at *1.

[124] *Id.* at *1.

[125] *Id.* at *1.

[126] *Id.* at *4.

[127] *See id.* at *8-*9.

[128] *See id.* at *8-*9.

[129] *See id.* at *8.

[130] *See id.* at *9.

[131] *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

[132] *Hughes v. Xiaoming Hu*, No. CV 2019-0112-JTL, 2020 WL 1987029 (Del. Ch. Apr. 27, 2020) and *Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou*, No. CV 2019-0816-SG, 2020 WL 5028065 (Del. Ch. Aug. 24, 2020).

[133] *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019).

[134] *In re Boeing Co. Derivative Litig.*, No. CV 2019-0907-MTZ, 2021 WL 4059934 (Del. Ch. Sept. 7, 2021).

[135] *Firemen's Ret. Sys. of St. Louis v. Sorenson*, C.A. No. 2019-0965-LWW (Del. Ch. Oct. 5, 2021).

The *Boeing* case stems from the crashes of two Boeing 737 MAX airplanes that resulted from faulty software.[136] Shareholders of the company, after demanding and receiving books and records pursuant to 8 Del. C. § 220, filed a derivative suit alleging that Boeing's directors breached their fiduciary duties by failing to oversee "mission-critical" airplane safety.[137] The court allowed the *Caremark* claim to proceed, finding that plaintiffs adequately pled board liability based on both the directors' (1) alleged failure to set up a reporting system for airplane safety and (2) alleged conscious disregard of red flags signaling problems with airplane safety.[138] Because plaintiffs pled that a majority of Boeing's board of directors faced a substantial likelihood of personal liability for breaching their *Caremark* duties, the court found that plaintiffs pled sufficient facts to excuse making a demand on the board before filing suit under Court of Chancery Rule 23.1.[139]

To reach its conclusion, the court relied on *Marchand*'s "mandate that the board rigorously exercise its oversight function with respect to mission critical aspects of the company's business."[140] In finding that the complaint adequately pled that the board failed to set up a reporting system, the court—while reaffirming that boards have discretion to design and implement a reasonable reporting system—relied on shortcomings identified in *Marchand* because of similarities in the allegations about board failings in the two cases, including that there was no board committee with responsibility for monitoring airplane safety and no regular process for management to update the board on airplane safety.[141] The court then found that plaintiff pled particularized facts showing that, even if the board had a system in place for monitoring airplane safety, the board ignored red flags, including by allegedly passively accepting management's position that the 737 MAX airplanes were safe even after the first crash.[142]

In contrast, in *Sorenson*—a case arising out of Marriott's 2018 data security breach—the court dismissed plaintiff's suit, including for failure to plead demand futility with respect to plaintiff's *Caremark* claim because the directors did not face a substantial likelihood of liability.[143] The court found that the complaint's allegations of the means by which the directors were informed of cybersecurity risks themselves belied any argument that the board had not implemented systems to assess such risks and that plaintiff had not pled with particularity that the board was aware of legal or regulatory violations and, even if it had, the board did not knowingly choose to remain idle.[144]

Delaware Court of Chancery Refuses to Enforce Liability Limitations in a Contract Procured by Fraud

In August, the Delaware Court of Chancery issued a decision in *Online HealthNow, Inc. v. CIP OCL Investments, LLC*,[145] denying defendants' motion to dismiss and holding that Delaware law and public policy precludes a party from invoking provisions of a fraudulent contract in order to avoid a claim based on that very same contractual fraud.[146] In this case, plaintiffs brought fraud in the inducement and related claims against defendants after acquiring the target company from one of the defendants pursuant to a stock purchase agreement ("SPA").[147] Plaintiffs based their claims on the fact that defendants failed to disclose major financial and accounting irregularities despite defendants' awareness of them prior to the execution of the SPA, thereby making false the target and seller defendant's representations and warranties,

[136] *See Boeing* at *1.

[137] *See Boeing* at *1, n.1. The shareholder plaintiffs also brought another claim against the Boeing directors, as well as a claim against the Boeing officers for breach of fiduciary duty, which the court dismissed. *See id.* at *1, *35-*36.

[138] *See id.* at *1, *25-*34.

[139] *See id.* at *23-*34.

[140] *Id.* at *26.

[141] *See id.* at *26-*27, *29-*31.

[142] *Id.* at *34.

[143] *See Sorenson*, slip op at 1-2. The court dismissed other claims not herein discussed.

[144] *See id.*, slip op at 36-37.

[145] *Online HealthNow, Inc. v. CIP OCL Invs., LLC*, C.A. No. 2020-0654-JRS, 2021 WL 3557857 (Del. Ch. Aug. 12, 2021).

[146] *See id.* at *1, *18.

[147] *See id.* at *5-*8.

including that there were no undisclosed liabilities and that all tax returns had been "duly and timely" filed and were "true, complete and correct in all material respects."[148] Defendants, however, sought to defend against the lawsuit by invoking provisions in the SPA that purported to limit liability: an anti-reliance clause indicating that plaintiff only relied on specific representations and warranties set forth in the agreement, a survival clause that terminated all representations and warranties in the agreement upon closing, and a nonrecourse provision that permitted enforcement of the SPA against the actual parties to the agreement and not their affiliates.[149]

After concluding that plaintiffs had sufficiently pled fraud in the inducement, the court considered whether, under its prior case *ABRY Partners V, L.P. v. F&W Acquisition LLC*,[150] defendants could invoke the SPA's provisions to avoid liability.[151] It observed that *ABRY Partners* counseled that when a party contractually disclaims reliance on statements made outside the contract, it cannot bring a claim for fraud based on those statements.[152] However, where "an agreement purports to limit liability for a lie made within the contract itself, and parties *know* of the lie, such parties cannot skirt liability through contractual limits within the very contract they procured by fraud."[153] The court also noted that *ABRY Partners* implicitly rejected the contention that a non-recourse provision could shield a third-party from liability when that party facilitated the lies.[154] It further observed that *ABRY Partners* suggested that a survival clause would not bar a well-pled claim for contractual fraud.[155] Applying *ABRY Partners* and considering public policy, the court concluded that the provisions in the SPA did not bar plaintiffs' contractual fraud claim.[156]

Delaware Court of Chancery Strictly Enforces Termination Provision To Preclude Post-Termination Claims

The Delaware Court of Chancery's August decision in *Yatra Online, Inc. v. Ebix, Inc.*[157] underscores the importance of the decision whether to terminate a merger agreement. In *Yatra*, the court interpreted an effect of termination provision strictly to mean that claims for breach of the merger agreement terminated along with the agreement itself.[158] Therefore, the court dismissed plaintiff's suit despite allegations from plaintiff that defendants sabotaged the closing of a stock-for-stock reverse triangular merger once the deal, which involved a put right for the plaintiff's shareholders, became unattractive to defendants in light of the COVID-19 pandemic.[159] Whatever the merits of plaintiff's arguments for breach, the court held that these claims for breach of contract did not survive plaintiff's termination of the agreement because the plaintiff seller had two choices when confronted with a breach by the defendant buyer set forth in the agreement: "either (a) sue for damages (or specific performance) or (b) terminate the Merger Agreement and extinguish liability for all claims arising from the contract (except those specifically carved-out, including claims for fraud)."[160]

[148] *Id.* at *4-*8.

[149] *See id.* at *5.

[150] *ABRY Partners V, L.P. v. F & W Acquisition LLC*, 891 A.2d 1032 (Del. Ch. 2006).

[151] *See Online HealthNow* at *9-*10.

[152] *See id.* at *12.

[153] *Id.* at *12 (citing *ABRY Partners*, 891 A.2d at 1063).

[154] *See id.* at *14.

[155] *See id.* at *16.

[156] *See id.* at *16-*20.

[157] *Yatra Online, Inc. v. Ebix, Inc.*, C.A. No. 2020-0444-JRS, 2021 WL 3855514 (Del. Ch. Aug. 30, 2021).

[158] *See id.* at *7-*11.

[159] *See id.* at *1-*2.

[160] *Id.* at *10.

Delaware Supreme Court Allows Common Stockholders to Waive Statutory Appraisal Rights

In September, the Delaware Supreme Court addressed whether common stockholders can waive statutory appraisal rights in *Manti Holdings, LLC v. Authentix Acquisition Co.*[161] Following a 2008 merger, petitioners became minority shareholders of Authentix and entered into a stockholders agreement, under which they agreed to refrain from exercising any appraisal rights.[162] In 2017, Authentix merged with a third-party entity and, under the merger agreement, petitioners' stock was cancelled and converted into the right to receive merger consideration.[163] However, a waterfall provision gave preferred stockholders priority, leaving "little to no compensation" for common shareholders like petitioners.[164] Notwithstanding the waiver provision in the stockholders agreement, petitioners sought to enforce their statutory appraisal rights in the Court of Chancery under Section 262 of the Delaware General Corporate Law (DGCL).[165] On a motion for summary judgment brought by Authentix, the Court of Chancery held that petitioners had validly waived their appraisal rights.[166] On appeal, the Delaware Supreme Court affirmed.[167]

The Delaware Supreme Court found that petitioners agreed to a clear waiver of their appraisal rights, which applied to the 2017 merger, and that the waiver was intended to benefit Authentix.[168] The court also found that neither public policy nor statutory law prohibited Authentix from enforcing the appraisal rights waiver.[169] It affirmed the Court of Chancery's holding that the waiver was not a stock restriction required to be included in Authentix's certificate of incorporation under Section 151(a) of the DGCL because the stockholders agreement imposed personal obligations on the shareholders.[170] The court highlighted Delaware's strong public policy in favor of private ordering and held that Section 262's plain language did not preclude shareholders from agreeing to an *ex ante* appraisal rights waiver.[171] Thus, the court concluded that, at least as it pertains to "sophisticated and informed parties, represented by counsel and with the benefit of bargaining power," common shareholders can waive their statutory appraisal rights in exchange for valuable consideration.[172] The court also held that Delaware corporations can enforce stockholder agreements.[173]

Delaware Court of Chancery Delays Merger Vote to Facilitate Curative Disclosures

In October, the Delaware Court of Chancery issued a preliminary injunction in *Nantahala Capital Partners v. QAD Inc.*[174] that delayed the scheduled shareholder vote on a proposed merger until QAD, Inc., the target company, could provide additional disclosures to ensure an informed vote. Following sufficient disclosures and the lifting of the injunction, the stockholders approved the merger on November 2, 2021.[175]

In *Nantahala*, QAD engaged several potential buyers in a formal sale process to take the public company private, resulting in two private equity firms becoming the primary bidders.[176] After discussions with QAD's founder and controller, as well as the special committee evaluating the sale, one bidder, Thoma Bravo, reduced its offered price per share from a high of \$92 to \$87.50 to

161 *Manti Holdings, LLC v. Authentix Acquisition Co.*, No. 354, 2020, 2021 WL 4165159 (Del. Sept. 13, 2021).

162 *Id*. at *2-*3.

163 *Id*. at *2-*3.

164 *Id*. at *3.

165 *Id*. at *3.

166 *Id*. at *3-*4.

167 *See id*. at *2, *4.

168 *See id*. at *2, *7-*9.

169 *See id*. at *10-*20.

170 *Id*. at *2, *10.

171 *See id*. at *11-*15.

172 *Id*. at *1, *18.

173 *See id*. at *2, *20.

174 Telephonic Rulings of the Court on Plaintiff's Motion for Preliminary Injunction ("Preliminary Injunction Order"), *Nantahala Capital Partners v. QAD Inc.*, C.A. No. 2021-0573-PAF (Del. Ch. Oct. 8, 2021), at 46.

175 WAD Inc. Shareholders Approve Acquisition by Thoma Bravo, Businesswire (Nov. 2, 2021), https://www.businesswire.com/news/home/20211102006284/en/QAD-Inc.-Stockholders-Approve-Acquisition-by-Thoma-Bravo.

176 *See* Preliminary Injunction Order at 8-9.

incorporate a higher rollover of the controller's shares in QAD and to provide a board seat for the controller.[177] QAD publicly announced the sale to Thoma Bravo for $87.50 per share, accompanied by a right for the founder to roll over $300 million of her shares.[178]

After the announcement, plaintiffs sued for breaches of contract and breaches of fiduciary duty, alleging that the terms of the merger violated QAD's certificate provision providing that consideration for public shares must be no less favorable than the consideration offered for the founder's shares, and that these terms led to actionable contract and fiduciary duty breaches.[179] Plaintiffs sought a preliminary injunction of the merger vote based on the alleged violation of the "no less favorable provision" and their allegations that the director defendants disseminated a false and materially misleading proxy, in breach of their fiduciary duties.[180] Plaintiffs persisted in their claims even after QAD issued a supplement to its proxy.[181]

The court granted the preliminary injunction on the disclosure claim but denied it on the certificate claim. While ordering an injunction to facilitate pre-shareholder vote disclosures, including certain communications between QAD directors and Thoma Bravo regarding the founder's goals for the transaction, the court emphasized that the equities militated against enjoining the merger on the basis of the certificate claim.[182] The court found that the disclosure harm could be corrected without derailing the merger.[183] However, it determined that enjoining the transaction on the basis of the certificate claim was inappropriate because it could be a "deal-stopping injunction" that caused stockholders to "los[e] a premium offer for their shares in the absence of a competing offer."[184]

COVID-Related Litigation

As in the securities litigation context, the COVID-19 pandemic has formed the backdrop for litigation concerning M&A and corporate governance. In February, the Delaware Court of Chancery enjoined a poison pill in *The Williams Companies Stockholder Litigation*.[185] There, plaintiffs brought a class action against the directors of Williams, a publicly traded energy company, alleging that they breached their fiduciary duties by adopting and maintaining a stockholder rights plan in response to declining stock prices triggered by the pandemic and an oil price war.[186]

The Delaware Court of Chancery evaluated the board's decision to adopt the poison pill under the two-part *Unocal* standard. Under the first prong, the court found that the board's "generalized concern about stockholder activism" was not a cognizable threat under *Unocal*.[187] Likewise, the board's "hypothetical" concerns about activist short-termism or disruption caused by hypothetical activists were not legitimate threats.[188] However, the court assumed, without deciding, that the board's attempt to use the plan to detect threats before they would be noticed under the federal disclosure system was legitimate.[189] Nevertheless, the court found that, even if that justification were reasonable under *Unocal*'s first prong, the board did not satisfy the second prong as the "extreme, unprecedented collection of features" of the plan—such as the 5% beneficial ownership trigger, as well as the broad definitions of "beneficial ownership," "acting in concert," and "passive investor"—were not reasonable in relation to the board's valid corporate objective.[190] In November, the Delaware Supreme Court summarily affirmed the decision of the

177 *See id.* at 10-13.

178 *Id.* at 16.

179 *See id.* at 7, 17.

180 *Id.* at 18.

181 *See id.* at 18-19.

182 *See id.* at 25, 38-41.

183 *See id.* at 46.

184 *See id.* at 38-41, 46.

185 *See Williams Companies S'holder Litig.*, C.A. No. 2020-0707-KSJM, 2021 WL 754593, at *1, *40 (Del. Ch. Feb. 26, 2021), *aff'd sub nom. Williams Companies, Inc. v. Wolosky*, No. 139, 2021, 2021 WL 5112495 (Del. Nov. 3, 2021).

186 *See Williams* at *1-*2, *4, *16.

187 *Id.* at *32.

188 *Id.* *33.

189 *See id.* at *33-*34.

190 *See id.* at *35, *40.

Chancery Court.[191] *Williams* serves as a reminder that boards should take care in designing poison pills, particularly when the impetus for doing so arises from generalized concerns rather than specific threats.

In April, the Delaware Court of Chancery in its post-trial *Snow Phipps Grp., LLC v. KCAKE Acquisition, Inc.*[192] decision ordered a reluctant buyer to close on its acquisition of DecoPac, a cake decorations supplier.[193] The court rejected the buyer's claims that the COVID-19 pandemic was a material adverse effect and that the steps DecoPac took to respond to the pandemic breached the acquisition agreement's ordinary course covenant.[194] Notably, the court sidestepped the near-universal construct in leveraged buyouts that the seller is entitled to a specific performance remedy requiring the buyer to close only if the buyer's debt financing is also available by applying the "prevention doctrine." In particular, the court found that the buyer failed to use reasonable best efforts to obtain debt financing, which constituted a breach of the agreement.[195] Therefore, under the "prevention doctrine," the buyer could not rely on the unavailability of debt financing to avoid being ordered to specifically perform its obligations under the contract.[196]

Delaware Supreme Court Affirms Ruling that Seller's Pandemic Response Breached Ordinary Course Covenant

In December, in *AB Stable VIII LLC v. MAPS Hotels and Resorts One LLC*,[197] the Delaware Supreme Court affirmed the Delaware Court of Chancery's finding that a buyer was excused from closing on a portfolio of hotels after the seller substantially changed the hotels' operations early in the COVID-19 pandemic.[198] The sale agreement included an ordinary course covenant requiring the seller to conduct the hotels' business "only in the ordinary course of business consistent with past practice in all material respects," unless the buyer otherwise provided prior consent which was not to be unreasonably withheld.[199] After a closing delay, the pandemic began impacting the hotels' operations, leading the seller to close two hotels entirely, shut down amenities at thirteen other hotels, lay off or furlough over 5,200 employees, and minimize marketing and capital expenditures.[200]

The Delaware Supreme Court reasoned that the sale agreement's Material Adverse Event ("MAE") provision (which was not triggered) did not limit the ordinary course covenant because the covenant did not contain language to that effect.[201] Although the MAE provision "shifts systemic risks like the pandemic and its effects on valuation to the Buyer, the Ordinary Course Covenant . . . ensured that the Seller could not materially alter its course of business without the Buyer's notice and consent."[202] Because the seller in this case substantially modified its hotels' operations outside the ordinary course of business without seeking the buyer's consent, the Delaware Supreme Court found the seller's breach of the ordinary course covenant "excused the Buyer's obligation to close."[203]

[191] *See Williams Companies, Inc. v. Wolosky*, No. 139, 2021, 2021 WL 5112495 (Del. Nov. 3, 2021).

[192] *Snow Phipps Grp., LLC v. KCAKE Acquisition, Inc.*, C.A. No. 2020-0282-KSJM, 2021 WL 1714202 (Del. Ch. Apr. 30, 2021).

[193] *See id.* at *1-*2.

[194] *See id.* at *2, *28-*40.

[195] *See id.* at *50.

[196] *Id.* at *55.

[197] *AB Stable VIII LLC v. MAPS Hotels and Resorts One LLC*, No. 71, 2021, 2021 WL 5832875 (Del. Dec. 8, 2021).

[198] *Id.* at *15.

[199] *See id.* at *8.

[200] *Id.* at *10.

[201] *See id.* at *12-13.

[202] *Id.* at *13.

[203] *See id.* at *14-*15.

Courts Dismiss Shareholder Complaints Seeking to Hold Directors Liable for Lack of Diversity

In 2021, federal courts in California, Florida, Delaware, and the District of Columbia dismissed shareholder derivative suits seeking to hold directors and officers liable for perceived diversity failures at their companies.[204] As the dismissals show, shareholder attempts to remedy perceived diversity shortcomings in the workplace through the intervention of the courts face obstacles that, so far, shareholders have not overcome.

In *Ocegueda v. Zuckerberg*, the plaintiff challenged Facebook's alleged lack of diversity among its board of directors, management, and workplace; alleged discriminatory advertising; and alleged failure to stop hate speech.[205] The California federal district court granted Facebook's motion to dismiss on three grounds.[206]

First, the *Ocegueda* court found that a pre-suit demand was not excused as futile because plaintiff did not sufficiently plead lack of independence and directors did not face substantial liability either for (1) ignoring red flags about the company's allegedly illegal conduct, including because some of plaintiff's allegations were contradicted by the record, or for (2) having approved allegedly false statements about the board's commitment to diversity in the company's proxy statements.[207] Second, the court found that the plaintiff's state law claims were subject to the company's forum selection bylaw requiring them to be litigated in Delaware.[208] Third, the court dismissed plaintiff's Section 14(a) claim on the merits for failure to state a claim because aspirational assertions (such as, "Facebook is committed to diversity") were non-actionable, plaintiff's allegations did not support her claim of pervasive unlawful practices, and plaintiff did not allege loss causation.[209]

The Gap faced a similar challenge in *Lee v. Fisher*, in which plaintiff brought state and federal claims stemming from the company's alleged failure to create meaningful diversity on its board and management, as well as alleged false statements about its commitment to diversity.[210] The *Fisher* court only addressed the parties' forum-selection argument and found that the forum-selection clause in the company's bylaws, which required any derivative claim to be filed in the Delaware Court of Chancery, should be enforced despite the fact that plaintiff would be unable to assert her Section 14(a) claim in the Delaware Court of Chancery.[211] An appeal is pending in the Ninth Circuit.[212]

In *Klein v. Ellison*, plaintiffs alleged that Oracle failed to create meaningful diversity on its board of directors and had discriminatory practices in hiring and promoting employees.[213] Plaintiffs sued, asserting a breach of fiduciary duty claim, other state law claims, and a Section 14(a) claim against Oracle's directors and officers. The court dismissed the suit, finding that plaintiffs' state law claims must be filed in the Delaware Court of Chancery pursuant to Oracle's forum-selection clause, and that plaintiffs had not pled demand futility as to their Section 14(a) claim, which it severed from the state law claims.[214] The court found that plaintiffs' allegations about false and misleading statements were conclusory, not supported by particularized facts, and included puffery.[215]

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[204] *See Falat v. Sacks*, No. SACV 20-1782 JVS (KESx), 2021 WL 1558940 (C.D. Cal. Apr. 8, 2021); *Ocegueda on behalf of Facebook v. Zuckerberg*, 526 F. Supp. 3d 637 (N.D. Cal. 2021); *Lee v. Fisher*, No. 20-CV-06163-SK, 2021 WL 1659842 (N.D. Cal. Apr. 27, 2021); *Klein v. Ellison*, No. 20-CV-04439-JSC, 2021 WL 2075591 (N.D. Cal. May 24, 2021); *In re Danaher Corp. S'holder Derivative Litig.*, No. 1:20-CV-02445-TNM, 2021 WL 2652367 (D.D.C. June 28, 2021); *Esa v. Nortonlifelock Inc.*, No. 20-CV-05410-RS, 2021 WL 3861434 (N.D. Cal. Aug. 30, 2021); *Lee v. Frost*, No. 21-20885-CIV-ALTONAGA, 2021 WL 3912651 (S.D. Fla. Sept. 1, 2021); *Kiger v. Mollenkopf*, Civ. No. 21-409-RGA, 2021 WL 5299581 (D. Del. Nov. 15, 2021).

[205] *See Ocegueda*, 526 F. Supp. 3d at 641.

[206] *See id.*

[207] *See id.* at 647-48.

[208] *See id.* at 648-50.

[209] *See id.* at 651-52.

[210] *See Fisher*, 2021 WL 1659842, at *1.

[211] *See id.* at *2-*3.

[212] Appellant's Opening Brief, No. 21-15923 Dkt. # 12 (9th Cir., Oct. 10, 2021).

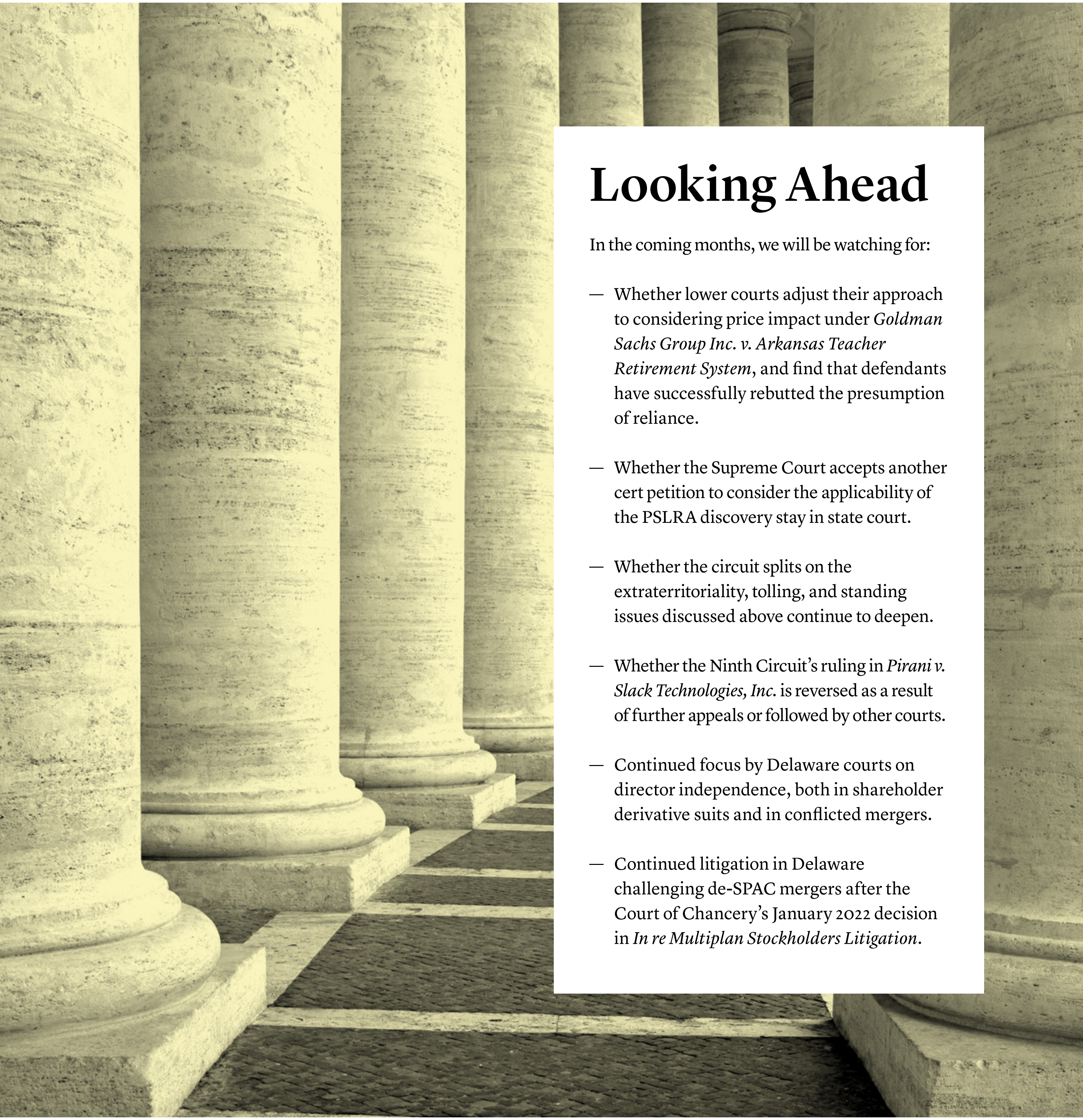
[213] *See Klein*, 2021 WL 2075591, at *1.

[214] *See id.* at *1, *8, *9.

[215] *See id.* at *4-*7.

Five more courts dismissed similar diversity-related shareholder derivative suits in *Falat v. Sacks, In re Danaher Corp. Shareholder Derivative Litigation, Esa v. Nortonlifelock Inc., Lee v. Frost,* and *Kiger v. Mollenkopf*, involving, respectively, energy drink company Monster Beverage, science and technology company Danaher, software company NortonLifeLock, healthcare company OPKO, and wireless technology company Qualcomm.

While to date these shareholder lawsuits demanding greater racial and ethnic diversity, inclusion, and equity in the workplace and on the boards of public companies have been unsuccessful, shareholder pressure continues to build for public companies to take DE&I seriously. As the public landscape continues to change, the litigation landscape may too.



Looking Ahead

In the coming months, we will be watching for:

— Whether lower courts adjust their approach to considering price impact under *Goldman Sachs Group Inc. v. Arkansas Teacher Retirement System*, and find that defendants have successfully rebutted the presumption of reliance.

— Whether the Supreme Court accepts another cert petition to consider the applicability of the PSLRA discovery stay in state court.

— Whether the circuit splits on the extraterritoriality, tolling, and standing issues discussed above continue to deepen.

— Whether the Ninth Circuit's ruling in *Pirani v. Slack Technologies, Inc.* is reversed as a result of further appeals or followed by other courts.

— Continued focus by Delaware courts on director independence, both in shareholder derivative suits and in conflicted mergers.

— Continued litigation in Delaware challenging de-SPAC mergers after the Court of Chancery's January 2022 decision in *In re Multiplan Stockholders Litigation*.

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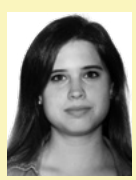

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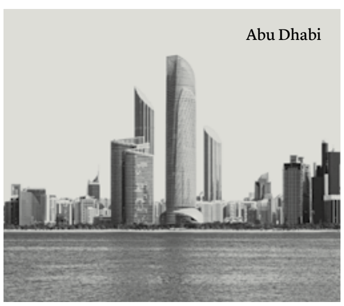
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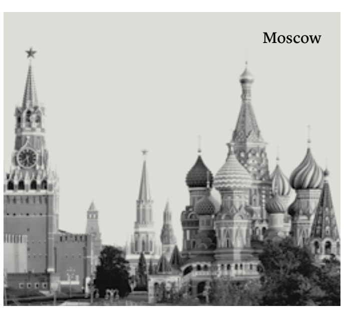
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