Preface for the 2024-2025 Edition

This year's additions to the Treatise include significant developments specific to derivative litigation, including the relationship between powers held by bankruptcy judges under federal law and state-law provisions that limit standing to bring suits on behalf of a business firm, as well as the criteria applicable under Delaware law to the court's choice among teams of lawyers competing for leadership roles as plaintiffs' counsel. Important as they are, these developments may be overshadowed by broader developments in equity ownership in public companies. They include increasingly aggressive tactics deployed by company founders who, as controlling or dominant shareholders, assert power over the corporation's directors. Among other consequences, this can challenge the reality of the conventional assumption that, under Delaware law and corporate law in the United States more generally, corporate governance in public companies is board-centric. The corporation's board of directors owes fiduciary duties to the corporation itself, not to any particular cohort of shareholders, and the board exercises business judgment on behalf of the corporation, unless the decision is one that by statute or under the corporation's certificate of incorporation requires a shareholder vote.

Recent cases (and legislative activity) illustrate dimensions of these developments. In *West Palm Beach Firefighters' Pension Fund v. Moelis*, the Delaware Court of Chancery evaluated the legal efficacy of a shareholders' agreement under which the company's board required prior written consent from the founder before taking action and required the board to assure the founder's ability to select a majority of its members and to populate any board committee with a comparable proportion of the founder's designees. The court held that these provisions, taken together, made the board "not really a board" because they permitted directors to manage the company only to the extent the controlling shareholder gave them permission to do so in contravention of section 141(a) of the Delaware General Corporation Act, which confers full management powers on directors. Not contained in the company's certificate of incorporation, the court held that the provisions were invalid. Responding to concerns from a cohort of transactional lawyers that the court's analysis raised doubts about a current market practice, the Delaware legislature amended the DGCL to permit such stockholder agreements. The haste with which the amendment was drafted—and without input from the Delaware Supreme Court—makes

future tweaks likely.

Moelis triggered critiques of Delaware's courts, as did the outcome following trial in *Tornetta v. Musk*, in which the court held that defendants had not met their burden of proving the entire fairness of the super-sized compensation plan that Tesla's directors awarded to its controlling shareholder, Elon Musk. Post-trial, Musk successfully sought shareholder approval to "ratify" the plan—raising novel questions under Delaware law—and move Tesla's state of incorporation to Texas. Subsequent developments in *Tornetta* clarified that Delaware law will govern the effect of the stockholder vote and that jurisdiction over the case itself will remain in Delaware. It's not evident that the substance of corporate law differs much in Texas as compared to Delaware. In contrast, in *Palkon v. Mattei* a shareholder challenged the conversion of a Delaware corporation to a *Nevada* corporation at the behest of its founder/CEO/controlling shareholder. The terms of the conversion did not include any protections for non-controlling shareholders that could simulate arms-length bargaining. Alleging that Nevada offers both fewer litigation rights to shareholders and greater protections to directors and other fiduciaries, the plaintiff alleged that the company's directors and founder/CEO/controlling shareholder approved the conversion to benefit themselves. The Court of Chancery held that entire fairness was the applicable standard of review because the conversion constituted a transaction that would confer nonratable benefits on the controller. The defendants had not implemented any of the measures that Delaware law permits to clear the way toward application of the business judgment standard and ousting the exacting requisites of review to establish entire fairness.

Shareholder derivative suits can raise fundamental questions about allocations of institutional authority and power. In *Eccles v. Shamrock Capital Advisors, LLC*, the New York Court of Appeals affirmed its adherence to the fundamental principle embodied in the internal affairs doctrine, which applies the substantive law of the place of incorporation to disputes involving a corporation's internal affairs. In *Eccles*, the issue was whether the corporation's directors owed fiduciary duties only to the company—as under the law of Scotland, the site of incorporation—or to the company *and* its shareholders—as under New York law. Reaffirming the application of the internal affairs doctrine, the court declined to create an exception. The interest of the place of incorporation (Scotland) in the company and the transaction was far from minimal, and the plaintiffs did not establish that New York had a dominant interest in applying its own law.

Even when only one national jurisdiction is relevant, a derivative suit may require resolving a collision between judicial authority conferred by federal law and provisions of the state law under which an entity was organized. In *In re Pack Liquidating, LLC*, an official committee of unsecured creditors moved (in federal bankruptcy court) for derivative standing to pursue a claim against an LLC's managers for breach of fiduciary duty. The defendants argued that the Delaware LLC Act precluded standing for the committee on fiduciary duty claims because under the statute only LLC members or the LLC's assignees can have derivative standing to sue on behalf of the company, as a derivative suit would require. Breaking with prior decisions from bankruptcy judges in Delaware, *In re Pack Liquidating* follows precedent from the Third Circuit (which includes Delaware) to hold that the bankruptcy court's authority to grant derivative standing to a creditors' committee derives, not from state law, but from the federal Bankruptcy Code as "one of the many tools" granted by the Code to bankruptcy judges to ensure that the debtor-in-possession of an insolvent entity performs its role in estate's best interests. Noting consistency between the Third Circuit's resolution and authority from the Second, Third, and Seventh Circuits, *In re Pack Liquidating* characterizes a bankruptcy court's authority to grant derivative standing as a "lesser power" that can be implied from its greater backstopping powers to convert a Chapter 11 case to Chapter 7, appoint a Chapter 11 trustee, or appoint a bankruptcy examiner. And even if the Delaware LLC statute purported to prevent a bankruptcy court from granting derivative standing, the court held it would be preempted by federal bankruptcy law, under which the most imperative objective of Chapter 11 is ensuring that a debtor-in-possession operates as a faithful trustee.

The materials added to the Treatise also address frequent issues in derivative suits. Recent amendments to Rule 23.1 of the Delaware Court of Chancery address a recurrent situation: when multiple shareholders file derivative complaints arising from the same underlying facts and the court consolidates the actions, by what criteria should the court resolve a leadership dispute among competing teams of plaintiffs' counsel? As amended, Chancery Rule 23.1(c)(3)(A) articulates eight factors that the court may consider when selecting counsel. These include counsel's competence and experience, access to the resources necessary to prosecuting the litigation, the quality of pleading, performance to date in the suit, and any conflicts between counsel or the derivative plaintiff and the entity. The court may also consider the structure for proposed leadership, the relationship between the derivative

plaintiff and the entity, and any other matter pertinent to the ability of counsel or the derivative plaintiff fairly and adequately to represent the entity's interests. In *In re Fox Corp. Derivative Litig.*, the Court of Chancery observed that the factors articulated in the rule are "not a scorecard." Each factor should receive weight only to the extent it bears on the ultimate question: which team, among the contenders, can best represent the entity's interests in pursuing the suit. Relevant to the court's choice in *In re Fox Corp.* between two contending teams, both with the experience and resources to prosecute the suit, were marked differences in the teams' composition and formation. The team chosen by the court appeared balanced, the result of an "organized, intentional, and client-driven process." In contrast, the other contender appeared to the court "more like a committee of the willing…assembled on the fly." And the fact that public officials were among the plaintiffs represented by the team chosen by the court was a benefit, in the court's evaluation, given the inevitability of media scrutiny as the case progresses.

Another recurrent issue in derivative litigation is the applicable standard of appellate review when a lower court dismisses a derivative suit for failure to allege facts establishing that making a demand on the board would be futile. Overruling its 1992 precedent (*Blasband v. Rales*) prescribing appellate review for an abuse of discretion, in *In re Cognizant Technology Solutions Corp. Derivative Litig.* the Third Circuit held that going forward, dismissals for failure to prove demand futility should receive *de novo* review. *In re Cognizant* brings the Third Circuit in line with the First, Second, Seventh, Eighth, and Tenth Circuits, as well as with several state supreme courts, most notably Delaware and New Jersey. Acknowledging its reluctance to overturn its precedents, the Third Circuit pointed to several reasons for its decision to adopt the *de novo* standard. First among them, practical issues arise when a district court applies Delaware law to determine whether the complaint adequately alleges that making demand would be futile because then the court exercises no discretion. More broadly, *In re Cognizant* reasons that in demand-excused cases, an appellate court performs the same task as the trial court, neither charged with making a decision that turns on balancing potentially competing factors. Additionally, substantive standards governing determinations of demand futility are relatively uniform and amenable to general rules. True, the determination in each case turns on its facts, but the same is true most of the time in applying law to facts. Moreover, nothing in the text of federal Rule 23.1 or its state-law counterparts reflects a preference for the trial court's decision on the issue, while the issue itself carries major consequences for shareholder cases, which points in favor of more intensive appel-

late review.

Many shareholder suits end well short of trial on the merits. This year's materials include two highly visible Delaware cases that either culminated in a trial or settled on the proverbial eve of trial, in both cases leading to disputes over attorney's fees for plaintiffs' counsel. In *In re Dell Technologies Inc. Class V Stockholders Litig.*, just before trial the plaintiff settled a class action challenging a redemption transaction that consolidated the company's ownership on terms allegedly advantageous to its controlling shareholders and disadvantageous to noncontrolling public shareholders. The board's special committee charged with negotiating terms of the redemption did so in the shadow of threats from the company and its advisors to proceed with an alternative transaction on non-negotiated terms. The defendants agreed to settle in exchange for $1 billion in cash, an amount that represented the largest cash recovery ever in representative litigation in the Delaware Court of Chancery. When a plaintiff has obtained a quantifiable result, settled Delaware precedent directs the court to derive an indicative fee as a percentage of that result, taking into account the stage of the case when the result was obtained to reward counsel for "taking more risk in pursuit of the best outcome." On the facts, in *In re Dell*, plaintiff's counsel "brought a real case, invested over $4 million of real money, and obtained a real and unprecedented result," justifying a fee award of $266.7 million, or 26.67% of the settlement amount. But a group of four investment funds objected to the fee award as excessive, arguing that the court should reduce the fee percentage as the size of the recovery increases, using a declining-percentage method to calculate fee awards as federal courts do in securities law cases.

Affirmed by the Delaware Supreme Court, the Court of Chancery did not adopt the declining-percentage method. The indicative fee, stemming from the stage-of-case percentage, is not the sole factor that the court considers in determining a fee award. Whether the case was litigated on a contingency-fee basis is relevant, as are counsel's time and effort, the case's relative complexity, and counsel's standing and ability, all of which can be deployed to adjust the indicative fee in either direction. Additionally, the Court of Chancery questioned how similar federal securities cases are to contemporary Delaware M&A litigation. Both the volume and the magnitude of recoveries in securities litigation greatly exceed the numbers for Delaware M&A cases. Additionally, the work requisite to identifying a high-quality case differs; federal securities actions generally follow the filing of criminal charges, the dismissal of a top officer, or a financial

restatement. No similar set of signals so consistently identifies a high-value value set of facts for a Chancery case, focused as they are on deals, most of which go unchallenged by federal or state law enforcement or daunted by comparable red flags. Counsel must conduct their own investigations, often making a demand for corporate books and records; and an ever-present risk of dismissal or loss on appeal contributes a distinctive risk. To be sure, on the court's computations, settlements in M&A cases vary based on deal size, just as settlements in securities cases vary based on market capitalization. But overall, the justifications for using a declining-percentage method are not compelling in the Chancery context, given the factors that differentiate M&A cases from securities cases and the scope of the court's discretion in determining a fee award.

Another closely watched case, *In re Oracle Corporation Derivative Litig.*, illustrates distinct risks for plaintiffs' counsel in high-stakes derivative suits. The suit challenged the terms on which Oracle acquired another company, NetSuite. Oracle's founder (also NetSuite's founder) was a major blockholder in both companies and held a proportionately greater interest in NetSuite. The founder also had great influence over Oracle's operation, while a majority of its directors were not independent of him. The case survived a motion to dismiss, followed by Oracle's appointment of two new independent directors who constituted the majority of a special litigation committee. Following investigation—and unusually for derivative suits—the committee determined that it was in Oracle's best interests for the suit to go forward, led by the derivative plaintiffs and their counsel. Following a ten-day trial and five amendments to the complaint, the defendants prevailed, the court finding that Oracle's founder had sufficiently insulated himself from the NetSuite transaction. Seeking an award of attorney's fees, plaintiffs' counsel argued that the case conferred a benefit on the corporation because it prompted the appointment of two independent directors. The court disagreed, holding that the independent directors' appointment neither mooted any issues in the case, nor was it an aim of the litigation. The court distinguished cases awarding fees following settlements that conferred therapeutic benefits (like the appointment of independent directors to a controlled corporation's board) because those benefits stemmed from the compromise of claims raised by the suit. Although laudatory about the skill and vigor with which plaintiffs' counsel prosecuted the case, the court noted the costs borne by the corporation during the trial, distinguishing the fee awards that follow settlements compromising claims in derivative suits from an unsuccessful outcome following trial.

The materials added to the Treatise also illustrate the fact that, although novel transactional structures emerge over time, general fiduciary principles—applied in derivative suits—nonetheless apply. In *Grabski v. Andreesen*, the plaintiffs alleged that the directors and officers of a cryptocurrency platform, which went public through a novel direct-listing structure, breached their fiduciary duties by selling their stock one month after the direct listing and shortly before the corporation announced disappointing earnings. Unlike an IPO, a direct listing involves the sale of existing shares directly to the public without the involvement of underwriters. Safeguards for public investors—like minimum holding periods imposed on insiders—are optional. The court held that the plaintiffs stated a viable claim and that making demand on the corporation's directors would have been futile because a majority faced a substantial likelihood of liability. The court also noted that the case represented "yet another instance where a stockholder plaintiff calls upon this court to deploy 'well-worn fiduciary principles' to a new transactional setting," citing the court's earlier fiduciary jurisprudence in cases involving SPAC transactions.

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