TRANSCRIPT
THE SIDLEY PODCAST

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Litigation Trends in Delaware and How Businesses and Boards Can Mitigate Risk
Sam Gandhi, Jim Ducayet, and Charlotte Newell
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Sam Gandhi:
SPAC sponsors, beware. Delaware's Chancery Court warrants are the failure to tell the whole truth, or else. In today's podcast, we look at the latest Delaware rulings and what they say about a SPAC board's fiduciary duty, as well as COVID's continuing effect on M&A deals, and what should members of the board do to mitigate their liability?

Jim Ducayet:
It is really the first word from the Delaware Courts on the fiduciary duties of directors of SPACs, as well as SPAC sponsors.

Charlotte Newell:
MultiPlan suggests, going forward, we're going to see courts parsing de-SPAC merger proxy statements and evaluating whether the SPAC's stockholders were fully informed in connection with the de-SPAC merger.

Jim Ducayet:
At least in Delaware, you're not going to have pandemic-only rules.

Charlotte Newell:
Delaware gives contracting parties flexibility, but that comes with risk. Your words are what you're going to live with in a future dispute.

Sam Gandhi:
From the international law firm Sidley Austin, this is *The Sidley Podcast*, where we tackle cutting-edge issues in the law and put them in perspective for businesspeople today. I'm Sam Gandhi.

Hello, and welcome to this edition of *The Sidley Podcast*, episode number 25. Today, we speak to two thought leaders and the implication of important M&A litigation decisions out of the Delaware Courts: Jim Ducayet and Charlotte Newell.

Jim is a partner in Sidley's Chicago office and co-head of the firm's Securities and Shareholder Litigation practice. He advises companies, boards, and individual directors and officers in high-stakes litigation, corporate governance and disclosure matters, and government internal investigations. Jim is an experienced trial lawyer and commercial litigator, with a particular focus on corporate and securities litigation, D&O and derivative litigation, internal investigations, and complex bankruptcy and financial litigation.

Charlotte's a partner in Sidley's New York Office and a member of the firm's Securities and Shareholder Litigation and Corporate Governance and Exec Comp practices. She focuses her practice on stockholder class and derivative actions, M&A litigation, securities class actions, and investment funds matters. Prior to joining Sidley, Charlotte was a law clerk for the Honorable J. Travis Laster, Vice Chancellor of the Delaware Court of Chancery. Jim and Charlotte, great to have you on the podcast today.

Charlotte Newell:
Great to be here.

Jim Ducayet:
Thanks for having us, Sam.

Sam Gandhi:
On January 3, the Delaware Court issued a novel decision involving a special purpose acquisition company. That's what we commonly call a SPAC. That case was tilted the MultiPlan Corp Stockholders Litigation. The court denied a motion to dismiss, allowing claims to proceed against a SPAC sponsor and its board of directors.

And as *Reuters* put it, Delaware's Chancery Court has just put the special purpose acquisition company insiders on notice. If they don't tell the whole truth about proposed deals, they may be on the hook to investors. We're going to see more of this litigation as we continue the SPAC wave, and as you know, SPACs have become wildly popular vehicles for raising funds, outside of the traditional IPO route for companies.

This is a kind of interesting combination of capital markets and M&A. And I think we saw, in the last two years, about 248 SPAC IPOs in 2020 and 613, an eye-boggling number, in 2021, and that compares to only 59 in 2019 and 46 in 2018. So, that's just continuing to increase, and likely, that instrument's here to stay. Jim, what is this case about, and why is it so important?

So, Sam, before I talk about the specifics of the MultiPlan case and why it's so interesting, it's probably useful to lay out a couple of important and distinctive features of SPACs. SPACs are ultimately a big pot of money. It's a publicly traded company, and it goes public through an IPO.

The sole purpose of that company is to do a transaction, usually within some sort of window. Commonly, it's about 24 months. And what's interesting about SPACs and important here, I think, for purposes of what we're going to talk about in the MultiPlan case, is two ways in which both the sponsors of the SPACs are compensated and the ways in which some of the directors may or may not be compensated.

And ultimately, it boils down to the concept of a redemption right. One of the very unique features of a SPAC is that, when you get your shares, you have the right, at certain periods during the life of the SPAC and then, ultimately, when there's a decision made to go forward with a merger, you have the right to decide to redeem your shares and essentially get your money back.

Typically, these shares are priced at 10 bucks a share, and so the idea would be you are investing in the IPO. You're putting 10 dollars into this trust. It sits in the trust. It can't be used for any purpose other than a transaction, and when you're ultimately asked to make a decision on whether to go forward with the merger, you have the ability to simply say, I want my money back.

I want to redeem, and that's important for reasons I'll get to in a second. The other important aspect of this is how the sponsors are compensated. The sponsors also have shares, but what's important is that those shares don't have a redemption right, and they're usually priced at a very nominal amount. So, instead of kicking in the 10 dollars a share, they may be priced at a far, far lower value.

What's important here is that this creates a potential set of incentives whereby, look, if you don't do a deal and you end up essentially liquidating the SPAC and returning all of your investor's money, you're not going to get paid, because you don't have a claim on that trust, and you don't get, essentially, the cost of the shares back to you. On the other hand, if you do make a deal, you will be able to realize value out of those shares.

And that may be true even if the ultimate value of that deal is less than the 10 dollars that every other shareholder who invested in the IPO would be entitled to, and so, there's a potential misalignment of incentives here, and that's driving some of what we're going to talk about in a moment.

The other important point here is that you've got boards of directors, and in some instances, this is not universal, but in some instances, you have boards of directors who are being compensated in founders shares. In other words, they get sort of the same economics that the sponsor does, and so, the question is does that misalign their interests, as well? Do they have an interest in doing a deal, essentially, any deal to get some value out of their founders shares, even if the shareholders would prefer not to do a deal and simply get their money back?

So, in MultiPlan, this was really the first ruling on what standard would apply here to a shareholder who comes in and says, I believe that the deal that the SPAC entered into was a bad deal, and I believe that the board of directors and the sponsor breached their fiduciary duties. And so, MultiPlan was an 11-billion-dollar merger that involved a healthcare-focused data analytics company.

It was a situation where the SPAC sponsor had founders shares. It was also a situation where the board of directors was picked by the sponsor, and it included lots of very, at least as the complaint alleged, close associates, you know, and others who were well known and closely aligned with the sponsor, and those directors were compensated in the form of founders shares.

This was a case where, in the course of the decision to enter into the merger, the SPAC did not get an independent fairness opinion, and instead, it retained a firm that was also affiliated with a SPAC sponsor to provide it with advice, and it ended up paying that sponsor affiliate about 30 million dollars.

Sam Gandhi:
Jim, is that normal for SPACs that are going through a merger? Do they normally get a fairness opinion?

Jim Ducayet:
We don't see it very often, and the theory there is, in a traditional M&A deal, you have, essentially, an operating business, and you're asking shareholders to sort of approve a deal versus an alternative of sort of letting that operating company to continue to operate.

And so, a fairness opinion makes some sense there, because you'd want to say what's the value of this transaction versus what is the value of this company if it didn't do the deal and simply continued on to business? Well, as I mentioned earlier, SPACs are just a big pot of money. They don't actually do anything, other than look for deals.

And so, the sort of received wisdom in SPAC circles has been a fairness opinion just doesn't really make a lot of sense here, and it requires you, essentially, to be valuing the target, which you can do, but that takes a little bit more work. So, in general, we have not been seeing fairness opinions.

We may start to see fairness opinions, frankly, as a result of this decision. As providing, essentially, an additional reason or justification to backstop the board's determination to go ahead and enter into the merger, but they're not common. There wasn't one in this case, and I would say, in most of the deals that we see coming out of the last couple of years, we've not seen fairness opinions.

Sam Gandhi:
Jim, what triggered the case? Why is this case unique? As we speak today, we see tremendous volatility in the market. Most shares are down about 20% as of late January from their highs of last year, and the SPAC market,

it’s getting hit, as well. Why is this stock drop leading the litigation that’s so unique?

Jim Ducayet:
Well, what’s interesting is that the stock drop here was really precipitated by a report from an equity research firm about the MultiPlan customer base, and one of its largest customers, apparently, had been contemplating canceling its relationship with MultiPlan. That fact came out after the merger closed, and it had a very dramatic impact on price, and at least as it was alleged in the complaint, this was information that was known to the SPAC, and it was not disclosed.

So, it’s a situation where you have a potentially very significant material adverse development at the company you’re about to buy, and the claim here was that that was not disclosed. And it sort of keyed up the question of, well, why wasn’t it disclosed, and were there procedures in place to ensure that this was information that was reviewed and taken into account, but more importantly, fully and fairly presented to shareholders.

So, ultimately, the case boils down to the question of did shareholders have sufficient information to be able to decide whether or not they wanted to go forward with the deal or whether they wanted to redeem their shares? So, that’s kind of the real basis of what the court held here. What it says is that shareholders didn’t have enough information.

They were being asked to make an important decision about whether to go forward and get equity in the new company or to get the 10 dollars in cash. And to your question, Sam, it’s not uncommon, but it arises in a very stark fashion in terms of the kind of post-merger disclosure landscape, and it really gave the plaintiffs here a hook to say there was very important material information that wasn’t disclosed to us.

Sam Gandhi:
Charlotte, from a Delaware law standpoint, what do you think is the most significant part about the ruling?

Charlotte Newell:
Sam, I think, for starters, MultiPlan is significant because it suggests, as Jim just mentioned, that the Delaware Courts are going to apply traditional

fiduciary duty principles in the novel SPAC context, at least in the presence of that well-pled disclosure claim here, that issue about the 35% customer. And so, that means that MultiPlan suggests, going forward, we’re going to see courts parsing de-SPAC merger proxy statements and evaluating whether the SPAC’s stockholders were fully informed in connection with the de-SPAC merger.

MultiPlan really reinforces the importance of robust disclosers, particularly in a context where, because of those alleged conflict issues, the downside risk is the application of a very onerous entire fairness standard, where the directors are ultimately bearing the burden of proving fairness of price and process in the deal. I should say, this focus on disclosure isn’t new. Adequate disclosure has been a real feature of M&A litigation for a long time right?

We know the duty of disclosure is a component of a director’s duty of loyalty. Directors have an obligation to be honest and provide stockholders the information they need to make decisions, but there’s a flip side to that coin, right? As then Vice Chancellor Strine put it, a great quote that’s always stuck in my head anyway, we shouldn't be ascribed rube-like qualities to stockholders.

And so, in addition to the concept that directors need to be providing information to stockholders, we also acknowledge that, with that information, stockholders are empowered to make their own decisions. And so, I say all of this to drive home the idea that one feature of MultiPlan is a focus on these traditional fiduciary principles where you have a well-pled disclosure issue, but again, the focus on disclosure isn’t new. What’s new is this context of a de-SPAC merger.

One other thing that I think is important to remember about the MultiPlan decision, and this is expressed, Vice Chancellor Will went out of her way, I think, to drive this home. As always, she was deciding the case before her.

She made the point that one could imagine a different outcome, had the facts been different. For example, most importantly, had there not been those well-pled disclosure claims. So, I say this, again, to remind that MultiPlan doesn’t give us the roadmap for all SPAC cases. It only gives us a roadmap where we have the conflict allegations and MultiPlan, plus that well-pled disclosure claim about a customer responsible for 35% of the company's revenue.

Jim Ducayet:
The other thing I'll add to that is this alleged misalignment of incentives is important because there are two important facets of this decision. One is, there was a concession by the defendants here that the SPAC sponsor was a controlling shareholder, and that's an important concession, and the other piece is, as I mentioned earlier, that the directors are being compensated by needs of founders shares.

Now, there is, obviously, a very well-trod path for how you would enter, and ultimately get approval, for a transaction in which you have a controlling shareholder or in which you have directors who may have a conflict. There's a process that was laid out in the MFW Case a number of years ago, but there was a real open question about whether or not the doctrine of entire fairness, which is what MFW is intended to sort of get you out of, would apply here.

And if it did apply, whether some of the procedural steps that you would take in a traditional controlling shareholder case would have any validity or impact, and that was the open question. That question's still sort of open, frankly, after this decision because, as Charlotte notes, this is largely driven by the disclosure question. There was, at least as pled, a very substantial disclosure problem.

And the court had no problem concluding that that was material to a decision that the shareholders are being asked to make about whether or not to redeem. And so, one of the important and open issues is if you put aside a disclosure problem, like the one that was alleged here, would the same structure get you to the same place in terms of entire fairness, and that is a question I think that remains to be answered.

Sam Gandhi:
I want to ask you both a quick question, which is that do you find this result surprising?

Charlotte Newell:

I don't, Sam. I think the application of traditional fiduciary principles to the actions of the directors of a Delaware corporation is, in many ways, unsurprising and kind of axiomatic. What is, I think, interesting about this decision is that it really leaves open, as Jim mentioned, how we're going to apply those principles to a de-SPAC merger when stockholders are fully informed, but Jim, what do you think? Surprising?

Jim Ducayet:
I was a little surprised, and I was a little surprised for two reasons. Number one is one of these unique aspects of SPACs is this redemption feature. And so I think there was a legitimate question about whether or not the courts in Delaware would say, because you effectively have an exit, right, you have the ability to get out of this deal for a sum certain that that would make the calculus of the fiduciary duties of the board a little bit different.

And so, it's not a traditional controlling shareholder transaction where, essentially, you're being dragged along, and your only real recourse, if you don't like the deal, is to seek an appraisal of your shares. It's a much different kind of process. I think there was a question about whether or not that might impact the decision here.

The other thing I will say is that, certainly, the disclosure issues, as pled — and it's worth stressing that this is a motion to dismiss, and so you have to take very plaintiff-favorable interpretations of the complaint — the disclosure issues are obviously pretty significant. And so, one of the first questions I had when I read this opinion was, well, why didn't this get resolved simply as a disclosure violation? Why did you need to talk about what the standard of review is for the board? Why do you need to get into questions about is it entire fairness? Is it business judgment?

Because if you're asking shareholders to take some action, in this case, to make a redemption decision, you already have a duty under Delaware law to provide them with sort of full and accurate disclosure. I can envision a way in which this case would've been resolved in a much narrower basis by simply saying there was a breach of a duty of disclosure.

And we'll leave for another day the question about exactly what standard of review should apply.

Sam Gandhi:
Charlotte, just a follow-up for you. Who's really affected by this decision, and what's the implication going forward?

Charlotte Newell:
I think it's fair to say that everyone involved in the SPAC life cycle is looking at MultiPlan and thinking through these issues. So, certainly, that includes SPAC sponsors, directors on SPAC boards, but also advisors, potential targets. Really everyone in the process, I think, is working through these matters.

In terms of the implications, first and foremost, disclosure matters, right? That certainly is one of the key features of this decision. And that means there's going to be, certainly, a renewed focus on providing clear disclosures to stockholders about, among other things, potential conflicts that could exist between the sponsor and/or members of the board, on the one hand, and common stockholders on the other.

You also, of course, want to make sure that the disclosures about the target. Its business, its financials and such are adequate so that stockholders really have the information they need to make that informed decision about whether to take their 10 dollars a share and walk away or remain invested and seek the benefits of the post-merger entity.

Beyond disclosures, though, there's clearly a menu of options that people can consider in the face of MultiPlan to perhaps reduce risk. As Jim mentioned earlier, we don't know the outcome in a case where — think of MultiPlan minus the disclosure issues, right? So, imagine all the conflicts alleged in MultiPlan, what the stockholders knew about all of them.

We don't know the outcome yet. That's a case for another day, and so, in the face of that uncertainty, some may, depending on the risk profile, want to take actions to reduce litigation risk, and you could imagine a lot of things here. You could imagine processes to mitigate conflict issues, to improve disclosures, but even maybe more foundational or fundamental changes.

Some have hypothesized, for example, that SPAC sponsors may incorporate outside of Delaware, outside the United States altogether, in larger numbers. We've seen some of this already. There are some SPACs, for example, incorporated in the Caymans. Maybe we see more of that, and if we take the decision as to where to incorporate, just as one example, right, one example of the menu of options that people involved with SPACs could consider.

There's a whole host of considerations, just on that particular point, right? How's the market going to react? How are people going to evaluate the decision to invest in the SPAC incorporated in Delaware as compared to another jurisdiction, including everywhere outside the United States? On the other hand, of course, for sponsors and directors making that decision, avoiding Delaware by virtue of incorporating elsewhere presents a different set of risks.

I think the Delaware Courts are generally perceived as being preeminent in the corporate law space, from my perspective, rightly so. And as a consequence, going to a jurisdiction that has a less well-developed body of corporate law and has jurists who — understandably, because they're not focused on these issues all the time — aren't as imbued in these corporate law issues. Creates its own set of risks, right? Presents a different type of uncertainty.

So, I think, fair to say, that there are a host of things that those involved with SPACs, or at least should be, considering in the face of MultiPlan and really everyone involved should be working through all of these issues with their counsel.

Sam Gandhi:
You're listening to *The Sidley Podcast*, and we've been speaking with Sidley thought leaders Jim Ducayet and Charlotte Newell about a Delaware Court's recent novel ruling involving a SPAC's litigation and what that portends for similar cases going forward.

Now, a theme of a lot of our podcasts has been the impact of COVID-19, and COVID has ushered just a ton of cases where buyers have walked away from an acquisition, and how buyers may justify their decision legally has been the subject of litigation recently in the Delaware Courts, and Jim, a lot of people are watching these types of M&A cases spawned by the pandemic.

And as we sit here, we thought the pandemic was largely behind us, and we're in the middle of another wave, which may, again, hurt earnings and potentially affect M&A out there. If I'm a buyer who's having second thoughts, what should I know?

Jim Ducayet:
I think you should know that, at least in Delaware, you're not going to have pandemic-only rules that apply. In other words, I think there's a theme that's come out of the cases that have been decided during the pandemic. That Delaware Courts are going to very closely review the language that the parties agreed to, the allocation of risk that's reflected in that language, and they're going to hold parties to it.

The assumption here is that you have very significant transactions involving lots of dollars with incredibly sophisticated legal and financial advisors, and that the words matter, and so, there's a very strong contractarian theme throughout Delaware law, and we've seen that continue even in situations that are truly extraordinary, like the pandemic. I will tell you, and Sam, you I'm sure remember this, as well.

The very outset, back in February, March, you know, April of 2020, I think many of us were expecting a ton of broken deal cases. Situations in which, because of the uncertainty that was created by the pandemic, those who had already signed up deals would not want to close, you know, and that would be true either on a buyer or a seller basis. And I have very, very vivid memories of advising clients about what the risks were of proceeding down various pathways and the like.

What's interesting is that, in fact, there have been fewer of these cases than you might've imagined, and I think part of that is reflective of what happened after the initial shock of the pandemic. And once people sort of picked up the pieces and started to think through a longer term, they were able to either get comfortable with the deals that they had struck or were able to restructure those deals on a consensual basis, and they didn't get to the point where they needed to be litigated.

But there had been a few cases, and I think they provide some interesting guidance, to get back to your original question, Sam, on what do you need to know if you're in a situation where you're contemplating trying to walk away from a deal that you've signed. And the cases, there have really been three important cases decided over the last couple of years.

They've been focused on two different aspects of a traditional merger agreement. One is the ordinary course covenant, and the other is the material adverse effect or material adverse change clause. As I think many of our listeners will know, most merger agreements contain a covenant that says, between signing and closing, you are obligated to operate the business in the ordinary course.

That's obviously designed to protect the buyer and make sure that, by the time you get to closing, what you're actually buying is what you thought you were buying, and then the material adverse effect provision is designed to really allocate the risk of something dramatic and unexpected happening between signing and closing; and in broad strokes, if there is a market-wide dislocation or break of some sort, that's traditionally going to be a risk that remains on the buyer.

In other words, it's not going to give them an excuse not to go forward with the deal. On the other hand, if it's a more sort of company-specific type of issue, then that's a risk that will get allocated contractually to the seller and will give the buyer, potentially, the right to walk away, and so, in many of these cases, there was a real question about was the pandemic a MAC, or an MAE, a material adverse effect? And if so, what did that mean in terms of the allocation of the risk?

And then, clearly, companies were forced to do some pretty dramatic things in the wake of the pandemic in order to preserve their business. And to what extent did any of those actions constitute breaches of an ordinary course covenant? And so, what we saw here are a few cases that really focused on those two issues, and I think the primary takeaway, as I said, is that the courts are going to very closely scrutinize the language.

There was a case involving a company called KCAKE, which made, essentially, cake decorating technology. And that was a deal that was signed right before the pandemic hit, and it was a situation where, in light of the fact that people were not having birthday and other sort of celebrations, you know, the pandemic had a very dramatic and immediate impact on the business.

And so, the buyer tried to get out of the deal by saying the pandemic was a material adverse effect, because people were not ordering birthday cakes. And what the court said was, essentially, look, that's not sufficient to show a material adverse change, because Delaware law, in particular, has long focused on the durational significance of a potential dislocation.

It's not enough to simply say, well, it's a bad quarter or something dramatic has happened, unless you can say that's going to last for some indefinite period and fundamentally alter the enterprise value of the entity that you're buying. That's a risk that stays with the buyer, and you've got to close, and in fact, that's exactly what happened here.

Sam Gandhi:
The fact that this pandemic is now, we're entering our third year, and it goes up and down. It may become an endemic. It's clear that everybody around the world is just as confused as everybody else. Does that affect what the court's going to possibly think of in terms of their views about duration?

Jim Ducayet:
It might. Although, frankly, the other important element of an MAE is, is it something that disproportionately impacts a particular business? Right, because, as I said at the outset, normally, if you're talking about a company-specific issue, that's when you would shift the risk back to the seller.

I think one of the things we've been grappling with is to what extent can you really say that the pandemic has an impact that disproportionately affects a particular seller? And look, you can imagine a situation, like in this KCAKE, where you'd say, okay, well, obviously, certain kinds of industries are going to be more impacted by the pandemic than others. So, those who are dependent upon people having parties are going to have a different impact.

Look, on the other hand, that's true of its competitors, as well, and so, you know, in some ways, that's just part of the risk that you assume when you go ahead and do a deal. And there was another case involving, you know, Hillrom, which is a medical device company, where that exact issue was presented, which is to say, look, the impact here of the particular decision was a regulatory requirement that the government put into place.

But it impacted everybody, and so that's not enough to shift the burden back to the buyer to be able to allow them to walk away. I think you're going to see the issue of duration continue to be a question, but there are multiple levers that the courts can turn to when it ultimately decides how you allocate that risk. Is it fairly put upon the buyer, or does it remain with the seller?

Sam Gandhi:
Charlotte, let's go back to something that you had said earlier. That words matter, and it's clear that the Delaware Courts say let's stick with the contract. What are the key takeaways for these cases, and what should buyers and sellers know about the contractual provisions that they're entering into?

Charlotte Newell:
Exactly right, Sam, that Delaware gives contracting parties flexibility, but that comes with risk. Your words are what you're going to live with in a future dispute. One of the features of these cases that really made a big difference is the ordinary course provision. One decision that really gave us a lot of guidance on the interpretation of ordinary course provisions during the pandemic was the AB Stable Case decided by Vice Chancellor Laster and then affirmed by the Delaware Supreme Court.

There, a portfolio of hotels, worth about nearly 6 billion dollars, was being sold, and the seller, in the face of the pandemic, made a number of operational changes to the business. They closed two of their hotels altogether. They ratcheted back operations at several others. They furloughed employees, et cetera.

So, that case presented squarely how we would interpret an obligation to act in the ordinary course during COVID-19, and here, again, the words on the page mattered. The key question was how the term ordinary course was defined in the parties' agreement. Was it with reference to the prior operations of just those businesses, the hotels being sold? Was it with reference to the broader industry or specified peer companies?

There, as is typical in Delaware, the words on the page carried the day, because the parties had defined the ordinary course to mean the prior practices of the business being sold. A decision to, for example, altogether close two hotels stood in stark contrast to their prior practices, and therefore, was a breach of the ordinary course covenant. So, I think it's fair to say that these cases really reaffirm the idea that the plain language is going to matter.

Another takeaway I think is that the ordinary course provisions that I just talked about, and the material adverse effect provisions that Jim talked about a couple of minutes ago, are designed to address different concerns, often appear in different portions of merger agreements and other related contracts, and are going to be interpreted separately, unless a contract specifically says otherwise.

MAEs, as Jim says, exist to address a sharp downward turn in a business' valuation, and we allocate that risk to one party or the other, depending on how steep that downward valuation change is and why it occurred. Ordinary course provisions, on the other hand, ensure that a buyer is getting the business that it thought it was buying and provide a roadmap for sellers to operate between signing and closing.

These different considerations are not going to be considered in tandem, unless the contract otherwise states. For example, the Delaware Supreme Court noted in AB Stable that you could say there is no ordinary course breach, unless the claimed breach rises to the level of an MAE. Again, the words on the page are going to matter.

Finally, one other practical piece of guidance from these cases is the importance of notice provisions and consent provisions. This came up both in KCAKE and AB Stable. It is often true that, when thinking about these ordinary course provisions, sellers have an obligation to notify buyers of changes that could run into those ordinary course standards.

In the AB Stable case, for example, the seller had an obligation to notify the buyer of changes and seek their consent in advance. The buyer, in turn, had an obligation to not unreasonably withhold its consent. Despite these provisions, the seller did not notify the buyer of some of the operational changes that they'd made. Closing two hotels, for example.

The court held that that was a breach of the agreement, and the decision makes very clear, and this is really helpful, practical guidance, right, that a seller is not obligated to run its business into the ground in the face of a pandemic. But it did have the straightforward contractual obligation to say, hey, dear buyer, in the face of the pandemic, we need to make a couple of operational changes, and we'd like your consent to those changes; and in turn, the buyer could not unreasonably withhold that consent.

So, I think one flag there is we didn't get a lot of guidance on what an unreasonable withholding of consent would be, but taken on the whole, these cases remind of the importance of notice provisions and consent provisions and will probably be a nudge for people on the sell side to think long and hard, and probably suggest you should send a notice about operational changes between signing and closing.

Jim Ducayet:
The only thing I would add to that, Charlotte, is on the notice provisions, you know, it's very common to have a provision that says ordinary course. To the extent that there's a deviation for an ordinary course, you can get the consent of the buyer, and frankly, I think that's where the pandemic issues really come to play. Because the question then becomes is what you're doing reasonable? And if you refuse to consent to a set of measures that are being taken to address this unexpected change in the business, that's really I think a better avenue to be litigating if you're attempting to stay in the deal, because a court's going to have to necessarily consider what's going on more broadly in the industry or in the market.

Whereas, in the AB Stable case, this express reference to past practice created an issue where it was obvious that what they were doing was not consistent with how they had done things in the past. That was sort of the point, and so making use of these notice provisions I think really would've created a much different context for the court to ultimately make its decision, and I think would've given it far more flexibility to consider what was happening more generally in the industry and in the market.

Sam Gandhi:

Right now, in the beginnings of 2022, we're already hearing a couple of fairly large M&A transactions being announced. We have the overhang of the SPAC market and the number of SPACs that are actively searching for targets, and where M&A goes, M&A litigation is sure to follow. As we come to the end of the podcast, I want to ask you both what you're seeing in the market?

Jim Ducayet:
Obviously, we're following the SPAC situation very closely, and as we talked about earlier, there are a whole menu of potential structuring things that planners can do to anticipate, and potentially resolve, some of the concerns that were raised in MultiPlan. But those have all kinds of commercial implications, and it's not at all clear whether some of them actually would be commercially viable if you were to try to impose a structure like that.

So, we're going to be paying a lot of attention to that. There are a number of cases where you don't have quite the dramatic disclosure issues that you had in MultiPlan. And to Charlotte's points, what's the outcome in a situation where you can say shareholders were perfectly aware of all these alleged conflicts, decided to go forward and make an informed decision anyway, and how does this standard or review, this entire fairness standard review, impact that? So, very much an open question, and hopefully, we'll get some better guidance on that in the course of the year.

Just briefly, a couple of other things that I've been seeing. There was an interesting decision a couple weeks ago in the 7th Circuit about forum-selection provisions. In particular, this is a case involving Boeing, where Boeing had a provision in its bylaws that said any derivative case can only be brought in the Delaware Chancery Court. The 7th Circuit considered a situation where it was a derivative federal proxy case, and we don't have time to get into what that consists of or what that might mean even, but it was a cause of action that arose under federal law, and under federal law, a proxy claim can only be brought in federal court.

And so, Boeing's position was, effectively, you're out of luck because it's a derivative case. Can only be brought in Delaware State Court, but guess what? Delaware State Court doesn't have jurisdiction to hear the claim. The 7th Circuit reversed and said that was impermissible. That you cannot have a forum-selection clause that would prohibit someone from bringing a federal derivative proxy claim.

What makes this interesting is there is a case in front of the 9th Circuit that raises the same issue. There've been a couple of decisions out in California, involving Facebook and others, where, of course, it would come out exactly the opposite way, and so, it does raise the possibility that the 9th Circuit disagrees with the 7th Circuit. We have a circuit split, and this ends up in front of the Supreme Court. That's something we're sort of watching carefully.

And then, finally, I'll just cover briefly, we continue to hear a lot from clients about this issue of Caremark, and I know, in an earlier podcast, we talked about this Boeing decision from the Delaware Chancery Court in a duty of oversight and what that might mean. It is, I think, very much on the minds of our clients as we try to figure out what is the appropriate duty of oversight, and what does that mean as a practical matter in terms of board process and procedure?

It has M&A implications, to the extent that when you're doing your diligence, you are potentially buying a claim, and so you want to understand what it is your target has done or what the exposure could potentially be. But trying to figure out exactly what the board's proper role is, and how that can be operationalized into a set of processes and procedures remains very much, I think, on people's minds, and it's something we're providing a lot of advice to clients about.

Sam Gandhi:
And Charlotte, to wrap up the podcast, what are you seeing and hearing from clients?

Charlotte Newell:
I agree with all the issues Jim raised. I'd also flag that we've seen a real increase in requests for books and records from stockholders over the last couple of years. I think that ties to a couple of decisions in the same time period that are at least perceived to be rather plaintiff friendly, and so, we've seen this increased number of requests for corporate books and records, and I think that's likely to continue.

I should flag for listeners who are interested in the topic, this is an item to consider with counsel when you're not facing a crisis. The time to evaluate and potentially refresh board-level governance practices around books and records, so things like the taking and retention of minutes and related materials, the time to do that's now, not when the litigation first emerges, not when a crisis first emerges. Certainly not as intellectually demanding a topic as MultiPlan and some of the other issues we've discussed today. But this is an area where a little bit of consideration now can lead to a lot of upside later.

Last, I think I'd also note that we're going to be watching for some changes at the Delaware Court of Chancery. Vice Chancellor Slights recently announced his retirement, and so we're going to have a new member of the court later this year. But before he retires, Vice Chancellor Slights is wrapping up a number of his pending cases.

The key there is the case that was tried last summer about Tesla's acquisition of SolarCity. That decision raises a lot of interesting questions about who is a controlling stockholder and what effect that can have on the court's review of M&A transactions. We all, I think it's fair to say, associate Elon Musk with Tesla and vice versa, but at the time of this transaction, he owned about 22% of the company.

So, I flagged that just to drive home that sometimes it's not so easy to assess who really is a controlling stockholder, and we're going to know a lot more about that question with the benefit of Vice Chancellor Slights' decision. And I should say, in closing, that we very much appreciate all of Vice Chancellor Slights' work for the Court of Chancery and the Superior Court before that, and wish him all the best in his retirement.

Sam Gandhi:
We've been speaking with Sidley partners Jim Ducayet and Charlotte Newell about recent and important M&A litigation in the Delaware Courts, and the potential impact on those decisions on businesses. Jim, Charlotte, great look at emerging trends in M&A litigation in the Delaware Courts, and thanks for being on the podcast.

Charlotte Newell:
Of course. It was great to chat with both of you.

Jim Ducayet:
Thanks, Sam. I really enjoyed it.

Sam Gandhi:
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