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# Court of Chancery Holds Controlling Stockholders May Owe Fiduciary Duties When Voting to Change Status Quo or Selling Their Shares

On January 24, 2024, the Delaware Court of Chancery held in *In re Sears Hometown and Outlet Stores, Inc. Stockholder Litigation* that when a controller affirmatively sells stock or exercises its voting power to alter a corporation's status quo, it may owe fiduciary duties of good faith and care to not intentionally, or through grossly negligent action, harm the corporation or its minority stockholders. Additionally, the court held that when analyzing whether a controller complied with this standard of conduct, it would apply the enhanced scrutiny standard of review, which requires that a controller establish it acted in good faith for a legitimate purpose, had a reasonable basis for believing that action was necessary, and pursued reasonable means to achieve its legitimate purpose.

The case concerned two sequential transactions (a controller intervention, followed by a take-private) undertaken by the controller of a company with one distressed and one profitable business segment. A special committee of independent directors was formed to evaluate potential strategic transactions between the corporation and the controller. After initial negotiations with the controller concerning a potential transaction failed, the special committee determined that a liquidation of the distressed business segment was the best path forward. The controller disagreed. In an effort to stop the liquidation, the controller amended the corporation's bylaws by written consent to make the liquidation impossible in the short term. The controller also removed two members of the special committee from the board.

The court noted that a controller remains free to decline to sell its stock, or to refuse to vote in favor of, or to vote against, a transaction or proposal. The court found, however, that where a controller *seeks to change the status quo* using its voting power or when deciding to sell its shares, the controller may owe a duty to do so in a way that does not harm the corporation knowingly or through grossly negligent action. The court

further concluded that the controller bears the burden of proving it satisfied its fiduciary duties. The court did not have the opportunity to consider the extent to which these duties and scrutiny would apply to transactions recommended or approved by a special committee of independent directors and/or has its actions ratified by a majority of the minority stockholder approval. The court also left open what sort of changes to the status quo might give rise to such duties, including whether the same framework might apply to routine corporate decisions that result in changes to the status quo, such as approving a new management equity plan, ratifying the selection of a new auditor or electing new directors nominated by the board.

The court's holding in *Sears* highlights the risk that any actions by a controlling stockholder of a Delaware corporation will receive intense scrutiny, even when the controller is acting strictly in its capacity as a stockholder. Unless reversed or modified on appeal, the *Sears* decision may increase the volume of litigation against controllers outside of the change of control context and may result in more of that litigation surviving a motion to dismiss. The decision may also incentivize controllers to retain separate legal and financial advisors, thereby increasing transaction costs, in order to substantiate the reasonableness of, and the absence of gross negligence or adverse intent in, how they cast their votes or decide to exit an investment.

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