

February 23, 2024

Delaware Court Declines to Enjoin Corporation's Move to Nevada, but Allows Claim for Damages to Proceed

On February 20, 2024, in *Palkon v. Maffei*, the Delaware Court of Chancery declined a plaintiff's request to enjoin a controlled corporation's decision to change its state of incorporation from Delaware to another state (in this case Nevada). The Court held, however, that plaintiff's claim for damages could proceed, and that Delaware's "entire fairness" standard of review will apply to those claims because (i) the plaintiff sufficiently alleged that the conversion would confer a non-ratable benefit to the controlling stockholder and the directors of the company and (ii) the conversion was not subject to approval at the outset by both an independent special committee and a majority of the minority stockholder vote ("*MFW* Protections"). The Court also indicated that the facts alleged and assumed to be true for purposes of a motion to dismiss ruling supported an inference that the conversion to a Nevada corporation was not substantively fair because the stockholders would own shares having a different bundle of rights afforded by Nevada law, including a lesser set of litigation rights which the court found could be proven to have lowered the value of the minority stockholders' shares by shielding officers and directors from breach of fiduciary claims brought against them by the corporation on behalf of stockholders.

The Court also rejected the defendants' claims that the decision would discriminate against Nevada corporations by suggesting that stockholders would likewise be entitled to bring claims for damages were a controlling stockholder to seek to convert a Delaware corporation to a Delaware LLC with a set of stockholder protections similar to that of a Nevada corporation. The Court strongly suggested that, given that the corporation is publicly traded, the best measure of damages would be linked to a decline in the company's stock price, if any, associated with company's plan to convert to a Nevada corporation.

This specific case concerned two Delaware corporations, both of which were "controlled" by the same individual who owned shares representing a majority of the outstanding voting power in each of the corporations. In April 2023, the boards of each corporation approved the conversion into Nevada

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corporations. Materials shared with both boards noted that one of the benefits of the conversion would be potentially greater protections against stockholder litigation for directors and officers. Both corporations sought stockholder approval, and the controlling stockholder provided the decisive votes in favor of the conversions. Neither conversion was made subject to the *MFW* Protections. Although finding the challenge to the conversions adequately pled, the Court declined to enjoin the conversion, allowing the companies to convert to Nevada corporations while the plaintiffs could continue to pursue claims for money damages, noting that “it seems likely that the court will have a sufficiently reliable basis to craft a monetary award for any harm that the Company’s stockholders suffer.”

The Court’s decision is particularly noteworthy given the stated desire by large stockholders of several publicly traded Delaware corporations to reincorporate those companies in other states. The Court made clear that, in the absence of a controlling stockholder, a fully informed stockholder vote on the conversion would render the conversion unreviewable. For controlled publicly traded companies, they too may now seek to proceed with conversion plans but the conversions are likely to attract litigation and potentially claims for significant damages unless (i) the companies validly subject the conversions to the *MFW* Protections, or (ii) the company’s stock price does not react negatively to the conversion.

The decision also continues recent developments in Delaware’s controlling stockholder law and broadens the inquiry into “non-ratable benefits.” These developments include the Court’s recent [Sears](#) decision, which held that controllers owe fiduciary duties when exercising their voting power to change the corporation’s status quo, in that case by removing directors and creating new by-laws. In the context of a conversion from a Delaware corporation to a non-Delaware corporation, it is unclear how the *MFW* Protections would be applied, particularly in a situation in which management or the Board, rather than the controller, first advanced the idea of reincorporating in a different state. It also remains to be seen whether strict compliance with the procedural prerequisites of the *MFW* Protections is feasible in transactions such as a conversion where the controller is not a transaction counterparty, or in situations in which the controller does not have majority voting control. Likewise, time will tell if the recent developments in Delaware’s controlling stockholder law including the new hurdles associated with exiting Delaware will affect the position of Delaware as the jurisdiction of choice for a significant majority of pre-IPO companies.

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