SULLIVAN & CROMWELL LLP

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Delaware General Assembly Proposes Important Corporate Law Reforms

Proposals Protect Directors, Officers, and Stockholders and Seek Recommendations to Address Excessive Attorney's Fee Awards

SUMMARY

On February 17, 2025, the Delaware General Assembly introduced important new proposals to address recent developments in Delaware caselaw that have resulted in a growing number of Delaware corporations moving their state of incorporation to Texas or Nevada, thus threatening the substantial revenue that Delaware receives from being the primary state of incorporation for U.S. corporations. The General Assembly's proposals, if adopted, would create more certainty in Delaware corporate law. Depending on how the General Assembly's proposals are applied by the Delaware judiciary, these reforms could reduce corporate departures to other states.

First, the Delaware General Assembly introduced Senate Bill 21 ("SB 21"), which would amend the Delaware General Corporation Law as to transactions concerning interested directors and/or controlling stockholders. Under the proposed amendments: (i) transactions involving conflicted directors would be immune from liability if those transactions were approved by a fully informed majority of the non-conflicted directors or an uncoerced and fully informed disinterested stockholder vote; (ii) transactions involving controlling stockholders other than going private transactions would be immune from liability if those transactions are approved by a fully informed and empowered independent committee of the board *or* approved by a vote of an uncoerced and fully informed majority of the corporation's disinterested stockholders; and (iii) going private transactions involving controlling stockholders would be immune from liability if they are approved by a fully informed and empowered independent committee of the board *and* approved by a vote of an uncoerced and fully informed majority of the corporation's disinterested stockholders.

Second, the proposed amendments would codify the definitions of both controlling stockholders and control groups, including to clarify that to be a controlling stockholder an individual or entity must have either majority voting power or at least one-third of the corporation's voting power alongside managerial control, as well as which transactions constitute a controlling stockholder transaction.

Third, the proposed amendments would clarify that neither controlling stockholders nor members of control groups can be held liable for monetary damages for breaches of the duty of care in their capacity as controllers.

Fourth, the proposed amendments would also define disinterested directors as those directors who do not have a material interest in a transaction, are not a party to that transaction, and do not have a material relationship with a person who has a material interest in that transaction. Importantly, the proposed amendments would further create a heightened presumption of director independence where a given director has been determined to be independent under the rules promulgated by the exchange on which that corporation's stock is listed, and the director is not a party to a given transaction. This presumption would only be rebuttable via a heightened pleading standard.

Fifth, the proposed amendments would also revise Section 220 of the DGCL in order to specifically enumerate which corporate materials constitute "books and records" for the purposes of stockholder inspections, define the scope of when a stockholder can request books and records of a corporation and how that stockholder's inspection must be conducted, and clarify that corporations may impose reasonable confidentiality restrictions on books and records produced pursuant to stockholder inspection demands. If adopted, this proposed change is likely to overrule recent caselaw that has expanded the amount of 220 materials that corporations have been ordered to provide to shareholders, who then use that information in the creation of their litigation claims.

Sixth, the Delaware General Assembly introduced Senate Concurrent Resolution 17 ("SCR 17"), which would request that the Council of the Corporation Law Section of the Delaware State Bar Association provide the General Assembly with a report of recommendations regarding how the General Assembly can best reform the methods for awarding attorney's fees in corporate representative litigation.

SB 21 and SCR 17 were introduced by leadership of both political parties in both the Delaware House and Senate and have the support of Delaware Governor Matthew Meyers. Accordingly, there is reason to believe that SB 21 and any final proposal under SCR 17 will attract the two-thirds votes needed to amend the DGCL.

BACKGROUND

In recent years, Delaware law has experienced what is often referred to as "*MFW* creep," the expansion of the requirements laid out in the seminal Delaware case of *Kahn* v. *M & F Worldwide Corp.*, which required special protections in take private transactions involving controlling stockholders. Under *MFW*'s framework,

in order to get the benefits of Delaware's deferential business judgment review, take private transactions with controlling stockholders are required to be preconditioned on both (1) approval by an independent, fully empowered independent special committee of the board that fulfils its duty of care, and (2) approval by a fully informed, uncoerced majority of a company's disinterested stockholders.[1] Over the years, the Delaware courts have expanded the scope of these requirements. Recently, in *In re Match Group, Inc. Derivative Litigation*, the Delaware Supreme Court held that *MFW*'s requirements apply to all transactions involving controlling stockholders.[2] The application of these requirements to transactions where public stockholders continue to retain equity in the corporation has led to extensive litigation over transactions that, absent a controlling stockholder, would be subject to review and deference under Delaware's business judgment rule.

Complying with the requirements of *MFW* has become complicated by Delaware caselaw that has broadened the parameters of who can constitute a controlling stockholder. As the traditional benchmark of greater than 50% voting control has been eroded, companies have faced prolonged litigation regarding allegations that clear minority stockholders are in fact controllers, often due to amorphous allegations of various "soft power" influences possessed by the stockholder over a corporation and its board.

In introducing these proposed amendments, the Delaware General Assembly has stated it seeks to preserve important protections for public stockholders in going private transactions with a controlling stockholder, while making clear that other transactions with a controlling stockholder can receive business judgment deference if they comply with certain stockholder protections.

Additionally, uncertainty regarding the permissible scope of books and records inspection demands under Section 220 of the DGCL has led to substantial increases in the costs related to responding to these demands. The proposed amendments seek to increase certainty by specifying which materials constitute books and records for the purposes of stockholder demands, when a stockholder has a proper purpose to seek books and records, and how books and records inspections must be conducted.

SCR 17 seeks to explore methods to rein in windfall attorney's fee awards while still with incentivizing risk-taking by plaintiffs' lawyers working on a contingent fee basis.

OVERVIEW OF PROPOSALS

A. Senate bill 21

1. Proposals Regarding Controlling Stockholder Transactions

a. Proposed Statutory Definitions

i. Controlling Stockholder and Control Group

SB 21 seeks to clarify who can be adjudicated as a "controlling stockholder" or a member of a "control group." The proposed amendments to DGCL Section 144 would define a "controlling stockholder" as any

person who either (a) owns or controls a majority in voting power of the outstanding stock entitled to vote in the election of directors, or (b) has functional control equivalent to that of a person who owns or controls a majority of the voting power, by owning or controlling at least one-third of the outstanding stock entitled to vote generally in the election of directors or for the election of directors who have a majority of the board's voting power, as well as power to exercise managerial authority over the business and affairs of the corporation.[3] This definition would create significantly more certainty as to who is a controlling stockholder, and would protect individuals with minimal voting power from being labeled controllers based on "soft power" factors. Further the proposed amendments would define a "control group" as two or more persons who are not themselves controlling stockholders but, by virtue of an agreement, arrangement, or understanding among them, act collectively as a controlling stockholder.[4] This concept helps clarify situations in which multiple individuals or entities may, through coordination, exert influence over corporate decisions and therefore be treated as a controlling stockholder group.

ii. Controlling Stockholder Transaction

SB 21 also seeks to provide a statutory definition for "controlling stockholder transactions." The bill defines these as (a) acts or transactions between the corporation (or its subsidiaries) and a controlling stockholder or control group, or (b) acts or transactions in which a controlling stockholder or control group receives a financial or other benefit that is not shared with the corporation's stockholders generally.[5] This clarification is key in determining when a transaction is deemed to implicate a potential conflict of interest due to the unique benefits accrued to the controlling stockholder.

b. Effect of Proposals on Transactions with a Controlling Stockholder Other Than Going Private Transactions

Under the proposed amendments, transactions with a controlling stockholder (other than going private transactions) would receive safe harbor from both equitable relief and damages liability if they receive *either* (1) approval from a fully informed, empowered, and independent committee of the board; *or* (2) approval or ratification from a fully informed, uncoerced majority of the company's disinterested stockholders.[6]

c. Effect of Proposals on Going Private Transactions with a Controlling Stockholder

SB 21 would also codify that boards must satisfy the higher standard established by *MFW* in order to benefit from the proposed safe harbor against both equitable relief and damages liability in going private transactions involving a controlling stockholder. Under the proposed amendments, the safe harbor against both equitable relief and damages liability will apply to going private transactions involving a controlling stockholder only if the transaction receives *both* (1) approval from a fully informed, empowered, and independent committee of the board; *and* (2) approval or ratification from a fully informed, uncoerced majority of the company's disinterested stockholders.[7] This maintains the important heightened protections provided to public stockholders by *MFW* in situations where those stockholders will be unable to retain equity in the going forward concern, while eliminating *MFW*'s requirement that these protections be a precondition for the approval of the transaction.

d. Effect of Proposals on Duty of Care Liability of Controllers

SB 21 would also codify that controlling stockholders and members of control groups cannot be held liable for monetary damages to a corporation or its stockholders for breaches of the duty of care in their capacity as controllers.[8] Damages liability for controllers in their capacity as controllers would be limited to breaches of the duty of loyalty or transactions from which the controller derived an improper personal benefit.[9] This provides important protections for controlling stockholders participating in transactions while allowing public stockholders to seek damages from controllers for disloyal or bad faith actions.

2. Proposals Regarding Director Independence

a. Defining a Disinterested Director

In addition to its provisions addressing controlling shareholders, SB 21 seeks to codify the definition of director independence. Under the proposed amendments, a director would be a "disinterested director" as long as the director was not a party to a given transaction, did not have a material interest in that transaction, and did not have a material relationship with a person having a material interest in the transaction.[10]

b. Effect of Proposals on Determining Director Independence

SB 21 would also create a strong presumption of director independence where (1) the director is not a party to the relevant transaction; and (2) the director has been determined to be independent under the rules of the exchange on which the corporation's stock trades.[11] This presumption would only be rebuttable via a heightened pleading standard requiring that a plaintiff plead substantial and particularized facts showing the director has a material interest in the transaction or a material relationship with someone interested in the transaction.[12] Further, a "material interest" would be limited to mean an actual or potential benefit other than one which would devolve to the corporation or its stockholders generally, that would reasonably be expected to impair the objectivity of the director's judgment when considering the transaction.[13] Likewise, a "material relationship" would be limited to mean familial, financial, professional, employment, or other relationships that would reasonably be expected to impair the objectivity of the director's judgment when considering the transaction.[14] This standard would provide additional certainty to directors when seeking to determine whether they are disinterested with regard to a given corporate transaction.

3. Proposals Regarding Stockholder Rights to Inspect Books & Records

SB 21's proposed amendments to Section 220 of the DGCL would clarify stockholder books and records inspection rights by explicitly defining what materials constitute "books and records," establishing conditions for when an inspection is proper, and introducing confidentiality requirements. The amendments would enumerate the specific "books and records" materials that stockholders can request, including corporate governance documents, board and committee minutes, financial statements, and director and officer independence questionnaires.[15] This would reverse the trend under which Delaware courts have increasingly granted stockholders access to a broader range of corporate documents, including informal communications such as emails and text messages. The amendments would also clarify that books and

records inspections must be conducted in good faith, have demands describing with reasonable particularity the proper purpose for the inspection and the records sought, and require that the requested records be specifically related to the stockholder's proper purpose.[16] Further, the amendments would allow corporations to impose reasonable confidentiality restrictions, limiting the use and distribution of inspected records and redacting irrelevant information, in an attempt to strike a balance between stockholder access and the protection of sensitive corporate data.[17] SB 21's proposals would likely narrow the scope of Section 220 materials that corporations are required to provide in response to books and records demands.

B. Senate concurrent resolution 17

The General Assembly is also looking to explore options to prevent windfall attorney's fees in representative corporate litigation. Through SCR 17, the General Assembly would request that the Council of the Corporation Law Section of the Delaware State Bar Association prepare a report with recommendations for legislative action on attorney's fee awards in cases claiming a corporate benefit or common fund.[18] SCR 17 acknowledges concerns about excessive fees and the impact of recurring stockholder lawsuits on corporations and their stockholders, while also recognizing the need to incentivize meritorious litigation by plaintiffs' attorneys who pursue this litigation on a contingent fee basis.[19] SCR 17 also emphasizes Delaware's commitment to maintaining a balanced approach and suggests examining a potential cap on attorney's fees based on the lodestar method.[20] The requested report would be due on March 31, 2025, and would be submitted to key state officials, including legislative leaders and the Governor.[21]

C. Opportunity for inputs

The Delaware General Assembly actively engages stakeholders to participate in the legislative process by providing opportunities to comment on senate bills, like SB 21. Stakeholders are encouraged to provide input on SB 21 to ensure that the proposed changes reflect a balanced approach to addressing concerns about *MFW*'s growing influence in corporate governance.

Additionally, the General Assembly will be inviting participation in the forthcoming report process for SCR 17. Stakeholders are encouraged to provide their feedback on attorney's fees in corporate litigation and on whether recurring stockholder litigation has become unproductive for investors and corporations.

IMPLICATIONS

SB 21's proposed amendments, if enacted, have important implications for controlling stockholders, boards of directors of corporations that have, or have been alleged to have, a controlling stockholder, and stockholders of those corporations.

SB 21 seeks to clarify that transactions are only subject to the requirements of *MFW* if those transactions are going private transactions involving a controlling stockholder. SB 21's aim is to create a more stable and predictable Delaware legal environment, and enable boards of directors and controlling stockholders to negotiate and structure transactions with more legal certainty.

SB 21's clarification of the standard for determining director independence also is aimed at providing a more stable and predictable framework for boards of directors to determine when their directors are potentially conflicted regarding a given transaction. This is designed to help boards and their advisors better determine when additional stockholder protections are needed with regard to a specific transaction and allow those transactions to receive protection from liability.

SB 21 will also create important certainty regarding the proper scope and purpose of stockholder books and records inspection demands under Section 220 of the DGCL. By restraining the definition of "books and records," and clarifying the limitations on stockholder access, these amendments could curtail stockholders' ability to leverage Section 220 requests as a pre-litigation discovery tool. This will also substantially decrease the costs and time associated with responding to these demands and empower corporations to better push back against improper and overly broad demands.

Finally, SCF 17 indicates a belief by the General Assembly that windfall attorney's fee awards can be harmful to corporations and their stockholders.

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ENDNOTES

1 88 A.3d 635, 639(Del. 2014).

2 315 A.3d 446, 451(Del. 2024).

3 Act to Amend Title 8 of the Delaware Code Relating to the General Corporation Law, SB 21, 153 General Assembly §144(e)(2) (2025).

4 *Id*. at § 144(e)(1).

5 *Id.* at § 144(e)(3).

6 *Id.* at § 144(b).

7 *Id.* at § 144(c).

8 *Id*. at § 144(e)(5).

9 *Id*.

10 *Id*. at § 144(e)(4).

11 *Id*. at § 144(d)(2).

12 *Id*.

13 *Id*. at § 144(e)(8).

14 *Id*. at § 144(e)(9).

15 *Id*. at § 220(a)(1).

16 *Id*. at § 220(b)(2).

17 *Id*. at § 220(b)(3).

18 Resolution to Request the Council of the Corporation Law Section of the Delaware State Bar Association Prepare a Report of Recommendations for Legislative Action Regarding Awards of Attorney's Fees in Certain Corporate Litigation Cases, SCR 17, 153 General Assembly (2025).

19 *Id.*

20 *Id.*

21 *Id.*

ABOUT SULLIVAN & CROMWELL LLP

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