Delaware Enacts Sweeping Changes to Treatment of Conflicted Transactions

March 28, 2025

Against the backdrop of several high-profile corporate departures from Delaware and chatter about possible future departures, on March 25, 2025, Delaware Governor Matt Meyer signed into law S.B. 21, which amends the Delaware General Corporation Law to provide greater clarity as to the treatment of transactions involving conflicted directors or controlling stockholders and to constrain the scope of materials available pursuant to stockholder books-and-records demands. The Office of the Governor touted the bill as "aimed at ensuring the state remains the premier home for U.S. and global businesses."

Below we explain how the law: (i) revises and makes more readily available safe harbors for conflicted transactions, including controller transactions; (ii) increases certainty as to when a stockholder will be treated as a controller; and (iii) pulls back some of the recent case law expansions with respect to books-and-records access. These new rules will apply in cases filed after February 17, 2025.

ENHANCED DEAL PROTECTIONS

S.B. 21 contains important modifications to the safe harbors available for transactions involving conflicted directors or controlling stockholders and applies to both public and private corporations. Although prior to S.B. 21, a transaction could be made subject to the business judgment rule (allowing for a high likelihood of pre-discovery dismissal) if certain judge-established procedural protections were implemented, it was not always clear whether a court would find that the requirements for those procedures were met. As a result, many transactions intended to receive business judgment review were nevertheless examined under the "entire fairness" standard of review—meaning that they were subject to close judicial scrutiny that typically precluded pre-discovery dismissal. Hence, the pre-S.B. 21 state of affairs was one marked by significant uncertainty as to whether a safe harbor would ultimately apply.

S.B. 21 codifies and modifies the existing safe harbors in ways that make them less burdensome and decreases the likelihood that they will be successfully challenged:

Conflicted Director Transactions

S.B. 21 provides that where one or more directors are conflicted, the transaction will not be subject to equitable relief or an award of damages if either: (i) the transaction is approved by a majority of the votes cast by fully informed disinterested stockholders (pre-S.B. 21, approval by a majority of the votes of all outstanding shares held by disinterested stockholders was required), or (ii) the deal is approved by a majority vote of disinterested directors, whether the entire board or a committee thereof, provided that when more than half of the directors are conflicted, the transaction must be approved by a fully disinterested special committee of at least two directors.

Controller Transactions (Other than Take-Private Deals)

Prior to S.B. 21, deals involving a conflicted controlling stockholder could be protected by the business judgment rule if "*MFW*"[1] procedural protections were put in place. *MFW* required ***both*** a fully independent special committee and the favorable vote of a majority of the votes of all *outstanding* shares held by disinterested stockholders. In addition, the deal had to be conditioned on both *MFW* requirements before commencement of substantive negotiations (the "*ab initio*" requirement). The presence of even one conflicted special committee director was fatal. Plaintiffs thus had multiple routes to plausibly allege that a defendant had not complied with *MFW*, meaning the entire fairness standard of review would apply, making pre-discovery dismissal unlikely.

The path to dismissal post-S.B. 21 is simpler. Now, in non-take-private transactions, a transaction will be provided safe harbor if there is ***either*** a disinterested special committee ***or*** a fully informed vote of a majority of the votes *cast* by disinterested stockholders. Additionally, the *ab initio* requirement was removed, with the only remaining timing requirement being that the transaction is made subject to the disinterested stockholder vote at the time of submission for approval to stockholders.

Moreover, when determining whether the special committee consists of disinterested directors, S.B. 21 requires only that the board determine in good faith that the members of the special committee are disinterested such that the protections of the special committee safe harbor would not be lost merely because it later turns out that one or more of the committee members are, in fact, interested, as long as a majority of the disinterested directors approve the transaction. And, unless there are "substantial and particularized facts" to the contrary, a director meeting stock exchange standards for

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1 *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

independence will be presumed to be disinterested so long as the director is not a party to the transaction in question.

Controller Take-Private Transactions

For controller take-private transactions, S.B. 21 retains the dual *MFW* requirements (i.e., both a disinterested special committee and a majority-of-the-minority stockholder vote), but it makes obtaining early dismissal easier and more predictable by removing the *ab initio* requirement, lowering the disinterested stockholder voting threshold, and focusing on the board's determination that all members of the special committee are disinterested (together with the presumption of disinterestedness for directors meeting national securities exchange independence requirements).

INCREASED CLARITY ABOUT CONTROLLER TRANSACTIONS AND DISINTERESTED DIRECTORS

Existence of a Controller

Prior to S.B. 21, there was no bright-line minimum shareholding requirement before a minority stockholder could be treated as a controller, and the applicable test was multi-factored and flexible. As a result, it could be difficult to predict when a stockholder holding less than 50% of a company's voting shares would be treated as a controller.

Now, a stockholder holding less than one-third of the voting stock cannot be a controlling stockholder (unless that stockholder has a right to cause the election of directors having a majority of the voting power on the board). In addition, to be considered a controlling stockholder, a minority stockholder must have the "power functionally equivalent" to that of a majority stockholder and must have the "power to exercise managerial authority over the business" of the company. S.B. 21 also eliminates the concept of "transactional control"—i.e., the concept that a stockholder not otherwise a controller could nevertheless be deemed a controller due to having significant influence with respect to the specific transaction being challenged.

Disinterested Directors

Before S.B. 21, some recent Delaware judicial opinions had taken a broad view of the circumstances that could give a director a disabling conflict. S.B. 21 provides defined terms and presumptions that govern whether a director is considered interested, including: (i) defined terms setting out what interests and relationships are considered "material" and (ii) as noted above, creating a presumption of disinterestedness (with respect to acts or transactions to which the director is not a party) based on a determination of director independence for national securities exchange purposes.

BOOKS-AND-RECORDS DEMANDS

Pre-S.B. 21, some Delaware courts had ordered corporations to produce directors' emails and text messages in response to stockholder books-and-records demands pursuant to Section 220. These decisions significantly increased the material available to plaintiffs, leading to expansive pre-suit discovery. The obtained information was then often used in an effort to support allegations that the parties failed to comply with the requirements for procedural protections that would result in business judgment review or a shift to plaintiffs of the burden of proof.

Post-S.B. 21, the materials available pursuant to books-and-records demands are more narrowly circumscribed outside of certain specific exceptions. Although plaintiffs still have the right to access a fairly comprehensive list of materials, that list does not include electronic communications (other than a narrowly defined set of such communications to stockholders).

WHAT WILL BE THE FOCUS OF FUTURE LITIGATION?

S.B. 21 should make dealmaking more efficient by providing a more predictable path to avoiding protracted deal litigation. But this law by no means spells the end of stockholder litigation over conflicted and controller transactions.

First, all of the procedural protections in S.B. 21 require that disinterested directors and stockholders (as applicable) be fully informed. Historically, Delaware courts have scrutinized whether proxy statements or other disclosures in fact resulted in a fully informed vote. We expect that Delaware plaintiffs will continue to rely on that body of case law to argue that the procedural protections were ineffective because stockholders were not fully informed or the board was not fully informed when it was determining that the members of the special committee were disinterested.

Second, S.B. 21 continues to treat as a controller transaction any deal in which a controller "receives a financial *or other benefit* not shared with the corporation's stockholders." The term "other benefit" is not defined, and we expect plaintiffs to argue that the term encompasses all manner of non-financial benefits. Thus, while the universe of controllers may have shrunk, the number of transactions involving a controller that are challenged may grow.

Third, S.B. 21 leaves in place the concept of a "control group" and does little to narrow that term. We can expect plaintiffs to focus on transactions involving two or more non-controlling stockholders that collectively have over one-third of voting shares.

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