Delaware law changes parameters for transactions involving interested directors, officers, and controlling stockholders

By Roger E. Barton, Esq., Barton LLP

MAY 8, 2025

On March 25, 2025, Delaware passed its controversial Senate Bill 21 (SB 21), which amended the Delaware General Corporation Law (DGCL). The bill changes previous case law specifically where it amends DGCL Section 144, which deals with corporate transactions involving financially interested directors, officers, and/or controlling stockholders.

Among other things, the new bill clarifies details regarding a safe harbor for these types of transactions if the transaction includes certain "cleansing mechanisms." (*See* legis.delaware.gov/BillDetail/141857).

The amendments lay out the circumstances under which a conflicted transaction cannot be the subject of equitable relief or give rise to an award of damages or other sanction against directors, officers, or controlling stockholders by reason of a breach of fiduciary duty.

When evaluating a controlling stockholder transaction, for example, Delaware courts use either the "business judgment" standard or the more stringent "entire fairness" standard. The business judgment standard protects business decisions made by corporate executives if they are found to have acted in good faith, performed a duty of care, and performed a duty of loyalty.

However, if a plaintiff can show that the decision-making process was not independent or that an executive breached their fiduciary duty, courts will apply the more burdensome entire fairness standard, which requires executives to prove that the transaction was fair to the corporation and its shareholders regarding price, timing, negotiations, etc.

In 2014, the precedential Delaware ruling in *Kahn v. M&F Worldwide* (*"MFW"*) established that, in a transaction involving a controlling stockholder with a conflict of interest, the transaction can employ two procedural mechanisms in order to be subject to the less onerous business judgment standard. These mechanisms include:

(1) the transaction is conditioned upon the approval by an informed committee of the board of directors that is made up of independent, disinterested directors, **AND**

(2) the transaction is conditioned upon approval by a majority of informed, minority stockholders (*See Kahn v. M&F Worldwide Corp*., 88 A.3d 635 (Del. 2014)).

Ten years later, in *In re Match Group, Inc. Derivative Litigation*, the Delaware Supreme Court reasserted the *Kahn v M&F Worldwide* ruling, emphasizing that it applies to all controlling stockholder transactions where the controlling stockholder receives a non-ratable benefit. *Match Group* also highlighted that the committee designated to approve the transaction must be *wholly* independent, i.e., made up entirely of independent directors, not just a majority of independent directors. (*See In re Match Group, Inc. Derivative Litigation*, 315 A.3d 446, 462-71 (Del. 2024)).

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SB 21 walks back several of the elements laid out in *MFW* and *Match Group*. In a controlling stockholder transaction (that is not a going-private transaction), the transaction now only has to employ one of the two "cleansing mechanisms" in order to be subject to the business judgment rule. Additionally, the amendments stipulate that the committee designated to approve the transaction need not be wholly independent — it must only be made up of a majority of disinterested directors.

The passing of SB 21 has been hotly contested. Proponents of the bill, which included bipartisan support in the Senate, argue that these changes help to better balance the interests of plaintiff shareholders with those of officers, directors, and controlling stockholders, without being tilted in favor of the former.

A press release issued by Delaware Governor Matt Meyer's office on March 26 stated that the bill would help to "reinforce Delaware's reputation for equitable, predictable, and efficient corporate oversight" for the 2.2 million entities registered there. (*See* news.delaware.gov (March 26, 2025)).

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Delaware has long been the domicile of choice for incorporation because of the state's consistency regarding its well-established corporate law and judicial decisions. Companies incorporated in Delaware have historically enjoyed the predictability of a well-established body of precedential case law, predominantly established by the Delaware Court of Chancery, which has been in existence since 1792.

Governor Meyer had asked for SB 21 to be drafted after several companies decided to leave or threatened to leave Delaware and reincorporate elsewhere — presumably in response to recent Delaware decisions favoring plaintiffs. Major companies such as Tesla, Dropbox, Meta, Pershing Square Capital, and Walmart were reportedly part of this wave, deemed "DExit" by some news outlets. Facing competition from other states like Nevada and Texas, Delaware's DGCL overhaul was likely a gambit to retain and attract corporations.

However, many critics have lamented the method and speed with which the bill came to fruition as it bypassed the typical procedure for DGCL amendments, which typically involves receiving approval from the Council of the Corporation Law Section of the Delaware State Bar Association. Instead, the bill was whisked through the Legislature and signed in a mere 36 days.

Others have criticized the content of the bill, arguing that it is overly friendly towards directors, officers, and controlling stockholders and lowers guardrails that are meant to protect shareholders from the potential biases of controlling members.

The Council of Institutional Investors (CII), a nonprofit that seeks to promote policies that benefit institutional asset owners, published an open letter to the Governor opposing the passing of the bill. The Council cites concerns related to Section 144 (d)(2), another part of the amendments that changes the definition of a "disinterested director":

"Among our substantive concerns with the provisions of SB 21 is the proposed presumption that a director deemed independent under stock exchange rules would be presumed disinterested unless strong, particularized evidence proves otherwise ... We observe that stock exchange independence standards are generally based on voluntary disclosure in director questionnaires, and as a result independence determinations can fail to account for undisclosed conflicts." (See "CII letter to Delaware Governor regarding SB 21." March 6, 2025. cii.org/correspondence).

The letter also points to the damage that the CII believes occurs when the state undercuts previous judicial decisions (such as *Match Group*) by legislating over them. They argue that this tactic undermines the predictability and power of the Delaware judiciary and could have the long-term effect of deterring companies from incorporating in the state.

At least one suit has already been filed challenging SB 21's constitutionality. The Plumbers & Fitters Local 295 Pension Fund filed a suit against Dropbox, Inc. (which recently reincorporated in Nevada) which alleged, among other things, that the DGCL amendments restrict the Delaware Court's power to provide equitable relief and are "divesting the Court of Chancery of its historical role of adjudicating breach of fiduciary duty claims." (*See Plumbers & Fitters Local 295 Pension Fund v. Dropbox, Inc.*, C.A. 2025-0354-KSJM (Filed April 8, 2025)).

Besides the matter of its constitutionality, two major questions regarding SB 21 remain. The first is which, if any, other previous Delaware cases could be effectively nullified by the amendments. The letter from the CII estimates, at the extreme end of the spectrum, that 34 Delaware Court decisions made over the last 40 years could potentially be overturned by the changes.

The other question that remains to be answered is, if the amendments stand, whether they will ultimately entice companies to remain incorporated in Delaware — thus stymying the DExit fears — or if they will ultimately push companies away to other states.

Roger E. Barton is a regular contributing columnist on securities regulation and litigation for Reuters Legal News and Westlaw Today.

About the author

Roger E. Barton is the managing partner of New York City-based **Barton LLP** and a litigator. He represents clients in the capital markets and financial services industries regarding securities fraud, breach of fiduciary duty, common-law fraud, 10b-5 class actions, and breach of representations and warranties. He is a fellow of the Litigation Counsel of America and can be reached at rbarton@bartonesq.com.

This article was first published on Reuters Legal News and Westlaw Today on May 8, 2025.