CADWALADER

Quorum

Insights Into Corporate Governance, M&A and Securities Law

Delaware Supreme Court Reverses Court of Chancery on Standard of Review Applicable to Reincorporation Transactions in "TripAdvisor" Appeal

By **Erin Ward**
Law Clerk | Corporate

By **Greg Patti**
Partner | Corporate

In its unanimous decision rendered on February 4, 2025, the Delaware Supreme Court reversed the Delaware Court of Chancery's ruling in the widely followed "TripAdvisor" case (*Palkon v. Maffei*) regarding the standard of review applicable to corporate reincorporations. The Delaware Supreme Court ruled that the TripAdvisor, Inc. (TripAdvisor) board's decision to reincorporate from Delaware to Nevada is subject to the business judgment rule. In its ruling, the Supreme Court underscored its commitment to preserving board discretion in strategic corporate decisions while clarifying the circumstances under which entire fairness review will be required.

Background:

In 2023, the boards of directors for TripAdvisor and its controlling stockholder, Liberty TripAdvisor Holdings, Inc. (Holdings), approved a plan to change their respective corporate domiciles from Delaware to Nevada. This move was challenged by minority stockholders, which argued that the reincorporation would disproportionately benefit the companies' directors and officers by reducing their potential liability exposure, given Nevada's more management-friendly corporate laws. The plaintiffs contended that this conferred on the insiders a non-ratable benefit not shared by all stockholders, warranting a stringent "entire fairness" review of the transaction. The Chancery Court declined to enjoin the reincorporations to Nevada, but agreed with plaintiffs that the decisions to approve the reincorporations were subject to entire fairness review because the conversions resulted in a non-ratable benefit for the controller stockholders and directors who approved the transactions. The Chancery Court also suggested that the reincorporations may not have been entirely fair, largely due to the fact that the minority stockholders would not receive "the substantial equivalent of what they had before," implying that the minority stockholders may have needed to receive some form of consideration for the transaction to be fair.

Decision:

The Supreme Court reversed the Chancery Court's decision, determining that the business judgment rule, rather than the entire fairness standard, should apply to the reincorporations. The Supreme Court's analysis focused on certain key factors:

- Materiality and Temporality: The Supreme Court found that neither the controlling stockholders nor the directors obtained a material, non-ratable benefit from the reincorporation. The Supreme Court emphasized that for the entire fairness standard to be triggered, any non-ratable benefit to the conflicted insiders must be material. In this case, the alleged benefit of reduced liability exposure under Nevada law as a general matter (and not with respect to any existing litigation or proposed corporate transaction) was deemed too speculative and not sufficiently material. The Supreme Court highlighted the importance of temporality in assessing the materiality of benefits, noting that there was no existing or threatened litigation against the directors or officers that would be impacted by the change in domicile.

The absence of imminent or ongoing litigation meant that any reduction in liability exposure was contingent on uncertain future events. Accordingly, the Supreme Court concluded that such hypothetical and speculative impacts do not meet the threshold for a material, non-ratable benefit that would necessitate entire fairness review.

- Comity and Judicial Restraint: The Supreme Court underscored the principle of comity, expressing reluctance to engage in comparative and quantitative evaluations of different states' corporate governance regimes. The Supreme Court recognized that directors consider a multitude of factors when determining the optimal state of incorporation, including, in addition to broad considerations with respect to corporate governance regimes, the court system, the composition of the judiciary, the state of the development of the case law in different jurisdictions and the familiarity of market participants with different states' legal regimes, noting that "none of these features is static, including statutory schemes at issue and their related case law developments." Absent well-pleaded allegations of material, self-serving conduct by directors (or controllers), the Supreme Court held that long standing Delaware policies of comity and judicial restraint favor deferring to the directors' business judgment in matters of corporate domicile.

Certain Takeaways:

The Supreme Court's decision in *Maffei v. Palkon* offers critical clarity on the standards governing judicial review of corporate reincorporation, providing that the business judgment rule applies unless plaintiffs are able to demonstrate that insiders received a material, non-ratable benefit—such as reduced liability exposure tied to existing litigation or a contemplated transaction—that would necessitate entire fairness review. Absent such specific and material existing conflicts, courts will defer to directors' business judgment, providing boards with greater latitude to determine the most advantageous state of incorporation without the heightened scrutiny of entire fairness review. Accordingly, the Supreme Court's decision may have the impact of accelerating the trend of companies exploring reincorporation options, particularly to states like Nevada and Texas, which have been perceived by some to have more business-friendly legal regimes. This shift has already been observed among various controlled companies, as illustrated by moves of high-profile firms like Tesla and Dropbox, each of which cited a preference for such regimes in their relocations.

Companies considering reincorporation should be aware of the fact that, while the Supreme Court's decision underscores the principle that reincorporations occurring on a "clear day" fall under the business judgment rule, the Supreme Court left open questions regarding the level of specificity required to demonstrate that a reincorporation was designed to avoid litigation risk, indicating that future case law may further clarify this threshold. Consequently, the ruling also highlights the importance of strategic planning for companies considering reincorporation. Controlled companies, in particular, should consider implementing processes to protect minority stockholders, such as establishing independent special committees and obtaining expert legal and financial advice to fully understand the impact of a potential reincorporation and ensure that the process aligns with fiduciary duties.