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Shielding Mergers from Fiduciary Duty Claims Requires Full Disclosure and a Fair Process

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In its 2015 decision in *Corwin v. KKR Financial Holdings*, the Supreme Court of Delaware held that litigation challenges to mergers are subject to the deferential "business judgment" standard of review when the transaction was approved by the "fully informed, uncoerced majority of disinterested stockholders." 125 A.3d 304 (Del. 2015). That decision reaffirmed a benchmark for mergers, as transaction parties wanted to ensure that their stockholder votes qualified for so-called "*Corwin* cleansing," i.e., an assurance that any later challenge would be subject to the business judgment rule.

Corwin centered on a challenge to KKR's acquisition of Financial Holdings LLC in a stock-for-stock transaction. Plaintiff stockholders of Financial Holdings brought suit in Delaware Chancery Court for breach of fiduciary duty against KKR and against Financial Holdings' directors, urging the court to examine the transaction under the exacting "entire fairness" standard of review. Chancellor Bouchard found that because a fully informed, uncoerced majority of Financial Holdings' disinterested stockholders had approved the transaction, business judgment review applied, and on that basis the court dismissed the claims against all of the defendants. In an opinion written by Chief Justice Strine, the Delaware Supreme Court affirmed, reasoning that "[w]hen the real parties in interest—the disinterested equity owners—can easily protect themselves at the ballot box by simply voting no, the utility of a litigation-intrusive standard of review promises more costs to stockholders in the form of litigation rents and inhibitions on risk-taking than it promises in terms of benefits to them."

Notwithstanding the *Corwin* benchmark, litigation challenges to mergers have not ceased. Instead, post-*Corwin* cases have focused on the question of what it means for the disinterested stockholders to be "fully informed" and "uncoerced," and what happens when they are not. This article reviews key recent *Corwin* decisions.

Where have defendants failed (at least at the motion to dismiss stage)?

Apollo Global Management's acquisition of Fresh Market provides an example of when *Corwin* cleansing was held not to apply despite a tender offer having closed with over 68% of outstanding shares validly tendered. There, a stockholder of Fresh Market made a books-and-records request under Section 220 of the Delaware General Corporation Law, seeking to inspect the corporation's documents surrounding the transaction. Litigation over the inspection request ensued, and the

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stockholder received documents allegedly showing that Fresh Market's founder and his son had teamed up with Apollo to create a bidding environment in which Apollo would buy the company at a low valuation and the founder and son would participate in an equity rollover. The stockholder then brought suit for breach of fiduciary duty. In that case, captioned *Morrison v. Berry*, Vice Chancellor Glasscock granted a motion to dismiss the fiduciary duty claim, holding that the transaction was cleansed under *Corwin*. The Delaware Supreme Court, however, disagreed in an opinion authored by Justice Valihura, holding that "[a] reasonable stockholder would have found these facts material because they would have shed light on the depth of the [founders'] commitment to Apollo, the extent of [founders'] and Apollo's pressure on the Board, and the degree that this influence may have impacted the structure of sale process." 191 A.3d 268 (Del. 2018). The high court reversed the lower court's decision based on the "fully informed" prong of *Corwin* and remanded the case for further proceedings on post-closing damages.

Corwin cleansing was also rejected in the case of Marlin Equity Partners' acquisition of Tangoe, Inc. There, a majority of Tangoe stockholders accepted a tender offer against the background of announced, but still pending, restated financials for eleven previous quarters and related regulatory problems for the company. After the acquisition closed at $6.50 a share—down from an initial expression of interest at $9.00—a plaintiff brought suit for breach of fiduciary duty. Vice Chancellor Slights denied a motion to dismiss, rejecting the argument that the transaction was Corwin-cleansed on multiple grounds, including the board's failure to provide stockholders with audited financial statements and the failure of the board to explain fully whether and when a restatement would ever be completed. *In re Tangoe, Inc. Stockholders Litig.*, No. CV 2017-0650-JRS, 2018 WL 6074435 (Del. Ch. Nov. 20, 2018).

Siris Capital's acquisition of Xura provides another example of allegations that were determined sufficient to defeat *Corwin*. In the *Xura, Inc. Stockholder Litigation*, a majority of stockholders voted in favor of the transaction. Stockholder Obsidian Management, however, brought an action for appraisal, i.e., a determination of the fair value of its shares. As discovery progressed, the litigation evolved and the stockholder asserted a claim for breach of fiduciary duty. Discovery had revealed, according to Obsidian, that Xura's CEO and Siris regularly communicated without the knowledge or approval of Xura's board or its financial advisor, that Xura's CEO advised Siris on what price Xura's board would likely accept, and that nonpublic information about the transaction was disclosed to a potential superior bidder (which decided to co-invest instead), among other issues. In moving to dismiss the fiduciary duty claim, defendants argued principally that the transaction had been cleansed by the stockholder vote under the *Corwin* doctrine. Vice Chancellor Slights, however, found that the plaintiff's allegations were enough to overcome its application: "[T]o invoke *Corwin* cleansing at the pleading stage, a fiduciary defendant must demonstrate that stockholders possessed all material information before casting the votes that provide the basis for cleansing. Plaintiff alleges that stockholders were entirely ignorant of the extent to which [the CEO] influenced the negotiations and ultimate terms of the Transaction, not to mention his possible self-interested motivation for pushing an allegedly undervalued Transaction on the Company and its stockholders." No. 12698-VCS, 2018 WL 6498677 (Del. Ch. Dec. 10, 2018).

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In the case of Virtu's acquisition of KCG Holdings, a deficient proxy was held to bar *Corwin* cleansing. In that case, although 75.5% of disinterested stockholders voted in favor of the transaction, Vice Chancellor McCormick allowed a complaint for breach of fiduciary duty to proceed past the dismissal stage. The complaint alleged, first, that the proxy was misleadingly ambiguous about the company's divestiture strategy even though the company actually had a detailed strategy; second, that the proxy failed to disclose the CEO's view that the purchase price was too low and that a restructuring would yield more value; and third, that the proxy omitted early optimistic projections in favor of later revised projections, without explaining the circumstances surrounding the revisions. No. 2017-0421-KSJM, 2019 WL 2564093 (Del. Ch. June 21, 2019).

The *Corwin* doctrine was also examined, and its application rejected, in an opinion following a bench trial. In *PLX Technology Stockholders Litigation*, Vice Chancellor Laster held a trial on breach-of-fiduciary-duty claims that an activist investor with three board seats aided and abetted breach of the board's fiduciary duties by steering the company towards a sale that, the plaintiff alleged, was based on incomplete information. The evidence was held to show that the activist investor hid relevant information from the certain members of the board and failed to credibly explain adjustments to PLX's projections. Based on this, the court held that the vote of disinterested stockholders was insufficient to invoke business judgment review: "In this case, the Board approved a sale of PLX to Avago for cash, making enhanced scrutiny the operative standard of review. Under *Corwin*, however, the business judgment rule would apply if the directors had complied with their duty of disclosure. This decision has held that the Recommendation Statement was misleading, so the fact that holders of a majority of the Company's shares tendered into the first step of the medium-form Merger does not lower the standard of review." Ultimately, however, judgment was entered in favor of the activist investor, as the court held that the merger consideration exceeded the value of the company and that the plaintiffs had therefore failed to prove damages. No. CV 9880-VCL, 2018 WL 5018535 (Del. Ch. Oct. 16, 2018), *aff'd*, 211 A.3d 137 (Del. 2019).

Where have defendants succeeded?

In cases where defendants prevailed, courts have tended to reject the substance of the plaintiff's allegations—whether through the lens of *Corwin* or for simple failure to state a claim.

In *English v. Narang*, for example, Chancellor Bouchard dismissed a complaint for breach of fiduciary duty following HIG Capital's acquisition of NCI, Inc. There, the plaintiff stockholder alleged that the board allowed a transaction that did not maximize value in order to meet the founder's (and 34% stockholder) personal liquidity needs. The plaintiff alleged that *Corwin* did not apply for two reasons. First, the plaintiff alleged that the transaction should be subject to entire fairness review because the founder and board member was conflicted with respect to the transaction. The court rejected this argument as a bar to *Corwin*: "[P]laintiffs have failed to plead facts to support a reasonable inference that Narang's retirement as NCI's CEO posed some sort of exigency or emergency situation where he needed liquidity fast so as to create a disabling conflict of interest with respect to the Transaction." Second, the plaintiff pointed out several purported deficiencies in the registration statement and alleged that the stockholders were not "fully informed." Specifically, the plaintiff cited

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alleged misleading projections, omissions surrounding post-closing employment for management, and alleged conflicts of the financial advisor. The court rejected these allegations as well: "In sum, each of plaintiffs' challenges to the Recommendation Statement fails to show that NCI's stockholders were not fully informed. . . . For this reason, and because entire fairness does not apply to the Transaction (as discussed above) and waste has not been alleged, the Transaction is governed by the business judgment rule under *Corwin* and its progeny." No. 2018-0221-AGB, 2019 WL 1300855 (Del. Ch. Mar. 20, 2019).

In other cases, the Chancery Court has held that where complaints are simply deficient, a *Corwin* analysis is not even needed. In *Towers Watson & Co. Stockholders Litigation*, a plaintiff stockholder brought breach-of-fiduciary-duty claims related to Towers Watson's merger with Willis Group Holdings, alleging that Towers's board allowed the allegedly conflicted Towers CEO to negotiate the transaction and that certain key facts were undisclosed. The defendants moved to dismiss, focusing on a *Corwin* defense. Vice Chancellor McCormick found, however, that the complaint's allegations were simply insufficient as a matter of law: "[T]his decision need not reach *Corwin*, as long-settled corporate law principles warrant business judgment deference. Namely, the plaintiffs do not argue that the merger, a mostly stock-for-stock transaction between widely held, publicly traded entities, is subject to enhanced scrutiny under *Revlon*. Nor do they challenge any deal protection devices to trigger enhanced scrutiny under *Unocal*. The transaction thus is presumptively subject to the business judgment rule." No. 2018-0132-KSJM, 2019 WL 3334521 (Del. Ch. Aug. 30, 2019).

In similar analysis, Vice Chancellor Slights declined to engage in a *Corwin* analysis in fiduciary duty claims surrounding Sycamore Partners' acquisition of Essendant Inc. There, a plaintiff stockholder brought breach-of-fiduciary-duty claims alleging that the board failed to maximize value. Citing the company's exculpation provision, the court dismissed the claims as insufficient: "[Plaintiffs] have failed to well plead either that the Essendant Board was dominated and controlled by Sycamore or that a majority of the Essendant Board acted out of self-interest or in bad faith when approving the Sycamore merger. Plaintiffs likewise have failed to plead viable breach claims against Essendant's CEO notwithstanding that the CEO cannot avail himself of exculpation." Though a *Corwin* defense was raised, the court did not reach it. *In re Essendant, Inc. Stockholder Litigation*, No. 2018-0789-JRS, 2019 WL 7290944 (Del. Ch. Dec. 30, 2019).

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