February 2017

The *Corwin* Effect: Stockholder Approval of M&A Transactions

The most important development in Delaware law during 2016 was arguably the courts' growing deference to stockholder approval. In 2015, the Delaware Supreme Court held in *Corwin v. KKR Financial Holdings* that a transaction subject to enhanced scrutiny under *Revlon* will instead be reviewed under the deferential business judgment rule after it has been approved by a majority of fully informed and uncoerced stockholders. During 2016, several Delaware courts applied *Corwin* with important consequences. Among other things, Delaware judges held that the business judgment rule becomes "irrebuttable" if invoked as a result of a stockholder vote; *Corwin* is not limited to one-step mergers and thus also applies where a majority of shares tender into a two-step transaction; the ability of plaintiffs to pursue a "waste" claim is exceedingly difficult; and if directors are protected under *Corwin*, aiding and abetting claims against their advisors will be dismissed too.

The *Corwin* Decision

In *Corwin*,[1] the Delaware Supreme Court affirmed the dismissal of an equityholder's challenge to a merger. The Supreme Court held that a merger is reviewable under the business judgment rule after it is approved by uncoerced, fully informed, and disinterested holders of a majority of the corporation's shares. The Supreme Court also said its holding applied to change of control transactions, which are initially subject to enhanced judicial scrutiny under *Revlon*. It explained that "*Unocal* and *Revlon* are primarily designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M&A decisions in real time, before closing. They were not tools designed with post-closing money damages claims in mind, the standards they articulate do not match the gross negligence standard for director due care liability under *Van Gorkom*, and with the prevalence of exculpatory charter provisions, due care liability is rarely even available."[2] Thus, a transaction subject to enhanced scrutiny under *Revlon* before a stockholder vote is, under *Corwin*, protected by the business judgment rule after the stockholder vote.

Traditionally, once the business judgment rule applies, a plaintiff is relegated to proving that the transaction constituted a "waste" of corporate assets. The Supreme Court, however, did not explain whether the business judgment rule, after being invoked by a stockholder vote, could still be rebutted by allegations of breach of fiduciary duty. If it could be rebutted, the protections under *Corwin* might have been of limited utility. As discussed below, subsequent Court of Chancery decisions have addressed this issue and concluded that a fully informed and uncoerced stockholder vote renders the business judgment rule irrebuttable.

---

[1] *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015).
[2] *Id.* at 312.

© 2017 Hunton & Williams LLP

Why *Corwin*?

Corwin arguably applies a basic principal of stockholder ratification that has long existed under the common law.[3] The Delaware Supreme Court's decision in *Corwin*, however, may have also been influenced by other factors. First, it may have been another way for the judiciary to reduce abusive stockholder litigation, which had proliferated over the past decade. Widespread M&A litigation imposes costs on M&A parties, stockholders, and the courts. For that reason, Delaware courts have recently taken steps to discourage meritless claims.[4] *Corwin* will make it difficult for plaintiffs to pursue post-closing claims (including those that would have nuisance value) because defendants will frequently be able to dismiss the complaint at the pleading stage based on the stockholder vote.

Second, the Delaware Supreme Court may have sought to encourage companies to provide even greater transparency through their disclosures to stockholders when seeking their approval. In addition to federal securities law requirements imposed on public companies, Delaware law requires disclosure of all material facts when stockholders are requested to vote on a merger. *Corwin* provides a strong incentive for companies to ensure full disclosure.

Third, the Delaware Supreme Court may have been responding to the reality of share ownership in modern society. Today, nearly all US public companies are held by sophisticated institutional investors capable of evaluating complex transactions that affect the value of their investments. The need for judicial review today is less compelling than it was, say, 30 years ago, when companies were held by large numbers of retail stockholders. As the Delaware Supreme Court explained in *Corwin*:

> When 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. The reason for that is tied to the core rationale of the business judgment rule, which is that judges are poorly positioned to evaluate the wisdom of business decisions and there is little utility to having them second-guess the determination of impartial decision-makers with more information (in the case of directors) or an actual economic stake in the outcome (in the case of informed, disinterested stockholders).[5]

In other words, institutional shareholders have both the ability and incentive to evaluate merger proposals.

The *Corwin* Effect in 2016 and Heading Into 2017

Several decisions in 2016 and early 2017 have applied and interpreted *Corwin*, leading to the following key points:

- ***Corwin* appears to be a powerful basis for obtaining dismissal of breach of fiduciary duty claims at the motion to dismiss stage.**
    - In May 2016, the Delaware Supreme Court reiterated the principles underlying *Corwin* in *Singh v. Attenborough*. There, the Supreme Court said that the lower court should not have considered post-closing whether the stockholder-plaintiffs had stated a claim for breach of the duty of care because conducting such an inquiry "after an informed, uncoerced vote of the disinterested stockholders would give no standard-of-review-

[3] *See In re Wheelabrator Techn., Inc. S'holders Litig.*, 663 A.2d 1194, 1205 (Del. Ch. 1995).
[4] *See In re Trulia, Inc. S'holder Litig.*, CA 10020-CB (Del. Ch. Jan. 22, 2016) (rejecting a disclosure-only settlement).
[5] *Corwin*, at 125 A.3d at 313-14.

© 2017 Hunton & Williams LLP

shifting effect to the vote."[6] It continued that "[w]hen the business judgment rule standard of review is invoked because of a vote, dismissal is typically the result."[7]

- Illustrating the powerful effects of stockholder approval, Vice Chancellor Slights in *OM Group* dismissed a claim despite acknowledging that the "[c]omplaint sets forth a disquieting narrative" concerning the company's sale process.[8] He reasoned that "[b]efore the Court launches into its *Revlon* analysis… it must first account for the fact that another 'qualified decision maker,' the disinterested OM stockholders, overwhelmingly approved the transaction."[9] Finding that the company had disclosed all material facts concerning the transaction, he granted the defendants' motion to dismiss.

- *Corwin* should also be considered in conjunction with the Delaware Supreme Court's 2014 decision in *Cornerstone*.[10] There, the Supreme Court held that directors can seek dismissal even in an entire fairness case unless the plaintiff sufficiently alleges that those directors engaged in non-exculpated conduct (i.e., disloyal conduct or bad faith). In practical terms, *Cornerstone* generally allows an outside, independent director to be dismissed from litigation challenging an interested transaction unless the plaintiff alleges a breach of the duty of loyalty against that director individually. As described below, the *Corwin* doctrine seemingly goes further by providing that if there is an informed stockholder vote, then directors who are interested or lack independence can obtain dismissal without having to defend the fairness of the transaction.[11]

- **The business judgment rule appears to be irrebuttable following a fully informed and uncoerced stockholder vote.**

  - In the immediate wake of *Corwin*, it was not clear whether plaintiffs would still have the ability to rebut the business judgment rule by pleading facts sufficient to support a breach of fiduciary duty claim. At least four post-*Corwin* decisions, however, have indicated that the business judgment rule is irrebuttable.[12] The Delaware Supreme Court has not formally addressed this issue.

---

[6] *Singh v. Attenborough*, 137 A.3d 151, 152 (Del. 2016).

[7] *Id.* at 151-52.

[8] *In re OM Group, Inc. S'holders Litig.*, No. CV 11216-VCS, 2016 WL 5929951, at *1 (Del. Ch. Oct. 12, 2016).

[9] *Id.* at *10.

[10] *In re Cornerstone Therapeutics Inc. S'holder Litig.*, 115 A.3d 1173 (Del. 2015).

[11] This assumes the transaction did not involve an interested controlling stockholder.

[12] *See Larkin v. Shah*, 2016 WL 4485447, at *1 (Del. Ch. Aug. 25, 2016) ("[T]he Defendants are entitled to invoke the *irrebuttable* business judgment rule.") (emphasis added); *id.* ("In the absence of a controlling stockholder that extracted personal benefits, the effect of disinterested stockholder approval of the merger is review under the *irrebuttable* business judgment rule, even if the transaction might otherwise have been subject to the entire fairness standard due to conflicts faced by individual directors.") (emphasis added); *id.* at *7 ("I conclude that, by operation of *Corwin* and related authority on the legal effects of stockholder approval, the irrebuttable business judgment rule applies, a holding that extinguishes all challenges to the merger except those predicated on waste."); *In re OM Grp., Inc. Stockholders Litig.*, 2016 WL 5929951, at *10 (Del. Ch. Oct. 12, 2016) ("If their approval was the product of a fully informed, uncoerced vote, then, under *Corwin v. KKR Financial Holdings, LLC*, the *irrebuttable* business judgment rule would apply") (emphasis added) (footnote omitted); *Volcano Corp. S'holder Litig.*, 143 A.3d 727, 738 (Del. Ch. 2016) ("[R]ecent Supreme Court decisions confirm that the approval of a merger by a majority of a corporation's outstanding shares pursuant to a statutorily required vote of the corporation's fully informed, uncoerced, disinterested stockholders *renders the business judgment rule irrebuttable*.") (emphasis added); *see also Chester Co. Ret. Sys. v. Collins*, 2016 WL 7117924, *2 (Del. Ch. Dec. 6, 2016) (ORDER) ("In the absence of a controlling stockholder that extracted personal benefits, the effect of disinterested stockholder approval of the merger is review under the *irrebuttable* business judgment rule, even if the transaction might otherwise have been subject to the entire fairness standard due to conflicts faced by individual directors.") (emphasis added) (quoting *Larkin*, 2016 WL 4485447, at *1).

© 2017 Hunton & Williams LLP

HUNTON&
WILLIAMS

- **Waste claims have little "real-world relevance."**

  - Once the business judgment rule applies under *Corwin*, plaintiffs are relegated to claiming waste. In *Singh*, the Delaware Supreme Court made clear that plaintiffs will rarely be able to state a waste claim. It explained that following a fully informed stockholder vote, "dismissal is typically the result…. because the vestigial waste exception has long had little real-world relevance, because it has been understood that stockholders would be unlikely to approve a transaction that is wasteful."[13]

  - Vice Chancellor Montgomery-Reeves made a similar observation in *Volcano*: because "the test for waste is whether any person of ordinary sound business judgment could view the transaction as fair," it is "logically difficult to conceptualize how a plaintiff" could succeed after a majority of disinterested stockholders approved the transaction.[14]

- ***Corwin* can insulate directors even if they are not independent.**

  - The lower court in *Corwin* stated that "even if the plaintiffs had pled facts from which it was reasonably inferable that a majority of… directors were not independent, the business judgment standard of review still would apply to the merger because it was approved by a majority of the shares held by disinterested shareholders… in a vote that was fully informed."[15] The Supreme Court, however, did not explicitly address this issue because it assumed the transaction was not subject to entire fairness.[16] This raised a question because a transaction approved by a majority of interested directors (i.e., directors with a material conflict of interest in the transaction) would typically be subject to entire fairness review.[17]

  - The issue was subsequently addressed by Vice Chancellor Slights in *Larkin v. Shah*, who asked "what did *Corwin* mean by 'a transaction not subject to the entire fairness standard' "?[18] He concluded that *Corwin* applies even if a majority of the directors were not independent.[19] He reasoned that the only exception to *Corwin* is when the transaction involves a controlling stockholder that has a conflict of interest, such as in a freeze-out merger.[20] Thus, it appears that the irrebuttable business judgment rule applies to an interested director transaction, assuming the directors' conflicts of interest were adequately disclosed.

---

[13] *Singh v. Attenborough*, 137 A.3d 151, 151-52 (Del. 2016).

[14] *Volcano*, 143 A.3d at 750 (internal quotation marks and citation omitted); *see also Chester County Ret. Sys. v. Collins*, 2016 WL 7117924, *3 (Del. Ch. Dec. 6, 2016) (ORDER) ("In light of the stockholders' approval, there is no rational argument that waste occurred here.").

[15] *KKR Fin.*, 101 A.3d at 1003.

[16] *Corwin*, 125 A.3d at 308-09 ("[W]hen a transaction not subject to the entire fairness standard is approved by a fully informed, uncoerced vote of the disinterested stockholders, the business judgment rule applies.").

[17] This assumes the transaction was not approved by a special committee of disinterested directors.

[18] *Larkin v. Shah*, 2016 WL 4485447, at *10 (Del. Ch. Aug. 25, 2016).

[19] *Id.* at *1 ("*In the absence of a controlling stockholder that extracted personal benefits*, the effect of disinterested stockholder approval of the merger is review under the irrebuttable business judgment rule, even if the transaction might otherwise have been subject to the entire fairness standard due to conflicts faced by individual directors.") (emphasis added).

[20] Arguably, the *Comstock* decision contributed to some uncertainty because, in dismissing the complaint, Chancellor Bouchard noted that the "plaintiff has not alleged facts showing that the challenged transaction, which was approved by a majority of disinterested and independent directors, should be subject to entire fairness review." *City of Miami Gen. Emp. & Sanitation Emp. Ret. Trust v Comstock*, C.A. No. 9980-CB, mem. op. (Del. Ch. Aug. 24, 2016). In *Solera*, however, Chancellor Bouchard noted the *Larkin* decision and seemingly approved of its conclusion that the Delaware Supreme Court intended to exclude only conflicted controlling stockholder transactions. *See Solera*, mem. op. at 15 n. 28.

© 2017 Hunton & Williams LLP

- ***Corwin* applies to two-step transactions and single-step mergers.**
  - Many acquisitions are structured as a tender offer followed by a back-end merger.[21] Although *Corwin* involved a single-step merger, several Court of Chancery decisions have logically extended *Corwin* to two-step transactions where a majority of the stockholders tender their shares in the first-step tender offer.[22] At least one of those decisions (*Volcano*) is on appeal.

- ***Corwin* can cut off aiding and abetting claims.**
  - Another key issue is whether, if the directors are protected by an irrebuttable business judgment rule, a plaintiff can still pursue aiding and abetting claims against third parties, such as financial advisors. Although the Court of Chancery has not engaged in an in-depth analysis of this issue, several decisions have dismissed aiding and abetting claims following a conclusion that, under *Corwin*, the plaintiffs failed to state a predicate breach of fiduciary duty claim against the directors.[23]

- **To avoid *Corwin*, plaintiffs must adequately plead a viable disclosure claim, but then the defendants have the burden to show the vote was fully informed.**
  - In *Solera*,[24] Chancellor Bouchard held that the defendants had the burden of proof to show a vote was fully informed when they raised a stockholder ratification defense. He continued, however, that the plaintiffs have the initial burden of stating a disclosure claim. "It makes little sense," he explained, "that defendants must bear this pleading burden [without plaintiffs' initially stating a claim] for it would create an unworkable standard, putting a litigant in the proverbially impossible position of proving a negative."[25]

What the Future Holds

- *A Potent Tool for Defendants*: As noted above, *Corwin* will likely result in outright dismissal of most stockholder litigation challenging transactions that have been approved by stockholders. Thus, *Corwin* will reduce the costs of post-closing litigation and will likely result in a decrease in the overall frequency with which stockholders pursue post-closing claims.

---

[21] *See* 8 Del. C. § 251(h).

[22] *See Volcano Corp. S'holder Litig.*, 2016 WL 3626521 (Del. Ch. June 30, 2016); *Larkin v. Shah*, 2016 WL 4485447 (Del. Ch. Aug. 25, 2016).

[23] *City of Miami Gen. Employees v. Comstock*, No. CV 9980-CB, 2016 WL 4464156, at *1 (Del. Ch. Aug. 24, 2016) ("I conclude that plaintiff's claims for post-closing damages against C&J's directors and officers are subject to the business judgment presumption under the Delaware Supreme Court's decision in *Corwin v. KKR Financial Holdings LLC* because of the legal effect of the stockholder vote, and that judicial review of plaintiff's fiduciary duty claims (*and related aiding and abetting claims*) thus ends there.") (emphasis added); *id.* at *23 ("A claim for aiding and abetting a breach of fiduciary duty cannot survive if the underlying fiduciary duty claims do not."); *In re Volcano Corp. S'holder Litig.*, 143 A.3d 727, 750 (Del. Ch. 2016) ("An aiding and abetting claim… may be summarily dismissed based upon the failure of the breach of fiduciary duty claims against the director defendants."); *In re KKR Fin. Holdings LLC S'holder Litig.*, 101 A.3d 980, 1003 (Del. Ch. 2014) (same); *Chester Co. Ret. Sys. v. Collins*, 2016 WL 7117924, *3 (Del. Ch. Dec. 6, 2016) (ORDER) ("Having failed to plead a claim for breach of fiduciary duty, the plaintiff likewise has failed to plead a claim for aiding and abetting."); *see also Singh v. Attenborough*, 137 A.3d 151, 153 (Del. 2016) ("Having correctly decided… that the stockholder vote was fully informed and voluntary, the Court of Chancery properly dismissed the plaintiffs' claims against all parties.").

[24] *In re Solera Holdings, Inc., S'holder Litig.*, Consol. C.A. No. 11524-CB, mem. op. (Del. Ch. Jan. 5, 2017).

[25] *Id.* at 19; *see also KKR Fin.*, 101 A.3d at 999; *Harbor Finance P'rs v. Huizenga*, 751 A.2d 879, 899 (Del. Ch. 1999).

© 2017 Hunton & Williams LLP

- *Will* Corwin *Contribute to More Appraisal Petitions?* As it becomes harder to pursue fiduciary duty claims, more stockholders may exercise appraisal rights in mergers. This would be an unwelcome development since appraisal rights create uncertainty for buyers by giving stockholders the potential to seek payment in excess of the merger price.[26] In addition, many appraisal petitions have nuisance value that incentivizes companies to settle to avoid the legal expenses associated with litigating the fair value of the target company stock, notwithstanding the minimum share requirements discussed below. The dynamics of appraisal proceedings, however, are quite different from fiduciary duty actions. Appraisal trials can be very fact-intensive and involve a quintessential "battle of the experts" given the focus on valuation. In addition, many plaintiffs who might typically pursue fiduciary duty actions may not satisfy the ownership requirements for seeking appraisal. Specifically, recent amendments to the Delaware appraisal statutes impose a *de minimis* requirement that shares valued at $1,000,000 or constituting 1% of the target company's outstanding shares must demand appraisal in order for an appraisal action to proceed from a long-form or medium-form merger of a publicly traded target corporation. The recent rise of appraisal actions over the past two years may continue, but whether *Corwin* and its progeny will contribute to more appraisal actions remains to be seen.

- *Cause for Alarm?*

  - Some observers may become concerned that the post-*Corwin* regime is too lax and that it is an over-correction to the problems stemming from widespread M&A litigation. For example, *Corwin*, *Trulia*, and other recent decisions might be criticized for making it too difficult to pursue viable fiduciary duty claims, and thus removing (i) an important check on director behavior and (ii) the likelihood of judicial oversight. In addition, some might accuse these rulings of eliminating an incentive for directors (or taking away advisors' leverage in counseling directors) to "do the right thing" if directors know that lawsuits either are unlikely or will be quickly dismissed after closing. These concerns, however, are based on highly negative views of human nature. They are also inconsistent with the business judgment rule, which presumes that directors have discharged their duties.

  - Another concern is that *Corwin* insulates bad faith conduct as long as it is fully disclosed to stockholders. Theoretically, stockholders might accept a transaction that offered them a premium rather than vote down the transaction and continuing with the corporation's standalone plan, even if directors or officers had acted in bad faith. To take an extreme hypothetical, what if directors disclosed that they illegally bribed a government official or embezzled money in connection with a merger? This issue has not been squarely addressed. *Corwin*'s progeny has dealt with breaches of the duty of loyalty in the context of a director's interest or independence, but not bad faith. While interesting, this issue should not be alarming. Delaware courts have generally excelled at ferreting out serious misconduct. If there are specific and credible allegations that directors intentionally harmed a corporation, a Delaware judge is likely to allow the case to proceed beyond a motion to dismiss. Moreover, it seems unrealistic to think that bad faith conduct would ever be disclosed at the level that would be required by Delaware courts to insulate it. Nevertheless, assuming that bad faith conduct was fully disclosed and the transaction was still approved, it remains to be seen whether the directors still could obtain dismissal.

- *Future Battlegrounds*:

  - *Corwin* will shift the focus of practitioners and litigators to the adequacy of disclosure. Plaintiffs may also have an incentive to challenge transactions pre-closing because they

[26] This assumes buyers do not protect themselves through closing conditions capping the number of stockholders that have exercised appraisal rights.

© 2017 Hunton & Williams LLP

benefit from a lower pleading standard ("colorability") to seek discovery[27] – although their ability to settle those claims in exchange for supplemental disclosures has become more difficult after *Trulia*. Alternatively, would-be plaintiffs may try to inspect corporate books and records in order to prepare a disclosure claim.[28] It is still unclear how Delaware will deal with disclosure claims that are pursued post-closing, particularly when a plaintiff did not possess information pre-closing that would have suggested a disclosure violation.

- Another relatively untested area is whether a plaintiff could escape *Corwin* by alleging that the stockholder vote was "coerced." Under the enhanced scrutiny standard, a transaction falls short if it was coercive, preclusive, or fell outside the range of reasonableness.[29] The coercion issue examines whether "the defendants have taken actions that operate inequitably to induce [stockholders] to tender [or vote] their shares for reasons unrelated to the economic merits of the offer."[30] Stockholder plaintiffs historically argued that termination fees (and particularly naked no-vote fees) were so large as to coerce the stockholder vote, but these claims got little traction. Coercion also can arise in controlling stockholder transactions, if the controller makes explicit or implicit threats about what would happen if the minority stockholders do not approve a transaction. In *Larkan*, Vice Chancellor Slights indicated that board-level conflicts are unlikely to result in actionable coercion that would undermine a stockholder vote.[31] More recently, Vice Chancellor Slights asked for supplemental briefing on this issue.[32] Because coercion offers a way to call into question the effectiveness of a stockholder vote, and because the consequences of stockholder approval are so significant, we should see more efforts by plaintiffs' lawyers to argue that particular transaction structures are coercive.

- *The Final Word Resides Within the Delaware Supreme Court*: The Delaware Supreme Court issued *Corwin* and *Singh*, but those rulings did not reach many of the issues discussed above. The Delaware Supreme Court will likely weigh in on more issues flowing from *Corwin* in the near future, and *Volcano* is on appeal as of the time of this article.

Contact

Steven M. Haas
shaas@hunton.com

This client alert is based on a forthcoming article by Steven Haas. All views expressed herein are solely those of the author.

© 2017 Hunton & Williams LLP. Attorney advertising materials. These materials have been prepared for informational purposes only and are not legal advice. This information is not intended to create an attorney-client or similar relationship. Please do not send us confidential information. Past successes cannot be an assurance of future success. Whether you need legal services and which lawyer you select are important decisions that should not be based solely upon these materials.

[27] *See Solera*, mem. op. at 20.
[28] *See id.* at 20 n. 42.
[29] *See Unitrin, Inc. v. American Gen. Corp.*, 651 A.2d 1361 (Del. 1995).
[30] *Eisenberg v. Chicago Milwaukee Corp.*, 537 A.2d 1051, 1061 (Del. Ch. 1987).
[31] *See Larkin v. Shah*, 2016 WL 4485447, at *12 (Del. Ch. Aug. 25, 2016) ("Coercion is deemed inherently present in controlling stockholder transactions of both the one-sided and two-sided variety, but not in transactions where the concerns justifying some form of heightened scrutiny derive solely from board-level conflicts or lapses of due care.") (footnote omitted).
[32] *See In re Saba Software, Inc. S'holder Litig.*, C.A. No. 10697-VCS, letter op. (Del. Ch. Jan. 31, 2017).