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The Continuing Evolution of *Corwin* in Delaware Courts

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Recent Delaware Supreme Court and Court of Chancery cases have continued to refine the impact and requirements of *Corwin v. KKR Financial Holdings LLC*,[1] in which the Delaware Supreme Court held that the business judgment rule is "the appropriate standard of review for a post-closing damages action when a merger that is not subject to entire fairness … has been approved by a fully informed, uncoerced majority of the disinterested stockholders."[2] Recent cases have focused on three areas: (1) the scope of the business judgment rule; (2) the adequacy of disclosures and coercion; and (3) the burdens of pleading and proof.

Scope of Business Judgment Rule

The Delaware Supreme Court recently confirmed the application of *Corwin* to tender offers executed under 8 Del. C. § 251(h) and affirmed a decision where the Court of Chancery determined that when *Corwin* applies, the business judgment rule is "irrebuttable," leaving only a claim for waste.

In June 2016, the Court of Chancery in *In re Volcano Corp. Stockholder Litigation*[3] extended *Corwin* to stockholder acceptance of a tender offer executed pursuant to 8 Del. C. § 251(h). When 89.1 percent of Volcano's outstanding shares tendered, lawsuits alleging breach of fiduciary duty followed. Granting the defendants' motion to dismiss, the Court of Chancery held: "[T]he acceptance of a first-step tender offer by fully informed, disinterested, uncoerced stockholders representing a majority of a corporation's outstanding shares in a two-step merger under Section 251(h) has the same cleansing effect under *Corwin* as a vote in favor of a merger by a fully informed, disinterested, uncoerced stockholder majority."[4] In doing so, the court likened the decision to tender to a statutorily required stockholder vote because both actions "effectuat[e a transaction] in the first instance."[5] As a result, a fully informed, disinterested and uncoerced tender under Section 251(h) "irrebuttably invoked" the business judgment rule, leaving only a potential claim for waste (which has been described as a "vestigial … exception" that is very difficult to prove).[6] On February 9, 2017, one day after hearing oral argument, the Delaware Supreme Court affirmed *Volcano* "for the reasons stated in [the Court of Chancery's] decision."[7]

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[1] 125 A.3d 304 (Del. 2015).

[2] *Id.* at 305-06.

[3] 143 A.3d 727 (Del. Ch. 2016).

[4] *Id.* at 747.

[5] *Id.* at 746.

[6] *Id.* at 740, 746-47, 750. In doing so, the Court of Chancery cited to the Delaware Supreme Court's decision in *Singh v. Attenborough*, 137 A.3d 151 (Del. 2016). *Id.* at 740. Writing for the court *en banc*, Chief Justice Leo E. Strine, Jr. stated in *Singh* that the court's decision "to consider ... whether the plaintiffs stated a claim for the breach of the duty of care after invoking the business judgment rule [under *Corwin*] was erroneous." *Singh*, 137 A.3d at 151. He explained that "employing this same standard after an informed, uncoerced vote of the disinterested stockholders would give no standard-of-review-shifting effect to the vote." *Id.* As a result, if *Corwin* applies, "dismissal is typically the result. That is because the vestigial waste exception has long had little real-word relevance. ..." *Id.* at 152.

[7] *In re Volcano Corp. Stockholders Litig.*, No. 372, 2016 (Del. Feb. 9, 2017) (ORDER).

Subsequent Court of Chancery decisions have continued to rely on *Corwin* to dismiss merger litigation and clarified that *Corwin* is applicable to fully informed, uncoerced votes unless there is "*a looming conflicted controller*."[8]

Adequacy of Disclosures and Coercion

Within days of each other, the Delaware Supreme Court and Court of Chancery came to opposite conclusions regarding whether disclosures were sufficient to dismiss allegations under *Corwin*. On March 23, 2017, the Supreme Court issued an order affirming the dismissal of claims under *Corwin* and rejecting the appellant-plaintiff's arguments that failure to disclose the presence of an additional bidder was sufficient to preclude a finding of a fully informed vote on a motion to dismiss.[9]

Eight days later, the Court of Chancery declined for the first time to grant a motion to dismiss under *Corwin* because the plaintiff had adequately alleged that the stockholder vote was not fully informed and had been coerced. In *In re Saba Software, Inc. Stockholder Litigation*, the Court of Chancery found two disclosure claims sufficient to preclude application of *Corwin* on a motion to dismiss.[10] First, the court found the plaintiffs had stated a disclosure claim because the proxy statement did not disclose why the company had missed the Securities and Exchange Commission's (SEC) final deadline to rectify its fraudulent financial statements, which led to the SEC deregistering the company's stock shortly before the vote on the merger.[11] Second, the plaintiff had stated a disclosure claim because the proxy statement failed to disclose "the post-deregistration options available to Saba" that were discussed by the ad hoc committee of the Saba board of directors formed to evaluate the transaction.[12] In addition to disclosure claims, the Court of Chancery also found *Corwin* not applicable on a motion to dismiss because the plaintiff had adequately pleaded that the stockholder vote was coerced, noting: (1) the circumstances of Saba at the time of the vote; (2) the "hell-bent" sales process "in the midst of … regulatory chaos"; and (3) the omitted disclosures that would have directly borne on Saba's circumstances. This resulted in Saba stockholders being "given a choice between keeping their recently-deregistered, illiquid stock or accepting the Merger price … consideration that was depressed by the Company's nearly contemporaneous failure once again to complete the restatement of its financials."[13] The Court of Chancery characterized this choice, if the allegations were proven true, as "no real choice at all."[14]

Burdens of Pleading and Proof

Recent Court of Chancery decisions also have explored who bears the pleading-stage burden under *Corwin*. In *In re Merge Healthcare Inc.*, the court dismissed a complaint under *Corwin* and explained that "[a] plaintiff alleging that a

[8] *Larkin v. Shah*, C.A. No. 10918-VCS, slip op. at 33 (Del. Ch. Aug. 25, 2016); *id.* at 3 ("In the absence of a controlling stockholder that extracted personal benefits, the effect of a 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."). *See also, e.g., In re Merge Healthcare Inc.*, C.A. No. 11524-CB, slip op. at 21 (Del. Ch. Jan. 5, 2017) (applying *Corwin* to dismiss case pursuant to business judgment rule where stockholder vote was fully informed); *Chester Cnty. Ret. Sys. v. Collins*, C.A. No. 12072-VCL, at 6 (Del. Ch. Dec. 6, 2016) (ORDER) (same); *In re OM Grp., Inc. Stockholders Litig.*, C.A. No. 11216-VCS, slip op. at 42 (Del. Ch. Oct. 12, 2016) (same).

[9] *City of Miami Gen. Emps.' & Sanitation Emps.' Ret. Trust v. Comstock* [C&J Energy], No. 482, 2016, at 2 (Del. Mar. 23, 2017) (ORDER).

[10] Consol. C.A. No. 10697-VCS, slip op. at 2 (Del. Ch. Mar. 31, 2017). While this is the first denial of a motion to dismiss under *Corwin*, in *In re Comverge, Inc. Shareholders Litigation*, the Court of Chancery declined to grant summary judgment for defendants under *Corwin* because material disputes of fact existed regarding certain disclosure claims. C.A. No. 7368-VCMR, at 8-10 (Del. Ch. Oct. 31, 2016) (ORDER). The *Comverge* motions to dismiss were decided prior to *Corwin*.

[11] *In re Saba Software, Inc.*, slip op. at 32-33. The Court of Chancery distinguished this "why" disclosure claim from others that are routinely rejected, noting that the claim was not related to "a purposeful decision of the Board" but "was a factual development that spurred the sales process and, if not likely correctible, would materially affect the standalone value of Saba going forward." *Id.* at 33.

[12] *Id.* at 36. The Court of Chancery admitted that this type of disclosure has not always been required, but Saba's issues with delisting and deregistration made this "hardly a typical case." *Id.* at 37.

[13] *Id.* at 40-42.

[14] *Id.* at 45 n.99.

stockholder vote was inadequately informed to cleanse a transaction must 'identify a deficiency in the operative disclosure document,' which shifts the burden to the defendants to show that 'the alleged deficiency fails as a matter of law in order to secure the cleansing effect of the vote.'"[15] In *In re Columbia Pipeline Group, Inc. Stockholder Litigation*, the court also dismissed claims under *Corwin* and explained that the "converse" of the burden scheme would not "make[] sense as a practical matter. The idea would be that the defendants would have to come forward and establish affirmatively everything regarding their disclosures."[16] As the Court summarized, "[t]he idea instead, I think, is the plaintiff has to plead something such that it is reasonably conceivable that a disclosure claim could exist, and then we go from there."[17]

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The Delaware Supreme Court's affirmation of *Volcano* and the Court of Chancery's continued willingness to dismiss litigation under *Corwin* have highlighted the importance of complete disclosure to stockholders prior to their vote or tender. These decisions confirm that Delaware law continues to emphasize the ability of stockholders to decide for themselves how to allocate capital and reward informed stockholder decisions while maintaining the right to hold companies accountable if disclosures fall short. While it is too early to know whether the Court of Chancery's decision in *Saba* represents a shift, the case appears to be an extreme one when compared to other recent decisions applying *Corwin*.[18]

[15] C.A. No. 11388-VCG, slip op. at 25-26 (Del. Ch. Jan. 30, 2017). *See also In re Solera Holdings, Inc. Stockholder Litig.*, C.A. No. 11524-CB, slip op. at 19 (Del. Ch. Jan. 5, 2017) (holding that "a plaintiff challenging the decision to approve a transaction must first identify a deficiency in the operative disclosure document, at which point the burden would fall to defendants to establish that the alleged deficiency fails as a matter of law in order to secure the cleansing effect of the vote").

[16] C.A. No. 12152-VCL, Tr. at 23 (Del. Ch. Sept. 6, 2016) (TRANSCRIPT) (granting motion to stay discovery pending resolution of motion to dismiss under *Corwin*).

[17] *Id.*

[18] Relatedly, in *In re Paramount Gold & Silver Corp. Stockholders Litigation*, the Court of Chancery dismissed under *Corwin* allegations of an uninformed and coerced vote, but noted an "apparent tension" between *Corwin* and *In re Santa Fe Pacific Corporation Shareholder Litigation*, 669 A.2d 59 (Del. 1985), which "held in the context of a post-closing challenge that a fully informed stockholder vote approving a merger did not preclude review of certain deal protection devices under *Unocal* [*Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985)]". Consol. C.A. No. 10499-CB, slip op. at 14-15 (Del. Ch. Apr. 13, 2017). While the Court of Chancery noted that the Delaware Supreme Court "did not discuss or expressly overrule this aspect of *Santa Fe*" in its *Corwin* decision, it concluded that it "need not address the apparent tension" because there was no unreasonable deal protection at issue. *Id.* As a result, this question remains unresolved.