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Presidio Shines Light on Key Delaware Deal Litigation Trends and Topics

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In *Firefighters' Pension System of the City of Kansas City, Missouri Trust v. Presidio, Inc.*, Vice Chancellor Laster of the Delaware Court of Chancery dismissed claims against directors of Presidio, Inc. (Presidio) and Presidio's controlling stockholder arising out of the sale of Presidio, while sustaining claims against Presidio's Chairman/CEO, the buyer (Buyer) and Presidio's financial advisor. The case is notable for the stockholder plaintiff's allegation of an undisclosed "tip" from the financial advisor to the buyer that purportedly allowed the buyer to strategically increase and structure its offer and close the deal.

The decision—which the court labeled as an "Opinion," indicating it was intended to cover significant or novel issues—addresses several deal litigation topics and is worthy of analysis by M&A practitioners. The court discusses (i) the applicable standard of review for the sale of a controlled company to a third party, and the applicability of the "*Synthes* safe harbor"; (ii) potential liability for financial advisors premised on a "fraud-on-the-board" theory; and (iii) the continuing trend of breach of fiduciary duty claims against officers, who are not protected by exculpation provisions in a corporation's certificate of incorporation.

Background

The case arose from the acquisition of Presidio in December 2019. Approximately seven months earlier, in May 2019, Presidio's controlling stockholder began exploring a sale of the company, assisted by financial advisor LionTree Advisors, LLC (LionTree). The controller and LionTree held early exploratory meetings with a potential financial buyer, and Clayton Dubilier & Rice, LLC (CD&R), a potential strategic buyer. In June 2019, LionTree and Presidio's chairman/CEO met with CD&R about a possible transaction with Presidio. CD&R allegedly suggested to the chairman/CEO that it desired a merger of equals with a portfolio company, in which his continued employment would not be guaranteed.

According to the plaintiffs, neither LionTree nor the chairman/CEO disclosed the meeting with CD&R to Presidio's board until several weeks later. The plaintiffs further alleged that when the meeting was disclosed, LionTree characterized it as "a casual discussion of the landscape" and told the board that CD&R had been "in no rush to consider strategic options."

In early July 2019, the Buyer contacted LionTree to discuss a potential acquisition of Presidio. The plaintiffs alleged that at a meeting on July 8, 2019, during which Presidio's board considered whether to engage with the Buyer and/or solicit interest from CD&R, LionTree told Presidio's board that CD&R conveyed it was "focused on closing [a] pending acquisition" and was "not focused on a strategic transaction in the near term." According to the plaintiffs, in fact, CD&R's "pending" acquisition had already closed, and CD&R had expressed interest to LionTree in pursuing a transaction with Presidio. The plaintiffs further alleged that based on LionTree's advice, which the chairman/CEO did not contradict, the board directed LionTree to engage with the Buyer, and elected not to contact CD&R.

Thereafter, an agreement was reached for the Buyer to acquire Presidio for $16.00 per share in cash. During a subsequent go-shop period, CD&R submitted a topping bid of $16.50 per share. Pursuant to the merger agreement, Presidio notified the Buyer the following day that CD&R was defined as an "Excluded Party," which meant that CD&R would be permitted to pay a discounted termination fee. However, the plaintiffs alleged that nearly two hours before that official notice was sent, LionTree shared CD&R's offer with the Buyer and, inferably, informed the Buyer of its price. Later that evening, the Buyer submitted a revised offer to LionTree at $16.60 per share, which contained a 24-hour deadline, and provided for an amended merger agreement (AMA) that would strip CD&R's ability to pay a discounted termination fee. Presidio's board directed LionTree to tell CD&R that it had until 5 p.m. the following day to submit a revised offer.

CD&R again topped the Buyer's bid with a nonbinding indication of interest at $17.00 per share, but rejected the increased termination fee and threatened to walk away if Presidio signed the AMA. Presidio signed the AMA and CD&R disengaged.

Post-closing, the plaintiff, a former Presidio stockholder, filed suit against (i) Presidio's controlling stockholder for breach of fiduciary duty or, in the alternative, aiding and abetting breaches of fiduciary duty; (ii) the members of the Presidio board for breaches of fiduciary duty; (iii) Presidio's chairman/ CEO for breaches of fiduciary duty in his capacities as both a director and an officer; (iv) the Buyer for aiding and abetting; and (v) LionTree for aiding and abetting breaches of fiduciary duty. The court dismissed the claims against Presidio's controller and directors, but sustained the claims against Presidio's chairman/CEO, LionTree and the Buyer.

Standard of Review and the *Synthes* Safe Harbor

The *Presidio* decision is notable for its analysis of the applicable standard of review for the sale of a company with a controlling stockholder to a third party, as well as the applicability of the "*Synthes* safe harbor."

In *In re Synthes, Inc. Shareholder Litig.*, 50 A.3d 1022 (Del. Ch. 2012), former Chief Justice, then-Chancellor Leo Strine held that entire fairness would not apply to the sale of a company to a third party, notwithstanding the presence of a controlling stockholder, where the controller did not engage in self-dealing and received the same consideration in the sale as the company's unaffiliated stockholders. In that circumstance, the court explained that "pro rata treatment remains a form of safe harbor under our law." Moreover, because 65% of the consideration paid in the sale at issue in *Synthes* consisted of stock, the deferential business judgement rule—rather than enhanced scrutiny under *Revlon*—applied and supported dismissal of the claims.

In *Presidio*, the defendants argued that the merger was subject to the business judgment rule, under either the Delaware Supreme Court's decision in *Corwin v. KKR Financial Holdings LLC*—which held that in the absence of a conflicted stockholder, the fully informed vote of disinterested, uncoerced stockholders will extinguish breach of fiduciary duty claims, leaving only claims for waste—or the "*Synthes* safe harbor," since Presidio's controller received the same consideration in the transaction as the company's unaffiliated stockholders.

As an initial matter, the court rejected the plaintiff's argument that the controller was conflicted in the sale due to an alleged need for liquidity, and acknowledged that the controller received the same consideration as all other stockholders and did not secure any nonratable benefits for itself. Although this satisfied one requirement of *Corwin*—the absence of a conflicted controller—the court found that *Corwin* could not apply

in these circumstances because, accepting plaintiff's allegations as true, the stockholder vote was not fully informed, since the proxy disseminated to stockholders in connection with the merger failed to disclose the facts and circumstances surrounding LionTree's alleged tip to the Buyer.

The court then rejected the defendants' reading of *Synthes* as requiring automatic application of the business judgment rule any time a controlling stockholder receives the same consideration in a sale as the unaffiliated stockholders do. In particular, Vice Chancellor Laster noted that "[t]he *Synthes* decision stands in contrast with *McMullin v. Beran*, 765 A.2d 910 (Del. 2000), in which the Delaware Supreme Court applied enhanced scrutiny" under *Revlon*—rather than the business judgment rule—"to the sale of a company by a controlling stockholder in which all of the company's stockholders received the same per-share consideration in cash."

Applying enhanced scrutiny under *Revlon*, the court found it reasonable to infer that Presidio's directors breached their duty of care by failing to provide "active and direct oversight" of LionTree. Such breaches of the duty of care were exculpated pursuant to the 102(b)(7) provision in the company's certificate of incorporation, and the court therefore dismissed the fiduciary duty claims against the directors. However, the court found that the directors' underlying duty of care breaches supported aiding-and-abetting claims against LionTree and the Buyer.

'Fraud-on-the-Board' Claims

In addition to addressing the applicable standard of review, the *Presidio* decision hints at other important doctrinal developments.

Notably, in two footnotes, the court suggested, in the context of analyzing the plaintiff's aiding-and-abetting claim against LionTree, that pleading a "fraud on the board" claim against a financial advisor that is not predicated on a breach of fiduciary duty may be possible.

Specifically, the court noted that even if the "business judgment rule governed the Merger such that it was not reasonably conceivable that the fiduciary defendants committed a breach of duty, the complaint still would state a claim for relief against LionTree." The court explained that, "[r]ather than a claim for secondary liability under a theory of aiding and abetting, the pled facts would support a claim for primary liability under a theory of fraud on the board." The court stated that the complaint pled all of the necessary elements of the equitable claim of "fraud on the

board," which, unlike a claim for aiding and abetting, would not require the plaintiff to plead an underlying breach of fiduciary duty.

Officer Liability

The *Presidio* decision is also significant as another recent example of stockholder plaintiffs' increased pursuit of claims against officers.[1]

Despite dismissing the claims against Presidio's nonexecutive directors, the court sustained claims against Presidio's chairman/CEO, concluding that it was "reasonably conceivable that [the chairman/CEO] tilted the sale process in favor of the Buyer and steered the Board away from a deal with CD&R for self-interested reasons." In doing so, the court remarked that "[the chairman/CEO's] obvious reasons for preferring a transaction with [the Buyer] make it reasonably conceivable that he was interested in the transaction," and the pleaded facts supported an inference that he "worked closely with LionTree to steer the deal in [the Buyer's] direction."

Takeaways

- This opinion demonstrates that the court continues to actively evaluate core Delaware law principles in the M&A context, such as the applicable standard of review for a sale transaction, and the allegations necessary to state an actionable post-closing "*Revlon*" claim. Notably, the primary focus of the opinion is not on whether, as alleged, a majority of the Presidio board was considered disinterested and independent, or "consciously disregarded" or "utterly failed" to satisfy its Both of these concepts have historically played a significant role in post-closing decisions analyzing *Revlon*, such as the Delaware Supreme Court's decisions in *Malpiede and Lyondell*, where the plaintiffs' failure to plead a majority of conflicted directors or a "bad faith" claim resulted in dismissal of all claims, including against directors who may have been alleged to be conflicted. Instead, the court's focus in *Presidio* centered more on whether board oversight of certain alleged aspects of the process—such as the purported "tip," the buyer's go-shop bid maneuvering and the CEO's interests post-closing—fell outside a range of reasonableness. The result of that shift in focus is that, rather than dismissing all claims, the court sustained claims against purportedly conflicted fiduciaries (who breached a duty of loyalty) and conflicted advisors (that aided and abetted such breaches of loyalty), but dismissed claims against unconflicted directors who at most breached their duty of care for grossly negligent conduct.
- *Presidio* reaffirms the central holding in *Synthes* that entire fairness will not apply to the sale of a controlled company to a third party if the controller does not negotiate nonratable benefits for itself and receives the same consideration as the affiliated stockholders. The holdings in both *Synthes* and *Presidio* are premised on the notion that a sale to a third party in which a controller does not receive unique benefits is not a "conflicted controller" transaction and, accordingly, entire fairness should not apply. The difference in outcome, therefore, appears at least in part to be a function of the form of consideration paid in the transaction—mixed consideration with a majority being stock in *Synthes*, and cash in *Presidio*—rather than any radical shift in Delaware law.

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[1] *See Skadden Insights—The Delaware Edition,* "Recent Trends in Officer Liability," December 18, 2020.

Ultimately, *Presidio* reaffirms that adequate disclosures (under *Corwin*) and the form of consideration (under *Revlon* and its progeny) remain critical factors in determining the standard of review applicable to a merger transaction.

- Financial advisors should be aware that *Presidio*'s recognition of a potential new "fraud on the board" claim may encourage plaintiffs to reframe claims that historically have been pled as aiding and abetting breaches of fiduciary duty. It remains to be seen whether such a fraud claim—which still must be pled with particularity under Court of Chancery Rule 9(b), and would require facts demonstrating scienter—will be more attractive to stockholder plaintiffs than traditional aiding-and-abetting claims, which also require a plaintiff to plead scienter (in the form of "knowing participation" of a fiduciary breach), and for that reason have been described as "among the most difficult to prove."[2] Whether the Delaware Supreme Court will recognize an independent cause of action for "fraud on the board" is also unclear.
- Stockholder plaintiffs challenging merger transactions continue to pursue claims not only against directors, but also against officers. The Delaware courts, particularly in the last two years, have repeatedly noted that officers owe the same fiduciary duties as directors, but are not entitled to the benefit of exculpation from money damages for breaches of the duty of care that directors benefit from pursuant to Section 102(b)(7) exculpatory charter provisions. Officers of Delaware companies should understand and recognize the potential for claims against them for breach of the fiduciary duty of care or loyalty.

[2] *RBC Capital Markets, LLC v. Jervis*, 129 A.3d 816, 866 (Del. 2015).