DELAWARE CORPORATE LAW BULLETIN

Chancery Court Holds that Defendant Directors' Failure to Disclose Material Facts Defeated Application of *Corwin*, but Nevertheless Dismisses Claims Against Directors Due to Plaintiff's Failure to Adequately Plead Directorial Breach of Their Duty of Loyalty

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INTRODUCTION

In 2015, the Supreme Court of Delaware held in *Corwin v. KKR Financial Holdings* ("*Corwin*") that the business judgment standard of review applies where a one-step merger not subject to the entire fairness standard of review is approved by a vote of disinterested stockholders.[1] Under *Corwin*, if defendant directors can establish that the stockholder vote approving the merger was both (1) fully informed and (2) uncoerced, then, absent a sufficient pleading of waste (no easy feat), a post-closing damages action will be dismissed at the pleading stage.[2] The Delaware Court of Chancery ("*Chancery Court*") subsequently expanded *Corwin* to cover two-step acquisitions,[3] and then clarified that *Corwin* will apply "even if the transaction might otherwise have been subject to the entire fairness standard due to conflicts faced by individual directors."[4]

Thus, *Corwin* and its progeny have provided target company directors with a tool, via disinterested stockholder approval, to cleanse their breaches of fiduciary duty in connection with M&A transactions not involving "a controlling stockholder *that extracted personal benefits*,"[5] thereby reducing the opportunity for stockholders to obtain post-closing damages.[6] The Chancery Court has continued to grapple with establishing the bounds of this expansive holding, including the

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1. Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 305–06, 314 (Del. 2015).

2. Appel v. Berkman, No. 12844-VCMR, 2017 WL 2999000, at *3 (Del. Ch. July 7, 2017), *rev'd on other grounds*, No. 316, 2017, 2018 WL 947893, at *8 (Del. Feb. 20, 2018). For a discussion of this decision, see Robert S. Reder & John L. Daywalt, *Delaware Supreme Court Reverses Dismissal of Fiduciary Breach Claims Against Target Company Directors*, 71 VAND. L. REV. EN BANC 123 (2018).

3. That is, a tender offer followed by a merger. *In re* Volcano Corp. Stockholder Litig., 143 A.3d 727, 750 (Del. Ch. 2016), *aff'd*, 156 A.3d 697 (Del. 2017). For a discussion of this decision, see Robert S. Reder, *Delaware Chancery Court Extends "Cleansing Effect" of Stockholder Approval Under* KKR *Two-Step Acquisition Structure*, 69 VAND. L. REV. EN BANC 227 (2016).

4. *In re* Merge Healthcare Inc. S'holders Litig., No. 11388-VCG, 2017 WL 395981, at *6 (Del. Ch. Jan. 30, 2017) (quoting Larkin v. Shah, No. CV 10918-VCS, 2016 WL 4485447, at *1 (Del. Ch. Aug. 25, 2016)) . For a discussion of this and related decisions, see Robert S. Reder & Tiffany M. Burba, *Delaware Courts Confront Question Whether "Cleansing Effect" of* Corwin *Applies to Duty of Loyalty Claims*, 70 VAND. L. REV. EN BANC 35 (2017).

5. *Van Der Fluit*, No. 12553-VCMR, 2017 WL 5953514, at *5 (quoting *In re* Merge Healthcare Inc., No. CV 11388-VCG, 2017 WL 395981, at *6 (Del. Ch. Jan. 30, 2017)); *see also Corwin*, 125 A.3d at 309 (Del. 2015);
In re Merge Healthcare, 2017 WL 395981, at *6.

6. *Corwin*, 125 A.3d at 308; *see also* Matthew D. Cain, et al., *The Shifting Tides of Merger Litigation*, 71 VAND. L. REV. 603, 606 (2018).

questions of (i) what constitutes a fully informed stockholder vote and (ii) whether a target company has a controlling stockholder.[7]

Despite concerns expressed by some commentators that the Delaware courts potentially have gone too far in providing target company directors with the ability to obtain a stockholder vote to cleanse their fiduciary breaches, the requirement that the vote be fully informed presents a real limit on the scope of *Corwin*. For instance, in *Van der Fluit v. Yates*, Vice Chancellor Tamika Montgomery-Reeves recently determined that *Corwin* was not available because target company stockholders were not provided with materially accurate disclosures in connection with their approval of the transaction.[8] Specifically, the Vice Chancellor found that stockholders were not adequately informed that the two largest stockholders—who also served on the board of directors, functioned as the company's top management, and received employment with the acquiring company—led the negotiations with the acquiring company.[9] Notwithstanding *Corwin*'s inapplicability, however, the Vice Chancellor dismissed plaintiff's claim for failure to adequately plead that defendant directors had breached their duty of loyalty.[10]

I. FACTUAL BACKGROUND

Opower, Inc. ("*Opower*") "provides cloud-based software to the utility industry."[11] Opower's co-founders and top executives, Daniel Yates ("*Yates*") and Alex Laskey ("*Laskey*"), both served on Opower's board of directors.[12] Yates and Laskey, who together controlled approximately thirty percent of Opower's outstanding shares, were parties, together with other early stage investors, to a pre-IPO stockholders' agreement providing for registration and informational rights (the "*Investors Agreement*").

Following on-and-off discussions, on March 28, 2016, Oracle Corporation ("*Oracle*") proposed to acquire Opower for between $9 and

7. The Delaware Supreme Court previously held that a controlling stockholder will have the power to (a) elect directors, (b) cause a break-up of the corporation, (c) merge it with another company, (d) cash-out the public stockholders, (e) amend the certificate of incorporation, (f) sell all or substantially all of the corporate assets, or (g) otherwise alter materially the nature of the corporation and the public stockholders' interests. Paramount Commc'n Inc. v. QVC Network Inc., 637 A.2d 34, 43 (Del. 1994).

8. *Van der Fluit*, 2017 WL 5953514, at *8.

9. *Id.*

10. *Id.* at *12.

11. *Id.* at *2.

12. *Id.* at *1.

$10 per share in cash.[13] Qatalyst Partners ("*Qatalyst*"), retained as Opower's financial advisor, thereafter initiated a seventeen-day market check for other potential buyers. Only strategic bidders were contacted based on the belief "there was a low probability that a financial buyer could submit a competitive bid."[14] Fourteen strategic bidders were contacted, four of whom entered into confidentiality agreements with Opower.[15] Based upon meetings with these potential bidders, Opower determined that Oracle's offer was too low and countered at $11 per share.[16] After the other strategic bidders dropped out of the process, Oracle raised its offer to $10.30 per share. In response, Opower granted Oracle exclusive negotiating rights.[17]

During the exclusivity period, Oracle and Opower (led by Yates and Laskey) negotiated a merger agreement providing for the terms of the acquisition. The acquisition was structured as a two-step transaction, consisting of a tender offer followed by a merger under section 251(h) of the Delaware General Corporation Law. In addition to the $10.30 per share cash purchase price, the merger agreement provided for:

(1) a $20 million termination fee and up to $5 million in expense reimbursement; (2) the right for Yates, Laskey, and other members of management to convert a portion their unvested Opower options into comparable unvested Oracle options; and (3) a waiver by Yates and Laskey of ten percent of their portion of the merger compensation unless and until each has worked one full year at Oracle.[18]

Yates and Laskey, among other stockholders, separately agreed to tender their shares to Oracle in the first step (the "*Tender Agreements*").[19]

After Qatalyst rendered a fairness opinion to Opower's board of directors, the board approved the transaction and the parties signed the merger agreement. Opower stockholders "overwhelmingly" tendered their shares in the first step and, after the second-step merger was completed, on June 13, 2016, Opower became a wholly owned subsidiary of Oracle.[20] According to Yates, "[i]t was clear to us and our investors, earlier this year and over the last couple of years as we've

13. *Id.* at *3. The companies ceased discussing a possible merger in light of Opower's initial public offering ("*IPO*") in April 2014. *Id.* at *2.

14. *Id.* at *3.

15. *Id.* at *3.

16. *Id.* at *3.

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.* at *4.

evolved, that merging with Oracle was a faster way for us to reach our product vision and was going to be right for our customers and shareholders."[21]

Peter van der Fluit ("*van der Fluit*" or "*plaintiff*"), an Opower stockholder, filed suit in the Chancery Court approximately four months later, seeking damages from Opower's directors ("*defendants*") on the basis that the transaction resulted from "an unfair deal orchestrated by a controlling stockholder."[22] One month later, the defendants, relying on *Corwin*, filed a motion to dismiss.[23] The defendants argued in the alternative that van der Fluit's complaint failed to plead a breach of duty by the board members, thereby entitling them to dismissal even if *Corwin* was inapplicable.[24]

The litigants disputed the appropriate standard of review. Van der Fluit argued for application of the entire fairness standard on the basis that (i) Opower had a control stockholder who was interested in the transaction, and (ii) the transaction was not approved by a "disinterested and independent board majority."[25] If the Court rejected entire fairness, he sought application of enhanced scrutiny under *Revlon*.[26] The defendants sought application of the business judgment rule because, consistent with *Corwin*, "fully informed, uncoerced stockholders tendered a majority of their shares in a transaction that does not involve an interested controlling stockholder."[27] While agreeing with neither position, Vice Chancellor Montgomery-Reeves nevertheless granted defendants' motion to dismiss.

II. VICE CHANCELLOR MONTGOMERY-REEVES'S ANALYSIS

A. Corwin Not Applicable

Because 87.8 percent of Opower's outstanding shares were tendered in the first step of the Oracle transaction, disinterested stockholder approval was given for purposes of *Corwin*.[28] Vice Chancellor Montgomery-Reeves therefore explained that, to survive dismissal, van der Fluit must show that either (i) Opower had a controlling stockholder interested in the transaction, or (ii) the

21. *Id.*
22. *Id.* at *1, *4.
23. *Id.* at *4; *see also* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015).
24. *Van der Fluit*, 2017 WL 5953514, at *4; *see also Corwin*, 125 A.3d 304.
25. *Van der Fluit*, 2017 WL 5953514, at *4.
26. *Id.*; *see also* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).
27. *Van der Fluit*, 2017 WL 5953514, at *4.
28. *Id.* at *5.

stockholders had not been fully informed or had been coerced to tender their shares.[29]

1. No Controlling Stockholder

The Vice Chancellor explained that for a stockholder (or a group of stockholders) to be a controller, they must either (i) own greater than fifty percent of the voting power, or (ii) "*exercise[] control* over the business affairs of the corporation."[30] For a group to be considered a controller under the second prong, "some indication of an actual agreement" must exist to show the members of the group intended to act as one.[31] Because Yates and Laskey together owned only thirty percent of the stock, the key question was whether they exercised control over the business affairs of Opower.[32]

The Vice Chancellor rejected plaintiff's argument that the two agreements between Yates, Laskey, and other stockholders constituted agreements to act together and exercise joint control over Opower.[33] The Investors Agreement, an early-stage investors agreement signed before Opower's IPO, provided registration and informational rights but, importantly, contained no agreements as to voting or decisionmaking.[34] The Tender Agreement only obligated its signatories to tender their shares to Oracle pursuant to the terms of the merger agreement.[35] Accordingly, the Vice Chancellor concluded that neither of these agreements alone rendered Yates and Laskey a control group.[36]

The Vice Chancellor also rejected plaintiff's contention that Yates and Laskey constituted a control group by virtue of their managerial roles. Plaintiff failed to plead "facts sufficient to show meaningful connections[between the two] or managerial control of Opower."[37] Rather, the Vice Chancellor characterized their interactions as "simply working with a 'concurrence of self-interest' " as stockholders.[38] In so ruling, the Vice Chancellor distinguished two

29. *Id.* at *5.

30. *Id.* (quoting *In re* KKR Fin. Holdings LLC S'holder Litig., 101 A.3d 980, 991 (Del. Ch. 2014)).

31. *Id.*

32. *Id.* at *5–6.

33. *Id.* at *6.

34. *Id.*

35. *Id.*

36. *Id.* *6.

37. *Id.* In this connection, the Vice Chancellor pointed to plaintiff's failure to plead any facts about the relationship between the two, their voting history, or specific examples where Yates and Laskey dominated the business affairs of the corporation. *Id.*

38. *Id.* (quoting In re Crimson Expl. Inc.Stockholder Litig., No. CIV.A. 8541-VCP, 2014 WL 5449419, at *15 (Del. Ch. Oct. 24, 2014)).

earlier decisions relied upon by van der Fluit, one of which featured stockholders owning a total of 71.19 percent of the outstanding stock,[39] and the other of which featured a significant stockholder who had a subordinate on the board, was related to certain company executives, exhibited managerial dominance, and had the potential for dominant control in any contested election.[40]

2. Stockholders Not Fully Informed

Next, Vice Chancellor Montgomery-Reeves considered whether "fully informed, uncoerced stockholders tendered a majority of their shares" as required by *Corwin*.[41] Fully-informed stockholders are those who are made aware of "all material information."[42] Materiality depends upon whether a stockholder would consider an omitted fact important, not whether it "might be helpful."[43]

The Vice Chancellor noted that the disclosure materials given to Opower stockholders in connection with the first-step tender offer failed to explicitly disclose that Yates and Laskey actually led the negotiations with Oracle. Particularly in view of the fact that each of Yates and Laskey "each received post-transaction employment [with Oracle] and the conversion of unvested Opower options into unvested Oracle options,"[44] the Vice Chancellor concluded that this omission effectively "prohibited Opower stockholders from determining the interests of those fiduciaries who negotiated the deal," creating a "substantial likelihood that a reasonable shareholder would consider" the omitted fact "important in deciding" whether to tender their shares to Oracle.[45]

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39. *Id.* *7; *see also* Frank v. Elgamal, No. 6120–VCN, 2012 WL 1096090, at *1 (Del. Ch. Mar. 10, 2014).

40. *Id.*; *see also In re* Cysive Inc. S'holders Litig., 836 A.2d 531 (Del. Ch. 2003).

41. *Id.* at *4. The Vice Chancellor dismissed the argument that the stockholders were impermissibly coerced to tender their shares because van der Fluit failed to plead any facts relating to coercion other that a single conclusory sentence. *Id.* at *5, n.78.

42. *Id.* at *7.

43. *In re* Rouse Props., Inc., No. 12194-VCS, 2018 WL 1226015, at *21 (Del. Ch. Mar. 9, 2018). For example, failure to notify stockholders that the company failed to complete an SEC-required restatement by the deadline and alternatives to the merger after the stockholders' shares were deregistered by the SEC were both material omissions sufficient to find that the vote was not fullyinformed. *In re* Saba Software, Inc. S'holder Litig., No. 10697-VCS, 2017 WL 1201108, at *12–13 (Del. Ch. Mar. 31, 2017). For a discussion of this decision, see Robert S. Reder, *Delaware Court Refuses to Invoke* Corwin *to "Cleanse" Alleged Director Misconduct Despite Stockholder Vote Approving Merger*, 70 VAND. L. REV. EN BANC 47 (2017).

44. *Van der Fluit*, 2017 WL 5953514, at *8.

45. *Id.* at *7–8 (citing Eisenberg v. Chi. Milwaukee Corp., 537 A.2d 1051, 1061 (Del. Ch. 1987)).

As such, the omission constituted a "material disclosure violation" precluding dismissal under *Corwin*.[46]

B. Failure to Plead Breach of Duty of Loyalty Fatal

Although *Corwin* was not available to achieve dismissal of plaintiff's claims, all was not lost for defendants. To withstand the motion to dismiss, Vice Chancellor Montgomery-Reeves noted, plaintiff must plead "non-exculpated claims against a director who is protected by an exculpatory charter provision."[47] In other words, because Opower's charter exempted the directors for monetary liability for breaches of their duty of care,[48] van der Fluit was required to adequately allege breach of their duty of loyalty or bad faith on the part of defendants.[49] To satisfy this standard in this particular context, van der Fluit had to allege facts suggesting a majority of the board either (i) was interested in the sales process (i.e., would receive a personal financial benefit), or (ii) acted in bad faith (i.e., demonstrating a conscious disregard for their duty).[50]

The Vice Chancellor held that each of plaintiff's arguments in this regard failed:

First, van der Fluit failed to plead nonconclusory facts to support his contentions that (i) early conversations with Oracle demonstrated Opower's "long-held desire for an Oracle acquisition," resulting in "deep-seated favoritism towards Oracle" in the bidding process, and (ii) defendants sought "to maximize their own pre-IPO investments" rather than maximize the sale price of Opower for all stockholders.[51]

Second, van der Fluit did not sufficiently plead that the "seventeen-day market check" was "unreasonably rushed" in view of the facts that the process involved fourteen potential bidders, four of whom progressed forward for a time but ultimately dropped out due to either their inability or disinclination to put forth a competing bid in a reasonable timeframe.[52]

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46. *Id.* at *8.

47. *Id.* (citing *In re* Cornerstone Therapeutics Inc. Stockholder Litig., 115 A.3d 1173, 1175 (Del. 2015)).

48. Pursuant to 8 Del. C. § 102(b)(7), a director may not be held personally liable for monetary damages for breach of fiduciary duty absent, among other things, a finding of a breach of that director's duty of loyalty.

49. *Van der Fluit*, 2017 WL 5953514, at *8

50. *Id.*

51. *Id.* at *8–9.

52. *Id.* at *10. The Vice Chancellor distinguished the cases cited by van der Fluit, as one involved a twenty-four hour market check over a holiday weekend and the other involved a two-week market check over the December holidays where the banker warned this would not be a "real

Third, in attacking the deal protections included in the merger agreement, van der Fluit miscalculated the termination fee rate, which actually fell within the range previously held by Delaware courts to be reasonable.[53]

Fourth, van der Fluit failed to proffer any evidence supporting his claims that (i) a majority of the board had a "material" self-interest in the transaction, or (ii) those directors who were to receive post-transaction employment with Oracle controlled the board and kept the rest of the directors in the dark about any post-transaction benefits they would receive.[54]

Thus, due to the absence of adequate pleadings that defendants breached their duty of loyalty or

acted in bad faith, the Vice Chancellor granted defendants' motion to dismiss.[55]

CONCLUSION

The Chancery Court's ruling in *van der Fluit* demonstrates once again that there indeed are limits to the reach of *Corwin*. Going forward, M&A practitioners are well-advised to disclose with specificity the role played by potentially conflicted corporate officers in transaction negotiations.

Vice Chancellor Reeves' opinion also demonstrates the high bar faced by plaintiffs seeking damages from target company directors in connection with a completed M&A transaction, even absent *Corwin* cleansing. Setting forth sufficient facts to establish a directorial breach of the duty of loyalty or bad faith, even at the early pleading stage of a proceeding, is not an insignificant task, requiring more than conclusory allegations of conflicts or other bad acts on the part of directors.

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market check." *Id.*; *see also* Chen v. Howard-Anderson, 87 A.3d 648, 675 (Del. Ch. 2014); *In re* Answers S'holders Litig., No. 6170-VCN, 2012 WL 1253072, at *2 (Del. Ch. Apr. 11, 2012).

53. *Van der Fluit*, 2017 WL 5953514, at *10 (holding the true termination fee was 3.62 percent, not the alleged 4.699 percent); *see also In re* 3Com S'holders Litig., No. 5067-CC, 2009 WL 5173804, at *7 (Del. Ch. Dec. 18, 2009).

54. *Van der Fluit*, 2017 WL 5953514, at *10–11. To remedy these deficiencies, van der Fluit argued, the board should have established an independent committee to approve the Oracle transaction. Further, the Vice Chancellor did not decide whether Yates' and Laskey's post-transaction employment and roll-over of options would constitute sufficient self-interest because, in any case, van der Fluit failed to demonstrate either that Yates and Laskey controlled the board or failed to inform the board of these benefits. *Id.* at *12.

55. *Id.* at *12.