This Practice Note discusses the fiduciary duties of boards of directors under Delaware law in the context of merger and acquisitions transactions. The Note describes the standards of review of board conduct applicable in different transaction scenarios and how liability is determined under those standards. For a general overview of fiduciary duties, see Practice Note, Fiduciary Duties of the Board of Directors (http://us.practicallaw.com/6-382-1267).

Every director of a Delaware corporation owes two core fiduciary duties to the corporation and its stockholders:

- The duty of care, which requires that directors be fully and adequately informed and act with care when making decisions and acting for the corporation.
- The duty of loyalty, which requires that directors act and make decisions in the best interest of the corporation, not in their own personal interest.

In ordinary situations where the directors do not face a conflict of interest and the company's ongoing existence as a corporate enterprise is not at issue, the directors' decisions are entitled to deference under the business judgment rule. In sale transactions, however, the courts scrutinize the directors' decisions more carefully under stricter standards of review. The potential for stricter scrutiny has implications for directors' potential liability and for the structuring of transactions.

This Practice Note discusses the fiduciary duties of the board of directors under Delaware law in the context of M&A transactions. The Note focuses on Delaware law because:

- The majority of public companies are incorporated in Delaware and public merger transactions produce the bulk of court opinions that discuss fiduciary duties in the M&A context.
- Delaware's law on fiduciary duties is well established and widely followed by other states.

For a general overview of fiduciary duties, including their interpretation and application in non-sale contexts, see Practice Note, Fiduciary Duties of the Board of Directors (http://us.practicallaw.com/6-382-1267). For a discussion of fiduciary duty considerations and takeover defenses in the context of hostile bids, see Practice Note, Defending Against Hostile Takeovers (http://us.practicallaw.com/9-386-7206). For information on how fiduciary duties are applied in other states, see Corporation Law: State Q&A Tool: Question 5 (http://us.practicallaw.com/5-517-3521).

**THE BUSINESS JUDGMENT RULE**

The basic principle that informs all discussion of fiduciary duties is the "cardinal precept," as the Delaware Supreme Court has put it, that the corporation's directors, not its stockholders, manage the corporation's business and affairs (Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984), overruled on other grounds by Brehm v. Eisner, 746 A.2d 244, 253-54 (Del. 2000)). Because directors act as agents for the stockholders, they are charged with fiduciary duties to protect the interests of the corporation and to act in the stockholders' best interests.

An extension of the principle that directors manage the corporation is the business judgment rule. Courts are reluctant to substitute their business judgment for the directors' or to question business decisions with the benefit of hindsight, unless the decision of the board cannot be attributed to any rational business purpose (Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)). To give directors space to take risk for the benefit of the corporation, directors' actions are protected by the presumptions of the business judgment rule. The rule presumes that disinterested and independent directors acted on an informed basis and in the honest belief that the action was taken in the best interest of the corporation. In a lawsuit alleging a breach of the duty of care, the court makes this presumption unless the plaintiff can show that a majority of the directors did not meet the following three elements:

- **Informed.** The director must keep informed about the corporation and its decisions. Directors can rely on information and opinions from consultants, management and employees, but need to make a good faith determination that those persons can competently produce the reports and make the analysis on which the board relies (see 8 Del. C. § 141(e)).
- **Good faith.** The directors must act in good faith. The decision-making process must be substantive and cannot just rubber-stamp management's actions.
Best interest of the corporation. The directors must reasonably believe that the action or transaction was made in the best interest of the corporation. A director with a conflict of interest in the underlying action is not entitled to the presumptions of the business judgment rule.

If a majority of the board qualifies for the presumptions of the business judgment rule, the standard for a finding of a breach of the duty of care is gross negligence (see In re Citigroup Inc. S’holder Deriv. Litig., 964 A.2d 106, 124 (Del. Ch. 2009), citing Aronson v. Lewis, 473 A.2d at 812). If, as is common, the company's certificate of incorporation exculpates directors for breaches of the duty of care, as is authorized under Section 102(b)(7) of the DGCL, liability must be premised on a finding of a breach of the duty of loyalty (see Liability for Failure to Satisfy Revlon).

UNSOLICITED BIDS

Based on the animating principles of the business judgment rule, if a Delaware corporation receives an unsolicited bid to acquire the shares of the company, even at a substantial premium, the board of directors of the target company can refuse to sell the company and outright decline to enter into negotiations with the bidder. Assuming a disinterested and independent board that has acted on an informed basis and in the honest belief that declining to sell is in the best interest of the corporation, the directors are entitled to the presumptions of the business judgment rule. The board has no standing obligation to entertain bids, even generous ones. Although it is conceivable that an offer may be so generous that it renders the decision to decline it so transparently outrageous that it cannot be attributed to a rational business purpose, a disinterested and independent board acting on an informed basis has never lost the presumptions of the business judgment rule based on the generosity of the bid alone.

As a strategic matter, the board of the target company receiving the takeover bid must consider its available takeover defenses, including a poison pill, a staggered board provision in its charter, and other tools for delaying a bid or proxy contest (see Practice Note, Defending Against Hostile Takeovers (http://us.practicallaw.com/9-386-7206)). However, strictly as a matter of compliance with its fiduciary duties, the board is entitled to the presumptions of the business judgment rule for declining to enter into negotiations.

SALE OF CONTROL: ENHANCED SCRUTINY

Once a change of control of the corporation becomes inevitable, both the focus of the directors’ efforts and the standard of review under which the directors’ conduct is judged change. The business judgment rule ceases to be available until certain hurdles are met, because the specter of a conflict of interest exists in which the directors will take action to benefit or entrench themselves at the expense of the stockholders.

When a board makes the decision to approve a sale of control, Delaware law requires the board to focus its efforts on obtaining the highest price reasonably attainable for the stockholders (Revlon, Inc. v. MacAndrews & Forbes Hldgs., Inc., 506 A.2d 173, 182 (Del. 1986); Mills Acquisitions Co. v. Macmillan, Inc., 559 A.2d 1261, 1288 (Del. 1989)). These efforts are judged by the enhanced-scrutiny standard of review, in which the court examines whether the board’s overall course of action in pursuit of its new objective was reasonable under the circumstances. If the directors fail to meet their obligations under Revlon, they face the prospect of liability unless a majority of the disinterested directors approved the sale in a fully informed vote, which restores the presumptions of the business judgment rule (see Restoring the Business Judgment Rule with a Stockholder Vote).

The board’s duties in this context are frequently referred to colloquially as “Revlon duties” or “heightened duties.” These naming devices imply that the board's fiduciary duties change once a sale process begins, but the courts consider them something of a misnomer. Enhanced scrutiny under Revlon does not change the nature of fiduciary duties owed by directors. Revlon instead emphasizes that the board must perform its traditional fiduciary duties in the service of a specific objective, namely, to maximize the sale price of the enterprise (Malpiede v. Townsend, 780 A.2d 1075, 1083 (Del. 2001)).

TYPES OF TRANSACTIONS THAT TRIGGER REVLO

Enhanced scrutiny under Revlon attaches in change-of-control transactions, where the “omnipresent specter” exists that the board of the target company will act in its own interests to the detriment of the stockholders (Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985)). Conversely, Revlon does not apply, and the board retains the presumptions of the business judgment rule, in stock-for-stock deals, if control of the post-merger entity remains in a “large, fluid, changeable and changing public market” (Paramount Commc’ns Inc. v. Time Inc., 1989 WL 79880 (Del. Ch. July 14, 1989), aff’d, 571 A.2d 1140, 1150 (Del. 1990); see also Paramount Commc’ns Inc. v. QVC Network Inc., 637 A.2d 34, 47 (Del. 1994)). Based on that precedent, Revlon is triggered if the sale of control or break-up of the company is structured as either:

- A cash-out transaction, in which the stockholders exchange their shares for cash consideration.
- A stock-for-stock transaction where control of the combined business does not remain among a large and changeable base of stockholders, but becomes concentrated in a few large stockholders.

Revlon in Mixed-Consideration Deals

The analysis of whether Revlon applies in mixed-consideration transactions turns on the percentage of cash and stock being paid. The Delaware Court of Chancery in Smurfit-Stone applied Revlon where the mix of consideration at signing was 50/50 stock and cash consideration, even though the cash portion fell below 50 percent following the signing date (In re Smurfit-Stone Container Corp. S’holder Litig., 2011 WL 2028076, at *12-16 (Del. Ch. May 20, 2011, rev’d, May 24, 2011)). In an earlier transcript ruling, Vice Chancellor Laster had stressed that the important factor in determining when enhanced scrutiny applies is the percentage of the surviving entity that the current target-company stockholders will own, rather than the percentage of cash versus stock consideration (see Legal Update, Delaware Chancery Court’s Occam Ruling Applies Revlon to Mixed Consideration Transaction (http://us.practicallaw.com/8-504-6664)). However, Vice Chancellor Laster himself adopted the Smurfit-Stone formulation in Chen v. Howard-Anderson, 87 A.3d 648, 667 (Del. Ch. Apr. 8, 2014).
THE STAGE WHEN REVLON IS TRIGGERED

*Revlon* attaches only once the directors have decided to sell the company or, before that, if a sale has become inevitable. The board is not subject to *Revlon* merely because the corporation is "in play" or a candidate for takeover (see *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 242 (Del. 2009)).

The Delaware Supreme Court has held that *Revlon* can be triggered retroactively if the board of directors ratifies a special committee's previous decision to initiate a sale process (*RBC Capital Markets, LLC v. Jervis*, 129 A.3d 816, 852 (Del. 2015)). In *RBC*, the target company's special committee, without the knowledge of the full board, hired a financial advisor to help it explore strategic alternatives for the company. Three months later, the full board passed a resolution ratifying all actions taken by the committee during that three-month period. The court held that the initiation of the sale process began when the special committee, without board authorization, hired a financial advisor to sell the company, for these reasons:

- **Ratifying resolution.** The board passed a resolution restating and ratifying the actions of the special committee taken during the previous three months. While a sale may not necessarily have been inevitable at that point, the Delaware Supreme Court has recognized that the initiation of an active sale process triggers *Revlon* (*Arnold v. Soc'y for Sav. Bancorp, Inc.*, 650 A.2d 1270, 1290 (Del. 1994)).

- **Process initiated by the company itself.** The court distinguished the facts of *Lyondell* for purposes of the argument that the company was merely "in play" until later in the process. *Lyondell* involved a third party putting the target company in play by filing a Schedule 13D and the target board responding with a decision that it did not intend to put the company up for sale or implement defensive measures to fend off a possible hostile bid. In *RBC*, by contrast, the process was initiated by the company's own chairman of the board and of the special committee.

- **Policy.** The court expressed a concern that allowing the defendants to postpone application of *Revlon* to the end stages of the sale process also allows the board to benefit from a deferential standard of review, precisely when the board and its advisor engaged in a flawed and conflict-riddled process.

The policy argument seemingly amounts to a rationale for the court to apply a desired standard of review to generate the outcome that seems just. Even so, the decision provides extra reason for the board to exercise care in *Revlon* situations. If the board's conduct is less than satisfactory, it may provide a rationale for the court to extend the *Revlon* period itself.

SATISFYING REVLON

To satisfy enhanced scrutiny under *Revlon*, the directors' decisions must be reasonable, not perfect (*Lyondell*, 970 A.2d at 243). Beyond that standard, the courts have declined to specify a roadmap of actions that directors must take to satisfy *Revlon*, preferring a principles-based approach that allows directors to "select the path to value maximization, so long as they choose a reasonable route to get there" (*In re Dollar Thrifty Sh'dler Litig.*, 14 A.3d 573, 595-96 (Del. Ch. 2010)). However, the burden is on the defendant directors to show that, when they made the decisions at issue, they were adequately informed and acted reasonably (*Paramount Commc'n's Inc. v. QVC Network Inc.*, 637 A.2d 34, 45 (Del. 1994)). To that end, when a board decides to accept a bidder's offer, it should be able to demonstrate that it has explored strategic alternatives and found them to be inferior to the offer in terms of stockholder value. A well-developed record of the sale process showing affirmative steps to optimize value is likely to help a court reach the conclusion that the board has satisfied its duties under *Revlon*.

The court's review of the board's conduct tends to be intertwined with its determination of the standard for personal director liability. If the corporation has an exculpation provision in its charter, the court analyzes the board's efforts toward satisfying its duties under *Revlon* with a view to the question of whether the directors acted in bad faith (see Liability for Failure to Satisfy *Revlon*). Similarly, if a majority of the disinterested stockholders have approved the transaction in a fully informed vote, the court considers the board's conduct under the assumption that the directors are entitled to the presumptions of the business judgment rule (see Restoring the Business Judgment Rule with a Stockholder Vote). The advent of the possibility of restoring the business judgment rule—a relatively new phenomenon under Delaware law—is a powerful cleanser of any blemishes in the sale process. Nevertheless, for the sake of best practices and building the strongest case possible for any eventual litigation, directors should still consider the following suggestions:

- The board should obtain a fairness opinion, carefully review any valuations of the corporation, and consider alternative valuation methodologies. The board must also carefully consider the role and independence of any financial advisors. For detailed discussion of all these factors, see Practice Note, Fairness Opinions (http://us.practicallaw.com/0-503-5037).

- The board (or special committee assigned to the transaction) should monitor negotiations between the CEO (or other management) and the buyer.

- Any potential conflicts of interest should be fully disclosed to the board and stockholders. If any directors have a personal interest in the transaction, a special committee of disinterested directors should be convened (Practice Note, Making Good Use of Special Committees (http://us.practicallaw.com/3-502-5942)).

- Parties with a personal interest in the transaction should not negotiate the terms of the transaction.

- The board should conduct a meaningful market check to confirm the existence (or nonexistence) of a better deal.

- The board should consider the totality of the deal protections provided for in the merger agreement.

- The board should consider the particular circumstances affecting the corporation. For example, the Chancery Court held that an auction of a smaller corporation can require significantly more marketing than an auction of a widely held public corporation to be considered reasonable (*In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171 (Del. Ch. 2007)).

Although directors should give each of these recommendations its due weight, the Delaware courts have repeatedly emphasized that there is no single blueprint for directors to follow to fulfill their *Revlon* role and independence of any financial advisors. For detailed discussion of all these factors, see Practice Note, Fairness Opinions (http://us.practicallaw.com/0-503-5037).
duties (see Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989)). Recent case law provides the following guidance:

- The board of directors can satisfy Revlon even if it negotiates with a single bidder, without conducting a pre-signing market check or demanding a post-signing go-shop right, if the directors can justifiably rely on their financial advisor’s advice and have sufficient industry expertise to conclude that the bidder with which they have agreed to a sale is likely to produce the best bid (In re Plains Exploration & Prod. Co. S’holder Litig., 2013 WL 1909124 (Del. Ch. May 9, 2013)).

- At the same time, the court does not consider the suggestions listed above in isolation. For example, in NetSpend, the Chancery Court held that the board’s decision to conduct a single-bidder process, though not unreasonable per se, put the board’s other decisions in the sale process under even greater scrutiny (Koehler v. NetSpend Hldgs. Inc., 2013 WL 2181518 (Del. Ch. May 21, 2013)).

- Although the Chancery Court has at times applied enhanced scrutiny strictly, the Delaware Supreme Court has emphasized that the board of the target company has no obligation to perform an auction or post-signing market check and does not have to have “impeccable knowledge” of the company’s value (the phrase used in Plains) to enter into single-bidder negotiations. In the Supreme Court’s view, if a majority of the board is disinterested and independent and the stockholders hold an informed vote on the sale, the board can rely on a passive market check enabled by a fiduciary out and modest break-up fee to fulfill its duties under Revlon (C&J Energy Serv., Inc. v. City of Miami Gen. Emps’ and Sanitation Emps’ Ret. Trust, 107 A.3d 1049 (Del. 2014)).

- However, a passive market check enabled by mild deal-protection provisions cannot cleanse a flawed sale process if the stockholders do not have enough information to fully evaluate the proposed sale. The C&J Energy Services decision had emphasized that the board can only rely on a passive market check when, in evaluating the merits of the transaction for its own satisfaction, it can take into account that its stockholders will have a fair chance to evaluate the board’s decision for themselves. This condition is only satisfied if the stockholders will be fully informed when they vote on the merger. If, however, inadequate disclosures leave the stockholders unaware of deficiencies like the financial advisor’s conflicts and how those conflicts potentially impacted the proposed offer, the board cannot unload its evaluation of the merits of the transaction to a passive market check (RBC Capital Markets, LLC v. Jervis, 129 A.3d 816, 856 (Del. 2015)).

In considering all possible offers, the board’s duty to maximize price does not mean it should robotically accept whichever bid it receives that contains the largest dollar figure. The board can turn down the highest priced bid if it reasonably determines that the proposed deal is at risk of failing to close due to financing or regulatory uncertainty or due to the bidder’s necessity to obtain its own stockholder approval. For example, the Chancery Court held that a board of a target company acted reasonably when, for reasons of antitrust uncertainty, it refused to engage with a third-party bidder that had made a higher per-share bid than the agreement the company had in place. The court credited the board’s view that the antitrust risk associated with the third-party bid was too great (In re Family Dollar Stores, Inc. S’holder Litig., 2014 WL 7246436, at *16 (Del. Ch. Dec. 19, 2014)).

**Deal Protections in Revlon Transactions**

When buyers and target companies agree to a merger agreement for the sale of a public company, they negotiate provisions that balance a desire for deal certainty with a need for target companies’ boards to remain open to accepting a better offer to satisfy their fiduciary duties. These deal-protection provisions are common and, when drafted in the range of market practice and common law precedent, are relatively uncontroversial. Courts recognize that the initial buyer cannot be expected to enter into an agreement that leaves the door open for third parties with no compensation for the initial buyer’s time, expenses, and expectations. At the same time, the deal protections cannot foreclose the possibility of a topping bid. With these competing considerations in mind, the analysis of deal-protection provisions mirrors the analysis of defensive measures under Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 957 (Del. 1985). In that sense, the deal protections cannot be:

- Preclusive of topping bids, such as by making bids prohibitively expensive for potential interloping bidders or creating a process too complicated to make a topping bid worthwhile.

- Coercive of the stockholders, by charging the target company a break-up fee so high that the stockholders feel forced to approve the sale to avoid the fee.

The primary deal-protection device that operates during the immediate post-signing stage is the non-solicitation or no-shop covenant. The no-shop restricts the target company from soliciting competing bids, providing information to third-party bidders, or negotiating a competing transaction. Owing to their need to be able to consider superior offers without being fully locked up by the terms of the acquisition agreement, however, directors need to be able to withdraw their approval of the deal and cause the corporation to terminate the agreement if a better deal comes along. For this purpose, target boards negotiate a fiduciary out, which allows the board to change its recommendation to the stockholders for the initial merger. To compensate the buyer, nearly all public merger agreements provide for the payment of a break-up fee to the buyer if the target company changes its recommendation or terminates the agreement for a better offer.

For more information on various deal-protection measures and the ways in which the Delaware judiciary has analyzed particular provisions, see:

- Practice Note, Break-Up or Termination Fees (http://us.practicallaw.com/6-382-5500).

- Practice Note, No-Shops and Their Exceptions (http://us.practicallaw.com/8-386-1078).


- Deal Protections and Remedies: A Comparative Analysis of 2014 Public Merger Agreements (http://us.practicallaw.com/2-608-8806), a study analyzing trends in deal-protection measures, including no-shops and go-shops, fiduciary outs, matching rights, and break-up fees.
RESTORING THE BUSINESS JUDGMENT RULE WITH A STOCKHOLDER VOTE

The presumptions of the business judgment rule have traditionally been rebuttable in one of two principal circumstances:

- If a controlling stockholder stood on both sides of the transaction.
- If half or more of the board of directors were not disinterested or independent when they approved the transaction.

If the plaintiff were to prove that either of these two situations exists, the court would apply entire fairness review to the transaction and the burden of proof of the transaction’s fairness would shift to the defendants. In KKR Financial, the Chancery Court suggested that in the latter scenario, the presumptions of the business judgment rule should be restored if a fully informed vote of a majority of disinterested stockholders approves the transaction (In re KKR Fin. Hldgs. LLC S’holder Litig., 101 A.3d 980, 1003 (Del. Ch. Oct. 14, 2014)). The theory was that when there is no controlling stockholder present, the court can defer to the stockholders, who are positioned well enough to decide for themselves to approve the board’s actions, even though that endorsement is an imperfect substitute for a careful, deliberative investigation into the merits of the transaction by a disinterested and independent board.

The Delaware Supreme Court endorsed this policy soon after (Conlin v. KKR Fin. Hldgs. LLC, 125 A.3d 304, 308 (Del. 2015)). The court held that a vote by the fully informed and uncoerced stockholders is outcome-determinate, even when the merger is a change-of-control transaction to which Revlon ordinarily applies. In so ruling, the court emphasized that Revlon’s primary purpose is to give stockholders the ability to prevent injury before closing. However, in the post-closing stage after the stockholders have approved the transaction, Revlon is not designed for bringing suit for money damages.

The Conlin decision should diminish the number of post-closing claims that are brought seeking damages. Unless a plaintiff can demonstrate that a stockholder exercised control over the transaction or that seriously defective disclosures undermined the stockholder vote, the typical Revlon claim becomes mostly useless for anything other than pre-closing injunctions.

For a description of the disclosures that are necessary for the vote to be considered fully informed, see Duty of Disclosure.

Following the decision in Conlin, the Chancery Court ruled that when the standard of review shifts from enhanced scrutiny to business judgment as a result of a fully informed vote of a disinterested majority of the stockholders, the standard for a finding of fault on the part of the board is gross negligence, not waste (In re Zale Corp. S’holders Litig., 2015 WL 6551418, at *3 (Del. Ch. Oct. 29, 2015)).

LIABILITY FOR FAILURE TO SATISFY REVلون

Even if the board fails to restore the presumptions of the business judgment rule and is found to have acted unreasonably under Revlon, its conduct may only amount to a breach of its duty of care. In that event, a claim against the directors still fails if the corporation’s charter contains an exculpation provision under Section 102(b)(7) of the DGCL. In these situations, the plaintiff must also prove that the directors breached their duty of loyalty. Assuming that a majority of the directors were disinterested and independent, the claim of a breach of the duty of loyalty must be premised on a finding that the directors did not act in good faith. (Though practitioners sometimes refer to the duty of good faith as a standalone fiduciary duty, Delaware courts treat it as a component of the core fiduciary duty of loyalty.)

To act in good faith, a director must act with honesty of purpose and in the best interest of the corporation. No single definition or set of factors exists that defines good faith or bad faith, but the courts have identified several situations that usually involve bad faith. These include:

- An intentional failure to act in the face of a known duty to act, demonstrating a conscious disregard for one’s duties. For example, a director knows management is violating corporate policy, but makes no attempt to change the situation.
- A knowing violation of law. For example, if a director approves a waste removal plan knowing it violates environmental laws (but saves the corporation money).
- If a director acts for any purpose other than advancing the best interests of the corporation or its stockholders. For example, if a director approves a sale transaction because the director wants to sell its stock.

Because a finding of gross negligence is necessary to establish a breach of the duty of care (which is exculpated), an act taken in bad faith (which is not exculpated) must be “qualitatively more culpable than gross negligence” (Disney, 906 A.2d at 66).

In the context of a sale of the corporation, the most common argument that plaintiffs make in the hope of establishing bad faith is that the board intentionally failed to act. In Lyondell, where the Delaware Supreme Court described the bad-faith standard in the context of a sale process, the court emphasized the “vast difference” between an inadequate effort at satisfying the board’s duties and a conscious disregard of those duties (Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 243 (Del. 2009)). The Lyondell decision and its progeny in the Delaware Court of Chancery have described the standard for this allegation as a showing that the board “utterly failed to attempt to obtain the best price” (Lyondell, 970 A.2d at 244). To establish an utter failure that rises to the level of conscious disregard for its duties, the board’s failure to act must have been “so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith” (In re Alloy, Inc. S’holders Litig., 2011 WL 4863716, at *10 (Del. Ch. Oct. 13, 2011)). To illustrate, the Chancery Court dismissed a fiduciary duty claim against a board that had failed to obtain a formal fairness opinion and failed to audit the company’s financial statements. Even though the board “did not conduct a perfect sales process,” it defeated the claim because it did not “utterly fail to undertake any action to obtain the best price for stockholders” (Houseman v. Sagerman, 2014 WL 1478511, at *7 (Del. Ch. Apr. 16, 2014)).

As a practical matter, an inability by a plaintiff to provide a motive for why the disinterested and independent members of a board would prefer a transaction that favors management or the interested directors over the stockholders is likely to be fatal to any attempt to establish bad faith (see In re Morton’s Rest. Corp., Inc. S’holders Litig., 74 A.3d 656, 662 (Del. Ch. 2013); Miramar Firefighters Pension Fund v. AboveNet, Inc., 2013 WL 4033905, at *7 (Del. Ch. July 31, 2013);
Damages proximately caused by the breach.

A breach of the fiduciary's duty.

Fiduciary Duties in M&A Transactions

and abetting breaches of fiduciary duty as:

The Delaware Supreme Court has described the elements of aiding and abetting a director's breach, even if the directors committing the breach did not act in bad faith and are therefore personally exculpated (In re Rural Metro Corp. S'holders Litig., 88 A.3d 54, 86 (Del. Ch. 2014), aff'd, RBC Capital Markets, LLC v. Jervis, 129 A.3d 816, 873 (Del. 2015)). This approach relies on establishing that the board intentionally acted with a purpose other than that of advancing the best interests of the corporation, the third scenario of bad faith described in Disney. For example, for reasons of "greed...hatred, lust, envy, revenge...shame or pride," the board may have made decisions that are "outside the range of reasonableness for reasons other than pursuit of the best value reasonably available" (Chen v. Howard-Anderson, 87 A.3d at 684).

Exculpated Breach Forms Basis for Financial Advisor Liability

A 102(b)(7) exculpation provision eliminates personal monetary liability for the directors. However, it does not erase the underlying breach of that duty. (An underlying breach can be found either on a standard of gross negligence, if a fully informed stockholder vote has restored the presumptions of the business judgment rule, or on a standard of reasonableness, if deficiencies in the stockholder vote cause Revlon to remain in place.) A third party (such as a financial advisor) can therefore be held liable for aiding and abetting a director's breach, even if the directors committing the breach did not act in bad faith and are therefore personally exculpated (In re Rural Metro Corp. S'holders Litig., 88 A.3d 54, 86 (Del. Ch. 2014), aff'd, RBC Capital Markets, LLC v. Jervis, 129 A.3d 816, 873 (Del. 2015)).

The Delaware Supreme Court has described the elements of aiding and abetting breaches of fiduciary duty as:

- The existence of a fiduciary relationship.
- A breach of the fiduciary's duty.
- Knowing participation in the breach by the third-party defendants.
- Damages proximately caused by the breach.

(Malpiede v. Townsend, 780 A.2d 1075, 1096 (Del. 2001).)

The Supreme Court held in RBC that a third party is liable for aiding and abetting a breach of fiduciary duty if it knows that the board is breaching its duty of care and participates in the breach by misleading the board or creating an "informational vacuum" (RBC, 129 A.3d at 862). This knowing participation must be created with scienter. Scienter is established when the third party acts knowingly, intentionally, or with reckless indifference. It is a high standard for culpability and is not established on the part of the financial advisors if they merely fail to prevent a breach committed by the board. In that vein, the Supreme Court rejected the Chancery Court's description of the role of financial advisors as a "gatekeeper," which had implied a broader possibility of liability. However, if the financial advisors are found liable for aiding and abetting a breach, they cannot seek contribution from the exculpated directors.

In a decision rendered after RBC and Conwin, the Chancery Court provided an example of board misconduct that may rise to the level of gross negligence and provide a basis for liability for aiding and abetting the breach on the part of the board's financial advisor. In TIBCO, a miscalculation caused the parties to believe the total consideration was $100 million more than it was meant to be on the basis of the per-share consideration. On learning of the error, the board did not ask its advisor how the error had happened, whose fault it was, whether the buyer had been aware of it, or whether the buyer would be willing to pay some or all of the $100 million. The court held, for purposes of a motion to dismiss, that it was reasonably conceivable that the board's failure to make those basic inquiries amounted to gross negligence (In re TIBCO Software S'holders Litig., 2015 WL 6155894, at *23 (Del. Ch. Oct. 20, 2015)). The court also held that it was reasonably conceivable that the advisor had created the informational vacuum that forms the basis for liability for aiding and abetting by failing to volunteer the information it had to the board about the error (TIBCO, 2015 WL 6155894, at *25).

By contrast, the Chancery Court in Dole Food held that the financial advisor had not aided and abetted the defendants who had been found to have breached their fiduciary duties. The court explained that knowing participation requires "substantial assistance" in those acts that caused the breach of fiduciary duty. There is no broad theory of umbrella liability for advisors of individuals who are found to have breached their duties (In re Dole Food Co., Inc. S'holder Litig., 2015 WL 5052214, at *41-42 (Del. Ch. Aug. 27, 2015)).

CONFLICT TRANSACTIONS: ENTIRE FAIRNESS REVIEW

Delaware case law holds that sales of control (and other transactions) in which actual conflicts of interest exist are not entitled to the protections of the business judgment rule. Instead, the board's conduct and the terms of the transaction are reviewed under the "entire fairness" standard (Kahn v. Lynch Commc’n Sys., Inc., 638 A.2d 1110, 1115 (Del. 1994)).

Entire fairness is Delaware law's "most onerous standard" (In re Trados Inc. S’holder Litig., 73 A.3d 17, 44 (Del. Ch. 2013)). The standard traditionally applies in two general circumstances:


- If at least half of the directors approving the transaction were not disinterested or independent (Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

Entire fairness review requires a judicial determination of whether the transaction was objectively fair to the stockholders. In analyzing the entire fairness of a transaction, the defendants must establish that the transaction was the product of both:

- **Fair dealing.** The court considers how the transaction was timed, how it was initiated, structured, negotiated, disclosed by management to the directors, and how the approvals of the directors and the stockholders were obtained.

- **Fair price.** The court considers all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock. (Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983)).
UNITARY CONCLUSION ON PROCESS AND PRICE

The distinction between price and process is "not always neatly distinguishable," nor is it supposed to be (Hamilton Prs, L.P. v. Highland Capital Mgmt., L.P., 2016 WL 612233, at *5 (Del. Ch. Feb. 2, 2016)). The inquiry is not bifurcated. The court conducting an entire fairness review examines the transaction for both procedural and substantive fairness as a whole and reaches a "unitary conclusion" (In re Nine Sys. Corp. S'holders Litig., 2014 WL 4383127, at *47 (Del. Ch. Sept. 4, 2014)). Usually, a fair process results in a fair price, and evidence of fair dealing can help convince the court that the board obtained a fair price (Americas Mining Corp. v. Theriault, 51 A.3d 1213, 1244 (Del. 2012)). But this is not always the case.

For example, in the Trados decision, the Chancery Court concluded that a merger satisfied entire fairness in spite of an unfair process that led to it. The court held that the directors were personally interested in the transaction and that the board had wrongfully considered only the interests of the preferred stock, to the exclusion of the interests of the common stockholders. However, the court deemed the deal fair based on price, because the value of the common stock in the company as a going concern was worthless (Trados, 73 A.3d at 78).

By contrast, in Nine Systems, the Chancery Court held that a recapitalization transaction priced fairly to the common stockholders still failed entire fairness review because of an unfair process (Nine Sys. Corp., 2014 WL 4383127, at *46). The Nine Systems court favorably cited to the conclusion in Trados that an equity value of $0 necessarily meant that plaintiff stockholders receiving no consideration still received a fair price. The court did not, however, conclude, as Trados can be interpreted, that the fair price necessarily meant that the transaction satisfied entire fairness. To rationalize the apparent conflict with Trados, the court distinguished recapitalizations, in which the company's stockholders remain on as stockholders in the company, from third-party mergers, where price may be the more crucial element.

The degree of egregiousness of the flaws in the sale process can also influence the court's decision on price. In Dole Food, the court held that the two defendants had committed fraud by deliberately misleading the special committee of directors that was charged with negotiating the transaction and by taking other actions to reduce the company's stock price ahead of the transaction. The court ruled that although the final merger price was "arguably fair," the stockholders were entitled to a "fairer price" because of the fraud (In re Dole Food Co., Inc. S'holder Litig., 2015 WL 5052214, at *45 (Del. Ch. Aug. 27, 2015)).

LIABILITY FOR FAILURE TO SATISFY ENTIRE FAIRNESS

Directors are not automatically found liable on a finding that entire fairness was not met. As discussed in the context of enhanced scrutiny, directors may have a defense against liability for breach of the duty of care if the corporation's charter contains an exculpation clause under Section 102(b)(7) of the DGCL. Alternatively, the directors may be able to claim that in spite of the deal failing on price, they themselves justifiably relied on their advisors, as authorized by Section 141(e) of the DGCL.

Breaches of the duty of loyalty, however, cannot be exculpated. If a self-dealing transaction has been found unfair and the corporation has an exculpatory provision, the directors can be found liable in one of two ways:

- Any directors disinterested and independent of the controlling stockholder can be held liable, but only if they are found to have approved the transaction in bad faith. This finding requires an inquiry into each director's state of mind. Furthermore, the disinterested and independent directors can win dismissal of the complaints against them at the pleadings stage without having to remain as a defendant until the ultimate conclusion of the litigation (In re Cornerstone Therapeutics Inc. S'holder Litig., 115 A.3d 1173, 1180 (Del. 2015)).
- Any director lacking in disinterest or independence is subject to damages regardless of the individual's subjective bad faith (Cornerstone Therapeutics, 115 A.3d at 1181).

Exculpatory provisions do not benefit the controlling stockholders themselves in their role as controllers (In re Dole Food Co., Inc. S'holder Litig., 2015 WL 5052214, at *39 (Del. Ch. Aug. 27, 2015), citing In re Emerging Commc'ns S'holder Litig., 2004 WL 1305745, at *38 (Del. Ch. May 3, 2004)). A controller engaging directly or indirectly in an interested transaction is potentially liable for breach of fiduciary duty even if it participated in the transaction through intervening entities. The plaintiff does not have to make a case that the controller aided and abetted breaches committed by the directors (In re EZCORP Inc. Consulting Agreement Derivative Litig., 2016 WL 301245, at *9 (Del. Ch. Jan. 25, 2016)).

DIRECTOR DISINTEREST AND INDEPENDENCE

If at least half of the directors approving the transaction were not disinterested or independent, the transaction is subject to entire fairness review. To determine whether a majority of the directors approving the transaction were disinterested and independent, the court conducts a director-by-director analysis (Trados, 73 A.3d at 45).

Director Disinterest

Under Delaware law, the test for a finding of a disabling interest on the part of a director is met if either:

- The director has a material financial interest in a transaction with a third party that is not shared equally by the stockholders (Rales v. Blasband, 634 A.2d 927, 936 (Del. 1993)).

The materiality of a financial benefit to a director is determined in the context of the director's personal financial circumstances. The benefit has to have made it improbable that the director could perform their fiduciary duties without being influenced by their overriding personal interest (New Jersey Carpenters Pension Fund v. infoGROUP, Inc., 2011 WL 4825888, at *9 (Del. Ch. Sept. 30, 2011)). The benefit must cause the director's personal interest to diverge from the stockholders' interests at large. The fact that a director owns shares in the company and stands to gain from a sale does not itself represent a disabling
interest, absent a "compelling" or "idiosyncratic" need for liquidity (In re Crimson Exploration Inc. S’holder Litig., 2014 WL 5449419, at *19-20 (Del. Ch. Oct. 24, 2014)).

**Director Independence**

Under Delaware law, there is a presumption of director independence that must be rebutted. A director is presumed to be independent even when appointed by a controlling stockholder or allegedly interested party (Aronson v. Lewis, 473 A.2d 805, 816 (Del. 1984)).

To successfully challenge a director’s independence, stockholder plaintiffs must show that the director is so "behind" to the controlling stockholder or so under its influence that "the director's discretion would be sterilized" (Roles, 634 A.2d at 936). Bare allegations that a director is friendly with or has had past business relationships with the controlling stockholder approving the transaction are not enough to rebut the presumption of independence. The mere fact of compensation from the corporation is also not enough (In re The Limited, Inc., 2002 WL 537692, at *5 (Del. Ch. Mar. 27, 2002)). The director’s ties to the controller must instead be sufficiently substantial, from a subjective point of view, that the director could not have objectively evaluated the transaction (see Kahn v. M & F Worldwide Corp., 88 A.3d 635, 648-49 (Del. 2014)).

Determining whether a director is independent is often a fact-specific inquiry. For example, in various contexts, the Delaware Chancery Court has held that:

- A director was independent and not forced to approve a challenged transaction by the CEO of the corporation even though the director maintained a 15-year long professional and personal relationship with the CEO (Crescent/Mach I Partners, L.P. v. Turner, 846 A.2d 963, 981 (Del. Ch. 2000)).
- Where a director had served on the boards of two other companies owned by a venture capital firm with a financial interest in the challenged transaction and served as a high ranking executive in other companies owned by that firm, there was a reasonable doubt regarding the director's independence (Goldman v. Pogo. com, Inc., 2002 WL 1358760, at *3 (Del. Ch. Jun. 14, 2002)).
- The members of a compensation committee were independent even though they had been appointed by the controlling stockholder, had served on the board for many years, served on the boards of other entities controlled by the stockholder, and were otherwise retired (Friedman v. Dolan, 2015 WL 4040806 (Del. Ch. Jun. 30, 2015)).

The Delaware Supreme Court has cautioned that a director’s personal and business ties to an interested party cannot be analyzed separately from each other, but must be considered in their totality (Del. Cnty. Emps. Ret. Fund v. Sanchez, 124 A.3d 1017 (Del. 2015)). The Sanchez court also held that a long-term friendship carries a greater inference of compromise of independence than do “thin, social-circle friendships.” As a result, the court found, for purposes of demand futility, that a director deriving primary employment and income from the company and having a close friendship of more than 50 years with the company's chairman and largest stockholder was not independent for demand-futility purposes (see Practice Note, Shareholder Derivative Litigation: When Demand Requirement Is Excused (http://us.practicallaw.com/8-508-8277#a643652)).

**DEFINING CONTROL FOR ENTIRE FAIRNESS**

Delaware law defines “controlling stockholder” as a stockholder who either:

- Owns more than 50% of the voting power of the corporation.
- Exercises control over the business and affairs of the corporation. (Kahn v. Lynch Commc’n Sys., Inc., 638 A.2d 1110, 1113-14 (Del.1994).)

Based on the control test, a stockholder can be a “controlling stockholder” and owe fiduciary duties to the other stockholders even if it owns only a minority of the company’s shares. However, a stockholder is not considered a controlling stockholder unless it has “such formidable voting and managerial power” that, as a practical matter, it is no differently situated than if it had majority voting control (In re PNB Hldg. Co. S’holders Litig., 2006 WL 2403999 (Del. Ch. 2006)).

The threshold question of whether a stockholder should be deemed controlling can only be answered on the facts of the particular case. For example:

- A 27.7% stockholder with two representatives on a board with ten members was not considered a controlling stockholder (In re Morton’s Rest. Grp. Inc. S’holders Litig., 74 A.3d 656, 661 (Del. Ch. 2013)).
- A 49.7% stockholder with two representatives on a board with nine members was not considered a controlling stockholder (Ivanhoe Prs v. Newmont Mining Corp., 535 A.2d 1334, 1344 (Del. 1987)).
- A 43.3% stockholder with five representatives on a board with 11 members was considered a controlling stockholder (Kahn v. Lynch, 638 A.2d at 1114).

Other indicators of influence aside from board-designation rights can also be relevant to determining whether a stockholder is controlling. For example, the Chancery Court has held that a stockholder’s separate contractual rights, when combined with significant stock holdings, can support a finding that a particular stockholder is controlling (Superior Vision Servs. Inc. v. RelaStar Life Ins. Co., 2006 WL 2521426, at *5 (Del. Ch. Aug. 25, 2006)). On that basis, the court has held that:

- A 39% stockholder who was also the CEO and chairman of the board was reasonably considered to be the controlling stockholder because he “used his influence on the corporation...to his own benefit and to the detriment of the interests of the minority stockholders” (La. Mun. Police Employees’ Ret. Sys. v. Fertitta, 2009 WL 2263406, at *7 (Del. Ch. July 28, 2009)).
- A stockholder was deemed controlling because it held 48% of a corporation’s stock, 82% of its debt, and it entered into short-term forbearance agreements with the corporation to time the corporation’s restructuring (Hamilton Prs L.P. v. Highland Capital Mgmt., L.P., 2014 WL 1813294 (Del. Ch. May 7, 2014)).
- A 26% stockholder with significant veto rights over the company’s ability to raise new debt financing or file for a voluntary bankruptcy was a controller (Calesa Assoc., L.P. v. Am. Capital, Ltd., 2016 WL 770251, at *10 (Del. Ch. Feb. 29, 2016)). (Notably, the Calesa court distinguished Superior Vision Services and discounted the stockholder’s contractual rights in its analysis, even though those rights gave the stockholder effective control over the company's decision-making. The decisions can potentially be reconciled in...
The transaction is with an unrelated third-party buyer, but the transaction is with the company's controlling stockholder, and be working together toward a shared goal to be deemed a control group (PNB Hldg. Co., 2006 WL 2403999, at *9-10).

Even if no individual stockholder owns enough shares or exerts enough control to qualify as a controlling stockholder, two or more stockholders, working in tandem, may collectively be considered a control group for purposes of the standard of review for controlling-stockholder transactions. To constitute a control group, allegations of mere "parallel interests" between the stockholders, without more, are insufficient (Williamson v. Cox Commc'ns, Inc., 2006 WL 1586375, at *6 (Del. Ch. June 5, 2006)). The stockholders must instead be connected by contract, common ownership, agreement, or other arrangement and be working together toward a shared goal to be deemed a control group (PNB Hldg. Co., 2006 WL 2403999, at *9-10).

**TRANSACTION STRUCTURES THAT TRIGGER ENTIRE FAIRNESS**

Based on the case law defining the conflicts of interest that trigger entire fairness review, several transaction scenarios can be assumed to be governed under the entire fairness standard:

- At least half the directors are either not disinterested or not independent, even if the transaction is not with the company's controlling stockholder (Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).
- The transaction is with the company's controlling stockholder, even if a majority of the directors are disinterested and independent (Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994)).
- The transaction is with an unrelated third-party buyer, but the company has a controlling stockholder that receives different consideration in the transaction than the other stockholders (In re John Q. Hammons Hotels Inc. S'holder Litig., 2009 WL 3165613, at *12 (Del. Ch. Oct. 2, 2009)). Entire fairness should apply in this scenario even if a majority of the directors are disinterested and independent. Even though the scenario is not governed by Kahn v. Lynch, the controlling stockholder can be said to be competing with the other stockholders for the merger consideration, which is sufficient to trigger entire fairness review.

In virtually all cases where entire fairness preliminarily applies, the parties can structure the transaction to either shift the burden of proof of the transaction's fairness back to the plaintiff or even qualify for the presumptions of the business judgment rule.

**SHIFTING THE BURDEN WHEN ENTIRE FAIRNESS APPLIES**

If the controlling stockholder stands on both sides of the merger transaction, the controlling stockholder can shift the burden of proving entire fairness to the plaintiff by either:

- Approximating an arms'-length negotiation by using a well-functioning special committee comprised entirely of independent directors that negotiates with the controlling stockholder.
- Obtaining the approval of a majority of the unaffiliated minority stockholders. The vote must not be tainted by disclosure violations or coercive deal-protection measures.

(Kahn v. Lynch Commc’n Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994).)

To try to satisfy potential challenges to a special committee process, the target company's board should, among other things:

- Ensure that each member of the special committee is in fact disinterested and independent.
- Establish a clear mandate for the special committee, including a well-defined scope of authority, power, and responsibility. In particular, the special committee should have the authority to negotiate the transaction and to say no if that is in the best interests of the corporation and its stockholders.

Once it has its mandate, the special committee must remain fully engaged during the transaction process and should, among other things:

- Select qualified, experienced and independent financial and legal advisors ensuring that the:
  - advisors have no material past or present relationships with the controlling stockholder; and
  - committee chair and/or the committee as a whole are engaged in interviewing and selecting the advisors.
- Consider the feasibility and potential benefits of alternative value-enhancing transactions.
- Negotiate vigorously and use the bargaining power available to it in reaching the final terms of the transaction with the controlling stockholder, rather than merely accepting the terms dictated in the proposal.
- Encourage all members of the special committee to be active participants in the process, including attending all or almost all meetings of the special committee and keeping fully informed of all material information about the negotiations and consideration of alternatives.
- Exercise its own judgment in negotiating the principal elements of the transaction and, if applicable, in approving the transaction, rather than merely relying on the judgment of the advisors to the special committee.

Following either of these procedural safeguards should shift the burden of proof to the plaintiff in either the Kahn v. Lynch or John Q. Hammons scenarios where entire fairness applies.

© 2016 Thomson Reuters. All rights reserved.
BUSINESS JUDGMENT RULE USING PROCEDURAL PROTECTIONS

In Kahn v. M & F Worldwide Corp., the Delaware Supreme Court upheld the Chancery Court’s decision in In re MFW Shareholders Litigation, 67 A.3d 496 (Del. Ch. 2013), affirming that the business judgment rule applies, even in transaction with the controlling stockholder, if the controlling stockholder conditioned its offer **upfront** on both:

- Approval by an independent special committee empowered to negotiate and choose to reject the deal.
- Approval by a majority of the unaffiliated minority stockholders. (Kahn v. M & F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014.).)

If this test is met and the target company is not otherwise up for sale, the standard for review is the business judgment rule, not entire fairness and not enhanced scrutiny under Revlon. Enhanced scrutiny does not apply even though the company is being sold to its controlling stockholder, because Revlon is only triggered when a sale to a third party becomes inevitable. Because a controlling stockholder has no duty to sell its stock, it has the power to reject on behalf of the company any transaction it does not want, which means a sale to a third party cannot be inevitable (Frank v. Elgamil, 2014 WL 957550, at *21 (Del. Ch. Mar. 10, 2014)).

The Delaware Supreme Court fleshed out the conditions for restoring the presumptions of the business judgment rule, holding that the business judgment rule can apply if and only if:

- The controlling stockholder conditions the process of the transaction on the approval of both a special committee and a majority of the minority stockholders.
- The special committee is independent.
- The special committee is empowered to freely select its own advisors and to say no definitively.
- The special committee meets its duty of care in negotiating a fair price.
- The vote of the minority is informed. This means the parties must consider what information and materials should be included in the proxy statement (for example, financial projections and underlying assumptions) to ensure that appropriate and sufficient information is made available to the voting stockholders and to try to avoid or, at least, limit future plaintiffs’ claims of inadequate disclosure.
- The vote of the minority is not coerced.

While the Chancery Court in MFW only required that the special committee act with care, the Supreme Court added particular focus on the duty of care in negotiating the price. In a bench ruling, the Chancery Court interpreted the price element to mean that it must review the special committee’s efforts on the price negotiations under a standard of gross negligence (Swomley v. Schlecht (“Synqor”), 2014 WL 4470947 (Del. Ch. Aug. 27, 2014) (TRANSCRIPT)).


CONTROLLING-STOCKHOLDER TRANSACTION STRUCTURED AS A FRONT-END TENDER OFFER

There are currently competing lines of Chancery Court decisions regarding the question of which standard of review to apply if a controlling-stockholder transaction is structured as a tender offer followed by a short-form merger. Governing precedent for this scenario is not completely clear because the M & F Worldwide decision did not directly address controlling-stockholder transactions structured as tender offers.

A controlling stockholder historically avoided entire fairness review by structuring a going-private transaction as a non-coercive tender offer (followed by a short-form merger). The test for non-coerciveness requires a showing of each of the following:

- The tender offer was subject to a non-waivable majority-of-the-minority tender condition.
- The controlling stockholder promised to complete a prompt short-form merger at the same price as was offered in the tender offer if it obtained more than 90 percent of the shares in the tender offer.
- The controlling stockholder made no threats of retribution to the minority stockholders if they were to fail to tender into the offer.
- The independent directors had both “free rein and adequate time” to consider the tender offer and provide the minority stockholders with a recommendation and adequate information with which to make their decision. (See In re Pure Resources S’holders Litig., 808 A.2d 421, 446 (Del. Ch. 2002).)

However, in the 2010 CNX Gas decision, the court declined to follow Pure Resources and applied a “unified standard” of review to a going-private transaction structured as a front-end tender offer, similar to the standard eventually affirmed in M & F Worldwide. Under the unified standard of review, the business judgment rule only applies when the non-coercive tender offer is both:

- Negotiated and recommended by a special committee of independent, disinterested directors.
- Conditioned on an affirmative tender of a majority-of-the-minority shares. (See In re CNX Gas Corp. S’holders Litig., 4 A.3d 397 (Del. Ch. 2010).)

This standard is more onerous than the Pure Resources approach because:

- The special committee must actually negotiate the terms of the tender offer with the buyer, not simply review and recommend (or take a neutral position on) the tender offer to the minority stockholders. Indeed, the CNX Gas Court requires that the special committee of the board be granted authority comparable to what the full board possesses in an arms'-length transaction, including authority to consider alternative transactions, establish a poison pill, and litigate against the controlling stockholder. By contrast, in Pure Resources the court concluded that the special committee did not need to have expanded powers beyond evaluating the offer and making a recommendation to the stockholders.
It imposes the entire fairness standard of review if the special committee does not affirmatively recommend a tender offer. As a result, the buyer must consider another strategic question, whether to either:

- Negotiate with both a special committee and minority stockholders in order to invoke the business judgment rule.
- Rely on only one of the two procedural protections and face entire fairness review, but with the burden of disproving entire fairness shifted to the plaintiff stockholders.

In light of CNX Gas and M & F Worldwide, buyers should anticipate that special committees and plaintiffs are likely to demand that the special committee be given greatly expanded powers and negotiating authority.

CONTROLLING STOCKHOLDER IS NOT THE BUYER, NO DIFFERENTIAL CONSIDERATION

A transaction does not trigger entire fairness review just because a company has a controlling stockholder (In re Crimson Exploration Inc. Shareholder Litig., 2014 WL 5449419, at *12 (Del. Ch. Oct. 24, 2014)). If the company enters into a third-party transaction and the controlling stockholder shares its control premium equally with the minority stockholders, the appearance of conflict is avoided at the outset (see In re Synthes, Inc. Shareholder Litig., 50 A.3d 1022, 1039 (Del. Ch. 2012) and In re Morton's Rest. Cfp. Inc. Shareholder Litig., 74 A.3d 656, 662 (Del. Ch. 2013)). In that event, the business judgment rule applies. (Revlon does not apply, even though the sale is to a third party, because the presence of a controlling stockholder means the sale is never inevitable (see Business Judgment Rule Using Procedural Protections)).

The business judgment rule clearly applies in this scenario if a majority of the board is comprised of disinterested and independent directors. Even if at least half the directors are not disinterested and independent as to the controlling stockholder, the business judgment rule should still apply, because the controller is not at issue. (In the unlikely scenario in which a majority of the directors are disinterested and independent as to the controller, yet not disinterested and independent as to the buyer, it seems that entire fairness would preliminarily apply, regardless of the fact that the controlling stockholder does not stand on both sides of the transaction. However, the business judgment rule should then be restored through a fully informed vote of the stockholders—which by definition takes place if the controlling stockholder is agreeing to the transaction.)

DUTY OF DISCLOSURE

Directors have a duty to communicate honestly with the stockholders and to make full and fair disclosures. This duty, also referred to as a "duty of candor," does not obligate the board to provide all of the corporation’s financial or business information to the stockholders. Rather, the information must meet a materiality standard of a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable stockholder as having significantly altered the total mix of information made available" (Rosenblatt v. Getty Oil Co., 493 A.2d 929, 944 (Del. 1985)). Delaware law does not require the board of directors to disclose information simply because that information "might be helpful" (Skeen v. Jo-Ann Stores, Inc., 750 A.2d 1170, 1174 (Del. 2000)). The courts have similarly admonished against "the fallacy that increasingly detailed disclosure is always material and beneficial disclosure" (Zirn v. VLI Corp., 1995 WL 362616, at *4 (Del. Ch. June 12, 1995)).

In sales of public corporations, the SEC's rules promulgated under the Securities Exchange Act of 1934 govern much of the disclosure that the target company must make. For information about these rules, see Practice Note, Proxy Statements: Public Mergers (http://us.practicallaw.com/6-383-4972). Beyond these required disclosures, stockholder plaintiffs frequently bring Revlon claims alleging that the board of directors of the target company failed to disclose other material information to the stockholders in the proxy statement, such as:

- Management's projections for the company on a stand-alone basis.
- The compensation and potential conflicts of the financial advisor.
- Details of the background to the transaction and how the board reached a decision to approve a sale.

The courts measure each of these claims against the reasonable-investor standard, with the analysis turning on the specific facts of the case.

Under Delaware law, there is no duty per se to disclose to stockholders the financial projections given to and relied on by the financial advisor for the formulation of its fairness opinion (McMillan v. Intercargo Corp., 1999 WL 288128, at *6 (Del. Ch. May 3, 1999)). Particularly in a merger with a controlling stockholder where the outcome of the vote itself is not in question, there is less of a need to provide these disclosures (Dent v. Ramtron Int’l Corp., 2014 WL 2931180, at *11 (Del. Ch. June 30, 2014)). However, in a cash-out merger where there is no controlling stockholder, reliable management projections are typically considered material (In re PNB Hldg. Co. Shareholder Litig., 2006 WL 2403999, at *15 (Del. Ch. Aug. 18, 2006)). The disclosure of inherently unreliable or speculative information is not required, but management projections made in the course of business are generally deemed reliable (Cede & Co. v. Technicolor, Inc., 2003 WL 23700218, at *7 (Del. Ch. July 9, 2004), aff’d in part, rev’d in part, 884 A.2d 26 (Del. 2005)).

If the financial advisor has in fact relied on management's projections to render its fairness opinion, the failure to disclose the projections is considered a material omission that warrants injunctive relief if not corrected (In re Netsmart Techs., Inc. Shareholder Litig., 924 A.2d 171, 203 (Del. Ch. 2007); In re BioClinica, Inc., Shareholder Litig., 2013 WL 673736, at *5 (Del. Ch. Feb. 25, 2013)). Projections and other inputs provided by the board but not relied on by the financial advisor, however, do not need to be disclosed (In re Micronet, Inc. Shareholder Litig., 2012 WL 681785, at *12-13 (Del. Ch. Feb. 29, 2012)).

Delaware courts generally require full disclosure of investment banker compensation and potential conflicts (In re Del Monte Foods Co. Shareholder Litig., 25 A.3d 813, 832 (Del. Ch. 2011)). Particularly where the financial advisor for the target company is also providing staple financing for the buyer, the courts require disclosure of that arrangement and the banker’s fee, and the courts pay particular attention to the management of the inherent conflicts in that arrangement (see Del Monte; In re Toys “R” Us, Inc. Shareholder Litig., 877 A.2d 975, 1005–06 (Del. Ch. 2005); In re Rural Metro Corp. Shareholder Litig., 88 A.3d 54, 106 (Del. Ch. 2014)).
As for detailed narratives of the background to the transaction, the Chancery Court has stated that the standard “does not require a blow-by-blow description of events leading up to the proposed transaction” (Matador Capital Mgmt. Corp. v. BRC Hldgs., Inc., 729 A.2d 280, 295 (Del. Ch. 1998)). However, once the board voluntarily makes a partial disclosure, it has “an obligation to provide the stockholders with an accurate, full, and fair characterization” of the facts relating to that partial disclosure (Arnold v. Soc’y for Sav. Bancorp, Inc., 650 A.2d 1270, 1280 (Del. 1994)).

**DISCLOSURE-ONLY SETTLEMENTS**

To stem the tide of strike suits that challenge nearly every public merger transaction, the Chancery Court has established a new standard for the approval of settlements that trade releases of all known and unknown claims for minor additional disclosures and an attorney fee. To win approval, the supplemental disclosures must address a “plainly material” misstatement or omission in the proxy statement, while the release must be narrowly tailored and encompasses only disclosure claims and fiduciary duty claims concerning the sale process (In re Trulia, Inc. S’holder Litig., 2016 WL 270821 (Del. Ch. Jan. 22, 2016)). The court also warned that:

- Disclosures that are a "close call" on the question of their materiality will not qualify as plainly material.
- The court advised that disclosure claims that go forward should do so in an adversarial process in one of two ways:
  - Through a preliminary injunction motion. In this context, plaintiffs bear the burden of demonstrating on the merits that the alleged omission or misrepresentation is material. The court is then able to fulfill its gate-keeping function and dismiss frivolous lawsuits.
  - By plaintiffs’ counsel making an application to the court for an award of attorneys’ fees after the defendants voluntarily supplement their proxy materials with the requested disclosures, rendering the plaintiffs’ disclosure claims moot. In this context, because the defendants are not receiving a release in exchange for the disclosures, they are incentivized to challenge any excessive fee requests. This, in turn, assists the court in determining the true value of the supplemental disclosures, because the defendants will oppose any fee it deems unreasonable. Alternatively, the parties may resolve the mootness-fee application privately.