ALERT MEMORANDUM

Delaware Court of Chancery Applies Irrebuttable Business Judgment Rule After a Majority of Fully Informed, Uncoerced, Disinterested Stockholders Tender Shares in a Section 251(h) Merger

July 8, 2016

On June 30, 2016, the Delaware Court of Chancery extended the Delaware Supreme Court's recent holding in *Singh v. Attenborough*, 2016 WL 2765312 (Del. May 6, 2016) to find that the business judgment rule irrebuttably applies to judicial review of a two-step merger under Section 251(h) after a majority of fully informed, uncoerced, disinterested stockholders tender their shares. In *In re Volcano Corporation Stockholder Litigation*,[1] the Chancery Court rejected the plaintiffs' argument that the Recommendation Statement for the tender offer inadequately disclosed an alleged conflict of interest on the part of the target's financial advisor and dismissed all claims against the target's directors for breach of fiduciary duty and all claims against the target's financial advisor for aiding and abetting that breach after finding that the claims were extinguished by the tender.

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[1] Cleary Gottlieb served as a defense counsel in this case.

Background

In re Volcano Corporation Stockholder Litigation arose from the purchase of Volcano Corporation ("Volcano") by Philips Holding USA Inc., the Delaware subsidiary of Koninklijke Philips, N.V. (collectively, "Philips") through a tender offer and merger conducted under Section 251(h) of the Delaware General Corporation Law ("DGCL") (the "Merger"). Volcano's stockholders overwhelmingly approved the transaction, tendering nearly 90% of their shares. After the transaction closed, certain Volcano stockholders sought damages, alleging that undisclosed conflicts of interest relating to Volcano's preexisting corporate financing had tainted the sale process. Specifically, in 2012, Volcano issued convertible notes, which could be converted into shares of Volcano common stock if the stock were trading above a certain price. To limit the dilution of existing stockholders in the event of such a conversion, Volcano also entered into "call spread transactions" with the convertible note underwriters (the "Counterparties"), pursuant to which (i) Volcano purchased call options to purchase the same number of shares that could be issued in the event the notes were converted into equity at the same price as the strike price of the convertible notes, and (ii) Volcano sold warrants to the Counterparties obligating Volcano to deliver that same number of shares at a higher per-share price. Together, the call spread transactions effectively raised the stock price at which Volcano's existing stockholders would be diluted in the event of the notes' conversion. Under certain conditions, such as an all-cash sale, termination of the call spread transactions could result in net payments to the Counterparties.

In seeking post-closing damages, plaintiffs alleged in relevant part that (i) Volcano's board breached their duties of care and loyalty by relying on supposedly "flawed advice" from its financial advisor, which was also one of the Counterparties to the call spread transactions, and (ii) the financial advisor aided and abetted the board's breaches of fiduciary duty by allegedly hiding its interests in the call spread transactions and seeking a quick sale to trigger a payment under them.

Business Judgment Rule Irrebuttably Applies

The Court's decision of what standard of review to apply to the transaction ultimately proved dispositive. Relying on *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015) and *Singh v. Attenborough*, 2016 WL 2765312 (Del. May 6, 2016), the Court held that the fully-informed approval of the Merger through the tender of a majority of Volcano's stockholders rendered the business judgment rule irrebuttable, extinguishing all claims other than waste. Because plaintiffs did not allege any claim of waste, defendants' motions to dismiss were granted.

The specific question before the Court was whether stockholders tendering their shares in a two-step merger pursuant to Section 251(h) of the DGCL would have the same cleansing effect as *Corwin* and *Attenborough* gave to a merger approved by the vote of a majority of fully informed, uncoerced, disinterested stockholders under Section 251(c). Opining that the first-step tender offer in a Section 251(h) two-step merger "essentially replicates" the statutorily required stockholder vote, the Court held that waste was the only available post-closing damages claim after a majority of fully informed, uncoerced, disinterested stockholders tendered their shares in a two-step merger.[2]

As to whether the completed Volcano tender offer would have such a cleansing effect, plaintiffs argued that the target's financial advisor allegedly had an undisclosed interest in completing a transaction quickly, as the value of its warrants in the call spread transactions declined over time. The Court found, however, that the disclosures in the Recommendation Statement for the tender offer that the termination value of the warrants held by the financial advisor expired "over a series of expiration dates in 2018" adequately informed stockholders of the financial

[2] *Volcano*, slip op. at 34.

advisor's financial interest, noting that additional disclosures would not have "significantly alter[ed] the total mix of available information."[3] Accordingly, the irrebuttable business judgment rule extinguished all claims except waste, which plaintiffs did not plead (nor could they meet such a high standard).[4]

Finally, although all claims had been extinguished as a result of the tender, the court also considered the adequacy of the aiding and abetting claim against the financial advisor. The Court emphasized the high bar for pleading aiding and abetting breach of fiduciary duty claims, citing the Supreme Court's guidance in *Attenborough* that "reiterated the high burden that a plaintiff faces in attempting to plead facts from which a court could reasonably infer that a financial advisor acted with the requisite scienter for an aiding and abetting claim."[5] As in *Attenborough*, the Court noted that "[n]othing in this record comes close to approaching the sort of [financial advisor misconduct] at issue" in other cases, where there was "fraud on the Board" or "intentional[] dup[ing]" of the board.[6]

Takeaways

The *Volcano* decision again underscores the importance of disclosure to stockholders in post-closing damages cases. By applying the irrebuttable business judgment rule standard to change of control transactions approved by a majority of fully informed, uncoerced, disinterested stockholders—whether by a vote or by tendering their shares into the first step of a two-step merger under Section 251(h)—the Court's analysis provides the crucial carrot of claim extinguishment where adequate disclosure is made. In *Volcano*, the plaintiffs' disclosure claims ultimately fell short where the amended Recommendation Statements for the tender offer set forth the salient facts that a reasonable investor would need. Like *Attenborough*, the decision here also provides a counter to a number of recent cases allowing aiding and abetting claims against financial advisors to proceed past the pleading stage or imposing liability for such claims.

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3 *Id*. at 46-47.
4 *Id*. at 47-48.
5 *Id.* at 49.
6 *Id*. at 49 & n.95.