GIBSON DUNN

M&A Report – Determining the Likely Standard of Review Applicable to Board Decisions in Delaware M&A Transactions

Client Alert | May 4, 2020

M&A practitioners are well aware of the several standards of review applied by Delaware courts in evaluating whether directors have complied with their fiduciary duties in the context of M&A transactions. Because the standard applied will often have a significant effect on the outcome of such evaluation, establishing processes to secure a more favorable standard of review is a significant part of Delaware M&A practice. The chart below identifies fact patterns common to Delaware M&A and provides a preliminary assessment of the likely standard of review applicable to transactions fitting such fact patterns. However, because the Delaware courts evaluate each transaction in light of the transaction's particular set of facts and circumstances, and due to the evolving nature of the law in this area, this chart should not be treated as a definitive statement of the standard of review applicable to any particular transaction.

No.	Facts	Likely Standard of Review[2]
1.	Fully independent and disinterested[3] board of directors; no controlling stockholder[4]	Business judgment[5]
2.	Majority of board is independent and disinterested; no controlling stockholder	Business judgment[6]
3.	Board is evenly split between directors who are independent and disinterested and directors who are not independent and disinterested; no controlling stockholder	Entire fairness[7] Business judgment if transaction is approved by a properly functioning special committee[8] or a fully-informed, uncoerced stockholder vote[9]
4.	Majority of board is not independent and disinterested; no controlling stockholder	Entire fairness[10] Business judgment if transaction is approved by a properly functioning special committee[11] or a fully-informed, uncoerced stockholder vote[12]
5.	None of the board members is independent and disinterested; no controlling stockholder	Entire fairness[13] Business judgment if transaction is approved by a fully-informed, uncoerced

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		stockholder vote[14]
6.	Transaction with a controlling stockholder where majority of the board is independent and disinterested	Entire fairness, but either (a) a properly functioning special committee or (b) approval of a majority of the minority will shift the burden of proof to the plaintiff[15] Business judgment if both (a) a properly functioning special committee and (b) approval of a majority of the minority[16]
7.	Transaction with a controlling stockholder where a majority of the board is not independent and disinterested	Entire fairness, but either (a) a properly functioning special committee or (b) approval of a majority of the minority will shift the burden of proof to the plaintiff[17] Business judgment if both (a) a properly functioning special committee and (b) approval of a majority of the minority[18]
8.	Controlling stockholder; majority of the board is independent and disinterested with respect to the controlling stockholder; controlling stockholder is not the counterparty in the transaction; and controlling stockholder is treated the same as other stockholders	Business judgment[19]
9.	Controlling stockholder; majority of the board is not independent and disinterested with respect to the controlling stockholder; controlling stockholder is not the counterparty in the transaction; and controlling stockholder is treated the same as other stockholders	Business judgment[20]
10.	Controlling stockholder; majority of the board is independent and disinterested with respect to the controlling stockholder; controlling stockholder is not the counterparty in the transaction; and controlling stockholder receives different treatment in the transaction than other stockholders	Entire fairness, but either (a) a properly functioning special committee[21] or (b) approval of a majority of the minority will shift the burden of proof to the plaintiff[22] Business judgment if both (a) a properly functioning special committee and (b) approval a of majority of the minority[23]
11.	Controlling stockholder; majority of the board is not independent and disinterested with respect to the controlling stockholder;	Entire fairness, but either (a) a properly functioning special committee[24] or (b) approval of a majority of the minority will shift the burden of proof to

controlling stockholder is not the counterparty in the transaction; and controlling stockholder receives different treatment in the transaction than other stockholders	the plaintiff[25]
	Business judgment if both (a) a properly functioning special committee and (b) approval of a majority of the minority[26]

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[1] This report updates our report, "Determining the Likely Standard of Review Applicable to Board Decisions in Delaware M&A Transactions," as originally published on November 18, 2014 and updated on February 8, 2016 and April 12, 2017.

[2] Assumes duty of care is discharged. In addition to the standards of review identified in this chart, a transaction is subject to enhanced judicial scrutiny under *Revlon, Inc. v. Macandrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) "when a company embarks on a transaction — on its own initiative or in response to an unsolicited offer — that will result in a change of control." *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 242 (Del. 2009). However, under the so-called *Corwin* doctrine, if a transaction (other than a transaction in which a controlling stockholder extracts personal benefits) has been ratified by a vote of a "fully informed, uncoerced majority of the disinterested stockholders," it will be subject to business judgment review even if *Revlon* would otherwise apply. *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304, 305–06 (Del. 2015); *see also, e.g.*, *Morrison v. Berry*, 191 A.3d 268, 274 (Del. 2018) (explaining the *Corwin* doctrine).

[3] "Independence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences." *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984), *overruled in part on other grounds by Brehm v. Eisner*, 746 A.2d. 244, 254 (Del. 2000). "Such extraneous considerations or influences may exist when the challenged director is controlled by another." *Orman v. Cullman*, 794 A.2d 5, 24 (Del. Ch. 2002). Thus, a "lack of independence can be shown when a plaintiff pleads facts that establish that the directors are beholden to [the controlling person] or so under [that person's] influence that [the directors'] discretion would be sterilized." *Id.* (first alteration in original) (internal quotation marks omitted). "Put differently, a director is not independent if particularized facts support a reasonable inference that she would be more willing to risk her reputation than risk the relationship with the [controlling] person." *Sciabacucchi v. Liberty Broadband Corp.,* 2018 WL 3599997, at *11 (Del. Ch. 2018). Disinterestedness means that "directors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally." *Id.* at 23.

[4] A stockholder is a controlling stockholder under Delaware law where the stockholder (1) owns more than 50% of the voting power of a corporation or (2) exercises control over the business affairs of the corporation. *Kahn v. Lynch Commc'ns Sys. (Kahn I)*, 638 A.2d 1110, 1113–14 (Del. 1994). When evaluating whether a stockholder exercises the requisite control, Delaware courts will evaluate whether the stockholder controlled the board "such that the directors . . . could not freely exercise their judgment" with respect to a transaction. *In re KKR Fin. Holdings LLC S'holder Litig.*, 101 A.3d 980, 993 (Del. Ch. 2014); *see also In re Crimson Exploration Inc. S'holder Litig.*, 2014 WL 5449419, at *10–*12 (Del. Ch. Oct. 24, 2014) (analyzing Delaware case law concerning controlling stockholders). "A group of stockholders, none of whom individually qualifies as a controlling stockholder, may collectively be considered a control group that is analogous, for standard of review purposes, to a controlling stockholder." *Frank v. Elgamal*, 2014 WL 957550, at *18 (Del. Ch. Mar. 10, 2014). However, "[a] plaintiff must provide that the group of stockholders 'was connected in some legally significant way—e.g., by contract, common ownership, agreement, or other arrangement—to work together toward a shared goal.'" *In re Nine Systems Corp. Shareholders Litigation*, 2014 WL 4383127 (Del. Ch. Sept. 4, 2014).

[5] *See In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 36 (Del. Ch. 2013) (explaining that the business judgment rule applies to decisions by board members who are "disinterested and independent"); *see also In re PLX Technology Inc. S'holders Litig.*, 2018 WL 5018535, at *30–*31 (Del. Ch. 2018).

[6] The business judgment rule is generally the applicable standard of review where a majority of the board is disinterested and independent. *See Cinerama, Inc. v. Technicolor*, 663 A.2d 1156, 1170 (Del. 1995). Nonetheless, a transaction must be "approved by a majority consisting of the disinterested directors" in order for the business judgment rule to apply. *See Aronson v. Lewis*, 473 A.2d at 812, *overruled in part on other grounds by Brehm v. Eisner*, 746 A.2d. at 254; *see also In re Trados Inc.*, 73 A.3d at 44 ("To obtain review under the entire fairness test, the stockholder plaintiff must prove that there were not enough independent and disinterested individuals among the directors making the challenged decision to comprise a board majority. . . . To determine whether directors approving the transaction comprised a disinterested and independent board majority, the court conducts a director-by-director analysis."); *Chaffin v. GNI Group, Inc.*, No. 16211-NC, 1999 WL 721569, at *5–*6 (Del. Ch. Sept. 3, 1999) (holding that where a board had three independent and disinterested members and two interested members, and the board approved a merger by a vote of 4-1, with one of the independent and disinterested directors voting against the merger, the merger approval "was one vote short of the required disinterested majority").

[7] "A board that is evenly divided between conflicted and non-conflicted members is not considered independent and disinterested." *Gentile v. Rossette*, No. 20213-VCN, 2010 WL 2171613, at *7 n.36 (Del. Ch. May 28, 2010); *see also Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1046 n.8 (Del. 2004). "[T]he business judgment rule has no application" to a merger transaction that is "not approved by a majority consisting of the disinterested directors," *Aronson v. Lewis*, 473 A.2d at 812, *overruled in part on other grounds by Brehm v. Eisner*, 746 A.2d. at 254, and where the business judgment rule has been "rebut[ted]" this "lead[s] to the application of the entire fairness standard," *In re Crimson Exploration Inc.*, 2014 WL 5449419, at *20; s*ee also In re PLX Technology Inc., Litig.*, No. 9880-VCL, 2018 WL 5018535, at *30 (explaining that the entire fairness test applies to director decision-making when "directors making the decision did not comprise a disinterested and independent board majority").

[8] "[I]n the instant context, where there is no controlling stockholder but the board is conflicted…a fully constituted, adequately authorized, and independent special committee can cleanse such a transaction…remov[ing] the malign influence of the self-interested directors, and thus should result in business judgement review". *Salladay v. Lev*, 2020 WL 954032, at *9 (Del. Ch. Feb. 27, 2020) (also noting the special committee must be formed *ab initio* and "prior to substantive economic negotiations, which include valuation and price discussions if such discussions set the field of play for the economic negotiations to come"). However, the Delaware Supreme Court has not definitively resolved the question of which standard of review applies when a special committee approves a transaction and there is no controlling stockholder because there is some precedent that could be read to suggest that a properly functioning special committee does no more than shift the burden of the proof to the plaintiff, *see In re Tele-Commc'ns*, *Inc. S'holders Litig.*, No. 16470, 2005 WL 3642727, at *8 (Del. Ch. Dec. 21, 2005), although the better reading of this precedent may be that it involved a controlling stockholder, *see In re John Q. Hammons Hotels Inc. S'holder Litig.*, No. 758-CC, 2009 WL 3165613, at *11 (Del. Ch. Oct. 2, 2009) (interpreting *In re Tele-Commc'ns* as having involved a controlling stockholder).

[9] *See Corwin*, 125 A.3d 304 (holding that, in the absence of a controlling stockholder, an uncoerced, informed stockholder vote causes the application of the business judgment standard of review even where enhanced scrutiny would otherwise apply); *see also* Vice Chancellor J. Travis Laster, *The Effect of Stockholder Approval on Enhanced Scrutiny*, 40 Wm. Mitchell L. Rev. 1443 (2014) (providing substantial discussion of the interplay between stockholder approval and the standard of review prior to the decision in *Corwin*). Note, however, that the failure to disclose all material information to stockholders can

prevent a stockholder vote from being fully informed, and would thus prevent the vote from "ratifying" the transaction. *See Chen v. Howard-Anderson*, 87 A.3d 648, 669 (Del. Ch. 2014) (noting that, even if defendants had argued that the stockholder vote ratified the challenged transaction, "disclosure deficiencies" would undermine the vote and render the ratification ineffective); *In re Saba Software, Inc. S'holder Litig.*, No. 10697-VCS, slip op. at 20–23 (Del. Ch. Mar. 31, 2017) (concluding that material omissions from a proxy statement "undermined the stockholder approval"); *see also Morrison v. Berry*, 191 A.3d at 274–75 (overturning a decision applying the ratification doctrine, stating "stockholders cannot possibly protect themselves when left to a vote on an existential question in the life of a corporation based on materially incomplete or misleading information").

[10] *See In re Trados Inc.*, 73 A.3d at 45 (holding that entire fairness was the applicable standard of review in scrutinizing a board's approval of a merger where "the plaintiff proved at trial that six of the seven . . . directors were not disinterested and independent"); *In re Tele-Commc'ns, Inc.*, 2009 WL 3165613, at *6–*8 (explaining that an "entire fairness analysis" is required whenever "evidence in the record suggests that a majority of the board of directors were interested in the transaction" and providing several examples).

[11] *See* note 8, *supra*.

[12] *See* note 9, *supra*.

[13] *See In re PNB Holding Co.*, 2006 WL 2403999, at *12–*15 (concluding that all of the members of the board were interested and that entire fairness was the standard of review, recognizing that stockholder approval for the merger was accordingly "the only basis for the defendants to escape entire fairness review," but ultimately concluding that "[b]ecause a majority of the minority did not vote for the Merger, the directors cannot look to our law's cleansing mechanism of ratification to avoid entire fairness review").

[14] *See* note 9, *supra*.

[15] *See Kahn I*, 638 A.2d at 1117 (the "standard of judicial review in examining the propriety of an interested cash-out merger transaction by a controlling or dominating shareholder is entire fairness. . . . However, an approval of the transaction by an independent committee of directors or an informed majority of minority shareholders shifts the burden of proof . . . to the challenging shareholder-plaintiff.").

[16] The detailed requirements for the business judgment review to apply to a controlling-stockholder transaction are set forth in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) as follows: "(i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority." *Id.* at 645. *See also Flood v. Synutra International, Inc.*, 195 A.3d 754 (Del. 2018) (clarifying that "so long as the controller conditions its offer on [the approval of both a Special Committee and a majority of the minority stockholders] at the germination stage of the Special Committee process, when it is selecting its advisors, establishing is method of proceeding, beginning its due diligence, and has not commenced substantive negotiations with the controller, the purpose of the pre-condition requirement of *MFW* is satisfied.").

[17] *Kahn I*, 638 A.2d at 1117.

[18] *See* note 16, *supra*.

[19] *See In re Synthes, Inc. S'holder Litigation*, 50 A.3d 1022, 1046 (Del. Ch. 2012) (applying business judgment review despite pled facts that a majority of the board was not

independent with respect to the controlling stockholder because the controlling stockholder "received equal treatment in the Merger").

[20] "Entire fairness is not triggered solely because a company has a controlling stockholder. The controller also must engage in a conflicted transaction." *In re Crimson Exploration Inc.*, 2014 WL 5449419, at *12. A conflicted transaction exists if the controlling stockholder is the counterparty to, or otherwise "stands on both sides of," the transaction. *Gamco Asset Mgmt. Inc. v. iHeartMedia Inc.*, No. 12312-VCS, 2016 WL 6892802, at *15 (Del. Ch. Nov. 23, 2016). A conflicted transaction also exists if the controlling stockholder receives different treatment or "competes with the common stockholders for consideration" in the transaction. *Id.* In some cases, such as when a controlling stockholder receives disparate consideration, it is relatively simple to conclude that the controlling stockholder was not treated the same as other stockholders. *See In re Delphi Fin. Grp. S'holder Litig.*, No. 7144-VCG, 2012 WL 729232, at *3 (Del. Ch. Mar. 6, 2012) (controlling stockholder negotiated a substantial premium for his shares); *In re Tele-Commc'ns*, *Inc.*, 2005 WL 3642727, at *6–*8 (controlling stockholder received more valuable high-vote stock). In other cases, however, where the controlling stockholder receives a unique benefit (other than disparate consideration) or a continuing stake in the acquiring entity, the question is more complex. *Compare New Jersey Carpenters Pension Fund v. infoGROUP, Inc.*, No. 5334-VCN, 2011 WL 4825888, at *9–*11 (Del. Ch. Sept. 30, 2011) (controlling stockholder received "desperately needed liquidity"), *and In re John Q. Hammons Hotels Inc. S'holder Litig.*, 2009 WL 3165613, at *1 (controlling stockholder received "an array of private benefits" including a continuing stake in the acquiring entity), *with Larkin v. Shah*, No. 10918-VCS, 2016 WL 4485447, at *15 (Del. Ch. Aug. 25, 2016) (rejecting plaintiffs' assertion that a venture capital firm's desire to exit its investment was a hurried attempt to sell the company and extract a unique benefit).

[21] *See In re John Q. Hammons Hotels Inc. S'holder Litig.*, No. 758-CC, 2011 WL 227634, at *2 (Del. Ch. Jan. 14, 2011) ("[P]laintiffs bear the ultimate burden to show the transaction was unfair given the undisputed evidence that the transaction was approved by an independent and disinterested special committee of directors.").

[22] Although we have not identified any Delaware cases explicitly addressing the effect on the standard of review of approval by a majority of the minority stockholders in this factual scenario, it would be reasonable to conclude that the reasoning of *Kahn I*, 638 A.2d 1110, would apply.

[23] *See In re John Q. Hammons Hotels Inc. S'holder Litig.*, 2009 WL 3165613, at *12 (in transaction where controlling stockholder receives different consideration than minority stockholders, "business judgment would be the applicable standard of review if the transaction were (1) recommended by a disinterested and independent special committee, *and* (2) approved by stockholders in a non-waivable vote of the majority of all the minority stockholders").

[24] *In re Tele-Commc'ns*, *Inc.*, 2005 WL 3642727, at *8 (explaining that because of the directors' interested status "[t]he initial burden of proof rests upon the director defendants to demonstrate . . . fairness," but further explaining that "[r]atification by a majority of disinterested directors, generally serving on a special committee, can have the effect of shifting the burden onto the plaintiff shareholders to demonstrate that the transaction in question was unfair. In order to shift the burden, defendants must establish that the special committee was truly independent, fully informed, and had the freedom to negotiate at arm's length.").

[25] *See* note 22, *supra*.

[26] *See* note 23, *supra*.

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