July 2016

Delaware Court Extends Cleansing Effect of Stockholder Votes to Two-Step Tender Offers

On June 30, 2016, in *In re Volcano Corp. Stockholder Litigation*, the Delaware Court of Chancery held that, where a majority of fully informed stockholders voluntarily tender into a "two-step" tender offer, the business judgment rule will apply irrebuttably, and the transaction can only be challenged as corporate waste. This decision is an important extension of the Delaware Supreme Court's recent decision in *Corwin v. KKR Financial Holdings* and *Singh v. Attenborough*, which gave a cleansing effect to a merger that was approved by a fully informed stockholder vote. These decisions are making it increasingly hard for stockholder-plaintiffs to challenge transactions once they are approved by a majority of stockholders.

The Court's Decision

Volcano[1] involved a stockholder challenge to a completed two-step tender offer structured under Section 251(h) of the Delaware General Corporation Law. Under Section 251(h), which was adopted in 2013, a buyer can promptly consummate a second-step merger without having to call a stockholders meeting or reach the 90% threshold necessary to consummate a short-form merger if, among other conditions, it acquired the same number of shares in the tender offer that would be required to approve a long-form merger. The challenging stockholders in *Volcano* sought to have the court review the directors' negotiation and approval of the transaction under *Revlon*'s enhanced scrutiny standard. The defendants, meanwhile, sought to invoke the Delaware Supreme Court's recent decisions in *Corwin*[2] and *Attenborough*[3] to have the claims dismissed on the theory that the transaction was cleansed by Volcano's stockholders since 89.1% of the outstanding shares were tendered to the buyer.

The court agreed with the defendants and dismissed the stockholders' challenge to the transaction. Specifically, the court held that "the acceptance of a first-step tender offer by fully informed, disinterested, uncoerced stockholders representing a majority of a corporation's outstanding shares in a two-step merger under Section 251(h) has the same cleansing effect under *Corwin* as a vote in favor of a merger by a fully informed, disinterested, uncoerced stockholder majority." Applying *Attenborough*, the court further held that the business judgment rule was irrebuttable, meaning that the only way for the stockholders' claims to survive a motion to dismiss was for them to allege facts indicating that the transaction constituted corporate waste. Because "the test for waste is whether any person of ordinary sound business judgment could view the transaction as fair," the court stated that "it is logically difficult to conceptualize how a plaintiff" could prove such a claim in light of the approval of *many* disinterested stockholders. Additionally, the court dismissed aiding and abetting claims against Volcano's financial advisor because of the failure to plead a breach of fiduciary duty against the directors.

[1] Consol. C.A. No. 10485-VCMR, mem. op. (Del. Ch. June 30, 2016).

[2] 125 A.3d 304 (Del. 2015).

[3] 2016 WL 2765312 (Del. May 6, 2016) (ORDER).

Implications

The court's decision is significant. First, the court held that the cleansing effect resulting from majority stockholder approval results in an *irrebuttable* presumption of the business judgment rule. This means that the only remaining challenge is one for "waste," which the Supreme Court has already described as "vestigial" and of "little real-world significance." Accordingly, creating an irrebuttable presumption of the business judgment rule gives essentially dispositive effect to the approval of a transaction by a majority of fully informed, uncoerced, disinterested stockholders. It rejects the plaintiff's argument that, even though the transaction was approved by stockholders, the complaint could still plead facts supporting a breach of fiduciary duty and thus rebut the business judgment rule.

Second, this decision extends the cleansing effect given to a stockholder vote under *Corwin* to a two-step tender offer structured under Section 251(h). Prior decisions of the Court of Chancery had left open the question of whether *Corwin* would apply to transaction structures other than a traditional long-form merger. Because a Section 251(h) transaction mirrors a long-form merger in many respects by requiring, among other things, that the board approve a merger agreement and declare its advisability, the court found this type of tender offer to be sufficiently analogous to extend the doctrine.

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