November 3, 2015

Delaware Court of Chancery Clarifies Application of Business Judgment Review in Post-Closing Merger Context

In two opinions published in the last week, the Delaware Court of Chancery had the opportunity to apply and clarify the Delaware Supreme Court's recent decision in *Corwin v. KKR*, which held that, in situations where entire fairness review does not apply (*e.g.*, a merger without a controlling stockholder), the approval of the transaction by a fully informed, uncoerced vote of disinterested stockholders, even if statutorily required, will invoke the business judgment rule, to the exclusion of other heightened standards of review, such as *Revlon* or *Unocal*.[1] Notably, the court in one case applied the heightened pleading standard required by the application of the business judgment rule to post-closing claims against both the board of directors and alleged aiders and abettors, such as financial advisors.

In *In re Zale Corporation Stockholders Litigation*, the Delaware Court of Chancery held that, once the stockholder vote has shifted the standard of review to business judgment, a complaint must contain well pleaded allegations of facts that a company's directors were grossly negligent in order to maintain a claim for a breach of the fiduciary duty of care. Gross negligence is a higher threshold than under *Revlon* (which examines whether directors' actions were in a range of reasonableness) and requires that the directors' actions be "so grossly off-the-mark as to amount to reckless indifference or a gross abuse of discretion". Plaintiffs must "articulat[e]. . . facts that suggest a *wide* disparity between the process the directors used. . . and [a process] which would have been rational." In this particular case, the court found that such facts were not sufficiently pleaded to support a finding that the defendant directors breached their duty of care under the gross negligence standard. Because there was no predicate breach of fiduciary duty, the court also dismissed any allegations of aiding and abetting liability on the part of the company's financial advisers. This is a fact intensive inquiry, however, and while gross negligence is a high threshold, it is not one that is wholly impossible to meet, especially at a pretrial stage such as on a motion to dismiss. For example, in the recent *In re Tibco Software Inc. Stockholders Litigation* decision, the Delaware Court of Chancery found that a target board's failure to make basic inquiries after discovering an error in the count of shares outstanding that resulted in an effective $100 million (or approximate 2.4%) reduction in the equity value payable for target raised litigable questions as to whether the board acted in a grossly negligent manner. Although the claims against the board were exculpated under the target's certificate of incorporation and therefore dismissed, the court found that the alleged breach of the fiduciary duty of care was sufficient as the predicate for an aiding and abetting claim against target's financial advisor, allowing such claim to move on to a trial.

Facts and formalities also play an important role in the procedures needed to invoke the business judgment rule in the post-closing merger context. In *Espinoza v. Zuckerberg*, the Delaware Court of Chancery confirmed that only a formal vote or written consent of the majority of disinterested stockholders that complies with the technical requirements for stockholder action under the Delaware General Corporation Law will be effective to shift the standard of review. Because of a desire to ensure precision and transparency of the stockholder action, any alternative or less formal indications of stockholder assent, such as tendering into a tender offer or deposition testimony and an affidavit in support of the particular action (as occurred in *Espinoza*), is insufficient.

For the *Zale* decision, click here. For the *Tibco* decision, click here. For the *Espinoza* decision, click here.

---

[1] For more detail on the *Corwin* decision, see our memo here.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Ariel J. Deckelbaum
Partner
New York Office
212-373-3546
Email

Ross A. Fieldston
Partner
New York Office
212-373-3075
Email

Justin G. Hamill
Partner
New York Office
212-373-3189
Email

Stephen P. Lamb
Partner
Wilmington Office
302-655-4411
Email

Jeffrey D. Marell
Partner
New York Office
212-373-3105
Email

Counsel Frances Mi and associate Justin A. Shuler contributed to this alert.

Our M&A Group

The Paul, Weiss M&A Group consists of 30 partners and over 100 counsel and associates based in New York, Washington, Wilmington, London, Toronto, Tokyo, Hong Kong and Beijing. The firm's Corporate Department consists of 60 partners and more than 200 counsel and associates.

Our M&A Partners

Matthew W. Abbott
Edward T. Ackerman
Angelo Bonvino
Jeanette K. Chan
Yvonne Y. F. Chan
Ariel J. Deckelbaum
Ross A. Fieldston
Brian P. Finnegan
Adam M. Givertz
Robert D. Goldbaum
Neil Goldman
Bruce A. Gutenplan
Justin G. Hamill
David K. Lakhdhir
Stephen P. Lamb
John E. Lange
Xiaoyu Greg Liu
Jeffrey D. Marell
Toby S. Myerson
Kelley D. Parker
Marc E. Perlmutter
Carl L. Reisner
Kenneth M. Schneider
Robert B. Schumer
John M. Scott
Tarun M. Stewart
Steven J. Williams
Kaye N. Yoshino
Tong Yu
Taurie M. Zeitzer