September 1, 2016

Delaware Court of Chancery Dismisses Post-Closing Merger Challenge Due to Fully Informed Stockholder Approval

In *Larkin* v. *Shah* issued last week, the Delaware Court of Chancery dismissed a stockholder challenge to a merger due to the cleansing effect of fully informed stockholder approval, applying the Delaware Supreme Court's recent *Corwin* v. *KKR Financial Holdings LLC* decision (which held that fully informed and uncoerced stockholder approval of a merger not subject to entire fairness review invokes the business judgment rule rather than heightened scrutiny under *Revlon*). The *Larkin* opinion confirms that, other than with respect to transactions to which entire fairness applies *ab initio* (i.e., transactions involving a conflicted controlling stockholder or group), a fully informed stockholder approval cleanses board-level conflicts and invokes the business judgment rule irrebuttably.

Background

Larkin concerned a stockholder challenge to the May 2015 acquisition of Auspex Pharmaceuticals, Inc. by Teva Pharmaceuticals Industries, Inc. The acquisition was structured as a two-step merger under Section 251(h) of the DGCL, which in general permits a back-end merger to close without a stockholder vote upon the successful completion of a front-end tender offer for a majority of a public company's shares. Approximately 70% of the shares not bound by tender agreements to support the transaction tendered into the offer.

The plaintiffs' primary allegations of wrongdoing were that three of Auspex's nine directors were affiliated with a "control block" of venture capital firms collectively holding approximately 27% of the outstanding shares. Moreover, although the merger consideration represented more than a 42% premium to the shares' trading price and all stockholders were treated equally, the plaintiffs asserted that the alleged controllers received a non-ratable benefit, in that the venture capital firms had unique liquidity needs and the three directors implemented a rushed sale process that favored Teva's all-cash bid over potentially higher, mixed consideration offers. Alternatively, even if the three directors and venture capital firms were not a control group, the plaintiffs argued that entire fairness should apply because a majority of the board suffered from "disabling conflicts of interest, including contemporaneous employment with the two venture capital firms, post-merger employment offers with the surviving entity . . . and special compensation opportunities," specifically, higher than usual one-time option grants that would vest upon a merger and compensation for taxes owed in connection with such a merger.

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Corwin Analysis: Absent a "Conflicted Controller," Fully Informed Stockholder Approval Extinguishes All Claims Other Than Waste

The Court began its analysis by considering what the Delaware Supreme Court meant in *Corwin* when it held that the business judgment rule applies following proper stockholder approval of "a transaction not subject to the entire fairness standard." Based on its review of the factual context of *Corwin*, the precedents cited in that case and related Supreme Court precedent, most notably *Singh* v. *Attenborough*, the Court concluded that "the business judgment rule irrebuttably applies if a majority of disinterested, uncoerced stockholders approve a transaction *absent a looming conflicted controller*." In other words, unless a controlling stockholder (or group) stands on both sides of a transaction or receives a non-ratable benefit as to which the entire fairness standard applies *ab initio*, proper stockholder approval insulates transactions from fiduciary challenge on all grounds other than waste, and a plaintiff cannot avoid dismissal merely by alleging that a majority of the board harbored a conflict of interest or failed to exercise due care.

With that standard in mind, the Court then found:

- The merger did not involve a "looming conflicted controller" because the plaintiffs had not adequately pled the existence of a group wielding "actual control" over the company and, even if there were, the plaintiffs had not pled the purported unique liquidity needs in any way other than conclusory statements generally applicable to all venture capital firms;
- Relying on *In re Volcano Corp. Stockholder Litigation* from June of this year, the tenders by a stockholder majority into a front-end offer under Section 251(h) constituted stockholder approval sufficient to invoke the *Corwin* standard; and
- Because the plaintiffs did not challenge the adequacy of the disclosures in the company's recommendation statement or plead a claim of waste, the business judgment rule irrebuttably applied.

Accordingly, the Court dismissed the case without needing to consider the plaintiffs' alternative argument that board-level conflicts tainted the sale process.

Observations

Larkin applies *Corwin* in a way that substantially simplifies the judicial inquiry for post-closing merger claims, allowing the Court to disregard allegations of board-level conflicts due to the cleansing effect of fully informed stockholder approval so long as the transaction did not involve a conflicted controller (i.e., a controller that stands on both sides of the transaction or that received a unique benefit). While plaintiffs may continue to argue that such board conflicts may nevertheless rebut the business judgment

presumption despite stockholder approval and lack of a controller, the strength of this position may be weaker after *Larkin*. Such claims were considered in another opinion that was issued one day before *Larkin* in *City of Miami General Employees' & Sanitation Employees' Retirement Trust* v. *Comstock* with the Court finding that the plaintiff's theory of board-level conflicts was insufficient to rebut the business judgment presumption and invoke entire fairness review.

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Scott A. Barshay
Partner
New York Office
212-373-3040
Email

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

Partner Richard A. Rosen, Counsel Frances Mi and Associate Jason S. Tyler contributed to this alert.

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