CORWIN DOCTRINE

DISCLOSURE DEFICIENCIES AND STOCKHOLDER APPROVED TRANSACTIONS

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The central goal of any for-profit entity, regardless of its industry, is very simple and is always the same: continuously increase value for all of its stockholders. While companies can increase value in a number of ways, one of the most common, time-tested, and effective ways to grow stockholder value is through mergers and acquisitions. Transactions not only provide organizations the ability to increase market share, but also frequently grant companies with access to new product offerings, market segments, and customer bases. The concept and value proposition of mergers and acquisitions is straight forward, and, in a perfect world, every interested party would end up happy with each and every transaction. The world, however, is anything but perfect, and as a result, it is not uncommon for a subset of stockholders to formally challenge the validity of a corporation's actions and/or the underlying transaction. For a corporation's directors, officers and in-house counsel, the key to successfully navigating these roadblocks is taking the appropriate steps during the transaction process to ensure that the corporation can overcome them if and/or when they occur.

Perhaps the most important and relevant guidance to defending post-closing lawsuits from stockholders comes out of *Corwin v. KKR Financial Holdings, LLC,* which was decided by the Delaware Supreme Court in 2015. The aptly named Corwin Doctrine provides that so long as the decision being challenged was approved by a majority of disinterested, fully informed and uncoerced stockholders with no interested/conflicted controlling stockholder present at the time of said vote, the business judgment rule applies, and the claims are entitled to dismissal. Seems like a clear cut and easy way for directors to ensure their actions and decisions are safe from scrutiny, right? Indeed, for several years following the emergence of the *Corwin Doctrine*, the number of cases in which it applied and benefited directors and their organizations steadily increased. Commencing in 2018, however, that trend abruptly reversed course, with the *Corwin Doctrine* being applied much more conservatively. So, what happened? In a nutshell, plaintiffs attacked one of the principal tenets of the *Corwin Doctrine*: the premise that stockholders have been fully informed.

Two cases heard by the Delaware

Supreme Court in 2018, *Morrison v. Berry* and *Appel v. Berkman*, highlight this tactic. In *Morrison*, a company called The Fresh Market ("Fresh Market") entered into a merger agreement with an entity controlled by private equity firm Apollo Global Management LLC ("Apollo"). As a part of the transaction, Fresh Market's founder agreed to roll over his equity interest in Fresh Market into shares of the acquiring entity. Fresh Market's Board of Directors recommended that the company approve the transaction, and the shareholders approved it. Following closing of the acquisition, however, one of Fresh Market's shareholders filed suit, claiming the directors of Fresh Market breached their fiduciary duties. Although Delaware's Court of Chancery applied the *Corwin Doctrine* and dismissed the case, the plaintiff appealed, arguing that Fresh Market failed to make material disclosures that prevented shareholders from accurately evaluating the transaction, and the Delaware Supreme Court reversed the decision. Specifically, the Supreme Court, noted, among other things, that Fresh Market's failure to disclose to stockholders that the company's founder had agreed with Apollo prior to the board's consideration of the acquisition, to roll over his equity in Fresh Market to the acquiring entity and that he had previously denied the existence of that agreement to Fresh Market's board was a material disclosure defect. In reversing the Court of Chancery's decision, the Supreme Court also stated that the relevant test in determining whether the failure to disclose information is material is not whether it would have made stockholders less likely to accept a tender offer, but if "there is a substantial likelihood that a reasonable stockholder would have considered the omitted information important when deciding whether to tender her shares or seek appraisal." The Supreme Court also held that material information includes any information or facts that a stockholder may "generally want to know in making a decision, regardless of whether it actually sways a stockholder one way or the other" and that "a single piece of information rarely drives a stockholder's vote."

In *Appel*, Diamond Resorts International ("Diamond"), a hospitality and vacation company, completed a two-step merger transaction for cash with Apollo. In the first step of the merger, Diamond's shareholders were provided with the tender offer and a Schedule 14D-9 Solicitation/Recommendation Statement, in which Diamond's board of directors recommended the merger. Following the tender offer, once Apollo had acquired more than 50% of Diamond's stock, the second step of the process was completed through a backend merger under Section 251(h) of the Delaware General Corporation Law ("DGCL"), without a stockholder vote. Shortly after closing of the merger, however, one of Diamond's shareholders filed suit, questioning the transaction's fairness and alleging that Diamond's board of directors failed to disclose all material information to Diamond's shareholders regarding the tender offer. Specifically, the plaintiff argued that the Schedule 14D-9 failed to disclose that Diamond's founder, largest stockholder, and chairman of the board, had told the board of directors that "he was disappointed with the price and the Company's management for not having run the business in a manner that would command a higher price" and that "it was not the right time to sell the Company."

Relying on *Corwin*, the Court of Chancery granted the defendant's motion to dismiss, holding that the "stockholders' acceptance of the first-step tender offer was fully informed" and that (i) Diamond's failure to disclose its chairman's statement and reason for abstaining from the vote on the merger was immaterial, and (ii) including it in the disclosures would not have materially altered the mix of information provided. On appeal, the Delaware Supreme Court reversed the Court of Chancery's ruling. In its opinion, the Supreme Court noted that "directors of a Delaware corporation have a fiduciary duty to disclose fully and fairly all material information within the board's control that would have a significant effect upon a stockholder vote when it seeks or recommends shareholder action." Applying that principle to the facts in *Appel*, the Supreme Court explained that a chairman abstaining from voting on the sale of a business he or she founded and led is not a standard occurrence, especially when the "reasons for doing so contradict the board's recommendations to the stockholders," and the failure to include such facts in the company's disclosures is material and precludes reliance of the business judgment rule in connection with a motion to dismiss at the pleading stage.

CRITICAL TAKEAWAYS

1. The plaintiffs in both *Morrison* and *Appel* relied upon board minutes, e-mails and other documents obtained under Section 220 of the DGCL, which gives shareholders the right to inspect the books and records of the corporation. It is critical to be mindful of what those documents state in relation to what is and is not disclosed to shareholders in Schedule 14D-9 statements and other documents. Consistency and transparency are key.

2. In order to minimize potential landmines, it is vital for boards of directors to consult with legal counsel in order to ensure that the corporation discloses any and all material information to shareholders (i.e. information for which there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote or information for which there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by a reasonable investor as having significantly altered the total mix of information made available).

3. In determining whether something is material for disclosure purposes, boards of directors should place themselves in the shoes of an unassuming shareholder, with no special knowledge of the corporation's dealings or internal discussions, and ask themselves whether the information at issue is something that they, as individual shareholders, would find relevant or want to know in making a decision in connection with a merger or acquisition. Within reason and subject to first consulting with legal counsel, leaning towards the side of disclosure is better than withholding or omitting information.

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