Vanderbilt Law Review En Banc

Volume 75
Issue 1 *En Banc - 2022*

Article 9

"Necessary but Not Sufficient": Chancery Court Clarifies Role of Enhanced Scrutiny in Assessing Damages Claims against Corporate Actors in Revlon Transactions

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DELAWARE CORPORATE LAW BULLETIN

"*NECESSARY BUT NOT SUFFICIENT*": CHANCERY COURT CLARIFIES ROLE OF ENHANCED SCRUTINY IN ASSESSING DAMAGES CLAIMS AGAINST CORPORATE ACTORS IN *REVLON* TRANSACTIONS

Also explains that preliminary steps taken by self-interested corporate officers to tilt playing field for benefit of favored bidder may invite application of Revlon principles several months before board approval of sale transaction

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INTRODUCTION

In early 2021, Vice Chancellor J. Travis Laster ("*Vice Chancellor*") of the Delaware Court of Chancery ("*Chancery Court*") addressed the continuing relevance of the enhanced scrutiny level of judicial review in post-closing damages claims challenging corporate sales transactions. In *Firefighters' Pension Sys. of the City of Kansas City, Mo. Tr. v. Presidio, Inc.*, 251 A.3d 212 (Del. Ch. 2021) ("*Presidio*"), the Vice Chancellor carved out a role for enhanced scrutiny in this context. Under the *Presidio* analysis, while application of enhanced scrutiny is not determinative, it does serve as an important stepping stone to reaching a final determination on the availability of damages. Based on this analysis, the Vice Chancellor rejected pleading-stage dismissal of plaintiff's damages claims against several defendants alleged to have engaged in a tainted sale process. Among the infirmities cited by the Vice Chancellor was a secret tip given by the board of directors' financial advisor to one of the competing bidders, effectively ending the bidding process.

A little more than a month later, in *In re Columbia Pipeline Grp., Inc. Merger Litig.*, C.A. No. 2018-0484-JTL, 2021 WL 772562 (Del. Ch. Mar. 1, 2021) ("*Columbia Pipeline*"), Vice Chancellor Laster sharpened his *Presidio* analysis. In denying pleading-stage dismissal of post-closing damages claims against two corporate officers alleged to have engaged in fiduciary breaches at an early stage—three months before the merger agreement was signed—of a sales process, the Vice Chancellor ruled that enhanced scrutiny was a "necessary but not sufficient" tool for assessing the merits of the damages claims. As so often is the case in successful challenges under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) ("*Revlon*"), the *Columbia Pipeline* sale process attracted troubling allegations—a largely unsupervised management team favoring one bidder over others in an effort to obtain enhanced retirement benefits rather than the best value for company stockholders—that, similar to the *Presidio* "tip," tainted the reasonableness of the process.

I. LEGAL BACKGROUND

In *Revlon*, the Delaware high court proclaimed that, in the change-of-control context, the duty of loyalty requires "the maximization of the company's value at a sale for the stockholders' benefit." The *Revlon* Court also designated "enhanced scrutiny" as the applicable judicial standard for reviewing *Revlon*-based claims.

Nearly thirty years later, in *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015) ("*Corwin*"), the Delaware Supreme Court cast doubt on *Revlon*'s continued relevance in post-closing damages actions. By ruling that a "fully informed, uncoerced vote of the disinterested stockholders" could, in effect, "cleanse" alleged breaches of fiduciary duties in connection with corporate sales transactions, *Corwin* provided corporate fiduciaries with a potent defense against post-closing damages. Moreover, the *Corwin* court explained that "*Revlon* [is] primarily designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M&A decisions in real time, before closing," giving rise to the question whether enhanced scrutiny retained any relevance in assessing the merits of post-closing damages claims.

However, recent Delaware decisions indicate that *Revlon* remains a highly relevant check on fiduciary breaches in M&A-related litigation, at least where *Corwin*-cleansing is unavailable:

- In *Kahn v. Stern*, 183 A.3d 715 (Del. 2018) ("*Kahn*"), the Delaware Supreme Court explained that "*Revlon* remains applicable as a context-specific articulation of the directors' duties" in those cases where *Corwin* is not applicable. For a discussion of *Kahn*, see Robert S. Reder & Victoria L. Romvary, *Delaware Supreme Court Clarifies Pleading Standard in Post-Closing Damages Action Alleging Breach of* "Revlon *Duties*," 72 Vand. L. Rev. En Banc 29 (2018).
- The following year, in *Morrison v. Berry*, C.A. No. 12808-VCG, 2019 WL 7369431 (Del. Ch. Dec. 31, 2019) ("*Morrison*"), the Chancery Court cited *Kahn* for the proposition that "*Revlon* applies to the underlying company sales process—and is thus a context-specific lens through which to look at the defendants' duties." For a discussion of *Morrison*, see Robert S. Reder & Lorin Hom, *Chancery Court Dismisses Breach of Fiduciary Duty Claims Against Target Company Directors Despite*

Unavailability of Corwin *Defense,* 73 Vand. L. Rev. En Banc 111 (2020).

- Subsequently, in *In re USG Corp. S'holder Litig.*, C.A. No. 2018-0602-SG, 2020 WL 5126671 (Del. Ch. Aug. 31, 2020) ("*USG*"), the Chancery Court presented a more detailed analysis of the *Revlon* "context-specific lens" identified in *Morrison,* explaining that "where a board decides to sell the company and thus terminate stockholder ownership, the director[s'] fiduciary duties mandate that they concentrate on securing the best price. Put differently, to comply with *Revlon,* 'when a board engages in a change of control transaction, it must not take actions inconsistent with achieving the highest immediate value reasonably attainable.' " For a discussion of *USG,* see Robert S. Reder & Spencer Lutz, *No* Corwin*, No Problem: Chancery Court Discusses* Revlon*'s Role in Analyzing Post-Closing Damages Claims Against Target Company Directors,* 74 Vand. L. Rev. En Banc 71 (2021).
- Just two months later, in *In re MINDBODY, Inc. S'holder Litig.*, C.A. No. 2019-0442-KSJM, 2020 WL 5870084 (Del. Ch. Oct. 2, 2020) ("*Mindbody*"), the Chancery Court addressed damages claims brought against a target company founder alleged to have breached his *Revlon* duties by manipulating a sales process. In rejecting the founder's motion to dismiss, the *Mindbody* Court observed that this "paradigmatic *Revlon* claim involves a conflicted fiduciary who is insufficiently checked by the board and who tilts the sales process toward his own personal interests in ways inconsistent with maximizing stockholder value." For a discussion of *Mindbody,* see Robert S. Reder & Victoria D. Selover, *Chancery Court Again Refuses Preliminary Dismissal due to Well-Plead Allegations that Sale Process Orchestrated by Target Company Fiduciary Failed to Satisfy* Revlon *Standards,* 74 Vand. L. Rev. En Banc 407 (2021).
- Shortly thereafter, as discussed above, Vice Chancellor Laster utilized *Presidio* to explain enhanced scrutiny's continuing role in assessing whether corporate actors may be held personally liable by disgruntled target company stockholders challenging a sale process. For a discussion of *Presidio,* see Robert S. Reder & Connor J. Breed, *Chancery Court Employs Revlon Analysis In Assessing Whether Corporate Sale Process Was Reasonable,* 75 Vand. L. Rev. En Banc ___ (2022).

Columbia Pipeline provided Vice Chancellor Laster with another opportunity to discuss the continuing role of enhanced scrutiny in *Revlon*-based post-closing damages actions. Moreover, in focusing on acts taken by corporate officers allegedly seeking to tilt the playing field for the benefit of a favored bidder several months before the board of directors' approval of the sale, the Vice Chancellor clarified the application of principles introduced in *Revlon* some thirty-five years earlier.

II. FACTUAL BACKGROUND

A. The Spinoff

Columbia Pipeline Group, Inc. (the "*Company*") "developed, owned, and operated natural gas pipeline, storage, and other midstream assets." Before its spinoff as a separate, publicly-owned company on July 1, 2015 ("*Spinoff*"), the Company was wholly owned by NiSource Inc., a "publicly traded utility" ("*NiSource*"). At this time, Robert Skaggs, Jr. ("*Skaggs*") served as chairman of the board and CEO of NiSource, while Steven Smith ("*Smith*" and, together with Skaggs, "*Officers*") served as its Executive Vice President and CFO. Both Officers enjoyed compensation packages with NiSource providing "lucrative change-in-control arrangements" that would "provide materially greater benefits if their employment ended after a sale of NiSource." Notably, a sale by NiSource of the Company "would not trigger the change-in-control benefits." Both Officers had targeted 2016 for their retirements and, in this connection, Skaggs' financial advisor indicated "that 'the single greatest risk' to the retirement plan was Skaggs' 'single company stock position in NiSource.' "

In anticipation of the Spinoff, the NiSource board of directors designated Skaggs as the Company's chairman of the board and CEO and Smith as its CFO. Both Officers were eager to join the Company as "they did not 'want to work forever' and they saw an opportunity for a 'sale in the near term.' " Consistent with their near-term retirement plans, both "entered into change-in-control agreements with the Company that tracked their arrangements with NiSource," except they provided an enhanced payout if employment terminated after a sale of the Company, rather than NiSource.

B. Preliminary Interest from Potential Suitors

The Officers, who viewed the Company as a prime acquisition target as early as May 2015, obtained an investment banker presentation outlining "strategic alternatives" and "possible acquirers" for the Company post-Spinoff. Although several potential buyers quickly emerged, "a sharp, cyclical downturn" in energy markets rendered their preliminary offers unattractive to the Company's board of directors ("*Board*"). Then, "in mid-October 2015, Skaggs recommended a dual-track strategy," ultimately accepted by the Board, whereby "the Company would prepare for an equity offering" unless it was able to secure a buyout offer of "at least $28 per share." To this end, the Company executed nondisclosure agreements with several suitors that included standstill provisions forbidding offers without a written invitation from the Board. At this point, the interested suitors included TransCanada Corporation ("*TransCanada*") and Spectra Energy Corporation ("*Spectra*"), among others.

On November 19, the Officers invited TransCanada and one other bidder to make cash bids by November 24. However, unbeknownst to the Board, because both Officers preferred an all-cash deal without a stock component, they failed to extend this invitation to Spectra or other suitors. On November 25, the Board terminated discussions with all potential suitors because indications of interest were "too low" and, instead, pursued an equity offering. The equity offer was "oversubscribed," indicating "that market participants regarded the Company's stock as undervalued."

C. TransCanada Emerges as the Officers' Favored Bidder

On the same day the Board terminated the sale process, Smith alerted TransCanada, without the Board's knowledge or approval, that the Company "probably" would recommence the sale process "in a few months." In a foreshadowing of things to come, no other suitor received this message.

In response, TransCanada reached out to Smith—in violation of its standstill—to reiterate interest in the Company. Rather than calling foul, Smith arranged a meeting for January 7, 2016 ("*January Meeting*"). Smith advised Board financial advisor Goldman Sachs & Co. ("*Goldman*"), but not the Board, of this development. Two days before the January Meeting, Smith emailed TransCanada "190 pages of confidential information about the Company," including "updated financial projections" and "counterparty agreements with [Company] customers." In "talking points" prepared by Goldman for the January Meeting, Smith was to "explain[ ] how TransCanada could convince the Board to agree to a deal with TransCanada without putting the Company 'in-play,' thereby avoiding a competitive auction."

At the January Meeting, Smith "literally handed" his "talking points" to TransCanada, then declared that the Company had "'eliminated the competition'" from other bidders. Then, on January 25, again in violation of its standstill, TransCanada "expressed interest" in a Company buyout "in the range of $25 to $28 per share." During a two-day Board meeting in late January, Skaggs vigorously supported TransCanada's offer. Ignoring the standstill violation, the Board granted TransCanada exclusivity through March 4 (later extended to March 8) unless it received a "bona fide written unsolicited Transaction Proposal" from another bidder.

On March 4, the Board directed the Officers to (i) demand a formal buyout proposal from TransCanada and (ii) waive standstills with other potential buyers. The Officers delayed waiving the standstills until the day after the Board "reiterated its directive" on March 11, presumably "because they favored a deal with TransCanada." About this time, when Spectra sought buyout talks, Skaggs "downplayed the seriousness of Spectra's offer to the Board" and, consistent with a "moral commitment" demanded by TransCanada, "effectively shut out Spectra" from the process by "requiring a fully financed proposal before due diligence . . . ." Skaggs even went so far as to "instruct[ ] Goldman to screen Spectra's calls" to prevent Spectra from reaching Company management. As a result, "Spectra never made a written offer, and TransCanada never faced competition from Spectra."

D. TransCanada Takes Advantage of Preferred Position

Although "the Company's business was rebounding," on March 14 TransCanada, recognizing the playing field was tilted in its favor, (i) lowered its bid to $25.50, (ii) demanded a response within three days, and (iii) "threatened that if the Company did not accept the offer within that timeframe, then TransCanada would announce the termination of negotiations." This placed Company in a precarious position; if TransCanada followed through on its threat, the Company would appear as "damaged goods" to other potential bidders.

In the face of TransCanada's aggressive approach, the Board accepted the reduced offer on March 16 and entered into a merger agreement with TransCanada the next day ("*Merger Agreement*"). After the stockholders approved the transaction following the Board's circulation of proxy materials describing the transaction ("*Proxy Statement*"), the parties closed the buyout on July 1. Both Officers retired "[s]hortly thereafter," earning $17.9 million and $7.5 million more, respectively, "than [t]he[y] would have received absent a sale of the Company."

E. Litigation Ensues

The transaction triggered "a procession of litigation":

- *First,* several former Company stockholders alleged breach of fiduciary duty by the Officers and other Board members, but because their complaint was based solely on information in the Proxy Statement, the Chancery Court found they "failed to plead a viable disclosure claim" and granted dismissal at the pleading stage based on a *Corwin* defense.
- *Second,* an action by "two groups of hedge funds" seeking appraisal of the "fair value" of their Company shares under Section 262 of the Delaware General Corporation Law ("*Appraisal Action*") resulted in a Chancery Court determination that "the fair value of the Company's stock at the time of the Merger was equal to the deal price . . . ."
- *Third,* an action by another former Company stockholder in federal court alleging disclosure violations under both federal securities and Delaware law was "largely" dismissed at the pleading stage.
- *Fourth,* in *Columbia Pipeline,* after conducting an extensive books and records investigation, a plaintiff unrelated to the plaintiffs in the other actions ("*Plaintiff*") alleged that the Officers "breached their fiduciary duties" as officers and, in the case of Skaggs, as a director of the Company by "tilting the sale process in favor of TransCanada, and failing to engage adequately with Spectra," in a bid to "retire with significant change-in-control benefits."

In *Columbia Pipeline,* Vice Chancellor Laster refused to grant the Officers' motion to dismiss, finding a "reasonably conceivable inference" from Plaintiff's allegations that the Officers "breached their duty of loyalty." The Vice Chancellor also announced he would address Plaintiff's "motion for summary judgment separately."

III. VICE CHANCELLOR LASTER'S ANALYSIS

A. Standard of Review

Vice Chancellor Laster began by determining that, because the transaction "involved a sale of the Company for cash," enhanced scrutiny was the proper standard for "evaluating" the transaction. He explained that the intermediate standard of enhanced scrutiny requires that fiduciary defendants " 'bear the burden of persuasion to show that their motivations were proper and not selfish' and that 'their actions were reasonable in relation to their legitimate objective' "—namely, maximizing stockholder value. On the other hand, he pointed out, a court does not apply enhanced scrutiny when determining whether a fiduciary should be held liable. Instead, when assessing claims for personal liability, the court "must determine whether the fiduciary breached either the duty of loyalty, including its subsidiary element of good faith, or the duty of care."

Defendants asked Vice Chancellor Laster nevertheless to employ *Corwin* cleansing to lower the standard of review, granting deferential business judgment review to the transaction. To determine whether *Corwin* applied, the Vice Chancellor analyzed whether the Proxy Statement disclosures "apprised stockholders of all material information and did not materially mislead them." In fact, the Appraisal Action already had determined that "the Proxy [Statement] contained material misstatements and omissions," namely:

- Misleading statements regarding the standstills, including that the Board ignored TransCanada's breach of its standstill;
- Lack of information concerning the Officers' plans to retire; and
- Incomplete disclosures regarding the January Meeting.

For Vice Chancellor Laster, these facts supported a reasonable inference that the Proxy Statement contained material omissions. Because only "one violation is sufficient to prevent application of *Corwin*," the Vice Chancellor ruled that enhanced scrutiny, rather than business judgment, was the appropriate standard of review.

B. Who triggered Revlon*, and when?*

"[T]o avoid confronting many of the actions challenged by" Plaintiff–including the January Meeting, TransCanada's standstill breaches, and the exclusivity arrangements–defendants argued that *Revlon* was not triggered until March 4, "when [the Company] first demanded a written merger proposal from TransCanada." Rejecting this approach, Vice Chancellor Laster explained that "[e]nhanced scrutiny in the M&A context addresses the situationally specific pressures that boards of directors, their advisors, and management face when considering a sale or similar strategic alternative that carries significant personal implications for those individuals." The "operative question," therefore, "is when those situational conflicts come into play."

Next, he noted that "although usually it will be the board that causes the corporation to initiate an active sale process," and thereby trigger a *Revlon* analysis, "other corporate actors can take action that implicates enhanced scrutiny." For instance, the Vice Chancellor observed that actions taken by the Officers as early as completion of the Spinoff arguably were sufficient "to view the situational pressures that animate enhanced scrutiny as having come into play . . . ." For purposes of his analysis, however, the Vice Chancellor focused on the January Meeting—which occurred *three months before* the Merger Agreement was signed—as the point at which "it [was] reasonable to infer that Smith initiated a sale process" that the Board "could have stopped" but elected, at the urging of the Officers, not to do so. Accordingly, the Vice Chancellor reviewed the events occurring from and after the January Meeting under the lens of enhanced scrutiny.

C. Application of Enhanced Scrutiny to Sales Process

Next, Vice Chancellor Laster pointed out that while corporate actors may show favoritism to a bidder "if, but only if, it is in the shareholders' interest" to "maximiz[e] the price the stockholders receive for their shares," such favoritism "falls outside the range of reasonableness" when done for "personal reasons." With reference to "the paradigmatic *Revlon* claim" as reformulated in *Mindbody,* the Vice Chancellor found that the factual allegations of the complaint—including those pertaining to the January Meeting, the "moral commitment" demanded by TransCanada, and the Officers "brush[ing] off Spectra's interest"—supported a reasonable inference that the Officers displayed "persistent and substantial" favoritism towards TransCanada, principally for self-interested reasons. Therefore, it was "reasonable to infer," at least at the pleading stage, that these actions inhibited the Company from obtaining a superior transaction.

D. Damages Claims Against the Officers

In his application of enhanced scrutiny, Vice Chancellor Laster emphasized the distinction drawn by Delaware law between " 'the transactional justification' setting" and the " 'personal liability' setting." The focus in the transactional justification setting is typically on "evaluat[ing] the question of breach when determining whether to enjoin a transaction . . . ." Moreover, "establishing a breach of duty under the enhanced scrutiny standard is *necessary but not sufficient* to impose personal liability against a fiduciary" (emphasis added). When the question turns to the personal liability setting, "invoking so-called *Revlon* duties does not change the showing of culpability a plaintiff must make in order to hold the [fiduciaries] liable for monetary damages":

- In the case of directors protected by an exculpatory charter provision in accordance with Section 102(b)(7) of the Delaware General Corporation Law ("*DGCL § 102(b)(7)*"), "a plaintiff must plead and later prove that the fiduciary failed to act reasonably to obtain the best value reasonably available due to interestedness, because of a lack of independence, or in bad faith."
- In the case of officers to whom DGCL § 102(b)(7) does not apply, "[a] plaintiff can recover monetary damages for a breach of the duty of care . . . by establishing that the fiduciary was grossly negligent," meaning "reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of or reason."

The Officers argued the complaint could not state a claim without pleading "a non-exculpated claim against a majority of the Board." Vice Chancellor Laster rejected this argument, asserting "[a] plaintiff can plead a claim against an officer by showing that the officer committed a fraud on the board by withholding material information from the directors that would have affected their decision-making or by taking action that materially and adversely affected the sale process without informing the board." Consistent with this approach, the Vice Chancellor found the allegations in Plaintiff's complaint supportive of a reasonable inference that each Officer hampered the sales process primarily in service of his personal interests, and that the Board was not sufficiently informed to overcome these actions. These allegations also were sufficient to "state a claim for money damages against Skaggs in his capacity as a director" based on a nonexculpated "claim for breach of the duty of loyalty . . . ."

CONCLUSION

In two decisions rendered in early 2021, Vice Chancellor Laster provided important data points for those engaged in corporate sale transactions subject to *Revlon* review:

- *First*, both *Presidio* and *Columbia Pipeline* reaffirm the principle set forth in *Kahn* and reiterated in *Morrison*, *USG*, and *Mindbody* that "*Revlon* applies to the underlying company sales process—and is thus a context-specific lens through which to look at the defendants' duties" in the context of a post-closing damages action. As such, achieving the "best value reasonably available" for stockholders remains the key area of focus.
- *Second*, *Presidio* and *Columbia Pipeline* clarify that enhanced scrutiny remains a "necessary," albeit not "sufficient," tool for

determining whether corporate actors may be held personally liable for monetary damages in a corporate sale context, at least where *Corwin*-cleansing is unavailable. Once the court determines, after applying enhanced scrutiny, that " 'the adequacy of the decisionmaking process employed by the directors, including the information on which the directors based their decision,' fell outside the range of reasonableness," it then turns to a fiduciary-by-fiduciary analysis to assess whether plaintiff has met the high bar for establishing individual liability.

- *Third*, it is commonly understood that actions of a board of directors "to initiate an active sale process" can trigger *Revlon* concerns. However, *Columbia Pipeline*, by addressing *who* can trigger an enhanced scrutiny review and the point *when* that review begins, reveals that actions taken by unsupervised corporate officers as early as three months before board approval of a merger agreement, may play a crucial role in the enhanced scrutiny analysis. Clearly, directors and their legal advisors must be mindful that Delaware courts may apply enhanced scrutiny significantly before a board has taken formal steps to initiate the process.