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Robert S. Reder

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DELAWARE CORPORATE LAW BULLETIN

Chancery Court Declares *Corwin* is not a "Massive Eraser" for all Fiduciary Wrongdoing

Robert S. Reder

Professor of the Practice of Law at Vanderbilt University Law School. Professor Reder has been serving as a consulting attorney at Milbank, Tweed, Hadley & McCloy LLP in New York City since his retirement as a partner in April 2011

Demands "a far more proximate relationship" between the transaction approved by stockholders and the claims sought to be "cleansed"

INTRODUCTION

The Delaware Supreme Court's 2015 decision in *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304 (Del. 2015) ("*Corwin*"), has given boards of directors an ex post defense to challenges of their actions undertaken in connection with M&A transactions. Under *Corwin*, the deferential business judgment rule attaches to post-closing damages actions alleging directorial breach of fiduciary duties where the transaction "is approved by a fully informed, uncoerced vote of the

disinterested stockholders." In such cases, the stockholder vote approving the merger in effect "cleanses" the directorial fiduciary breach, resulting in a pleading stage dismissal absent a sufficient pleading of waste (no easy feat).

Subsequent decisions have clarified the boundaries of *Corwin*, indicating Delaware courts will critically examine the facts before them to ensure the "cleansing" stockholder vote satisfies the requirements of *Corwin*:

- *In re Saba Software, Inc. Stockholder Litigation.*, C.A. No. 10697–VCS, 2017 WL 1201108 (Del. Ch. Mar. 31, 2017) ("*Saba Software*") refused to apply *Corwin* because "the situation in which the Board placed its stockholders as a consequence of its allegedly wrongful action and inaction . . . created a 'circumstance[ ] [that was] impermissibly coercive.' " Specifically, in the Vice Chancellor's opinion, Saba stockholders faced a "Hobson's choice" of either (i) voting in favor of the transactions in question, or (ii) retaining their stock "in the midst of . . . regulatory chaos," leaving them "with no practical alternative but to vote in favor of the Merger." (For a discussion of *Saba Software*, see Robert S. Reder, *Delaware Court Refuses to Invoke* Corwin *to "Cleanse" Alleged Director Misconduct Despite Stockholder Vote Approving Merger*, 70 VAND. L. REV. EN BANC 47 (2017)).
- *Sciabacucchi v. Liberty Broadband Corp.*, C.A. No. 11418–VCG, 2017 WL 2352152 (Del. Ch. May 31, 2017) ("*Sciabacucchi*") refused to apply *Corwin* due to "structural coercion," that is, "a situation where a vote may be said to be in avoidance of a detriment created by the structure of the transaction the fiduciaries have created, rather than a free choice to accept or reject the proposition voted on." Notably, whereas most decisions applying *Corwin* have involved a vote of *target company* stockholders, *Sciabacucchi* considered the potential cleansing effect of a vote of *acquiring company* stockholders. (For a discussion of *Sciabacucchi*, see Robert S. Reder & Victoria L. Romvary, *Delaware Court Determines* Corwin *Not Available to "Cleanse" Alleged Director Misconduct Due to "Structurally Coercive" Stockholder Vote*, 71 VAND. L. REV. EN BANC 199 (2017)).
- In *Appel v. Berkman*, 180 A.3d 1055 (Del. 2018) ("*Appel*"), the Delaware Supreme Court declared that omissions from disclosures provided to stockholders "are material and their omission precludes the invocation of the business judgment rule standard at the pleading stage." (For a discussion of *Appel*, see

Robert S. Reder & John L. Daywalt, *Delaware Supreme Court Reverses Dismissal of Fiduciary Breach Claims Against Target Company Directors*, 71 VAND. L. REV. EN BANC 59 (2018)).

- In *Van der Fluit v. Yates*, C.A. No. 12553-VCMR, 2017 WL 5953514 (Del. Ch. Nov. 30, 2017) ("*Van Der Fluit*"), stockholders were found not to have been furnished with materially accurate disclosures that the two largest stockholders, who also served as directors and functioned as the company's top management, not only led the negotiations with, but also received post-closing employment from, the acquiring company. (For a discussion of *Van Der Fluit*, see Robert S. Reder & Elizabeth F. Shore, *Chancery Court Holds that Defendant Directors' Failure to Disclose Material Facts Defeated Application of* Corwin, 72 VAND. L. REV. EN BANC 41 (2018)).
- *Lavin v. West Corporation*, C.A. No. 2017–0547–JRS, 2017 WL 6728702 (Del. Ch. Dec. 29, 2017) ("*Lavin*"), rejected defendant's argument that *Corwin* should bar an otherwise proper demand for inspection of corporate books and records under Delaware General Corporation Law § 220. (For a discussion of *Lavin*, see Robert S. Reder & Dylan M. Keegan, *Chancery Court Declines to Apply* Corwin *to Foreclose a Books and Records Inspection Under DGCL § 220*, 72 VAND. L. REV. EN BANC 1 (2018)).

These are not the only circumstances under which Delaware courts have refused to apply *Corwin*. For instance, in May 2017, in *In re Massey Energy Co. Deriv. and Class Action Litigation.*, 160 A.3d 484 (Del. Ch. 2017), target company stockholders complained the price paid to them in a merger was effectively reduced due to prior misconduct on the part of company directors and officers that negatively impacted the stock price. Chancellor Andre G. Bouchard of the Delaware Court of Chancery ("Chancery Court") rejected defendants' *Corwin* defense, explaining "there logically must be a far more proximate relationship than exists here between the transaction or issue for which stockholder approval is sought and the nature of the claims to be 'cleansed' as a result of a fully-informed vote."

I. FACTUAL BACKGROUND

Massey Energy Company ("Massey" or the "Company") "was the largest producer of Central Appalachian coal, and the fourth largest producer of bituminous coal in the United States." Massey is perhaps best known for the April 2010 explosion at its Upper Big Branch coal mine in West Virginia, which tragically resulted in the deaths of

twenty-nine miners. In the aftermath of this explosion, Company Chairman and CEO Don Blankenship was convicted in a criminal proceeding and served time in prison.

Both before and after the Upper Big Branch explosion, Massey was involved in very public battles with regulators over "systematic and willful violations of federal and state safety regulations." These issues spawned "numerous derivative lawsuits, seeking to recover damages on behalf of the company for fines, judgments and other harm it would suffer because of the alleged failure of Massey directors and officers to make a good faith effort to ensure that Massey complied with mine safety regulations" (the "Stockholder Actions").

As Massey's stock price fell from $53.05 before the mine disaster to the low thirties, its board of directors (the "Board") "issued a press release . . . announcing that it was engaging in a 'formal review of strategic alternatives.' " Following a sales process involving several strategic bidders, the Board accepted a mixed cash and stock offer totaling $7 billion from Alpha Natural Resources, Inc. ("Alpha"). This price represented "$69.33 per share based on Alpha's January 26, 2011 closing stock price, a . . . 95% premium to Massey's last closing price before the October 19, 2010 Wall Street Journal article reporting that Massey was exploring strategic transactions." Following stockholder approval, the transaction, structured as a merger of Massey with an Alpha subsidiary (the "Merger"), closed on June 1, 2011.

In light of the Alpha buyout, plaintiffs in the Stockholder Actions amended their complaint to allege both direct and derivative claims that, among other things,

> The . . . Defendants consciously breached their fiduciary duties by causing Massey to employ a deliberate and systematic business plan of willfully disregarding both internal and external safety regulations . . . . [and] [a]s a direct and proximate result of the . . . Defendants' breaches of fiduciary duty, Massey entered into the merger agreement with Alpha at an inadequate, fire sale price for Massey shares.

The Stockholder Actions were stayed for five years due to ongoing criminal proceedings against Massey and the subsequent bankruptcy of Alpha. Once the Stockholder Actions resumed, the defendants moved to dismiss, arguing (among other defenses) that, under *Corwin*, any fiduciary breaches they may have committed were "cleansed" via the Massey stockholder vote approving the Merger.

II. CHANCELLOR BOUCHARD'S ANALYSIS

Chancellor Bouchard granted the Massey defendants' motion to dismiss both the derivative and direct claims underlying the

Stockholder Actions, but notably for purposes of this article, *not in reliance on Corwin*:

- *Derivative Claims*. The Chancellor dismissed the derivative claims on the basis of "well-settled Delaware law for over three decades that stockholders of Delaware corporations . . . will lose standing when their status as stockholders of the company is terminated as a result of a merger." In this connection, the Chancellor deemed neither of the two exceptions to this principle—"if the merger itself is the subject of a claim of fraud, being perpetrated merely to deprive stockholders of the standing to bring a derivative action; or . . . if the merger is in reality merely a reorganization which does not affect plaintiff's ownership in the business enterprise"—to be applicable to the Merger. The Board had a legitimate business purpose to pursue the Merger, and the Chancellor recognized nothing in the record to "support the notion that the Massey Board's pre-Merger conduct necessitated the Merger with Alpha."
- *Direct Claims*. The Chancellor dismissed the direct claims on the basis that they were, in reality, derivative claims related to "very serious allegations of mismanagement" in the pre-Merger period. According to the Chancellor, "these allegations cannot be alchemized into a direct claim because . . . the duty implicated—to manage the affairs of Massey—was owed to the Company and not any stockholder separately."

Although he sided with defendants in dismissing the Stockholder Actions on other grounds, "for the sake of completeness," Chancellor Bouchard addressed "defendants' reliance on *Corwin* as a separate ground for dismissal." To put it bluntly, the Chancellor found this defense "mystifying." He recognized plaintiffs did not "challenge the economic merits of the Merger itself" or that "the Massey directors played favorites with any bidder, erected improper defensive measures, or otherwise failed to maximize value for the Company's stockholders." Instead, they challenged conduct allegedly causing harm to Massey "well *before* the Merger and the sale process that led to the Merger."

In response, the Chancellor noted "[t]he policy underlying *Corwin*, to my mind, was never intended to serve as a massive eraser, exonerating corporate fiduciaries for any and all of their actions or inactions preceding their decision to undertake a transaction for which stockholder approval is obtained." The analysis may have been different had the Massey stockholders been asked "in any direct or straightforward way to approve releasing defendants from any liability they may have to the Company for the years of alleged mismanagement

that preceded the sale process." But this was not the case; the stockholders simply voted on the consideration offered to them in the Merger. Hence, the Chancellor concluded that "defendants' *Corwin* argument is flawed and does not provide a separate basis for dismissal of plaintiffs' claims."

CONCLUSION

Chancellor Bouchard utilized his dismissal of plaintiffs' claims in *Massey* to demonstrate an additional limitation on the "cleansing" effect of *Corwin*. While the defense is a potent one, defendants must establish "a far more proximate relationship than exists here" between "the nature of the claims to be 'cleansed' " and the matter on which stockholders are asked to vote. For those commentators who fear *Corwin* has provided defendants with an undue advantage, *Massey*'s admonition that *Corwin* is not a "massive eraser" available to cleanse all fiduciary wrongdoing—along with the other decisions discussed above defining *Corwin*'s boundaries—should offer a reasonable degree of comfort.