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Expert Analysis

The Dramatic Transformation Of M&A Law Since 2014

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After three decades of evolution of an analytical framework for judicial review of board decisions relating to merger and acquisition transactions, the Delaware courts have, in just the last few years, radically transformed M&A law.

While the foundational principle of Delaware corporate law has always been deference to the business judgment of independent boards of directors (reflected in the "business judgment rule"), the courts had applied a "heightened scrutiny," and even an "entire fairness," standard in the more difficult settings of M&A transactions. Those standards had, since the advent of "modern" M&A in the 1980s, set the stage for directors' conduct when faced with a takeover bid or the negotiation and execution of a sale of the company. Now there has been a dramatic change of course—in the words of Vice Chancellor Slights, as reported in *The M&A Lawyer*, "a narrowing of the more exacting standards of review toward business judgment deference" in M&A matters in almost every scenario.

The following critical developments reflect the new framework:

- *MFW*—pursuant to which the court will now review post-closing challenges to transactions involving a conflicted controlling stockholder under the deferential business judgment rule rather than the traditionally applicable "entire fairness" test, so long as certain procedural requirements are met. *Kahn v. M&F Worldwide*, 88 A.3d 635 (Del. 2014);
- *Corwin*—under which post-closing actions for damages challenging a transaction are now reviewed under the business judgment rule (regardless of the standard that applied *pre*-closing) so long as the transaction was approved by the stockholders in a "fully-informed" and "uncoerced" vote. *In re KKR Financial Hldgs. S'holder Litig.*, 101 A.3d 980 (Del. Ch. 2014), aff'd sub

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nom. *Corwin v. KKR Financial Hldgs.*, 125 A.3d 304 (Del. 2015);

• *C&J Energy*—which reflects the erosion of the concept of "heightened scrutiny," and sets a lower bar, for sale of the company transactions subject to the *Revlon* duty to seek to obtain the best price reasonably available. *C&J Energy Services v. City of Miami General Employees' & Sanitation Employees' Retirement Trust*, 107 A.3d 1049 (Del. 2014);

• *Cornerstone*—pursuant to which, even when the transaction at issue is subject to an entire fairness standard of review, claims against disinterested directors who are not alleged to have violated any non-exculpated duties (e.g., the duties of loyalty and good faith) are dismissible at the early pleading stage of litigation. *In re Cornerstone Therapeutics Stockholder Litig.*, 115 A.3d 1173 (Del. 2015);

• Numerous decisions reflecting a higher bar than in the past to establishing controller status, the non-independence of directors, and the materiality of disclosure; and

• Although this is not a change, consistent affirmation of the remote nature of any possibility of personal liability for independent, disinterested directors due to the almost universal inclusion of exculpation provisions in company charters (which, as permitted by the Delaware statute, preclude liability for duty of care violations) and the courts' ongoing strict interpretation of the duty of loyalty in the context of M&A transactions.

In the same timeframe, the Delaware courts have altered the litigation process itself, culminating with the Court of Chancery's January 2016 *Trulia* decision (*In re Trulia Stockholder Litigation*, C.A. No. 10020-CB (Del. Ch. Jan. 22, 2016), Slip. Op.). Under *Trulia,* significantly greater judicial scrutiny has been applied to traditional disclosure-only settlements of *pre-closing* M&A litigation. Thus, the courts will approve disclosure-only settlements only if the supplemental disclosures are "plainly material" and the proposed release "is narrowly circumscribed to encompass nothing more than the disclosure claims and fiduciary duty claims concerning the sale process" that have been investigated by the plaintiffs. In the past, disclosure-only settlements, with *minimal* supplemental disclosure and *very broad* (so-called "intergalactic") releases previously had provided an easy route to quick settlement of M&A litigation—and their demise, particularly combined with the lowering of standards for director liability after *Corwin*, and the continued narrow gloss on the reach of the duty of loyalty, has discouraged the filing of M&A lawsuits in Delaware.

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The other critical aspects of the changing M&A litigation landscape include:

• Resistance by the courts to issuing "targeted" preliminary injunctions that enjoin the specific features of transaction agreements that are viewed as problematic—with a perspective, instead, that a preliminary injunction should address the transaction as a whole and either the entire transaction should be enjoined or no injunction should issue;

• Resistance by the courts to enjoining transactions based on pre-closing actions brought by stockholders in a context in which the possibility of an alternative transaction was theoretical only (e.g., there was no actual alternative bid available to the stockholders);

• More restrictive judicial standards for the award of legal fees in connection with bringing putative class action M&A lawsuits;

• Statutory changes permitting corporations to adopt forum selection bylaws requiring that M&A litigation be brought only in Delaware, as well as the adoption of these bylaws by many Delaware corporations; and

• The procedural consequences that have accompanied the changes in the substantive law, which have resulted in a much greater likelihood of successful motions to dismiss and limitations on or the elimination of discovery.

Vice Chancellor J. Travis Laster has commented that one predominant influence precipitating the transformation in the law has been the rise of sophisticated institutional investors who have the ability to influence the direction of the corporations in which they invest and to determine the outcome of M&A events. "When stockholders cannot protect themselves, litigation becomes the principal check on fiduciary behavior. But when stockholders can protect themselves, they do not need judges," he wrote in an article called "Changing Attitudes." He also noted the court's recognition of the increasing sophistication of directors and an understanding that their conduct is motivated not only by the law's commands but by a desire to avoid stains on their reputations. We observe that these developments also have been accompanied by an increasing sophistication of advisors (legal counsel and investment bankers) in the M&A sphere. In this context, an embrace of business judgment as the primary regulator of director conduct is possible, rather than any necessity for heightened scrutiny.

Another factor often cited as motivating the courts' new direction is that litigation challenging M&A deals had become almost universal, which many have viewed as reflecting an essential failure in the system. Importantly, Vice Chancellor Laster commented in "Changing Attitudes" that it was not simply the prevalence of litigation but its failure to generate meaningful benefits for investors that led to a re-thinking on the magnitude that has been seen. In any event, the courts appear to have been guided by a view, as articulated by the Vice Chancellor, that "voting by sophisticated stockholders ha[s] emerged as an alternative, market-based means of protecting against fiduciary overreaching"; and that, "when a market-driven protection is available and the litigant-driven mechanism has failed, it makes sense to favor the former over the latter." Moreover, the courts appear to have been motivated by a desire to avoid an environment in which litigation accompanies every transaction, joined by a belief that motions to dismiss should be more readily granted so that bidders, targets and their directors are not be burdened with the costs and inconveniences of a motion for summary judgment or a trial.

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One question is whether another objective of these profound changes may be conceptual simplification—possibly, an effort to move toward clearer guidelines and black-line rules and away from the more difficult and intrusive burden of an evaluation of the "facts and circumstances" presented in each case.

To be sure, notwithstanding the new paradigm, there remain compelling reasons for faithful adherence by directors to a proper standard of conduct. First, liability issues aside, directors generally want to fulfill their duties to stockholders and to maintain their personal reputations for professionalism and integrity. Second, in a pre-closing action in which stockholders seek to enjoin a proposed transaction, claims of breach of fiduciary duties retain their potency in providing a foundation for judicial injunction of a transaction. Finally, Delaware law has been context-driven and the facts have been critical. Some of the emphasis on facts and circumstances no doubt has diminished as the court has moved conceptually to more black-line approaches (as evident in the *MFW* and *Corwin* decisions). But even in these cases the facts were critical—Did the board and special committee operate effectively? Was the proxy statement an accurate and fair description of the events and developments described? Whatever the issue that may arise in litigation, as a practical matter, albeit within a broad range, the judicial result is likely to be strongly influenced by the "atmospherics" resulting from the general approach and overall course of conduct in which the directors have engaged.