FRIED FRANK
M&A/Private Equity BRIEFING™

March 8, 2021

Corporate Officers Face Personal Liability for Steering Sale of the Company to a Favored Buyer Based on Their Self-Interest (and the Buyer Faces Aiding and Abetting Liability)– Columbia Pipeline

In *In re Columbia Pipeline Group, Inc. Merger Litigation* (Mar. 1, 2021), the Delaware Court of Chancery held that the CEO-Chairman and the CFO ("Skaggs" and "Smith," respectively; together, the "Officers") of Columbia Pipeline Group, Inc. (the "Company") may have breached their fiduciary duties in connection with the $13 billion merger in 2016 of the Company with TransCanada Corporation (the "Merger").

Vice Chancellor Laster found it reasonably conceivable, at the pleading stage of litigation, that the Officers had tilted the sale process to favor TransCanada, and that they were motivated by their plans to retire and their desire to receive their change-in control benefits that would be triggered on the Company's sale. The court held that *Corwin* "cleansing" of the breaches was not available because the disclosure to stockholders relating to the Merger was inadequate. In addition, the court held that TransCanada may have aiding and abetting liability as it was reasonably conceivable that it knew that the Officers were violating their fiduciary duties in connection with the sale process and it "exploited the resulting opportunity."

Key Points

- **The decision highlights the court's recent focus on the "fraud on the board" theory of liability.** Under this theory, in connection with a company sale process, a plaintiff can plead a claim against a corporate officer, director or advisor by showing that he or she withheld material information from the directors that would have affected their decision-making or took action that materially and adversely affected the sale process without informing the board. (We note that Vice Chancellor Laster emphasized this theory of liability in the recent *Presidio* decision as well.)

- **While corporate officers and directors have wide discretion in crafting and implementing a sale process, the court consistently has been especially critical of certain particular flaws in a sale process.** These include a corporate officer, director or advisor: providing a "tip" to a bidder that has the effect of reducing competition or giving an unfair advantage to the bidder, without a corporate purpose for doing so; failing to follow the board's specific directions with respect to the process; and/or withholding from the board material information relating to the sale process–all of which the Officers allegedly did in this case.

Copyright © 2021 Fried, Frank, Harris, Shriver & Jacobson LLP
A Delaware Limited Liability Partnership

- **The decision is notable in that the court found it reasonably conceivable that the Officers favored TransCanada based on their self-interest in obtaining their change-in-control benefits–even though they would have obtained those benefits in *any* sale of the Company.** Presumably (although the court did not address this), the key economic interest the Officers had in a sale was through their change-in-control benefits rather than their shareholdings. Thus, their primary personal objective would be that a deal occur, which would take precedence over maximizing the sale price. The court seemed to suggest that, once TransCanada emerged as a serious bidder, the Officers sought to advantage TransCananda in an effort to ensure that a deal would be done (rather than potentially jeopardizing the deal by engaging with other interested parties and seeking to maximize the sale price). The facts alleged by the plaintiffs did not address this, or any other, rationale for the Officers' favoring TransCanada over other bidders. It appears that the court viewed the Officers as potentially having had a *self-interested* purpose in favoring TransCanada given *their conduct* that reflected "extreme" favoritism toward TransCanada without any apparent corporate purpose.

- **A buyer should be aware that it potentially could have aiding and abetting liability for fiduciary breaches by target officers (or directors) in crafting a sale process to favor it.** Generally, there is a very high bar to a plaintiff's success in pleading an aiding and abetting claim against a buyer (given the required elements of "knowing participation" and "scienter"). In this case, however, the court found it reasonably conceivable that TransCanada knew that the Officers were breaching their fiduciary duties given the Officers' blatant favoritism. Also, the court emphasized TransCanada's having taken advantage of the situation by lowering its bid at the last minute (although the Company's business was on the upswing), imposing a short deadline for the Company's response, and threatening to publicly announce that merger discussions had terminated.

- **Of note, the same fiduciary and disclosure claims made by the plaintiffs had been rejected in three previous suits.** The merger had been challenged, unsuccessfully, in an earlier fiduciary suit, an appraisal action, and a federal securities law disclosure suit. Critically, in this case, the plaintiffs had bolstered their fiduciary claims with extensive discovery that had been provided in the earlier appraisal action. Also, the court explained, the issues and standards applicable in the appraisal and federal securities law contexts were different than those applicable in this fiduciary suit.

Background. In 2016, TransCanada acquired the Company in the Merger for $25.50 per share in cash. In 2014, Skaggs and Smith had selected 2016 as the target year for their retirement and they had been actively preparing for retirement. Both had lucrative change-in-control arrangements that were triggered if their employment ended after a sale of the Company. In 2015, they planned a spinoff of the Company from its then-parent corporation (a public utility company), allegedly to facilitate a post-spinoff sale of the Company that would qualify as a "sale" that would trigger their change-in-control benefits. While the Company planned for the spinoff, it engaged an investment banker to consider strategic alternatives, and the banker had identified a list of potential acquirors. The banker contacted just one of them, TransCanada, to let it know that the Company likely would be for sale after the spinoff In July 2015, within days after the spinoff, potential bidders started contacting the Company to express their interest in acquiring it. The Officers rebuffed one expression of interest, by Spectra, allegedly because they thought it would involve primarily a stock deal (and they wanted cash for their shares). The Officers informed the board of another expression of interest, by Dominion, at $32.50 to $35.50, which the board rejected as too low in light of significant growth projects the Company would soon be embarking on. In early October

2015, TransCanada's Vice President of Corporate Development ("Pokier") called Smith (who was his friend) to express interest in a transaction.

In October 2015, in light of liquidity needs, the board, at Skaggs' urging, decided that it would move forward with an equity offering unless a potential buyer offered to pay at least $28 per share. Told of the board's decision, Dominion proposed a complicated transaction involving a combination of cash and stock and a co-bidder.

In early November 2015, the Company entered into nondisclosure agreements (NDAs) with a number of parties. Each included a "don't-ask-don't-waive" (DADW) standstill agreement (prohibiting the party from making a bid unless requested by the Company). The Officers then invited TransCanada and Berkshire (both of which were expected to propose cash bids) to submit bids by November 24. The Officers did not inform the other potential bidders about the bid deadline. TransCanada expressed interest at $25 to $26 per share, and Berkshire at $23 per share. Skaggs told the board that the Company had not heard from the other potential bidders–but did not tell the board that the other potential bidders had not been told about the bid deadline. The board decided that the two bids submitted were too low, and it directed the Officers to terminate merger talks and proceed instead with the equity offering. Skaggs told TransCanada that the Company probably would want to resume talks with it in a few months. In early December 2015, the Company completed the equity offering, which was oversubscribed, at $17.50 per share.

In mid-December 2015, in violation of TransCanada's standstill, Poirier reiterated TransCanada's interest in acquiring the Company. The Officers scheduled a meeting with Poirier for January 7, 2016 (the "January 7 Meeting") and, without informing the board, invited Poirier to make an offer for the Company. Smith sent extensive, confidential due diligence materials to TransCanada–without authorization from the board or providing the information to any of the other potential bidders. At the January 7 Meeting, Smith told Poirier how TransCanada could convince the Company's board to agree to a deal with TransCanada without putting the Company in play, thereby avoiding a competitive auction. He also told Poirier, in substance, that the TransCanada would not face any competition in the process as the Company had "eliminated" the competition. On January 25, 2016, TransCanada expressed interest in a transaction in the range of $25 to $28 per share. Skaggs urged the board to do a deal with TransCanada. The board directed the Officers to grant TransCanada exclusivity. On March 4, the board instructed the Officers to demand a formal proposal from TransCanada and to waive the standstills in the NDAs with the other potential bidders. The Officers did not waive the standstills for over a week.

On March 9, TransCanada made an offer at $26 per share (90% cash and 10% stock). On March 11, Spectra emailed Skaggs to start merger talks and was rebuffed. The Officers formally extended the exclusivity agreement with TransCanada, which had expired. Further, Smith agreed to TransCanada's request for a "moral commitment" that the Company would not engage with any other party unless that party had submitted a fully-financed proposal that was subject to no conditions other than confirmatory due diligence *(i.e.*, an "inversion of the process" such that a fully-financed proposal would have to precede due diligence). On March 14, although the Company's business had been rebounding and the Company was outperforming its projections, TransCanada lowered its bid from $26 to $25.50. Although that action terminated TransCanada's exclusivity under the agreement, TransCanada placed a three-day deadline on its offer and threatened that if the Company did not accept the offer within that timeframe, TransCanada would publicly announce the termination of merger negotiations with the Company.

On March 16, 2016, the board approved the Merger at the lowered price. The merger agreement included a no-shop, unlimited matching rights for TransCanada, and a customary termination fee and expense

reimbursement provision (that if paid would represent up to $0.87 per share). In June 2016, the stockholders approved the Merger (with 77.5% of the outstanding shares voting, and over 95% of them voting in favor). Soon after the Merger closed, the Officers retired. Skaggs received almost $27 million in change-in-control benefits (about $18 million more than he would have received without a sale of the Company). Smith received almost $11 million in benefits (about $7.5 million more than he would have received without a sale of the Company).

Discussion

The court found that the alleged facts supported a reasonable inference that the Officers breached their fiduciary duties in connection with the sale process. The court cited the following actions that the Officers took, without informing the board or obtaining its authorization:

- Repeatedly allowing TransCanada to breach its standstill agreement;
- Prior to the January 7 Meeting, inviting TransCanada to make a bid for the Company;
- In anticipation of the January 7 Meeting, providing TransCanada with extensive confidential due diligence information not provided to any other interested party;
- At the January 7 Meeting, "tipping" TransCanada about the status of the sale process–explaining how TransCanada could convince the board to agree to a deal with it without a competitive auction- and stressing to TransCanada that it would not face competition in the process;
- Delaying for a week releasing the other interested parties from their standstills (notwithstanding the board's repeated instructions to release them);
- Urging the board to grant TransCanada exclusivity; treating TransCanada exclusively even after its exclusivity right terminated; and, after receiving an expression of interest from Spectra that was subject to due diligence, formally renewing the exclusivity agreement with, and providing a "moral commitment" to, TransCanada that the Company would not engage with any other party unless it made a fully financed, binding offer subject only to *confirmatory* due diligence (which "established a standard that no party could meet" and, "effectively shut out Spectra"); and
- Misleading the board–into thinking that no other interested parties had submitted bids due to a lack of interest when in reality these parties were still subject to DADW standstills; by downplaying the extent of Spectra's interest; and by mis-describing the analyses and advice of the Company's financial advisor with respect to TransCanada's offer.

The court found it reasonably conceivable that these actions by the Officers "undercut the Company's leverage with TransCanada and prevented a competing bid from emerging." The court emphasized that, due to the "bad situation" that the Officers had created, during the final stages of the negotiations, TransCanada was able to lower its bid (below the range it had offered to obtain exclusivity) and to threaten to publicly walk from the deal unless the Company quickly accepted the lowered bid. This effectively left the Company's board with no practical alternative to approving the Merger (as such an announcement "could...turn[ ] Columbia into damaged goods and hurt[ ] the Board's ability to secure an alternative transaction"). As a result, the court concluded, the Company was only able to obtain a price of $25.50 per share, rather than the greater consideration that loyal fiduciaries could have obtained."

The defendants argued that the court's finding in the earlier appraisal case–i.e., that the sale process was sufficient to support a determination that appraised fair value was equal to the deal price–validated the sufficiency of the sale process. The court disagreed, emphasizing that the appraisal case findings relating to the sale process validated the sufficiency of the process for determining whether the deal price reflected *at least the standalone value of the Company.* By contrast, in this fiduciary case, the issue was whether the sale process was sufficient to support a determination that the deal price was *the best price reasonably available on a sale of the Company.*

The court amplified its focus on the "fraud on the board" theory of liability. The court expressly rejected the defendants' argument that the plaintiff could not validly state a fiduciary claim unless it could plead a non-exculpated claim against a majority of the board. "This misunderstands Delaware law," the Vice Chancellor wrote. Rather, he wrote: "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." The court cited a litany of precedents in which the court has advanced this theory with respect to claims made against corporate officers, directors, controlling stockholders, and financial advisors.

The "fraud on the board" concept was emphasized by Vice Chancellor Laster also in his recent post-trial opinion in *Presidio* (Feb. 2021). *Presidio* also involved claims that the target company's CEO (and, in that case, also the target's directors, controlling stockholder, and financial advisor) had favored a sale to a particular bidder rather than engaging in a more drawn-out competitive sales process that could have led to a bidding war and a higher price. The Presidio CEO's motivation, the court found in that case, was to secure the lucrative post-closing employment that the bidder had offered him. The court found that the financial advisor also was self-interested (although more "subtly" so) by its ongoing, lucrative relationships with both this bidder and the target's controlling stockholder. In *dicta*, in a footnote in the *Presidio* opinion, Vice Chancellor Laster commented that the allegations against the financial advisor, in addition to supporting an aiding and abetting claim against it for secondary liability, "also would support a claim for primary liability under a theory of fraud on the board." (Of note, in both *Presidio* and *Columbia*, the Vice Chancellor cited as support a recent article which discusses the circumstances under which claims against financial advisors should be permitted to proceed even in the absence of an underlying claim of fiduciary breach.)

The court found it reasonably conceivable that TransCanada aided and abetted the Officers' breach of fiduciary duties. The court characterized the aiding and abetting claim against TransCanada as "weaker" than the fiduciary claims against the Officers, and acknowledged that a claim against an acquirer for aiding and abetting is among the most difficult of claims to plead and prove. However, the court concluded that, at the pleading stage, it was "reasonable to infer that TransCanada knew that [the Officers] acted wrongfully and exploited their conflicts," and "sought to take advantage of the situation it had worked with [the Officers] to create," which enabled it "to acquire the Company more cheaply than it otherwise could have." These inferences were sufficient at the pleading stage to support an inference of "knowing participation."

The court noted specifically TransCanada's "repeated violations of its standstill agreement...with impunity...while [k]nowing that [the Officers] were eager for a deal so they could retire"; and its receiving "tips" about the sale process from Smith during the January 7 Meeting, which was confidential information "that a loyal fiduciary would not have provided." Taken together, these allegations suggested "that TransCanada knew that Skaggs and Smith were compromised." Particularly "evidencing [TransCanada's]

understanding of [the] situation," the court wrote, was that TransCanada "took advantage of [the Officers'] compromised position" by extracting the "moral commitment," and then, again, by "lowering its offer..., combined with a three-day deadline and a threat to publicly announce the breaking off of talks if the Company did not accept."

The court applied *Revlon* enhanced scrutiny as the standard of review. The court noted that, for a transaction to meet the Revlon standard, a board must have sought to obtain the best price reasonably available and the sale process must have been "reasonable." The court emphasized that the *Revlon* doctrine "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 court cited precedent supporting that not only directors but also "other corporate actors can take action that implicates enhanced scrutiny"—including, for example, a controlling stockholder, a special committee chair, or a company's financial advisor. Vice Chancellor Laster reiterated the court's previous framing of the "paradigmatic context for a good *Revlon* claim"–that is, "a supine board under the sway of an overweening CEO bent on a certain direction tilts the sale process for reasons inimical to the stockholders' desire for the best price." The Vice Chancellor also noted Vice Chancellor McCormick's recent "reframing" of this principle, in her *Mindbody* decision (Oct. 2020), to state, "more broadly," that "the paradigmatic *Revlon* claim involves a conflicted fiduciary who is insufficiently checked by the board and who tilts the sale process toward his own personal interests in ways inconsistent with maximizing stockholder value." The court concluded that, based on the alleged facts (as well as evidence from the earlier appraisal action relating to the Merger), there was a reasonable inference that the "situational pressures" that "animate enhanced scrutiny" came into play at least as early as the January 7 Meeting—or even possibly earlier, the court commented, given that "immediately after the spinoff, the Company began engaging with potential bidders and exploring alternatives in a context where enhanced scrutiny would apply."

The court held that *Corwin* "cleansing" of the alleged fiduciary breaches was not available due to disclosure violations that rendered the stockholder approval of the merger not "fully informed." In the earlier fiduciary suit that had challenged the Merger, the Court of Chancery ruled that the disclosure to stockholders relating to the Merger was adequate—and that case was dismissed under *Corwin.* However, Vice Chancellor Laster noted that the plaintiffs in that case had not alleged that the proxy statement failed to disclose material facts "regarding the sequence of events" leading up to the Merger; rather, they had simply "contended that the defendants were obligated to disclose that they had acted for selfish and self-interested reasons." The court had explained in that case that Delaware law "requires only that fiduciaries disclose facts; it does not demand that fiduciaries engage in self-flagellation." In the other earlier suit, brought before a federal court on disclosure claims, the federal court had dismissed the claims. Vice Chancellor Laster noted that the pleading standard for those claims in federal court *(i.e.*, "plausibility") was different from the pleading standard in this fiduciary suit under Delaware law *(i.e.*, "reasonable conceivability").

The Vice Chancellor noted that in the appraisal proceeding, however, he had found (with the benefit of extensive discovery) that the proxy statement *did* contain material misstatements and omissions. The Vice Chancellor wrote: "For purposes of *Corwin* cleansing, these findings and the evidence that supported them give rise to a reasonable pleading-stage inference that the stockholder vote on the Merger was not fully informed."

The key disclosure violations were as follows: (i) ***Standstills.*** The proxy disclosed that there were other bidders and that they did not engage with the Company after submitting their bids, but did not disclose

that they were bound by DADW standstill agreements, nor that TransCanada also had been subject to (but, with the officers' acquiescence, had breached) its DADW standstill. (ii) ***Retirement plans.*** The proxy statement did not disclose that the Officers wanted, and had plans, to retire in 2016. The court cited case law supporting the materiality of "information that sheds light on the financial incentives and motivations of key members of management who are involved in negotiating the deal." In particular, "a CEO's interest in securing his retirement nest egg" may be a material fact "when that motivation could rationally lead that negotiator to a deal at a less than optimal price, because the procession of a deal was more important to him, given his overall economic interest, than only doing a deal at the right price." (iii) ***Tips.*** The proxy statement did not disclose that Smith "invited a bid [from TransCanada prior to the January 7 Meeting] and told Pokier that TransCanada did not face competition" in the sale process. (The court characterized (iii) above as the "most glaring" of the disclosure violations).

Practice Points

- **A board may favor a particular bidder in a sale process if it in good faith and advisedly believes that doing so would further the shareholders' interests.** A board that makes decisions in a sale process that favor a particular bidder should carefully consider those decisions, articulate the ways in which the board believes that making those decisions will advantage the shareholders' interests, and document the board's reasoning therefor. If a director, lead negotiator, key manager, or financial advisor has a personal interest that may conflict with the shareholders' interest in maximizing the sale price for the company, the conflict should be disclosed to, and addressed by, the board, and ultimately disclosed to the stockholders in the proxy statement. We note that, in *Columbia*, the court emphasized that "[t]he favoritism TransCanada received was persistent and substantial."

- **A buyer that is favored in a sale process should be sensitive to the possibility of aiding and abetting liability if the favoritism is later held to have resulted from fiduciary breaches by the target's directors, officers or a controlling stockholder.** As noted, there is a high standard for a plaintiff's success on an aiding and abetting claim. In addition, a buyer, of course, does not have the responsibility of overseeing a sale process or monitoring the fiduciary duties of others in terms of the treatment it receives in the process. However, a buyer should carefully consider how to respond if it receives "tips"; is treated with material favoritism vis a vis other bidders; or knows of other actions that on their face appear to entail fiduciary breaches, or other misconduct in connection with the sale process, by the target's directors or officers, a controlling stockholder, or the advisors.

- **A target board should carefully oversee a sale process.** In this case, claims were made against the corporate officers who were the lead negotiators, and not against the target directors. Indeed, the theory of the case was that the officers had committed a "fraud on the board" (suggesting that the directors were not to blame). We would emphasize that a board should be proactive in monitoring the actions taken by officers or others tasked with implementing a sale process. In particular, a board should seek to ensure that it is aware of, and appropriately addresses, any conflicts of interest that the lead negotiators, key managers, financial advisors, a controlling stockholder, or others significantly involved in the sale process, may have with respect to a sale of the company. A board should also be proactive in seeking to ensure and that it has accurate and sufficient information from management, the financial advisors or others with respect to the process generally and the actions that they have taken. A board should consider instructing senior management that they should not communicate with any interested bidders without authorization of the board, informing the board, and/or involving the board, as the case may be.

- **It bears repeated emphasis that if the disclosure to stockholders is adequate, any fiduciary breaches are "cleansed" under *Corwin.*** If not for the disclosure violations, notwithstanding the Officers' fiduciary breaches, the case would have been dismissed at the pleading stage under *Corwin.* Thus, typically, it will make sense to err on the side of more disclosure rather than less *(particularly* on more sensitive issues, as to which the inclination is often *not* to make fulsome disclosure).

* * *

Fried Frank M&A/PE Group:

Amber Banks (Meek)	Erica Jaffe	David L. Shaw
Bret T. Chrisope	Randi Lally	Peter L. Simmons
Andrew J. Colosimo	Mark H. Lucas	Matthew V. Soran
Warren S. de Wied	Scott B. Luftglass	Steven J. Steinman
Steven Epstein	Brian T. Mangino	Roy Tannenbaum
Christopher Ewan	Shant P. Manoukian	Gail Weinstein*
Arthur Fleischer, Jr.*	Philip Richter	Maxwell Yim
Andrea Gede-Lange	Steven G. Scheinfeld	
David J. Greenwald	Robert C. Schwenkel	

This Briefing is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this Briefing, please call your regular Fried Frank contact or an attorney listed below:

Contacts:

New York

Amber Banks (Meek)	+1.212.859.8522	amber.banks@friedfrank.com
Andrew J. Colosimo	+1.212.859.8868	andrew.colosimo@friedfrank.com
Warren S. de Wied	+1.212.859.8296	warren.dewied@friedfrank.com
Steven Epstein	+1.212.859.8964	steven.epstein@friedfrank.com
Christopher Ewan	+1.212.859.8875	christopher.ewan@friedfrank.com
Arthur Fleischer, Jr.*	+1.212.859.8120	arthur.fleischer@friedfrank.com
David J. Greenwald	+1.212.859.8209	david.greenwald@friedfrank.com
Erica Jaffe	+1.212.859.8442	erica.jaffe@friedfrank.com
Randi Lally	+1.212.859.8570	randi.lally@friedfrank.com
Mark H. Lucas	+1.212.859.8268	mark.lucas@friedfrank.com
Scott B. Luftglass	+1.212.859.8968	scott.luftglass@friedfrank.com
Shant P. Manoukian	+1.212.859.8617	shant.manoukian@friedfrank.com
Philip Richter	+1.212.859.8763	philip.richter@friedfrank.com
Steven G. Scheinfeld	+1.212.859.8475	steven.scheinfeld@friedfrank.com
Robert C. Schwenkel	+1.212.859.8167	robert.schwenkel@friedfrank.com
David L. Shaw	+1.212.859.8803	david.shaw@friedfrank.com
Peter L. Simmons	+1.212.859.8455	peter.simmons@friedfrank.com
Matthew V. Soran	+1.212.859.8462	matthew.soran@friedfrank.com
Steven J. Steinman	+1.212.859.8092	steven.steinman@friedfrank.com
Roy Tannenbaum	+1.212.859.8169	roy.tannenbaum@friedfrank.com
Gail Weinstein*	+1.212.859.8031	gail.weinstein@friedfrank.com
Maxwell Yim	+1.212.859.8214	maxwell.yim@friedfrank.com

Washington, D.C.

Bret T. Chrisope	+1.202.639.7445	bret.chrisope@friedfrank.com
Andrea Gede-Lange	+1.212.859.8862	andrea.gede-lange@friedfrank.com
Brian T. Mangino	+1.202.639.7258	brian.mangino@friedfrank.com

*Senior Counsel