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Court of Chancery Notes Uncertainty Whether Unocal *Heightened Scrutiny Applies in* Corwin *Stockholder-Approved Transactions–* Paramount Gold & Silver

In *Paramount Gold and Silver Stockholders Litigation* (April 13, 2017), the shareholder-plaintiffs claimed that the directors of Paramount Gold and Silver Corporation had breached their fiduciary duties by agreeing to an unreasonable "deal protection device" in connection with the merger pursuant to which Paramount was being acquired by Coeur Mining, Inc. Specifically, the plaintiffs contended that a royalty payment to be paid by Coeur was effectively a "second termination fee" that, when combined with the termination fee included in the merger agreement, was an unreasonably high fee that could deter a potential topping bid. The plaintiffs also argued that the Paramount directors had breached their fiduciary duties by "rushing" the sale process and not negotiating for a pre-signing auction of the company or a post-signing go-shop, and had acted in bad faith in agreeing to the unreasonable deal protection provisions and in providing stockholders with inadequate disclosure.

The Delaware Court of Chancery found that the royalty fee was not a second termination fee and that the merger agreement termination fee, standing alone, as conceded by the plaintiffs, was reasonable under the *Unocal* heightened scrutiny standard of review. The court also found that the stockholder vote was fully informed and uncoerced and that, therefore, under *Corwin*, business judgment review applied to the remaining claims, which resulted in dismissal of the case. The court noted that, even if *Corwin* had been inapplicable, business judgment review would have applied and the complaint would have been dismissed (under *Cornerstone*) because no *un*exculpated claims (i.e., claims of duty of loyalty breaches or bad faith) had been validly pled.

Key Points

- **Consistent with the court's other decisions indicating the general applicability of business judgment review.** The decision is consistent with the long line of cases over the past couple of years in which the Delaware courts have tended to apply business judgment review to post-closing actions relating to non-controller transactions. The court noted that, even if *Corwin* had *not* been applicable to the plaintiff's sale process claims, business judgment review would have applied and the complaint would have been dismissed (under *Cornerstone*) because court had rejected the plaintiffs' claims for which the directors would not have been exculpated (*i.e.*, claims for duty of loyalty violations or bad faith). The decision highlights that, even when *Corwin* is not applicable (in the rare case that the court may find that the stockholder vote was not fully informed or was coerced), most often, business judgment review will be available under

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Cornerstone given the very high bar for plaintiffs to successfully make duty of loyalty or bad faith claims against directors.

- **Open issue as to whether *Corwin* would "cleanse" an unreasonable deal protection device.** The Chancellor noted (but, because he found that the termination fee satisfied the *Unocal* standard, he did not rule on) an open issue as to whether *Unocal* would continue to apply to a review of defensive actions notwithstanding fully informed and uncoerced approval of a transaction—in other words, whether *Corwin* would "cleanse" a defensive action that otherwise might be found to be unreasonable under a *Unocal* review.

Background. Paramount had mining assets in Nevada (the "Nevada Project") and Mexico (the "Mexico Project"). Paramount entered into agreements with Coeur, pursuant to which (i) the Nevada Project assets were spun off into a separate entity ("Spinco"), 95.1% of the shares of which were distributed to Paramount's stockholders, and the remaining interest was held by Coeur after its $10 million investment in Spinco, and (ii) following the spinoff, Coeur acquired Paramount (which then held only the Mexico Project assets) in a stock-for-stock merger (the "Merger"). On the same day that Paramount entered into the merger agreement, it also entered into a royalty agreement pursuant to which Coeur, for $5.25 million, acquired a 0.7% royalty interest in the net returns of the production from the Mexico Project.

An independent special committee of the Paramount board, after receiving a fairness opinion from its independent financial advisor, had approved the spin-off, merger agreement and royalty agreement. The merger was approved by the Paramount stockholders, with 54% of the outstanding shares voted and 97% of the shares voted being in favor of the merger. The merger price represented an implied 20% premium over Paramount's trading price as of its last trading day). The implied value of the transaction was $146 million, without attributing any value to Spinco. The estimated aggregate value of Spinco was $37.5 million. The merger agreement also provided that, if Paramount's stockholders voted against the merger, Paramount would have to pay Coeur a $5 million termination fee if (i) an alternative acquisition proposal was received by Paramount, and (ii) within twelve months after termination of the merger agreement, Paramount consummated an alternative transaction.

Discussion

The court's conclusion that the deal protections were not unreasonable under *Unocal*. Under *Unocal*, for a board to adopt deal protection measures, the board must have reasonable grounds for believing that "a danger to corporate policy and effectiveness" exists and then must demonstrate that the defensive response adopted was "reasonable in relation to the threat" posed. The plaintiffs conceded that the termination fee—which represented 3.42% of the estimated value of the merger excluding Spinco—standing alone was reasonable. The court commented that "this court has routinely upheld termination fees of this magnitude."

In the plaintiff's view, however, the royalty payment served as a "second termination fee"—on the basis that it would require the payment of at least an additional $5.25 million (or approximately 3.6% of the transaction's value) by any superior bidder to "unshackle" the Mexico Project from Coeur. The combined royalty payment and termination fee, totaling $10.25 million, represented 7.02% of the transaction value. "This amount would be problematic," if true, the court stated. However, the court found it "plainly incorrect" that the royalty payment was a second termination fee. The court reasoned that the royalty agreement was not contingent on consummation of the merger, and "[m]ore importantly, plaintiffs have not pled any facts suggesting that a superior bidder had any obligation to buy out Coeur's royalty interest (for $5.25

million or any other price) in order to propose or consummate a transaction with Paramount." The court wrote: "[A] potential bidder could simply acquire Paramount subject to the Royalty Agreement," in which case "the bidder would assume the obligations under that agreement and reap the benefit of the $5.25 million cash infusion." Further, the court noted that the only prohibitions in the royalty agreement on changes of control or asset sales applied to the two specified Paramount subsidiaries that owned the Mexico Project, and not to Paramount itself.

Open issue as to the applicability of *Unocal* when *Corwin* applies. The defendants had argued that the *Unocal* heightened scrutiny standard of review did not apply to the deal protections in this case because the stockholders had approved the transaction in a fully informed, uncoerced vote and *Corwin* business judgment review therefore applied. The plaintiffs had countered that application of *Corwin* to the deal protection issue could not be squared with the 1995 holding in *Santa Fe Pacific Corp. Shareholder Litigation*, where the Delaware Supreme Court held, in the context of a post-closing action for damages, that stockholder approval of the transaction did not constitute ratification of the deal protection measures that had been put into place and were effective *before* the stockholder vote. The Chancellor noted that *Corwin* does not discuss or expressly overrule this "apparent tension" with *Santa Fe.* The Chancellor reasoned that the issue did not have to be addressed in this case because the issue raised by the defendants here was that *Corwin* could not apply because the deal protection device was unreasonable under *Unocal*. Having concluded that that was not so, the court did not have to reach the issue whether Corwin has the potential to, in effect, cleanse a fee that could be found unreasonable under *Unocal.* It is thus uncertain whether a post-closing challenge to deal protection devices under *Unocal* would or would not survive if *Corwin* were applicable.

The court's conclusion that the stockholder vote was fully informed. The court rejected the plaintiffs' claim that *Corwin* did not apply because the stockholder vote was not "fully informed."

- **Analyst price targets.** The proxy/registration statement disclosed that the board had considered available equity analyst research that "generated illustrative values in the range of $52 to $81 million or $0.32 to $0.50 per share of Paramount common stock." The plaintiffs argued that the disclosed price target of $0.32 to $0.50 per share contradicted the financial advisor's fairness presentation to the board which had cited price targets of $0.80 to $2.25 per share based on analysts' research. The court rejected this claim. First, the court found that the materiality of the information was "highly questionable" given that the registration statement explicitly stated that the review of analysts' research was given "less weight" by the banker. Second, the court found that, when read in context, it was apparent that the price targets disclosed in the registration statement referred to the value of the Mexico Project alone, while the higher price targets in lthe fairness presentation referred to Paramount as a whole. That approach, of valuing the Mexico Project alone, made "logical sense given the structure of the transaction," as Paramount's value after spinning off the Nevada Project business "effectively consisted of the [Mexico] Project."

- **Banker fee arrangement.** Paramount's engagement letter with its banker was amended to increase the banker's compensation after the banker requested additional compensation. The request related to the its services rendered to enable Paramount to obtain the proposed $10 million cash infusion to Spinco and the proposed $5.25 million royalty payment, as neither of these had been contemplated at the time the initial engagement letter was entered into. The plaintiffs argued that the registration statement should have disclosed the reasons for the amendment because that information was allegedly relevant to assessing the banker's potential conflicts of interest with respect to the transaction. The court rejected this claim. "Because the

> Registration Statement disclosed the total amount and the contingent share of [the banker]'s compensation in connection with the merger, Paramount's stockholders were made aware of the full magnitude and nature of [the banker]'s financial interest in the transaction…[and how] the Paramount board and [the banker] negotiated to arrive at the fully disclosed final fee arrangement is immaterial in my view," the Chancellor wrote.

The court's conclusion that plaintiffs did not plead a valid bad faith claim. The plaintiffs' claimed that the directors had acted in "bad faith"—for which they would not be exculpated under the customary exculpation provision in the Paramount charter. The court emphasized the high bar to making a valid bad faith claim. The plaintiffs' claim was based on the board's having approved "unreasonable and preclusive" deal protections, failing to disclose material information, and "failing to inform themselves of Paramount's value by running a rushed process with Coeur and failing to conduct an auction or to negotiate a go-shop." The court rejected the bad faith claim, explaining that it had determined that the deal protections were not unreasonable and that the disclosure was adequate. "Even if reasonable minds could differ" with respect to the disclosure claims, the court stated, "the Complaint is devoid of any facts from which one reasonably could infer that Paramount's directors intentionally disregarded their duties or otherwise acted in bad faith with respect to the disclosures in the Registration Statement." With respect to the claim of a rushed process and no pre-signing auction or post-signing go-shop, the court stated: "These allegations fall short of supporting a reasonable inference of bad faith," as, even if the process were flawed, there were no facts pled indicating "a conscious disregard" by the directors for their duties (which would be required even, the court noted, in the context of *Revlon*, which the plaintiffs had not contended was applicable here). The plaintiffs also argued that the banker's fairness opinion was "utterly lacking and far from complete." This contention, the court stated, even if true, would not support a showing of bad faith by the board without "facts creating the reasonable inference that the board purposely relied on analyses that were inaccurate for some improper reason."

The court's conclusion that business judgment review would have applied even if *Corwin* had not. The court noted that, even if Corwin did not apply (*i.e.*, if the court had found that the stockholder vote had not been fully informed and uncoerced), business judgment would have applied and the case would have been dismissed anyway because the plaintiffs had not validly pled any *un*exculpated breaches of fiduciary duty. The Delaware Supreme Court's 2015 *Cornerstone* decision established that a case will be dismissed at the pleading stage if the only validly pled claims are for breaches for which the defendant directors would be exculpated from liability under the company's charter.

Practice Points

- **General applicability of business judgment review.** As now widely discussed and noted, the Delaware courts have set high bars for a plaintiff to be successful in avoiding dismissal at the pleading stage of litigation of claims that a stockholder vote was not fully informed or was coerced or that directors violated the duty of loyalty or acted in bad faith. As a result, it is the rare case in which *Corwin* will be found not to apply—and, even if it does not, it will be the rare case in which *Cornerstone* does not then apply. We note that, while the plaintiffs' disclosure and bad faith claims in *Paramount* appeared to be relatively weak, the court has consistently dismissed cases under *Corwin* or *Cornerstone* in the face of even much stronger claims.

- **Separate valuation of Spinco.** In the context of both the price targets set based on valuation of the target company and the percentage of the deal value represented by the termination fee, the court endorsed the target company banker's approach in valuing the Spinco and the remaining

company separately. The Chancellor wrote: "After spinning off the Nevada business, Paramount's value effectively consisted of the [Mexico] project…. The values of the 'gives' and the 'gets' in the overall transaction depend on the values of the [Mexico] project, [the spun-off company], and Coeur separately, and not the pre-spinoff value of Paramount as a whole."

- **Termination fee claims if *Corwin* cleansing applies.** As discussed, it is an open issue whether, under *Corwin*, stockholder approval of a transaction would "cleanse" an unreasonable termination fee or other defensive device. If the court ultimately decides that it would, then the only route to successful post-closing challenge of a termination fee would be to show that the stockholder vote was not fully informed or was coerced. "Coercion" by a board has been described in other cases as actions by the directors that put stockholders in a position such that their vote would not be based on the economic merits of the transaction—or, put differently, that they would have no practical choice but to approve the transaction. We expect that plaintiffs may argue (as they frequently do in pre-closing injunctive actions) that coercion exists when there is a significant fee that was payable on failure of the stockholders to approve the transaction absent an alternative transaction.

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