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Court of Chancery Confirms Directors' Self-Interest Does Not Exclude "Cleansing" Under Corwin*—And Disclosure Is Sufficient If Stockholders Can "Stitch Together the Facts" to Infer Self-Interest*—Columbia Pipeline

In *Columbia Pipeline Group, Inc. Stockholder Litigation* (March 7, 2017), Vice Chancellor Laster granted the defendants' motion to dismiss a putative class action challenging the $13 billion sale of Columbia Pipeline Group, Inc. to TransCanada Corporation. The plaintiffs alleged that all of the Columbia Pipeline directors and certain officers had breached their duty of loyalty by having engineered a self-interested plan (when they were directors and officers of the company's former parent) to spin the company off and then to sell the post-spin company in order to trigger their change-in-control benefits. In what has become an increasingly familiar pattern for disposition by the Court of Chancery of post-closing challenges to M&A transactions (not involving a controller who has extracted a personal benefit), the court: (i) found that the stockholders had approved the transaction in a fully informed vote; (ii) held that, as a result, under *Corwin*, the business judgment rule standard of review applied; and (iii) dismissed the case.

This is now the fifth in a series of Court of Chancery opinions that has interpreted *Corwin* as permitting "cleansing" of a transaction even when the directors approving the transaction allegedly breached their duty of loyalty by having been not independent and disinterested and/or having acted primarily based on their own self-interest rather than a corporate interest. This case involved a more "vivid" conflict of interest issue than the previous cases, with the court finding that the plaintiff's allegations supported a breach of loyalty claim at the pleading stage. Nonetheless, the court dismissed the case, under *Corwin*, based on the transaction having been cleansed by the stockholder vote.

Background

In July 2015, Columbia Pipeline, then a wholly owned subsidiary of NiSource, Inc., was spun off. Prior to the spinoff, NiSource had received expressions of interest for an acquisition of Columbia Pipeline. In the spinoff, the CEO-director and the CFO of NiSource were transferred to those positions at Columbia Pipeline (the spun-off company); and other NiSource directors also became directors of Columbia Pipeline. In addition, agreements with these individuals relating to a change-in-control of NiSource were transferred over to Columbia Pipeline on a dollar-for-dollar basis (although Columbia Pipeline was much smaller than NiSource). In March 2016, Columbia Pipeline agreed to a $13 billion sale of the company to TransCanada Corporation. The change-in-control benefits would not have been triggered if the company had been sold by NiSource, but were triggered by the post-spin merger with TransCanada. The merger

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price represented a premium of 32% over the unaffected market price; the board was advised by two independent financial advisors; and over 95% of the outstanding shares voted in favor of the merger.

Key Points

- **The opinion reaffirms that *Corwin* will "cleanse" a transaction even if the target directors allegedly were not independent and disinterested and even if there are well-pled facts indicating that they may have acted in their own self-interest.** We note that the Delaware Supreme Court has not yet addressed this issue.
- **The opinion reaffirms that, while directors must disclose the facts *relating* to their self-interest in a transaction, there is no requirement that they expressly disclose that they acted for a self-interested purpose.**
- **The opinion confirms that disclosure by a sell-side financial adviser in its Form 13F of its ownership of shares in the buyer is generally sufficient, without repeating the disclosure in the proxy statement—at least where there is not an actual "economic conflict."**

Discussion

***Corwin* "cleansing" is available even if the directors approving the transaction allegedly were not independent and disinterested and were motivated primarily by their self-interest.** *Corwin* applies, in a post-closing action for damages, when the challenged transaction (a) did not involve a controller who extracted a personal benefit and (b) was approved by the stockholders in a "fully informed" and uncoerced vote (or tender offer). When *Corwin* applies, the court will apply the business judgment rule standard of review, which almost invariably will result in dismissal at an early stage of the litigation. After *Corwin* was decided, it was an open issue whether a fully informed and uncoerced stockholder vote would "cleanse" a transaction even if there were allegations of duty of loyalty (as opposed to only duty of care) violations by the board—that is, even if there were well-pled facts indicating that the directors were not independent and disinterested and/or actually acted based on their own interests. The post-*Corwin* opinions that have addressed the issue all have interpreted *Corwin*, expansively, to answer that such a transaction *could* be cleansed. This series of opinions is comprised of the lower court *Corwin* opinion (Chancellor Bouchard); *Solera* (Chancellor Bouchard); *Larkin* (Vice Chancellor Slights); *Merge Healthcare* (Vice Chancellor Glasscock); and, now, *Columbia Pipeline* (Vice Chancellor Laster).

As noted, *Columbia Pipeline* involved a more "vivid" conflict of interest issue than the previous cases. In the previous cases, the allegations were that a majority of the directors had not been independent and disinterested; whereas, in *Columbia Pipeline*, the allegations were that all of the directors had actually acted based primarily or exclusively on their self-interest rather than a corporate interest. Indeed, the court wrote that "the allegations … in support of th[e] [plaintiffs' breach of loyalty] theory [were] sufficiently detailed to state a pleadings-stage claim for breach of the duty of loyalty." Based on *Corwin*, however, the court concluded that "if stockholders approved the conflict of interest after full disclosure, then the business judgment rule applies," and "dismissal is typically the result." As noted, the Delaware Supreme Court has not yet addressed this issue of whether, under *Corwin*, a stockholder vote can cleanse a duty of loyalty violation.

Fiduciaries are not required to disclose that they acted for a self-interested purpose if the stockholders can "readily stitch together" from the facts disclosed an inference of self-interest. If target company directors act in their own self-interest with respect to a transaction, can the stockholder

vote approving the transaction be "fully informed" if the proxy statement does not expressly disclose that the directors acted in their self-interest? The court confirmed that the answer is yes. "[T]he duty of disclosure demands that fiduciaries disclose facts," the court stated; and does not require that fiduciaries "engage in 'self-flagellation' and draw legal conclusions as to the inferences to be drawn from those facts." There is no requirement that directors "disclose that they acted for selfish and self-interested reasons."

It is sufficient, the court stated, that the material facts from which "a reader of the Proxy [could] readily stitch together the facts to draw the inference" of self-interested action are disclosed. "When a proxy statement describes the facts that create differing incentives for fiduciaries, it need not explain how those differing incentives could produce a self-interested outcome." The court noted that the plaintiffs did not allege that the proxy statement failed to disclose "any material facts regarding the sequence of events between the announcement of the spinoff … and the merger vote"; the "basic terms of Defendants' compensation packages were publicly available"; and the proxy statement disclosed that "the total value that [the CEO and the CFO]earned through the TransCanada merger was higher than the benefits [they] would have received if NiSource had sold the Company without a spinoff." The stockholders "had access to the same information as the plaintiffs" and "could have evaluated [the facts disclosed] and decided whether the defendants had incentives that caused them to engage in a quick sale or which enabled them to divert consideration from the public stockholders to the defendants that they would not have received if [there had not been a spinoff prior to the sale of the Company]." The court concluded: "To require the defendants to aver that they acted for that [self-interested] purpose, assuming it were true, would be to force them to engage in self-flagellation. The material facts were disclosed. That is all that Delaware law requires."

We note that, as a practical matter, it is very difficult to determine the motivation for directors' actions (that is, what was in the directors' minds—and that this is even more so at the pleading stage, without the benefit of discovery). However, arguably, motivation primarily for self-interest, if true, would indeed be a material fact; thus, one might argue that it should be disclosable (at least in those unusual circumstances in which there is actual evidence of it at the pleading stage—say, an email admitting the primary motivation of self-interest).

A target financial advisor's ownership of shares in the buyer generally does not have to be disclosed in the proxy statement if it is disclosed in the banker's Form 13F—at least if there is not an actual "economic conflict." The court reiterated that, because of the central role that bankers play in the evaluation, selection and implementation of M&A transactions, the law requires "full disclosure of investment banker compensation and potential conflicts." At the same time, the court noted, citing its 2012 *Micromet* decision: "[T]his court has held that a financial advisor need not disclose positions that do not rise to the level of an actual conflict." The plaintiffs claimed that the proxy statement failed to disclose that one of Columbia Pipeline's financial advisors had a conflicting interest due to its ownership of about $28.4 million worth of the buyer's stock. The plaintiffs "gleaned this information about [the banker]'s holdings from [the banker's] 319-page 2015 Form 13F … in which [the banker] disclosed 11,194 separate equity positions collectively valued at $319 billion …." The court noted that the same Form 13F disclosed that most of those shares were held by the banker's asset management affiliate that manages third-party funds. In addition, the Form 13F reported ownership by the adviser of Columbia Pipeline shares worth $50.4 million (as well as limited partner units of a Columbia Pipeline affiliate, worth $30.1 million). "One cannot infer from these positions that [the banker]'s interests favored the Buyer," the court stated. "If

anything, [the banker]'s holdings appear more heavily weighted towards the Company. Disclosure of those holdings therefore was not required."

Notably, Vice Chancellor Laster wrote that he "personally would favor" a disclosure regime that would require that a proxy statement for a merger disclose a sell-side advisor's ownership positions in the buyer and its affiliates, the target and its affiliates, and any other participant in the sale process identified in the "Background to the Merger." The Vice Chancellor commented that it would be "preferable in [his] view," that such information be presented in a table, "rather than expecting the stockholders to uncover the information by mining other lengthy filings." Such an approach would have the additional benefits, the Vice Chancellor noted, of enabling an explanation of the nature of the holdings and of assisting boards in obtaining this information from their financial advisors. "But," the Vice Chancellor concluded, *Micromet*—which, "absent contrary guidance from the Delaware Supreme Court, is dispositive"—held that "disclosure in a Schedule 13F is sufficient, particularly where the balance of the investment adviser's ownership does not create an economic conflict."

With regard to the issue of a potential "economic conflict," we note, first, that the banker's "ownership" of the shares at issue reflected only an ability to vote and manage the shares, not a true economic interest in the shares; and, second, as a practical matter, in any event, the banker's interest in the advisory fee it was to receive would have dwarfed its interest in the buyer's shares or the target's shares.

As has been long-established, there is no fiduciary duty to disclose preliminary merger discussions (let alone financial analyses of such discussions). The proxy statement disclosed that, days before the merger agreement was signed, the target directors received from "Party A" an indication of continuing interest in a transaction and that a formal offer would be forthcoming. The proxy statement disclosed that, at the board meeting at which the merger was approved, the target's financial advisors presented to the board "preliminary illustrative financial analyses" of a potential transaction with Party A. The plaintiffs objected that the only information disclosed about the financial analysis in the proxy statement was the price range indicated by Party A. The court noted the long-established principles that "a board does not have a fiduciary duty to disclose preliminary discussions, much less an analysis of preliminary discussions"; and that "fiduciaries need not summarize a financial adviser's analyses if the analyses do not relate to the fairness of the transaction that the stockholders are being asked to consider." Moreover, the court noted that "the Proxy disclosed the financial analyses and valuation methods underlying the [two financial advisers'] fairness opinions[;] Party A never made an offer[;] [and the adviser]'s analysis addressed a range of theoretical offers from Party A that were and were not made."

Factual context. Viewing the challenged transaction in the overall factual context, it does not appear likely that the directors acted primarily based on their self-interest. Importantly, there were two independent financial advisors, a 30% merger premium, and approval of the merger by over 95% of the outstanding shares. Further, a spinoff-followed-by-a-merger is generally readily justifiable for numerous tax and business reasons. Moreover, if the objective had been to provide more compensation to these directors and officers, that could have been accomplished much more simply and directly by amendment of the change-in-control agreements. Generally, in connection with the spinoff of a subsidiary, the parent can put into place at the spinco whatever arrangements it determines.

Columbia Pipeline highlights that, to the extent that directors of the parent become directors of the spinco, there is the possibility of their being challenged for arrangements that were allegedly part of a "plan" that they engineered pre-spin as directors of the parent and post-spin as directors of the spinco—such as, in

this case, a transfer of value from the triggering of change-in-control agreements (as the benefits would not have been triggered in a sale of the subsidiary by the parent but were triggered in the merger following the spinoff). We note that these issues did not need to be addressed by the court given that the court analyzed the case under the *Corwin* framework—which made the case dismissible based on stockholder approval, raising only the issue whether the disclosure had been sufficient for the vote to have been "fully informed."

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