DELAWARE CORPORATE LAW BULLETIN

CHANCERY COURT EMPLOYS *REVLON* ANALYSIS IN ASSESSING WHETHER CORPORATE SALE PROCESS WAS REASONABLE

The court carves out role for enhanced scrutiny review while recognizing that personal liability requires defendant-by-defendant analysis

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 LLP in New York City since his retirement as a partner in April 2011.

Connor J. Breed

Vanderbilt University Law School, J.D. Candidate, May 2022.

INTRODUCTION 98
I. FACTUAL BACKGROUND 100
A. *Apollo Triggers a Company Sale* 100
B. *BCP and CD&R Compete for the Company* 100
C. *The Go-Shop and the Tip* 101
D. *Litigation Ensues* 102
II. VICE CHANCELLOR LASTER'S ANALYSIS 103
A. *Proper Standard of Review* 103
B. *Lowering the Standard of Review* 104
1. Apollo a Conflicted Controller? 104
2. Stockholder Vote Fully Informed? 104

C. *Application of* Revlon*-style Enhanced Scrutiny to Sales Process* 105
D. *Sustainability of Damages Claims* 105
CONCLUSION 107

INTRODUCTION

Several recent Delaware Court of Chancery ("*Chancery Court*") decisions demonstrate the continuing relevance of principles laid out by the Delaware Supreme Court in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) ("*Revlon*"). In *Revlon*, the Delaware high court proclaimed that, "in the change-of-control context, the duty of loyalty requires "'the maximization of the company's value at a sale for the stockholders' benefit.'" The *Revlon* court also designated "enhanced scrutiny" as the applicable standard of review for claims questioning corporate fiduciary adherence to their so-called "*Revlon* duties."

Nearly thirty years later, in *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015) ("*Corwin*"), the Delaware Supreme Court provided corporate fiduciaries with a powerful tool to defend post-closing damages actions alleging breach of so-called "*Revlon* duties." Under *Corwin*, a "fully informed, uncoerced vote of disinterested shareholders" will "cleanse" any such breach. The *Corwin* court also instructed that "*Revlon* [is] primarily designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M&A decisions in real time, before closing. [*Revlon* was] not [a] tool[ ] designed with post-closing damages in mind. . . ." *Corwin*, therefore, raises the question whether *Revlon* has any continuing role in merger and acquisitions ("*M&A*") related litigation. Recent Delaware decisions evaluating the strength of *Revlon* claims where *Corwin* "cleansing" was *not* available at the pleading stage suggest the answer is a resounding "yes":

- In *Kahn v. Stern*, No. 12498-VCG, 2018 WL 1341719 (Del. Mar. 15, 2018) ("*Kahn*"), the Delaware Supreme Court explained that "*Revlon* remains applicable as a context-specific articulation of the directors' duties" in those cases where *Corwin* is not applicable. (For a discussion of *Kahn*, see Robert S. Reder & Victoria L. Romvary, *Delaware Supreme Court Clarifies Pleading Standard in Post-Closing Damages Action Alleging Breach of "Revlon Duties"*, 72 Vand. L. Rev. En Banc 29 (2018).)

- The following year, in *Morrison v. Berry*, No. 12808-VCG, 2019 WL 7369431 (Del. Ch. Dec. 31, 2019) ("*Morrison*"), the Chancery Court cited *Kahn* for the proposition that "*Revlon* applies to the underlying company sale process—and is thus a context-specific lens through which to look at the defendants' duties." When viewed through this "lens," plaintiff's allegations of director misconduct in conducting a sale process fell short of the high bar for pleading directors' breach of their duty of loyalty, leading to dismissal of defendant directors' motion to dismiss. (For a discussion of *Morrison*, see Robert S. Reder & Lorin Hom, *Chancery Court Dismisses Breach of Fiduciary Duty Claims Against Target Company Directors Despite Unavailability of Corwin Defense*, 73 Vand. L. Rev. En Banc 111 (2020).)
- Next, in *In re USG Corp. S'holder Litig.*, No. 2018-0602-SG, 2020 WL 5126671 (Del. Ch. Aug. 31, 2020) ("*USG*"), the Chancery Court presented a more detailed analysis of the *Revlon* "context-specific lens" identified in *Morrison*. After rejecting defendant directors' *Corwin* defense, the Chancery Court explained that

> where a board decides to sell the company and thus terminate stockholder ownership, the director[s'] fiduciary duties mandate that they concentrate on securing the best price. Put differently, to comply with *Revlon*, "when a board engages in a change of control transaction, it must not take actions inconsistent with achieving the highest immediate value reasonably attainable."

(For a discussion of *USG*, see Robert S. Reder & Spencer Lutz, *No Corwin, No Problem: Chancery Court Discusses Revlon's Role in Analyzing Post-Closing Damages Claims Against Target Company Directors*, 74 Vand. L. Rev. En Banc 71 (2021).)

- Just two months later, in *In re MINDBODY, Inc. S'holder Litig.*, No. 2019-0442-KSJM, 2020 WL 5870084 (Del. Ch. Oct. 2, 2020) ("*Mindbody*"), the Chancery Court addressed damages claims brought against a target company founder alleged to have breached his *Revlon* duties by manipulating a sales process. In dismissing the founder's motion to dismiss, the *Mindbody* court observed that this "paradigmatic *Revlon* claim involves a conflicted fiduciary who is insufficiently checked by the board and who tilts the sales process toward his own personal interests in ways inconsistent with maximizing stockholder value." (For a discussion of *Mindbody*, see Robert S. Reder & Victoria D. Selover, *Chancery Court Again Refuses Preliminary Dismissal Due to Well-Plead Allegations that Sale Process Orchestrated by Target Company Fiduciary Failed to Satisfy Revlon Standards*, 74 Vand. L. Rev. En Banc 407 (2021).)

Clearly, where *Corwin* is not available to secure pleading-stage dismissal, *Revlon* continues to play a prominent role in the analysis of post-closing damages claims in corporate sale transactions. Less clear, however, is the status of the enhanced scrutiny level of judicial review in these actions. In early 2021, Vice Chancellor J. Travis Laster addressed this issue in *Firefighters' Pension Sys. of Kansas City Tr. v. Presidio, Inc.*, 251 A.3d 212 (Del. Ch. 2021) ("*Presidio*"). In *Presidio*, the Vice Chancellor carved out a role for enhanced scrutiny review, explaining the relationship between enhanced scrutiny and the availability of damages to disgruntled target company stockholders. Under this analysis, while application of enhanced scrutiny is not determinative, it does serve as an important stepping stone to reaching a final determination.

I. FACTUAL BACKGROUND

A. Apollo Triggers a Company Sale

Presidio, Inc. (the "*Company*") "provided information technology solutions, including services related to digital infrastructure, the cloud, and security." In February 2015, private equity giant Apollo Global Management LLC ("*Apollo*") purchased the Company from another private equity firm for approximately $1.3 billion. Two years later, the Company completed an initial public offering ("*IPO*") of its common stock at $14 a share. Apollo retained a 75.6% stake immediately following the IPO. LionTree Advisors, LLC ("*LionTree*") "acted as the Company's financial advisor for the IPO."

Between November 2017 and March 2019, Apollo completed four secondary offerings of Company shares, reducing its equity stake to 42%. As a result, per a stockholder agreement with the Company, Apollo lost its right to designate a majority of the nine-member Company board of directors ("*Board*"). Instead, its ownership stake would entitle Apollo to designate only four directors at the Company's next annual stockholders meeting, scheduled for late 2019. In light of its pending loss of Board control, in May 2019, Apollo turned to LionTree for assistance in considering a Company sale. Apollo was familiar with LionTree not only through its work on the IPO but, at the time, LionTree was advising Apollo on two multibillion dollar acquisitions. This lucrative relationship with Apollo had generated "almost $16 million in investment banking fees and commissions" for LionTree over the previous two years.

B. BCP and CD&R Compete for the Company

In May 2019, before the Company began a sale process and unbeknownst to the Board, Apollo, LionTree, and Robert Cagnazzi, the Company's Board Chairman and CEO, met with two potential private equity buyers, BC Partners Advisors L.P. ("*BCP*") and Clayton Dubilier & Rice, LLC ("*CD&R*"). These meetings made clear that, if it succeeded in acquiring the Company, BCP would retain Company management (including Cagnazzi), while CD&R, the owner of a portfolio company "in the same line of business as the Company," could "offer a price that included synergies" but likely would not retain Company management. Neither Cagnazzi, Apollo, nor LionTree would inform the Board of these initial meetings "until months later."

Two months later, on July 8, LionTree advised the Board that BCP was interested in purchasing the Company, but CD&R likely was not. Based on this advice, the Board "opted to pursue a single-bidder strategy" and directed LionTree to engage only with BCP. Later that month, BCP offered to acquire the Company for $15.60 a share, signaling it would retain Company management. The Board directed LionTree to inform BCP that it was "not prepared to support" a sale at that price. Nevertheless, in a sign that a deal was possible, the Board cleared BCP to begin discussions to obtain the debt financing it would need for an acquisition. When BCP requested a counter-offer, the Board suggested $16.25 a share "coupled with a robust 'go-shop.' " The next day, BCP presented its "best and final" offer of $16.00 and agreed to a go-shop. The Board "decided to move forward with negotiations with [BCP] on the basis of [its] revised offer." The offer price, which represented a 20% premium, valued the Company at approximately $2.1 billion.

On August 13, LionTree delivered its opinion to the Board that the $16.00 a share offer price fell within the $14.99 to $21.30 a share range produced by a discounted cash flow analysis. With LionTree's fairness opinion in hand, the Board approved the transaction (the "*Merger*"). The next day, the parties signed a Merger agreement (the "*Original Merger Agreement*"). The Original Merger Agreement contemplated both postclosing employment for Cagnazzi as well as a rollover of two-thirds of his equity position in the Company, making him a "net buyer."

C. The Go-Shop and the Tip

The Original Merger Agreement provided for a postsigning go-shop scheduled to run through September 23, although negotiations could continue through October 3 with any party (an "*Excluded Party*") making an offer "the Board determined in good faith '. . . would be reasonably expected to lead to a Company Superior Proposal.' " The Original Merger Agreement also featured a "two-tiered termination fee" payable to BCP: $18 million (1.4% of the aggregate purchase price) if the Company accepted a competing offer made *during* the go-shop period, and $40 million (3% of the aggregate purchase price) if the Company accepted a competing offer made *after* the go-shop period. BCP negotiated for the right to learn the identity of any Excluded Parties, but not their offer prices.

At the commencement of the go-shop, "LionTree contacted fifty-two potential buyers, including CD&R." CD&R jumped at the opportunity and, on September 19, delivered a markup of the Original Merger Agreement that deleting all references to Cagnazzi's post-Merger employment and equity rollover. CD&R also provided a detailed debt commitment letter from Credit Suisse. Then, on September 23, CD&R offered $16.50 a share for the Company. CD&R communicated its expectation that its offer terms would remain confidential from BCP, apart from its identity.

Although the Board declared CD&R an Excluded Party, LionTree secretly tipped the price and terms of CD&R's offer to BCP (the "*Tip*"). BCP "immediately" raised its offer to $16.60 per share and requested that (i) the termination fee be increased to $41 million, including for Excluded Parties, and (ii) the go-shop deadline be accelerated such that CD&R would have to "respond within twenty-four hours." When informed that BCP had increased its offer, although it had no pricing details, CD&R assured LionTree it could improve its offer to at least $17.00 per share. At the same time, however, CD&R threatened to abandon the process due to the tighter timeline. Rather than negotiate further with CD&R, the Board—"still oblivious" to the Tip—accepted BCP's increased offer and approved a revision to the Original Merger Agreement. True to its threat, "CD&R walked away." The Company and BCP jointly announced their new arrangement on September 26.

D. Litigation Ensues

An unhappy Company stockholder filed suit in Chancery Court on October 21, ultimately asserting (a) breach of fiduciary duty claims against (i) Cagnazzi, in his dual capacities as a director and an officer, for "steer[ing] the deal to BCP" due to his desire for "a lucrative compensation package and equity upside"; (ii) Apollo, as the Company's "controlling stockholder," for promoting a "near-term sale" with BCP that would close quickly; and (iii) the other eight members of the Board, consisting of five associated with Apollo (the "*Apollo Directors*") and three independent of Apollo (the "*Independent Directors*"), for prioritizing Apollo's interest in a near-term transaction over the interests of the other stockholders; and (b) aiding and abetting claims against (i) LionTree, for "steering the deal to BCP and away from CD&R" via the Tip; and (ii) BCP for taking advantage of the Tip "to end an active bidding contest." After the Chancery Court refused to preliminarily enjoin the Company stockholders' meeting called to approve the Merger, "holders of more than 85% of the Company's outstanding voting power" (including Apollo) gave their approval. The Merger "closed on December 19."

All defendants moved to dismiss. Vice Chancellor Laster denied the motions as to Cagnazzi, LionTree, and BCP, but granted the motions as to Apollo, the Apollo Directors, and the Independent Directors.

II. VICE CHANCELLOR LASTER'S ANALYSIS

A. Proper Standard of Review

Vice Chancellor Laster commenced his analysis by "determin[ing] the correct standard of review" of plaintiff's damages claims. Because "the defendants sold the Company for cash," the Vice Chancellor found that "enhanced scrutiny provides the standard of review for evaluating the Merger." As such, despite *Corwin*'s admonition that *Revlon* is "not [a] tool[ ] designed with post-closing damages in mind," the Vice Chancellor observed that "plaintiff thus can state a claim for breach of duty by pleading facts supporting a reasonable inference that the Merger and the process that led to it fell outside the range of reasonableness." On the other hand, he noted, "[f]ailing to meet the higher standard of review does not lead ineluctably to liability for the fiduciaries who made the decision."

Vice Chancellor Laster addressed this dichotomy by examining "[t]he relationship between the standard of review and a damages claim." In terms of enhanced scrutiny, this relationship draws a distinction "between 'the traditional justification setting' and 'the personal liability setting.' " The former "operates on a transactional basis" when a plaintiff seeks an injunction or other equitable relief, while the latter operates "when determining whether a fiduciary defendant should be held liable" in damages. Further, the Vice Chancellor noted (quoting from *USG*) that "an allegation implying that a Defendant failed to satisfy *Revlon* is insufficient" to establish "a loyalty-based damages claim" in the personal liability setting. Rather, when corporate fiduciaries are protected from personal liability for breach of their duty of care by virtue of an exculpatory charter provision authorized by Section 102(b)(7) of the Delaware General Corporation Law ("*Exculpatory Provision*"), "the plaintiff must plead facts supporting a reasonable inference that the defendant failed to act reasonably to obtain the best transaction reasonably available, *either due to interestedness, because of a lack of independence, or in bad faith*" (emphasis added).

B. Lowering the Standard of Review

Before assessing individual liability for the various defendants, Vice Chancellor Laster addressed defendants' contention that *Corwin* "cleansing" was available to lower "the standard of review from enhanced scrutiny to the business judgment rule." In this vein, the Vice Chancellor considered whether (i) Apollo was a conflicted controller and (ii) the Company stockholder vote was fully informed.

1. Apollo a Conflicted Controller?

Because the parties did not dispute that Apollo controlled the Company, the key question was "whether Apollo had a divergent interest in the Merger that gave rise to a conflict." Although Apollo received the same Merger consideration as other stockholders, plaintiff claimed "Apollo faced a liquidity-driven conflict" due to a desire for an early exit from its investment. The Vice Chancellor found that "plaintiff's allegations . . . do not support a reasonable inference that Apollo's desire for liquidity was so strong that Apollo would be willing to leave money on the table" in favor of a lower-priced deal with BCP simply because it could close several months before the "higher-priced deal with CD&R."

2. Stockholder Vote Fully Informed?

On the other hand, Vice Chancellor Laster criticized the Board's failure to disclose the Tip to stockholders when it sought approval of the Merger, noting that a "reasonable stockholder would view as important the fact that LionTree provided BCP with CD&R's specific price, enabling BCP to bid just above CD&R's offer rather than having to make a larger move because of uncertainty about CD&R's bid." And because "[o]ne violation is sufficient to prevent application of *Corwin*," *Corwin* was not available to "lower the standard of review."

C. Application of Revlon*-style Enhanced Scrutiny to Sales Process*

Proceeding with his enhanced scrutiny review, Vice Chancellor Laster framed the operative question as whether plaintiff's "allegations support a reasonable inference that the sale process fell outside the range of reasonableness," thereby implicating "the core animating principle of *Revlon*. . . ." In this connection, the Vice Chancellor noted *Mindbody*'s recent characterization of the "paradigmatic *Revlon* claim" as one that "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." However, because not all the *Presidio* defendants were corporate fiduciaries in the traditional sense, the Vice Chancellor effectively "broadened" the "paradigmatic *Revlon* claim" to encompass "a *conflicted actor* 'who is insufficiently checked by the board and who tilts the sale process towards his own personal interests . . . ,' " such as a deal advisor (e.g., LionTree) or other transaction participant (e.g., BCP).

Against this backdrop, the Vice Chancellor focused on the Tip—"the principal defect in the sales process"—which prematurely halted an active bidding contest by "tilt[ing] the sale process in favor of BCP and against CD&R." Absent the Tip, the Vice Chancellor observed, "the sale process as a whole would fall within the range of reasonableness." But the Tip effectively short-circuited the bidding process by placing BCP in an advantageous position from which it could make a slightly more attractive offer yet demand both a shortened timeline and an increased termination fee. While favoritism towards one bidder can be justified if it serves the stockholders' best interests, here the playing field was tilted in favor of BCP in a way that elevated the interests of LionTree, Cagnazzi, and BCP over those of the stockholders.

Thus, for purposes of assessing the *Presidio* defendants' pleading-stage motion to dismiss, Vice Chancellor Laster found it "reasonably conceivable that 'the adequacy of the decisionmaking process . . .' fell outside the range of reasonableness." As such, "the complaint's allegations support a reasonable inference that . . . the directors could have breached their fiduciary duties."

D. Sustainability of Damages Claims

This, however, was not the end of the Vice Chancellor's analysis. Turning from the "traditional justification setting" to the "personal liability setting,' " Vice Chancellor Laster next engaged in a defendant-by-defendant analysis to determine whether any of plaintiff's damages claims should survive the *Presidio* defendants' motions to dismiss.

As for LionTree and BCP, the Vice Chancellor concluded that plaintiff's aiding and abetting "allegations support a pleading-stage inference that LionTree sought to earn its fee by delivering the transaction that BCP and Cagnazzi wanted, at a price that was acceptable to Apollo, rather than striving to assist the Board in obtaining the best transaction reasonably available for all of the Company's stockholders." While the pleading standard to avoid dismissal was rigorous, the Vice Chancellor explained it was "not an insuperable one. Just as the pled facts support a pleading-stage inference that LionTree knew it should not have tipped BCP, the pled facts support a pleading-stage inference that BCP knew the Tip was wrongful."

Likewise, Vice Chancellor Laster refused to dismiss the damages claim against Cagnazzi. The Vice Chancellor found it "reasonably conceivable [Cagnazzi] tilted the sale process in favor of BCP and steered the Board away from a deal with CD&R for self-interested reasons."

By contrast, the Vice Chancellor found that the claims against both the Apollo Directors and the Independent Directors "falter[ ] on the [E]xculpatory [P]rovision. . . ." "To plead a non-exculpated claim," the Vice Chancellor explained, plaintiff was required to offer "facts supporting a rational inference that the director harbored self-interest adverse to the stockholders' interests, acted to advance the self-interest of an interested party from whom they could not be presumed to act independently, or acted in bad faith." The Vice Chancellor not only found no allegations with respect to the Independent Directors that satisfied this high bar, but he recognized no "meaningful difference" between the Independent Directors and the Apollo Directors other than their affiliation with Apollo. And because the Vice Chancellor previously determined, as part of his *Corwin* analysis, that "Apollo's interests did not diverge from those of the unaffiliated stockholders" with respect to the Merger, he dismissed the claims against both the Independent Directors and the Apollo Directors.

Finally, Vice Chancellor Laster also dismissed the damages claims against Apollo. According to the Vice Chancellor, the "only possible theory of recovery would be for a breach of the duty of care," as Apollo's interests were otherwise wholly aligned with the Company's stockholders, foreclosing a breach of the duty of loyalty. While acknowledging open questions under Delaware law whether (i) a controlling stockholder "owes a duty of care" to the controlled corporation or (ii) an Exculpatory Provision can shield a controlling stockholder from liability for breach of a duty of care, if one exists, the Vice Chancellor chose not to delve into these issues. Instead, he focused on the absence of any allegation that Apollo engaged in "conduct . . . that rises to the level of recklessness" as required to support a claim for breach of the duty of care. While the Company sale process may have fallen "outside the range of reasonableness[,] [u]nreasonableness does not equate to recklessness."

CONCLUSION

In *Presidio*, Vice Chancellor Laster called upon familiar *Revlon* concepts in analyzing whether to dismiss damages claims brought against corporate fiduciaries and other "conflicted actors" in connection with a corporate sales process. This was consistent with the *Revlon* "context-specific lens" employed in *Kahn*, *Morrison*, *USG*, and *Mindbody*. But it is noteworthy, in light of the *Corwin* court's admonition that *Revlon* is not a "tool[ ] designed with post-closing damages in mind," that the Vice Chancellor also employed the intermediate enhanced scrutiny standard of review in assessing whether the Board may have breached its fiduciary duty of loyalty in orchestrating and approving the Merger, particularly in light of the Tip. Based on this level of review, the Vice Chancellor concluded, solely for pleadings-stage purposes, that it was "reasonably conceivable that 'the adequacy of the decisionmaking process . . .' fell outside the range of reasonableness." But also consistent with the analysis employed in *Morrison*, *USG*, and *Mindbody*, the Vice Chancellor turned to a defendant-by-defendant examination to determine whether to grant pleading-stage dismissal of breach of fiduciary and aiding and abetting claims seeking damages from the various *Presidio* defendants. All this points to the continued relevance of *Revlon* in M&A-related litigation, while helping to fill in some of the analytical gaps created by *Corwin*.