

# Delaware Extends “Cleansing Effect” of Stockholder Merger Vote to Tender Offer Acquisitions

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Mergers & Acquisitions

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In its recent *In re Volcano Corporation Stockholder Litigation*<sup>1</sup> decision, the Delaware Court of Chancery extended the “cleansing effect” of the majority vote of fully informed, uncoerced, and disinterested stockholders in favor of a merger not subject to the entire fairness standard—as reinforced by the Delaware Supreme Court last fall in *Corwin v. KKR Financial Holdings LLC*<sup>2</sup> (discussed in our [prior alert](#))—to the acceptance by a majority of such stockholders of a first-step tender offer pursuant to Delaware General Corporation Law Section 251(h) (“DGCL 251(h)”), which governs certain two-step mergers. Unless overturned or modified on appeal, *Volcano* establishes that, with the requisite stockholder approval, Delaware courts will afford both one- and two-step mergers (the latter, if conducted pursuant to DGCL 251(h)) the “irrebuttable” protection of the business judgment rule.

## The *Volcano* Decision

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**Background.** Plaintiffs, putatively representing a class of stockholders of Volcano Corporation, alleged the directors of the company breached their fiduciary duties in connection with the all-cash sale of the company to Philips Holding USA, Inc. (“Philips”), a subsidiary of Koninklijke Philips, N.V., for \$18 per share.<sup>3</sup> The transaction was structured as a two-step merger pursuant to DGCL 251(h), in which 89.1 percent of Volcano’s shares were tendered in the first-step tender offer, followed by a second-step short-form merger of Volcano with a subsidiary of Philips. Plaintiffs initially sought expedited pre-closing proceedings but, after Volcano made supplemental disclosures, agreed to pursue only post-closing damages.

**Opinion.** Deciding post-closing motions to dismiss by the directors of Volcano and their financial advisor, the Court of Chancery accepted the defendants’ argument that the decision of a majority of disinterested, uncoerced, and fully informed Volcano stockholders to tender their shares in a first-step tender offer conducted pursuant to DGCL 251(h) had the same “cleansing effect” as such a stockholder vote on a single-step merger not subject to the entire fairness standard was held to have in *Corwin*. As a result, “the business judgment rule irrebuttably” applied to the court’s review of the directors’ actions.<sup>4</sup> Observing that DGCL 251(h) (passed in 2013 and amended twice since)

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<sup>1</sup> Consolidated C.A. No. 10485-VCMR, 2016 WL 3583704 (Del. Ch. June 30, 2016).

<sup>2</sup> 125 A.3d 304 (Del. 2015).

<sup>3</sup> Plaintiffs also named Philips and Volcano’s financial advisor, Goldman Sachs (“Goldman”), as aiding and abetting defendants, although they agreed to dismiss voluntarily claims against Philips. *Volcano*, 2016 WL 3583704, at \*2 & n.4. The claims against Goldman were derivative of the fiduciary breach claims against the Volcano directors and were dismissed along with those claims. *Id.* at \*18.

<sup>4</sup> *Id.* at \*9.

effectively codified the longstanding practice of using “top-up options” to conduct two-step mergers and, based on the specific requirements of DGCL 251(h), the court rejected plaintiffs’ arguments that (1) the lack of board involvement in a tender offer materially distinguished it from a stockholder vote; and (2) a first-step tender offer is more coercive than a stockholder vote in a one-step merger. As to the first concern, the court stressed that DGCL 251(h) requires that a first-step tender offer be effected pursuant to a merger agreement recommended by the target’s board of directors, resulting in a similar level of board involvement as a one-step merger.<sup>5</sup> Taken together, the court found, “Sections 251(a), (b) and (h) of the DGCL mandate that a target corporation’s board negotiate, agree to, and declare the advisability of the terms of both the first-step tender offer and the second-step merger in a Section 251(h) merger, just as a target corporation’s board must negotiate, agree to, and declare the advisability of a merger involving a stockholder vote under Section 251(c).”<sup>6</sup> The court rejected plaintiff’s second argument for similar statutory reasons, finding that DGCL 251(h) “alleviates the coercion that stockholders might otherwise be subject to in a tender offer” by (1) requiring the tender offer be for all outstanding stock; (2) requiring that the second-step merger be effected as soon as practicable thereafter for the same kind and amount of consideration; and (3) making appraisal rights available to dissenting stockholders.<sup>7</sup> Finally, the court noted that neither the “policy considerations underlying the holding in *Corwin*” nor Delaware precedent “provide[s] any basis for distinguishing between a stockholder vote and a tender offer” in this context.<sup>8</sup>

Because plaintiffs raised no colorable allegations that the tendering Volcano stockholders were not fully informed, disinterested and uncoerced, the court held that the “business judgment rule irrebuttably applies” to the directors’ conduct under the Delaware Supreme Court’s recent decision in *Singh v. Attenborough*,<sup>9</sup> making the sole remaining basis for a stockholder challenge the “vestigial waste exception.”<sup>10</sup> And, following *Singh*, the court rejected such a claim as “logically difficult to conceptualize ... in the face of a decision by fully informed, uncoerced, independent stockholders to ratify the transaction, given that the test for waste is whether any person of ordinary sound business judgment could view the transaction as fair.”<sup>11</sup>

## Conclusion

The *Volcano* decision provides corporate boards and practitioners with meaningful comfort that the protections affirmed in *Corwin* with respect to single-step mergers apply with equal force to two-step mergers, provided the requirements of DGCL 251(h) are satisfied.

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<sup>5</sup> *Id.* at \*12.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *Id.* at \*13-15.

<sup>9</sup> – A.3d –, 2016 WL 2765312 (Del. May 6, 2016).

<sup>10</sup> *Volcano*, 2016 WL 3583704, at \*11, 17.

<sup>11</sup> *Id.* at \*17.