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DELAWARE CORPORATE LAW BULLETIN

Chancery Court Dismisses Breach of Fiduciary Duty Claims Against Target Company Directors Despite Unavailability of *Corwin* Defense

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But sustains fiduciary breach claims against corporate officers unprotected by exculpatory charter provision

INTRODUCTION 112
I. FACTUAL BACKGROUND 113
  A. *Fresh Market Receives an Offer from Apollo* 113
  B. *Fresh Market Seeks a Buyer* 114
  C. *Apollo Completes the Buyout; Litigation Ensues* 115
II. VICE CHANCELLOR GLASSCOCK'S ANALYSIS 116

A. *Failure to State a Non-Exculpated Claim Against Director Defendants* 116
1. No Self-Interest or Lack of Independence....... 116
2. Absence of Bad Faith....... 117
i. *Initiation of the Sale Process*....... 118
ii. *Structure of the Sale Process*....... 118
iii. *14D-9 Disclosure*....... 119
B. *Treatment of Berry*....... 119
C. *Treatment of Non-Exculpated Officer Defendants* .. 120
CONCLUSION....... 120

INTRODUCTION

In connection with a post-closing claim for damages alleging breach of fiduciary duties in negotiating the sale of a company and obtaining stockholder approval, defendant directors and officers often undertake two alternative defenses. The first is drawn from *Corwin v. KKR Financial Holdings LLC,* 125 A.3d 304 (Del. 2015) ("*Corwin*"), in which the Delaware Supreme Court ruled that breaches of fiduciary duties tainting a deal can, in effect, be "cleansed" when the transaction is "approved by a fully informed, uncoerced vote of the disinterested stockholders." The alternative defense contends that, if *Corwin* is not available, no breaches of fiduciary duties in fact occurred.

In *Morrison v. Berry,* C.A. No. 12808-VCG, 2017 WL 4317252 (Del. Ch. Sept. 28, 2017) ("*Morrison I*"), Vice Chancellor Sam Glasscock III of the Delaware Court of Chancery ("*Chancery Court*") dismissed fiduciary breach claims on the basis of *Corwin* without concurrently investigating whether a breach had occurred, "finding that the majority vote of disinterested stockholders cleansed any breaches of duty." In *Morrison v. Berry,* No. 445, 2017, 2018 WL 3339992 (Del. July 9, 2018) ("*Morrison II*") the Delaware Supreme Court reversed, determining defendants' actions were not entitled to *Corwin* cleansing because they failed "to show the stockholder vote was fully informed." (For a discussion of *Morrison I* and *Morrison II*, *see* Robert S. Reder, *Delaware Supreme Court Once Again Reverses Dismissal of Fiduciary Breach Claims Brought Against Target Company Directors*, 72 VAND. L. REV. EN BANC 71 (2018).) Then, in *Morrison v. Berry,* C.A. No. 12808-VCG, 2019 WL 7369431 (Del. Ch. Dec. 31, 2019) ("*Morrison III*"), the Vice Chancellor considered the alternative defense raised by defendant

directors and officers that they had not in fact breached their fiduciary duties.

In *Morrison III*, Vice Chancellor Glasscock again dismissed the claims of fiduciary breach brought against all but one of the named target company directors, citing failure by plaintiff to adequately plead facts satisfying the high bar imposed by an exculpatory provision contained in the target company's certificate of incorporation by virtue of § 102(b)(7) of the Delaware General Corporation Law ("*Exculpatory Provision*"). The one exception was the chairman of the board—who also was the company's founder and a major stockholder—who was found to have acted in bad faith in connection with receipt of personal benefits from the transaction not available to other stockholders. Further, because the named target company officers did not benefit from the protections of the Exculpatory Provision, the Vice Chancellor was satisfied that plaintiff's allegations of grossly negligent behavior were adequate to withstand dismissal of the fiduciary breach claims brought against these officers.

I. FACTUAL BACKGROUND

A. *Fresh Market Receives an Offer from Apollo*

After "specialty grocery retailer" The Fresh Market, Inc. ("*Fresh Market*" or the "*Company*") terminated the employment of its CEO in January 2015—"without cause and without a permanent replacement lined up"—its stock price plunged, drifting down to "a low of $18.70" during the subsequent eight-month search period. Internally, however, there was optimism the market price was not accurately projecting the Company's prospects. It was in this context that giant private equity firm Apollo Global Management LLC ("*Apollo*"), on July 3, 2015, reached out to Fresh Market founder Ray Berry ("*Berry*")—Chairman of the Board and the owner (together with his son, Brett Berry (collectively, the "*Berrys*")) of 9.8% of Fresh Market shares—to explore "taking the Company private." Despite protocols established by the board of directors ("*Board*"), "Berry did not disclose Apollo's inquiries to either the interim-CEO or the lead director." Additional private equity firms made contact with Berry and other directors during this period, but none piqued Berry's interest quite like Apollo.

Meanwhile, in response to demands from institutional stockholders for "urgent action to end the downward drift" in the stock price, on September 1st, the Company hired Richard Anicetti ("*Anicetti*") to serve as the new CEO. Soon thereafter, as discussions

between Apollo and the Berrys continued, "the Berrys orally agreed with Apollo to roll over their equity in the event of a successful Apollo acquisition." Yet, still, Berry had "not informed the Board about his discussions with Apollo." Despite the retention of Anicetti, the Company's institutional investors continued to pressure the Board, at this point "for a comprehensive strategic review of the Company, including a sale exploration."

Buoyed by the Berrys' promise of support, on October 1st, Apollo submitted to the Board its proposal to "acquire Fresh Market at $30 per share." The proposal revealed Apollo and the Berrys would be "working together in an exclusive partnership," which included "an equity rollover" by the Berrys. Amid Berry's subsequent proclamations no such exclusivity existed, the Board formed a Strategic Transaction Committee ("*Committee*") to consider Fresh Market's "strategic and financial alternatives." At this point, "Berry recused himself from all future Board meetings" while issuing a not-so-veiled threat, if the Company was not sold, to "give serious consideration to selling his stock . . . as he does not believe [Fresh Market] is well positioned to prosper as a public company . . . ." To add to the strain, the Board became concerned "over 'continued shareholder pressure,' " as well as fears that word of Apollo's bid and less specific proposals from other potential bidders "could become public."

B. Fresh Market Seeks a Buyer

After an October 18th meeting, in response to press rumors, the Board publicly announced the "commencement of a review of strategic and financial alternatives," indicating that any sale process would involve soliciting "multiple bids, rather than just Apollo's." With Berry's preference for Apollo clear, Fresh Market requested, and Berry confirmed, (1) his "willingness to discuss an equity rollover with a successful bidder other than Apollo" and (2) "an agreement not to discuss an equity rollover with any party until authorized to do so by Fresh Market."

During the sale process, the Committee's financial advisor, J.P. Morgan, contacted thirty-two potential bidders, representing to them Berry was "open to discussing a potential rollover when authorized to engage by the Company." Ultimately, "Fresh Market accelerated the process for Apollo," whose "best and final" offer landed at $28.50 per share (reduced from its original $30 bid) on March 9, 2016. That same day, "the Committee decided to allow Apollo to engage in 'chaperoned' discussions with the Berry family, although the price remained

confidential." A few days later, the Committee, and then the Board, approved the buyout at Apollo's price and authorized signing of a merger agreement with Apollo providing for (i) a "twenty-one-day 'go-shop' period" following signing, (ii) matching rights for Apollo if a superior bid arose during the go-shop, and (iii) a termination fee payable to Apollo representing 2.5% of the purchase price if the Board decided to accept a superior proposal. The merger was to be accomplished in two steps: a tender offer followed by an intermediate-form merger. No alternative bidders emerged during the go-shop.

C. Apollo Completes the Buyout; Litigation Ensues

On March 25th, Fresh Market filed its Schedule 14D-9 ("*14D-9*") with the Securities and Exchange Commission, providing disclosures to stockholders in connection with the decision on whether to accept Apollo's first-step tender offer. Scott Duggan, the Company's Chief Legal Officer and Senior Vice President-General Counsel ("*Duggan*"), drafted the document, and the Board provided its approval. After sufficient shares were tendered in the first step, Apollo consummated the second-step merger to complete the buyout. As a result of their rollover, the Berrys owned "approximately 22%" of Fresh Market's equity, with various Apollo entities owning the remainder.

On October 6th, a former Company stockholder ("*Plaintiff*") filed a complaint in Chancery Court alleging breaches of fiduciary duty in connection with the Apollo buyout on the part of Berry, the other members of the Board (collectively, "*Director Defendants*"), and corporate officers Anicetti and (via subsequent amendment) Duggan. Plaintiff's complaint also alleged the 14D-9 failed to disclose several key facts, including:

- Apollo's pre-offer communications with Berry on July 3rd, regarding his participation in a potential Apollo buyout of Fresh Market;
- Berry's subsequent oral agreement with Apollo to roll over his family equity in a successful Apollo acquisition;
- Representations by Apollo in its initial offer that it enjoyed an exclusive partnership with the Berrys;
- Berry's threat to sell his shares if the Board did not arrange a sale of the Company; and

- The Board's recognition of "existing shareholder pressure" to complete a transaction.

II. VICE CHANCELLOR GLASSCOCK'S ANALYSIS

Because the *Morrison II* Court rejected the defendants' *Corwin* defense, in *Morrison III* Vice Chancellor Glasscock turned to a consideration of whether those defendants were entitled to a pleading stage dismissal on the basis that Plaintiff failed to adequately plead breaches of fiduciary duty. Because the Director Defendants benefitted from the Exculpatory Provision, Plaintiff was required to offer allegations sufficient to establish they had breached their fiduciary duty of loyalty. On the other hand, a lower burden of proof—establishing a breach of the fiduciary duty of care—would be sufficient to avoid dismissal of the claims against the two corporate officers.

A. Failure to State a Non-Exculpated Claim Against Director Defendants

Vice Chancellor Glasscock explained that, in light of the Exculpatory Provision, to survive Berry and Defendant Directors' motion to dismiss, Plaintiff needed to "plead a non-exculpated claim, which requires sufficiently alleging the Director Defendants were either self-interested, lacked independence, or acted in bad faith." Citing the Delaware Supreme Court's decision in *Kahn v. Stern*, No. 393, 2018 WL 1341719 (Del. Mar. 15, 2018) ("*Kahn*"), the Vice Chancellor added that "*Revlon* applies to the underlying company sale process—and is thus a context-specific lens through which to look at the defendants' duties . . ." (For a discussion of this aspect 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).) With this framework in mind, Vice Chancellor Glasscock concluded "the facts, as alleged," failed to prove director interest, dependence, or bad faith, and therefore granted the Director Defendants' motion to dismiss.

1. No Self-Interest or Lack of Independence

To establish self-interest on the part of a director, Vice Chancellor Glasscock instructed that Plaintiff must show "he or she will receive a personal financial benefit from a transaction that is not equally shared by the stockholders." Further, a "director lacks

independence if . . . her judgment is controlled by another director or driven by extraneous considerations."

In arguing the Director Defendants were interested in the transaction and "held pecuniary interests not shared with the stockholders," Plaintiff contended "activist shareholder pressure improperly motivated the Director Defendants to act with self-interest, in consideration of those directors' reputations." To assuage such pressure and "eliminate their personal and professional problems," Plaintiff argued, the Director Defendants pretended to auction the Company while "in reality handing it to Apollo in a short-term, unfairly cheap sale."

While acknowledging the "mounting activist pressure" and reputational concerns facing the Director Defendants, Vice Chancellor Glasscock rejected the implication they therefore "acted for improper motives." Because the Board was classified, or "staggered," meaning just one-third of the directors were up for election at the forthcoming annual meeting, the Vice Chancellor saw "no logical force to the suggestion that otherwise independent, disinterested directors" would disloyally "agree to a sale of their company 'on the cheap' " simply because of perceived stockholder dissatisfaction or potential re-election opposition.

Further, Plaintiff's contention the Board initiated a "sham sale process" to protect director reputations required Vice Chancellor Glasscock to infer "the Director Defendants, for the purpose of protecting their reputations as fiduciaries, breached their fiduciary duties, risking the far greater blackening of their fiduciary reputations, in the hope that the *Corwin* pleading standard would hide their misdeeds, *at the same time* . . . sowing material omissions in the disclosures, thereby eliminating *Corwin's* protections." Unwilling to "draw this unreasonable inference," the Vice Chancellor found neither self-interest nor lack of independence on the part of the Director Defendants.

2. Absence of Bad Faith

"A demonstration of bad faith," the final avenue available to Plaintiff to "plead a claim for a breach of the duty of loyalty," according to Vice Chancellor Glasscock, requires a showing of "acts or omissions taken against the interest of the Company, with scienter." Once again referring to the *Revlon* "lens," the Vice Chancellor explained Plaintiff's pleading must "show that it is reasonably conceivable that Director Defendants *knowingly chose* to ignore their duty once a sale process was

commenced; to maximize stockholder value." Plaintiff alleged the existence of such misconduct at several stages of the transaction.

i. Initiation of the Sale Process

Plaintiff first claimed the Director Defendants exhibited bad faith in the initiation of the sale process by deciding to "institute an auction and solicit multiple bids" when "two alternatives existed": either just saying "no" to Apollo, or "leverag[ing] exclusivity with Apollo for a higher price range." The Vice Chancellor explained that Plaintiff, to succeed with this argument, had to show the "Director Defendants were aware of these alternatives, understood that they would maximize value, *but nonetheless chose instead to act against the interests of the Company and its stockholders*."

In light of the facts alleged, and recognizing "*Revlon* can provide a contextual inquiry about whether the Director Defendants' choices were 'reasonable under the circumstances as a good faith attempt to secure the highest value reasonably attainable,' " the Vice Chancellor did not find reasonable support for the proposition that "the Director Defendants 'knowingly and completely failed to undertake their responsibilities' by instituting an auction and soliciting bids from a wide field of suitors, rather than opting for a different potential value-enhancing choice." Despite the Board's awareness of "Berry's strong preference for Apollo," the purported facts failed to demonstrate to the Vice Chancellor that the "sale's outcome . . . was intentionally structured to forgo value available to the stockholders." On this basis, the Vice Chancellor found the Director Defendants in good faith selected an auction process to maximize value in a world where there is "no blueprint to fulfill fiduciary duties in the company-sale situation."

ii. Structure of the Sale Process

In relation to the sale process structure, Plaintiff pled bad faith underlaid the Board's "choice to refuse potential bidders an opportunity to communicate with the Berrys" until given a go-ahead by the Board. The Vice Chancellor viewed this choice differently, characterizing it as "rational, rather than . . . bad faith," noting "[t]here is no single path that a board must follow" for purposes of fulfilling *Revlon* obligations. With the auction process meant to encourage competing bids, the Board "[l]ogically" siphoned Berry off from the auction field to eliminate the possibility of Berry "discourag[ing] competing bids." In other words, this "no-communications policy" was, in the Vice Chancellor's view, "a

reasonable decision for structuring the auction process" to "neutralize Apollo's advantage and stimulate competition."

iii. 14D-9 Disclosure

With respect to the 14D-9, "Plaintiff contend[ed] the failure to disclose material facts" established bad faith, noting the Delaware Supreme Court eliminated any potential "cleansing effect" due to "material omissions" in the disclosures. However, Vice Chancellor Glasscock explained bad faith is not shown "simply" through "adequate pleading of a material omission," but rather "requires that the omission be intentional and constitute more than an error of judgment or gross negligence."

While the 14D-9 failed to provide Company stockholders with a "full and accurate portrait of the decision to sell," the breadth of the information actually provided in the 14D-9 belied the notion the Director Defendants engaged in "the knowingly-crafted deceit or knowing indifference to duty that would show bad faith." Although the drafters of the 14D-9 "at least negligently failed to portray the full extent" of Apollo's dominance over the sale process, Berry's position in the process, and "the stockholder pressure that encouraged the sale in the first place," the Vice Chancellor deemed it unreasonable to find "an intentional derogation of duty" or calculated deceit by the Director Defendants.

B. Treatment of Berry

Vice Chancellor Glasscock viewed Berry's actions in an entirely different light from the conduct of the Director Defendants. Refusing to dismiss the claims against Berry, he found Plaintiff "adequately allege[d] that Berry acted in self-interest and in bad faith in a manner that conceivably harmed Fresh Market." Although, normally, "deliberate and effective removal from the decision-making process can shield a director from liability from claims that he was an interested party," the Vice Chancellor recognized "Berry engaged in a pattern of misdirection and lack of candor with the Board for nearly five months prior to the sale process." To make matters worse, "Berry intentionally obscured the extent of his involvement with Apollo" and "failed to correct the misleading statements" concerning his early engagement with the private equity firm. Because these actions were taken in his capacity as a director rather than simply as a stockholder, he had placed "his own interests as a potential buyer foremost."

C. Treatment of Non-Exculpated Officer Defendants

Because only the Director Defendants benefited from the Exculpatory Provision, to avoid dismissal of the claims against Anicetti and Duggan in their capacities as Company officers, Plaintiff only had to plead facts alleging "a breach of the duty of care." To successfully plead a breach of the duty of care, a plaintiff must sufficiently allege "gross negligence," which means not just "simple carelessness," but rather conduct rising to the level of "reckless indifference or actions that are without the bounds of reason."

Vice Chancellor Glasscock found the distortions in the 14D-9 disclosures created a reasonable inference, "at this pleading stage," that Duggan, the document's crafter acting in his capacity as the Company's chief legal officer, "conceivably acted with gross negligence" when he knowingly "creat[ed] a misleading proxy, and was at least indifferent to his contrary duty to stockholders." Further, as Fresh Market's CEO, Anicetti likely "possessed the same knowledge as Duggan," and in "drafting and disseminating" the 14D-9, is susceptible to "an inference of gross negligence" in breach of his duty of care. On this basis, the Vice Chancellor denied the two officers' motion to dismiss.

CONCLUSION

Because *Corwin* "cleansing" was unavailable as a defense to Plaintiff's breach of duty claims following the *Morrison II* Court's finding of material omissions in the 14D-9, *Morrison III* focused on whether Plaintiff adequately pled breach of fiduciary duty on the part of the defendants in connection with the Fresh Market sale process. Vice Chancellor Glasscock's grant of Defendant Directors' motion to dismiss demonstrates the high pleading bar plaintiffs face when seeking to overcome an Exculpatory Provision.

With *Revlon* providing the contextual backdrop for the fiduciary conduct required in connection with the sale of Fresh Market, the Exculpatory Provision presented Plaintiff with the tall order of demonstrating director self-interest, lack of independence, or bad faith conduct. Despite the flaws in the sale process, Plaintiff was unable to sustain her claims against the Defendant Directors even with the *Corwin* defense off the table. The allegations against Berry, on the other hand, created sufficient doubt about his motivations, at the pleading stage, to defeat his defense. By contrast, because the two Company officers were ineligible to benefit from the Exculpatory Provision, Plaintiff faced a lower bar to defeating their motions to dismiss, having

only to adequately allege a breach of their duty of care through grossly negligent conduct. Plaintiff was able to satisfy this lower bar.