Vanderbilt Law Review En Banc

Volume 72
Issue 1 *En Banc - 2018-2019*

Article 8

2024

Delaware Supreme Court Once Again Reverses Dismissal of Fiduciary Breach Claims Brought against Target Company Directors

Robert S. Reder

Follow this and additional works at: https://scholarship.law.vanderbilt.edu/vlreb

Recommended Citation
Reder, Robert S. (2024) "Delaware Supreme Court Once Again Reverses Dismissal of Fiduciary Breach Claims Brought against Target Company Directors," *Vanderbilt Law Review En Banc*: Vol. 72: Iss. 1, Article 8.
Available at: https://scholarship.law.vanderbilt.edu/vlreb/vol72/iss1/8

This Delaware Corporate Law Bulletin is brought to you for free and open access by Scholarship@Vanderbilt Law. It has been accepted for inclusion in Vanderbilt Law Review En Banc by an authorized editor of Scholarship@Vanderbilt Law. For more information, please contact mark.j.williams@vanderbilt.edu.

DELAWARE CORPORATE LAW BULLETIN

Delaware Supreme Court *Once Again* Reverses Dismissal of Fiduciary Breach Claims Brought Against Target Company Directors

Robert S. Reder

Professor of the Practice of Law at Vanderbilt University Law School. Professor Reder also has been serving as a consulting attorney at Milbank, Tweed, Hadley & McCloy LLP in New York City since his retirement as a partner in April 2011.

Corwin defense defeated due to tendering stockholders not being "fully informed" as to founder's side deal with winning bidder

INTRODUCTION 71
I. FACTUAL BACKGROUND 73
A. *Apollo Acquires Fresh* 73
B. *Litigation Ensues* 74
II. THE CHANCERY COURT'S DISMISSAL 74
III. THE SUPREME COURT'S REVERSAL 75
CONCLUSION 76

INTRODUCTION

For the second time this year, the Delaware Supreme Court (the "Supreme Court") has reversed a dismissal by the Delaware Court of Chancery (the "Chancery Court") of a post-closing damages claim

brought against target company directors. In each case, the Supreme Court determined that inadequate disclosures to stockholders defeated the stockholder ratification defense championed by the Supreme Court in *Corwin v. KKR Financial Holdings*, 125 A.3d 304 (Del. 2015) ("*Corwin*").

Under *Corwin*, the deferential business judgment rule attaches to a post-closing damages action alleging directorial breach of fiduciary duties in connection with an M&A transaction where the transaction is approved by a vote of disinterested stockholders. If defendants can establish that the stockholder vote approving the transaction was both (1) fully informed and (2) uncoerced, the vote in effect "cleanses" the directorial fiduciary breach, usually leading to dismissal at the pleading stage.

Corwin involved an acquisition structured as a one-step merger. The Supreme Court extended *Corwin* to two-step acquisitions (i.e., a tender offer followed by a cash-out merger) in *In re Volcano Corp. Stockholder Litig.*, 143 A.3d 727 (Del. Ch. 2016), *aff'd*, 156 A.3d 697 (Del. 2017) ("*Volcano*"). According to the *Volcano* Court, the same policy reasons dictate that "the acceptance of a first-step tender offer by fully informed, disinterested, uncoerced stockholders representing a majority of a corporation's outstanding shares in a two-step merger ... has the same cleansing effect under *Corwin*." For a discussion of *Volcano*, see Robert S. Reder, *Delaware Chancery Court Extends "Cleansing Effect" of Stockholder Approval Under* KKR *to Two-Step Acquisition Structure*, 69 VAND. L. REV. EN BANC 227 (2016).

The requirement that disinterested stockholders be "fully informed" as a precondition to the invocation of *Corwin* "cleansing" is not an empty one. In an order issued in *Appel v. Berkman*, C.A. No. 12844-VCMR, 2017 WL 2999000 (Del. Ch. July 7, 2017) ("*Appel*"), Vice Chancellor Tamika Montgomery-Reeves determined that a target company's disclosures were adequate to fully inform tendering stockholders under *Corwin* and, on that basis, granted defendant directors' motion to dismiss. However, on February 20, 2018, the Supreme Court reversed (*Appel v. Berkman*, 180 A.3d 1055 (Del. 2018)), declaring that omissions from the disclosures provided to tendering stockholders "are material and their omission precludes the invocation of the business judgment rule standard at the pleading stage." For a discussion of *Appel*, see Robert S. Reder & John L. Daywalt, *Delaware Supreme Court Reverses Dismissal of Fiduciary Breach Claims Against Target Company Directors*, 71 VAND. L. REV. EN BANC 123 (2018).

The pattern evinced in the *Appel* litigation recently re-emerged in litigation over the sale of The Fresh Market ("Fresh"). In an order issued on September 28, 2017, in *Morrison v. Berry*, C.A. No. 12808-

VCG, 2017 WL 4317252 (Del. Ch. Sept. 28, 2017) ("*Morrison*"), Vice Chancellor Sam Glasscock III relied on *Corwin* in dismissing fiduciary breach claims brought against target company directors in connection with the sale of Fresh. On July 9, 2018, the Supreme Court reversed (*Morrison v. Berry*, No. 445, 2017, 2018 WL 3339992 (Del. July 9, 2018)), determining that "[d]efendants did not meet their burden for triggering application of the business judgment rule under *Corwin*." Emphasizing the importance of the "fully informed" requirement for *Corwin* "cleansing," the *Morrison* Court "offer[ed] a cautionary reminder to directors and the attorneys who help them craft their disclosures: 'partial and elliptical disclosures' cannot facilitate the protection of the business judgment rule under the *Corwin* doctrine."

I. FACTUAL BACKGROUND

Fresh operates a grocery store chain of over 170 stores in twenty-four states. Fresh's founder Ray Berry and his son (the "Berrys") collectively owned just under ten percent of the outstanding stock. The father also served on Fresh's board of directors (the "Board") along with seven other members, all of whom were independent.

A. Apollo Acquires Fresh

On October 1, 2015, the well-known private equity firm Apollo Global Management LLC ("Apollo") delivered a letter containing an "unsolicited preliminary non-binding indication of interest" to buy Fresh, offering to purchase the company "for $30 per share in cash." The letter also disclosed an "exclusive partnership" with the Berrys providing for them to roll over their equity stake in Fresh into the company resulting from the acquisition. In response, the Board formed a committee of three independent directors (the "Committee") to "consider strategic alternatives." Despite the disclosures in the Apollo letter, the Berrys at first denied they had reached any agreement with Apollo. However, when Apollo renewed its offer in November, Berrys' counsel advised Fresh's counsel that the Berrys indeed had an agreement with Apollo at the time of the initial letter.

In furtherance of their charter to consider strategic alternatives for Fresh, in December, the Committee initiated a sale process that stretched over five months. Of the thirty-two potential buyers initially solicited, five provided indications of interest. Apollo emerged as the winning bidder, ultimately offering $28.50 per share, representing a "large premium" for Fresh shares. The acquisition was structured as a

two-step transaction under DGCL Section 251(h) of the Delaware General Corporation Law, and Apollo granted Fresh a post-signing "go-shop period" in which to solicit superior proposals (although none emerged). In the first-step tender offer (the "Tender Offer"), a majority of the outstanding Fresh shares were tendered to Apollo by the expiration date. Thereafter, the second-step was consummated via a merger, with all untendered shares being converted into the same per share paid in the Tender Offer. The Berrys' equity rollover resulted in their owning twenty percent of the company emerging from the transaction, with Apollo owning the rest.

B. Litigation Ensues

Plaintiff, a Fresh stockholder, sued the members of the Board in Chancery Court, claiming defendants breached their fiduciary duties to Fresh stockholders in negotiating and approving the transaction with Apollo. Specifically, Plaintiff alleged the Berrys "teamed up with Apollo to buy The Fresh Market at a discount by deceiving the Board and inducing the directors to put the Company up for sale through a process that 'allowed the Berrys and Apollo to maintain an improper bidding advantage' and 'predictably emerge[ ] as the sole bidder for Fresh Market' at a price below fair value." Defendants sought dismissal on the basis that the successful Tender Offer "cleansed" any potential breaches under *Corwin*. Plaintiff countered by attacking the disclosures provided to Fresh stockholders in connection with the Tender Offer, including the alleged failure of the Tender Offer materials to disclose that (1) the Berrys initially misled the Board with respect to their agreement with Apollo, (2) the Berrys' "clear preference for a rollover transaction involving Apollo—and reluctance to engage in such a transaction if another buyer were to prevail," and (3) the Berrys' "threat" to sell their shares "if the Board did not undertake a sale process."

II. THE CHANCERY COURT'S DISMISSAL

Vice Chancellor Glasscock described the issues before him as "an exemplary case of the utility of th[e] ratification doctrine, as set forth in *Corwin* and *Volcano*." In granting defendants' motion to dismiss, the Vice Chancellor discussed the two pre-conditions to application of *Corwin*, that is, that disinterested stockholder approval of the transaction be *both* uncoerced *and* fully informed.

With respect to the first element, the Vice Chancellor listed a number of factors leading him to conclude that Fresh stockholders were not coerced to tender their shares into the Tender Offer:

- The Board consisted of seven out of eight independent directors;
- The Board formed the Committee to "consider strategic alternatives" after receiving Apollo's initial letter;
- The elder Berry recused himself from all Board proceedings relative to the transaction;
- The Board approved the transaction based on the Committee's recommendation; and
- The process followed by the Committee in soliciting bids from a number of potential buyers and negotiating the transaction lasted over a five-month period.

For a discussion of two Chancery Court cases addressing the coercion element of *Corwin*, see Robert S. Reder, *Delaware Court Refuses to Invoke* Corwin *to "Cleanse" Alleged Director Misconduct Despite Stockholder Vote Approving Merger*, 70 VAND. L. REV. EN BANC 47 (2017); and Robert S. Reder and Victoria L. Romvary, *Delaware Court Determines* Corwin *Not Available to "Cleanse" Alleged Director Misconduct Due to "Structurally Coercive" Stockholder Vote*, 71 VAND. L. REV. EN BANC 131 (2018).

With respect to the second element, the Vice Chancellor rejected plaintiff's attack on the Tender Offer disclosures. From his point of view, the Berrys' "position as of the time of the auction process and go-shop—that is, at the time material to stockholders—was adequately disclosed." As for the Berrys' threat to sell their shares if the Board failed to initiate a sales process, the Vice Chancellor opined "it is not clear to me how this would have affected the total mix of information disclosed."

III. THE SUPREME COURT'S REVERSAL

In reversing Vice Chancellor Glasscock's dismissal of plaintiff's damages claim against the Fresh directors, the Supreme Court emphasized the importance of adequate disclosure to a *Corwin* defense. Essentially, "stockholders cannot possibly protect themselves when left to vote [or tender] on an existential question in the life of a corporation based on materially incomplete or misleading information. Careful application of *Corwin* is important due to its potentially case-dispositive impact."

The Supreme Court took particular issue with the Vice Chancellor's characterization of the action as "an exemplary case of the utility of th[e] ratification doctrine." Rather, the Supreme Court concluded that defendants "have not shown, as required under *Corwin*, that the vote was fully informed—especially given that Plaintiff's complaint alleges facts showing that the Company failed to disclose

'troubling facts regarding director behavior . . . that would have been material to a voting stockholder' " (or, in this case, a tendering stockholder). Further, "Plaintiff has unearthed and pled in her complaint specific, material, *undisclosed facts* that a reasonable stockholder is substantially likely to have considered important in deciding how to vote."

CONCLUSION

As in *Appel*, the Supreme Court's reversal of Vice Chancellor Glasscock's ruling in *Morrison* demonstrates, once again, that defendant directors' reliance on *Corwin* following a favorable stockholder vote or tender will not automatically cleanse fiduciary breaches by those directors in connection with an M&A transaction. Deal planners and their advisors must be aware that the Delaware courts treat the directors' duty of disclosure very seriously, and will give credence to well-pled allegations (as opposed to merely conclusory claims) that material information has been withheld from target company stockholders.