Vanderbilt Law Review

Volume 73
Issue 7 *En Banc*

Article 3

2020

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DELAWARE CORPORATE LAW BULLETIN

Chancery Court Declines to Apply *Corwin* at Pleading Stage to "Cleanse" Breach of Fiduciary Duty Claim Due to Material Non-Disclosures

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Criticizes failure to disclose role of conflicted CEO in conducting private negotiations with buyer while excluding board committee and financial advisor

Also grants plaintiff standing to seek post-closing damages for breach of fiduciary duty despite pending statutory appraisal action

INTRODUCTION

For those who feared *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304 (Del. 2015) ("*Corwin*") would be used by Delaware courts to rubber stamp stockholder votes approving board actions, and thereby "cleanse" any related breaches of fiduciary duty, subsequent decisions demonstrate *Corwin* has real limits. Not only have *Corwin's* dual requirements that the disinterested stockholder vote be both "fully informed" and "non-coercive" proven to have teeth, but Delaware courts have imposed other limits as well. Consider the following:

- *In re Saba Software, Inc. Stockholder Litigation*, C.A. No. 10697–VCS, 2017 WL 1201108 (Del. Ch. Mar. 31, 2017) ("*Saba Software*") denied *Corwin* cleansing because "the situation in which the Board placed its stockholders as a consequence of its allegedly wrongful action and inaction . . . created a 'circumstance [that was] impermissibly coercive.' " (For a discussion of *Saba Software*, 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)).

- *Sciabacucchi v. Liberty Broadband Corp.*, No. 11418–VCG, 2017 WL 2352152 (Del. Ch. May 31, 2017) ("*Sciabacucchi*") ruled *Corwin* cleansing will not attach in the presence of "structural coercion": "[A] situation where a vote may be said to be in avoidance of a detriment created by the structure of the transaction the fiduciaries have created, rather than a free choice to accept or reject the proposition voted on." (For a discussion of *Sciabacucchi*, see Robert S. Reder & 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)).

- *Lavin v. West Corporation*, C.A. No. 2017-0547–JRS, 2017 WL 6728702 (Del. Ch. Dec. 29, 2017) ("*Lavin*") held *Corwin* is not available to forestall a books and records inspection under § 220 of the Delaware General Corporation Law ("*DGCL*"), "a

premature stage in the litigation to consider a proper *Corwin* defense." (For a discussion of *Lavin*, see Robert S. Reder & Dylan M. Keegan, *Chancery Court Declines to Apply Corwin to Foreclose a Books and Records Inspection Under DGCL § 220*, 72 VAND. L. REV. EN BANC 1 (2018)).

- *Appel v. Berkman*, 180 A.3d 1055 (Del. 2018) ("*Appel*") declared failure to disclose material facts "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 59 (2018)).

- *Van der Fluit v. Yates*, C.A. No. 12553-VCMR, 2017 WL 5953514 (Del. Ch. Nov. 30, 2017) ("*Van Der Fluit*") faulted failure to disclose adequate information to stockholders regarding post-employment opportunities offered by the acquiring company to the two largest stockholders (who were also directors and officers). (For a discussion of *Van Der Fluit*, see Robert S. Reder & Elizabeth F. Shore, *Chancery Court Holds that Defendant Directors' Failure to Disclose Material Facts Defeated Application of Corwin*, 72 VAND. L. REV. EN BANC 41 (2018)).

- *In re Massey Energy Co. Deriv. and Class Action Litigation*, 160 A.3d 484 (Del. Ch. 2017) ("*Massey*") held directors were not eligible for *Corwin* cleansing because "there logically must be a far more proximate relationship than exists here between the transaction or issue for which stockholder approval is sought and the nature of the claims to be 'cleansed' as a result of a fully-informed vote." (For a discussion of *Massey*, see Robert S. Reder, *Chancery Court Declares Corwin is not a "Massive Eraser" for all Fiduciary Wrongdoing*, 72 VAND. L. REV. EN BANC 93 (2018)).

- *Morrison v. Berry*, No. 445, 2017, 2018 WL 3339992 (Del. July 9, 2018) ("*Morrison*") denied *Corwin* cleansing because "[p]laintiff 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." (For a discussion of *Morrison*, 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)).

In late 2018, the Delaware Court of Chancery (the "*Chancery Court*") once again denied pleading-stage application of *Corwin* when faced with well-pled allegations a stockholder vote was not fully informed. In *In re Xura, Inc. Stockholder Litig.*, C.A. No. 12698-VCS, 2018 WL 6498677 (Del. Ch. Dec. 10, 2018) ("*Xura*"), Vice Chancellor Joseph R. Slights III refused to invoke *Corwin* to dismiss a post-closing damages action—despite disinterested stockholder approval of a corporate buyout—in light of allegations of undisclosed negotiations by a target company's conflicted chief executive officer with representatives of the buyer. The Vice Chancellor also refused to dismiss plaintiff's breach of fiduciary duty claim, even though plaintiff also had pending a related appraisal action under DGCL § 262.

I. FACTUAL BACKGROUND

A. Xura's CEO Leads Buyout Negotiations with Siris

Siris Capital Group, LLC ("*Siris*") acquired Xura, Inc. ("*Xura*" or "*Company*") for a cash price of $25 per share on August 16, 2016, in a transaction structured as a merger, following a majority stockholder vote. This represented the culmination of nearly two years of on-again, off-again negotiations in which Siris bid as low as $20 to 22 per share and as high as $35 per share before arriving at the final price near the low end of that range. The fluctuating offers reflected the initial decline, subsequent rise, and ultimate decline of Xura's fortunes over this period, during which (i) Xura's stock price fell to $18.94 per share, (ii) Xura "announced disappointing . . . results," and (iii) Xura was unable to make timely filings of its required Securities and Exchange Commission reports.

The leading player for Xura in this saga was its Chief Executive Officer, Philippe Tartavull ("*Tartavull*"), who also served on Xura's board of directors (the "*Board*"). Tartavull acted as Xura's primary negotiator with Siris throughout, even though the Board ultimately established a three-person committee (the "*Strategic Committee*") to "'review, evaluate and negotiate the terms of a potential transaction with Siris and to make certain decisions between meetings of the board of directors.'" The Board also authorized management to engage "Xura's longtime financial advisor," Goldman Sachs & Co. ("*Goldman*"), "to assist the Company in the process."

Several aspects of the negotiating process (based on plaintiff's allegations) described by Vice Chancellor Slights provide insight into his analysis:

- During the negotiations, Tartavull experienced significant uncertainty over his employment status with Xura. *First*, major stockholders expressed doubt regarding Tartavull's continued leadership. In fact, Obsidian Management LLC ("*Obsidian*") threatened "to launch a proxy contest" to oust Tartavull as CEO. *Second*, Tartavull learned if a transaction with Siris was not completed, the Board would likely terminate him as CEO. Thus, as Tartavull engaged in pricing and other negotiations with Siris, "he was facing a genuine risk that he would lose his job at Xura if the Company was not acquired. And he knew it." Even though "[a]fter closing, Tartavull negotiated a long-term incentive plan that could have paid him over $25 million," he was terminated "four months after the Transaction closed" by Siris "before the plan could be executed."

- From the earliest stages of the negotiations, Siris's primary communications were with Tartavull. Siris communicated its written and oral offers to or through Tartavull, each accompanied by a declaration to the effect that Siris was "excited about the opportunity of working with the Company and its leadership team to accelerate Xura's transformation without the scrutiny and pressures of the public markets." Tartavull failed to disclose many of these contacts to the Board. In addition, Xura's Chief Financial Officer expressed concern to Goldman that "Tartavull appears to be working directly with Siris on his own."

- Furthermore, during discovery, both Tartavull and various principals of Siris failed to turn over relevant text-message and e-mail exchanges, relying on such "my dog ate my homework" defenses as:

    - with respect to one of Tartavull's phones, after he returned the phone to Xura, "Xura then restored the factory settings on the phone and thereby wiped its data";

    - with respect to one of Siris's principals, he "found his Blackberry in a ski bag" but, because he "cannot remember the password, however, no one has been able to recover any data from that device either"; and

  - with respect to another Siris principal, he "incorrectly entered the password on his phone too many times thereby triggering a feature that automatically wiped the data from memory."

- Goldman was excluded from much of the negotiations: "Tartavull communicated directly with Siris on a regular basis without keeping Goldman informed—despite Goldman's stated preference that communications go through [Goldman]." Although Goldman asked Siris to copy Goldman "on all transaction-related communications with Xura moving forward," this request generally was ignored. On one occasion, although a Siris principal "indicated he would participate in the call orchestrated by Goldman [to respond to his data requests], internally he was working with his Siris team to come up with a plan to exclude Goldman and work directly with Xura management to 'get the remaining high priority data.' "

- The Strategic Committee, "[d]espite its mandate, . . . never met with Siris, never took any formal action and never kept minutes nor any written record of its activities." One Special Committee member "did not even realize that the Special Committee existed or that he was a member of the committee until he learned about it at his deposition."

- When the Board finally authorized Goldman to shop Xura to other potential bidders to achieve a better price, of the nine possible suitors identified, four executed confidentiality agreements, but none were willing to match Siris's price.

- When the Board granted a second exclusivity period to Siris to continue negotiations, a Goldman banker "predicted Siris's next move: '[h]ere comes the price negotiation . . . [w]e are in exclusivity and now [S]iris will create a crisis to take the price down[.]' " Surely enough, "[t]he day after Goldman predicted Siris's retrade, Siris retraded."

- After Xura publicly announced it had missed its Form 10-K filing deadline, private equity investor Francisco Partners contacted Tartavull, expressing interest in bidding on Xura. However, "Francisco Partners never made a bid because, somehow, it learned Siris was the potential buyer. Instead, Francisco Partners contacted Siris about a potential co-

investment on the buy-side of the transaction." Another private equity investor, Neuberger Berman, "which at the time held over 5% of Xura's stock," expressed interest in making a bid during a forty-five-day post-signing go-shop period. Like Francisco Partners, however, Neuberger Berman ultimately decided to co-invest with Siris, contributing "$16,985,345 on the buy-side of the Transaction."

- Goldman ultimately contacted 26 potential buyers during the post-signing go-shop, including Francisco Partners and all those contacted before signing. Only three of these parties were willing to sign non-disclosure agreements with Xura, but "none submitted acquisition proposals." As noted above, Francisco Partners ultimately co-invested with Siris rather than bid on its own during the go-shop.

B. Litigation Ensues

Obsidian initially dissented from the merger vote and filed an appraisal action with the Chancery Court to obtain fair value of its Xura shares under DGCL § 262. During discovery on its appraisal action, "Obsidian uncovered evidence that . . . Tartavull . . . breached his fiduciary duties to Xura stockholders in the sale process leading up to the merger." Obsidian thereafter filed a breach of fiduciary duty claim against Tartavull in the Chancery Court, seeking post-closing damages. Ultimately, the appraisal and fiduciary duty actions were consolidated, "and the appraisal action stayed pending final adjudication of the breach of fiduciary duty" action. Tartavull moved to dismiss Obsidian's breach of fiduciary duty action.

II. VICE CHANCELLOR SLIGHTS'S ANALYSIS

In his analysis, Vice Chancellor Slights tackled four distinct issues: (1) does Obsidian have standing to bring a breach of fiduciary duty action at the same time its DGCL § 262 appraisal action is pending; (2) "if so, does Corwin cleansing apply"; (3) "if not," has Obsidian pled a viable claim for breach of fiduciary duty against Tartavull; and (4) "if so," does Board approval of the Siris transaction cleanse Tartavull's conduct?

A. Obsidian Has Standing to Sue

Tartavull argued *In re Appraisal of Aristotle Corp.*, 2012 WL 70654 (Del Ch. Jan. 10, 2012) ("*Aristotle*") demanded dismissal because Obsidian "lacks standing to pursue breach of fiduciary duty claims given that he has already filed, and has pending, a petition for appraisal relating to the Transaction." The *Aristotle* Court "rejected the plaintiffs' attempt to 'complicate' a pending appraisal case by asserting a 'late-breaking' breach of fiduciary duty claim that would 'only yield [them] a right to a 'quasi' version of something they already possess in its actual form.' "

Vice Chancellor Slights distinguished *Aristotle* in several respects. First, he noted the fiduciary breaches in *Aristotle* "raised disclosure failures," whereas the "gravamen" of the claim against Tartavull was that "a conflicted fiduciary directed Xura to consummate an undervalued transaction for reasons other than the best interests of the stockholders." Additionally, *Aristotle* "sought only quasi-appraisal as a remedy for the alleged fiduciary breach," while Obsidian pursued "more traditional post-closing remedies," such as "rescissory damages and disgorgement." Based on these differences between *Aristotle* and the action before him, the Vice Chancellor concluded Obsidian "has standing to maintain both this claim and its appraisal claim."

B. Corwin Not Applicable

Tartavull argued "*Corwin* requires application of the business judgment standard and dismissal of the claim because an informed, uncoerced majority of Company's stockholders approved the Transaction." Vice Chancellor Slights disagreed, naming seven distinct disclosure violations sufficient to prevent application of *Corwin*. Among others, the Vice Chancellor cited (i) Tartavull's regular private discussions with Siris "without the knowledge or approval of the Board or Goldman," (ii) the Strategic Committee's failure to "do the work attributed to it" in the disclosure documents furnished to Xura stockholders in connection with their vote, (iii) the luring of both Francisco Partners and Neuberger Berman, after each initially expressed interest in bidding for Xura, to instead provide financing to Siris "on the buy-side," and (iv) Tartavull's role as lead negotiator with Siris even after he "received word . . . that his position at Xura was in jeopardy if the Company was not sold."

While acknowledging boards of directors need disclose only material information to stockholders—rather than "engage in self-flagellation"—the Vice Chancellor found, at least at the pleading stage,

the allegations of insufficient disclosure concerning Tartavull's role in influencing the negotiations, "not to mention his possible self-interested motivation for pushing an allegedly undervalued Transaction," adequate to justify denying *Corwin* cleansing. In short, "Xura's stockholders could not have cleansed conduct about which they did not know."

C. Obsidian Pled a Viable Claim Against Tartavull

Vice Chancellor Slights next turned to the viability of Obsidian's allegations that Tartavull had breached his fiduciary duty in connection with his negotiation of the Siris transaction. In this connection, the Vice Chancellor pointed to "well-pled" allegations demonstrating the difference between Tartavull's interests in the transaction—"a $25 million payout and continued employment post-closing in the face of his looming termination from stand-alone Xura"—and those of Xura stockholders seeking maximum value for their shares. The Vice Chancellor also noted allegations that, at the time Tartavull engaged in "unauthorized discussions with Siris," he knew his career at Xura and livelihood were on the line. "These allegations [were] adequate at this stage," in Vice Chancellor Slights's view, "to state a claim for breach of fiduciary duty."

D. Board Approval Not Ratification

Finally, Vice Chancellor Slights rejected Tartavull's argument that approval of the Siris transaction by a majority "independent and disinterested" Board in effect ratified his conduct in negotiating the transaction. The Vice Chancellor, consistent with his rejection of Tartavull's *Corwin* defense, noted "[t]he Board, like shareholders, cannot approve (and ratify) what it did not know." Citing the "well-pled allegations that the Board was uninformed," as well as Goldman's inability to update the Board, the Vice Chancellor found "no basis to invoke Board ratification as a defense at the pleading stage, even assuming that board ratification would be a defense to a CEO's alleged breach of fiduciary duty."

CONCLUSION

Vice Chancellor Slights's analysis in *Xura* demonstrates, once again, that Delaware courts will critically examine the allegations underlying a claim that a stockholder vote was not "fully informed" before extending the benefits of *Corwin* cleansing to a corporate

fiduciary. It is not overly surprising that the allegations which ultimately led to rejection of Tartavull's *Corwin* and Board ratification defenses also drove the Vice Chancellor's refusal to dismiss the substantive allegations of Tartavull's breach of fiduciary duty.

When presented with credible allegations that a potentially conflicted and self-interested CEO has been permitted by a docile and uninformed board of directors to control negotiations with a buyer, particularly to the exclusion of a duly appointed board committee, other senior officers, and the board's financial advisor, Delaware courts prove reluctant to grant a pleading stage motion to dismiss.