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Delaware Supreme Court Cautions that "Partial and Elliptical Disclosures" Cannot Support the Application of *Corwin* Business Judgment Review

Attorneys
Jane D. Goldstein
David Hennes
Paul S. Scrivano
John E. Sorkin
Peter L. Welsh
Martin J. Crisp

On July 9, 2018, the Delaware Supreme Court held in *Morrison v. Berry* that *Corwin* business judgment review will not apply to stockholder-approved transactions when "partial and elliptical" disclosures leave stockholders less than fully informed. This decision, which reversed a dismissal by the Court of Chancery, serves as a court-described "cautionary reminder" that disclosures to stockholders must faithfully reflect material facts in order for transaction parties to benefit from the director-friendly standard established by the Delaware Supreme Court in *Corwin*.

Background

In the underlying transaction, an affiliate of Apollo Global Management, LLC acquired The Fresh Market for $28.50 per share. Apollo had historically expressed interest in acquiring the company, and had engaged in preliminary discussions with the company's founder and Chairman, Ray Berry, concerning a potential transaction. Following Apollo's unsolicited indication of interest, the company's board of directors formed a strategic transaction committee to review and negotiate a potential transaction, and Mr. Berry agreed to recuse himself from all board meetings concerning a potential transaction. The committee ran a competitive auction process that resulted in multiple premium bids. Following the auction, Fresh Market entered into a merger agreement with Apollo providing for a two-step transaction at a price that represented a 53% premium over the company's unaffected stock price and a 21-day post-signing "go-shop" period. Mr. Berry and his son, Brett Berry, agreed to roll their collective 9.8% stake in the company into an approximately 20% stake in the post-closing entity. Holders of a majority of the company's shares held by unaffiliated stockholders tendered their shares in favor of the transaction.

As is customary, the announcement of the transaction led to multi-forum litigation. Certain stockholder plaintiffs asserted claims in federal courts in both Delaware and North Carolina under Section 14 of the Securities Exchange Act of 1934, arguing, among other things, that the Schedule 14D-9 filed by Fresh Market in connection with the transaction was materially misleading, and that the transaction violated the "Best Price" Rule under Rule 14d-10. Those claims were abandoned after Fresh Market made mooting supplemental disclosures. Certain other stockholders filed a breach of fiduciary duty action in North Carolina state court, alleging that the Fresh Market directors breached their duties by failing to take steps to maximize the consideration received by stockholders in the transaction and by agreeing to preclusive deal protection provisions. Other stockholders filed statutory appraisal actions in the Court of Chancery, which eventually settled. The *Morrison* plaintiffs, whose class action breach of fiduciary duty claim against the company's directors was the subject of this appeal, took a different approach, first pursuing the company's books and records through Section 220 of the Delaware General Corporation Law. To resolve the Section 220 litigation that was filed, the company produced over 2,000 pages of documents, including board meeting minutes and certain board-level communications, including an email from the Berrys' counsel to the company's counsel, to which plaintiffs cited extensively in their complaint.

In their post-closing breach of fiduciary duty action, plaintiffs in *Morrison* claimed that the Berrys had manipulated the transaction process to favor Apollo, thereby causing the transaction to be consummated at an unfair price, and asserted that the Schedule 14D-9 was materially misleading, particularly with respect to the disclosures concerning the relationship between the Berrys and Apollo. The directors moved to dismiss, arguing that, under *Corwin*, the approval (via tender) of the transaction by a majority of fully informed and uncoerced stockholders required dismissal. Vice Chancellor Glasscock agreed, finding that none of the omitted or allegedly misleading information would have been material to stockholders because it would not have made stockholders less likely to tender their shares. The plaintiffs appealed.

Delaware Supreme Court Decision

On appeal, relying primarily on the board minutes and the email from the Berrys' counsel to company counsel obtained in the Section 220 proceeding, the plaintiffs argued that the Schedule 14D-9 was materially incomplete or misleading in four primary respects:

- It allegedly omitted information regarding whether Ray Berry had misled the board regarding the existence of a side agreement with Apollo;
- It allegedly omitted information about Ray Berry's preference for a rollover transaction with Apollo and willingness (or lack thereof) to roll equity in a potential transaction with any other buyer;
- It allegedly omitted information about Ray Berry's statement to the board that he would consider selling his shares if the company remained public; and
- It allegedly misrepresented one of the board's reasons for forming a strategic transaction committee to evaluate a potential transaction, indicating that the committee was formed in part to avoid potential activist stockholder pressure when in fact the board was already facing activist pressure.

The Court of Chancery had held that those alleged omissions and partial disclosures were immaterial because they "would not have made investors less likely to tender" their shares. Reversing the Court of Chancery, in an opinion by Justice Valihura that was joined by Justices Strine and Vaughn, the Supreme Court rejected the materiality standard applied by the Court of Chancery, concluding that information is material "if there is a substantial likelihood that a reasonable stockholder would have considered the omitted information important when deciding whether to tender her shares or seek appraisal," which is the customary materiality standard articulated in *TSC v. Northway* and typically applied by Delaware courts. The Supreme Court also highlighted the duty to avoid misleading partial disclosures.

The Supreme Court then analyzed each of the alleged omissions or misleading statements, comparing, side by side in tabular form, the relevant language from the Schedule 14D-9 with the documents produced in response to the plaintiffs' books and records demand. The Court concluded that those documents showed "troubling facts regarding director behavior" that were not disclosed in the Schedule 14D-9, and that those facts were material because "they would have shed light on the depth of the Berrys' commitment to Apollo, the extent of Ray Berry's and Apollo's pressure on the Board, and the degree that this influence may have impacted the structure of [the] sale process." In particular, the Court was troubled by the allegation that Ray Berry, according to his counsel's email, appeared to have agreed to partner with Apollo early in the process but denied the existence of such an agreement when questioned by the board. As a result, the Court concluded that the company's stockholders were not fully informed when they approved the transaction, and that the *Corwin* business judgment standard of review did not apply.

Implications

The *Corwin* decision has provided defendants with a powerful motion to dismiss argument since it was issued in October 2015. Indeed, *Morrison* is only the second case in which the Supreme Court has reversed a dismissal based on the application of *Corwin* business judgment review, with the first being the Court's decision from earlier this year in *Appel v. Berkman*.[1] The Court in *Morrison* emphasized "careful" application of *Corwin* given its potentially case-dispositive impact, and closely scrutinized the company's contemporaneous documents to see if they supported the facts disclosed in the Schedule 14D-9. Given the discrepancies it found between those documents and the public disclosures, the Court cautioned "directors and the attorneys who advise them" to avoid "partial and elliptical disclosures." This warning underscores the self-evident importance of properly reflecting the underlying factual record in disclosures to stockholders. In addition, the Court also noted certain inconsistencies between the "background of the merger/offer" section in the Schedule 14D-9 issued by the company and in Apollo's Schedule TO, which highlights the need to synchronize target and buyer disclosures, where possible.

More broadly, the decision in *Morrison* illustrates the rising use of Section 220 books and records demands by stockholder plaintiffs in the M&A context. Such demands are being used as a substitute for the pre-closing discovery that plaintiffs previously sought to obtain in connection with expedited proceedings, and, as illustrated in *Morrison*, can be used to attempt to avoid dismissal if the documents produced reveal discrepancies between the factual record and the relevant disclosures. Of course, the *Morrison* decision also shows that, despite the "sky is falling" claims from some in the stockholder plaintiffs' bar, well-pled, fact-based claims can still survive a motion to dismiss based on *Corwin* under appropriate circumstances.

[1] 180 A.3d 1055 (Del. 2018).