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Delaware Court of Chancery Decision Protects Directors from Liability, But Increases Litigation Risk to Corporate Officers

The recent Delaware Court of Chancery decision in *Morrison v. Berry*[1] illustrates the protections provided to directors in connection with strategic transactions and the corresponding risks facing corporate officers in those same transactions, particularly conflict transactions. The decision is the latest in the Fresh Market litigation, which saw Vice Chancellor Glasscock's initial decision dismissing the litigation on *Corwin* grounds reversed by the Delaware Supreme Court last year. In his most recent decision, Vice Chancellor Glasscock again dismissed the plaintiff's claims against the independent directors, this time on grounds that the plaintiff failed to plead a non-exculpated claim against those directors. Vice Chancellor Glasscock, however, held that the plaintiff had adequately pleaded non-exculpated duty of care claims against the Company's former CEO and General Counsel.

Background

The stockholder litigation concerns the acquisition of The Fresh Market by an affiliate of Apollo Global Management, LLC. Apollo initially approached the Company's founder and Chairman, Raymond Berry, regarding a potential deal, and is alleged to have reached an agreement with Berry and his son to roll over their Fresh Market equity in connection with the potential transaction. Apollo subsequently submitted an unsolicited indication of interest to the Company, noting its agreement with the Berrys. The Company's General Counsel later asked Ray Berry about his involvement with the Apollo bid, and Berry allegedly told him that "he had no involvement in formulating" the proposal, had no "agreement with Apollo," and was "not working with Apollo on an exclusive basis." The General Counsel relayed that information to the Board. The plaintiff alleges that, as the five-month sale process continued, it became apparent that Berry's prior discussions with Apollo may have been more substantive than Berry had initially disclosed.

After the transaction was announced, stockholders sued the Company's directors, alleging that they breached their fiduciary duties in connection with the transaction and that the Schedule 14D-9 filed in connection with the deal was materially misleading, including in its description of the Berrys' relationship and communications with Apollo during the sale process. Vice Chancellor Glasscock disagreed and granted the defendants' motion to dismiss, holding that the Schedule 14D-9 contained no material omissions, and that the business judgment rule therefore applied under the Delaware Supreme Court's holding in *Corwin v. KKR Financial Holdings*, 125 A.3d 304 (Del. 2015). Vice Chancellor Glasscock's core holdings were that "the *facts* regarding Berry's involvement with Apollo were disclosed" and the plaintiff's conclusion "that the auction was a sham [was] not supported by the record."

The Delaware Supreme Court reversed that dismissal,[2] holding that when compared to documents obtained through the plaintiff's pre-suit Section 220 demand, the Schedule 14D-9 contained material omissions regarding, among other things, the extent of the Berrys' commitment to partner with Apollo on a proposed transaction and Ray Berry's statements to the General Counsel and the Board on that topic. The Supreme Court concluded that the Schedule 14D-9 omitted facts that 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." Following the Supreme Court's decision, the parties conducted extensive discovery and, eight months later, the plaintiff filed an amended complaint, which added numerous additional defendants, including the Company's outside legal and financial advisors, the Company's General Counsel, and Apollo. All defendants moved to dismiss.

The Chancery Court's Latest Decision

On December 31, 2019, Vice Chancellor Glasscock issued his latest decision, which addressed only the dismissal motions filed with respect to the breach of fiduciary duty claims against the Board and the Fresh Market officers. The

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1 *Morrison v. Berry* C.A. No. 12808-VCG, 2019 WL 7369431 (Del. Ch. Dec. 31, 2019).
2 *Morrison v. Berry*, 191 A.3d 268 (Del. 2018).

Court reserved decision on the aiding and abetting claims filed against Apollo and the Company's legal and financial advisors. In particular, the Court held that:

- The plaintiff failed to state a claim against the independent directors because the Company's Section 102(b)(7) provision exculpated the independent directors for breaches of the duty of care, and the plaintiff's allegations regarding the Board's management of the sale process did not support an inference that the Board was conflicted or that it acted in bad faith. Further, the Court held that the material omissions in the Schedule 14D-9 found by the Supreme Court did not support an inference of bad faith on the part of the directors, concluding that in light of the disclosures that were included in that filing, if the directors "intent" was to mislead the stockholders, "they did a poor job."
- The plaintiff adequately pleaded that the Company's CEO and General Counsel – officers not entitled to Section 102(b)(7) exculpation – breached their duty of care because the plaintiff's allegations regarding the false and misleading statements in the Schedule 14D-9 supported an inference of gross negligence on their part in light of their alleged extensive involvement in the sale process and the preparation of the Schedule 14D-9. The Court separately held that the plaintiff failed to plead a duty of loyalty claim against these defendants.
- The plaintiff adequately pleaded that Ray Berry breached his duty of loyalty by alleging that Berry "engaged in a pattern of misdirection and lack of candor with the Board" which supported an inference that Berry "was not motivated by the best interests of the Company, and that he intentionally ignored his duties as a director," even though he recused himself from the sale process.

Implications

Vice Chancellor Glasscock's second decision highlights the powerful protections that independent directors have under Delaware law. Having avoided dismissal under *Corwin* by pleading that the Section 14D-9 was materially misleading, the plaintiff was nonetheless still unable to overcome the protections afforded to directors by DGCL Section 102(b)(7) and the Delaware Supreme Court's decision in *In re Cornerstone Therapeutics Inc., Stockholder Litig.*, 115 A.3d 1173 (Del. 2015).

Other aspects of Vice Chancellor Glasscock's rejection of the plaintiff's claims against the independent directors are also instructive. First, the Court reiterated that such directors are presumed independent, holding that the mere alleged presence of an activist stockholder, and the potential reputational risks that accompany the presence of an activist, did not render those directors self-interested. This underscores the weakness of conflict allegations based on nascent activist activity. Second, the decision reaffirms the deference courts must give to directors in administering strategic processes, noting that "there is no blueprint to fulfill fiduciary duties in the company-sale situation" and that, to state an actionable claim, a plaintiff must plead that the directors chose "to act against the interests of the stockholders" despite being aware that alternatives existed that would maximize value. Third, the Court held that the Schedule 14D-9's material omissions did not constitute non-exculpated bad faith because it is not reasonable to infer that the omissions "demonstrate an intentional derogation of duty or an intent to create a misleading document" on the part of the independent directors.

In contrast, this decision highlights the risks that general counsels and other corporate officers, who lack Section 102(b)(7) protection, face in connection with stockholder litigation. Even though the Court rejected the plaintiff's duty of loyalty allegations against the officer defendants, and stated that it was possible that it will ultimately be found at trial that the errors in the Schedule 14D-9 were made in good faith, it still found that the plaintiff had credibly pleaded that the officers were grossly negligent. This finding allowed the duty of care claims in connection with the material misstatements in the Schedule 14D-9 found by the Supreme Court to survive dismissal. After Fresh Market, directors and corporate officers should pay particular attention in conflict transactions to what arrangements may or may not exist between existing stakeholders (including founders and incumbent management) and the buyer, and not settle for perfunctory answers. This decision could embolden plaintiffs to add officers in stockholder litigation going forward as a means to attempt to evade the protections of Section 102(b)(7).

One final note: this litigation demonstrates that the Supreme Court's decision in *Corwin* has not operated to extinguish stockholder suits in situations where the underlying transaction is approved by a majority of independent stockholders, as many in the plaintiffs' bar predicted. As detailed by Chancellor Bouchard in a speech at the NYU Corporate Governance Institute on November 13, 2019, while so-called *Corwin* motions to dismiss were consistently granted in the immediate wake of the Supreme Court decision, recently such motions have been denied with greater frequency. Chancellor Bouchard's research showed that in 2016, the year after *Corwin* was decided, the Court of Chancery granted all six *Corwin* motions that it considered. However, from 2017 to 2019, the Court of Chancery denied nearly 50% of the *Corwin* motions that it considered, with the majority of these denials based on the Court's conclusion that the stockholder vote was not "fully informed" due to incomplete or misleading public disclosures. Of course, to benefit from business judgment rule protection under *Corwin*, corporate officers and directors must endeavor to confirm that the documents filed in connection with strategic transactions do not contain material misstatements or omissions, including statements concerning discussions and agreements between significant stockholders and the ultimate acquirer, which are at issue in the Fresh Market litigation.

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