The Limits of "The *Corwin* Effect"

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In *Morrison v. Berry,*[1] the Delaware Supreme Court reversed the Court of Chancery's dismissal of M&A litigation under *Corwin v. KKR Financial Holdings LLC*.[2] As in *Appel v. Berkman*,[3] the Supreme Court held that *Corwin* did not apply because of the target's failure to disclose all material facts to stockholders. The decision reiterates that Delaware courts will scrutinize disclosures to determine whether *Corwin* should apply, and *Morrison* guides boards and their counsel about how to avoid the pitfall of partial disclosures.

Background Facts

The Fresh Market (the "Company") received an unsolicited offer from Apollo Global Management LLC on October 1, 2015. Apollo stated it had discussed whether Ray Berry, the Company's founder, board member, and owner of nearly 10% of its shares, would agree to roll his equity in a deal, thus rendering him potentially "interested" in a transaction with Apollo. The board then dutifully created a special committee, hired a banker, and ran a five-month process. At the end of that process the special committee and board recommended a deal with Apollo. The Company released the required Schedule 14D-9, which incorporated Apollo's Schedule TO. Nearly eighty percent of the Company's shares tendered into the deal.

The stockholder plaintiff made a books and records demand, then sued to challenge the deal. She argued that *Corwin* should not apply because the Company did not disclose all material facts. The Court of Chancery disagreed, ruling none of the alleged disclosure issues were material, stockholders were thus fully informed, and the case would be dismissed under *Corwin*.[4]

The Delaware Supreme Court's Ruling

The Supreme Court reversed on four grounds. First, Fresh Market failed to disclose that Berry and Apollo agreed to a rollover of his shares in October. Second, the Company did not disclose Berry's clear preference for Apollo. Third, the Company failed to disclose that Berry stated he would sell his shares if the Company refused all offers and stayed public. And fourth, the

[1] No. 445, 2017, — A.3d –, 2018 WL 3339992 (Del. July 9, 2018).

[2] 125 A.3d 304 (Del. 2015). In *Corwin*, the Delaware Supreme Court held that the fully informed, uncoerced approval of a merger by a majority of disinterested stockholders would restore the presumption of the business judgment rule.

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

[4] *Morrison v. Berry*, 2017 WL 4317252, at *3 (Del. Ch. Sept. 28, 2017).

Company mischaracterized the degree and timing of stockholder pressure as it relates to the board's decision to form the special committee.

As to the agreement between Berry and Apollo, the Supreme Court held the agreement at the beginning of the deal process was material, and that it contradicted Berry's statements at board meetings in October. Berry told the board he had not committed to a transaction with Apollo, and the Company disclosed this fact. But the Supreme Court concluded that a reasonable stockholder would have wanted to (1) know that Berry was not forthcoming with the board and (2) understand his "level of commitment to a potential purchaser." The Company obscured that level of commitment in its disclosures, which were "somewhat inconsistent" with Apollo's disclosures on the topic. This "tension" between the competing disclosures put "stockholders in the untenable position of determining which one [was] accurate."

Relatedly, the Court found that Berry's clear preference for Apollo was also material. The Company disclosed that Berry was willing to roll over his equity with other purchasers. But that disclosure was misleading because Berry had stated (i) he would only do so if he was confident in the purchasers' experience in the retail food industry, (ii) Apollo was "uniquely qualified" in that respect, and (iii) he was unaware of "any other potential private equity buyer" with sufficient experience. By itself, Berry's preference could have caused stockholders to question "the openness of the sale process." But more importantly, the Company's sanitized partial disclosure was misleading, at the pleadings stage, because it led stockholders to believe that Berry was open to other bidders when, in fact, he was not.

Next was Berry's November statements that the Company should pursue a sale "at this time," his reasoning why, and that if it did not, Berry would sell his shares. The Court of Chancery ruled the information, was not material because it would not have "made investors less likely to tender" their shares. That was error, because such "an economically relevant statement of intent," could also make a stockholder more likely to tender their shares, though it need not "actually sway[] a stockholder one way or the other" to be material.

Finally, the Company's statements about activist pressure were also deemed misleading. The Company disclosed it created the special committee because it "could become the subject of shareholder pressure" from stockholders. But board minutes revealed that the Company had already received "a significant amount" of stockholder pressure. Because the Company spoke on the topic, its "stockholders were entitled to know the depth and breadth of the pressure confronting the Company."

Because of these material disclosure violations, the Supreme Court held the Defendants had not shown the stockholder vote was fully informed. As a result, the Supreme Court reversed the Court of Chancery's ruling and remanded for further proceedings.

Lessons and Implications

Morrison foremost highlights the recurring problem of partial disclosure. The Delaware Supreme Court's concern over such "partial and elliptical disclosures" goes back more than two decades.[5] However tempting it may be to draft the disclosures in the most positive light possible

[5] *Arnold v. Soc'y for Sav. Bancorp, Inc.*, 650 A.2d 1270, 1280 (Del. 1994).

for the company, counsel must be careful that in doing so the gloss they use does not change the underlying facts in a way that leaves stockholders with a distorted impression of what occurred. And once a company speaks, it assumes an obligation to tell its stockholders the full "depth and breadth" of the issues it is confronting

The decision also reiterates one of the takeaways from *Berkman*: to assure the application of *Corwin*, companies should err on the side of disclosing the information or rationale underlying the intentions of a key board member. In *Berkman*, the company's disclosures omitted the reason that Stephen Cloobeck, its founder, largest stockholder and Chairman, abstained from voting on proceeding with merger discussions. Cloobeck's reasoning was that he believed it was not the right time to sell the company because management had mismanaged the Company and so it was not fetching a worthy price. The Supreme Court ruled that information was material.

The facts in *Morrison* were similar: it was material that Berry, the Company's founder, a large stockholder, and a member of the Board, had a clear preference for Apollo and stated that he would sell his shares without a deal. The Supreme Court cited *Berkman* on this point. Though the Supreme Court avoided a *per se* rule in either case that the reasons or rationale of any board member are material, its discussion on key board members provides strong guidance that the opinions and statements of founders, chairman, and large stockholders are more likely to be material.

Finally, disclosures on each side of the transaction should not raise questions when read together. Plaintiff's attorneys pour over disclosures to look for any gaps or missing information. When the acquirer and target both make disclosures, they should work together to avoid any inconsistencies wherever possible. As in *Morrison*, any perceived gaps or inconsistencies could lead to a books and records demand, allowing a plaintiff to look behind the disclosures themselves and investigate the perceived issues.

Conclusion

Though some have claimed *Corwin* "essentially render[ed] fiduciary duty litigation toothless as a means of exposing bad actors after the fact,"[6] *Morrison* is the most recent of a growing number of decisions that refuse to apply *Corwin*. Each of those decisions guide boards and their counsel on how to avoid the disclosure shortcomings of previous parties. But even avoiding the automatic dismissal that comes under *Corwin* leaves stockholder plaintiffs in a position of pleading a viable claim for a non-exculpated breach of fiduciary duty, itself rare and no easy task. To that point, *Morrison* declined considering other grounds for affirming the Court of Chancery decision, and on remand it is possible those other grounds, such as the Company's exculpatory charter provision, provide legal defenses that warrant dismissing the plaintiff's claims. It is too soon to tell whether plaintiffs who avoid *Corwin* fare any better against those remaining defenses than plaintiffs did before *Corwin*.

[6] https://corpgov.law.harvard.edu/2018/03/07/the-cost-of-turning-a-blind-eye