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'Partial and Elliptical Disclosures' May Preclude *Corwin* Doctrine

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Under *Corwin v. KKR Financial Holdings LLC*[1] and its progeny, "when disinterested, fully informed, uncoerced stockholders approve a transaction absent a looming conflicted controller," the irrebuttable business judgment rule applies.[2] *Corwin* "cleansing" precludes all challenges to a transaction except those predicated on waste, which are unlikely to succeed. As a result, whether *Corwin* applies can be case dispositive. In the recent *Morrison v. Berry* decision, the Delaware Supreme Court reversed a Delaware Court of Chancery dismissal that relied on the *Corwin* doctrine, reiterating when the application of *Corwin* would be appropriate and emphasizing the importance of complete and accurate disclosures in establishing a fully informed vote for purposes of invoking the *Corwin* doctrine.

In *Morrison* the court reversed a dismissal under *Corwin*, in which the plaintiff raised fiduciary duty claims arising from the sale of The Fresh Market (Market) to an entity controlled by private equity fund Apollo Management VII, L.P. (Apollo).[3] The acquisition was structured as a two-step merger pursuant to 8 *Del. C.* § 251(h). As part of the deal, Market's founder, Ray Berry, who together with his son owned approximately 9.8 percent of Market's outstanding common stock, rolled over his equity ownership for an approximate 20 percent stake in the acquiror post-closing. Nearly 80 percent of Market's outstanding shares tendered into the merger.

In connection with the transaction, Market publicly filed a Schedule 14D-9 and Apollo filed a Schedule TO, both of which included descriptions of the background of the transaction. While the tender offer was still pending, stockholder plaintiff Morrison sought and obtained books and records from the company pursuant to 8 *Del. C.* § 220. The plaintiff then filed a plenary action challenging the merger, alleging, among other things, that the 14D-9 contained material disclosure violations concerning Mr. Berry's role in the sale process.

The Court of Chancery found that, despite having "pursued documents to bolster her pleading under Section 220," the plaintiff had failed to plead facts from which it was reasonably conceivable that the potentially ratifying tender was materially uninformed. But on appeal, the Delaware Supreme Court disagreed with the vice chancellor and reversed, focusing on four alleged disclosure violations that rendered the 14D-9 materially misleading.

The court first concluded that the 14D-9 was misleading because it failed to disclose the timing of Mr. Berry's agreement to roll over his shares in a transaction with Apollo. An email, produced as part of the Section 220 demand, indicated that Mr. Berry and his son had agreed to roll over their equity as early as October 2015. That email contradicted Mr. Berry's prior statements to the Market board, memorialized in board minutes, that he did not have any such agreement with Apollo at that time. This undisclosed discrepancy was likely material, the court explained, because a "reasonable stockholder" "would want to know" that Mr. Berry had not been "forthcoming" with the board.

Next, the court concluded that the 14D-9 was misleading because it "impl[ied]" Mr. Berry's "openness to consider other bidders," but did not disclose that he had expressed to the board his view that "*only* Apollo would suffice."

In addition, the court found that the 14D-9 failed to disclose a "threat" that Mr. Berry would sell his shares if the board did not undertake a sale process. The Court of Chancery had found that the omission was not material because it would not "have made investors

[1] 125 A.3d 304 (Del. 2015). The *Corwin* doctrine, and its evolution, have been discussed at length in previous issues of this publication.

[2] *Larkin v. Shah*, C.A. No. 10918-VCS, slip op. at 20-21 (Del. Ch. Aug. 25, 2016).

[3] *Morrison v. Berry*, 191 A.3d 268, 288 (Del. 2018).

less likely to tender." But, the Supreme Court noted, "[t]hat is not the test." Rather, the proper inquiry of whether "omitted information is material" is whether "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."

Finally, the court concluded that the 14D-9's disclosure regarding the Market board's reason for forming a strategic committee was materially misleading. The 14D-9 stated the committee was formed because the company "could become" the subject of shareholder pressure, but Market had, in fact, "*already* become" subject to such pressure. Because "the Company chose to speak on the topic, stockholders were entitled to know the depth and breadth of the pressure confronting the Company, especially given that it already existed."

Based on these four disclosure violations, the Supreme Court reversed the Court of Chancery's dismissal and remanded the case for further proceedings.

Key Takeaways

- In *Morrison v. Berry*, the Delaware Supreme 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."
- With fewer cases seeking pre-closing injunctions, there is less opportunity for companies to resolve disclosure challenges with supplemental disclosures prior to a stockholder vote. This further underscores the importance for boards to retain and rely on knowledgeable and experienced legal and financial advisors throughout the sale process, particularly when the transaction structure permits the potential application of the *Corwin* defense to dismiss any post-closing litigation.
- *Morrison* comes on the heels of the Delaware Supreme Court's recent decision in *Appel v. Berkman*,[4] in which the court similarly reversed a dismissal under *Corwin* based, in part, on perceived inconsistencies between the company's public disclosures and documents obtained in response to a Section 220 demand. As these cases illustrate, Section 220 demands are an increasingly common tactic that may be utilized by stockholder plaintiffs in attempting to overcome a *Corwin* ratification defense.

[4] 180 A.3d 1055 (Del. 2018). *Appel v. Berkman* is discussed at length in "Delaware Supreme Court Reverses Court of Chancery's Dismissal Under *Corwin*," *Skadden Insights*.