

Delaware Supreme Court Reaffirms Incomplete Disclosures Do Not Qualify for *Corwin* Business Judgment Rule “Cleansing”

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Authors: [Michael Deyong](#), [Gabrielle Hodgson](#)

The Delaware Supreme Court has reversed the Delaware Chancery Court’s earlier dismissal of a stockholder challenge to the sale of The Fresh Market, finding that Fresh Market had not disclosed all material facts regarding the founder’s involvement in negotiations with the acquirer.

Since the proposed transaction involved a tender offer, the Company filed the required Schedule 14D-9 Solicitation/Recommendation Statement, which included a narrative of the events leading up to the transaction and disclosed that Fresh Market’s founder, Ray Berry, and his son—who together owned 9.8 percent of Fresh Market’s shares—were to roll over their equity and receive a 20 percent stake in the Company upon the closing. While the Delaware Chancery Court dismissed the stockholder challenge to the transaction, finding that the ratification doctrine set forth in *Corwin*, and extended to tender offers in *In re Volcano Corp.*, applied, the Supreme Court disagreed, finding instead that because the Company’s 14D-9 disclosures allegedly failed to include facts regarding the level of Berry’s commitment to the acquirer, the stockholders were not fully informed of all facts that would have been material to a voting stockholder. The Court thus held that failure to disclose these facts denied Fresh Market’s board the “cleansing” effect of stockholder approval of the transaction.

Background

In early 2016, Fresh Market announced plans to go private and filed a public 14D-9 setting forth the board’s recommendation to stockholders and a chronology of the bid process. The 14D-9 disclosed that, upon receiving a letter of interest from the acquirer, Ray Berry denied that he had an agreement with the acquirer and recused himself from board meetings through the date Fresh Market entered into the merger agreement. Although the acquirer’s Schedule TO—a filing required by the tender offer—noted that the acquirer had several discussions with the Berrys prior to submitting its proposal (including a call in which the Berrys confirmed they would participate in an equity rollover), the 14D-9 described this communication merely as a “courtesy call” and stated that Berry had not been involved in formulating the acquirer’s proposal. The tender offer closed as scheduled with 68 percent of the outstanding shares tendered.

Stockholder Elizabeth Morrison subsequently filed a lawsuit to obtain copies of Fresh Market’s books and records, and thereafter filed fiduciary breach claims against Fresh Market’s board (including Ray Berry) and a claim against Berry’s son for aiding and abetting the breach. Morrison alleged that an email from Berry’s counsel to Fresh Market’s lawyers disclosed that Berry had an agreement with the acquirer at the time the acquirer first

approached Fresh Market's board, despite Berry's denial to the board that such agreement existed. Through this and other communications obtained via the records request, Morrison identified the following undisclosed facts that allegedly rendered the 14D-9 materially misleading: (i) the existence of an agreement between Berry and the acquirer early in the bid process, contrary to Berry's denial of same, (ii) Berry's stated preference for a rollover transaction involving the acquirer, (iii) Berry's statement to the board that he would consider selling his shares if the company was not sold, and (iv) that the board was already subject to *existing* activist pressure at the time it formed a committee to review the acquirer's proposal.

The Court of Chancery rejected Morrison's claim that the auction process had a pre-determined winner and that the 14D-9 disclosures were inadequate to allow the vote to serve as ratification of the sale, finding that the facts regarding Berry's level of involvement in the bid process, including his outside discussions with the acquirer after the expiration of the acquirer's first offer, were disclosed in the 14D-9.

The Supreme Court's Decision

The Supreme Court found that the Chancery Court erred in finding that the facts regarding Berry's involvement with the acquirer were adequately disclosed, noting that Morrison had pled specific, material, undisclosed facts that a reasonable stockholder is substantially likely to have considered important in deciding how to vote, including "troubling facts regarding director behavior" (quoting *Corwin*). Although the acquirer's Schedule TO (incorporated into the 14D-9 by reference) disclosed several of the facts that Morrison's complaint claims the 14D-9 failed to include, the Supreme Court noted that tension between the 14D-9 and the Schedule TO put stockholders in the untenable position of determining which one is accurate, thus, a Schedule TO cannot repair inadequacies in 14D-9 disclosures. In addition, although the 14D-9 did disclose that Berry had been in communication with the acquirer and that the equity rollover was a key feature of the transaction, the Court reaffirmed Delaware Supreme Court precedent in asserting that the board had an obligation to provide an accurate, full and fair characterization of the history leading up to the transaction once it had "traveled down the road of partial disclosure." Since the stockholders had not been provided with all material facts relating to what the 14D-9 did disclose, the claims that the board had breached its fiduciary duties could not be "cleansed" by a fully informed stockholder vote.

Finding that Morrison's complaint alleged facts showing that Fresh Market failed to disclose material facts related to Berry's involvement with the acquirer and that the omission of such facts precluded the invocation of the business judgment rule standard at the pleading state, the Supreme Court reversed and remanded Morrison's claims to the Court of Chancery.

Conclusion

The Supreme Court's decision is consistent with its recent decision in *Appel v. Berkman*, which found that the reasons for a chairman's abstention from a vote to sell the company were material and should have been disclosed. While the business judgment rule, when invoked, usually results in dismissal of the claims (absent a showing of waste), the Supreme Court has reaffirmed through these decisions that boards will not receive the benefit of the "cleansing" effect of the business judgment rule for ambiguous, incomplete or misleading disclosures. Boards should scrutinize the presentation of their public disclosures for consistency and accuracy and not rely on disclosures made in other filings referenced or incorporated into their own disclosures to explain the full context of the transaction.

White & Case LLP
1221 Avenue of the Americas
New York, New York 10020-1095
United States

T +1 212 819 8200

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