DELAWARE CORPORATE LAW BULLETIN

Chancery Court Refuses To Dismiss Aiding and Abetting Claim Against Target Company Financial Advisor, but Grants Dismissal to Outside Counsel and Buyer

*Robert S. Reder**

*Katherine H. Monks***

**Professor of the Practice of Law at Vanderbilt University Law School. Professor Reder has been serving as a consulting attorney at Milbank LLP in New York City since his retirement as a partner in April 2011.*

***Senior En Banc Editor, 2021–2022, VANDERBILT LAW REVIEW; Vanderbilt University Law School, J.D. Candidate, May 2022.*

Well-pled allegations that financial advisor intentionally deceived target board regarding conflicts of interest defeat bid for pleading-stage dismissal

INTRODUCTION 446
I. FACTUAL BACKGROUND 448
A. Fresh Market Receives Apollo Buyout Offer 448
B. Fresh Market Sales Process 449
C. Committee Requests Additional Financial Projections . 450
D. Apollo Completes Buyout; Litigation Ensues 451
II. VICE CHANCELLOR GLASSCOCK'S ANALYSIS 452
A. Aiding and Abetting 452
B. JPMorgan Motion To Dismiss Denied 452

1. Revlon Claim 453
2. Disclosure Claim... 454
C. Cravath Motion To Dismiss Granted 454
D. Apollo Motion To Dismiss Granted 455
CONCLUSION.. 455

INTRODUCTION

In a search for deep-pocketed defendants in M&A-related stockholder litigation, plaintiffs often add aiding and abetting claims against financial advisors, outside counsel, and buyers to the underlying breach of fiduciary duty claims. Consider, for example, *RBC Cap. Mkts., LLC v. Jervis*, 129 A.3d 816 (Del. 2015) ("*RBC*"). In *RBC*, the Delaware Supreme Court ("*Supreme Court*") affirmed a ruling by the Delaware Court of Chancery ("*Chancery Court*") that assessed substantial damages against a financial advisor alleged to have aided and abetted a breach of fiduciary duties by its client, a target board of directors. The Chancery Court had determined that the financial advisor prevented the target directors from fulfilling their fiduciary duties by failing to disclose various conflicts of interest, even though the directors themselves were protected from liability by an exculpatory charter provision adopted under Section 102(b)(7) of the Delaware General Corporation Law ("*Exculpatory Provision*"). Nevertheless, the pleading standard established in *RBC* for establishing aiding and abetting liability—that is, scienter—is indeed a high one. For a discussion of *RBC*, see Robert S. Reder & Margaret Dodson, *Delaware Supreme Court Upholds Multi-Million Dollar Damages Award Against Sell-Side M&A Advisor*, 69 VAND. L. REV. EN BANC 27 (2016).

Six years after *RBC*, in the fourth installment of the litigation saga surrounding the buyout of "specialty grocery retailer" The Fresh Market, Inc. ("*Fresh Market*" or "*Company*") by private equity firm Apollo Global Management, LLC ("*Apollo*"), the Chancery Court delivered another potentially serious blow to a financial advisor accused of aiding and abetting a fiduciary beach (quoting *Morrison IV* here and throughout the piece unless otherwise noted). A former Fresh Market stockholder ("*Plaintiff*") initiated this saga in October 2016.

- In the *first* installment, *Morrison v. Berry*, No. 12808-VCG, 2017 WL 4317252 (Del. Ch. Sept. 28, 2017) ("*Morrison I*"), Vice Chancellor Sam Glasscock III dismissed breach of fiduciary duty claims against Fresh Market directors on the basis of *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015) ("*Corwin*"). Without investigating whether a breach occurred in connection

with the sales process, the Vice Chancellor found "that the majority vote of disinterested stockholders cleansed any breaches of duty" (quoting *Morrison III*).

- In the *second* installment, *Morrison v. Berry*, 191 A.3d 268 (Del. 2018) ("*Morrison II*"), the Supreme Court reversed *Morrison I*, determining that *Corwin* "cleansing" was unavailable because the Fresh Market directors failed "to show the stockholder vote was fully informed" (quoting *Morrison III*). For a discussion of *Morrison I* and *Morrison II*, see Robert S. Reder, *Delaware Supreme Court Once Again Reverses Dismissal of Fiduciary Breach Claims Brought Against Target Company Directors*, 72 VAND. L. REV. EN BANC 71 (2018).
- In the *third* installment, *Morrison v. Berry*, No. 12808-VCG, 2019 WL 7369431 (Del. Ch. Dec. 31, 2019) ("*Morrison III*"), on remand, Vice Chancellor Glasscock again dismissed fiduciary breach claims against all but one of the Fresh Market directors, namely, Chairman of the Board and former CEO Ray Berry ("*Berry*"). The other directors escaped liability because Plaintiff failed to plead facts satisfying the high bar to liability imposed by an Exculpatory Provision. On the other hand, Plaintiff adequately pled that Berry violated his duty of loyalty by acting in bad faith in connection with the sales process. For a discussion of *Morrison III*, see Robert S. Reder & Lorin Hom, *Chancery Court Dismisses Breach of Fiduciary Duty Claims Against Target Company Directors Despite Unavailability of* Corwin *Defense*, 73 VAND. L. REV. EN BANC 111 (2020).
- Finally, in the *fourth* installment, Vice Chancellor Glasscock confronted claims brought against Fresh Market financial advisor J.P. Morgan Securities, LLC, ("*JPMorgan*") and outside counsel Cravath, Swaine & Moore LLP ("*Cravath*"), as well as Apollo, for aiding and abetting the fiduciary duty claims addressed in *Morrison III*. *Morrison v. Berry*, No. 12808-VCG, 2020 WL 2843514 (Del. Ch. June 1, 2020) ("*Morrison IV*"). In *Morrison IV*, the Vice Chancellor denied JPMorgan's motion to dismiss, ruling that Plaintiff pled facts sufficient to reasonably infer that JPMorgan (i) intentionally deceived the Fresh Market board of directors ("*Board*") about ongoing conflicts, which in turn (ii) negatively impacted the Board's disclosures in materials furnished to Fresh Market stockholders in connection with their approval of the transaction. By contrast, the Vice Chancellor granted pleading-stage dismissal to both Cravath and Apollo, finding that Plaintiff failed to plead facts adequate to establish scienter on the part of those defendants.

I. FACTUAL BACKGROUND

A. Fresh Market Receives Apollo Buyout Offer

After Fresh Market's stock traded at an all-time high of $40.83 in early January 2015, on January 11 the Board terminated the President & CEO "without cause and without a permanent replacement lined up" (quoting *Morrison III* here and for the rest of the Factual Background section unless otherwise noted). In response, the Company's stock price dropped 11% in a single day and continued to fall "[d]uring the eight-month search for a CEO" until it reached a low of $18.70 in August. Nevertheless, the Company "evinced more optimism" than the market, with Berry (who together with his son owned 9.8% of the outstanding Company shares) asserting that the Company "had 'a huge untapped future.' " At that time, JPMorgan prepared a discounted cash flow analysis suggesting "a value range of $45.75 to $60.75."

Apollo " 'pounced' on the opportunity" presented by the declining stock price to discuss with Berry a potential buyout of Fresh Market. Berry "did not disclose Apollo's inquiries to either the interim-CEO or the lead director." Meanwhile, in response to demands from institutional stockholders for "urgent action to end the downward drift" in the stock price, on September 1 the Company hired a new CEO.

Despite the Board's decision not to pursue inquiries from two other private equity firms given the recent CEO hire, Berry not only continued discussions with Apollo but also "orally agreed with Apollo to roll over [the Berrys'] equity" in a proposed Company buyout that potentially "would increase the Berry[s'] . . . ownership from approximately 9.4% pre-deal to 28.3% post-deal." On September 25, Berry finally advised the Company's General Counsel "about Apollo's acquisition proposal." Then, on October 1, Apollo formally submitted a proposal to the Board to acquire the Company at $30 per share, "includ[ing] an equity rollover with the Berrys" with whom Apollo "will be working . . . in an exclusive partnership."

The Board called a special meeting for October 15 to discuss Apollo's offer, with Cravath in attendance. According to the Board minutes, Berry recounted three conversations with Apollo: (i) "a general industry discussion"; (ii) "a conversation about a potential transaction in which Berry expressed willingness to sell his shares for cash or roll over his equity, contingent . . . upon the Board's support"; and (iii) "a courtesy call." Berry also claimed he told certain Board members of his discussions with Apollo, "had no involvement formulating Apollo's proposal," had no "commitment to or agreement with Apollo," "was not working with Apollo on an exclusive basis," and was "unaware" of

separate discussions between Apollo and his son. Neither the Board nor Cravath "inquired further," although Cravath asked Berry if he would participate in an equity rollover with an acquirer *other than* Apollo (quoting *Morrison IV*). While maintaining "he had not committed to a transaction with Apollo," Berry also stated he was unaware of any potential private equity buyer other than Apollo with "experience in the food retail industry with whom he would be comfortable."

At the October 15 meeting, the Board formed a Strategic Transaction Committee ("*Committee*") to develop a strategic plan. That same day, Apollo sent the Board a follow-up letter regarding its " 'proposal (together with [the Berrys]) to acquire' Fresh Market," stating that "Apollo (together with the [Berrys'] rollover) is able and willing to provide 100% of the equity commitment required in this potential transaction." Apollo set a deadline of October 20 for a response.

After a news leak suggesting a potential private equity buyout of Fresh Market, at an October 18 meeting "the Board decided to publicly announce the commencement of a review of strategic and financial alternatives." Two day later, the Board informed Apollo that Berry had confirmed that "he has no . . . arrangement with Apollo." Apollo promptly withdrew its offer, but "continued to engage in discussion with the Berrys."

Then, on November 25, Apollo renewed its interest in a letter to JPMorgan, offering to purchase Fresh Market "together with [the Berrys]" for $30 per share. Prompted by inquiries from Cravath, on November 28 Berry's counsel sent Cravath an email indicating, among other things, that Berry would "roll his equity interest over into the surviving entity" if Apollo agreed to a buyout; if not, he "would consider rolling his equity interest over" into a buyout by another firm, "provided he has confidence in its ability." In addition to reaffirming his belief that Apollo was "uniquely qualified," Berry threatened to "give serious consideration to selling his stock when permitted" if the Company remained public because he believed that the Company was not then "well positioned to prosper as a public company."

B. Fresh Market Sales Process

The Board, at an early December meeting held to discuss Apollo's offer, authorized the Committee to design a sales process. Berry again confirmed his "willingness to discuss an equity rollover with a successful bidder other than Apollo," while committing "not to discuss an equity rollover with any party until authorized to do so by Fresh Market." Thereafter, Apollo and Fresh Market signed a confidentiality

agreement in which Apollo committed “not to ‘initiate or maintain contact’ with any director at Fresh Market without the Company’s express permission.” Despite this commitment, Apollo continued contacts with Berry and members of his family.

In the sales process, “J.P. Morgan contacted thirty-two potential bidders, twenty of whom signed confidentiality agreements and received due diligence.” JPMorgan represented to the bidders that “Berry was open to discussing a potential rollover,” despite internal Apollo documents showing “it considered itself partnered exclusively with the Berrys.” Although several bidders showed interest, the Company “accelerated the process for Apollo,” who submitted a definitive bid of $27.25 per share, $2.75 less than its initial indication.

Before the Board proceeded further with the process, JPMorgan provided a conflicts disclosure memorandum (“*Conflicts Memorandum*”) disclosing that JPMorgan team members “were not ‘currently providing services’ to Apollo.” However, unbeknownst to the Board, Apollo’s “client executive” at JPMorgan (“*Client Executive*”) “fed inside information on the bid process to Apollo, even though he was not on the Fresh Market transaction team” (quoting *Morrison IV*). This inside information “gave Apollo a distinct advantage, including being able to submit its bid earlier than other parties” (quoting *Morrison IV*). Then, after other bidders submitted initial indications of interest, the Client Executive “championed Apollo behind the scenes at J.P. Morgan,” who then advised the Committee that “Apollo continued to be motivated about the transaction, while other suitors[ ] . . . waned” (quoting *Morrison IV*).

C. Committee Requests Additional Financial Projections

From December 2015 until the end of the sales process in March 2016, management prepared several different financial projections for the Board, reflecting Committee “feedback . . . from potential bidders that there was a high degree of perceived execution risk inherent in the Corporation’s strategic plan.” On March 3, the Committee asked management and JPMorgan to “refine . . . and develop additional financial projection scenarios.” The resulting changes were substantial: “On March 7, the three initial scenarios provided a range of share value spanning from $27.24 to $40.12 per share; by the final version on the evening of March 8, the range was $20.89 to $32.73 per share.”

After the Committee determined on March 8 that Apollo’s $27.25 bid was “insufficient,” Apollo submitted its “ ’best and final’ offer of $28.50 per share.” At this point, the Committee allowed Apollo to “engage in ‘chaperoned’ discussions with the [Berrys]” regarding their

equity rollover. On March 10, the Committee recommended that the Board accept Apollo's offer. In this connection, the Committee described the latest management projections as "optimistic," justifying acceptance of the lowered bid. At the same time, however, inter-Company communications revealed "internal skepticism" concerning JPMorgan's valuation analysis in light of management's rosier projections and the downside scenarios utilized by JPMorgan. Absent these downside revisions, JPMorgan's analysis would have implied "a valuation range of $33.75 to $42.25 per share," well in excess of Apollo's final offer.

D. Apollo Completes Buyout; Litigation Ensues

The Board approved Apollo's $28.50 per share buyout offer on March 11, paving the way for the parties to sign a merger agreement ("*Merger Agreement*"). Fresh Market announced the "$1.36 billion" acquisition, including Berrys' equity rollover, three days later. The Merger Agreement provided for (i) a "twenty-one-day 'go-shop' period" following signing for Fresh Market to solicit higher offers, (ii) matching rights for Apollo if a superior bid arose during the go-shop period, and (iii) a $34 million termination fee payable to Apollo, representing 2.5% of the buyout price, if the Board accepted a superior proposal. No alternative bidder emerged within the go-shop period.

On March 25, the Company, with Cravath's assistance and following Board approval, filed materials with the Securities and Exchange Commission providing required disclosures to Fresh Market stockholders in connection with their decision of whether to accept Apollo's buyout ("*SEC Filing*"). Vice Chancellor Glasscock determined in *Morrison III* that the SEC Filing omitted several "conceivably material" facts (quoting *Morrison IV*). Soon thereafter, Apollo completed the buyout. Due to their equity rollover, the Berrys increased their ownership stake in the Company to 22%, with the remainder owned by Apollo.

Plaintiff filed her original Chancery Court complaint on October 6, alleging breaches of fiduciary duty by the Board members, including Berry. After the *Morrison II* Court reversed Vice Chancellor Glasscock's grant of defendants' motions to dismiss, Plaintiff added claims for "aiding and abetting a breach of fiduciary duty" against JPMorgan, Cravath, and Apollo (quoting *Morrison IV*). In *Morrison III*, the Vice Chancellor granted all Board members' motions to dismiss, other than Berry's. However, the Vice Chancellor reserved decision on motions to dismiss submitted by JPMorgan, Cravath, and Apollo, pending

supplemental briefing. On June 1, 2020, the Vice Chancellor decided *Morrison IV*.

II. VICE CHANCELLOR GLASSCOCK'S ANALYSIS

In "the current installment of this long-running litigation," Vice Chancellor Glasscock considered motions to dismiss advanced by the Company's financial and legal advisors and Apollo, claiming Plaintiff failed to plead adequately "aiding and abetting a breach of fiduciary duty." In *Morrison IV*, the Vice Chancellor granted Cravath's and Apollo's motions to dismiss but, notably, denied dismissal to JPMorgan.

A. Aiding and Abetting

According to the Vice Chancellor, "[a] party is liable for aiding and abetting when it knowingly participates in any fiduciary breach." "Knowing participation," in turn, "requires that the . . . party act with the knowledge that the conduct advocated or assisted constitutes such a breach." Thus, if the party (i) knows that a board of directors is breaching its duty and (ii) participates in the breach by "misleading the board or creating the informational vacuum," then the party can be held liable for aiding and abetting the fiduciary breach.

Vice Chancellor Glasscock channeled *RBC* for the proposition that aiding and abetting liability may attach "if the advisor, with the requisite scienter, caused the board to act in a way that made the transaction process itself unreasonable, under the situational reasonableness standard announced in *Revlon* and its progeny." Accordingly, "where a conflicted advisor has prevented the board from conducting a reasonable sales process, in violation of . . . *Revlon*, the advisor can be liable for aiding and abetting that breach without reference to the culpability of the individual directors." And, consistent with this principle, "[t]he advisor is not absolved from liability simply because its clients' actions were taken in good-faith reliance on misleading and incomplete advice tainted by the advisor's own knowing disloyalty." Nevertheless, the pleading standard in aiding and abetting litigation is "a high one; a plaintiff must plead facts making it reasonably conceivable that the alleged aider-and-abettor acted with scienter."

B. JPMorgan Motion To Dismiss Denied

Plaintiff alleged that JPMorgan aided and abetted the Board's (i) failure to ensure that the sale process complied with the standards

laid down in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) ("*Revlon*"), and its progeny, and (ii) preparation of the misleading SEC Filing.

1. Revlon Claim

At the outset, Vice Chancellor Glasscock observed that because (i) he dismissed claims in *Morrison III* that the Company directors (other than Berry) breached their duty of loyalty, and (ii) the directors were protected by the Exculpatory Provision, he had no need, at that time, to consider whether the directors breached their duty of care. The Exculpatory Provision, however, "does not insulate aiders-and-abettors from liability" if the directors had in fact breached their duty of care. Specifically, "[w]here a financial advisor like J.P. Morgan has knowingly misled the board in a way that has caused the board to fail to comply with its *Revlon* duties" to get the best value reasonably available for stockholders, "the advisor may be liable for aiding-and-abetting breaches of those duties."

With regard to the directors' duty of care, the Vice Chancellor turned to Plaintiff's allegations that JPMorgan was "incentivized to facilitate a sale to Apollo" because, as "a major client of JP Morgan," Apollo paid "over $116 million in fees in the two years preceding the Fresh Market sale." Moreover, the Conflicts Memorandum "gave the false impression to the Board that the Apollo [ ] team was distinct from the Fresh Market M&A team, when, in fact, JP Morgan and Apollo were using [the Client Executive] as a conflicted backchannel and intermediary." Moreover, following receipt of the Conflicts Memorandum, the Board "did not probe further." On this basis, the Vice Chancellor found "it reasonable to accept . . . Plaintiff's inference that . . . the Board's failure to comprehend its financial advisor's conflict of interest with the sole bidder conceivably breached duties imposed in the *Revlon* context."

Next, the Vice Chancellor concluded that Plaintiff also pled facts from which he could "infer that J.P. Morgan aided and abetted such a breach" by

- allowing Apollo "substantial contact" with the Fresh Market M&A team, "both directly and by using [the Client Executive] as [an] intermediary which . . . influenced the bid process in Apollo's favor";
- "artfully draft[ing]" the Conflicts Memorandum so that it "fail[ed] to mention these substantive back-channel communications"; and

- "intentionally disguised its communications with Apollo and thus knowingly deceived the Board about its ongoing conflicts."

From this, Vice Chancellor Glascock inferred that (i) JPMorgan acted with the "requisite scienter to support liability," and (ii) "if Apollo actually gained insight and favorable treatment, it may have used this to its advantage, . . . supporting damages."

2. Disclosure Claim

Vice Chancellor Glasscock also found it "reasonably conceivable," for purposes of JPMorgan's motion to dismiss, that JPMorgan aided and abetted the Board's breaches of its duty of care by virtue of the SEC Filing disclosure violations. Quoting from *RBC*, the Vice Chancellor explained that "an advisor's 'failure to fully disclose its conflicts and ulterior motives to the Board . . . led to a lack of disclosure.' " Had JPMorgan been forthcoming, and had the Board, in turn, disclosed JPMorgan's conflicts in the SEC Filing, Company stockholders plausibly would have found the omitted information "to be material."

C. Cravath Motion To Dismiss Granted

The "crux" of Plaintiff's allegation that Cravath aided and abetted the Board's duty of care violations stemming from the "negligently drafted" SEC Filing, according to the Vice Chancellor, was "Cravath's scienter." In other words, to aid and abet, "an advisor must act knowingly." According to the Vice Chancellor, this requirement "provides advisors . . . with 'effective immunity from due-care liability.' "

When the Vice Chancellor dismissed breach of duty of loyalty claims against Company directors in *Morrison III*, Plaintiff was left with "the difficult argument that Cravath *intentionally and knowingly* caused the Board to *carelessly* draft and release [the SEC Filing] with material facts omitted." In this connection, Plaintiff claimed "Cravath intentionally engineered a misleading [SEC Filing] to hide 'what may have been bad lawyering' . . . to evade potential objections from stockholders and collect its transaction fee." In support, Plaintiff pointed to Cravath's $5.5 million transaction fee paid at closing and the "significant effort" devoted by Cravath to preparation of the SEC Filing.

The Vice Chancellor was unconvinced, noting that "[t]he nonconclusory allegations supporting such a claim fall short of well-pled allegations of scienter." Indeed, the facts cited by Plaintiff were "unremarkable . . . [and] apply to virtually any outside counsel in [an

M&A] scenario." The Vice Chancellor also observed that allowing such an inference of scienter to stand would "work much mischief in the ability of a board to have confidential and competent advice from legal advisors."

D. Apollo Motion To Dismiss Granted

While, as a buyer, Apollo had "the right to work in its own interests to maximize its value," a buyer may be liable on an aiding and abetting theory to the extent it "attempts to create or exploit conflicts of interest in the board." Plaintiff alleged Apollo aided both (i) Berry's breaches of duty of loyalty and (ii) the Board's disclosure-related breaches. Vice Chancellor Glasscock dismissed this claim as well.

Although, in *Morrison III*, the Vice Chancellor found that Berry breached his duty of loyalty by using " 'silence, falsehoods, and misinformation' about his relationship with Apollo in a way that conceivably harmed the Company[,] . . . Plaintiff does not adequately allege that Apollo participated in this breach." For instance,

- not only was there was no allegation that Apollo knew Berry withheld information from the Board, but, to the contrary, Apollo informed the Board *five times* regarding its partnership with Berry;
- even after the Company told Apollo that "it had confirmed with [Berry] that he had no exclusive relationship with Apollo," Apollo continued to maintain its association with the Berrys; and
- by the time of the sale, the Board had "an accurate picture of the landscape."

Thus, the Vice Chancellor found no reasonable inference that Apollo "knowingly advocated or assisted" Berry's deception. This finding had implications for the disclosure violations as well. Even if continued communications with Berry violated Apollo's no-contact agreement with the Company, these communications were to "re-affirm an understanding about which the Board was already aware," rather than assist Berry's deceptive breach.

CONCLUSION

Although Apollo's acquisition of Fresh Market was completed in March 2016, stockholder litigation challenging various aspects of the sale process has dragged on. After addressing the fiduciary breach claims brought against Fresh Market's directors in *Morrison III*, Vice Chancellor Glasscock turned to aiding and abetting breach of fiduciary

duty claims brought against Fresh Market's financial and legal advisors, as well as the acquiror, in *Morrison IV*. Focusing on the adequacy of Plaintiff's pleadings, the Vice Chancellor's decision to grant dismissal to Cravath and Apollo, although not to JPMorgan, demonstrates the high pleading bar plaintiffs face when bringing aiding and abetting claims in the M&A context. In light of Chancery Court precedent, it is not particularly surprising that it was the financial advisor, rather than the outside counsel or buyer, who failed to gain pleading-stage dismissal in *Morrison IV*.

With *RBC* as the backdrop, Vice Chancellor Glasscock required Plaintiff to demonstrate, at least at the preliminary motion stage, that it was reasonably conceivable that, *first*, the Board engaged in an unreasonable transaction process under *Revlon* and, *second*, the alleged aider and abettors, acting with scienter, caused the Board to violate its fiduciary duties. Plaintiff was unable to carry this burden with regard to Cravath and Apollo due to an inability to plead "actions in bad faith through which the aider knowingly advanced the breach." By contrast, Plaintiff successfully pled sufficient facts to establish, at least for purposes of avoiding a preliminary motion to dismiss, both a breach of *Revlon* duties by the Board *and* that JPMorgan *knowingly* caused the Board to breach said duties and its disclosure duties. As such, it mattered not that the Board members themselves, other than Berry, won dismissal of the fiduciary breach claims leveled against them by Plaintiff.