Lessons In Chancery Toss Of Claims Against CoreLogic CEO

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In a Feb. 1 decision in Teamsters Local 677 v. Martell, the Delaware Court of Chancery, at the pleading stage of litigation, **dismissed** claims that Frank Martell, the former CEO-director of CoreLogic Inc., breached his fiduciary duties in connection with the $6 billion sale of the company to Stone Point Capital LLC and Insight Partners LLC.

The plaintiff alleged that the real reason CoreLogic's board chose the bid submitted by Stone Point and Insight — a financial buyer — over a competing all-stock bid with a higher implied value submitted by CoStar Group Inc. — a strategic buyer — was that the board deferred to the CEO's desire to sell to a financial buyer so that he would retain his job post-merger.

The plaintiff relied primarily on public comments by Andrew Florance, CoStar's CEO, that suggested that the sale process was infected by what he considered to be a usual preference by senior managers for financial buyers over strategic buyers based on their view that the former often retain senior management while the latter often do not.

Key Points

No Implicit Entrenchment Motive

The court dismissed claims that an officer steered an independent board to favor a financial buyer's bid over a strategic buyer's bid based solely on speculation that the officer had an implicit entrenchment motive.

Such a motive could not be reasonably inferred based solely on speculation arising from the CoStar CEO's public comments about the sale process, particularly as the plaintiff had conducted a Section 220 investigation of the corporate books and records and had cited nothing in these documents to substantiate the claims.

Concerns That Justify Selecting a Lower Competing Bid

Antitrust delay and uncertainty of value concerns can justify selecting a lower competing bid. The court rejected the plaintiff's contention that, given that there were no meaningful antitrust issues associated with CoStar's deal, the board's purported antitrust concerns about the bid must have been a pretext.

The court noted that a deal with no meaningful antitrust issues is different from a deal with no antitrust issues.

The court also found no basis on which to reasonably infer that the board did not actually have a concern about value certainty of CoStar's stock deal, particularly given that CoStar's stock, although high, had been steadily declining.

Background

CoreLogic's board was composed of Martell, who was the company's CEO, and 11 outside directors, three of whom had been recently elected in a proxy contest brought by investment funds whose unsolicited proposal to acquire the company had been rejected.

CoreLogic engaged in a monthslong shopping process, which attracted substantial interest. The board ultimately narrowed the field to an all-cash bid from Stone Point and Insight and a nominally higher all-stock bid from CoStar.

Based on concerns about CoStar's bid — namely, uncertainty of value due to volatility in CoStar's stock price, and possible antitrust issues that the board had concluded could lead to up to a 15-month delay in closing — the board made a counteroffer to CoStar, seeking a higher price and provisions to address the antitrust concerns.

CoStar ultimately made a final best offer, increasing the offer price to stock with an implied value of $86.30 per share, but making no other changes. Stone Point and Insight increased the all-cash offer to $80 per share.

The board accepted Stone Point and Insight's bid and entered into a merger agreement. CoStar then publicly submitted a competing bid, offering stock with an implied value of $95.76 per share.

The court noted that the board negotiated with CoStar to seek a cash component and a response addressing the antitrust concerns. CoStar revised its competing bid so it "included a $6.00 cash component" and stock with an implied value of $86 per share, and reiterated its view that the transaction would pose "no meaningful antitrust issues." CoStar did not respond to the board's requests for further negotiation.

CoreLogic's stockholders overwhelmingly approved the merger, which represented a 51% premium over the unaffected stock price. The merger closed in June 2021. On the date of closing, Stone Point and Insight announced that CoreLogic's senior management team would be retained post-closing.

Business-to-business internet platform Bisnow interviewed CoStar CEO Florance, about the CoreLogic sale process. In a March 21, 2021, Bisnow article, Florance suggested that CoStar's bid was not accepted because CoreLogic's senior management favored a sale to a financial buyer so that they could keep their jobs post-transaction.

The plaintiff then brought a Section 220 action to investigate possible fiduciary breaches in connection with the sale process, following which it filed suit against Martell. At the pleading stage, Vice Chancellor Nathan A. Cook granted Martell's motion to dismiss.

Discussion

The Bisnow Article

In response to questions about CoreLogic's sale process, Florance reportedly said that he believed that antitrust issues had nothing to do with the board's decision not to accept CoStar's offer and that, in fact, CoreLogic's executives did not want the company to be acquired by CoStar because some of them would have lost their jobs.

He was quoted as saying: "Most of the senior management team there might earn eight

digits a year in compensation, and in a merger, especially a strategic merger, inevitably some of those jobs go away….That's a powerful motive to not do a deal."

The Plaintiff's Claims

The plaintiff claimed that Martell had spearheaded the CoreLogic sale process and led the negotiations, and that the board had been supine in favoring a deal with Stone Point and Insight over CoStar in deference to Martell's interest in pursuing a deal that would guarantee his continued employment post-merger.

The plaintiff's counsel acknowledged that the suit would not have been brought but for Florance's statements in the Bisnow article. The plaintiff argued that the statements by Florance, who was a first-hand participant in the sale process, were more reliable — at least at the pleading stage, where any reasonable competing inferences are to be decided in favor of a plaintiff — than "the board minutes and proxy statement disclosures that were thirdhand … [and had been] reviewed and edited by however many lawyers."

The plaintiff alleged that, because the proxy statement did not disclose the real reason for the board's disfavoring CoStar's bid, and did not disclose Martell's conflict in wanting to ensure post-merger employment, the stockholder approval of the merger was not fully informed and the court should apply heightened scrutiny rather than business judgment review under the precedent of the Chancery Court's 2015 Corwin v. KKR Financial Holdings decision.

The Effect of the Bisnow Article

The court emphasized that the plaintiff, to support its disclosure claims, had relied exclusively on Florance's statements in the Bisnow article to argue that the board's minutes and identified sale considerations must have been false and that the real reason behind the merger was an undisclosed conflict Martell had in protecting his job.

Vice Chancellor Cook observed that Florance's reported statements in the Bisnow article:

- Stated his beliefs only;
- Were framed generically and may or may not have applied to the CoreLogic sale process;
- Were inconsistent with CoStar's press release, issued upon the merger's closing, in which Florance praised CoreLogic's sale process and congratulated the board on having achieved a strong valuation for the stockholders; and,
- "Perhaps … smack[ed] of post-process sour grapes."

The Board's Antitrust Concern

The court found no basis on which to infer that the board's disclosure that it had antitrust concerns about CoStar's bid was false. The plaintiff argued that the antitrust concerns must have been a pretext, as CoStar's proposed transaction did not present any meaningful antitrust issues. "But 'no meaningful antitrust concerns' does not reasonably mean 'no antitrust concerns,'" the court wrote.

The court also noted that the board had been informed about antitrust issues by its independent and unconflicted advisers; and had considered that CoStar was facing antitrust liability in another deal at the time and had been engaged in litigation over its refusal to pay a substantial reverse termination fee.

"Under these circumstances, it is not reasonably conceivable that the board — let alone Martell — fabricated a regulatory basis for choosing the Merger, which contained strong antitrust assurances, over CoStar's offers, which did not," the court concluded.

The Board's Value Uncertainty Concern

The court found no basis on which to infer that the board's disclosure that it had concerns about the value certainty of CoStar's bid was false.

The court noted that the board and its advisers had observed that CoStar's stock price, although high, had been declining steadily — for example, a 19% drop during a recent two-week period, based on which CoStar's competing bid had an implied value of $83.73 per share including the $6 cash component, not "the $90 per share that CoStar advertised."

The court also noted that the board had encouraged CoStar to substantially increase the cash component of its bid to mitigate future volatility but "rather than renegotiate, CoStar walked."

Discussions About Post-Merger Employment

The court rejected the plaintiff's contention that Martell must have had discussions with Stone Point and Insight about post-merger employment and that they should have been disclosed in the proxy statement.

The plaintiff argued that discussions must have taken place preclosing, given that Stone Point and Insight announced on the closing date that management was being retained and that financial buyers often retain management post-closing.

The court wrote:

The court cannot infer the existence of undisclosed, intra-process employment discussions between a target executive and an acquiror from speculation and innuendo.

Moreover, the court stated, it would only be discussions that took place during the sale process — not after signing and before closing — that would be material information required to be disclosed in the proxy statement.

Loss of Martell's Job If the CoStar Bid Had Been Selected

The court rejected the plaintiff's contention that Florance's statements in the Bisnow article substantiated that Martell would have lost his job in a CoStar transaction and that this should have been disclosed in the proxy statement.

The court observed that Florance's statements did not reference Martell and "seem[ed] to express a normative view about the consequences of strategic mergers" generally rather than referring to the CoreLogic process itself.

Further, the court stressed that the plaintiff pointed to nothing in the books and records it

had obtained in its Section 220 investigation as support for an inference that Florance or CoStar had suggested during the sale process that Martell would be terminated, In fact, the court stated, the board minutes reflected that Martell told the board that Florance had told him that Florance wanted him to play a significant role post-merger and, further, CoStar's bid letters stated that CoStar envisioned ongoing roles for management.

Failure to State a Claim Against Martell for Breach of the Duty of Loyalty

The court stated that, even if the court had found that a Corwin business judgment review did not apply, no specific facts were alleged from which it was reasonable to infer that Martell had a desire to entrench himself; had spearheaded the sale process; or had influenced the independent board.

Further, the court observed: It was "not clear from the complaint what role Martell played in the Merger anyway, Save for isolated scenes, he barely appears. In many ways, he is depicted as the Mr. Godot who never arrives."

Practice Points

Conducting a Careful Sale Process Led by Independent Directors and Advisers

Target boards are advantaged by engaging in a careful sale process, led by independent directors and assisted by independent advisers. The court's ready dismissal, at the pleading stage, of the plaintiff's claims in Martell was grounded in the overall factual context, which included:

- An independent, nonconflicted board;
- Independent, nonconflicted advisers;
- A monthslong shopping process;
- Extended negotiations with CoStar, during which the board persisted in encouraging CoStar to respond to its concerns;
- A record supporting that the board had valid concerns about CoStar's bid that it had carefully considered and disclosed; and
- A management team that had not indicated any entrenchment motive or attempts to influence the board.

Maintaining a Record

A board should maintain a good record — such as in board minutes — of sale process developments and the board's careful consideration of factors supporting its choice to favor a bid, especially if a competing bid has a higher nominal value.

The court may be inclined to reject a plaintiff's challenge to the truth and accuracy of board minutes and proxy statement disclosures when based only on a plaintiff's suppositions or speculation.

In particular, the court will be skeptical of a plaintiff's allegations that are not supported in

any way in documents the plaintiff obtained in a presuit Section 220 investigation. A potential plaintiff should keep in mind the possibility of such skepticism before making a Section 220 demand.

Selecting a Lower-Valued Bid

A board can select a lower-valued bid over a higher-valued bid if it has valid reasons to do so. Those reasons should be carefully considered and documented.

Value uncertainty relating to a stock bid, or antitrust delay or uncertainty relating to a strategic bid, or other factors relating to value or closing certainty — including, for example, a bidder's transaction and litigation history — are valid bases on which a board might determine to select a lower competing bid.

Also, a bidder generally should try to address valid concerns the board may raise about its bid, and a refusal to address such concerns can disadvantage the bid.

A bidder could, depending on the circumstances, address a concern about value certainty by adding or increasing a cash component, agreeing to collar provisions to protect the value of the stock portion, or raising the offer price; and could address a concern about antitrust delay or uncertainty by agreeing to a shorter end date for closing, undertaking to implement necessary antitrust remedial actions,or agreeing to a reverse termination fee.

Not Permitting Management Interest in Post-Transaction Employment to Infect a Sale Process

It is not problematic for a bidder to indicate that it intends to retain management post-closing; but, to avoid an actual or potential conflict of interest, an officer or director generally should not engage in negotiations with a bidder during a sale process with respect to post-transaction employment.

When possible, such discussions should not occur until after at least the economic and other key deal terms of the acquisition are largely finalized.

Monitoring Discussions About Post-Transaction Employment

If, during the sale process, a director or officer engages in any discussions regarding potential post-closing employment, those discussions and the details of the potential compensation should be disclosed to the board.

A board should be proactive in becoming informed whether any such discussions may be occurring, rather than relying solely on directors' and managers' self-reporting.

The board should monitor any such discussions and impose any restrictions appropriate to address the potential conflict of interest — which could include, for example, depending on the circumstances:

- Designating a different person as the lead negotiator in the sale process;
- Designating another person to act together with this person as lead negotiator in the sale process;

- Establishing a framework for frequent reporting on such discussions by such person to the board; and

- Designating a director to be present for and monitor any such discussions; requiring frequent and specific reporting from the person to the board with respect to such discussions.

Also, management and the board should consider to what extent disclosure to stockholders relating to such discussions and a potential conflict would be appropriate.

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