

M&A NOTES

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The Delaware Chancery Court recently refused to dismiss a complaint against directors of a company which failed to disclose secret merger negotiations while a company sponsored odd-lot stock purchase program was in effect.

The recent case *Alessi v. Beracha*, 2004 WL 1052389 (Del. Ch.), arose in connection with The Earthgrains Company's ("Earthgrains") undisclosed merger negotiations with Sara Lee Corporation ("Sara Lee").

On May 18, 2001, Earthgrains announced a buy-sell program that allowed its odd-lot shareholders to sell or buy shares at the current market value for a below normal brokerage fee. The program, which was sponsored by Earthgrains, was implemented to minimize the number of odd-lots of Earthgrains' shares.

Before the program had expired, Earthgrains became involved in merger negotiations with Sara Lee. These negotiations involved contacts such as discussion of a potential deal, signing of a confidentiality agreement, a formal acquisition presentation and presentation of a draft merger agreement. Earthgrains and Sara Lee also discussed valuation.

Alessi sold shares in the program just before Earthgrains announced that Sara Lee had agreed to purchase the company for almost double the market price. Alessi filed a complaint against Earthgrains and Earthgrains' directors alleging breach of fiduciary duty by failure to disclose material non-public information.

Earthgrains and its directors filed a motion to dismiss, arguing that Alessi had not stated a claim because Earthgrains and its directors did not have a fiduciary duty to disclose secret merger negotiations. The court, however, held that Alessi had stated a claim against the directors.

In reaching its decision, the court observed that the directors were involved in Earthgrains' buy-sell program

because they were knowledgeable or at least aware of the program. The court cited the complaint's statement that the directors had sponsored the buy-sell program and said that even if this were insufficient on its face, it would create an inference that the directors knew about the program. The court stated that "such an inference comports with the principle that 'the business and affairs' of Earthgrains was to be 'managed by or under the direction' of the director defendants." *Alessi v. Beracha* at 2.

The court also concluded that Alessi's argument is not based on a "fraud-on-the-market" theory because Alessi has already established reliance. The court stated that Alessi relied on the directors because the program was effectively a "request" for small shareholders to sell their shares. The court suggests that the adoption of the program together with the press release specifically sought out small shareholders and encouraged them to sell their shares.

The court also disagreed with the directors' broad reading of past case law to create a bright line rule that secret merger negotiations are immaterial. Instead, the court used a balancing approach and found that Earthgrains' merger negotiations, including the numerous discussions, the confidentiality agreement and the draft merger agreement were more than casual inquiries and clearly established that Earthgrains was for sale. The court stated that "the pending Sara Lee transaction was arguably the most important event in Earthgrains' short life: 'to wit, its death.'" *Alessi v. Beracha* at 7. The court continued that "it takes a certain blind arrogance to suggest that, as a categorical matter, Earthgrains' discussions with Sara Lee were immaterial to a reasonable shareholder asked to sell his or her shares in Earthgrains." *Alessi v. Beracha* at 7. In addition, the court found that secrecy is not always essential. The court stated that while secrecy is necessary at times "the secrecy rationale cannot be used in every circumstance as a 'free pass' to allow fiduciaries to withhold clearly material information from stockholders." *Alessi v. Beracha* at 6.

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