Harvard Law School Forum on Corporate Governance

Three Opinions on Fraud on the Board

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In a footnote in a two-page order issued in 2018, the Delaware Supreme Court quietly reminded corporate law practitioners that, per the 1989 case of *Mills Acquisition v. Macmillan*, a complaint seeking post-closing *Revlon* damages can survive a motion to dismiss without pleading nonexculpated breaches of fiduciary duty by a majority of directors so long as a single conflicted fiduciary deceived the entire board. See *Kahn v. Stern*, 183 A.3d 715 (Del. 2018) (TABLE). In the three years that followed, this "fraud-on-the-board" theory of liability has received long-form discussion in at least eight published Delaware opinions and evolved into a Swiss Army knife for stockholder-plaintiffs—indeed, Delaware courts have recently applied the once-obscure theory to serve at least three distinct doctrinal ends. This article describes, at a high level, what fraud on the board is by pinpointing the various doctrinal roles it has played in three recent opinions issued by the Delaware Court of Chancery.

First, fraud on the board can be an independent trigger of entire fairness review. The Court of Chancery so held in *In re Pattern Energy Group Shareholders Litigation*, 2021 WL 1812674 (Del. Ch. May 6, 2021), a case in which a target company's stockholder challenged an all-cash merger negotiated by a special committee on grounds that merger consideration was purportedly inequitably low. The court began its analysis by stating that entire fairness review applies in three circumstances, including not only the two familiar triggers of a conflicted controlling stockholder and a majority of conflicted directors, but also a third: "when a plaintiff pleads a fraud-on-the-board theory and the attendant illicit manipulation of a board's deliberative processes by self-interested corporate fiduciaries." The court proceeded to evaluate whether the complaint sufficiently alleged an illicit manipulation that would elevate the standard of review from intermediate scrutiny under *Revlon* to entire fairness. In analyzing and ultimately rejecting the plaintiff's fraud-on-the-board theory, the court held that the following five elements must be well pled in order to trigger entire fairness review: a materially interested rogue fiduciary, an inattentive board, deception of the board by the fiduciary, deception that was material, and deception that tainted the board's decision-making process.

Second, fraud on the board can be a breach of fiduciary duty sufficient to sustain a post-closing damages claim. In *In re Columbia Pipeline Group Merger Litigation*, 2021 WL 772562 (Del. Ch. Mar. 1, 2021), the Court of Chancery held that a stockholder sufficiently alleged two officers breached their fiduciary duties for committing a fraud on the board—in particular, the plaintiff alleged the officers had failed to act to reasonably maximize deal price under *Revlon* by tilting the sales process towards a committed buyer in order to secure material change-in-control benefits.

Without announcing or applying any particular elements, the court found the complaint's allegations sufficient to sustain the claim, and in so doing clarified that plaintiffs need not allege that even a single director breached his or her fiduciary duties to well plead *Revlon* claims against officers who manipulate the board into approving their desired transaction. This went a step beyond *Kahn v. Stern*, which held that fraud on the board perpetrated by a minority of directors constitutes a non-exculpated breach sufficient to defeat a motion to dismiss a post-closing damages claim.

Third, fraud on the board may be a standalone tort perpetrated by nonfiduciaries like financial advisors even absent a predicate breach of fiduciary duty by the board. The Court of Chancery discussed this doctrinal usage in *Firefighters' Pension System v. Presidio*, 251 A.3d 212 (Del. Ch. Jan. 29, 2021), where the plaintiff well pled aiding and abetting liability against a target company's financial adviser for allegedly passing information to one participant in a bidding contest. The court held the same conduct could support "a claim for primary liability" against the financial advisor for fraud on the board even if the plaintiff had failed to plead an underlying breach of fiduciary duty, an element required of aiding and abetting but not fraud on the board. The court went on to specify five requisite elements of fraud on the board loosely resembling *Pattern Energy*'s but explicitly modeled after "a claim for common law fraud" and ultimately held that the plaintiff's allegations against the financial advisor would clear Court of Chancery Rule 9(b)'s requirement to plead fraud with particularity (albeit without holding that Rule 9(b) necessarily applied as a matter of law).

These authorities offer the beginnings of an answer to the titular question—what is fraud on the board? As a matter of fact-based conduct, it is an act of deception by either a fiduciary or third party that is intended to, and does, affect a board's decision. And as a matter of doctrine, it is three separate things: an independent trigger of entire fairness, a subspecies of fiduciary misconduct that can be alleged against directors and officers, and a subspecies of tortious misconduct that can be alleged against a nonfiduciary (like a financial adviser).

These developments raise a host of issues for corporate counsel to consider as the law in this area continues to develop. Litigation defense counsel may wish to press courts further on the application of Rule 9(b), which applies to "all averments of fraud or mistake," to fraud-on-the-board claims. This is especially so given the Presidio court's express invocation of common law fraud elements and prior cases' analysis of the issue hinging on how closely common law fraud elements line up with elements of the claim at bar. See, e.g., *Desert Equities v. Morgan Stanley Leveraged Equity Fund, II*, 624 A.2d 1199 (Del. 1993). Deal counsel should remain mindful of the importance of maintaining board oversight over officers and advisors during a sale process, as effective corralling could mean the difference between pleading-stage dismissal and protracted litigation. In all events, practitioners should continue to monitor the evolution of the fraud-on-the-board theory, which has taken on renewed importance in corporate litigation since recently awakening from its 30-year slumber.