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Badowski v Carrao
2014 NY Slip Op 50042(U)
Decided on January 13, 2014
Supreme Court, New York County
Friedman, J.
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Decided on January 13, 2014

Supreme Court, New York County

Marcel Badowski, individually and on behalf of all others similarly situated, Plaintiff,

against

Peter A. Carrao, JOSEPH P. DURRETT, ADELE GOLDBERG, GERALD W. HEPP, LEE S. SIMONSON, LAWRENCE WEBER, VERTRO, INC., INUVO, INC. and ANHINGA MERGER SUBSIDIARY, INC., Defendants.

652986/2011

Counsel for the plaintiff is W. Scott Holleman, Levi Korinsky LLP, 30 Broad Street, 24th Floor, New York, NY 10004. Counsel for all defendants is Todd R. David, Alston & Bird LLP, 90 Park Avenue, New York, NY 10016.

Marcy S. Friedman, J.

In this class action, plaintiff alleges that individual defendants, the former directors and officers of Vertro, Inc. (Vertro), breached their fiduciary duties to Vertro's former shareholders by failing to maximize shareholder value, acting in their own interest, and failing to disclose material information in connection with Vertro's merger with Inuvo, Inc. (Inuvo). Plaintiff further alleges that corporate defendants Vertro, Inuvo, and Anhinga Merger Subsidiary, Inc. (Anhinga) aided and abetted those breaches. Plaintiff seeks rescission of the merger of the two companies, which was completed on March 1, 2012, or, in the alternative, rescissory damages. Defendants move to dismiss the Second Amended Complaint in its entirety for failure to state a claim, pursuant to CPLR 3211(a)(7).[FN1]

Background

Before the merger, Vertro was a publicly traded software and technology company that [*2]derived its revenue through an Internet search toolbar and applications. (Second Amended Complaint [SAC], ¶¶ 29-31.) Inuvo was and is a publicly traded Internet company that develops software and analytics technology for online advertisers and website publishers. (*Id.*, ¶ 20.) On October 17, 2011, Vertro announced that it had entered into a merger agreement with Inuvo and that Inuvo, through its wholly-owned subsidiary Anhinga, would acquire all outstanding shares of Vertro in a stock-for-stock transaction. (*Id.*, ¶¶ 1, 34.) Each share of Vertro was to be exchanged for 1.546 shares of Inuvo common stock. (*Id.*, ¶ 35.)

A joint proxy statement/prospectus was sent to Vertro and Inuvo shareholders and a shareholder meeting was called to approve the merger. (Aff. Of Alexander S. Lorenzo, dated August 27, 2012, Ex. C [Excerpts from Proxy Statement] at 1.) The boards of directors and a majority of the shareholders of both Vertro and Inuvo voted to approve the merger, and the merger closed on March 1, 2012. (*See* SAC, ¶ 37.) On October 14, 2011, the last trading day before the announcement of the merger, Inuvo common stock closed at $1.75, and Vertro stock closed at $1.61. (*Id.*, ¶ 36.) As of that date, the value of the merger to Vertro shareholders was $2.71 per share. (*Id.*) After the announcement of the merger, Inuvo's share price declined and, when the merger closed, the value of the merger to Vertro shareholders was $1.39 per share. (*Id.*, ¶ 37.)

Plaintiff pleads two causes of action for breach of fiduciary duty, alleging that the merger resulted from an inadequate sales process in which the Vertro directors acted for their own personal gain and to Vertro shareholders' detriment, and that the Vertro directors failed to make material disclosures to the shareholders. Plaintiff also pleads a third cause of action that Vertro, Inuvo, and

Anhinga aided and abetted in these breaches.

The Delaware Proceeding

In a parallel proceeding, the Delaware Chancery Court heard allegations virtually identical to those in the instant action and, on a motion for an expedited proceeding, rejected them. After the merger of Vertro and Inuvo was announced, but before it was completed, two institutional investors filed suit on behalf of a purported class of shareholders alleging, among other things, that in recommending the merger, the board breached its fiduciary duties of loyalty and care to Vertro's public shareholders because "no director of Vertro, in the exercise of reasonable business judgment, could have approved the Merger Agreement." (Aff. Of Alexander S. Lorenzo, dated August 27, 2012, Ex. A [Complaint in *Matter of Vertro, Inc. Shareholders Litig.*, C.A. No. 7010-VCP] [Delaware Complaint], ¶ 10.) Specifically, the institutional investors alleged that the Vertro board breached its fiduciary duties by

"(a) approving deal protection devices, such as an excessive $500,000 termination fee of almost 4%, based upon the current value of the Proposed Merger consideration; a no solicitation' provision; and a matching right' provision, all of which, in the aggregate, will unfairly inhibit or preclude any competing bid;

(b) approving the woefully inadequate Proposed Merger consideration to be paid by Inuvo to Vertro shareholders;

(c) rejecting at least one bidder who offered higher value than Inuvo because it did not intend to retain Vertro's senior management in the combined company; [*3]

(d) declining to solicit indications of interest from at least two well-known potential acquirors;

(e) authorizing change-of-control payments to some members of management and the Board of Directors, who will retain their lucrative compensation and fees, as well as the acceleration of the vesting of their options and restricted stock; and

(f) diluting the ownership of Vertro shareholders in favor of the Company's executive officers and directors."

(*Id.*, ¶ 12.) Further, the institutional investors alleged that the board misstated and omitted "material facts concerning the sales process and the relative values of Vertro and Inuvo," including but not limited to Inuvo's allegedly precarious financial situation (*id.*, ¶¶ 69-72), the benefits Vertro executives would receive upon closing (*id.*, ¶ 73), details regarding another bidder's offers (*id.*, ¶ 74), and the sales process and the analysis made by the board's financial advisor in issuing its fairness opinion (*id.*, ¶¶ 75-95). Based on these allegations, the institutional investors sought class certification and to preliminarily enjoin the merger or, in the event that it had already been consummated, recission of the merger or rescissory damages. (*Id.*, Wherefore Clause.)

The Delaware Court held that plaintiffs failed to state a colorable claim and a sufficient possibility of a threatened irreparable injury, and denied the request for a preliminary injunction. (Aff. Of Alexander Lorenzo, dated July 9, 2012, Ex. B [Telephonic Rulings of the Court on Plaintiff's Motion for Expedited Proceedings, dated Dec. 21, 2011 (Delaware Decision)] at 5-6.) Based on the Delaware Court's ruling, defendants sought a stay of this action pending resolution of the Delaware action. In determining that motion, this Court (Fried, J.) found that "[i]t is undisputed that both actions are substantially similar putative class actions" involving different nominal plaintiffs, and stayed the instant action in favor of the Delaware action.[FN2] (Transcript of Oral Argument of February 22, 2012 at 22-24; Order [Fried, J.], dated March 6, 2012.) The plaintiffs in the Delaware action voluntarily withdrew their complaint without prejudice on March 20, 2012. (Ds.' Memo. In Support at 6; Lorenzo Aff., Ex. D [Case History Search].)

The Motion to Dismiss

It is well settled that on a motion to dismiss addressed to the face of the pleading, "the pleading is to be afforded a liberal construction (*see*, CPLR 3026). [The court must] accept the facts as alleged in the complaint as true, accord plaintiffs the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory." (*Leon v Martinez*, 84 NY2d 83, 87-88 [1994]. *See also 511 W. 232nd Owners Corp. v Jennifer Realty Co.*, 98 NY2d 144 [2002].) However, "the court is not required to accept factual [*4]allegations that are plainly contradicted by the documentary evidence or legal conclusions that are unsupportable based upon the undisputed facts." (*Robinson v Robinson*, 303 AD2d 234, 235 [1st Dept 2003]; *see also Water St. Leasehold LLC v Deloitte & Touche LLP*, 19 AD3d 183 [1st Dept 2005], *lv denied* 6 NY3d 706 [2006].) When documentary evidence under CPLR 3211(a)(1) is considered, "a dismissal is warranted only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law." (*Leon*, 84 NY2d at 88; *see also*

Arnav Indus., Inc. Retirement Trust v Brown, Raysman, Millstein, Felder & Steiner, L.L.P., 96 NY2d 300 [2001].)

Application of Revlon

It is undisputed that Delaware law governs this action. (Ds.' Memo. In Support at 7; P.'s Memo. In Opp. at 8.) It is also undisputed that under Delaware law, directors owe shareholders fiduciary duties of care and loyalty. (*Paramount Communications Inc. v QVC Network Inc.*, 637 A2d 34, 43 [Del 1994].) Moreover, where the business judgment rule is applicable to the acts of the directors, it requires a deferential standard of review and affords a "presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." (*Aronson v Lewis*, 473 A2d 805, 812 [Del 1984], *overruled in part on other grounds by Brehm v Eisner*, 746 A2d 244, 253-254 [Del 2000]; *accord MM Cos., Inc. v Liquid Audio, Inc.*, 813 A2d 1118, 1127 [Del 2003] [internal quotation marks and citation omitted]; *Matter of Smurfit-Stone Container Corp. Shareholder Litig.*, 2011 WL 2028076, *11 [Del Chancery, May 24, 2011, No. 6164—VCP].)

Here, the threshold issue is whether the business judgment rule applies to the acts of the Vertro board in approving the merger, or whether such acts are subject to "heightened scrutiny" under *Revlon, Inc. v MacAndrews & Forbes Holdings, Inc.* (506 A2d 173 [Del 1986]). In *Revlon*, a case involving a hostile take-over, the Court held that once it became "apparent . . . that the break-up of the company was inevitable" or that the "company was for sale," the "duty of the board . . . changed from the preservation of [the company] to the maximization of the company's value at a sale for the stockholders' benefit." (506 A2d at 182.)

As subsequently refined by the Delaware Courts, the *Revlon* requirement that the directors seek the best value reasonably available to shareholders applies "in at least the following three scenarios: (1) when a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company; (2) where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the break-up of the company; or (3) when approval of a transaction results in a sale or change of control." (*Arnold v Society for Savings Bancorp, Inc.*, 650 A2d 1270, 1290 [Del 2009] [internal quotation marks and citation omitted].) The Courts have further clarified that the *Revlon* duty of value maximization is triggered "only when a company embarks on a transaction — on its own initiative or in response to an unsolicited offer — that will result in a change of control." (*Lyondell*

Chem. Co. v Ryan, 970 A2d 235, 242 [Del 2009].) In the context of a stock-for-stock merger, a change of control for *Revlon* purposes can be triggered if the target's shareholders are relegated to a minority in the resulting entity, and the resulting entity has a controlling stockholder or stockholder group. (*Matter of Santa Fe Pac. Corp. Shareholder Litig.*, 669 A2d 59, 71 [Del 1995]; *Paramount Communications Inc.*, 637 A2d [*5]at 43, 46—47; *Smurfit-Stone*, 2011 WL 2028076 at *12.) Where, however, ownership of the merged company will remain in "a large, fluid, changeable and changing market," *Revlon* is not implicated. (*Arnold*, 650 A2d at 1290; *Smurfit-Stone*, 2011 WL 2028076 at *12 n 92. *See also* Delaware Decision at 6-8.)

In the instant action, plaintiff does not allege that the shares of the resulting entity will not be freely traded in the marketplace or that the former Vertro shareholders will be subjected to a controlling shareholder or block of shareholders.[FN3] Instead, in arguing that the board was subject to the *Revlon* duty to seek the best value, plaintiff cites the board's active solicitation of a merger with a bidder other than Inuvo (Party A). (P.'s Memo. In Opp. at 12.) Significantly, however, the board's initiation of an active bidding process does not render the *Revlon* duty applicable unless the board "also seek[s] to sell control of the company or take[s] other actions which would result in a break-up of the company." (*Santa Fe Pac. Corp.*, 669 A2d at 71.)

Plaintiff also premises the applicability of the *Revlon* duty on so-called "change-in-control" provisions contained in contracts of Vertro's officers and directors. Plaintiff reasons that because the merger triggers these provisions — and with them additional compensation for officers and directors — the provisions establish change of control for *Revlon* purposes. (*See* P.'s Memo. In Opp. at 16-17.) Plaintiff, however, cites no authority that change-in-control provisions in employment contracts involve change in control of a company for *Revlon* purposes. *Louisiana Municipal Police Employees' Retirement System v Crawford* (918 A2d 1172 [Del Chancery 2007], *certificate of appealability denied* 2007 WL 2768805 [Del Chancery, Mar. 8, 2007, No. 2663-N], *interlocutory review refused* 931 A2d 1006 [Del 2007]), on which plaintiff relies for this proposition, expressed skepticism as to whether the proposed merger should constitute a change of control for purposes of the employment contracts but not for purposes of *Revlon*. (*Id.* at 1180 n 6.) The Court did not apply *Revlon*. Rather, it denied the requested injunction to block a shareholder vote on the merger, citing Delaware Courts' "great faith in the discernment and acumen of shareholders and directors" and the plaintiff's "heavy burden to persuade the Court that shareholders are somehow unable to provide for their own protection."[FN4] (*Id.* at 1176.) [*6]

Notably absent from plaintiff's complaint is any description of the combined entity's resulting

stock ownership structure, and any pleading of facts that have been found, under Delaware law, to warrant imposition of the *Revlon* duty — for example, facts showing that the merger would result in a controlling shareholder or block of shareholders, or that control of the combined entity "would not remain in a large, fluid, changeable and changing market.'" (*Santa Fe Pac. Corp.*, 669 A2d at 71 [quoting *Arnold*, 650 A2d at 1290].)

Under these circumstances, this court holds that the business judgment rule, rather than *Revlon* enhanced scrutiny, applies in reviewing the acts of the Vertro board of directors in approving the merger. This result is consistent with that in the related Delaware action, where the Court reasoned:

"While the current merger will result in a sale of Vertro, the type of sale contemplated in the transaction does not implicate *Revlon* because there is no sale or change of control because control of both companies will remain in a large, fluid, changeable, and changing market. Therefore, we apply the presumptions of the business judgment rule in reviewing the actions taken by the board in negotiating this transaction."

(Delaware Decision at 8.)[FN5]

Business Judgment Rule

As discussed above, the business judgment rule is a rebuttable presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. (*MM Cos., Inc.*, 813 A2d at 1127.) A party challenging the decision of the board bears the ultimate burden of establishing facts sufficient to rebut the presumption that the board exercised sound business judgment. (*Aronson*, 473 A2d at 812.) On a motion to dismiss, the party challenging the board's decision must plead such facts. (*Wayne County Empls.' Retirement Sys. v Corti*, 2009 WL 2219260, *10 [Del Chancery, July 24, 2009, No. 3534-CC], *affd* 996 A2d 795 [Del 2010]; *Orman v Cullman*, 794 A2d 5, 28-29 [Del Chancery 2002].) If a party cannot present facts rebutting the presumption, the court's review will be deferential: A "court will not substitute its judgment for that of the board if the [board's] decision can be attributed to any rational business purpose." (*MM Cos., Inc.*, 813 A2d at 1128 [internal quotation marks and citation omitted].) [*7]

The Second Amended Complaint alleges that the members of the Vertro board breached their fiduciary duties in three principal respects: The members suffered from conflicts of interest; the

sales process and the merger consideration were inadequate; and the proxy statement omits material information. This court finds that plaintiff fails to plead sufficient facts in support of these claims to rebut the presumption of the business judgment rule.

Alleged Conflicts of Interest

Plaintiff contends that the Vertro directors had "material conflicts of interest" and favored a deal with Inuvo because they stood to profit personally. (SAC, ¶ 82.) First, plaintiff alleges that several current directors will become directors of the new company and will receive greater remuneration as a result of the merger.[FN6] (*Id.*, ¶¶ 83-85, 87.) Specifically, Carrao will be the President and Chief Executive Officer of the combined company, and Pisaris, Vertro's general counsel, will be the general counsel of the combined company. (*Id.*, ¶¶ 83-84.) Defendants Durrett and Goldberg "are expected" to become members of the board of the merged company and to receive higher compensation than they received for service on Vertro's board. (*Id.*, ¶ 87.) Second, plaintiff alleges that due to the change of control, Carrao and other of Vertro's executives will receive guaranteed bonuses, in the form of Vertro common stock ranging in value from $110,00-$320,000, which would otherwise have been contingent upon Vertro's meeting performance goals. (*Id.*, ¶ 86.) Third, plaintiff alleges that all unvested stock options and restricted stock units held by Vertro's officers and directors will automatically vest. (*Id.*, ¶ 88.)

To rebut the presumption of the business judgment rule, a plaintiff must show that a majority of the Vertro board were not disinterested and independent, or that an interested director dominated or manipulated the board. (*See Cinerama, Inc. v Technicolor, Inc.*, 663 A2d 1156, 1167-1168 [Del 1995]; *Orman*, 794 A2d at 24-25.) Plaintiff does not meet his burden of pleading facts sufficient to make such a showing. As the Delaware Court noted in the related action, five of the six members of the Vertro board who approved the merger were outside directors, and three of the six would lose their positions on the board as a result of the merger. (Delaware Decision at 10-11.) That some board members would and did continue employment with the merged entity does not suffice to rebut the presumption. (*Wayne County Empls.' Retirement Sys.*, 2009 WL 2219260 at *13 n 69 [finding allegations that directors were not disinterested because "they retained their board seats in the combined company" to be "insufficient"]; *Orman*, 794 A2d at 28-29 [holding that director was not disinterested "*solely* because he will be a director in the surviving corporation"]; *see also* Delaware Decision at 12 [holding that "the fact that directors do not have to pursue a transaction to retain their positions significantly alleviates the concern that the directors are acting out of an impermissible entrenchment motive"].)

Similarly, that board members would gain financially through expedited vesting of options does not create an impermissible conflict of interest. (*See BioClinica, Inc.*, 2013 WL 5631233 at *5 [holding that "an interest in options vesting does not violate the duty of loyalty," and that "Delaware courts recognize that stock ownership by decision-makers aligns those [*8]decision-makers' interests with stockholder interests; maximizing price"]; *Krim v ProNet, Inc.*, 744 A2d 523, 528 [Del Chancery 1999] [holding that "neither the vesting of the options nor the fact some ProNet directors retained board seats in the merged entity created a substantial conflict'"]; *see also* Delaware Decision at 12.)

To establish that a director is impermissibly interested in a transaction, a plaintiff must show that the benefit is "*material* to that director," and "significant enough *in the context of the director's economic circumstances*, as to have made it improbable that the director could perform her fiduciary duties to the . . . shareholders without being influenced by her overriding personal interest.'" (*Orman*, 794 A2d at 23 [quoting *Matter of General Motors Class H Shareholders Litig.*, 734 A2d 611, 17 [Del Chancery 1999]].) The complaint, however, is devoid of any allegations as to the materiality of the sums pleaded to the individual directors. For example, plaintiff pleads that Inuvo outside directors were compensated at a higher rate than those at Vertro, and that the Vertro outside directors, Durrett and Goldberg, will receive more compensation serving on the board of the merged company. (SAC, ¶ 87.) Plaintiff estimates that Durrett and Goldberg will receive slightly less than $30,000 in additional compensation after the merger. (*Id.*) While $30,000 is not an insignificant sum, as the Delaware Court found with respect to a similar sum, "plaintiffs have made no showing or claims as to the materiality of this compensation as it relates to each director's economic circumstance." (Delaware Decision at 13.)

Further, the bonuses paid to Corrao and Pisaris were in the form of Vertro common stock, and the stock that automatically vested was Vertro stock. As a result, the value of the bonuses and vested stock was contingent upon the value of the merged entity. As the Delaware Court also found, rather than create a conflict, the award of additional Vertro stock "provide[d] the directors with a powerful incentive to seek a transaction offering the highest value per share, advancing the desired result of aligning the board's interest with those of Vertro's shareholders." (Delaware Decision at 14. *See also Orman*, 794 A2d at 27 n 56 ["A director who is also a shareholder of his corporation is more likely to have interests that are aligned with the other shareholders of that corporation as it is in his best interest, as a shareholder, to negotiate a transaction that will result in the largest return for all shareholders"].)

Finally, plaintiff does not plead that the majority outside directors were dominated by an inside director with a conflict of interest. (*See Orman*, 794 A2d at 24 [quoting *Aronson*, 473 A2d at 816] ["[i]ndependence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous influences"].) Other than making a conclusory allegation that Carrao "heavily influenced" the Vertro board (SAC, ¶ 59), plaintiff fails to allege that any pressure was applied to the Vertro board or that it was otherwise dominated. Plaintiff pleads no facts that "would raise any doubt, let alone a reasonable doubt, as to the outside directors' ability to act independently of management." (*Grobow v Perot*, 526 A2d 914, 924 [Del Chancery 1987], *affd* 539A2d 180 [Del 1980], *overruled in part on other grounds by Brehm v Eisner*, 746 A2d 244, 253-254 [Del 2000].)

Inadequate Sales Process & Merger Consideration

Plaintiff alleges that, in the merger with Inuvo, defendants "prematurely" favored Inuvo, agreed to such onerous and preclusive deal protection terms that no other bidder could compete with Inuvo, and sold Vertro for less than what it was worth. According to plaintiff, Vertro initially had another suitor, identified only as "Party A" in the SAC and the proxy statement. [*9](SAC, ¶ 40.) On April 21, 2011, an affiliate of Party A gave Vertro a non-binding letter of intent to purchase Vertro for approximately $50 million, which would yield approximately $6.50 to $7.00 a share. (*Id.*, ¶ 45.) Thereafter, the Vertro board retained America's Growth Capital, LLC (America's Growth Capital), as financial advisor, and America's Growth Capital commenced a sales process on June 21, 2011. (*Id.*, ¶¶ 52-53.) Vertro began negotiating a letter of intent with Inuvo in July 2011 "well before America's Growth Capital had the opportunity to (a) complete its sales process, (b) report to the Board on the results of the process, or (c) opine on the fairness of any proposal submitted by any potentially interested party, including Inuvo." (*Id.*, ¶ 56.) Under the alleged influence of Carrao, the Vertro board signed the letter of intent with Inuvo which, by its terms, precluded Vertro from contacting any potential purchasers other than those that America's Growth Capital had already contacted. (*Id.*, ¶¶ 58-59.) On August 1, 2011 Inuvo and Vertro executed the letter of intent. (*Id.*, ¶61.) On August 25, 2011 and September 9, 2011, Vertro received two non-binding letters of intent from affiliates of Party A for total purchase prices not to exceed $13.1 million and $14.2 million, respectively. (*Id.*, ¶¶ 63-64.) Negotiations between Vertro and Party A were "terminated" for reasons that have not been publicly disclosed, and Vertro and Inuvo executed a merger agreement on October 16, 2011. (*Id.*, ¶¶ 65-66.)

Although plaintiff contends that the Vertro board members favored Inuvo, plaintiff's own

allegations demonstrate that the Vertro board hired an outside financial advisor and instituted a sales process. As the Delaware Court noted, the Vertro board "conducted an extensive market check, contacting approximately 180 potential bidders." (Delaware Decision at 15.) Further, neither Party A nor its affiliates ever made a firm offer for Vertro. As pleaded in the complaint, Party A submitted only "non-binding" letters of intent with prices "not to exceed" certain amounts. The Delaware Court found that "the only viable deal that materialized was the one with Inuvo" (Delaware Decision at 16), and plaintiff pleads nothing new or different to this court.As to the deal protection measures to which plaintiff objects, the Vertro board agreed to a non-solicitation provision with a "fiduciary out" clause, matching rights, and a termination fee. (*See* SAC, ¶¶ 78-80.) While the reasonableness of deal protections must be assessed singly and in combination (*Matter of Cogent, Inc. Shareholder Litig.*, 7 A3d 487, 502 [Del Chancery 2010], *appeal refused* 30 A3d 782 [Del 2010]), deal protections of the type employed in this merger have frequently been upheld by the Delaware Courts. (*See e.g. Matter of Orchid Cellmark Inc. Shareholder Litig.*, 2011 WL 1938253, *8 [Del Chancery, May 12, 2011, No. 6373—VCN], *appeal refused sub nom. Silverberg v Bologna*, 19 A3d 302 [Del 2011] [describing deal protection measures as "commonplace"]; *Cogent, Inc.*, 7 A3d at 501-504; Delaware Decision at 20 [holding that the negotiated deal protections at issue were "garden variety, standard deal terms"].) Such protections serve to "entice an acquirer to make a strong offer" by providing a "buyer some level of assurance that he will be given adequate opportunity to buy the seller, even if a higher bid later emerges." (*Cogent, Inc.*, 7 A3d at 502.)

The non-solicitation provision prohibited Vertro from soliciting and facilitating inquiries or the making or submission of an acquisition proposal. However, the provision included a fiduciary out clause which allowed Vertro to furnish non-public information and to engage in negotiations with any person who made an unsolicited proposal which the board concluded "constitute[d] or could reasonably lead to a Superior Offer." (Merger Agreement, § 5.3[a].) By its terms, the board could have engaged another bidder, and, according to plaintiff's allegations, it [*10]did so in the form of Party A. Delaware Courts have frequently upheld non-solicitation clauses with a fiduciary out clause like the one here. (*See e.g. Cogent, Inc.*, 7 A3d at 502; *McMillan v Intercargo Corp.*, 768 A2d 492, 506 [Del Chancery 2000].)

Similarly, the matching rights provision required Vertro to negotiate in good faith with Inuvo for a minimum of five days if Vertro received a higher offer. (Merger Agreement, § 5.3[d].) This provision did not preclude other bidders, but rather gave Inuvo the opportunity to match a superior offer, if one was received. (*Orchid Cellmark Inc.*, 2011 WL 1938253 at *8 [holding that deal

protections including matching rights and termination fees were not unreasonable].)

Vertro also agreed to pay Inuvo a termination fee of $500,000. (Merger Agreement, § 7.2[c].) Defendants contend, and plaintiff does not contest, that this amount represents 2.38% of the estimated merger consideration. (Ds.' Memo. In Support at 20.) Delaware Courts have routinely upheld termination fees in the 3% range. (*See e.g. Cogent, Inc.*, 7 A3d at 503 ["A termination fee of 3% is generally reasonable"]; *see also Orchid Cellmark Inc.*, 2011 WL 1938253 at *7 [holding that a termination fee representing less than 3% of the deal price "is generally deemed reasonable under Delaware law"].) Plaintiff fails to allege any facts to show that the termination fee at issue was unreasonable under the circumstances.

Plaintiff also alleges that the Vertro board chose to sell Vertro when both Vertro and Inuvo's stock was declining in price, and without negotiating a necessary deal protection — namely, a "collar" to protect Vertro shareholders from a decrease in the merger consideration.[FN7] (*Id.*, ¶¶ 67-70.) However, "[t]he mere failure to secure deal protections that, in hindsight, would have been beneficial to shareholders does not amount to a breach of the duty of care." (*Matter of NYMEX Shareholder Litig.*, 2009 WL 3206051, *8 [Del Chancery, Sept. 30, 2009, Nos. 3621-VCN, 3835-VCN].) A court should not "independently scrutinize the adequacy of the consideration obtained for the shareholders" but, rather, should focus "on the board's decision making process." (*Wayne County Empls.' Retirement Sys.*, 2009 WL 2219260 at *16.) Whether to negotiate for a collar is "within a board's business judgment." (*See State of Wisconsin Inv. Bd. v Bartlett*, 2000 WL 238026, *9 [Del Chancery, Feb. 24, 2000, No. C.A. 17727].) A collar, like any other negotiated deal term, comes at a price. (*NYMEX*, 2009 WL 3206051 at *8 ["because contractual terms are the result of negotiations, concessions tend to come at a price"].) As the Delaware Court noted, "[w]hether the tradeoff for a collar is worthwhile is subject to the board's discretion." (Delaware Decision at 19.)

This court finds, as the Delaware Court did, that the deal protections agreed to by the Vertro board — both individually and cumulatively — were within the board's business judgment and not so unreasonable as to constitute a violation of the business judgment rule. Moreover, the decision whether to negotiate and pay the price for deal protections was within the Vertro board's business judgment. The court accordingly holds that plaintiff's first cause of action for breach of fiduciary duty based on failure to maximize shareholder value must be dismissed.

Insufficient Disclosures

Plaintiff alleges that the proxy statement sent to Vertro shareholders to solicit approval of

[*11]the merger omitted material information required by the shareholders to cast an "informed vote." (SAC, ¶ 101.) Specifically, plaintiff alleges that the proxy statement should have included the following disclosures, among others: various projections and analyses prepared by Vertro, Inuvo, and Inuvo's financial advisor, including "[r]evenue; EBIT (D & A); stock-based compensation; changes in working capital; capital expenditures; and unlevered free cash flow" (*id.*, ¶¶ 92-94); information, in light of Inuvo's declining performance, as to whether Vertro or America's Growth Capital was provided with Inuvo's third quarter 2011 results prior to executing the merger agreement (*id.*, ¶ 95); and more detailed "data and inputs" underlying the financial analyses supporting America's Growth Capital's fairness opinion (*id.*, ¶¶ 96-97).

Plaintiff also alleges that the proxy statement should have disclosed additional details about the sales process, including but not limited to: any attempts to negotiate a collar provision; the reasoning behind the Vertro board's decision in March 2011 to postpone engaging a financial advisor; the communications with Inuvo prior to the execution of a confidentiality agreement in May 2011; details regarding actions taken by America's Growth Capital to launch the sales process, and updates given to the Vertro board about the process; information on the share value of the non-binding offers made by Party A; and discussions and calculations regarding the share exchange ratio for Vertro to Inuvo shares. (*Id.*, ¶ 100.) Further, plaintiff contends that Vertro was obligated but failed to disclose the alleged conflicts of interest of Vertro's officers and directors and the compensation to be received by them. (*Id.*, ¶ 98.)

It is well settled that "Delaware law imposes upon a board of directors the fiduciary duty to disclose fully and fairly all material facts within its control that would have a significant effect upon a stockholder vote." (*Stroud v Grace*, 606 A2d 75, 85 [Del 1992].) Information is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix' of information made available." (*Malpiede v Townson*, 780 A2d 1075, 1086 [Del 2001] [quoting *Arnold*, 650 A2d at 1277].) A plaintiff bears the burden of demonstrating materiality. (*See David P. Simonetti Rollover IRA v Margolis*, 2008 WL 5048692, *6 [Del Chancery, June 27, 2008, No. 3694-VCN].) To survive a motion to dismiss, a plaintiff " must allege that facts are missing from the statement, identify those facts, state why they meet the materiality standard and how the omission caused injury.'" (*Malpiede*, 780 A2d at 1087 [quoting *Louden v Archer-Daniels-Midland Co.*, 700 A2d 135, 142 [Del 1997]].)

In essence, plaintiff seeks additional disclosure of underlying financial projections, calculations, and data considered by both the Vertro board and America's Growth Capital. Delaware

Courts, however, have repeatedly rejected claims that insufficiently specific disclosures were made of a board's reasons for recommending a merger, or of data relied on by a financial advisor in issuing a fairness opinion, provided that material data was disclosed. (*Cogent, Inc.*, 7 A3d at 509-10 ["Directors do not need to disclose, however, all information about a particular subject, or even information that is simply helpful if it does not meet the above [materiality] standard"];[FN8] *Matter of 3Com Shareholders Litig.*, 2009 WL 5173804, *2-3 [*12][Delaware Chancery, Dec. 18, 2009, No. 5067-CC] [holding that where financial advisor's analysis was accurately described and qualified, all back-up for summarized projections need not be disclosed]; *Matter of General Motors (Hughes) Shareholder Litig.*, 2005 WL 1089021, *16 [Del Chancery, May 4, 2005, No. 20269], *affd* 897 A2d 162 [Del 2006] ["[a] disclosure that does not include all financial data needed to make an independent determination of fair value is not, however, *per se* misleading or omitting a material fact. The fact that the financial advisors may have considered certain non-disclosed information does not alter this analysis"]; Delaware Decision at 38.)

Here, the proxy statement included an extensive description of financial analyses, including the materials relied on by America's Growth Capital in arriving at its fairness opinion. (Proxy Statement at 68-72.) It also provided a detailed chronology of the sales process, including meetings and communications with respect to each suitor. (*Id.* at 43-51.) Plaintiff fails to show that the specified omitted data was material and that the financial disclosures were therefore insufficient under the above authority. Further, Delaware law does not support plaintiff's claim that details of negotiations with other suitors should have been disclosed under these circumstances in which a price and the structure of the transaction had not been agreed upon. (*See Krim*, 744 A2d 528-529, citing *Bershad v Curtiss-Wright Corp.*, 535 A2d 840, 847 [Del 1987].) "[W]here a board has not received a firm offer or has declined to continue negotiations with a potential acquirer because it has not received an offer worth pursuing, disclosure is not required." (*Simonetti*, 2008 WL 5048692 at *12.)

Plaintiff's allegation that the proxy statement should have disclosed conflicts of interest of the board members also fails. As the court has held that plaintiff's allegations that the board members were not independent are insufficient as a matter of law, any omission of the alleged conflicts from the proxy statement cannot be material. (*See e.g. Orman*, 794 A2d at 33.) In any event, the conflicts of interest of which plaintiff complains were disclosed in the final proxy statement. The continued employment and positions of Carrao and Pisaris, as well as the fact that certain Vertro directors would continue to serve on the board of the merged entity, were expressly disclosed. (Proxy Statement at 73, 87, 184-185.) That the merger would trigger "accelerated vesting of all Vertro stock options and restricted stock units held by the directors and executive officers of Vertro" and

the payment of bonuses to Carrao and Pisaris was also disclosed, although no specific dollar amount was given. (*Id.* at 73.)

This court accordingly holds that under applicable Delaware law, plaintiff fails to show that any of the claimed omitted material would have had a substantial likelihood of significantly altering the total mix of information when viewed by the reasonable investor. Plaintiff's second cause of action for breach of fiduciary duty, based on defendants' alleged failure to disclose, must therefore be dismissed.

In view of this holding, the court does not reach defendants' further claim that plaintiff is [*13]not entitled to recover damages for its failure to disclose.[FN9] It is noted, however, that serious questions exist as to availability of money damages for failure to disclose where a curative disclosure has not first been sought. (*See e.g. Wayne County*, 2009 WL 2219260 at *8-9; *Matter of Transkaryotic Therapies, Inc.*, 954 A2d 346, 362 [Del Chancery 2008]; *Simonetti*, 2008 WL 5048692 at *13; *O'Reilly v Transworld Heathcare, Inc.*, 745 A2d 902, 917 [Del Chancery 1999].)

Aiding and Abetting

Corporations may be "liable for aiding and abetting a breach of a corporate fiduciary's duty to the stockholders if [they] knowingly participate[]' in the breach." (*Malpiede*,

780 A2d at 1096 [footnote omitted].) To state a claim, "the complaint must allege facts that satisfy the four elements of an aiding and abetting claim: (1) the existence of a fiduciary relationship, (2) a breach of the fiduciary's duty, . . . (3) knowing participation in that breach by the defendants, and (4) damages proximately caused by the breach." (*Id.* [internal quotation marks and citation omitted].) As this court holds that plaintiff fails to state a claim for breach of fiduciary duty, plaintiff's claim that Vertro, Inuvo, and Anhinga aided and abetted in the breach must also fail.

Even if a cause of action for breach of fiduciary duty were stated, the dismissal of the aiding and abetting cause of action would still be required. "Knowing participation in a board's fiduciary breach requires that the third party act with the knowledge that the conduct advocated or assisted constitutes such a breach." (*Malpiede*, 780 A2d at 1097.) The complaint is simply devoid of any allegations that Vertro, Inuvo, or Anhinga "participated in the [Vertro] boards's decisions, conspired with the board, or otherwise caused the board to make the decisions at issue." (*Id.* at 1098.)

Plaintiff seeks leave to replead in the event the motion to dismiss is granted. Plaintiff does not

request any discovery and does not specify any facts that it could replead in order to state a cognizable claim. Leave to replead will accordingly be denied.

The court has considered plaintiff's remaining contentions and finds them to be without merit.

This constitutes the decision and order of the court.

Accordingly, it is hereby ORDERED that the defendants' motions to dismiss are granted and the Second Amended Complaint is dismissed with prejudice.

Dated: New York, New York

January 13, 2014

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MARCY S. FRIEDMAN, J.S.C.

Footnotes

Footnote 1: Individual defendants move to dismiss under motion sequence 007, and corporate defendants move to dismiss the only cause of action asserted against them, for aiding and abetting, under motion sequence 008. Corporate defendants adopt and incorporate the arguments set forth in individual defendants moving papers. (Corporate Ds.' Memo of Law in Support at 2.) The motions are considered together.

Footnote 2: The determination of the motion to stay was made on the First Amended Complaint (FAC). However, the substantive allegations and the relief sought in the Second Amended Complaint are virtually identical to those in the First Amended Complaint. For example, both complaints contain allegations of inadequate merger consideration and inadequate sales process (FAC ¶¶ 46-55; SAC ¶¶ 39-76), preclusive deal protections (FAC ¶¶ 56-60; SAC ¶¶ 77-81), director conflicts of interests (FAC ¶¶ 61-68; SAC ¶¶ 82-89), and material omissions from proxy statement (FAC ¶¶ 69-81; SAC ¶¶ 90-102).

Footnote 3: The allegations of the complaint are at odds with the proxy statement on the point of whether Vertro shareholders would hold a majority of the shares in the merged company. The complaint pleads that "[u]pon consummation of the Merger, Vertro's former stockholders held less than a majority of the shared in the post-Merger entity." (SAC, ¶ 38.) The final proxy statement states, however, that upon completion of the merger, "current stockholders of Inuvo would hold . . . approximately 47.2% of the outstanding common stock of the combined company, and current

stockholders of Vertro would hold . . . approximately 52.8% of the outstanding shares of the combined company." Those percentages would change to 51.4% and 48.6%, respectively, "[a]ssuming exercise of all the outstanding options (whether or not vested) and warrants of both Inuvo and Vertro." (Lorenzo Aff., Ex. C [Excerpts from Proxy Statement at 43.) In either event, plaintiff does not claim that the Inuvo shares were voted as a block.

Footnote 4: Similarly, in *Steinhardt v Howard-Anderson* (Del Chancery Jan. 24, 2011, No. 5878—VCL), also relied upon by plaintiff, the Court applied heightened scrutiny where the public would hold only approximately 15% of the post-merger entity and would be subject to a controlling shareholder. (P.'s Memo. In Opp., Ex. 1 [Transcript of Decision on the Record] at 86.) Even in that circumstance, the Court limited the remedy to a curative disclosure, holding that "it's up to the stockholders to decide whether this is the price and the mix of consideration that they want for their shares." (*Id.* at 91.)

Footnote 5: Although the Delaware action was not resolved on the merits, the court finds the Delaware Court's reasoning persuasive. As a Delaware Court noted, "[w]here a complaint seeking to enjoin a merger on grounds of breach by the company's directors is insufficient to support a motion to expedite, the chances of the same allegations surviving a motion to dismiss are vanishingly small. Those chances are smaller still where the motion to dismiss comes after the merger has closed . . . ." (*Matter of BioClinica, Inc. Shareholder Litig.*, 2013 WL 5631233, *1 [Del Chancery, Oct. 16, 2013, No. 8272-VCG].) The Court reached this conclusion based on its holding that the standard on a motion to expedite is even lower than the standard on a motion to dismiss. (*Id.* at *1 n 1.)

Footnote 6: Although the SAC was filed after the merger had closed, several allegations in the complaint, including these, are drafted in the future tense. These allegations are virtually identical to those asserted in the First Amended Complaint, which was filed before the merger closed. (*See e.g.* FAC, ¶¶ 61-68.)

Footnote 7: A collar agreement would have set forth "the minimum and maximum price or ratio for a transaction." (Black's Law Dictionary [9th ed 2009].)

Footnote 8: As the Delaware Supreme Court further explained: "While directors must give stockholders an accurate, full, and fair characterization of the events leading up to a board's decision to recommend a tender offer, Delaware law does not require a play-by-play description of every consideration or action taken by a Board, especially when such information would tend to confuse stockholders or inundate them with an overload of information." (*Cogent, Inc.*, 7 AD3d at 511-12.)

Footnote 9: Similarly, in view of the above disposition dismissing the complaint, the court need not reach the applicability of the exculpatory provision in the Vertro certificate of incorporation (§ 7) to the claims in this action.

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