PAUL HASTINGS

STAY CURRENT

July 2018

Follow @Paul_Hastings

Perils of Imprecise M&A Disclosure: Court Scrutiny Results in Loss of Business Judgment Protection

By David Shine, Darcy White & Russell Franklin

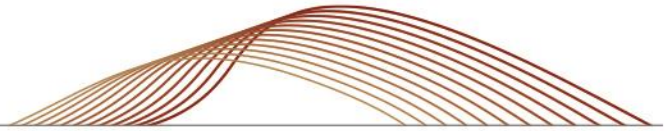
The Delaware Supreme Court, in a recent ruling involving the $1.4 billion private equity purchase of The Fresh Market, sent a loud and clear message about the importance of fully candid, and accurately worded, disclosures in merger proxies and tender offer statements.

The decision (*Morrison et al. v. Ray Berry et al.*) was an appeal from a lower court decision holding that the "business judgment rule," not the more stringent "entire fairness" standard, governed review of post-closing damages claims. (The applicable standard of review is the critical question in cases seeking post-closing damages—a business judgment rule standard in that context typically results in pleading stage dismissal and an entire fairness standard is much more challenging.)

The lower court had determined that the business judgment rule was applicable because it found that the transaction had been approved by a "fully informed, uncoerced majority of the disinterested stockholders." Therefore, in accordance with the landmark Delaware decision in *Corwin v. KKR*, the board was entitled to the protection of the business judgment rule. The Supreme Court disagreed. It instead found that the *Corwin* standards were not satisfied because stockholders were not "fully informed" due to "partial and elliptical disclosures." The Court therefore held that the entire fairness standard should apply to review of the transaction and sent the case back to the Court of Chancery.

In reaching its decision, the Court meticulously parsed certain tender offer disclosures and compared the disclosures side-by-side with various internal emails. The court found that in some cases the internal emails showed that the tender offer disclosures included material misstatements or omissions.

An example of what the Court found to be a material misstatement related to whether the company's founder (who was also a 10% stockholder) was committed to participating with the private equity firm at the time the firm first approached the company about a possible transaction. The degree of any such commitment was, the Court said, material to the ability of the stockholders to determine whether the subsequent sale process was "pre-ordained" in favor of the private equity firm or whether it was robust with the intent of obtaining the highest price. The tender offer disclosure said that the founder had no agreement to participate until after the first approach. But an internal email suggested that he had such an agreement at the time of the first approach.



An example of what the Court found to be a material omission related to whether the founder believed that the company should be sold and had threatened to sell his shares if it were not. The Court said that this information, if available, would have been important in a stockholder's decision of whether or not to tender. Nothing on this topic was included in the tender offer disclosure. But an internal email suggested that the founder believed a sale of the company was in the best interests of stockholders and noted that he would "give serious consideration to selling his stock" if the company were not sold.

The applicable standard of review is critical to post-closing transaction litigation, and the *Corwin* case requires a "fully informed" and uncoerced vote of disinterested stockholders in order for the business judgment rule standard to apply. It has therefore never been more important to assure that merger proxy and tender offer disclosures are accurate in all material respects. And this case provides another recent example of the extremely high degree of scrutiny that the Delaware court may apply in making this determination.

✧ ✧ ✧

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

David N. Shine
1.212.318.6484
davidshine@paulhastings.com

Darcy R. White
1.404.815.2525
darcywhite@paulhastings.com

Russell M. Franklin
1.212.318.6012
russellfranklin@paulhastings.com