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Recent Updates in Delaware Disclosure Law

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The Delaware Supreme Court recently issued two opinions weighing in on the scope of disclosures involving board advisors in connection with M&A transactions that warrant close attention. In both rulings — each written *en banc* — the Delaware Supreme Court reversed the lower courts' dismissals of all claims because (among other reasons) certain material information about the target companies' advisors was not disclosed. The Delaware Court of Chancery recently cited both rulings in denying motions to dismiss disclosure claims against directors and aiding and abetting claims against financial advisors. Companies and financial advisors alike should be aware of the court's rulings and changes to Delaware law, as they will undoubtably have an impact on disclosures with regard to advisors' prior and current engagements, as well as any proprietary equity holdings of merger parties.

In one of the two Delaware Supreme Court cases,[1] the Court of Chancery had originally dismissed a challenge to a $3.3 billion squeeze-out transaction under the *MFW* doctrine, holding that the transaction met MFW's requirements for dismissal because it was conditioned ab initio on, and received, approval by (i) a fully independent and empowered special committee formed at the outset of the process and (ii) a fully informed and uncoerced majority of the minority shares of the target company. On appeal, the court reversed the dismissal because it found that the minority stockholders of the target company were not fully informed prior to when they voted to approve the transaction. The court held that information pertaining to conflicts involving financial advisors on the special committee involved in the sale should have been disclosed to the target's minority stockholders when soliciting their approval of the transaction, including:

- The special committee's financial advisor held $470 million of equity in the controller for its own accounts, even though that amount accounted for only .1% of the advisor's portfolio value. This figure, and the fact that the financial advisor held the interest on a proprietary basis, was not disclosed.

[1] *City of Dearborn Police & Fire Revised Ret. Sys. (Chapter 23) v. Brookfield Asset Mgmt., Inc.*, — A.3d —, 2024 WL 1244032 (Del. Mar. 25, 2024).

- The proxy statement disclosed that the financial advisor "may have committed and may commit in the future to invest in private equity funds managed by [controller] or its affiliates," when in fact the advisor had already had done so. The court concluded this disclosure was "misleading" and also was grounds for reversal.

In its rulings, the Supreme Court commented that "'[b]ecause of the central role played by investment banks in the evaluation, exploration, selection, and implementation of strategic alternatives, [the Court of Chancery] has required full disclosure of investment banker compensation and potential conflicts.'" The court further explained that "[i]t does not matter whether the financial advisor's opinion was ultimately influenced by the conflict of interest; the presence of an undisclosed conflict is still significant."

Following its ruling in *City of Dearborn*, the Delaware Supreme Court again reversed a dismissal from the Court of Chancery under the *MFW* doctrine in a case challenging the $7.3 billion acquisition of a controlled company by a consortium of third-party private equity buyers.[2] In *Inovalon*, the CEO of the target company (Inovalon) controlled 64.1% of the voting power of the company. The CEO and another director (together owning approximately 86% of Inovalon's voting power) agreed to roll over their equity while the minority stockholders were cashed out, with 99% of the minority stockholders voting to approve the transaction.

In its ruling, the court reversed the Court of Chancery's decision because of inadequate disclosure related to the financial advisors of Inovalon board and special committee. Stating that "[a] special committee's advisor's conflicts are uniquely important considerations for minority stockholders when deciding how to vote," the court held that the proxy statement should have disclosed the following information:

- Affiliates of the special committee's financial advisor were concurrently representing the primary buyer and another member of the equity consortium in unrelated transactions.
    - The court, referring to its prior opinion, held that the proxy statement was "misleading" when disclosing that the advisor and its affiliates "may" provide services to those parties because "there was an actual concurrent conflict" involving services to those parties.
- The specific amount of fees that the Inovalon board's financial advisor stood to earn from its concurrent representations of the primary buyer and another member of the equity consortium in unrelated transactions.

[2] *City of Sarasota Firefighters' Pension Fund v. Inovalon Hldgs., Inc.*, — A.3d —, 2024 WL 1896096 (Del. May 1, 2024).

- Here, the court held that it was not enough for the proxy statement merely to disclose that the advisor would receive "customary compensation" for such representations.

- The specific amount of fees earned over the last two years by the Inovalon board's financial advisor from all members of the equity consortium (which totaled approximately $400 million).

    - The court found it misleading for the board's financial advisor to omit the fees from all members of the equity consortium and disclose only that the financial advisor would make $15.2 million in fees earned from work performed for the primary buyer.

The Delaware Supreme Court also compared the proxy statement disclosures to the minutes of relevant special committee meetings (obtained through a books and records demand), focusing specifically on the work performed by the special committee's financial advisor. According to the court, if the minutes were assumed to be accurate, then the proxy statement "overstated" the role of the committee's financial advisor in the process. Nevertheless, the court determined that it "need not 'pile on' another basis for reversal," though it cautioned that "the Proxy's description of [the committee's advisor's] role in the market outreach efforts do[es] not sit comfortably with the corresponding accounts set forth in the minutes. Boards, committees, and their advisors should take care in accurately describing the events and the various roles played by board and committee members and their retained advisors."

Finally, the Delaware Court of Chancery recently refused to dismiss breach of fiduciary duty claims against directors for failing to disclose certain financial advisor conflicts, and refused to dismiss aiding and abetting claims against those advisors.[3] Citing the recent statements from the Delaware Supreme Court on the importance of disclosing financial advisor conflicts, the Court of Chancery held that the Information Statement issued in connection with a merger failed to disclose all material information by omitting, among other things, that the compensation for the financial advisors for the target board and the special committee was tied, in part, to the value of a non-ratable benefit flowing to the controller of the target. This compensation structure was also used, among other things, to sustain aiding and abetting claims against both financial advisors.

Key Points

- When the Delaware Supreme Court issues not one, but two, opinions on financial advisor conflict issues and related disclosures, practitioners and M&A participants must take

[3] *Firefighters' Pension Sys. of City of Kansas City v. Found. Bldg. Mats., Inc.*, 2024 WL 2795026 (Del. Ch. May 31, 2024).

notice. In particular, the court has made clear that there is risk in failing to disclose specifics around prior and concurrent work performed by the financial advisors in an M&A process, as well as regarding fees earned or expected to be earned for such work. Accordingly, previously accepted disclosure language may no longer be sufficient.

- Moreover, the scope of such disclosures depends on who the participants are in the transaction, as the requirements are not as simple as stating “buyer” and “seller.” In certain circumstances, disclosure requirements may extend to affiliates and/or members of a group, such as affiliates of the financial advisor, and other deal participants on the buy side, including members of a consortium.

- In consultation with legal counsel, directors and officers should seek updates regarding conflicts from their financial advisors throughout the process, as well as take reasonable steps to ensure that public filings disclose all material information.

- Directors and officers must be mindful about the description of events in the proxy statements and ensure they accurately reflect the content of the company’s internal meeting minutes.

- Financial advisors must consider the risk that a third party could view a compensation structure as containing embedded conflicts.

- The Delaware courts’ recent decisions highlight the need for directors, officers, companies and financial advisors to seek expert legal advice about the scope of disclosure for conflicts and descriptions of a financial advisor’s role in the transaction process. In certain circumstances, the role of legal advisers may need to be analyzed as well, particularly if a target board or special committee’s legal advisers are concurrently representing the buyer, a controller or other material deal participants.