In Support Of Delaware's Merger Litigation Jurisprudence

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In a recent Law360 article titled "Fair to Whom? Examining Delaware's Fair Summary Standard,"[1] two members of the plaintiffs bar criticized the principle of Delaware law that stockholders should be provided a "fair summary" of an investment adviser's work in connection with a solicitation of votes relating to a proposed corporate transaction. In the view of those authors, this principle, combined with recent legislative reforms concerning appraisal litigation and judicial decisions addressing the viability of post-closing litigation, has left stockholders wondering if "fairness in Delaware is judged from the corporation's perspective, not the shareholders'." This article contends that the authors' criticism is misplaced and posits that Delaware courts have taken appropriate steps to incentivize full and fair disclosure — fair to all — while at the same time minimizing frivolous litigation that harms both companies and stockholders.

Delaware's Fair Summary Standard

The "Fair to Whom?" authors contend that Delaware's materiality standard for corporate disclosure has become more corporate-friendly in recent years, and they take specific aim at the "fair summary" standard applicable to disclosures relating to bankers' analyses. The "fair summary" standard, however, evolved not as a concession to companies and their boards, but rather as a protection for stockholders. The current formulation of the "fair summary" standard can be traced to the Delaware Court of Chancery's decision in In re Pure Resources Inc. Shareholders Litigation.[2] The Pure Resources court explained that "Delaware courts [previously] ha[d] been reluctant [even] to require informative, succinct disclosure of investment banker analyses ...." For instance, in Skeen v. Jo-Ann Stores Inc., a case from 2000, the Delaware Supreme Court "was inclined towards the view that a summary of the bankers' analyses and conclusions was not material to a stockholders' decision whether to seek appraisal."[3]

In Pure Resources, the court held that "it is time that this ambivalence be resolved in favor of a firm statement that stockholders are entitled to a fair summary of the substantive work performed by the investment bankers upon whose advice the recommendations of their board as to how to vote on a merger or tender rely." In devising this pro-stockholder standard, the court nonetheless observed that Delaware "law should not encourage needless prolixity" in deal disclosures, and it assessed what a reasonable stockholder would consider to be "material" information in casting a vote. While the authors suggest that Delaware courts are not applying the "federal" materiality standard, they don't dispute that Delaware defines "materiality" in the same way as federal courts: as a fact that would be considered by a reasonable stockholder as significantly altering the total mix of information available.[4] What the authors are really complaining about is not

the standard applied, but the Delaware courts' reasoned application of that standard in the context of disputes as to which no judicial body in the country is more expert.

Since Pure Resources, the Delaware Court of Chancery has carefully defined the contours of what constitutes "material" as opposed to merely "helpful" (and therefore nonrequired) disclosure. In doing so, courts have required companies to provide stockholders fair insight into bankers' fairness analyses without counterproductively overwhelming stockholders with unnecessary information. Delaware courts also have repeatedly and consistently admonished that companies need not provide stockholders with information that would allow them to calculate value entirely on their own (a task that is appropriately delegated to boards and their bankers). The authors offer no justification that would permit a departure from the customary role played by boards and their bankers or to require companies to provide so much information that stockholders are equipped to usurp that role and calculate fair value on their own. And in the limited circumstances that might justify a departure from board deference — e.g., where a controlling stockholder stands on both sides of the transaction — the "Fair to Whom?" authors' concerns are mooted by the application of the "entire fairness" standard in such circumstances. Indeed, contrary to the authors' concern, the entire fairness standard would apply in that situation even if a stockholder vote is determined to have been "fully informed."[5]

Nor do the authors suggest an outer bound on the appropriate amount of disclosure, instead suggesting only that "adding a few tables" of information would not threaten to bury stockholders with information. The problem, of course, is that a line must be drawn somewhere, and the absence of a particularized disclosure standard would encourage frivolous litigation because a stockholder — or a plaintiffs lawyer purporting to act on behalf of a stockholder — always could seek a "few more tables." Indeed, the potential information that a single litigant might seek — even if irrelevant to the bankers' analyses of fair value — is endless. The "fair summary" standard offers a reasonable and fair compromise, allowing stockholders to understand the analysis undertaken by the bankers, without distracting them with immaterial information, while at the same time affording deference to a board's assessment of value.

The New Legislation Governing Appraisal

The "Fair to Whom?" authors also take aim at Delaware's recently enacted amendment that prohibits stockholders from seeking judicial appraisal of their shares where they hold less than $1 million or 1 percent of a company's stock. This amendment is aimed at repeat players who use the appraisal remedy as an alternative to "strike suits" that are no longer as profitable in light of the Delaware court's crackdown on disclosure-only settlements. In particular, the amendment bars stockholders from seeking appraisal where the value of shares is minimal and, therefore, companies are incentivized to provide nuisance-value settlements (both to avoid litigation costs and the distraction of an appraisal proceeding).

The authors suggest that the amendment leaves small investors without a remedy, but in reality, the legislation merely reflects a continuation of Delaware's balancing act between stockholder protection and the avoidance of vexatious or frivolous litigation aimed at Delaware companies. Indeed, research supports the intent behind the amendment. A recent study by Columbia Business School and Vanderbilt Law School projected that the appraisal amendment would cut

appraisal litigation by one quarter, but was "unlikely to distort the underlying economic reasons why shareholders seek appraisal."[6] Critically, the study found that "small appraisal cases," i.e., those that would be barred by the recent amendment, were "the cases most likely to constitute strike suits." The study found that those cases settled 100 percent of the time, whereas larger cases proceeded to trial 50 percent of the time. The study authors ultimately concluded that appraisals were "provid[ing] an avenue for small investors to file a new form of strike-suit litigation seeking to force friendly acquirers to pay them a bit extra."

Conclusion

The recent changes in Delaware statutory and common law can be viewed negatively only from the narrow perspective of the plaintiffs bar. A closer inspection reveals that Delaware law remains, as it has been, focused on providing a fair balance between individual stockholder rights and the avoidance of frivolous litigation, the existence of which continues to harm boards, companies and all of their stockholders.

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[1] Miles D. Schreiner and Juan E. Monteverde, "Fair To Whom? Examining Delaware's Fair Summary Standard," Law360, March 22, 2017.

[2] In re Pure Resources Inc. Shareholders Litigation, 808 A.2d 421 (Del. Ch. 2002).

[3] Id. (citing Skeen v. Jo-Ann Stores Inc., 750 A.2d 1170 (Del. 2000)).

[4] Basic Inc. v. Levinson, 485 U.S. 224 (1988).

[5] See, e.g., In re Merge Healthcare Inc., 2017 WL 395981 (Del. Ch. Jan. 30, 2017).

[vi] Wei Jiang et al., "Reforming the Delaware Appraisal Statute to Address Appraisal Arbitrage: Will It Be Successful?" Vanderbilt Law & Economics, Vol. 59 (August 2016).