

Fair Summary II: An Update on Delaware's Disclosure Regime Regarding Fairness Opinions

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In May 2008, the authors published an article discussing the general principles behind Delaware cases involving disclosure regarding fairness opinions and the financial advisors that provide them. This Article updates that prior article and discusses the evolution of Delaware law on this topic. Principally, this Article discusses developments in three areas: disclosure regarding the financial advisor's analysis, disclosure regarding management's projections, and disclosure regarding the financial advisor's potential conflicts. Included are analyses of the most recent Delaware cases, including transcript rulings, as well as general discussions of other issues relating to Delaware's fiduciary duty of disclosure.

Three years ago, we published an article in this journal setting forth a general framework for fiduciary disclosure regarding fairness opinions under Delaware law.¹ While the issues we discussed in the prior article are still litigated with some frequency, the Court of Chancery has noted that financial disclosures in recent years have been far more robust than they had been in the past—undoubtedly due largely to the court's rulings.² In response, plaintiffs have sought new lines of

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1. Blake Rohrbacher & John Mark Zeberkiewicz, *Fair Summary: Delaware's Framework for Disclosing Fairness Opinions*, 63 BUS. LAW. 881 (2008) [hereinafter *Fair Summary*]. See generally 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, *THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS* § 17.2 (Supp. 2011) (discussing Delaware's common-law disclosure principles).

2. See, e.g., Transcript of Settlement Hearing at 40, *In re Alberto-Culver Co. S'holder Litig.*, C.A. No. 5873-VCS (Del. Ch. Feb. 21, 2011) ("The reality is that practices are, in general, far better. It's far fuller disclosure about the economics of a deal, much more disclosure about the bankers, which means that a lot of times things that get attacked are more tangential."); Transcript of Status Conference at 4–5, *Forgo v. Health Grades Inc.*, C.A. Nos. 5716-VCS & 5732-VCS (Del. Ch. Aug. 18, 2010) ("You'll start realizing the reality, which is that in past cases the plaintiffs' bar has had substantial success. As a result of that, and as a result of changes at the Securities and Exchange Commission, . . . in part because of the SEC itself but also recognizing decisions from this Court, there's a lot more disclosure out there. More disclosure and more high quality disclosure because, frankly, you didn't get projections 20 years ago."); Transcript of Argument and Ruling on Motion to Expedite in C.A. No. 5149-VCS and Scheduling Conference in C.A. No. 5214-VCS at 20, *Pirrello v. James*, C.A. Nos. 5149-VCS & 5214-VCS (Del. Ch. Feb. 17, 2010) ("The quality and thoroughness of banker disclosure has never been greater than it is in the current year. I think it does have something to do with decisions of this Court

attack, and the Delaware courts have therefore begun to focus not only on the disclosure of underlying financial analyses broadly, but also on specific and discrete issues involving fairness opinions and projections as well as on issues beyond the fairness opinion itself,³ most notably the financial advisor's potential conflicts and incentives. In this article, we discuss the current state of Delaware's fiduciary disclosure regime and the developments over the last three years.⁴

In particular, we discuss three major areas of development in Delaware disclosure cases. First, we discuss the "fair summary" requirement for disclosure of the financial analysis underlying a banker's fairness opinion. Next, we discuss the court's recent statements regarding disclosure of management's projections, including cash flow measures. Finally, we discuss developments regarding the disclosure of financial advisors' potential conflicts, including compensation arrangements and buy-side work.

DISCLOSURE REGARDING THE FINANCIAL ADVISOR'S ANALYSIS

In the last three years, the Delaware Court of Chancery has addressed a number of issues regarding disclosure of the financial aspects of fairness opinions. As we noted in our earlier article, directors are generally required, if they rely on a fairness opinion⁵ to support their recommendation of a particular transaction, to

as well as the SEC."); Transcript of Settlement Hearing at 22, *Masucci v. Fibernet Telecom Grp., Inc.*, C.A. No. 4680-VCS (Del. Ch. Nov. 25, 2009) ("But as a combination of some of my rulings and those of my colleagues, and frankly some of the lead the SEC took from those rulings, the disclosure about financial information and projection is much fuller and richer than it's ever been. That should actually lead people to file fewer suits about financial information rather than more."); Transcript of Argument and Ruling on Motion to Expedite at 25, *In re Hiland Partners, LP Unit Holders Litig.*, C.A. No. 4397-VCS (Del. Ch. Sept. 11, 2009) ("But there has been a trend toward [disclosing projections], which is good for investors. It may not be good for people who bring cases, because the more there is thorough disclosure, the less there is to shoot at.")

3. *Fair Summary*, *supra* note 1, at 882–83 ("Fairness opinions are typically produced at the request of the target's board (or a special committee of the board) by investment bankers who value the target company and come up with a range of values. The bankers then opine on whether the consideration to be received by the target company's stockholders in the business combination is fair . . ." (footnote omitted)).

4. One aspect that has not changed is the balance that the Delaware Court of Chancery tries to strike between under- and overdisclosure. *See, e.g., In re Answers Corp. S'holders Litig.*, C.A. No. 6170-VCN, 2011 WL 1366780, at *5 (Del. Ch. Apr. 11, 2011) ("Non-material facts need not be disclosed, and additional details underlying financial projections are not necessarily material, especially where they would tend to confuse stockholders or inundate them with an overload of information." (internal quotation marks omitted)); Transcript of Telephonic Rulings of the Court on Plaintiffs' Motion to Expedite at 16, *In re Cal. Micro Devices Corp. S'holders Litig.*, C.A. No. 5159-VCP (Del. Ch. Jan. 15, 2010) ("In light of the information disclosed, I cannot see how the requested information would be material to a shareholder in determining whether to tender his or her shares or would do anything more than bury the shareholder in an avalanche of trivial information."); *see also Fair Summary*, *supra* note 1, at 883–84.

5. We note that a "fair summary" disclosure might also be required of any advisor's analysis that was presented to the board and relied on by it in recommending a transaction to the stockholders, even if the board did not receive a formal fairness opinion. *See Berger v. Pubco Corp.*, C.A. No. 3414-CC, 2008 WL 2224107, at *3 (Del. Ch. May 30, 2008) ("Because Kanner utilized the short-form merger statute, he did not have to set a fair price and, therefore, could have used any method—no matter how absurd—to set the merger consideration. Defendants argue that disclosure of his methodology is

provide a “fair summary” of the analysis underlying that fairness opinion.⁶ Such a “fair summary” might include, for example, “the basic valuation exercises that [the financial advisors] undertook, the key assumptions that they used in performing them, and the range of values that were thereby generated.”⁷

As an initial matter, the court is still rejecting—as disclosure claims—plaintiffs’ substantive challenges of the bankers’ analyses.⁸ That is, challenges of the *substance* of the valuation (or “quibbles,” as the Court of Chancery has called them), such as second-guessing the particular methods used, the companies selected as comparables, or the discount rates employed, are not disclosure claims.⁹

The “fair summary” requirement includes the “valuation exercises” performed and the “key assumptions” used by the financial advisor. Many disclosure claims accordingly take issue with the nature or scope of disclosure regarding the financial advisor’s different valuation methodologies. “Under Delaware law, the valuation

unnecessary. Defendants’ argument entirely misses the mark, however, because the issue is not about necessity—it is about materiality. In the context of Pubco, an unregistered company that made no public filings and whose Notice was relatively terse and short on details, the method by which Kanner set the merger consideration is a fact that is substantially likely to alter the total mix of information available to the minority shareholders. Where, as here, a minority shareholder needs to decide only whether to accept the merger consideration or to seek appraisal, the question is partially one of trust: can the minority shareholder trust that the price offered is good enough, or does it likely undervalue the Company so significantly that appraisal is a worthwhile endeavor? When faced with such a question, it would be material to know that the price offered was set by arbitrarily rolling dice. In a situation like Pubco’s, where so little information is available about the Company, such a disclosure would significantly change the landscape with respect to the decision of whether or not to trust the price offered by the parent. This does not mean that Kanner should have provided picayune details about the process he used to set the price; it simply means he should have disclosed in a broad sense what that process was, assuming he followed a process at all and did not simply choose a number randomly.” (footnote omitted), *rev’d on other grounds*, 976 A.2d 132 (Del. 2009); *see also* *Wacht v. Cont’l Hosts, Ltd.*, C.A. No. 7954, 1994 WL 525222, at *3 (Del. Ch. Sept. 16, 1994) (“While it may be true that [defendant] Stanley Lewin knew more about Continental than an outside investment banker, he did not apply this knowledge, or disclose it to the shareholders, in any rational, logical way, from which the shareholders could determine how he arrived at the \$12 per share figure. . . . A shareholder, in determining whether to seek appraisal or accept the terms of the Merger, would surely deem information regarding how the merger price was determined to be material.”). This proposition is based on, among other things, Delaware law regarding “partial disclosure.” *See In re Netsmart Techs., Inc. S’holders Litig.*, 924 A.2d 171, 203 (Del. Ch. 2007) (“Once a board broaches a topic in its disclosures, a duty attaches to provide information that is ‘materially complete and unbiased by the omission of material facts.’”). Thus, when directors have relied on a financial analysis and tout it to the stockholders as a basis for approving a given transaction, they should probably provide a “fair summary” of that analysis. *See id.*

6. *Fair Summary*, *supra* note 1, at 902.

7. *In re Pure Res., Inc. S’holders Litig.*, 808 A.2d 421, 449 (Del. Ch. 2002); *see also Fair Summary*, *supra* note 1, at 891–92.

8. *See, e.g., In re Sauer-Danfoss Inc. S’holders Litig.*, C.A. No. 5162-VCL, 2011 WL 2519210, at *14–15 (Del. Ch. Apr. 29, 2011); *In re Atheros Commc’ns, Inc. S’holder Litig.*, C.A. No. 6124-VCN, 2011 WL 864928, at *10 (Del. Ch. Mar. 4, 2011); *In re CNX Gas Corp. S’holders Litig.*, 4 A.3d 397, 419 (Del. Ch. 2010); *In re 3Com S’holders Litig.*, C.A. No. 5067-CC, 2009 WL 5173804, at *6 (Del. Ch. Dec. 18, 2009); *Cnty. of York Emps. Ret. Plan v. Merrill Lynch & Co.*, C.A. No. 4066-VCN, 2008 WL 4824053, at *11 (Del. Ch. Oct. 28, 2008).

9. *Fair Summary*, *supra* note 1, at 897–98; *In re JCC Holding Co. S’holders Litig.*, 843 A.2d 713, 721 (Del. Ch. 2003) (stating that “kind of quibble with the substance of a banker’s opinion does not constitute a disclosure claim”).

work performed by an investment banker must be accurately described and appropriately qualified.”¹⁰

Nevertheless, the “fair summary” requirement does not mean that every aspect of a banker’s analysis (or the banker’s entire presentation to the directors) must be disclosed. For example, the Delaware Court of Chancery has held that a corporation “committed no disclosure violation by failing to include the manner in which [its financial advisor] derived the discount rate it used in its analysis.”¹¹ Similarly, the court has stated that Delaware law does not require a corporation “to disclose why [its] advisor chose one method of analysis over another.”¹²

But the results may be quite different when the court determines that directors have engaged in “partial disclosure”¹³ or have otherwise been misleading¹⁴ or incomplete.¹⁵ For example, in *Maric Capital*, the Court of Chancery required the defendant directors to make corrective disclosure regarding their financial advisor’s range of discount rates.¹⁶ The proxy statement of target PLATO Learning indicated that the board’s financial advisor had selected discount rates “‘based upon an analysis of PLATO Learning’s weighted average cost of capital’” and that the advisor had used a range of 23 percent to 27 percent when conducting its DCF analysis.¹⁷ But the advisor’s calculations of the company’s weighted average cost of capital—disclosed to PLATO’s special committee—had actually generated discount rates of 22.5 percent and 22.6 percent (below the 23 percent at the bottom of the disclosed range).¹⁸ The financial advisor representative, at his deposition, provided various reasons why the higher range was used and disclosed, but there

10. *In re 3Com*, 2009 WL 5173804, at *6.

11. *Merrill Lynch*, 2008 WL 4824053, at *12.

12. Transcript of Telephonic Rulings of the Court on Plaintiffs’ Motion to Expedite, *supra* note 4, at 14 (“Delaware law . . . does not require an investment banker to perform a discounted cash flow analysis or the Company to disclose why the advisor chose one method of analysis over another.”); see also *In re Best Lock Corp. S’holder Litig.*, 845 A.2d 1057, 1073 (Del. Ch. 2001) (“Delaware courts have held repeatedly that a board need not disclose specific details of the analysis underlying a financial advisor’s opinion.”); *Sauer-Danfoss*, 2011 WL 2519210, at *13 (holding that a supplemental disclosure was “immaterial” when the original “Schedule TO accurately stated that [bidder] Danfoss obtained a premiums analysis and attached a copy of that analysis”).

13. Partial disclosure “normally refers to when a board has disclosed part of something but has not disclosed the whole thing to ensure the information provided is materially complete (and therefore not misleading by omission).” *Fair Summary*, *supra* note 1, at 902.

14. See, e.g., *Gantler v. Stephens*, 965 A.2d 695, 711 (Del. 2009) (holding that “a board cannot properly claim in a proxy statement that it had carefully deliberated and decided that its preferred transaction better served the corporation than the alternative, if in fact the Board rejected the alternative transaction without serious consideration”). The Delaware Supreme Court held in *Gantler* that the board’s disclosure was materially misleading. *Id.* (“By stating that they ‘careful[ly] deliberat[ed],’ the Board was representing to the shareholders that it had considered the Sales Process on its objective merits and had determined that the Reclassification would better serve the Company than a merger.” (alterations in original)).

15. See, e.g., *Fair Summary*, *supra* note 1, at 892 (“Once particular details of a valuation are disclosed, . . . further disclosures must be made to avoid any misimpressions created by those details.”).

16. *Maric Capital Master Fund, Ltd. v. PLATO Learning, Inc.*, 11 A.3d 1175, 1177–78 (Del. Ch. 2010).

17. *Id.* at 1176.

18. *Id.* The range disclosed in the proxy statement also served to make the proposed transaction appear fairer. *Id.* at 1177.

was no evidence that he had explained these reasons to the special committee and no explanation had been provided to the stockholders in the proxy statement.¹⁹ The court therefore ordered disclosure of the values that would be obtained by using the discount rates generated by the company's weighted average cost of capital.²⁰

Where, on the other hand, the range of discount rates disclosed was "actually calculated and used" by the financial advisor, no further disclosure should be required.²¹ In *Atheros*, the proxy statement disclosed that a range of discount rates from 10 percent to 14 percent was used in the advisor's analysis. The advisor's presentation to the directors showed two ranges, using different methodologies: one from 9.9 percent to 13 percent and one from 9.9 percent to 13.8 percent.²² The court held that the advisor's "decision not to use a slightly narrower range of rates, calculated using a different methodology, does not form the basis of a disclosure claim."²³

The "fair summary" requirement also includes the "range of values" generated by the financial advisor's analysis.²⁴ In one case, where (among other information) the value ranges were disclosed, the court found that a fair summary had been given.²⁵ In another case, the court described as a "partial disclosure" a failure to disclose a range of values generated by one of the advisor's methodologies where ranges generated by the other methodologies had been disclosed.²⁶ The court therefore required disclosure of the value range resulting from each valuation methodology: "You need to give the range. You gave the ranges for all the others, but for some reason, on accretion/dilution, you just said accretive or not accretive. So that's an incomplete summary. Stockholders are entitled to a fair summary."²⁷

19. *Id.* at 1176–77.

20. *Id.* at 1178.

21. *In re Atheros Commc'ns, Inc. S'holder Litig.*, C.A. No. 6124-VCN, 2011 WL 864928, at *10 (Del. Ch. Mar. 4, 2011).

22. *Id.*

23. *Id.*

24. *In re Pure Res., Inc. S'holders Litig.*, 808 A.2d 421, 449 (Del. Ch. 2002); *see also In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171, 203–04 (Del. Ch. 2007) ("[W]hen a banker's endorsement of the fairness of a transaction is touted to shareholders, the valuation methods used to arrive at that opinion as well as the key inputs and range of ultimate values generated by those analyses must also be fairly disclosed."); *Fair Summary, supra* note 1, at 901 (stating that the "range of values resulting from the analyses must also be disclosed").

25. *In re 3Com S'holders Litig.*, C.A. No. 5067-CC, 2009 WL 5173804, at *6 (Del. Ch. Dec. 18, 2009) ("These summaries include the final range of value estimates for each analysis.").

26. Transcript of Ruling of the Court: Plaintiffs' Motion for a Preliminary Injunction at 11, *Steinhardt v. Howard-Anderson*, C.A. No. 5878-VCL (Del. Ch. Jan. 24, 2011).

27. *Id.* at 12; *see also* Transcript of Scheduling Office Conference at 12–13, *Maric Capital Master Fund, Ltd. v. PLATO Learning, Inc.*, C.A. No. 5402-VCS (Del. Ch. Apr. 23, 2010) ("There may be some things that are actually . . . partial disclosure problems. I mean, I had a situation yesterday . . . in a motion to expedite where I noted that, for example, . . . the multiple that was used by the banker [in] the comparable companies analysis was set forth, but the very next paragraph with the comparable transaction analysis, they didn't disclose the multiple or the median or the mean, which created a lack of symmetry in the disclosure.").

Regarding partial disclosure, a pair of cases decided a month apart provides instructive guidance. In the *Starent* case, the Court of Chancery granted a motion to expedite on a disclosure claim—that the proxy statement had inconsistently treated stock-based compensation as an expense.²⁸ Two of the advisor’s methodologies had treated stock-based compensation as a non-cash expense, but the advisor’s DCF analysis treated it instead as a cash expense (allegedly resulting in a lower valuation range).²⁹ The court’s primary concern was that “this detour is not disclosed or otherwise highlighted in the relevant proxy statement section.”³⁰ On the other hand, in *3Com*, the opposite result was obtained on a similar claim.³¹ Goldman Sachs had “departed from the norm by treating stock-based compensation expense as a cash expense in its discounted cash flow analysis.”³² But the *3Com* court distinguished *Starent* and reached the opposite conclusion: “[I]n *Starent Networks* it was nowhere disclosed in the proxy that the financial advisor had embarked on this departure from the norm. In contrast, in this case, it is plainly disclosed that Goldman treated stock-based compensation as a cash expense in its DCF Analysis.”³³ Thus, even if the financial advisor uses an unconventional methodology in a given valuation, so long as the advisor’s analysis is described so that stockholders can understand what the advisor did, the Delaware courts will generally accept the disclosure as sufficient.³⁴

28. *Laborers Local 235 Benefit Funds v. Starent Networks, Corp.*, C.A. No. 5002-CC, 2009 WL 4725866, at *1 (Del. Ch. Nov. 18, 2009).

29. *Id.*

30. *Id.*

31. *In re 3Com S’holders Litig.*, C.A. No. 5067-CC, 2009 WL 5173804, at *5 (Del. Ch. Dec. 18, 2009).

32. *Id.* at *3.

33. *Id.* (footnote omitted); *see also id.* (“Thus, shareholders can plainly determine from reading the proxy that Goldman made a departure from the norm in conducting its discounted cash flow analysis. There is no disclosure violation here, merely a disagreement with Goldman’s methodology.”).

Similarly, the court in *Micro Devices* denied a motion to expedite on disclosure claims where the plaintiff contended that the 14D-9 statement failed to disclose the criteria that the board’s financial advisor (Needham) used to select precedent transactions or the multiples observed for those precedent transactions. Transcript of Telephonic Rulings of the Court on Plaintiffs’ Motion to Expedite, *supra* note 4, at 17. The court held that the disclosures contained “sufficient information on the criteria Needham used to select precedent transactions and the multiples related to these transactions to satisfy the Company’s disclosure requirements.” *Id.* The disclosures in the 14D-9 were simple but explained clearly what Needham did; no more is typically required. *Cal. Micro Devices Corp., Solicitation/Recommendation Statement (Schedule 14D-9)*, at 27 (Dec. 28, 2009) (“Needham & Company analyzed publicly available financial information for 16 all-cash merger and acquisition transactions involving selected technology companies completed after January 1, 2007 with transaction values between \$50 million and \$150 million, where both the acquirer and the target company were publicly traded.”); *id.* at 26 (“In reviewing the transactions identified above, Needham & Company calculated, for the selected transactions and for California Micro Devices implied by the Transaction, the ratio of the enterprise value implied by the consideration offered in the transaction to the target company’s LTM revenue and EBITDA, as well as the ratio of the transaction value to LTM net income, as set forth in the following table.”).

34. Transcript of Settlement Hearing and Rulings of the Court at 9, *In re Hawk Corp. S’holders Litig.*, C.A. No. 5925-VCL (Del. Ch. May 3, 2011) (“I’m with you as far as the fact that applying the size discount was weird. You know, it’s not something that one sees all the time; but they were completely open about it.”); *id.* at 27–28.

Finally, the Court of Chancery has generally not required directors to go beyond their advisor's analysis and make a "negative" disclosure (that is, disclose what was not done or not analyzed). As then-Vice Chancellor Strine has noted, "if you fairly disclose what you did, you've met your disclosure obligations. You don't have to disclose what you did not do."³⁵ Those comments responded to a disclosure claim demanding explanation of why a board's financial advisor used trailing rather than projected multiples.³⁶ Because what the advisor had done was disclosed, the court refused to require disclosure of what the advisor did not do (and why).³⁷ Similarly, the court has refused to require disclosure of which comparables were not selected when the comparables that were selected (along with description of the selection criteria used) are disclosed.³⁸

The Delaware Court of Chancery has generally held directors to the "fair summary" requirement and not required additional details. Nevertheless, directors must be careful not to create asymmetrical (or "partial") disclosure by omitting information about one aspect of a fairness opinion where similar information about other aspects is disclosed. Further, when the advisor uses methodologies that depart from the norm, those departures should be fully disclosed to the stockholders. Directors should also be careful to ensure that disclosures match the analyses actually performed.

DISCLOSURE REGARDING MANAGEMENT'S PROJECTIONS

In our earlier article, we also discussed the need to disclose management's reliable projections underlying the advisor's fairness opinion³⁹: "[P]rojections underlying a fairness opinion are presumed material—and therefore should be disclosed—so long as they are sufficiently reliable to help the stockholders make an informed decision."⁴⁰ The Delaware Court of Chancery has generally required

35. Transcript of Scheduling Office Conference, *supra* note 27, at 13; see also *In re Sauer-Danfoss Inc. S'holders Litig.*, C.A. No. 5162-VCL, 2011 WL 2519210, at *13 (Del. Ch. Apr. 29, 2011) ("If a disclosure document does not say that the board or its advisors did something, then the reader can infer that it did not happen."); *In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171, 204 (Del. Ch. 2007) ("[T]his court has noted that so long as what the investment banker did is fairly disclosed, there is no obligation to disclose what the investment banker did not do").

36. Transcript of Scheduling Office Conference, *supra* note 27, at 13.

37. See also Transcript of Argument and Ruling on Motion to Expedite in C.A. No. 5149-VCS and Scheduling Conference in C.A. No. 5214-VCS, *supra* note 2, at 19 (stating that "[y]ou need a fair summary of what the banker did . . . , not everything that the banker didn't do").

38. *Id.* at 19–20 ("I think there are eight or nine comparables listed. We have a commercial world. That means thousands of other companies were not selected. Do they have to disclose why they selected those comparables? They gave . . . a range of medians. You can assess if the deal is outside the median. You can make the calculation for yourself."); see also *In re Ness Techs., Inc. S'holders Litig.*, C.A. No. 6569-VCN, slip op. at 11–12 (Del. Ch. Aug. 3, 2011) ("[T]he Plaintiffs seek additional details regarding the financial advisors' analyses, such as the reasons why different companies were selected for each advisor's comparable company analysis or information regarding how the advisors arrived at the multiples they used for those comparable companies. Again, the Preliminary Proxy provides shareholders with fair summaries of the financial advisors' work, and the Plaintiffs have not shown that additional detail would be material to shareholders." (footnote omitted)).

39. *Fair Summary*, *supra* note 1, at 902–05.

40. *Id.* at 904.

directors to disclose the projections provided to their financial advisors.⁴¹ Then-Vice Chancellor Strine has stated his view that “projections of cash flow are more useful to investors, probably, than bankers’ opinions.”⁴²

Issues regarding multiple sets of target management’s projections often lead to disputes.⁴³ In *Simonetti*, target management had prepared three sets of projections.⁴⁴ The plaintiff argued that the target’s proxy statement failed to disclose that the financial advisor used the most conservative set of projections in formulating its fairness opinion and that the “failure to disclose the existence of more optimistic projections . . . was a material omission.”⁴⁵ Citing *Netsmart’s* requirement that a “proxy statement should ‘give the stockholders the best estimate of the company’s future cash flows,’” the *Simonetti* court rejected this argument.⁴⁶ The proxy statement disclosed the projections actually given to the banker and disclosed that management believed those projections to be the best estimates of the target’s financial performance.⁴⁷ The court therefore rejected the plaintiff’s argument, noting that the plaintiff had not met its “burden of showing how disclosing lower-probability projections would have been considered material by the reasonable stockholder.”⁴⁸ No matter how many sets of projections have been created, the Delaware courts likely will require only that the set used by the financial advisor

41. See, e.g., Transcript of Settlement Hearing and Rulings of the Court at 31, *In re Burlington N. Santa Fe S’holder Litig.*, C.A. No. 5043-VCL (Del. Ch. Oct. 28, 2010) (“I like projections. I like to see people disclosing projections. I think they’re material. I think people ought to have them in there.”); see also Transcript of Defendants’ Motion to Proceed in One Jurisdiction and Dismiss or Stay Litigation in Other Jurisdictions and the Court’s Ruling at 13, *Kahn v. Chell*, C.A. No. 6511-VCL (Del. Ch. June 7, 2011) (suggesting that the Court of Chancery might scrutinize an intentional failure to disclose projections under concepts of bad faith: “to the extent that people are consciously or can be inferred to have been consciously leaving things out that are covered by prior decisions [for purposes of accommodating disclosure-based settlements], that’s something we’re going to have to take into account on an ongoing basis”).

42. Transcript of Argument and Ruling on Motion to Expedite in C.A. No. 5149-VCS and Scheduling Conference in C.A. No. 5214-VCS, *supra* note 2, at 18–19; see also Transcript of Argument and Ruling on Motion to Expedite, *supra* note 2, at 23–24 (“[M]y understanding of corporate finance is that when you are being asked to accept money for something, and the something you are giving up is the equity of a company, that what you most want to know, based on finance theory, is the expected future cash flows of the company, and that in comparison, actually, to a banker’s opinion, it’s probably, for sophisticated investors, more important to know the projections of management, and to know that there aren’t any undisclosed projections out there, that you have all the information, so that you can make your own judgment as an investor about whether to give up what you have now, which is your stake in those future cash flows, for a fixed price. . . . And there is about everything else in the proxy statement that I would strip out before the projections.”).

43. See *Fair Summary*, *supra* note 1, at 889–90 (discussing *In re Netsmart Techs., Inc. S’holders Litig.*, 924 A.2d 171 (Del. Ch. 2007)).

44. *David P. Simonetti Rollover IRA v. Margolis*, C.A. No. 3694-VCN, 2008 WL 5048692, at *9 (Del. Ch. June 27, 2008).

45. *Id.*

46. *Id.* at *10 (quoting *In re Netsmart Techs.*, 924 A.2d at 203).

47. *Id.*

48. *Id.* (“Although including the more optimistic projections in the Proxy Statement and then explaining why they were not relied upon may have been somewhat helpful to stockholders, it is doubtful that any such additional disclosures would have materially altered the total mix of information provided.”).

(generally, management’s “best” projections) and/or the bidder be disclosed.⁴⁹ On the other hand, if the advisor used more than one set of projections, they should all be disclosed.⁵⁰

Another issue that occasionally arises is the level of divisional detail that must be provided in the projections disclosed to the stockholders. Generally, the Court of Chancery has held that “divisional information is material and must be disclosed where the purchaser utilizes such information in formulating its bid.”⁵¹ Where plaintiffs have been unable to demonstrate that the bidder used such information in formulating its bid, therefore, the court has rejected the disclosure claim as not colorable.⁵² Nevertheless, if the target board or its financial advisor used divisional information in determining whether an offer was fair, the Delaware courts would likely require disclosure of that information. Noting that there is generally no “obligation to disclose what you did not do,” the Court of Chancery has rejected a claim that divisional information must be provided, in the absence of evidence that the target considered such information.⁵³

A major development in the last three years regarding the disclosure of management’s projections has involved the free cash flow numbers provided to the board’s financial advisors. In *Maric Capital*, then-Vice Chancellor Strine addressed disclosure claims in the context of the acquisition of PLATO Learning, Inc. by Thoma Bravo, LLC.⁵⁴ PLATO’s proxy statement had “selectively” excised the free cash flow estimates from the projections that PLATO had provided to its financial advisor, Craig-Hallum.⁵⁵ The court required PLATO to disclose those free cash flow estimates to its stockholders.⁵⁶ In then-Vice Chancellor Strine’s view, “management’s best estimate of the future cash flow of a corporation that is proposed to be sold in a cash merger is clearly material information.”⁵⁷ If stock value is based on expected future cash flows, “as is encouraged under sound corporate finance theory,” the then-vice chancellor stated, the free cash flow estimates would let

49. See also, e.g., *In re Orchid Cellmark Inc. S’holder Litig.*, C.A. No. 6373-VCN, 2011 WL 1938253, at *11 (Del. Ch. May 12, 2011) (finding no reasonable probability of success on a claim that the company should have disclosed optimistic management projections when a set of projections deemed more reliable by the board of directors and used by the financial advisor in its fairness opinion had already been disclosed).

50. See *In re 3Com S’holders Litig.*, C.A. No. 5067-CC, 2009 WL 5173804, at *5 (Del. Ch. Dec. 18, 2009) (“I am aware of no rule that precludes management or its financial advisor from using alternative sets of financial projections in evaluating the advisability and fairness of a merger. Indeed, given the unpredictability of the future, it is common for companies to have multiple sets of projections based on different assumptions about what will transpire going forward. 3Com management disclosed both sets of projections in the Proxy and clearly explained that both were used.”).

51. *Id.* (citing *In re Envirodyne Indus., Inc. S’holders Litig.*, C.A. No. 10702, 1989 WL 40792, at *3 (Del. Ch. Apr. 20, 1989)).

52. *Id.*

53. Transcript of Argument and Ruling on Motion to Expedite, *supra* note 2, at 28, 26–30.

54. *Maric Capital Master Fund, Ltd. v. PLATO Learning, Inc.*, 11 A.3d 1175 (Del. Ch. 2010).

55. *Id.* at 1178.

56. *Id.*

57. *Id.*

PLATO's stockholders determine whether the offer price was a fair trade for their interest in the company.⁵⁸

Shortly after *Maric Capital* was decided, however, the court distinguished that opinion in a significant manner. In *Walter*, the Court of Chancery denied a motion to expedite, holding that the disclosure of free cash flow estimates would not be material to the stockholders of inVentiv Health, Inc., which had entered into a transaction with Thomas H. Lee Partners, L.P.⁵⁹ Goldman Sachs (inVentiv's financial advisor) provided a fairness opinion based on projections of the company's net revenue, net income, earnings per share, and EBITDA estimates for five years—but inVentiv had not provided free cash flow estimates to Goldman Sachs.⁶⁰ Therefore, Chancellor Chandler held that the free cash flow estimates would not be material; he distinguished *Maric Capital* on the ground that, in that case, the free cash flow estimates had been given to (and used by) the financial advisor and later excised from the proxy statement.⁶¹

In *Scully*, the court confirmed that free cash flow estimates are not material unless they were provided to the board's financial advisor.⁶² Vice Chancellor Laster denied a motion to expedite in a suit challenging the acquisition of Nighthawk Radiology Holdings, Inc. by Virtual Radiology, finding only one disclosure claim to have potential merit. Nighthawk's proxy statement had omitted the free cash flow estimates from the disclosure of management's projections. While the court agreed with the principles set forth in *Maric Capital* regarding the materiality of free cash flow estimates generally, it held that the disclosure claim was not colorable, based on counsel's representation that those numbers had not been provided to Nighthawk's financial advisors.⁶³

58. *Id.*; cf. Transcript of Settlement Hearing and Rulings of Court, *supra* note 34, at 19, 24, 29 (suggesting that, while a plaintiff should not litigate over one particular missing input to the free cash flow calculation, supplemental disclosure of free cash flow numbers calculated by the financial advisor from inputs given it by the company—and not derivable from the projections disclosed—was sufficiently material to support a settlement).

59. Transcript of Ruling on Motion to Expedite, *Steamfitters Local Union 447 v. Walter*, C.A. No. 5492-CC (Del. Ch. June 21, 2010).

60. *Id.* at 9.

61. *Id.* ("Unlike in *Maric*, in this case no free cash flow estimates were actually provided to Goldman Sachs. The internal analyses that were approved by management for Goldman's use in this case didn't have a line item for free cash flow estimates, and so unlike the *Maric* decision, there was no deliberate excising of free cash flow numbers. . . . The proxy here gave management's projections that were actually used by Goldman, and those projections included net revenue, net income, EPS and EBITDA estimates for five years. So based on all of that, there doesn't appear to me to be a colorable claim of a misrepresentation or omission of material information that would alter the total mix of information already available to the stockholders." (italics added)). Recognizing the different approaches taken in the court's decisions, Chancellor Chandler suggested that he would certify an interlocutory appeal to the Delaware Supreme Court in an attempt to provide clarity on the question whether free cash flow estimates must always be disclosed. *Id.* at 10–11. The plaintiffs, however, did not appeal.

62. Transcript of Telephonic Oral Argument on Plaintiff's Motion for Expedited Proceedings and Rulings of the Court at 24, *Scully v. Nighthawk Radiology Holdings Inc.*, C.A. No. 5890-VCL (Del. Ch. Oct. 21, 2010); see also *Fair Summary*, *supra* note 1, at 888 (setting forth a disclosure principle that directors need only disclose what they reviewed and relied on).

63. Transcript of Telephonic Oral Argument on Plaintiff's Motion for Expedited Proceedings and Rulings of the Court, *supra* note 62, at 23–24; see also *In re 3Com S'holders Litig.*, C.A. No. 5067-CC, 2009 WL 5173804, at *2 (Del. Ch. Dec. 18, 2009) (holding that the directors did not have to disclose

In summary, projections provided to the board's financial advisor should be disclosed.⁶⁴ Of course, if those projections are not reliable, they may not have to be fully disclosed (so long as the proxy materials describe why the projections are not reliable and not disclosed).⁶⁵ If the *bidder's* financial projections were provided to the target board's banker for purposes of determining the fairness of the transaction—for example, in a stock-for-stock merger—a court might also conclude that those projections should be disclosed under the principles set forth above. Of course, directors “cannot disclose projections that do not exist.”⁶⁶ Further, if the projections provided to the target board's financial advisors are already disclosed, the Court of Chancery generally will not require the disclosure of additional details underlying the projections.⁶⁷

DISCLOSURE REGARDING THE FINANCIAL ADVISOR'S POTENTIAL CONFLICTS

The third area in which major developments have been made relates less to the fairness opinion itself, and more to the financial advisor providing the fairness opinion. The Delaware courts have long been sensitive to issues regarding banker conflicts,⁶⁸ but the last three years have seen several developments in this area. The Court of Chancery in *Del Monte* recently stated that, “[b]ecause of the central

cash flow measures or EBIT or EBITDA estimates, where the projections (which contained operating profit numbers) provided to the board's financial advisor were disclosed).

64. *But cf.* Cnty. of York Emps. Ret. Plan v. Merrill Lynch & Co., C.A. No. 4066-VCN, 2008 WL 4824053, at *12 (Del. Ch. Oct. 28, 2008) (“[P]ursuant to Delaware law, Merrill was not required to disclose all financial projections considered by [its financial advisor].”).

65. See *Fair Summary*, *supra* note 1, at 904–05; see also Transcript of Settlement Hearing and Rulings of the Court at 54, *IBEW Local Union 98 v. Noven Pharms. Inc.*, C.A. No. 4732-CC (Del. Ch. Dec. 8, 2009) (Laster, V.C.) (“Like Vice Chancellor Strine, I share the belief that projections are important and particularly when a discounted cash flow analysis is used. That’s the type of thing that is important for stockholders to have. I know in our law that we have talked about whether projections are sufficiently reliable, and that’s certainly a consideration. But as the disclosures in this case show[], it’s perfectly possible for corporations to qualify those disclosures and explain the degree of reliability that they place on the projections.”); Transcript of Rulings of the Court from Oral Argument on Plaintiffs’ Motion for a Preliminary Injunction at 14–15, *In re Zenith Nat’l Ins. Corp. S’holders Litig.*, C.A. No. 5296-VCL (Del. Ch. Apr. 22, 2010) (similar).

66. *In re CNX Gas Corp. S’holders Litig.*, 4 A.3d 397, 419 (Del. Ch. 2010).

67. *Id.* (“The Offer to Purchase and the Schedule 14D-9 already disclose the projections that were provided to Stifel and Lazard. The plaintiffs have not convinced me that anything more is needed in this case, such as the ‘price deck’ underlying the projections.”); see also *In re Ness Techs., Inc. S’holders Litig.*, C.A. No. 6569-VCN, slip op. at 11 (Del. Ch. Aug. 3, 2011) (“[T]he Plaintiffs seek additional detail regarding management’s projections of Ness’s continued performance as a standalone entity. The Preliminary Proxy provides a fair summary of these projections; the Plaintiffs have not offered a theory as to how additional detail would be relevant to shareholders’ decisions regarding the Proposed Transaction.” (footnote omitted)); *In re Answers Corp. S’holders Litig.*, C.A. No. 6170-VCN, 2011 WL 1366780, at *7 (Del. Ch. Apr. 11, 2011) (“Although all of this granular information might be of interest to Answers’ shareholders, the information regarding revenue, EBITDA, and cash-on-hand already provided in the Proxy Materials is sufficient to allow shareholders to evaluate the Proposed Transaction in light of these factors. That is, the three charts would not be material to the shareholders’ vote, and they need not be disclosed.”).

68. See *Fair Summary*, *supra* note 1, at 899–900.

role played by investment banks in the evaluation, exploration, selection, and implementation of strategic alternatives, this Court has required full disclosure of investment banker compensation and potential conflicts.⁶⁹ Because stockholders need to be aware of a banker's potential conflicts in determining how much weight to place on the fairness opinion, the court has required disclosures in several areas relating to bankers' engagement and their potential interest in the transaction on which they are opining.

The court has also discussed claims regarding disclosure of the reasons that a financial advisor was retained.⁷⁰ Generally, so long as the disclosure statement provides rational reasons for the advisor's retention—and no special circumstances or suspicious facts exist—the Court of Chancery will likely find that sufficient disclosure has been made.⁷¹

The most basic area of "banker conflict" disclosure involves the fee paid to the target's banker. Three years ago, we discussed the principles regarding disclosure of the financial advisor's fee structure.⁷² *Globis* had recently been decided, suggesting that, "so long as the proxy disclosed that there was a contingent fee and stated that the fee would be 'customary,' the disclosure was sufficient."⁷³ We noted that this

69. *In re Del Monte Foods Co. S'holders Litig.*, C.A. No. 6027-VCL, 2011 WL 532014, at *16 (Del. Ch. Feb. 14, 2011); see also Transcript of Oral Argument at 96, *Continuum Capital v. Nolan*, C.A. No. 5687-VCL (Del. Ch. Feb. 3, 2011) ("I think two of these disclosures were quite critical. First, that the banker was engaged in discussions with the buyer about potential business; and, second, the details of the banker's fee. Bankers play a key role in the M&A process. They are out there advising the board about how to go about the process of maximizing stockholder value. They're usually the one conducting the negotiations with potentially interested parties. They are the ones giving the presentations to the board; the board books that we all see so often on which the board relies heavily in making its decisions about a deal. They ultimately opine as to fairness. And they typically give advice—at least they should be giving advice, and I think usually do give advice, about whether the transaction really is the best transaction reasonably available, or whether further efforts would be likely to develop a superior transactional proposal. So I have information about the banker's interests is quite material.").

70. See, e.g., *David P. Simonetti Rollover IRA v. Margolis*, C.A. No. 3694-VCN, 2008 WL 5048692, at *7 (Del. Ch. June 27, 2008) (terming disclosures "sufficient" when the proxy statement stated that "[advisor] UBS and its affiliates had 'acted as joint bookrunner in connection with a convertible notes offering by [target] TriZetto in April 2007,' 'acted as a counterparty in connection with the related bond hedge and warrant transactions entered into by TriZetto (referred to as the BHW Transaction),' 'provided certain cash management services to TriZetto,' and acted as 'a participant in a credit facility of TriZetto'" and explained that "the Board selected UBS as its financial advisor 'because UBS is an internationally recognized investment banking firm with substantial experience in similar transactions and because of UBS's familiarity with TriZetto and its business'"); *Cnty. of York Emps. Ret. Plan v. Merrill Lynch & Co.*, C.A. No. 4066-VCN, 2008 WL 4824053, at *11 (Del. Ch. Oct. 28, 2008) ("These passages sufficiently disclose the material facts regarding [target] Merrill's selection of [advisor] MLPFS: It was an entity known to Merrill and BAC, and it had done a substantial amount of financial advisory work for both entities in the past. And Defendants were not required to cast this relationship in a negative light. Therefore, Plaintiff has failed to plead a colorable disclosure violation." (footnote omitted)).

71. See, e.g., *supra* note 70; Transcript of Telephonic Rulings of the Court on Plaintiffs' Motion to Expedite, *supra* note 4, at 12–13 (denying a motion to expedite on, among others, the following grounds: "It is disclosed, for example, in the 14D-9 that [the financial advisor] Needham had done work . . . in the past for the Company at its customary rates, that they were selected to do this job because they had done these kinds of matters many times before; they had experience in this particular industry and, in fact, with CAMD itself.").

72. *Fair Summary*, *supra* note 1, at 899.

73. *Id.* (citing *Globis Partners, L.P. v. Plumtree Software, Inc.*, C.A. No. 1577-VCP, 2007 WL 4292024, at *13 (Del. Ch. Nov. 30, 2007)).

holding should be “seen as a floor” and doubted whether the Delaware courts would follow *Globis* “in all situations.”⁷⁴ The Court of Chancery confirmed this prediction in *Atheros*, stating that the “differential between compensation scenarios may fairly raise questions about the financial advisor’s objectivity and self-interest.”⁷⁵

In *Atheros*, the proxy statement disclosed that the target’s financial advisor would be “‘paid a customary fee, a portion of which is payable in connection with the rendering of its opinion and a substantial portion of which will be paid upon completion of the Merger.’”⁷⁶ The total fee was not disclosed, and approximately 98 percent of the fee was contingent on the merger’s completion.⁷⁷ Because that contingency percentage “exceeds both common practice and common understanding of what constitutes ‘substantial,’” the court required disclosure of the percentage of the fee that was contingent.⁷⁸ The court declined to draw any “bright line” rule on what percentage would trigger disclosure, but it stated that “it is clear that an approximately 50:1 contingency ratio requires disclosure.”⁷⁹ Finally, the court declined to resolve the debate over “whether the amount of a financial advisor’s fee needs to be disclosed or whether merely disclosing that the fee is customary (which it is in this instance) suffices.”⁸⁰ Nevertheless, in the context of the large contingent fee (and the late-in-the-process fee agreement), the court required disclosure of the fee amount as well.⁸¹

The *Atheros* decision is consistent with recent statements that Vice Chancellor Laster made in approving a settlement. In discussing the value of particular disclosures agreed to in the settlement, the vice chancellor referred to disclosures of the banker’s fee as “material.”⁸² The court further distinguished *Globis*: “I do not think [‘]customary fee[’] provides meaningful insight to stockholders as to the banker’s incentives. Some of these fees are quite large—they’re quite large and can be on the order of—particularly in small deals—almost termination fee-sized consideration. So I think that the details of the banker’s fee are quite important.”⁸³

74. *Id.*

75. *In re Atheros Commc’ns, Inc. S’holder Litig.*, C.A. No. 6124-VCN, 2011 WL 864928, at *8 (Del. Ch. Mar. 4, 2011) (citing *Fair Summary*, *supra* note 1, at 900).

76. *Id.*

77. *Id.*

78. *Id.*; *see also id.* (“Stockholders should know that their financial advisor, upon whom they are being asked to rely, stands to reap a large reward only if the transaction closes and, as a practical matter, only if the financial advisor renders a fairness opinion in favor of the transaction. In essence, the contingent fee can readily be seen as providing an extraordinary incentive for [the financial advisor] to support the Transaction.”).

79. *Id.* at *9. *But see* *Cnty. of York Emps. Ret. Plan v. Merrill Lynch & Co.*, C.A. No. 4066-VCN, 2008 WL 4824053, at *11 (Del. Ch. Oct. 28, 2008) (holding “not colorable” a claim that the amount of the bankers’ contingent compensation needed to have been disclosed). In *Merrill Lynch*, the advisor was the target’s subsidiary, and the proxy statement disclosed that a “substantial portion” of the banker’s fee was contingent on the merger’s consummation. *Id.* The total amount of consideration (\$25 million) was, however, disclosed, and the court cited *Globis* in rejecting the plaintiff’s claims. *Id.* (“And this Court has held that the precise amount of consideration need not be disclosed, and that simply stating that an advisor’s fees are partially contingent on the consummation of a transaction is appropriate.”).

80. *Atheros*, 2011 WL 864928, at *9 (citing *Fair Summary*, *supra* note 1, at 899–900).

81. *Id.*

82. Transcript of Oral Argument, *supra* note 69, at 97.

83. *Id.*

While the court noted that cases in the past had “been dismissive of banker-oriented disclosure,” it stated that, “given the banker’s role in the process, this is the type of thing that is quite material.”⁸⁴ Over time, it appears that the Delaware courts are likely to require more disclosure of the fees to be paid to a board’s financial advisor and of how much of those fees are contingent.

In a similar context, the Delaware Court of Chancery has required disclosure of a banker’s other financial interests in the transaction under consideration. For example, in *Simonetti*, the court analyzed disclosures in the context of a proposed acquisition by Apax Partners, L.P. of The TriZetto Group, Inc.⁸⁵ TriZetto’s financial advisor, UBS, held a not insubstantial amount of notes and warrants in TriZetto and would be entitled to cash payments upon, or shortly after, the merger’s consummation.⁸⁶ Noting that a “financial advisor’s own proprietary financial interest in a proposed transaction must be carefully considered in assessing how much credence to give its analysis,” the court ordered disclosure of the range of value of UBS’s note holdings in TriZetto.⁸⁷

What is no longer a close question is whether buy-side business relationships must be disclosed at all. The Court of Chancery has “stressed the importance of disclosure of potential conflicts of interest of financial advisors,” noting that it is “imperative that stockholders be able to decide for themselves what weight to place on a conflict faced by the financial advisor.”⁸⁸ Significantly, the requirement to disclose conflicts includes all advisors—both financial and legal.⁸⁹

For example, the Court of Chancery recently required detailed disclosure of the target banker’s buy-side fees and engagements. For example, in *Art Technology*, the court enjoined a merger until the target company disclosed to its stockholders additional information about its financial advisor’s prior work for the buyer.⁹⁰ *Art Technology* involved a challenge to a proposed merger of Oracle Corporation and Art Technology Group, Inc. Morgan Stanley was Art Technology’s financial advisor

84. *Id.* (noting also that “[e]ach case obviously turns on its own facts and circumstances”).

85. David P. Simonetti Rollover IRA v. Margolis, C.A. No. 3694-VCN, 2008 WL 5048692 (Del. Ch. June 27, 2008).

86. *Id.* at *8.

87. *Id.*; see also *id.* (“The financial advisor’s opinion of financial fairness for a proposed transaction is one of the most important process-based underpinnings of a board’s recommendation of a transaction to its stockholders and, in turn, for the stockholders’ decisions on the appropriateness of the transaction. Thus, it is imperative for the stockholders to be able to understand what factors might influence the financial advisor’s analytical efforts.”).

88. *In re John Q. Hammons Hotels Inc. S’holder Litig.*, C.A. No. 758-CC, 2009 WL 3165613, at *16 (Del. Ch. Oct. 2, 2009) (“Such disclosure is particularly important where there was no public auction of the Company and ‘shareholders may be forced to place heavy weight upon the opinion of such an expert.’”).

89. *Id.* (denying summary judgment to defendants on disclosure claims regarding potential conflicts of a special committee’s financial and legal advisors); see also *id.* at *17 (“Again, the compensation and potential conflicts of interest of the special committee’s advisors are important facts that generally must be disclosed to stockholders before a vote. This is particularly true, where, as here, the minority stockholders are relying on the special committee to negotiate on their behalf in a transaction where they will receive cash for their minority shares.”).

90. Order Granting Preliminary Injunction, *In re Art Tech. Grp., Inc. S’holders Litig.*, C.A. No. 5955-VCL (Del. Ch. Dec. 21, 2010).

in the transaction, but Morgan Stanley had also performed work for Oracle for a number of years. The court ruled that Art Technology and Oracle had to disclose (i) the aggregate annual compensation paid by Oracle to Morgan Stanley from 2007 to 2010 and (ii) a description of the nature of services that Morgan Stanley provided to Oracle.⁹¹ While this level of detail should not always be required (for example, a two-year period is more typical),⁹² practitioners should be aware that the Court of Chancery appears to be moving toward more stringent disclosure requirements regarding banker's buy-side work.

The Court of Chancery in *Hammons* denied summary judgment to the defendants on a disclosure claim regarding the target special committee's banker's contacts with the bidder about potentially underwriting a significant security offering planned by the bidder after the merger.⁹³ Following trial in *Hammons*, the court found for the defendants on that claim, stating that the evidence

demonstrated that the employee of [target advisor] Lehman's real estate finance group that contacted [bidder] Eilian never actually received "the numbers" regarding the hotels Eilian intended to refinance, never submitted a written bid or term sheet for the business, and never got any business from Eilian. In addition, the Lehman representatives that advised the Special Committee never actually spoke with the Lehman representative who contacted Eilian.⁹⁴

91. *Id.* at 1; *cf. also* *In re* Del Monte Foods Co. S'holders Litig., C.A. No. 6027-VCL, 2011 WL 2535256, at *11 (Del. Ch. June 27, 2011) ("Equally important, the Proxy Supplement disclosed Barclays' extensive financial conflicts, including the \$21 to \$24 million in fees that the bank would receive for providing buy-side financing for the Sponsors (comparable to and potentially more than its \$23.5 million fee for serving as a sell-side advisor) and the over \$70 million in fees that Barclays had received from the Sponsors in the prior two years."). As a side note, Oracle's payments to Morgan Stanley over the four-year period were not significantly greater than Art Technology's payment to Morgan Stanley for its work on the merger.

92. *See also, e.g., In re* Ness Techs., Inc. S'holders Litig., C.A. No. 6569-VCN, slip op. at 10 (Del. Ch. Aug. 3, 2011) ("If the amount of business that one of the financial advisors has done with [buyer] CVCI or its affiliates is material, then the failure to disclose fully the extent of that business could violate the duty of disclosure. By contrast, if the amount of business involved is not material to either financial advisor, then the existing disclosures would likely be adequate." (footnote omitted)); *David P. Simonetti Rollover IRA*, 2008 WL 5048692, at *7 ("Although the Proxy Statement perhaps does not provide as much information as a shareholder would think optimal, the Court concludes that its disclosures regarding Deutsche Bank are adequate. The Proxy Statement discloses that [target] TriZetto was considering the PIPE Transaction in November of 2007 and that Deutsche Bank had acted as its financial advisor. It also discloses that Deutsche Bank advised [bidder] Apax on the Merger. Thus, the stockholders are made aware that the same investment bank that had represented TriZetto in November 2007 was representing its potential acquirer through the Merger. No further disclosures on this point would have altered the total mix of information available, viz., that the same investment bank had represented parties with opposed interests in the Merger in temporal proximity." (footnotes omitted)).

93. *Hammons*, 2009 WL 3165613, at *16 ("There is no rule, however, that conflicts of interest must be disclosed only where there is evidence that the financial advisor's opinion was actually affected by the conflict. Thus, defendants cannot defend the alleged omission as immaterial by arguing that any contacts between [advisor] Lehman and [bidder] Eilian regarding the refinancing occurred after Lehman opined in December 2004 that the then-high bid of \$21 per share was fair to the minority stockholders.").

94. *In re* John Q. Hammons Hotels Inc. S'holder Litig., C.A. No. 758-CC, 2011 WL 227634, at *6 (Del. Ch. Jan. 14, 2011) (footnote omitted), *aff'd*, No. 70, 2011 (Del. Aug. 25, 2011) (TABLE).

As important, the court found that the directors did not know of these potentially conflicting contacts: “Under Delaware law, directors do not owe a duty to disclose facts that they are not aware of.”⁹⁵

Other cases have also discussed the need for directors to disclose their advisors’ buy-side business relationships. In *Zenith*, the Court of Chancery denied a motion for preliminary injunction on such a disclosure claim, finding sufficient the disclosure in the proxy statement of the advisor’s “five key engagements” with the bidder as well as the total compensation paid to the advisor by the bidder.⁹⁶ The court was concerned that the disclosure created a “partial disclosure” problem⁹⁷ because the individual banker who worked on the bidder’s recent engagement was the “No. 2” on the target’s team.⁹⁸ Nevertheless, different factors pushed the court the other way: it was a cash deal, it was an arm’s-length deal, and the advisor was only acting in an advisory capacity—it was not negotiating with the bidder or running the shopping process.⁹⁹ For those reasons, and because the amount of the buy-side compensation had been disclosed, the court denied the motion for preliminary injunction.¹⁰⁰ The court noted that the disclosure regarding the banker’s buy-side compensation was “really the key disclosure that you ought to have.”¹⁰¹

The Court of Chancery has even suggested that disclosure of bankers’ buy-side contacts that do not lead to business may need to be disclosed, particularly if those contacts occur during the pendency of the transaction. For example, in approving a settlement, Vice Chancellor Laster stated: “It may well be that [we] are jaded about the degree to which bankers talk and pitch business and sell. But that doesn’t mean that stockholders wouldn’t find it material that the sell-side banker

95. *Id.* (“[N]one of the directors . . . were even aware that Eilian was contacted by any employee of Lehman; nor is there any basis to suggest that they should have been aware of the contact. . . . Moreover, plaintiffs offered no evidence regarding how Lehman’s alleged conflict actually affected the advice it provided to the Special Committee.”). We do not believe, however, that the court’s statement should be read to allow directors to engage in non-disclosure through willing blindness. Directors are still required to “fully and fairly disclose all material information within [their] control when seeking shareholder action.” *Pfeffer v. Redstone*, 965 A.2d 676, 686 (Del. 2009). That is, directors will generally be responsible for disclosing all material information that they know or should know, but not otherwise. *See id.* at 686–87 (“For the Viacom Directors to have either misstated or failed to disclose the cash flow analysis in the Prospectus, those directors must have had reasonable access to that Blockbuster information. . . . If the Viacom Directors did not know or have reason to know the allegedly missing facts, however, then logically the directors could not disclose them.”).

96. Transcript of Rulings of the Court from Oral Argument on Plaintiffs’ Motion for a Preliminary Injunction, *supra* note 65, at 17 (“[T]he banker conflict issue . . . has really been the one that has given me the most problems throughout this. And there are pros and cons. There are reasons why this additional disclosure should be required and there are reasons why it shouldn’t be required.”).

97. *See generally Fair Summary*, *supra* note 1, at 902 (discussing “partial disclosure”).

98. Transcript of Rulings of the Court from Oral Argument on Plaintiffs’ Motion for a Preliminary Injunction, *supra* note 65, at 18.

99. *Id.* at 18–19. *But cf. In re Del Monte Foods Co. S’holders Litig.*, C.A. No. 6027-VCL, 2011 WL 532014 (Del. Ch. Feb. 14, 2011) (discussing a go-shop process run by a conflicted advisor).

100. Transcript of Rulings of the Court from Oral Argument on Plaintiffs’ Motion for a Preliminary Injunction, *supra* note 65, at 19 (“I also, again, return to the fact that there is good disclosure in the proxy on the . . . prior engagements and on the \$9 million fees.”).

101. *Id.*

was making a buy-side pitch for business.”¹⁰² Then-Vice Chancellor Strine made similar remarks during the preliminary-injunction hearing in *Maric Capital*: if “the same banker who was doing the representation on [target] PLATO is talking to [bidder] Thoma Bravo about potential situations in which Thoma Bravo might be the client of [the banker], that would be troubling. It should be disclosed.”¹⁰³ But the court was careful to distinguish between the types of buy-side contacts that the target’s advisor was making, suggesting that general contacts need not be disclosed, while contacts with the specific bidder did.¹⁰⁴

If the target’s banker does not have any past or present business relationships with the bidder, however, directors generally need not make negative disclosures of that nature. The Court of Chancery stated in 2007 that, “[t]o the extent that defendants disclosed the existence of one such relationship, shareholders may infer that no other material relationships exist.”¹⁰⁵ Similarly, the court in 2010 approved of a proxy statement silent as to any business relationship between the target’s financial advisor and the bidder, where there was none: “The Schedule 14D-9 is silent as to any work that Lazard is currently doing for CONSOL because Lazard is not currently doing any work for CONSOL.”¹⁰⁶

To summarize, the Delaware Court of Chancery has become increasingly concerned about potential conflicts affecting directors’ advisors and has required significant disclosures regarding banker compensation and buy-side conflicts.¹⁰⁷ “[T]he role of the financial advisors, including its authorship of the fairness opinion in the sale scenario, is critical and, oftentimes, . . . an important underpin-

102. Transcript of Oral Argument, *supra* note 69, at 96–97; *id.* at 97 (“One would think that one could restrain one’s self during the period that the deal was under consideration.”).

103. Transcript of Oral Argument on Plaintiff’s Motion for a Preliminary Injunction and Partial Rulings of the Court at 88, *Maric Capital Master Fund, Ltd. v. PLATO Learning, Inc.*, C.A. No. 5402-VCS (Del. Ch. May 13, 2010); *id.* (“I don’t mean that it means that they can’t be the banker. It means it should be disclosed. I’ve said before I’d rather have some of the best bankers with their conflicts disclosed than some of the worst bankers who don’t have any conflicts. And the reason they don’t have any conflicts is because they can’t get any work. It’s part of life.”); *cf. id.* at 89 (“Obviously it’s relevant whether the person giving the fairness opinion has any material relationships with the person on the other side of the deal.”).

104. *Id.* at 31 (“It matters what they were doing. I mean, really, honestly speaking, the idea that a sell-side advisor for other people is regularly going to the market asking to be a buyer, that that creates a conflict and always has to be disclosed seems to me odd. If, on the other hand, a sell-side advisor in one engagement is approaching a buyer about [having] the buyer become one of its clients and actually doing work for the buyer, that obviously could be, I think, a different sort of thing.”).

105. *La. Mun. Police Emps.’ Ret. Sys. v. Crawford*, 918 A.2d 1172, 1186 (Del. Ch. 2007); *see also id.* at 1187 (“Defendants are not required to make this type of negative disclosure. Further, such a disclosure will not significantly alter the total mix of information available to stockholders and is, thus, immaterial.”).

106. *In re CNX Gas Corp. S’holders Litig.*, 4 A.3d 397, 419 (Del. Ch. 2010) (“The Schedule 14D-9 discloses that Lazard ‘may provide investment banking services to [CNX Gas] or CONSOL in the future, for which Lazard may receive compensation.’ The plaintiffs had the opportunity to take discovery and have not identified anything that would suggest that Lazard in fact is performing any financial services for CONSOL now or expects to in the future.” (alteration in original)).

107. The court’s concern regarding buy-side conflicts is not limited to bankers, however; the court has also required additional disclosures regarding buy-side conflicts (particularly employment arrangements) of the target’s negotiators, including management. *See, e.g., In re Atheros Commc’ns, Inc. S’holder Litig.*, C.A. No. 6124-VCN, 2011 WL 864928, at *11 (Del. Ch. Mar. 4, 2011) (“[T]he record

ning of the directors' recommendation of support for a particular transaction."¹⁰⁸ Accordingly, the court has not been impressed with the excuse that directors "are limited in their ability to make these disclosures because [the advisor] is unwilling to share the necessary information."¹⁰⁹ In fact, the court in *Simonetti* suggested two possible solutions to that issue:

First, perhaps the Board should reconsider its choice of financial advisor. . . . Second, perhaps (and the Court need not express a view at this time) disclosure of the financial advisor's unwillingness to provide the appropriate information should be shared with the stockholders and then they would be able to consider that recalcitrance in their own assessment of whether to rely upon the fairness opinion and to approve the proposed transaction.¹¹⁰

Further, the court recently made comments suggesting that bankers should bear some financial responsibility for withholding disclosures desirable under Delaware law.¹¹¹ Practitioners should consider addressing these issues at the outset in the engagement letter.

indicates that, as of a date earlier than December 14, 2010, [target CEO] Barratt had overwhelming reason to believe he would be employed by [bidder] Qualcomm after the Transaction closed. Because the Proxy Statement partially addresses the process by which Barratt negotiated his future employment with Qualcomm, the Board must provide a full and fair characterization of that process."); Transcript of Ruling of the Court: Plaintiffs' Motion for a Preliminary Injunction, *supra* note 26, at 12–13 ("It is, therefore, incorrect for the proxy to say that nobody has any clue who the [director on the surviving company board] is going to be. So the defendants need to disclose that it is currently anticipated, or there is an agreement in principle, or whatever the apt view of it is, and is consistent with the deposition testimony that [target director] Pardun will be the director. That could be material to the stockholders' view of his interest in supporting the merger."); *Maric Capital Master Fund, Ltd. v. PLATO Learning, Inc.*, 11 A.3d 1175, 1179 (Del. Ch. 2010) (requiring the proxy statement to clarify the extent of discussions between the target's CEO and bidder Thoma Bravo "in which the typical equity incentive package given by Thoma Bravo to management was discussed"); *Cnty. of York Emps. Ret. Plan v. Merrill Lynch & Co.*, C.A. No. 4066-VCN, 2008 WL 4824053, at *12–13 (Del. Ch. Oct. 28, 2008) (discussing an amended proxy that mooted plaintiff's claims regarding disclosure of the target chairman's discussions with the bidder regarding his future employment and noting that the "material facts regarding the Chairman's compensation package and on-going employment have all been disclosed"); *In re Lear Corp. S'holder Litig.*, 926 A.2d 94, 114 (Del. Ch. 2007) (requiring disclosure of target CEO's conflict of interest where he acted as the negotiator and stating that "a reasonable stockholder would want to know an important economic motivation of the negotiator singularly employed by a board to obtain the best price for the stockholders, when that motivation could rationally lead that negotiator to favor a deal at a less than optimal price, because the procession of a deal was more important to him, given his overall economic interest, than only doing a deal at the right price").

108. *David P. Simonetti Rollover IRA v. Margolis*, C.A. No. 3694-VCN, 2008 WL 5048692, at *14 (Del. Ch. June 27, 2008) ("Perhaps it is unavoidable that financial advisors regularly seem to suffer from conflicts of one degree or another, but, if that is the likely state of affairs, then the stockholders are entitled to know what material factors, if any, may be motivating the financial advisor. The Company is asking its stockholders to have faith in UBS and to rely upon its expertise; UBS may well be deserving of that confidence, but the stockholders have every right to expect the Company to share with them any extraneous, substantial reasons UBS may have for seeing that the transaction is consummated.").

109. *Id.* at *14 n.66.

110. *Id.* ("One wonders how a board should expect its stockholders to rely upon the sponsor of a fairness opinion who is unwilling to disclose the nature and scope of its potential conflicts.").

111. Transcript of Oral Argument, *supra* note 69, at 44–45 ("I get the feeling that a lot of these disclosures are driven by banker's counsel's own willingness to put information in a proxy statement. It's too bad the bankers can't be required to pay the fee. I sometimes wonder if there shouldn't be a carve-out in the bankers' indemnification letter that says, if we are required to pay a fee or a successor of the

CONCLUSION

The Delaware Court of Chancery routinely addresses many types of disclosure claims—for example, one common type of non-financial disclosure claim involves alleged deficiencies in the “background” section of the proxy materials.¹¹² Nevertheless, disclosure claims regarding fairness opinions and the analyses,

acquirer is required to pay a fee to the plaintiffs’ lawyer as a result of a disclosure that we asked you to put in and you refused to put in, like the actual amount of your fee as opposed to just describing it as reasonable and customary, which, frankly, is the standard with a spectrum about as broad as the electromagnetic one, why the banker doesn’t pick that up. It’s an odd thing. But maybe that can be something for [counsel] to negotiate next time they’re negotiating a banker’s engagement letter.”)

112. With the exception of injunctions to rectify inadequate, misleading, or “partial” disclosures in the process background section, the Delaware Court of Chancery typically will not require directors to disclose all the details of the process leading up to the proposed acquisition. *Compare In re Atheros Commc’ns, Inc. S’holder Litig.*, C.A. No. 6124-VCN, 2011 WL 864928, at *11–12 (Del. Ch. Mar. 4, 2011) (requiring disclosure of CEO’s negotiation of future employment with bidder), Transcript of Ruling of the Court: Plaintiffs’ Motion for a Preliminary Injunction, *supra* note 26, at 12–13 (requiring disclosure of likely identity of target director who will serve on surviving company’s board), Transcript of Telephonic Oral Argument on Plaintiff’s Motion for Expedited Proceedings and Rulings of the Court, *supra* note 62, at 21 (referring to disclosures regarding background of merger as “breezy” and “subpar in terms of details” and noting that additional detail of CEO-to-CEO negotiations is generally preferred), and *Maric Capital Master Fund, Ltd. v. PLATO Learning, Inc.*, 11 A.3d 1175, 1179 (Del. Ch. 2010) (requiring the proxy statement to rectify misleading disclosure by clarifying the extent of discussions between the target’s CEO and bidder), *with In re Ness Techs., Inc. S’holders Litig.*, C.A. No. 6569-VCN, slip op. at 12–13 (Del. Ch. Aug. 3, 2011) (“The Preliminary Proxy describes, over fourteen pages, the eleven-month sale process in which the Special Committee and the Board engaged. The Plaintiffs have not indicated how additional information regarding the contacts the Board had with over thirty potential buyers, the extensive negotiations with Bidder D and [buyer] CVCI, or the role [the financial advisor] played in these negotiations would affect shareholders’ decisions regarding the Proposed transaction. Shareholders are not entitled to a play-by-play description of merger negotiations, but, instead, to a fair summary of the sale process. The Plaintiffs’ allegations do not state a colorable claim that the Preliminary Proxy failed to provide such a fair summary.” (alteration, footnotes, and internal quotation marks omitted)), *In re Sauer-Danfoss Inc. S’holders Litig.*, C.A. No. 5162-VCL, 2011 WL 2519210, at *12 (Del. Ch. Apr. 29, 2011) (“Delaware law does not require that a fiduciary disclose its underlying reasons for acting.”), *Atheros*, 2011 WL 864928, at *12 (refusing to require disclosure of the “rejected proposals of each side”), Transcript of Telephonic Rulings of the Court on Plaintiffs’ Motion to Expedite, *supra* note 4, at 16–17 (“[O]ur cases hold that shareholders are not entitled to a play-by-play description of merger negotiations and the lead-up to it.”), *Globis Partners, L.P. v. Plumtree Software, Inc.*, C.A. No. 1577-VCP, 2007 WL 4292024, at *14 (Del. Ch. Nov. 30, 2007) (noting that the duty of disclosure does not require that a board “give its shareholders a ‘play-by-play’ description of merger negotiations”), *McMillan v. Intercargo Corp.*, C.A. No. 16963, 1999 WL 288128, at *9 (Del. Ch. May 3, 1999) (noting that a disclosure statement need not describe all of the “bends and turns in the road” when summarizing a proposed transaction), *In re Lukens Inc. S’holders Litig.*, 757 A.2d 720, 736 (Del. Ch. 1999) (holding that the company was not required to disclose why it “chose not to take particular courses of action” or “did not take other steps or follow another process”), *aff’d sub nom. Walker v. Lukens, Inc.*, 757 A.2d 1278 (Del. 2000) (TABLE), *Skeen v. Jo-Ann Stores, Inc.*, C.A. No. 16836, 1999 WL 803974, at *7 (Del. Ch. Sept. 27, 1999) (stating that “shareholders are not entitled to a ‘play-by-play’ description of merger negotiations”), *aff’d*, 750 A.2d 1170 (Del. 2000), *Kahn v. Corporella*, C.A. No. 13248, 1994 WL 89016, at *8 (Del. Ch. Mar. 10, 1994) (holding that a failure to disclose an indication of interest received by a third party was not material, where that potential bidder did not make a competing offer), *Van de Walle v. Unimation, Inc.*, C.A. No. 7046, 1991 WL 29303, at *15 (Del. Ch. Mar. 7, 1991) (“Where, as here, arm’s-length negotiation has resulted in an agreement which fully expresses the terms essential to an understanding by shareholders of the impact of the merger, it is not necessary to describe all the bends and turns in the road which led to that result.” (internal quotation marks omitted)), and *Repairman’s Serv. Corp. v. Nat’l Intergroup, Inc.*, C.A. No. 7811, 1985 WL 11540, at *8 (Del. Ch. Mar. 15, 1985) (same).

materials, and potential conflicts regarding those fairness opinions will probably remain among the most common disputes in Delaware deal litigation.¹¹³ The Delaware courts will likely continue to eschew a bright-line approach to these disclosure issues;¹¹⁴ this article therefore attempts to provide, along with our prior article, a helpful guide to practitioners regarding the Delaware courts' facts-and-circumstances approach.

113. See generally *Fair Summary*, *supra* note 1, at 881–82 (discussing reasons for the prevalence of disclosure claims in deal litigation).

114. See, e.g., *In re Atheros Commc'ns*, 2011 WL 864928, at *9; *cf. also* *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309 (2011) (eschewing use of bright-line rule for materiality in federal securities law context). Given the infinite combinations of business-specific factors (like what projections have been created and when), advisor-specific factors (like what methodologies are employed and what data are analyzed), board-specific factors (like what information is considered), and transaction-specific factors (like the transaction's form and the counterparty's identity), a bright-line rule seems particularly unsuitable for policing directors' duty of disclosure. See *Fair Summary*, *supra* note 1, at 885–86.