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DISCLOSURE

Disclosure Obligations in Private Company Transactions under Delaware Law

BY JOSEPH CHRISTENSEN
AND MEREDITH M. STEWART

In two recent decisions—*Dubroff v. Wren Holdings, LLC*[1] and *Berger v. Pubco Corporation*[2]—the Delaware Court of Chancery expanded the substantive disclosure obligations of corporations taking action by stockholder written consent (*Dubroff*) or providing notice of appraisal rights (*Pubco*). Prior cases had mandated certain substantive disclosures in these contexts and *Dubroff* and *Pubco* create additional disclosure obligations. For public corporations, much of this additional substantive information is publicly available in SEC filings and, thus, *Dubroff* and *Pubco* will have the greatest impact on private corporations that are not subject to the disclosure requirements of the federal securities laws.

The stockholder written consent statute and appraisal statute of the General Corporation Law of the State of Delaware (the ''DGCL'') betray none of the expansive disclosure obligations created by the courts. The statutes, Sections 228 and 262 of the DGCL, provide stockholders only the right to notice of corporate action accomplished by written consent and of their appraisal rights, respectively. Accordingly, the Delaware courts' interpretation of statutory notice requirements to include substantive disclosure obligations, via the fiduciary duty of disclosure, can be a trap for the unwary.

Statutory and Fiduciary Disclosures Under Sections 228 and 262 Section 228 provides that stockholders holding a sufficient percentage of voting power to guarantee approval can take stockholder action by signing written consents approving the action.[3] It further provides that a corporation must give ''[p]rompt notice of the taking of the corporate action without a meeting by less than unanimous written consent'' to ''those stockholders . . . who have not consented in writing.''[4] Likewise, the appraisal statute, Section 262, requires a corporation to provide to its stockholders who are entitled to appraisal rights notice of ''the approval of the merger . . . and that appraisal rights are available'' within 10 days of the ef-

Joseph Christensen and Meredith M. Stewart are associates at Richards, Layton & Finger, P.A., Wilmington, Del. The authors would like to thank C. Stephen Bigler for his substantial guidance and comments. The opinions expressed in this article are those of the authors and not necessarily those of Richards, Layton & Finger or its clients.

[1] 2009 WL 1478697 (Del. Ch. May 22, 2009).
[2] 2008 WL 2224107 (Del. Ch. May 30, 2008) [hereinafter *Pubco*] *rev'd on other grounds*, 976 A.2d 132 (Del. 2009).
[3] 8 *Del. C.* § 228(e).
[4] *Id.*

fective date ''and shall include in such notice a copy of [Section 262].''[5]

The Delaware courts' interpretation of statutory notice requirements to include substantive disclosure obligations, via the fiduciary duty of disclosure, can be a trap for the unwary.

In parallel with any statutory requirements, whenever a board of directors acts, it must also comply with any fiduciary duties imposed by the courts.[6]

There are two kinds of fiduciary disclosure in Delaware that overlay the notice requirements imposed by Sections 228 and 262. The first applies when the board of directors requests stockholder action. This happens, for example, when directors ask stockholders to vote on a merger[7] or ratify past action.[8] The Delaware courts have also held that when a stockholder is faced with the investment decision whether to seek appraisal or accept the offered merger consideration the board is deemed to be requesting action from the stockholders.[9] When directors seek stockholder action in any of these contexts, they are charged with disclosing all material information reasonably available to them.[10] The definition of ''materiality'' derives from the standard under the federal securities laws,[11] and is inherently contextual; one must always look at the information that is already available in determining whether additional information would be material.[12] This fiduciary duty applies in the context of appraisal, but not in the context of stockholder written consent because in the latter case the board is not requesting stockholder action.

The second type of fiduciary disclosure duty is implicated when a board communicates publicly or directly with stockholders. Since both Sections 228 and 262 require some communication with stockholders, this duty is implicated in both instances. This duty requires the communications to be honest.[13] Previous cases have not described it as an affirmative duty, nor one of substantive disclosure; instead, it requires only that the disclosure be honest. In order to state a claim under this theory, a stockholder plaintiff must allege that (1) the directors ''knowingly disseminate[d] false information,'' (2) the stockholders relied on the false or misleading communication and (3) the stockholders suffered damages as a result.[14]

Berger v. Pubco Corporation In *Berger v. Pubco Corp.*, the Court of Chancery considered the disclosure given to minority stockholders in connection with their appraisal rights after the majority stockholder effected a short-form merger.[15] Robert Kanner owned more than ninety percent of the outstanding stock of Pubco Corporation (''Pubco'') and was its president and sole director. In late 2007, his acquisition corporation, which was formed specifically for the merger, merged with and into Pubco pursuant to Section 253, the short-form merger statute. The short-form merger statute contains no disclosure duties itself[16] and the procedure contemplates that minority stockholders have no part to play in

[5] 8 *Del. C.* § 262(d)(2).

[6] *See Malone v. Brincat*, 722 A.2d 5, 11 (Del. 1998) (''Even when shareholder action is sought, the provisions in the General Corporation Law requiring notice to the shareholders of the proposed action do not require the directors to convey substantive information beyond a statutory minimum. Consequently, in the context of a request for shareholder action, the protection afforded by Delaware law is a judicially recognized equitable cause of action by shareholders against directors.''); *see also Schnell v. Chris-Craft Indus., Inc.*, 255 A.2d 437 (Del. 1971).

[7] *See, e.g., In re CheckFree Corp. S'holders Litig.*, 2007 WL 3262188, at *2 (Del. Ch. Nov. 1, 2007) (analyzing disclosure in proxy statement seeking approval of merger).

[8] *See, e.g, Gantler v. Stephens*, 965 A.2d 695, 714 (Del. 2009) (''[B]ecause we have determined that the complaint states a cognizable claim that the Reclassification Proxy was materially misleading . . . that precludes ruling at this procedural juncture, as a matter of law, that the Reclassification was fully informed.''); *In re Freeport-McMoran Sulphur, Inc. S'holder Litig.*, 2005 WL 1653923, at *14 (Del. Ch. June 30, 2005) (''Without proper disclosure of all material information, the Sulphur board cannot rely on stockholder ratification in its attempt to invoke the protection of the business judgment rule.'').

[9] *Glassman v. Unocal*, 777 A.2d 242, 248 (Del. 2001) (''Although fiduciaries are not required to establish entire fairness in a short-form merger, the duty of full disclosure remains, in the context of this request for stockholder action.''); *Turner v. Bernstein*, 1999 WL 66532, at *5 (Del. Ch. Feb. 9, 1999) (''[The] disclosure duty is triggered (*inter alia*) where directors . . . present to stockholders for their consideration a transaction that requires them to cast a vote and/or make an investment decision, such as whether or not to accept a merger or demand appraisal.'').

[10] *Stroud v. Grace*, 606 A.2d 75, 85 (Del. 1992) (''Delaware law imposes upon a board of directors the fiduciary duty to disclose fully all material facts within its control that would have a significant effect upon a stockholder vote.'').

[11] *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1985) adopting *TSC Indus. v. Northway*, 426 U.S. 438, 449 (1976).

[12] *Pubco*, 2008 WL 2224107, at *3 (Del. Ch. May 30, 2008) (''Thus, 'plaintiffs must explain why receiving information in addition to the basic financial data already disclosed will significantly alter the total mix of information available.' '') (quoting *In re Checkfree S'holders Litig.*, 2007 WL 3262188, at *2 (Del. Ch. Nov. 1, 2007) (emphasis added by *Berger* court).

[13] *Malone v. Brincat*, 722 A.2d 5, 11 (Del. 1998) (''[W]hen directors communicate publicly or directly with shareholders about corporate matters the *sine qua non* of directors' fiduciary duty to shareholders is honesty.'').

[14] *See Id.* at 10-11; *see also A.R. DeMarco Enters., Inc. v. Ocean Spray Cranberries, Inc.*, 2002 WL 31820970, at *4 n. 10 (Del. Ch. Dec. 4, 2002) (''When shareholder action is absent, plaintiff must show reliance, causation, and damages.'').

[15] *Berger v. Pubco Corp.*, 2008 WL 2224107 (Del. Ch. May 30, 2008). A short-form merger is an abbreviated merger process that Delaware corporations may use when one corporation owns 90% or more of each class of voting stock of another corporation. 8 *Del. C.* § 253.

[16] When the parent company in a Section 253 merger is not the survivor, the parent corporation must notify the stockholders 20 days in advance of a meeting held to act on the merger. 8 *Del. C.* § 253(a). In addition, Section 253 does provide that the corporation must file a certificate of ownership and merger that sets forth the resolution of the parent corporation's board approving the merger. The resolution must also ''state the terms and conditions of the merger, including the'' the merger consideration. *Id*. This requirement could be seen as a disclosure requirement, but it is one that runs to the state and not to the stockholders directly. As a publicly-filed document, the certificate could be obtained by a stockholder, but the statute

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the merger, but it provides that when minority stockholders are squeezed out, they are entitled to appraisal rights under Section 262 with its accompanying disclosure requirements.[17]

The merger cashed-out the minority for $20 per share. Pubco sent a notice to its stockholders informing the minority stockholders of their appraisal rights. The notice disclosed ''some information about the nature of Pubco's business, the names of its officers and directors, the number of shares and classes of stock, a description of related business transactions, and copies of Pubco's most recent interim and annual financial statements.''[18] It also provided ''telephone, fax, and email contact information where shareholders could obtain additional information upon request.''[19]

The Court addressed many of plaintiff's charges of the defendants' non-disclosures and noted that, among other things: the disclosure lacked detail (with the exception of the financial statements), the description of the company was vague, there was no discussion of the company's operations or plans and prospects, and the financial statements did not break down the finances by company division or disclose how the company's sizable cash reserves would be utilized.[20] The Court, however, did not find that these omissions amounted to disclosure violations and ultimately found just one to constitute a fiduciary disclosure violation. The Court found that the failure to disclose how the company had settled on the $20 per share valuation for the minority stock violated the board's fiduciary duty of disclosure.[21]

The Court held that the methodology used to reach the $20 per share valuation was material. In a Section 253 merger, the parent has no duty to offer a fair price and absent fraud, illegality or a disclosure violation, the stockholder's only remedy is appraisal.[22] The defendants argued that the methodology used to determine the offer price would only be relevant to evaluate the offer's fairness and since there was no obligation to offer a fair price, it was unnecessary, and possibly even misleading, to disclose the methodology.[23] The Court rejected this argument, holding that it confused ''necessity'' with materiality and that, in the case of Pubco—''an unregistered company that made no public filings and whose Notice was relatively terse and short on details''—knowing what methodology the majority stockholder used was material to the question of whether the valuation was reliable.[24] Where little information is otherwise available, the directors must ''disclose[] in a broad sense what [the valuation] process was.''[25]

The Court explained that the purpose of requiring disclosure of valuation methodology in a short-form merger was to allow the minority stockholder to decide ''whether or not to trust and accept the price offered by the parent.''[26] According to the Court, the decision of whether to seek appraisal ''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?''[27]

Berger v. Pubco may create something very near to a *per se* rule that valuations, and presumably the facts surrounding such valuations, must be disclosed in all Section 253 mergers where a minority is cashed out; or, at a minimum, in all such mergers involving companies that are not publicly traded.

In dismissing some of Berger's other disclosure claims, the Court noted that ''[i]n effect, plaintiff demonstrates that the financial information disclosed *has* allowed her to determine that she did not trust the parent's valuation of the Company.''[28] Despite finding that

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does not require the corporation to provide the certificate to the stockholder directly.

[17] 8 *Del. C.* § 253(d).

[18] *Pubco*, 2008 WL 2224107, at *1.

[19] *Id.* On the limited effect of such an offer to provide additional information upon request, see *Turner v. Bernstein*, 776 A.2d 530, 544 (Del. Ch. 2000) (finding that ''a board's willingness to provide additional information orally might conceivably be a factor in a close case'' the affirmative duty to disclose remains on the directors and the stockholders do not have a duty to ''elicit the material facts'' where a corporation had provided telephone numbers for stockholders to call to request additional information).

[20] *Pubco*, 2008 WL 2224107, at *1.

[21] The failure to attach the current version of the appraisal statute to the notice of short-form merger was a technical disclosure violation, though one of the statutory rather than fiduciary variety. The defendants conceded that they had violated Section 262 by failing to include the then-current version of the statute, which had been amended in August 2007, three months prior to the merger. *Id.* at *3; *see also Nebel v. Southwest Bancorp, Inc.*, 1995 WL 405750, at *6 (Del. Ch. July 5, 1995) (''[A]ny argument that the erroneous inclusion of a page from another state's appraisal statute was 'immaterial' is foreclosed by the mandatory nature of the statutory requirement. The requirement that the corporation 'shall' include a copy of its provisions in the Notice necessarily imports a subsidiary requirement that the included statutory provision be accurate and complete.'').

[22] *Glassman v. Unocal Exploration Corp.*, 777 A.2d 242, 248 (Del. 2001) (''In order to serve its purpose, § 253 must be construed to obviate the requirement to establish entire fairness. . . . [A]bsent fraud or illegality, appraisal is the exclusive remedy available to a minority stockholder who objects to a short-form merger. . . . Although fiduciaries are not required to establish entire fairness in a short-form merger, the duty of full disclosure remains . . . .'').

[23] *See Gantler v. Stephens*, 965 A.2d 695, 712 (Del. 2009). In *Gantler*, a conflicted board of directors made the representation that, after ''careful deliberations,'' it was recommending a stockholder vote for a reclassification. ''Had the 'careful deliberations' representation never been made, the shareholders might well have evaluated the Reclassification more skeptically, and perhaps even less favorably on its merits.'' *Id.*

[24] *Pubco*, 2008 WL 2224107, at *3.

[25] *Id.*

[26] *Id.*

[27] *Id.*

[28] *Id.* at *4 (emphasis original). This finding seems substantially similar to the defendant's argument—rejected by the Court because it confused necessity with materiality—that additional disclosures were not necessary in this particular context.

the minority stockholders had sufficient information to distrust the parent's valuation, the Court held that the defendants were required to disclose the valuation method in order to give the stockholders adequate information from which to judge the defendants trustworthy or not. In so finding, the Court concluded implicitly that valuation methodology is material (and not merely accretive) even when the already disclosed information is sufficient to distrust the parent's valuation.[29] This holding may create something very near to a *per se* rule that valuations, and presumably the facts surrounding such valuations, must be disclosed in all Section 253 mergers where a minority is cashed out; or, at a minimum, in all such mergers involving companies that are not publicly traded and thus, presumably, are lacking in publicly available information. On appeal, the Supreme Court of Delaware did not consider the disclosure issue.[30]

Dubroff v. Wren Holdings, LLC In *Dubroff v. Wren Holdings, LLC*,[31] the Court of Chancery considered the disclosure of a recapitalization of Nine Systems Corporation that was approved by written consent of stockholders (consisting primarily of the defendants). The recapitalization took place in August 2002 and converted debt held by the defendants into preferred stock.[32] The defendants' equity holdings increased from approximately 56% to 80%.[33]

In connection with the recapitalization, Nine Systems sent a notice pursuant to Section 228 because the recapitalization was approved by stockholder written consent. The notice informed the non-consenting stockholders, including the plaintiffs, of the corporate action taken.[34] ''The notice provided to the Plaintiffs following the Recapitalization accurately described the precise action accomplished through the written consent . . . .''[35] The notice also disclosed the number of common shares that would be issued if the preferred stock (into which the debt was converted pursuant to the recapitalization) was converted into common stock.[36]

But the notice also failed to disclose certain facts. Generally, it did not disclose ''who benefited from the Recapitalization and what benefits'' they received.[37] Specifically, it did not disclose that the defendants ''were the primary recipients of the new convertible preferred stock;'' failed to ''inform the stockholders of the pricing of the conversion of the [defendants'] debt into convertible preferred stock;'' did not ''provide any other numbers that would provide a context to enable the Plaintiffs to understand the full consequence of the transaction;'' and did not disclose the defendants' ownership increase.[38]

The Court explicitly declined to define what the proper scope of disclosure is under Section 228. The Court instead analyzed the issue under general fiduciary principles.[39] ''[T]he sine qua non of directors' fiduciary duty to shareholders is honesty.''[40] The Court held that even if Section 228 does not ''require[] full fiduciary duty disclosure of all material information as in the context of a request for shareholder action . . . the Complaint [sufficiently alleged] that the board *deliberately omitted material information with the goal of misleading*'' the other stockholders.[41] Thus, the Court found that the disclosure violated the board's duty to communicate honestly with stockholders because the practical effects of the recapitalization were not disclosed.

Analysis: Expanding Common Law Disclosure Requirements In the recent past, the Supreme Court of Delaware had a very different view of adding equitable disclosure obligations beyond statutory mandates. In *Stroud v. Grace*,[42] the Supreme Court addressed issues similar in certain respects to both *Pubco* and *Dubroff*. Milliken Enterprises, Inc. was a privately held corporation. Its 200 stockholders were mostly descendants of the founder. Eventually, two different branches of the family, the Strouds and the Millikens, came to disagree on certain issues relating to the company. The board, controlled by the Millikens, recommended an amendment to the certificate of incorporation to be voted on at a stockholder meeting. In connection with the amendment, the board of directors distributed a notice of meeting as required by Section 222(a) of the DGCL[43] and included a resolution declaring the amendment advisable and a copy of the proposed charter amendments as required by Section 242(b)(1) of the DGCL.[44] Significantly, the board stated in the meeting notice that it was

[29] *Id.*

[30] *Berger v. Pubco Corp.*, 976 A.2d 132, 138 n. 16 (Del. 2009) (''Because the defendants-appellees have not challenged that adjudicated disclosure violation on this appeal, it is established that the duty of full disclosure mandated by *Glassman* was violated, leaving for determination only the question of remedy.'').

[31] 2009 WL 1478697, at *1 (Del. Ch. May 22, 2009).

[32] *Id.*

[33] *Id.* at *5, n.39.

[34] *Id.* at *5-6.

[35] *Id.* at *6. Specifically, the notice stated: ''[Nine Systems] has recapitalized by converting its outstanding subordinated debt into shares of several new series of convertible preferred stock, and by declaring and implementing a one-four-twenty [sic] reverse stock split on all outstanding shares of common stock of the Company.'' It also stated that, '' 'a round of $3.8 million in senior debt was raised from existing investors.' '' The meaning and relevance of this senior debt is not clear from the opinion.

[36] *Dubroff*, 2009 WL 1478697, at *5, n. 38 (''The notice also indicated that, if the convertible preferred shares were all converted, 8,989,786 additional common shares would be issued.'').

[37] *Id.* at *6.

[38] *Id.* at *5.

[39] *Id.* at *6 (''The Court need not delineate the parameters of the disclosure required by § 228(e) because the Court holds that regardless of the precise scope, the Plaintiffs have stated a claim for breach of fiduciary duty.'').

[40] *Id.* (quoting *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998)).

[41] *Id.*

[42] 606 A.2d 75 (Del. 1992); *see also Unanue v. Unanue*, 2004 WL 2521292, at *8-9 (Del. Ch. Nov. 9, 2004) (discussing *Stroud* and its application in a private, family-owned corporation in which all stockholders were familiar with the corporate actions in question).

[43] At the time, 8 *Del. C.* § 222(a) provided as follows: ''Whenever stockholders are required or permitted to take any action at a meeting, a written notice of the meeting shall be given which shall state the place, date and hour of the meeting, and, in the case of a special meeting, the purpose or purposes for which the meeting is called.'' 56 Del. Laws ch. 50, Section 1, § 222. Current version at 8 *Del. C.* § 222(a).

[44] At the time, 8 *Del. C.* § 242(b) provided in relevant part as follows: ''Every [charter] amendment authorized by subsection (a) of this section shall be made and effected in the following manner: If the corporation has capital stock, its board of

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not soliciting proxies in connection with the vote on the amendment. Among other claims, the Strouds alleged various disclosure violations. One allegation was that the notice ''failed to explain the differences between'' the amendments proposed and earlier amendments that had been abandoned and, thus, the board violated its duty of disclosure in circulating the notice.[45]

> ***Pubco* and *Dubroff* continue an expansion of disclosure requirements for private company transactions beyond the statutory requirements that is seemingly at odds with the Delaware Supreme Court's decision in *Stroud v. Grace*.**

The Supreme Court held that when a board of directors is not seeking proxies, ''questions of disclosure beyond those mandated by statute become less compelling.''[46] The Millikens argued that to add substantive disclosure requirements to the statutes as the trial court had done would be ''to extend this duty of disclosure into a substantive requirement which supervenes 8 *Del. C.* §§ 222(a) & 242(b)(1).''[47] The Court adopted this argument. It overturned the trial court's decision because ''[t]he trial court's extension of the duty of disclosure beyond that mandated by statute effectively amends the law.''[48] In the same vein the Court stated that ''[t]he directors' duty to disclose all material facts in connection with contemplated shareholder action does not exist in a vacuum. The provisions of the Delaware General Corporation law also establish mandatory disclosures in certain circumstances.''[49] The Court cited Section 222 and Section 242 and noted that ''[s]ignificantly, the General Corporation Law does not require any further disclosures in the absence of a proxy solicitation.''[50]

Pubco and *Dubroff* continue an expansion of disclosure requirements for private company transactions beyond the statutory requirements that is seemingly at odds with the language of *Stroud*. Before *Pubco* the list of required disclosure items to be included in an appraisal notice had already swelled beyond any statutory mandate. This expansion has taken place under the fiduciary duty to provide all material information to stockholders who must decide whether to accept the proposed merger consideration or seek appraisal. The list includes the merger agreement,[51] financial statements,[52] revenue projections,[53] and instructions as to executing and filing a valid objection or demand for payment.[54] *Pubco* adds valuation methodology.[55] *Dubroff* adds disclosure of the practical effect on interested parties.

In contrast to Delaware, the Model Business Corporation Act (the ''MBCA'') enumerates the disclosure items in its appraisal notice statute.[56] ''By specifying certain disclosure requirements, section 13.20(d) reduces the risk, in the transactions to which it applies, of an uninformed shareholder decision whether or not to exercise appraisal rights.''[57] The MBCA requires the board to give notice of appraisal rights, attach a copy of the appraisal chapter of the MBCA and to disclose ''the annual financial statements . . . and the latest available quarterly financial statements of such corporation, if any.''[58] In addition, once the corporate action has become effective, pursuant to MBCA § 13.22, the corporation must disclose ''the corporation's estimate of the fair value of the shares'' in addition to various procedural information.[59] ''The purpose of section 13.22 is to

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directors shall adopt a resolution setting forth the amendment proposed, declaring its advisability, and [directing that the proposal be considered at a special meeting or the next annual meeting]. Such special or annual meeting shall be called and held upon notice in accordance with § 222 of this title. The notice shall set forth such amendment in full or a brief summary of the changes to be effected thereby, as the directors shall deem advisable.'' 64 Del. Laws ch. 112, Section 24. Current version at 8 *Del. C.* § 242(b)(1).

[45] *Stroud*, 606 A.2d at 84.

[46] *Id.* at 86.

[47] *Id.* at 85.

[48] *Id.* at 87; *see also Stroud v. Grace*, 1990 WL 176803, at *14 (Del. Ch. Nov. 1, 1990) (''Several older Delaware cases seemed to indicate that mere compliance with the provisions of 8 *Del.C.* § 222 and § 242(b)(1) would discharge the directors' duty unless there were omissions that would likely mislead the stockholders.'' (citing *Edelman v. Salomon*, 559 F. Supp. 1178, 1184 (D. Del. 1983); *Michelson v. Duncan*, 407 A.2d 211, 220 (Del. 1979); *Lacos Land Co. v. Arden Group, Inc.*, 517 A.2d 271, 279 (Del. Ch. 1986))).

[49] *Id.* at 86.

[50] *Id.* at 85.

[51] We have been unable to find a case in which a merger agreement was not disclosed or where the Court compelled its disclosure in the context of appraisal disclosure. Once the rule is applied that all material information relevant to the stockholders' decision whether to seek appraisal or accept the merger consideration must be disclosed, the merger agreement is perhaps the most material item of information to be disclosed.

[52] *Erickson v. Centennial Beauregard Cellular, LLC*, 2003 WL 1878583, at *6 (Del. Ch. Apr. 11, 2003) (''[D]efendant did not include *any* financial statements or any comparable information for review or analysis by its minority stockholders. Therefore, ACLC shareholders were not provided with any basic financial material upon which they could make an informed judgment about ACLC's value. Furthermore, ACLC was not a public company, which means the stockholders had no objective market data upon which to measure the fairness of the proposed merger consideration.'').

[53] *Id.* (''[S]ome indication of business revenue projections is still necessary for shareholders to determine whether they are receiving a fair price for their shares.'').

[54] *Raab v. Villager Indus., Inc.*, 355 A.2d 888, 895 (Del. 1976) (''A Delaware corporation, engaged in § 262 proceedings, henceforth shall have an obligation to issue specific instructions to its stockholders as to the correct manner of executing and filing a valid objection or demand for payment under [§ 262] . . . .'').

[55] The Court of Chancery had suggested in a transcript ruling issued prior to the *Pubco* opinion, that valuation methodology may be *per se* material in the context of a freeze-out merger of the minority stockholders of a small, privately held company where the acquirer is an entity controlled by the majority stockholder. *See McVey v. McVey*, C.A. No. 4756-VCN, Memorandum Op. at 17 (Del. Ch. Jan. 22, 2008). The Court also noted that the merger disclosure requirements ''may constitute overkill'' when they are applied to publicly traded companies. *Id.*

[56] MODEL BUS. CORP. ACT § 13.20(d), adopted 62 BUS. LAW. 1061 (2007).

[57] Official Comment, MODEL BUS. CORP. ACT § 13.20.

[58] MODEL BUS. CORP. ACT § 13.20(d).

[59] *Id.* at § 13.22(b)(2).

require the corporation to provide shareholders with information and a form for perfecting appraisal rights. The content of this notice and form are spelled out in detail to ensure that they accomplish this purpose.''[60] These detailed substantive and procedural disclosure requirements are notably absent from the Delaware appraisal statute.

Disclosing financial and other substantive information can conflict with the interests of the private corporation and its stockholders in keeping its information confidential.

Disclosing the items on the judicially imposed disclosure list can present difficult issues for a private company. In many private companies audited financial information may not be available or even exist. Available unaudited financial information may be misleading since it has not been subjected to the rigors of auditing. When the information does exist it may or may not be compiled according to generally accepted accounting principles (''GAAP'') and is often not readily available in a form that is understandable to stockholders who are accustomed to seeing financial statements prepared in accordance with GAAP.[61] Disclosing this financial information as well as other substantive information (such as the practical effects of a corporate action on certain parties) can also conflict with the interests of the private corporation and its stockholders in keeping its information confidential. The ability to keep corporate information confidential is one of the principal benefits of operating as a private company rather than operating as a public company subject to federal mandatory disclosure.

The expanded disclosure requirements are particularly ill-suited to the short-form merger context. The purpose of requiring majority stockholders who own less than 90% of a company's stock (that is, stockholders who cannot take advantage of the short-form merger statute) to submit interested transactions to various procedural safeguards is to replicate arms-length dealing and, as a result, a sufficient price.[62] The short form merger statute's benefit is that the process is truncated and need not be subjected to processes such as the recommendation of an independent committee or conditioning the merger on approval of a majority of the minority to test its fairness.[63] By requiring the majority stockholder to disclose the methodology by which it arrived at the offered price, *Pubco* forfeits some of this benefit.[64]

Some of the benefit of the short-form merger statute is forfeited because *Pubco* establishes an *ad hoc* ''comply or explain'' disclosure regime for short-form mergers similar to those enacted under European corporate governance regulations.[65] *Pubco* does not directly mandate that a 90% stockholder must set a fair price after a trustworthy valuation process. But by requiring disclosure of how the price was chosen and sufficient information to allow the minority to *trust*[66] the majority, *Pubco* pushes majority stockholders in that direction. The purpose of ''comply or explain'' regimes is to institute substantive reforms flexibly toward a perceived best practice.[67] But, as indicated, the benefit of Section 253 is at odds with substantive or procedural fairness, however gently that fairness is imposed.

[60] Official Comment, Model Bus. Corp. Act § 13.22.

[61] *See, e.g.*, *Cliff House Condominium Council v. Capaldi*, 1991 WL 165302, at *4 (Del. Ch. Aug. 26, 1991) (explaining various levels of accounting review).

[62] *See In re PNB Holding Co. S'holders Litig.*, 2006 WL 2403999, at *9 (Del. Ch. Aug. 18, 2006) (''Absent clarifying guidance from our Supreme Court, after *Lynch*, it is difficult for this court to subject such a merger to anything but entire fairness review, regardless of whether the proponents of the transaction employed all the procedural protections necessary to replicate an arms-length merger, by negotiating the transaction with a special committee of independent directors and conditioning the transaction on a non-waivable majority-of-the-minority vote.'') (citations omitted).

[63] *See Glassman v. Unocal Exploration Corp.*, 777 A.2d 242, 243 (Del. 2000) (''By enacting a statute that authorizes the elimination of the minority without notice, vote, or other traditional indicia of procedural fairness, the General Assembly effectively circumscribed the parent corporation's obligations to the minority in a short-form merger. The parent corporation does not have to establish entire fairness, and, absent fraud or illegality, the only recourse for a minority stockholder who is dissatisfied with the merger consideration is appraisal.'').

[64] Additionally, because the question of materiality is highly contextual, the Delaware Supreme Court has cautioned against ''grafting affirmative equitable disclosure obligations onto the clear statutory requirements of the DGCL.'' *Unanue v. Unanue*, 2004 WL 5383942, at *10 (Del. Ch. Nov. 3, 2004). The Court observed previously that ''[i]t is for the Legislature not for the court, to declare the public policy of the state, and it is not, therefore, the function of the court to graft an exception on plain and positive terms of the statute [authorizing merger of two or more corporations so as to prevent merger of parent and subsidiary corporation].'' *Fed. United Corp. v. Havender*, 11 A.2d 331, 337 (Del. 1940).

[65] *See e.g.* Financial Reporting Council (UK), The Combined Code on Corporate Governance, June 2008, *available at* http://www.frc.org.uk/corporate/combinedcode.cfm (setting forth a comply-or-explain regime that applies to United Kingdom-incorporated companies that are publicly-traded on the Main Market of the London Stock Exchange); Corporate Governance Code Monitoring Committee (Netherlands), Dutch Corporate Governance Code, January 2009, *available in English at* http://www.corpgov.nl/page/downloads/DEC_2008_UK_Code_DEF__uk_.pdf (setting forth a comply-or-explain regime that applies to Dutch-incorporated publicly-traded companies); *see also* Sarbanes-Oxley Act §§ 406, 407, 15 U.S.C. §§ 7264, 7265 (2006) (requiring companies to have a code of ethics for senior financial officers and to have an audit committee financial expert and, if not, to explain why not).

[66] *See supra* n. 27-29 and accompanying text (discussing *Pubco*'s use of the term ''trust'').

[67] *See* European Corporate Governance Forum, Statement of the European Corporate Governance Forum on the comply-or-explain principle, Feb. 22, 2006, *available at* http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf-comply-explain_en.pdf (''The experience of countries which have implemented this approach for several years shows that it does lead to a movement of convergence towards better governance practices.''). The European Corporate Governance Forum was set up by the European Commission, the executive branch of the European Union, ''to encourage the co-ordination and convergence of national codes'' of corporate governance. Overview of the European Corporate Governance Forum, *available at* http://ec.europa.eu/internal_market/company/ecgforum/index_en.htm.

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Tying materiality to the concept of 'trust' makes materiality even more difficult to ascertain.

Gaining the trust of the minority in a short-form merger through disclosure would be difficult. The Delaware courts have shown consistently that there is no amount of disclosure that will make the courts trust a majority stockholder (and thus apply business judgment rule deference) when the majority is self-dealing. The concept of ''trust'' in fixing a price for a Section 253 merger is curious, at best. Since the majority shareholder has no duty to offer a fair price, it seems inconsistent to inject the concept of ''trust'' in determining if there has been a disclosure violation as to the pricing decision. Query whether under any circumstances a rational minority stockholder should trust a majority stockholder that is under no obligation to offer a fair price to or to deal fairly with the minority. Following *Pubco*, potentially, a company may be better served by disclosing that it is simply not offering a fair price, although this may invite all minority stockholders to submit demands for appraisal. It is under no obligation to offer a fair price and if it so disclosed, it would not face disclosure claims.

The materiality standard is already indeterminate. Tying materiality to the concept of ''trust'' makes materiality even more difficult to ascertain. In determining what to disclose, the majority stockholder must answer the question: What amount of disclosure will allow the minority to *trust* the majority stockholder? Adding this concept in the context of a short-form merger is particularly unhelpful because the benefit of the short-form merger statute[68] is to truncate the merger process and allow 90% stockholders to avoid the expensive procedural trappings that help simulate an arms-length—and, therefore, trustworthy—transaction.[69] Transparency and disclosure thus provide minority stockholders little reassurance. Only if the pricing procedures are fulsome and fair is the minority likely to trust the price offered.

Dubroff may dictate further substantive disclosures in the context of short-form mergers and any other communications with stockholders. In *Dubroff* the board of Nine Systems ''accurately described the precise action accomplished through the written consent'' but the court found that this bare disclosure was misleading by omission.[70] The court held that in order not to be misleading, the board would have to disclose more than the legal effects despite the fact that the statute mandates only that the board communicate the legal effects; the board would also have to disclose the practical effects such as the way that certain stockholders benefited. This changes the parameters of the duty to communicate honestly with stockholders as previously understood. As originally conceived, the obligation to communicate honestly with stockholders was not an affirmative or substantive disclosure obligation. The duty only required that if the board communicated with stockholders it do so honestly. In *Dubroff*, the board complied with the statutory mandate to disclose a corporate action taken by written consent. Its affirmative statements were honest, accurate and complied with the statute. However, in adhering strictly to the statutory mandate the directors did not communicate to stockholders the practical effects of the action taken and, as a result, the directors were criticized by the Court. Imposing such a requirement converts the duty to communicate honestly into a duty to affirmatively disclose additional substantive information about a transaction whenever the board is required by statute to provide notice to stockholders. In the context of an appraisal notice this may require certain additional disclosures that describe more fully how stockholders, directors or management may benefit from the transaction giving rise to appraisal rights.

Another effect of *Dubroff* may be to require the disclosures in contexts where the board is not requesting stockholder action to resemble more closely the disclosures in contexts where the board is requesting stockholder action.[71] As discussed above, when a board is not seeking stockholder action it is charged only with being honest, not with disclosing all material information.[72] Yet *Dubroff* begins to erode this distinction because it holds that it is not enough to disclose a transaction's legal effect accurately and honestly, material information about the practical effects must also be disclosed.[73] While the *Dubroff* court did not frame the issue in precisely these terms, a requirement to disclose the practical effects of a transaction (including how certain parties will benefit from the transaction) closely resembles a requirement that all material information must be disclosed. Material information largely consists in the type of disclosures that the *Dubroff* court held it was misleading to omit, such as who benefits, how the transaction was priced, and ''provid[ing] a context to enable the Plaintiffs to understand the full consequence of the transaction.''[74]

[68] As the Court in *Fed. United Corp.* further noted: ''[t]he state has an interest in the corporate structures erected under its authority. Having provided for the merger of corporations, they are not regarded with disfavor. On the contrary, mergers are encouraged to the extent that they tend to conserve and promote corporate interests. The catholic quality of the language of the merger provisions of the law negatives a narrow or technical construction of the purpose for which they were enacted is to be accomplished.'' *Fed. United Corp.*, 11 A.2d at 338. While the legislative history available for Section 253 (as well as many other Delaware statutes) is limited, these objectives likely were considered by the legislature in adopting Delaware's short-form merger statute.

[69] *See supra* note 64.

[70] *Dubroff*, 2009 WL 1478697, at *6.

[71] *Id.* (''[S]uch a failure to disclose *material* facts necessitates the conclusion that the Plaintiffs have stated a claim that the NSC board breached its fiduciary duties regarding disclosure of *material* information.'') (emphasis added).

[72] *See Unanue*, 2004 WL 5383942, at *9 n. 74 (''Moreover, because action by written consent requires individual acts of volition by the stockholders, the potential for abuse that gives rise to the federal proxy [disclosure] rules is not present.'').

[73] *Dubroff*, 2009 WL 1478697, at *6.

[74] *Dubroff*, 2009 WL 1478697, at *5. A further doctrinal problem with *Dubroff* is that there is no indication that the plaintiffs relied or alleged that they relied to their detriment on the non-dislcosures. As discussed above, reliance is an element of a disclosure claim that alleges that the board, while not seeking stockholder action, failed to communicate honestly with the stockholders. *See supra* note 14 and accompanying text. The court does allude to the allegation by plaintiffs that

Conclusion At times it is easy to see that a case will move the law in a particular direction. With respect to the law of disclosure, it remains to be seen whether *Pubco* or *Dubroff* will mark turning points or merely small detours.

''had the Update contained accurate and full disclosures, Plaintiffs could have made a claim for rescissory relief.' '' *Dubroff*, 2009 WL 1478697, at *5 (quoting Pls.' Ans. Br at 38). This could be seen as an allegation of reliance, but requiring information so that plaintiffs can bring claims against the board would appear to run afoul of a further rule of Delaware disclosure law—that directors need not self-flagellate. *In re Lukens Inc. S'holders Litig.*, 757 A.2d 720, 736 (Del. Ch. 1999), *aff'd sub nom. Walker v. Lukens, Inc.*, 757 A.2d 1278 (Del. 2000) (''It is well understood that directors are not required to engage in 'self-flagellation' by disclosing their alleged breaches of duty.'').

After *Pubco* and *Dubroff*, private corporations should disclose at least the following to the extent available (and, to the extent not available, a statement that such items are not available) when providing appraisal notice: the merger agreement, financial statements, revenue projections, instructions as to executing and filing a valid objection or demand for payment, valuation methodology and the practical effect on interested parties. In addition, whenever the directors communicate with stockholders, even when merely providing a notice required by statute, the corporation must disclose how certain stockholders, directors or management may benefit from the disclosed action in ways that stockholders in general will not.

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