Court of Chancery Clarifies the Scope of Disclosure Liability in Novel Contexts

By Brian T.M. Mammarella

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Under Delaware law, corporate fiduciaries owe an affirmative duty of disclosure when seeking stockholder action—including, for example, presenting a matter for stockholder approval or proposing a transaction that otherwise requires stockholders to make an investment decision, such as whether to seek appraisal or participate in a corporation's self-tender. In these circumstances, directors owe an affirmative duty to disclose all material information within the board's control. Delaware courts have also established that when directors are not seeking stockholder action but choose to speak on a given topic, they must be truthful. In two recent opinions, the Delaware Court of Chancery addressed the scope of disclosure liability in two novel contexts.

First, in *Cygnus Opportunity Fund v. Washington Prime Group*, 2023 WL 5113279 (Del. Ch. Aug. 9, 2023), the Court of Chancery considered whether fiduciaries had an affirmative disclosure duty in connection with a third-party private tender offer and second-step merger. There, the controlling unitholder of a privately held Delaware limited liability company squeezed out minority unitholders through an all-cash tender offer followed by a merger. Although the LLC's operating agreement eliminated both directors' and the controller's fiduciary duties, it was silent as to officers, who owed the same fiduciary duties as corporate directors and officers by default. That enabled plaintiffs to challenge the transaction in part on grounds that the LLC's officers breached their fiduciary duties by failing to provide any disclosure on the tender offer and by issuing "paltry" disclosures about the merger. Defendants moved to dismiss for failure to state a claim, arguing that no affirmative disclosure duties arose because the controlling unitholder, which was the only party that could have possibly been obligated to make disclosures to the minority unitholders, owed no fiduciary duties under the operating agreement, and no disclosure duty applied in the second-step merger because it did not require unitholder approval.

The Court of Chancery rejected both arguments and denied the motion to dismiss. First, the court held that the officers "could have owed" a duty of disclosure in connection with the tender offer. The court reasoned that although no Delaware court had ever imposed a disclosure duty in the context of a third-party private tender offer, fiduciaries' more general "affirmative obligation to respond to threats" could require a response, "depending on the circumstances." Those "circumstances," the court observed, might include a "severely underpriced tender offer."

Similarly, the *Cygnus* court held that officers may have owed an affirmative disclosure duty in connection with the second-step merger even though no equityholder action was sought or required. The court reasoned that the fiduciary duties of corporate directors and officers derive from those of trustees, who have a duty to inform beneficiaries of "material information" necessary to protect their interests. The court next reasoned that while this "duty to inform" is more limited in the corporate setting (directors, for example, have no regular reporting obligations), the duty could require disclosure about "extraordinary events." And in the court's words, "if the duty to inform could apply anywhere, it would apply to a transaction in which a fiduciary unilaterally effectuates a taking of a beneficiary's interest." Accordingly, the court held that the complaint stated a claim that officers both owed and breached an affirmative duty of disclosure in connection with the merger.

Second, in *New Enterprise Associates 14 v. Rich*, 292 A.3d 112 (Del. Ch. 2023), the Court of Chancery assessed whether stockholders whose consents were not sought could challenge the sufficiency of disclosures made in a consent solicitation. There, a Delaware corporation sought to amend its certificate of incorporation to increase the number of authorized shares in advance of a preferred stock offering and solicited written consents from a limited subset of stockholders who ultimately approved the amendment. Dissenters whose consent was neither sought nor required challenged the solicitation's disclosures as inadequate. The Court of Chancery concluded that these stockholders could challenge the consent solicitation's disclosures as the product of a breach of fiduciary duty despite having never received them. The court reasoned that actions consenting stockholders are induced to take can harm stockholders not asked to consent because the outcome of stockholder votes can harm the latter. In *New Enterprise Associates*, that outcome was the transaction the vote "cleared the way" for—the preferred stock offering—which harmed plaintiffs at the "entity level" rather than the misleading disclosures themselves, whose only "stockholder level" harms affected stockholders who received the disclosures. Accordingly, the court held that the plaintiffs could challenge the disclosures derivatively (rather than directly). Ultimately, however, because stockholder-plaintiffs had lost their shares in a subsequent merger, they lost standing to assert derivative claims, and the court dismissed their disclosure-based claim on that basis.

These authorities offer several important takeaways:

- The practical effect of *Cygnus* may be limited because affirmative disclosure duties usually apply in both scenarios *Cygnus* addressed. In particular, many third-party tender offers are subject to disclosure requirements under federal securities laws, and many squeeze-out mergers trigger state-law disclosure requirements because they require stockholder action (including deciding whether or not to seek appraisal). *Cygnus* was, in some sense, an outlier because it involved both a private company (to which federal disclosure requirements did not apply) and an LLC (for which appraisal rights were not available).
- With that said, following *Cygnus*, plaintiffs may attempt to bring disclosure claims against corporate fiduciaries even where stockholder action is not required. The *Cygnus* court held that a duty of disclosure could apply for "extraordinary events" and suggested that the duty could require disclosure of "material information" sufficient to allow stockholders to protect their interests.
- Because the *Cygnus* court provided little guidance on what qualifies as an "extraordinary event," corporate planners should carefully consider whether a particular event or action may constitute an "extraordinary event" for which disclosures should be made to stockholders.
- Finally, in light of *New Enterprise Associates*, fiduciaries and corporate counsel should continue to be thoughtful when drafting disclosure documents even where the action may be approved by a subset of stockholders without involvement from nonconsenting or nonvoting stockholders.

Brian T.M. Mammarella *(mammarella@rlf.com) is an associate of Richards, Layton & Finger. His practice focuses on transactional matters involving Delaware corporations, including mergers and acquisitions, corporate governance, and corporate finance. The views expressed in this article are those of the author and not necessarily those of Richards, Layton & Finger or its clients.*