DELAWARE CORPORATE LAW BULLETIN

Delaware Court Enjoins Stockholder Vote Pending Corrective Disclosures

*Robert S. Reder**

Requires a "complete picture of the facts in one place" before allowing acquiring company stockholder meeting to proceed

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INTRODUCTION

When a stockholder vote is challenged, Delaware courts will pay particular attention to whether the vote was properly informed. In the case of corporations that are subject to the regulatory regime of the Securities and Exchange Commission ("*SEC*"), the mechanisms for providing disclosures necessary to assure that votes are informed are found in the proxy rules promulgated by the SEC under the Securities Exchange Act of 1934.

The adequacy of disclosures provided to stockholders in the M&A context has taken on greater prominence in recent years as

Delaware courts sought to cope with an explosion of M&A-related litigation.[1] Disclosure issues have arisen in two distinct timeframes:

- *Pre-closing*. In January 2016, Chancellor Andre G. Bouchard of the Delaware Court of Chancery (the "*Chancery Court*") devoted nearly twenty pages of his opinion in *In re Trulia, Inc. Stockholder Litigation*[2] to criticize disclosure-only settlements in general and, perhaps, set the stage for their demise. The Chancellor declined to approve the proposed disclosure settlement on the ground that the informational "get" to be received by Trulia stockholders was not sufficiently material to warrant their "give" of an overly broad release to the acquiring corporation (not to mention the lucrative fee received by plaintiffs' counsel). In his view, the settlement was fatally out of balance: it did "not afford [stockholders] any meaningful consideration to warrant providing a release of claims to the defendants."[3]
- *Post-closing*. In October 2015, the Delaware Supreme Court ruled in *Corwin v. KKR Financial Holdings LLC*[4] that a fully informed, uncoerced, and disinterested stockholder approval can "cleanse" certain directorial breaches of fiduciary duty for purposes of a post-closing action seeking damages from directors who approved a contested M&A transaction. In view of the glut of M&A-related litigation, as well as the traditional respect shown by Delaware courts for informed stockholder votes, the *Corwin* court's willingness to defer to stockholder decisions in this context is, in retrospect, by no means surprising.

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* Robert S. Reder, Professor of the Practice of Law at Vanderbilt University Law School, has been serving as a consulting attorney at Milbank, Tweed, Hadley & McCloy LLP in New York City since his retirement as a partner in April 2011.

1. *In re* Trulia, Inc. Stockholder Litigation, 129 A.3d 884, 894 (Del. Ch. Jan. 22, 2016) ("*Trulia*"). "In just the past decade, the percentage of transactions of $100 million or more that have triggered stockholder litigation in this country have more than doubled, from 39.3% in 2005 to a peak of 94.9% in 2014." *Id.* For a discussion of the *Trulia* decision, see Robert S. Reder & Lauren Messonnier Meyers, *Delaware Chancery Court Resets the Rules of the Road for Disclosure-Only Settlements*, 69 VAND. L. REV. EN BANC 41 (2016).
2. 129 A.3d 884 (Del. Ch. Jan. 22, 2016).
3. *Id.* at 887.
4. 125 A.3d 304 (Del. 2015) ("*Corwin*"). For a discussion of the *Corwin* decision and follow-on decisions, see Robert S. Reder & Tiffany M. Burba, *Delaware Courts Confront Question Whether "Cleansing Effect" of Corwin Applies to Duty of Loyalty Claims*, 70 VAND. L. REV. EN BANC 187 (2017).

Clearly then, the quality of disclosures made to target company stockholders in connection with proposed M&A transactions can have a significant impact on the outcome of related litigation. While much rarer, acquiring company stockholders may on occasion have an opportunity to vote on transactions in which the buyer is using its stock as consideration. In such cases, the SEC's proxy rules require that detailed disclosures be made to inform the vote of these stockholders. The quality of these disclosures—or the lack thereof—will be policed by the courts when challenged by unhappy stockholders.

Recently, Chancellor Bouchard once again had an opportunity to consider the quality of disclosures made to stockholders, but this time, the challenged disclosures were made by an acquiring company to its stockholders. The stockholder vote was required under applicable Nasdaq Stock Exchange ("*Nasdaq*") rules governing the issuance of shares in M&A transactions.[5] In a letter opinion issued in *Vento v. Curry*,[6] Chancellor Bouchard took the rather unusual step of enjoining an acquiring company's stockholders meeting pending the filing of supplemental disclosures.

I. FACTUAL BACKGROUND

On December 3, 2016, Consolidated Communications Holdings, Inc. ("*Consolidated*") signed a merger agreement with FairPoint Communications, Inc. ("*FairPoint*") providing for a stock-for-stock merger under which Consolidated would acquire FairPoint. Pursuant to the merger agreement, Consolidated was "required to issue approximately 24.2 million shares of Consolidated common stock to FairPoint stockholders, who would hold approximately 28.7% of the issued and outstanding common stock of the combined company if the merger is approved."[7] The proposed issuance of shares representing at least twenty percent of Consolidated's outstanding shares of common stock obligated Consolidated to ask its stockholders for approval under Nasdaq's listing rules.

In proxy materials filed with the SEC on January 26, 2017, Consolidated "announced that a special meeting of Consolidated's stockholders would be held on March 28, 2017, to consider approving the proposed share issuance" to FairPoint stockholders (the "*Special*

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5. A Nasdaq-listed company that issues twenty percent or more of its common stock in an M&A transaction is required to obtain the approval of its stockholders as a precondition to such issuance.

6. C.A. No. 2017-0157-AGB, 2017 WL 1076725 (Del Ch. Mar. 22, 2017) ("*Vento v. Curry*").

7. *Id.* at *1.

Meeting").[8] Among other things, the proxy materials made disclosures about the dual role played by Morgan Stanley & Co. LLC and certain of its affiliates (together, "*Morgan Stanley*") on behalf of Consolidated in connection with the transaction. As Consolidated's financial advisor, Morgan Stanley issued a fairness opinion to the board of directors in support of the board's decision to approve the acquisition. And as a lender to Consolidated, Morgan Stanley "committed *to provide part* of $935 million in debt financing for the merger."[9]

In advance of the Special Meeting, a Consolidated stockholder ("*Plaintiff*") asked the Chancery Court to enjoin the Special Meeting because Consolidated's proxy materials "fail[ed] to disclose certain information relating to Morgan Stanley's conflicts of interest with respect to the proposed transaction."[10] In particular, Plaintiff complained about the disclosure concerning Morgan Stanley's overall compensation for its various roles. The proxy materials revealed that:

> Consolidated has agreed to pay Morgan Stanley a transaction fee of $13 million, which is payable upon and is contingent upon the consummation of the Merger . . . . Morgan Stanley . . . is providing to Consolidated a portion of the financing required in connection with the Merger, for which Morgan Stanley will receive *additional fees* from Consolidated.[11]

Plaintiff demanded to know the full extent of these "additional fees."

Consolidated countered that the lending fee "could be determined by piecing together information from publicly available documents" previously filed by Consolidated with the SEC.[12] *First*, Consolidated noted that a line item appearing in a table of *pro forma* adjustments in its proxy statement (the "*Pro Forma Disclosure*") listed "$14.025 million for 'financing commitment fees.' "[13] *Second*, Consolidated pointed to a Form 8-K filed the previous December (the "*Form 8-K Disclosure*") in which, "[a]bout 100 pages into that filing," Morgan Stanley "is identified as contributing 40% of the aggregate principal amount of the debt financing."[14] On this basis, Consolidated argued that its stockholders "can reasonably conclude" that Morgan Stanley would receive forty percent of $14.025 million, or $5.6 million.

Chancellor Bouchard, unpersuaded by Consolidated's argument, ordered that the Special Meeting not be held until "five days after

8. *Id.*
9. *Id.* (emphasis added).
10. *Id.*
11. *Id.* at *2 (emphasis added).
12. *Id.* at *3.
13. *Id.*
14. *Id.*

Consolidated has supplemented its disclosures to include a clear and direct explanation of the amount of financing-related fees . . . ."[15] The purpose of this disclosure was to give Consolidated stockholders "a complete picture of the facts in one place" before casting a vote on the transaction.[16]

II. CHANCELLOR BOUCHARD'S ANALYSIS

Chancellor Bouchard granted the preliminary injunction requested by Plaintiff on the basis that he had "a reasonable probability of success on the merits," "irreparable harm" would flow from the failure to grant an injunction, and "the need for protection outweighs any harm that can reasonably be expected to befall the defendants if the injunction is granted."[17] In this regard, the Chancellor considered two key questions: *first*, "whether the financial advisor's interest in the transaction was material" and, *second*, "if so, whether that interest was quantifiable."[18]

Materiality. Not even Consolidated argued that Morgan Stanley's overall compensation was not material. Given that "the magnitude of such fees would affect a voting stockholder's assessment of the independence of the financial advisor, whose 'opinion of 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,' "[19] the Chancellor had no hesitation in declaring such compensation "material."

Quantifiablity. Rather than claiming that Morgan Stanley's aggregate compensation was not quantifiable, Consolidated argued instead that any of its stockholders who read the Pro Forma Disclosure together with the Form 8-K Disclosure could calculate the fees. Chancellor Bouchard rejected this argument for two reasons:

- *First*, the Chancellor noted that just because Morgan Stanley had committed to forty percent of the acquisition

15. *Id.* at *4. Chancellor Bouchard complimented Plaintiff for "seek[ing] relief to correct the alleged disclosure deficiencies in advance of the pending stockholder vote, which is the appropriate time to do so …." *Id.* at *1. However, the Chancellor also was critical of Plaintiff "for wait[ing] an inordinate amount of time …, eighteen days after the stockholder meeting was scheduled, to file his motion for a preliminary injunction." *Id.* Because Consolidated was not "prejudiced by the delay," however, the Chancellor allowed the action to proceed despite "an unnecessarily compressed timeframe." *Id.*

16. *Id.* at *4.

17. *Id.* at *2.

18. *Id.*

19. *Id.* at *3 (citing David P. Simonetti Rollover IRA v. Margolis, C.A. No. 3694–VCN, 2008 WL 5048692 at *8 (Del. Ch. June 27, 2008)).

financing, as revealed in the Form 8-K Disclosure, stockholders could not necessarily assume that Morgan Stanley would receive forty percent of the fees. For instance, according to the Chancellor, a stockholder could reasonably conclude that "[g]iven Morgan Stanley's lead advisory role in the transaction . . . , it may have been able to extract a higher percentage of the aggregate commitment fees relative to its financing commitment."[20]

- *Second*, and more important, the Chancellor stated that "[d]isclosure is inadequate if the disclosed information is 'buried' in the proxy materials."[21] Further, a "stockholder should not have to go on a scavenger hunt to try to obtain a complete and accurate picture of a financial advisor's financial interests in a transaction."[22] Given the materiality of Morgan Stanley's overall interests in the transaction, the Chancellor saw "simply no excuse for Consolidated's failure to disclose that information in a clear and transparent manner along with related information bearing on its financial advisor's potential conflicts of interest."[23] The Chancellor ordered that this disclosure be included in a new filing.

CONCLUSION

The Chancery Court does not lightly grant equitable relief in connection with pending M&A transactions. But as Chancellor Bouchard's opinion in *Vento v. Curry* demonstrates, companies must exercise care when it comes to putting together disclosures to their stockholders in connection with votes. The Chancery Court is very protective of the stockholder franchise, and will be particularly vigilant in scrutinizing disclosures relating to financial advisor compensation and conflicts. Consolidated's *ex post* argument that stockholders could parse the language in several voluminous disclosure documents to find the information they required was too clever by half. These are hot button issues for the Chancery Court that corporations and their advisors are well advised to consider carefully when preparing disclosure documents.

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20. *Id.* at *3.

21. *Id.* (quoting Weingarden v. Meenan Oil Co, CIV. A. Nos. 7291, 7310, 1985 WL 44705 at *3 (Del. Ch. Jan. 2, 1985)).

22. *Id.* at *4.

23. *Id.*