Disclosure of Management Projections in Mergers and Acquisitions: are there any bright line rules?

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Practitioners who regularly litigate mergers and acquisitions cases know that one of the hot bed disclosure issues for plaintiffs' attorneys these days is banker fairness opinions. Shareholder complaints generally center on disclosure claims which allege that the proxy statement omits a litany of purportedly material information concerning the banker's analysis. Often at the center of these allegations is the disclosure of management projections. While plaintiffs advocate a bright line rule which would require disclosure of all management projections in every case, Delaware courts have not universally adopted that rule. This article explores the question of whether management projections must always be disclosed in connection with M&A activity.

Delaware Disclosure Law

The duty of disclosure under Delaware law requires that directors "'disclose fully and fairly all material information within the board's control....'"[2] Borrowing from federal law, the Delaware Supreme Court has stated: "[o]mitted facts are material if there is a substantial likelihood that a reasonable stockholder would consider them important in deciding how to vote."[3] "Omitted facts are not material simply because they might be helpful. To be actionable, there must be a substantial likelihood that the undisclosed information would significantly alter the total mix of information already provided."[4]

Moreover, "Delaware law does not require disclosure of inherently unreliable or speculative information which would tend to confuse stockholders or inundate them with an overload of information."[5] Thus, "[i]n determining what information must be disclosed to shareholders, directors must perform 'a careful balancing of the potential benefits of disclosure against the possibility of resultant harm.'"[6]

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[2] *Skeen v. Jo-Ann Stores, Inc.*, 750 A.2d 1170, 1172 (Del. 2000) quoting *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1997).

[3] *Id.* at 1172 (internal citation omitted).

[4] *Id.* at 1174.

[5] *Arnold v. Soc'y for Savings Bancorp, Inc.*, 650 A.2d 1270, 1280 (Del. 1994).

[6] *In re Micromet, Inc. S'holders Litig.*, No. 7197-VCP, 2012 WL 681785, at *13 (Del. Ch. Feb. 29, 2012) quoting *Arnold*, 650 A.2d at 1279.

Against this backdrop, Delaware courts have long recognized that there is no per se duty to disclose financial projections to shareholders in connection with a merger or acquisition.[7] The last time it spoke on this issue, the Delaware Supreme Court upheld the Court of Chancery's dismissal of disclosure claims premised on the defendants' failure to disclose management projections in a cash out merger. In rejecting the plaintiffs' claims, the Delaware Supreme Court specifically rejected the plaintiffs' argument that shareholders must be given all financial data they might need in order to perform an independent valuation, including management projections.[8]

In recent years, however, the Delaware Court of Chancery has required disclosure of management's projections, especially if those projections formed the basis of a banker fairness opinion. However, the Court of Chancery has also made clear that "context matters" and the "materiality of any fact, projection, or figure cannot be divorced from the particular circumstances facing the defendant company and the challenged transactions."[9]

Disclosure Required

The case often cited by plaintiffs in favor of a bright-line rule requiring disclosure of projections is *Netsmart Tech. Shareholders Litigation,* in which then-Vice Chancellor Strine enjoined a merger because the proxy failed to disclose the projections relied upon by Netsmart's banker in rendering the fairness opinion.[10] In holding the omission of the projections to be material, then-Vice Chancellor Strine stressed that "projections of this sort are probably among the most highly-prized disclosures by investors. Investors can come up with their own estimates of discount rates (or as discussed) market multiples. What they cannot hope to do is replicate management's view of the company's prospects."[11]

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[7] *McMillan v. Intercargo Corp.*, No. CIV. A. 16963, 1999 WL 288128, at *6-7 (Del. Ch. May 3, 1999) (rejecting disclosure claims where plaintiffs did not show that the projections were of "sufficiently reliable evidence of value that their disclosure was required") (internal citation omitted).

[8] *Skeen,* 750 A.2d at 1174. Notably, there was no allegation that bankers had relied upon the projections at issue.

[9] *In re Midas, Inc. S'holders Litig.*, CA No. 7346-VCP, at 18 (Del. Ch. Apr. 12, 2012) (TRANSCRIPT).

[10] *In re Netsmart Tech. Inc. S'holders Litig.*, 924 A.2d 171 (Del. Ch. 2007)

[11] *Id.* at 203; *see also id.* at 200 ("When stockholders must vote on a transaction in which they would receive cash for their shares, information regarding the financial attractiveness of the deal is of particular importance. This is because the stockholders must measure the relative attractiveness of retaining their shares versus receiving a cash payment, a calculus heavily dependent on the stockholders' assessment of the company's future cash flows.").

Then-Vice Chancellor Strine expanded on his *Netsmart* analysis in his 2010 decision in *Maric Capital Master Fund, Ltd. v. Plato Learning, Inc.*[12] Plato's proxy statement had disclosed the projections that Plato's management provided to its banker, but selectively excluded the free cash flow estimates. While recognizing that "reasonable minds may differ on this issue," then-Vice Chancellor Strine enjoined the merger, stating that, "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."[13]

Vice Chancellor Laster echoed these sentiments in *In re Burlington N. Santa Fe S'holder Litig.*[14] In awarding fees to plaintiffs who had negotiated a settlement with defendants and obtained disclosure of various management projections relied upon by Goldman Sachs, Vice Chancellor Laster was clear: "I like projections. I like to see people disclosing projections. I think they're material. I think people ought to have them in there."[15]

Disclosure Not Required

While *Netsmart, Plato Learning*, and *Burlington* may suggest a bright line rule, other Delaware opinions have taken a more nuanced approach.

In *In re Checkfree,*[16] former-Chancellor Chandler refused to enjoin a merger on the grounds that defendants had failed to disclose management projections utilized by Goldman Sachs in evaluating the fairness of the merger. He distinguished the holding in *Netsmart*, noting that the Netsmart proxy had affirmatively disclosed an earlier misleading version of management's

[12] *Maric Capital Master Fund, Ltd. v. Plato Learning, Inc.*, 11 A.3d 1175 (Del. Ch. 2010).

[13] *Id.* at 1178.

[14] *In re Burlington N. Santa Fe S'holder Litig.*, C.A. No. 5043-VCL, at 31 (Del. Ch. Oct. 28, 2010) (TRANSCRIPT).

[15] *See also Gaines v. Narachi*, No. 6784-VCN, 2011 WL 4822551, at *2 (Del. Ch. Oct. 6, 2011) ("This Court has stated that shareholders who are being advised to cash out are entitled to the best estimate of the company's future cash flows."); *Dias v. Purches*, No. 7199VCG, 2012 WL 4503174, at *2 (Del. Ch., Oct. 1, 2012) ("[T]his Court has held that '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.'") (internal citation omitted); *In re Hiland Partners, LP Unit Holders Litig.*,C.A. No. 4397-VCS, at 23-24 (Del. Ch. Sept. 11, 2009) (TRANSCRIPT) ("[M]y understanding of corporate finance ... 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.").

[16] *In re Checkfree Corp. S'holders Litig.*, No. 3193-CC, 2007 WL 3262188 (Del. Ch. Nov. 1, 2007).

projections and "[o]nce a board broaches a topic in its disclosures," complete disclosure is required.[17] In contrast, the Checkfree proxy did not purport to disclose the projections at issue and, in fact, warned of their inaccuracy. As such, disclosure was not mandated.

In *Midas,* Vice Chancellor Parsons took a similar limited view of *Netsmart,* noting "Netsmart teaches that when a company discloses any set of management projections, those projections should be complete and should be the most up-to-date projections on which the investment bankers rely."[18] He further rejected plaintiffs' argument that *Plato Learning* mandated disclosure of free cash flow projections in every situation. Rather, he viewed *Plato Learning* as establishing a standard that "management must disclose those projections that are most relevant to the question of whether the price being offered now provides fair compensation for the benefits the shareholder will receive as a stockholder from the future expected cash flows of the corporation if the corporation remains as a going concern."[19] Vice Chancellor Parsons refused to enjoin the tender offer because plaintiffs had not made this showing with respect to the free cash flows at issue.

In *David P. Simonetti Rollover IRA v. Margolis,* Vice Chancellor Noble echoed *Netsmart*'s sentiments regarding the import of projections to shareholders.[20] Ultimately, he found no disclosure violation, however, because the proxy at issue actually disclosed the projections relied upon by the banker in the fairness opinion. Vice Chancellor Noble rejected plaintiff's argument that defendants were also required to include more optimistic projections prepared by management thereafter, upon which the banker did not rely.

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[17] *Id.* at *3 quoting *In re Netsmart Tech., Inc. S'holders Litig.,* 924 A.2d 171, 203 (Del. Ch. 2007); *see also Netsmart,* 924 A.2d at 203 ("The conclusion that this omission is material should not be surprising. 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. For this reason, when 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. Only providing some of that information is insufficient to fulfill the duty of providing a fair summary of the substantive work performed by the investment bankers upon whose advice the recommendations of the board as to how to vote rely.") (citations omitted).

[18] *In re Midas*, C.A. No. 7346-VCP, at 20.

[19] *Id.* at 20-21("Nothing in [the *Plato Learning*] opinion, however, suggests that free cash flows, in particular, must always be disclosed.").

[20] *David P. Simonetti Rollover IRA v. Margolis*, No. 3694-VCN, 2008 WL 5048692, at *10 (Del. Ch. June 27, 2008) ("[t]he key assumptions made by a banker in formulating his opinion are of paramount importance to the stockholders because any valuation analysis is heavily dependent upon the projections utilized … Delaware law places a premium on management's predictions of future performance).

Former Chancellor Chandler rejected a similar attempt to expand the reach of projections disclosures in *In re 3com*.[21] As in *Margolis*, defendants had disclosed the main management projections relied upon by the bankers, but plaintiffs wanted additional disclosure of cash flow, EBIT and EDBITDA. In denying a motion for expedited proceedings, the court held that no further disclosure was required, noting that "[a] disclosure that does not include all financial data needed to make an independent determination of fair value is not … *per se* misleading or omitting a material fact."[22]

Most recently, in *Dent v. Ramtron Int'l Corp.*,[23] Vice Chancellor Parsons again departed from *Netsmart* and refused to enjoin a merger, despite defendants' failure to disclose projections that were relied upon by Ramtron's banker in preparing its discounted cash flow analysis. Relying on the Delaware Supreme Court's decision in *Skeen v. Jo-Ann Stores*, which also involved a cash out merger by a majority shareholder, the Court rejected plaintiffs' disclosure claims because "there [we]re no facts suggesting that the undisclosed information is inconsistent with, or otherwise significantly differs from, the disclosed information."[24] In rejecting plaintiffs' arguments that the projections were material, the Court noted that shareholders could discern from the DCF analysis, which valued the stock at $3.57 to $5.01 per share, that the underlying projections supported a higher price. The Court also noted that the deal was originally a hostile one, that Ramtron's board continuously rejected Cypress's offers and attempted to obtain a higher price, but that no other company ultimately expressed an interest in buying Ramtron at any price.

Thoughts For The Future

While the Delaware Court of Chancery does not appear to have reached a consensus on any bright line rules involving the disclosure of projections, certain members of the Court have clearly exhibited a strong preference for such disclosure, particularly in cases where those projections are relied upon by the company's bankers in analyzing the fairness of the transaction. Some helpful rules of thumb:

1) Courts will generally require disclosure of management projections relied upon by bankers in rendering their fairness opinions;

2) Courts will certainly require disclosure of management projections relied upon by bankers if any projections are disclosed to shareholders;

3) Courts are less likely to require disclosure of "optimistic" or outdated management projections upon which the company's banker did not rely in rendering a fairness opinion;

4) Courts are more likely to require disclosure of reliable projections created as part of standard operating procedure;

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21 *In re 3com S'Holders Litig.*, No. 5067-CC, 2009 WL 5173804 (Del. Ch. Dec. 18, 2009).

22 *Id.* at *3 (internal citation omitted).

23 *Dent v. Ramtron Int'l Corp.*, C.A. No. 7950-VCP (Del. Ch. Nov. 19, 2012) (TRANSCRIPT).

24 *Id.* at 69.

5) Courts are less likely to require disclosure of projections where shareholders are only evaluating whether to seek appraisal;

6) Courts are likely to require more intensive valuation disclosures in "friendly" deals and those transactions that do not follow a robust auction process.