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Boards of Directors May Be Required to Disclose Reasons Behind Financial Advisor Withdrawal

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In a prior client alert (available at: https://www.pepperlaw.com/publications/boards-of-directors-may-be-required-to-disclose-reasons-behind-a-directors-vote-abstention-2018-03-28/), we discussed a decision by the Delaware Supreme Court, *Appel v. Berkman*, in which the court held that the board's failure to disclose the reasons why the chairman of the board abstained from voting on a proposed tender offer rendered the proxy statement regarding the tender offer misleading.

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On February 27, 2020, the Court of Chancery issued a similar ruling regarding a financial advisor's termination of its engagement in connection with a proposed merger.[1] The court held that the failure to disclose the reasons why the financial advisor withdrew from its engagement just days after it was retained to evaluate the fairness of the merger rendered the proxy statement issued in connection with that merger misleading. The decision, like the Supreme Court's decision in *Appel*, serves as a stark reminder that proxy statements and other disclosures issued in connection with a stockholder vote on a transaction may be rendered misleading by the failure to disclose divergent viewpoints of directors, advisors and high-ranking officers regarding the fairness of a proposed transaction.

Background and Analysis

In September 2018, a group of investors — referred to in the opinion as the iSubscribe Investor Group — proposed a transaction with Intersections, Inc., an identity protection services company. In the transaction, the investor group would purchase Intersections and, along with some of the existing stockholders, cash out the remaining stockholders and take the company private. After some initial negotiations, Intersections formed a special committee to evaluate the investor group's offer.

To assist in that endeavor, the committee hired counsel and a "nationally recognized investment banking firm" as its financial advisor for the proposed transaction. Just days after its retention, however, the investment banking firm abruptly terminated its engagement. Thereafter, the committee retained North Point Advisors to evaluate the transaction. North Point provided an opinion declaring the transaction fair to Intersections' stockholders eight days later.

The merger agreement was signed on October 31, 2018, and Intersections issued its proxy statement seeking approval of the merger on November 29, 2018. The proxy statement disclosed that the first investment bank retained by the committee withdrew several days after it was engaged by the committee, but it did not disclose why.

On January 22, 2019, certain stockholders of Intersections filed suit challenging the merger. The stockholders claimed that some of Intersections' directors breached their fiduciary duties by approving the merger. The director defendants moved to dismiss. One of the grounds that the director defendants asserted in favor of dismissal was a *Corwin*[2] defense — the director defendants argued that the merger must be reviewed under the

deferential business judgment rule because it was approved by a fully informed, uncoerced vote of disinterested stockholders. The plaintiff stockholders argued that the stockholder vote was insufficient to cleanse the merger and warrant business judgment review because, among other things, the proxy statement failed to disclose the reasons why the first investment banking firm retained by the committee terminated its engagement just days after being retained. The court agreed with the stockholder plaintiffs, at least at the pleading stage.

In issuing its ruling, the court explained that, when soliciting stockholder approval of a transaction, "a company ought to put itself in the shoes of what its own decision-makers would want to know" and that "stockholders should not be expected to speculate about facts any reasonable board advisor or director would find to be of importance." Under that rubric, the court found that the reasons why the investment banking firm terminated its engagement just days after being retained to evaluate the fairness of a proposed merger was information that a reasonable board advisor or director would want to know, and therefore should have also been disclosed to stockholders. For that reason, the court rejected the defendant directors' *Corwin* defense and denied the director defendants' motion to dismiss the complaint.

Takeaway

Delaware law gives significant, and in some cases dispositive, weight to stockholders' expressions of their will in connection with a proposed transaction. Indeed, outside of the controlling stockholder context, a fully informed, uncoerced stockholder vote of the disinterested stockholders in favor of a transaction will cleanse that transaction and trigger business judgment review. As explained in the Court of Chancery's decision in *Salladay*, however, stockholder approval will cleanse a transaction only to the extent that decision is made on a fully informed basis.

A stockholder vote will not be considered to be fully informed when the disclosures made in connection with that vote misrepresent or omit a material fact regarding the proposed transaction. Under Delaware law, there are no bright-line rules regarding whether a particular fact is material and must be disclosed. That said, Delaware courts leave no doubt that, in making these decisions, boards of directors should consider whether their own decision-makers, including the directors and high-ranking officers, and their advisors would want to know that information in evaluating the transaction. Under that standard, a director's or an advisor's contrary viewpoint regarding the fairness of a transaction and the reasons for maintaining that viewpoint are likely material information that needs to be disclosed to stockholders.

Endnotes

1 *Salladay v. Lev*, C.A. No. 2019-0048-SG (Del. Ch. Feb. 27, 2020).

2 *Corwin v. KKR Fin. Holdings, LLC*, 125 A.3d 304 (Del. 2015).