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Delaware Chancery Court Enjoins Stockholder Vote For Lack Of Adequate Disclosures In Proxy Statement

In *Maric Capital Master Fund, Ltd. v. PLATO Learning, Inc.*, C.A. No. 5402-VCS (Del. Ch. May 13, 2010), the Court of Chancery of the State of Delaware granted plaintiff Maric Capital Master Fund's ("Maric") motion for a preliminary injunction to halt a stockholder vote on a proposed merger in which Thoma Bravo, LLC ("Thoma Bravo") would acquire PLATO Learning, Inc. ("PLATO"). Although the court held that Maric failed to demonstrate a likelihood of success on the merits of its assertion that the directors of PLATO failed to meet their duties under *Revlon, Inc. v. McAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), the court nonetheless enjoined the vote based upon a determination that three specific disclosures in the proxy statement were materially misleading. The court ordered that corrective disclosures on those items be issued before the vote could proceed. This decision reflects the Chancery Court's efforts to ensure that proxy disclosures in advance of stockholder votes are not materially misleading.

Maric was a stockholder of PLATO. Shortly after the proposed merger was announced, it filed an action seeking to enjoin the transaction, alleging that the directors of PLATO failed to comply with their *Revlon* duty to maximize share value in connection with the $5.60 per share price obtained for PLATO stock. Maric also alleged that the proxy statement issued by PLATO was materially misleading. The parties engaged in expedited proceedings, leading to a preliminary injunction hearing just one week before the scheduled vote.

The court rejected Maric's *Revlon* argument, holding that Maric failed to meet its burden of demonstrating a likelihood of success on the merits of the claim. Turning to the disclosure claims, the court found that three specific statements or omissions in PLATO's proxy statement to be materially misleading and so enjoined the stockholder vote on the proposed merger pending the dissemination of corrective disclosures.

First, the court held that the proxy statement presented a materially misleading description of how the investment bank that provided the PLATO board with a fairness opinion came to its determination of value. In performing its discounted cash flow valuation, the financial adviser used a discount rate determined by adding additional premiums (illiquidity and micro cap premiums) to the calculated cost of capital of the company. The proxy statement disclosed the range of discount rates used, as did the discussion materials provided to the special committee, but the special committee apparently was not told why the financial adviser was using a discount rate higher than the company's calculated cost of capital. The court held that disclosure of the additional premiums to the cost of capital calculation and the discount rates deemed appropriate and used by the financial adviser were not sufficient to provide investors with complete information. The court held that PLATO should have disclosed the valuation ranges that would have resulted from using discount rates equal to the calculated cost of capital.

Second, the court determined that the proxy statement selectively disclosed projections relating to PLATO's future performance. In particular, the proxy statement disclosed management's estimates of revenue, gross profit, operating income and net income, but omitted management's estimates of free cash flow. The court found this omission "odd." The court opined 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," and thus, until that information is available to stockholders, the merger should be enjoined.

Third, and finally, the court held that the proxy statement did not provide sufficient information about the discussions between management and the prospective purchaser regarding the retention of existing management. The original proxy statement disclosure explained that "[i]n reaching their decision to approve the merger and the merger agreement," PLATO's special committee and board considered "the fact that Thoma Bravo did not negotiate terms of employment, including any compensation arrangements or equity participation in the surviving corporation, with [PLATO's] management for the period after the merger closes." The court referred to handwritten notes and other documents indicating that while PLATO's CEO and Thoma Bravo did not engage in "formal negotiations," they *did* have "extended discussions" where the typical equity incentive package given by Thoma Bravo to management was indeed discussed. Hence, the court held that the proxy statement created a materially misleading impression that management was given no expectations regarding the treatment they could receive from Thomas Bravo. The court ordered the proxy statement to be corrected to clarify the extent of actual discussions between PLATO's CEO and Thoma Bravo. Until corrective disclosures were made on the three aforementioned issues, the merger was enjoined.

The Maric Capital decision provides helpful guidance regarding the frequently litigated subject of financial adviser work product descriptions in proxy statements, while also reaffirming the Chancery Court's views on the importance of disclosing management projections for potential acquisition transactions. The opinion also highlights disclosure issues lurking in pre-signing discussions between potential acquirers and management regarding post-closing employment.

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