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Mergers & Acquisitions Alert

Maric Capital: Delaware Court of Chancery Halts Merger on Duty of Disclosure Grounds

" . . . once timely and satisfactory disclosures are made in a way that gives . . . stockholders adequate opportunity to digest them before a final merger vote, the injunction will be lifted"

– Vice Chancellor Leo J. Strine, Jr.¹

On May 13, 2010, Vice Chancellor Strine of the Delaware Court of Chancery issued an opinion in *Maric Capital Master Fund, Ltd. v. PLATO Learning, Inc.*, an opinion that provides important guidance for those in the mergers and acquisitions industry, including those involved in public company deals.² In *Maric Capital*, a pending merger was enjoined because the proxy statement issued ahead of a stockholder vote was found by the court both to contain materially misleading information and to omit material information.³ The decision in *Maric Capital* was based upon the fiduciary duty of disclosure under Delaware law. Notably, in addressing the disclosures required under Delaware law, the decision highlights the dual role played by Delaware law and federal securities law in regulating disclosure to public company stockholders.⁴

Under Delaware law, the duty of disclosure (which is also referred to as the duty of candor) is a somewhat ethereal concept that has developed over several decades.⁵ Although it is termed as a separate "duty," Delaware courts today treat it as a specific application of both the duties of care and loyalty, instead of as a distinct fiduciary duty.⁶ Under this disclosure duty, directors are required to disclose, accurately, fully and fairly, all material facts when seeking stockholder approval; for example, the approval of a merger.⁷ Generally, information is "material" if there is a substantial likelihood that a reasonable stockholder would consider such information important in voting on the issue in question.⁸

In *Maric Capital*, the court addressed three different disclosure issues in rendering its decision, as follows⁹:

- **Discount Rate used for DCF Valuation:** The court held that the description in the proxy statement of how the investment bank involved in the deal arrived at its discount rate was materially misleading.¹⁰ The proxy statement stated the investment bank arrived at the discount rate based upon an analysis of the target's weighted average cost of capital.¹¹ The court found, however, that the discount rate was based on other calculations that, in actuality, yielded a discount rate below the discount rate that was stated in the proxy statement.¹² Because this higher discount rate was used, the deal price appeared more favorable than if the lower discount rate had been used, a fact that "bears materially on the decision to be made by" the acquirer's stockholders.¹³

The court held that since the proxy statement addressed the discount rate, "there was a duty to do so in a non-misleading fashion."¹⁴

- **Failure to Disclose Free Cash-Flow Estimates:** The court held that because management's best estimate of future cash flows was not included in the proxy statement, the proxy statement omitted material information.¹⁵ The court noted that, because "corporate finance theory" dictates that the value of stock should be based on future cash flows, management's estimates as to such cash flows is material information that should be disclosed.¹⁶ Because the fairness of the price offered for the stock *vis-à-vis* the valuation of such stock is of material importance to stockholders in voting on a merger, the court enjoined the merger until the cash-flow estimates were disclosed in the proxy statement.¹⁷
- **Disclosure of Arrangements with Incumbent Management:** The court held that the proxy statement contained a material misstatement in stating that the acquirer did not negotiate post-closing terms of employment with the target's incumbent management.¹⁸ According to the court, this suggestion was incorrect because there had been "extended discussions" with incumbent management about the typical equity incentive package given to incumbent management by the acquirer in other transactions, and incumbent management had the expectation that it would be given similar incentives by the acquirer post-closing.¹⁹ Therefore, the court held that the proxy statement was materially misleading until the extent of actual discussions was clarified in the proxy statement.²⁰

Therefore, the court imposed an injunction until such time as "satisfactory disclosures" are given to the target's stockholders, and they have an "adequate opportunity to digest them" before voting.²¹

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The holding in *Maric Capital* provides important guidance for making disclosures to stockholders prior to stockholder votes. Practitioners and parties should be sure that not only is the information provided in such disclosures accurate, full and fair, but also that such disclosures do not omit material information in any way. Most notably, *Maric Capital* teaches that future cash-flow estimates should be included in any disclosure regarding the value of stock, and that information provided about valuation analysis and discussions with incumbent management must be sufficiently accurate and fulsome. Moreover, the decision in *Maric Capital* reminds public company merger parties of the dual role played by Delaware law and federal securities law in regulating disclosure to stockholders. As demonstrated by the decision in *Maric Capital*, assuring that disclosures are accurate, full and fair is important for avoiding subsequent litigation and transaction delays.

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1. *Maric Capital Master Fund, Ltd. v. PLATO Learning, Inc.*, C.A. No. 5402-VCS, May 13, 2010 Memorandum Opinion, page 5 (Del. Ch. 2010).
 2. *Maric Capital Master Fund, Ltd.*, C.A. No. 5402-VCS, May 13, 2010 Memorandum Opinion.
 3. *Id.*
 4. *Id.*
 5. See, e.g., *In Re Transkaryotic Therapies, Inc.*, 954 A.2d 346 (Del. Ch. 2010).
 6. *Id.* at 357.
 7. See, e.g., *Id.*; *Skeen v. Jo-Ann Stores, Inc.*, 750 A.2d 1170, 1172 (Del. 2000).
 8. *Skeen*, 750 A.2d at 1172.
 9. *Maric Capital Master Fund, Ltd.*, C.A. No. 5402-VCS, May 13, 2010 Memorandum Opinion.
 10. *Id.* at 2-5
 11. *Id.*
 12. *Id.*
 13. *Id.*
 14. *Id.*
 15. *Id.* at 5-6.
 16. *Id.*
 17. *Id.*
 18. *Id.* at 6-8.
 19. *Id.*
 20. *Id.*
 21. *Id.* at 8.

→ [William E. Doran](#)

→ [Lori L. Lasher](#)

→ [Nicholas A. Long](#)

→ [Catharina Y. Min](#)

Partner, Chicago
+1 312 207 6412

Partner, Philadelphia
+1 215 851 8136

Partner, Chicago
+1 312 207 3877

Partner, Silicon Valley
+1 650 352 0526

→ [Jonathan P. Moyer](#)
Associate, Philadelphia
+1 215 851 8115

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