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Chancery Court: Disclosure Claims Should Be Brought Before Closing

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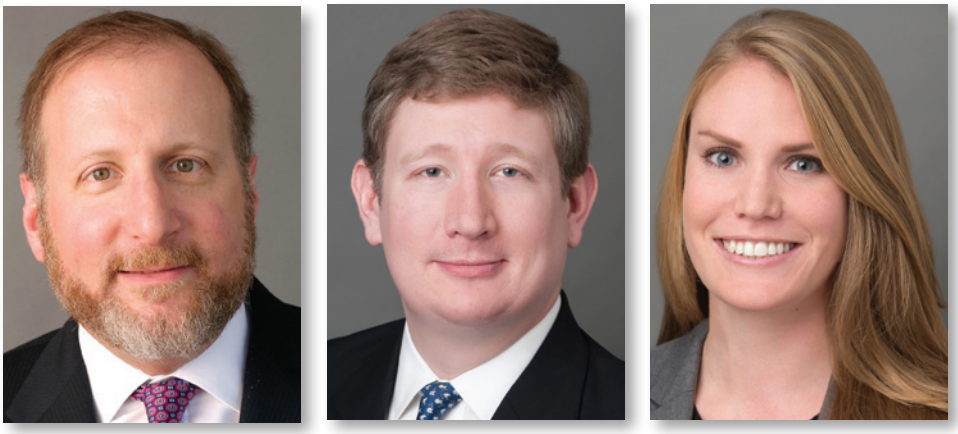

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In a recent ruling, the Delaware Court of Chancery made clear that claims based on allegedly inadequate disclosures brought after a merger closes face an exacting standard on a motion to dismiss. Vice Chancellor Sam Glasscock III in *Nguyen v. Barrett*, C.A. No. 11511-VCG,rejected the assertion that plaintiffs with a pre-closing disclosure claim can choose to bring the claim post-closing without repercussion—clarifying that the "preferred method for vindicating truly material disclosure claims is to bring them pre-closing, at a time when the court can ensure an informed vote." Glasscock further opined that a rule that disclosure claims "pleaded but not pursued pre-close" are waived would be "salutary."

Background

The lawsuit arose from the October 2015 acquisition of Millennial Media Inc. by AOL Inc. Plaintiff An Nguyen, on behalf of a class of Millennial stockholders, brought a pre-closing action challenging the acquisition based on allegedly deficient disclosures by Millennial. Nguyen's initial complaint identified nearly 30 disclosures, but he moved for a preliminary injunction based on only his "most serious" claim—that Millennial selectively disclosed its cash flow projections. Glasscock denied the preliminary injunction, finding that Nguyen failed to demonstrate that the projections were materially misleading, and the merger closed. Nguyen moved for certification of an interlocutory appeal to the Delaware Supreme Court, which Glasscock denied. The Delaware Supreme Court subsequently denied Nguyen's appeal.

In January 2016, Nguyen amended his complaint. Because the transaction had already closed, Nguyen sought money damages through the available remedy of quasi-appraisal for two allegedly deficient disclosures. The first disclosure claim substantially restated Nguyen's already rejected argument that Millennial inadequately disclosed its cash flow projections. The second disclosure claim alleged that Millennial failed to disclose the degree to which the financial adviser's fee was contingent upon the successful completion of the merger. Nguyen had pleaded this allegedly insufficient disclosure in his earlier complaint, but failed to pursue it in his motion for a preliminary injunction.

Pre- and Post-Closing Disclosure Claims

Before evaluating the defendants' motion to dismiss, the court emphasized the high burden faced by the plaintiffs who bring disclosure claims after closing. The court stated that a plaintiff asserting a pre-closing disclosure claim in a motion for a preliminary injunction must demonstrate only "a reasonable likelihood

of proving that the alleged omission or misrepresentation is material." But a plaintiff bringing a post-closing disclosure claim for damages against directors "must allege facts making it reasonably conceivable that there has been a non-exculpated breach of fiduciary duty by the board in failing to make a material disclosure." In the present case, where the board was protected by exculpatory provisions pursuant to Delaware General Corporation Law Section 102(b)(7), Nguyen had to allege a breach of the duty of loyalty, meaning that a majority of the board was not disinterested or that the board was otherwise disloyal. The latter requires an "extreme set of facts" demonstrating that the disinterested directors "intentionally disregarded their duties or that the decision ... was so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith." Only by satisfying these burdens, will a plaintiff bringing post-closing disclosure claims survive a motion to dismiss, and be permitted to seek quasi-appraisal.

The court found that both of Nguyen's claims failed to meet these heightened standards. With respect to the allegedly insufficient financial disclosures, the court found that Nguyen had not alleged facts sufficient to establish that it was "reasonably conceivable" that the board members breached their duty of loyalty. Indeed, the only conflict alleged by Nguyen was that six directors stood to gain from stock options that vested upon completion of the transaction. The court found that this alleged conflict was insufficient as a matter of law because the stock options aligned the interests of the directors and the stockholders.

With respect to the disclosures related to the financial adviser's fee, the court first addressed whether that claim was waived when Nguyen pleaded it but failed to pursue a preliminary injunction. Nguyen argued that Delaware has recently established a "new 'regime' under which a plaintiff can elect to bring disclosure claims pre- or post-close." The court disagreed. Indeed, the court counseled it would be beneficial to establish a rule that a plaintiff who has a pre-closing claim but fails to bring it at that time waives it. Such a rule would incentivize plaintiffs to bring disclosure claims at the "preferred" time—"pre-close, at a time when the court can insure an informed vote." The court did not decide the waiver issue, however, instead dismissing the claim because Millennial's disclosure, that a "substantial portion" of the financial adviser's fee was contingent, was sufficient under well-established precedent.

Nguyen follows a slew of decisions over recent years from Delaware courts that impose high burdens on plaintiffs who bring post-closing damages suits, particularly when there has been approval by disinterested shareholders, which permits invocation of the business judgment rule, as in *Singh v. Attenborough*, 137 A.3d 151 (Del. 2016) (en banc) (business judgment deference given to transactions approved by a fully informed stockholder vote); and in *Corwin v. KKR Financial Holdings*, 125 A.3d 304, 314 (Del. 2015) ("where the stockholders have had the voluntary choice to accept or reject a transaction, the business judgment rule standard of review is the presumptively correct one"); in *In re Volcano Stockholder Litigation*, 143 A.3d 727, 738 (Del. Ch. 2016), ("business judgment rule irrebuttable" when approved by majority of "fully informed, uncoerced, disinterested stockholders"); in *Larkin v. Shah*, C.A. No. 10918-VCS, 2016 (Del. Ch. Aug. 25, 2016). *Nguyen* also provides additional guidance that plaintiffs with pre-closing disclosure claims should bring such claims pre-closing in order to provide the court and the stockholders with a meaningful opportunity to assess the value of the disclosures. That avenue, according to Glasscock, is preferable—as "a stockholder's right to a fully informed vote" is "irretrievably lost" otherwise. •

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