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Corporate Governance Group Client Alert

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DELAWARE COURT PROVIDES USEFUL GUIDANCE CONCERNING CONTESTED DISCLOSURES IN M&A PROXY STATEMENT

In *In re 3Com Shareholders Litigation*,[1] the Delaware Court of Chancery recently denied plaintiffs' motion to expedite discovery in their effort to stop the proposed acquisition of 3Com Corporation by Hewlett Packard Company. The plaintiffs based their effort (in part) on alleged inadequate disclosures in the proxy statement to be used by 3Com to solicit shareholder votes in favor of the transaction. In connection with its ruling that "plaintiffs have failed to state colorable disclosure claims," the Court provided useful guidance concerning issues that often arise in the preparation of M&A-related disclosure documents.

Background

Late last year, the board of directors of 3Com approved an all-cash merger in which 3Com would be acquired by Hewlett Packard. In approving the transaction, the 3Com board relied in part on a presentation by its financial advisor, Goldman Sachs, concerning the fairness (from a financial point of view) of the $7.90 per share payable to 3Com shareholders in the merger. On December 4, 2009, 3Com filed a proxy statement with the Securities and Exchange Commission which included the board's recommendation that 3Com shareholders vote in favor of the merger, Goldman's opinion and a summary of Goldman's analysis.

[1] Civil Action No. 5067-CC (Del. Ch. Dec. 18, 2009).

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Soon thereafter, various 3Com shareholders sought to preliminarily enjoin the transaction, and asked the Court for expedited discovery in order to gather the facts necessary to support that effort. In support of its motion, the plaintiffs alleged that the 3Com proxy statement failed to disclose (i) a "meaningful description" of the projections used by management and by Goldman; (ii) management's downward revision of its projections after Hewlett Packard made its offer; (iii) valuations of each of 3Com's three operating units; (iv) 3Com's stand-alone plan and strategic alternatives considered by the board as an alternative to the merger; and (v) that Goldman deviated from "accepted" valuation practices and the methodology used in valuing a previous attempted buyout of 3Com.

The Court denied plaintiffs' motion.[2]

The Court's Analysis

The Court began by noting that the key issue to be resolved was "whether there is a colorable claim that any of plaintiffs' alleged disclosure allegations are material." Next, the Court explained that in determining whether there is such a colorable claim, "an omitted fact is material if a reasonable stockholder would consider it important in a decision pertaining to his or her stock" by "significantly alter[ing] the total mix of information available to stockholders." The Court also noted, however, that "'[o]mitted facts are not material simply because they are helpful.' So long as the proxy statement, viewed in its entirety, sufficiently discloses and explains the matter to be voted on, the omission or inclusion of a particular fact is generally left to management's business judgment."

Description of Projections

With respect to plaintiffs' claim that the proxy statement's summary description of the projections contained material omissions – including cash flow measures, EBIT measures and EBITDA measures – the Court observed that the proxy statement contained a "thorough description regarding the process … [management] went through to obtain the Merger price, adequately explains why they believe the Merger price is fair ... and thoroughly summarizes the work done by Goldman in rendering its fairness opinion." Rejecting the notion that "full versions of the summarized projections must be included," the Court added that it was "reluctant to require full disclosure of the projections underlying such summaries as I do not believe it would alter the total mix of available information and may even undermine the clarity of the summaries."

Management's Revised Projections

Plaintiffs claimed that 3Com management revised its projections downward, *after* receiving Hewlett Packard's $7.90 per share all-cash offer, in order "to make HP's offer look more appealing, and attacked the proxy statement for failing to disclose the reasons for that revision." The Court, recognizing "no rule that

[2] In addition to the disclosure claims, plaintiffs alleged that 3Com's board breached its fiduciary duties by (a) approving the inclusion in the merger agreement of (i) no-solicitation and matching right provisions and (ii) a termination fee and expense reimbursement representing over 4% of the equity value of the merger, and (b) "failing to make an effort to solicit other buyers before entering the Merger agreement." The Court noted that the deal protection measures are provisions that "this Court has repeatedly held ... are standard merger terms, are not *perse* unreasonable, and do not alone constitute breaches of fiduciary duty." The Court also noted that not only had plaintiffs failed to explain how the challenged provisions prevented a competing offer, but that no other bidders had in fact emerged.

precludes management or its financial advisor from using alternative sets of financial projections in evaluating the advisability and fairness of a merger," noted that the proxy statement "disclosed both sets of projections … and clearly explained that both were used." As such, "[a] further explanation … would not significantly alter the total mix of information available to stockholders."

Operating Unit Disclosure

The Court held that management's failure to include information concerning the value of 3Com's three operating segments in the proxy statement was not actionable because plaintiffs had not alleged that such information was utilized by Hewlett Packard in making its offer to 3Com. Similarly, the Court found that the question whether Goldman should have conducted a "sum-of-the-parts" analysis as part of its valuation of 3Com "is best left to the discretion of investment bankers and company management." In the Court's view, plaintiffs' complaint represented "a mere disagreement with the fairness opinion that can be adequately addressed by an appraisal action" under Section 262 of the Delaware General Corporation Law.

3Com's Stand-Alone Plan and Other Strategic Alternatives

The Court was not troubled by the failure of the proxy statement to include a discussion of 3Com's alternatives to the Hewlett Packard merger. In analyzing this alleged deficiency, the Court clearly distinguished the roles and responsibilities of management versus shareholders. According to the Court, "Delaware law does not require management 'to discuss the panoply of possible alternatives to the course of action it is proposing ….' This is consistent with the principle that too much information can be as misleading as too little. Moreover, under our law stockholders have a veto power over fundamental corporate changes (such as a merger) but entrust management with evaluating the alternatives and deciding which fundamental changes to propose."

Goldman's Valuation Methodology

The Court addressed plaintiffs' claim that the proxy statement should have disclosed "why Goldman deviated from accepted practices" by noting that the Delaware standard for reviewing valuation work of an investment banker is that the valuation "must be accurately described and appropriately qualified. So long as that is done, there is no need to disclose any discrepancy between the financial advisor's methodology and the Delaware fair value standard under Section 262 (or any other standard for that matter)." In the Court's view, the proxy statement provided "sufficient disclosure under Delaware law" by accurately describing "the sources of information Goldman relied on, significant assumptions that were made in generating estimates, and important limitations on the validity of Goldman's opinion that the Merger is fair to stockholders," as well as the "material analyses" performed by Goldman and furnished to management and the "final range of value estimates for each analysis."

The Court also observed that because "[v]aluing a company as a going concern is a subjective and uncertain enterprise" with "limitless opportunities for disagreement … , quibbles with a financial advisor's work simply cannot be the basis of a disclosure claim." Rather, in the Court's view, disputes of this nature should be "resolved via an appraisal action." Similarly, the Court characterized plaintiffs' complaint that Goldman used a valuation methodology different from that used in a previous valuation of 3Com as another "quibble" that can best be "remedied by the appraisal remedy."

Conclusion

The Court's decision in *In re 3Com* will be helpful to deal makers and their professional advisors in assessing various disclosure issues that often arise in the preparation of M&A disclosure documents. They should be particularly comforted by the Court's characterization of several of plaintiffs' complaints as "quibbles," as well as by the Court's recognition that *more* disclosure is not necessarily *good* disclosure.

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