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Recent Developments in Disclosure of Financial Analyses

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A recent decision issued by Vice Chancellor Laster of the Delaware Chancery Court (In Re Sauer-Danfoss Inc. Shareholders Litigation, C.A. No. 5162-VCL, April 29, 2011) provides some insight as to "materiality" under Delaware law as it applies to disclosure of financial advisor analyses. The plaintiff in Sauer-Danfoss made numerous claims regarding deficient disclosure in a Schedule 14D-9 relating to projections and the financial advisor analysis. The Delaware Chancery Court held that none merited the awarding of plaintiff attorney fees.[1]

This decision is important because most litigation in the mergers and acquisitions context is driven by fee-seeking plaintiff's lawyers. Decisions that deprive plaintiffs of attorneys fees cut off the life blood that drives much of such litigation. Thus, judicial decisions that clearly state that attorney fees will not be awarded for certain types of disclosure claims should be expected to result in fewer future suits making such claims.

"Why" was the common theme in the court's rejection of allowing attorney's fees for additional financial advisor related disclosure. That is, the court stated that "[a]sking 'why' [in the context of why a financial advisor selected certain ranges and/or multiples] does not state a meritorious disclosure claim."

In particular, seeking additional disclosure of "Lazard's methodology/rationale for arriving at . . . [a] . . . range, and why the selected range is lower than . . ." certain peers, did not constitute a meritorious disclosure claim. The court cited In Re JCC Holding Co. for the propositions that (i) "a quibble with the substance of a banker's opinion does not constitute a disclosure claim" and (ii) when a plaintiff's "only beef is that [an investment banker] made mistakes in subjective judgment even though those judgments were disclosed to the stockholders" such a complaint does not rise to a level of material omission or misstatement.

Vice Chancellor Laster's rationale seems to be that reasonable investors know that bankers use subjective judgments to select multiple ranges. To require additional disclosure as to exactly how the bankers come to such subjective judgments does not materially add to the mix of information, at least in typical situations.

This line of reasoning should be equally applicable to weighted average cost of capital calculations in discounted cash flow analyses (DCF). There have been recent cases in which the plaintiff’s bar have attempted to boot-strap Delaware appraisal valuation methods into DCF related disclosure claims. Examples include: use of Ibbotson's historical equity risk premium vs. "supply side" equity risk premium measurements, use of Barra forward looking betas, and failure to conduct a DCF analysis.

Sauer-Danfoss may help financial advisors in two respects. First, it should bolster banks' ability to resist their clients' efforts to "throw the bankers' disclosure under the bus" when it comes to negotiating changes to disclosure documents in the context of Delaware mergers and acquisitions shareholder litigation.

In addition, the case may be helpful in resisting indiscriminate SEC comments of a similar nature.[2] Traditionally, the SEC has requested "legal support" for banks' resistance to provide exhaustive detail as to the thought process underlying their opinions. Sauer-Danfoss provides legal support for the view that such detail does not materially improve disclosure. It should also provide support for resisting disclosure of each multiple in a comparable company and/or comparable transaction analysis; the 14D-9 at issue in Sauer-Danfoss contained only high/low/median data.

This case, however, should not be viewed as a retreat from Delaware's recent push to expand certain disclosures related to financial advisors. In particular, Vice Chancellor Laster's decisions in Steinhardt v. Occam Networks, Inc. (requiring disclosure of the amount of accretion or dilution derived from an accretion/dilution analysis; not just whether the transaction is expected to be accretive or dilutive) and In Re Art Technology Group, Inc. Shareholder Litigation (requiring disclosure of previous four years of fees received from the other party to the transaction), show a tendency for the Delaware courts to require the participants in merger and acquisition transactions to lay out additional "numbers".

Together with other recent Delaware cases, Sauer-Danfoss supports the view that the Delaware judiciary is seeking full disclosure of banker analyses and fee arrangements, but is not seeking (i) exhaustive details as to why the numbers are-what-they-are, (ii) disclosure of analyses that the bankers did not do, or (iii) expositions on valuation theories more generally.

As noted above, this decision is good news for financial advisors in that it may lead to fewer claims relating to deficient disclosure of financial advisor analyses. The bad news for financial advisors is that the plaintiffs' bar is unlikely to be going away anytime soon. In light of Del Monte and other recent lawsuits directly against the financial advisors for aiding and abetting breaches of fiduciary duties, it is possible that the litigation battleground will migrate from disclosure focused claims to substantive claims that the "subjective" judgments of the bankers amounted to aiding and abetting breaches of fiduciary duties by boards of directors. In such instances, allegations of negligent behavior by boards of directors in relying on their financial advisors that is otherwise protected from monetary damages by Delaware General Corporation Law Section 102(b)(7) could move the plaintiff's focus directly onto the financial advisors themselves. Such a development would keep the behavior and analyses of financial advisors in the judicial spotlight, at an increased risk of direct liability for the financial advisors.

[1] The underlying transaction was ultimately abandoned, but only after the defendants supplemented their Schedule 14D-9 to add the additional sought after disclosure.
[2] The Schedule 14D-9 at issue in Sauer-Danfoss received a comment from the SEC relating to the comparable companies analysis that was similar to the plaintiff's complaint.