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Case No. 3414-CC

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

BARBARA BERGER,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Civil Action No. 3414-CC
	)	
PUBCO CORPORATION and ROBERT H. KANNER,	)	
	)	
	)	
Defendants.	)	
	)	

MEMORANDUM OPINION

Date Submitted: April 22, 2008
Date Decided: May 30, 2008

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CHANDLER, Chancellor

Delaware's short-form merger statute does not impose onerous burdens on parent corporations seeking to make use of its expeditious process for merging with subsidiaries. In fact, it simply mandates that the minority shareholders of the subsidiary be notified of their statutory right to appraisal. Such notice must include a copy of the appraisal statute and, of course, implicates the parent's fiduciary duty to disclose all material information with respect to the shareholder's decision whether or not to seek appraisal. Because the parent in this case failed both to attach a correct copy of the appraisal statute and to include all material information, the fiduciary duty of disclosure was breached. Consequently, the minority shareholders must now be given an opportunity to seek a quasi-appraisal remedy.

I. BACKGROUND

Plaintiff Barbara Berger owned an unknown number of shares of common stock in defendant Pubco Corporation ("Pubco" or the "Company"), which is organized under the laws of Delaware but which is not and was not a publicly traded corporation.[1] In November 2007, Berger received a written notice from Pubco (the "Notice") stating that the Company's controlling shareholder had effected a short-form merger and that she and the other minority shareholders were

[1] The facts are drawn from the complaint and from undisputed assertions in the briefing completed by the parties. Plaintiff has not alleged or otherwise stated the number of shares she owned.

being cashed out for $20 per share. That controlling shareholder was, in effect, defendant Robert H. Kanner, who was (and is) Pubco's president and sole director and who owned more than 90% of Pubco. Specifically, Kanner formed Pubco Acquisition, Inc., and transferred to it his Pubco holdings in order to effect the merger.[2]

Pursuant to the short-form merger statute, the Notice explained that shareholder approval was not required and that the minority shareholders had a right to seek appraisal. The Notice also contained some information about the nature of Pubco's business, the names of its officers and directors, the number of shares and classes of stock, a description of related business transactions, and copies of Pubco's most recent interim and annual financial statements. The Company, although not publicly traded, was traded sporadically over the counter, and the thirty open-market trades that occurred in the twenty-two months leading up to the merger ranged in price from $12.55 to $16.00, with an average price of $13.32. Finally, the Notice provided telephone, fax, and email contact information where shareholders could obtain additional information upon request.

With the possible exception of the financial statements, the Notice did not provide much detail. For example, the description of the Company was a scant

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[2] This maneuvering was necessary because the short-form merger statute is available only to corporate controlling shareholders. *See* 8 *Del. C.* § 253 ("In any case in which at least 90% of the outstanding shares of each class of the stock of a corporation . . . is owned by *another corporation* . . . .").

five sentences, one of which vaguely stated only that "[t]he Company owns other income generating assets."[3] There was no disclosure relating to the Company's plans or prospects, and no meaningful discussion of the Company's actual operations. There was no disclosure of the Company's finances by division or line of business; instead, the unaudited financial statements lumped all of the Company's operations together. Moreover, although the financial statements indicated that the Company held a sizeable amount of cash and securities, there was no discussion or explanation of how those assets were utilized or were going to be utilized by the Company. Finally, the Notice contained no disclosure whatsoever of how Kanner determined the price at which he set the merger consideration.

As required by statute, the Company attached to the Notice a copy of the appraisal statute, but the copy attached was outdated and, therefore, incorrect. Although 8 *Del. C.* § 262 was updated by the General Assembly with changes that took effect in August 2007, the version attached to the Notice did not reflect those changes. The Company never sent a correct copy of the current appraisal statute to its minority shareholders.

On December 14, 2007, Berger initiated this case, purportedly as a class action representing the interests of all minority shareholders of Pubco. Berger

[3] Compl. Ex. A. at 2.

claims that the class is entitled to receive the difference between the $20 per share each member received and the fair value of his or her shares, regardless of whether or not a class member demanded appraisal. On January 31, 2008, Pubco and Kanner moved to dismiss the complaint under Rule 12(b)(6). Berger answered that motion on February 21, 2008, and at the same time filed an opening brief in support of her counter motion for summary judgment. Thereafter, defendants abandoned their motion to dismiss, and on March 20, 2008, answered Berger's counter motion for summary judgment and filed an opening brief of their own in support of a cross motion for summary judgment. Briefing on these competing summary judgment motions was completed on April 22, 2008.

II. SUMMARY JUDGMENT STANDARDS

Summary judgment is appropriate when "there is no genuine issue as to any material fact and . . . the moving party is entitled to a judgment as a matter of law."[4] Although claims alleging a violation of disclosure duties involve mixed questions of law and fact,[5] this Court has found it appropriate to grant summary judgment in the context of such disputes.[6]

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[4] Ct. Ch. R. 56(c); *United Rentals, Inc. v. RAM Holdings, Inc.*, 937 A.2d 810, 829–30 (Del. Ch. 2007).

[5] *Zirn v. VLI Corp.*, 681 A.2d 1050, 1055 (Del. 1996).

[6] *E.g.*, *Arnold v. Soc'y for Savings Bancorp, Inc.*, 650 A.2d 1270, 1276 (Del. 1994) (affirming the trial court's decision to grant summary judgment on disclosure claims in favor of plaintiffs); *In re PNB Holding Co. S'holders Litig.*, C.A. No. 28-N, 2006 WL 2403999, at *18 n.96 (Del. Ch. Aug. 18, 2006) (noting that the Court had granted summary judgment on disclosure claims in favor of defendants).

III. DUTY OF DISCLOSURE IN SHORT-FORM MERGERS

The so-called "duty of disclosure" is not quite "a separate and distinct fiduciary duty;"[7] indeed, "[i]t represents nothing more than the well-recognized proposition that directors of Delaware corporations are under a fiduciary duty to disclose fully and fairly all material information within the board's control when it seeks shareholder action."[8] The standard for determining materiality is well settled:

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote . . . . It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.[9]

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[7] *In re Checkfree S'holders Litig.*, C.A. No. 3193-CC, 2007 WL 3262188, at *2 (Del. Ch. Nov. 1, 2007).

[8] *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992).

[9] *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1985) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

In the context of a short-form merger, shareholders do not need to cast an informed vote on whether or not to effect the merger itself.[10] Instead, "[w]here the only choice for minority shareholders is whether to accept the merger consideration or seek appraisal, they must be given all of the factual information that is material to *that* decision."[11] Importantly, "[t]he parent need not provide *all* the information necessary for the stockholder to reach an independent determination of fair value; only that information material to the decision of whether or not to seek appraisal is required."[12] Clearly, some financial data about the company is materially relevant to the decision of whether or not to seek appraisal, but such disclosure is ultimately asymptotic; it eventually becomes an exercise in diminishing returns. Additional information may always be helpful, but "[o]mitted facts are not material simply because they might be helpful[; . . .] there must be a substantial likelihood that the undisclosed information would *significantly alter the total mix of information already provided*."[13] Thus, "plaintiffs must explain why receiving information *in addition to* the basic

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[10] *Glassman v. Unocal Exploration Corp.*, 777 A.2d 242, 247 (Del. 2001) ("[In a § 253 merger, t]he minority shareholders receive no advance notice of the merger; their directors do not consider or approve it; and there is no vote.").
[11] *Id.* at 248 (emphasis added).
[12] *In re Unocal Exploration Corp. S'holders Litig.*, 793 A.2d 329, 352 (Del. Ch. 2000), *aff'd*, *Glassman*, 777 A.2d 929.
[13] *Skeen v. Jo-Ann Stores, Inc.*, 750 A.2d 1170, 1174 (Del. 2000) (emphasis added).

financial data already disclosed will significantly alter the total mix of information available."[14]

Here, defendants concede there was at least one problem with the notice distributed to minority shareholders: the wrong version of the appraisal statute was attached. The Delaware appraisal statute explicitly requires its inclusion in any notice of a merger giving rise to appraisal rights.[15] It is undisputed that the Notice attached a noncurrent version of § 262, and this represents a clear violation.[16] The parties disagree on the scope of the proper remedy, and they also dispute the materiality of the plaintiff's other alleged disclosure violations.

Plaintiff alleges there was a material omission because the Notice did not disclose how Kanner set the $20 per share price. Defendants argue that it cannot be material, because it could not matter in the context of a short-form merger. Specifically, defendants argue that in a short-form merger the parent has no

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[14] *In re Checkfree S'holders Litig.*, C.A. No. 3193-CC, 2007 WL 3262188, at *2 (Del. Ch. Nov. 1, 2007) (emphasis added).

[15] *See* 8 *Del. C.* § 262(d)(2) ("[the] corporation . . . shall include in any such notice a copy of this section").

[16] *See Nebel v. Sw. Bancorp, Inc.*, C.A. No. 13618, 1995 WL 405750, at *6 (Del. Ch. July 5, 1995). The defendants do argue that the "unintentional attachment of the previous version of the appraisal statute was immaterial" (Defs.' Reply Br. at 3), but then-Vice Chancellor Jacobs dismissed this same argument in *Nebel*. There, he wrote, "[i]n my view, any argument that [a technical violation of the appraisal statute] is 'immaterial' is foreclosed by the mandatory nature of the statutory requirement. . . . Where the legislature so commands but the command is not observed, the corporation cannot be heard to argue that its violation of the statute is not material." 1995 WL 405750, at *6; *see also Jackson v. Turnbull*, C.A. No. 13042, 1994 WL 174668, at *6 (Del. Ch. Feb. 8, 1994) ("Our Supreme Court has emphasized the need for stockholders to strictly comply with the formalities of § 262 when seeking to exercise their appraisal rights. Corporations should be held to the same standard." (citation omitted)).

obligation to set a fair price and, therefore, has no obligation to explain how or why the price set is fair. Moreover, the defendants contend, holding that the process by which Kanner set the merger price was material would lead to a foolish *per se* rule. Defendants then list a series of absurd, hypothetical "methods" Kanner could have used, which range from unreliable valuation software to rolling dice.[17] Because Kanner utilized the short-form merger statute, he did not have to set a fair price and, therefore, could have used any method—no matter how absurd—to set the merger consideration. Defendants argue that disclosure of his methodology is unnecessary.[18]

Defendants' argument entirely misses the mark, however, because the issue is not about necessity—it is about materiality. In the context of Pubco, an unregistered company that made no public filings and whose Notice was relatively terse and short on details, the method by which Kanner set the merger consideration is a fact that is substantially likely to alter the total mix of information available to the minority shareholders. Where, as here, a minority shareholder needs to decide only whether to accept the merger consideration or to seek appraisal, the question is partially one of trust: can the minority shareholder

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[17] *See* Defs.' Answering Br. at 7.

[18] *See, e.g.*, Defs.' Reply Br. at 2 (arguing that disclosure is adequate "[i]f the information in a § 253 notice of merger is *sufficient* for a minority shareholder to decide whether to exercise appraisal rights" (emphasis added)); Defs.' Answering Br. at 17 ("The information provided in Pubco's Notice was *sufficient* for Pubco's minority shareholders to either demand appraisal or lodge informed inquiries with Pubco about the Merger price." (emphasis added)).

trust that the price offered is good enough, or does it likely undervalue the Company so significantly that appraisal is a worthwhile endeavor? When faced with such a question, it would be material to know that the price offered was set by arbitrarily rolling dice. In a situation like Pubco's, where so little information is available about the Company, such a disclosure would significantly change the landscape with respect to the decision of whether or not to trust the price offered by the parent. This does not mean that Kanner should have provided picayune details about the process he used to set the price; it simply means he should have disclosed in a broad sense what that process was, assuming he followed a process at all and did not simply choose a number randomly. In a section 253 merger, the parent need not "set[] up negotiating committees, hire[] independent financial and legal experts, etc." because it need not "establish entire fairness."[19] Nevertheless, the minority shareholders of an unregistered, non-reporting company are entitled to know at least whether the parent did or did not use such methods when setting the merger consideration, because such a fact "would have assumed actual significance in the deliberations of the reasonable shareholder"[20] faced with the decision of whether or not to trust and accept the price offered by the parent.

[19] *Glassman v. Unocal Exploration Corp.*, 777 A.2d 242, 247–48 (Del. 2001).

[20] *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1985) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

Plaintiff's other arguments about alleged disclosure violations are less persuasive. Although plaintiff correctly notes that the description of the Company left much to the imagination, plaintiff has not explained why additional details about the products and services Pubco offered would have been materially relevant to the decision of whether or not to seek appraisal. Finally, plaintiff also challenges the financial information disclosed in the Notice. Specifically, Berger argues that defendants committed a material omission by failing to explain why the Company was sitting on $96 million in cash and securities or what the Company planned to do with this money. Plaintiff's argument on this point and plaintiff's other criticisms of the financial information are effectively self-defeating. Plaintiff very rightly notes that the financial disclosures reveal that the Company held cash and securities that amounted to approximately $36 per share—$16 per share *more* than the merger consideration.[21] This information does not indicate a material omission; it indicates that the minority shareholders should give serious thought to pursuing appraisal rights. In effect, plaintiff demonstrates that the financial information disclosed *has* allowed her to determine that she did not trust the parent's valuation of the Company.[22] Because plaintiff has not explained why

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[21] Compl. ¶ 11.

[22] *See also* Pl.'s Opening Br. at 2 (noting that the limited over-the-counter trades occurred "at a huge discount to the Company's fair value"). If Berger is able to conclude that such trades were at a "huge discount to the Company's fair value," she must have had an understanding of the Company's value. If in fact she had such an understanding, her argument that the financial

additional disclosures would significantly alter the total mix of information available in the Notice, she has not demonstrated the materiality of her alleged omissions.

IV. REMEDY

A disclosure violation results in an irreparable injury,[23] which implicates the jurisdiction of this Court. Indeed, "the Court of Chancery has the inherent powers of equity to adapt its relief to the particular rights and liabilities of each party."[24] Where, as here, "the challenged merger has already occurred, the disclosure claims might warrant rescission of the merger or (in cases where rescission is impractical and the circumstances otherwise warrant) a recovery of the monetary equivalent of rescission."[25] However, in the case of a short-form merger, rescissory remedies are unavailable for disclosure claims because the merger was effective as a matter of law under section 253 before disclosures were even made to the minority shareholders.[26] In other words, because a short-form merger does not require

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disclosures contained material omissions falls short, because it is unclear how additional disclosures would alter the total mix of information available.

[23] *See, e.g.*, *In re Netsmart Techs. S'holders Litig.*, 924 A.2d 171, 207 (Del. Ch. 2007) ("[T]his court has typically found a threat of irreparable injury to exist when it appears stockholders may make an important voting decision on inadequate disclosures."); *ODS Techs., Inc. v. Marshall*, 832 A.2d 1254, 1262 (Del. Ch. 2003) ("The threat of an uninformed stockholder vote constitutes irreparable harm.").

[24] *Gilliland v. Motorola, Inc.*, 873 A.2d 305, 312 (Del. Ch. 2005) (quoting *Hanby v. Wereschak*, 207 A.2d 369, 370 (Del. 1965)); *see also Weinberger v. UOP, Inc.*, 457 A.2d 701, 714 (Del. 1983) (discussing "the Chancellor's powers . . . to fashion any form of equitable and monetary relief as may be appropriate .").

[25] *Nebel v. Sw. Bancorp, Inc.*, C.A. No. 13618, 1995 WL 405750, at *2 (Del. Ch. July 5, 1995).

[26] *See* 8 *Del. C.* § 253(a).

shareholder approval, the inadequacy of disclosures cannot possibly have caused a merger to happen where it otherwise would not have. Instead, minority shareholders have a statutory right to appraisal in a merger under section 253, so a proper remedy would preserve that right.[27]

Such a remedy is a "quasi-appraisal." The parties seem to agree on this point, but they disagree about how such a quasi-appraisal should be implemented. Each side champions one case in particular. The plaintiff argues that *Nebel v. Southwest Bancorp, Inc.*[28] governs. There, the plaintiffs alleged a series of disclosure violations, but the Court only found one to be actionable: the company had inadvertently attached a page from another state's appraisal statute to its notice of the short-form merger.[29] The Court ordered that all minority shareholders should receive the difference between the merger consideration and the "fair value" of their shares, which was determined in a parallel appraisal hearing.[30] The defendants, however, argue that Vice Chancellor Lamb's more nuanced treatment of the quasi-appraisal remedy in *Gilliland v. Motorola, Inc.*[31] should govern this case. There, two years after a short-form merger was effected, a minority

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[27] *Cf. Arnold v. Soc'y for Sav. Bancorp, Inc.*, C.A. No. 12883, 1995 WL 376919, at *7 (Del. Ch. June 15, 1995) ("Where a misinformed stockholder could lose his right to a statutory appraisal, this Court may provide a quasi-appraisal remedy to place those stockholders in the position they would have been in but for the board of directors' inadequate disclosure of material facts.").
[28] C.A. No. 13618, 1995 WL 405750 (Del. Ch. July 5, 1995).
[29] *Id.* at *7.
[30] *Id.*
[31] 873 A.2d 305 (Del. Ch. 2005).

shareholder brought a purported class action challenging the disclosures in the notice of merger because the notice did not include any financial information.[32] The Court agreed despite the fact that such financial information had been disclosed earlier during a related tender offering.[33] Vice Chancellor Lamb noted that "*Nebel* appears to assume, without deciding, that all minority stockholders should be entitled to participate in the quasi-appraisal class without having to 'opt-in' or choose to participate, as would be true of a real appraisal action."[34] Thus, the Court fashioned a quasi-appraisal remedy in greater detail because, Vice Chancellor Lamb concluded, "*Nebel* does not address these issues."[35]

The quasi-appraisal remedy fashioned in *Gilliland* attempted to mirror as best as possible the statutory appraisal remedy.[36] Because I agree that *Nebel* does not directly address the issue of defining the contours of the quasi-appraisal remedy, and because I believe the *Gilliland* approach wisely follows the General Assembly's instructions by patterning itself after the statute, I conclude this case is governed by *Gilliland*. The parties are directed to confer and submit to the Court an order calling for a quasi-appraisal remedy based on the *Gilliland* decision. Thus, the order should require four things.

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[32] *Id.* at 307–08.
[33] *Id.* at 308; *see also Gilliland v. Motorola, Inc.*, 859 A.2d 80 (Del. Ch. 2004).
[34] 873 A.2d at 312.
[35] *Id.*
[36] *See id.* at 312–15.

First, Pubco must make supplemental disclosures to address the violations discussed above; namely, Pubco must disclose the method, if any, used by Kanner to set the merger consideration and must include a correct and current copy of the appraisal statute. Second, the order should "require minority shareholders to make a choice to participate in the action, in order to replicate the situation they would have faced if they had received proper notice."[37] As in *Gilliland*, these "opt-in procedures . . . will not be as stringent as those under the statute[, and] stockholders seeking to opt-in will need to provide only proof of beneficial ownership of the [Pubco] shares on the merger date."[38] Third, "this quasi-appraisal action should be structured to replicate a modicum of the risk that would inhere if this were an actual appraisal action, *i.e.*, the risk that the Court will appraise [Pubco] at less than [$20] per share and the dissenting stockholders will receive less than the merger consideration."[39] I am hopeful that the parties can agree on an amount that the opt-in shareholders will need to place in escrow.[40] Finally, the order should then call for a valuation of the Pubco shares as of the date of the merger using the method prescribed by the appraisal statute.[41] In the event counsel are unable to agree on a proposed form of order, each side should submit its own proposal and the Court will simply select one.

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[37] *Id.* at 313.
[38] *Id.*
[39] *Id.*
[40] *See id.* at 313–14.
[41] *Id.* at 314.

IT IS SO ORDERED.