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Delaware Supreme Court Confirms All Material Facts Must be Disclosed to Receive *Corwin* Business Judgment Rule "Cleansing" Effect

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The Delaware Supreme Court has reversed the Delaware Court of Chancery's earlier dismissal of a stockholder challenge to the sale of Diamond Resorts International, finding that the reasons why Diamond's chairman abstained from the merger vote should have been disclosed to stockholders.

Although the chairman of Diamond's board of directors abstained from voting to approve a sale of the company, Diamond did not disclose the reasons why he abstained, and the Delaware Supreme Court held this to be material information without which Diamond's stockholders could not have made a fully informed tender into the deal. Delaware Supreme Court Chief Justice Leo E. Strine, Jr. reasoned that because Delaware law gives important effect to an informed stockholder decision, Delaware law also requires that the disclosures the board makes to stockholders contain all material facts and not describe events in a materially misleading way. The Supreme Court also did not find persuasive the argument that the Chairman's views were non-material because they were opinions and not facts, finding that the very nature of the fiduciary relationship entitles stockholders to give weight to their fiduciaries' opinions about important business matters. Failure to make such material disclosures denied Diamond's board of the "cleansing" effect of stockholder approval of the transaction and that, at the pleading stage, this precluded the invocation of the business judgment rule standard.

Background

Stephen J. Cloobeck founded Diamond Resorts and served as its Chairman and CEO from its inception until the company went public, after which Cloobeck continued to serve as Chairman. In 2016, Diamond Resorts began a public sale process, during which it received bids to acquire the company ranging from $23 per share to $33 per share, including a bid by Apollo for $30.25 per share. Following the auction process, the Diamond Resorts board voted in favor of the company's sale to Apollo. Cloobeck, however, abstained from that vote. During board meetings, documented in minutes, Cloobeck said that he was abstaining because mismanagement of Diamond Resorts had negatively affected the sale price and it was therefore not the right time to sell the company. In its Schedule 14D-9 Solicitation/Recommendation Statement recommending that stockholders tender their shares to Apollo, the board stated that Cloobeck had abstained from the vote and had not yet determined whether to tender his own shares, but did not disclose the reasons for his abstention. The plaintiffs served a statutory demand on the company, asking to inspect its books and records. A week later, Cloobeck tendered his 15 percent of the Diamond Resorts shares. Apollo then consummated the merger.

Two months after the deal closed, the plaintiffs sued, challenging the merger's fairness and the failure of the board to disclose all material information to Diamond Resorts' stockholders regarding the tender offer. Citing the Delaware Supreme Court's *Corwin* decision, and its subsequent extension to tender offers in *In re Volcano Corp*., the Court of Chancery held that, in connection with a transaction not otherwise subject to entire fairness, the acceptance of a tender offer by fully informed, disinterested, uncoerced stockholders representing a majority of a corporation's stockholders has a "cleansing" effect resulting in the application of the business judgment rule, whereby fiduciary duty claims are dismissed unless there is a showing of waste. The Court of Chancery therefore dismissed the plaintiffs' claims for damages because the stockholders "overwhelmingly" accepted the tender offer upon disclosure of all material facts.

The Supreme Court's Decision

The Supreme Court found that the Chancery Court erred by not finding Cloobeck's views to be a material fact, citing to Delaware Supreme Court precedent in asserting that an omitted fact is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having altered the total mix of information made available." If a director's views are material, they must be disclosed. The Supreme Court noted that Delaware law adheres to the "contextual approach" in its analysis of materiality. Thus, while in this case, Cloobeck's long pedigree with the company reinforced the likelihood that a reasonable stockholder would consider his views important, the Supreme Court stated that its decision "in no way implies that the reason for a particular director's dissent or abstention will always be material." The Supreme Court also noted that, since the company's Schedule 14D-9 was otherwise a long list of reasons why the directors voted in favor of the transaction, Cloobeck's views would have caught a reasonable stockholder's attention had they been included. Since the stockholders had not been provided with all material facts, the claims that the board had breached its fiduciary duties could not be "cleansed" by a fully informed stockholder vote.

Finding Cloobeck's views to be material, and that their omission precluded the invocation of the business judgement rule standard at the pleading state, the Supreme Court reversed and remanded the plaintiffs' claims to the Court of Chancery.

Conclusion

The Supreme Court's decision requires boards to carefully consider how the dissenting opinions of directors are discussed in disclosures to stockholders. In many instances, merely stating that a director has dissented or abstained will not be sufficient. Stockholders cannot be expected to read between the lines or speculate about facts. The decision serves as a reminder that only by providing all material information will a court determine that a fully informed stockholder vote or tender "cleanses" a transaction not otherwise subject to the standard of entire fairness.

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