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Court To Sellers: Stockholder Notice Rights Matter

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In *Mehta v. Mobile Posse, Inc.*, six causes of action were before the Delaware Court of Chancery in Plaintiff's complaint alleging inadequate stockholder notice and breach of directors' fiduciary duty of disclosure regarding the merger of Mobile Posse. The defendants, Mobile Posse and its board, asserted motions for judgments on the pleadings for all counts, arguing they were entitled to the judgments because the violations were remedied by the supplemental notice they issued. The Court denied all but one of defendants' motions, finding numerous deficiencies in the notice process and finding that the merger was not entirely fair.

In completing a merger, Mobile Posse and its board had to abide by basic requirements imposed by the Delaware General Corporation Law ("DGCL"). The complaint alleged that the defendants failed to satisfy some of the basic merger notification requirements of Sections 228 (Consent of Stockholders or Members in Lieu of Meeting), 251 (Merger or Consolidation of Domestic Corporations), and 262 (Appraisal Rights) of the DGCL. Mobile Posse sent an initial notice to its common stockholders, which did not contain any information about the consideration any stockholders would receive. It also failed to inform the stockholders of any procedures for asserting their appraisal rights. Defendants, through this litigation, became aware of the mistakes they made in the initial notice and issued a supplemental notice to amend the previous mistakes. When seeking the stockholders' consent, a written consent was used in lieu of holding a meeting. The defendants failed to provide the appropriate information in the initial notice to those common stockholders who did not consent to the merger. The Court was not persuaded that a supplemental notice could serve as a replicated remedy, and in any event, the supplemental notice contained incorrect and internally inconsistent instructions. The supplemental notice provided stockholders with an incorrect time period for submitting their demand for appraisal, and it also provided the stockholders with the wrong procedures for enforcing their appraisal rights.

The Court addressed the defendants' motion to dismiss arguing that Section 144 of the DGCL provides protection against the potential negative consequences that can flow from interested transactions, where directors are on both sides of the transaction or expect to derive a financial benefit from the transaction. Section 144(a)(2) provides a safe harbor to directors and officers where material facts as to their interests in the transaction are disclosed to the stockholders. The initial notice failed to disclose any material facts to the stockholders as to how and when the merger came about and who would receive consideration. It was reasonable to infer that some directors were conflicted as to the merger and likely owed fiduciary duties to the company and stockholders. Thus, the Court rejected defendants' motion on this count. The possibility that the entire fairness standard of review may apply tends to preclude a court from granting a defendant's motion to dismiss. To overcome this, defendants must be able to show conclusively that the entire transaction was fair based solely on the allegations of the complaint and related documents. Defendants cited to *In re Trados Inc. Shareholder Litigation*, where the court concluded post-trial that if the common stock had no economic value before the merger, then common stockholders received the substantial equivalent in value to what they had before, and the merger satisfied the fairness test. Nonetheless, Mobile Posse and its' board are not entitled to a comparable finding at the pleading stage. Allegations in the complaint are accepted as true by the court for the purpose of this motion. Defendants failed to address the allegations concerning the process, leaving it reasonably conceivable that the merger was not entirely fair.

The complaint also alleged that defendants breached their fiduciary duty of disclosure by failing to comply with the statutory notice requirements of the DGCL. Statutory and fiduciary duties often overlap. The requirements set forth in the DGCL are per se material, so failing to disclose the statutorily required information can constitute a fiduciary breach. Sending an appraisal notice suggests the "fiduciary duty to disclose all material facts with respect to the stockholders' decision to seek appraisal," including "financial information about the company that w[ould] be material to the stockholders' decision to accept [the] merger consideration or pursu[e] appraisal." Defendants had an obligation to specifically instruct its stockholders as to the correct manner of executing and filing a valid objection. The court found that the plaintiff sufficiently pleaded that defendants breached their fiduciary duty of disclosure by properly pleading that defendants failed to comply with the statutory requirements of the DGCL.

The final count alleged that each of the defendants were interested in the merger and therefore had the burden of establishing that the merger was entirely fair to the common stockholders. The court summarized the burden of demonstrating entire fairness− while the price of the merger may have been fair, the court concluded that it was possible, based on the pleadings, to find that the dealings were not entirely fair. Therefore, all but one portion of defendants' motions for judgments on the pleadings were denied due to finding that questions of material facts remained.

[*Anurag Mehta v. Mobile Posse, Inc.* et al. memorandum opinion 190508 (Del. Ch. May 8, 2019)](https://www.natlawreview.com/article/court-to-sellers-stockholder-notice-rights-matter)

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