Maric Capital Master Fund, Ltd. v. *PLATO Learning, Inc.*: Disclosure of Projections and Absence of Management Arrangements Deemed Misleading Leads to Enjoining of Vote on Merger

On May 13, 2010, the Delaware Court of Chancery issued an opinion in *Maric Capital Master Fund, Ltd.* v. *PLATO Learning, Inc.*[1] granting plaintiff Maric Capital Master Fund's request for a preliminary injunction against the procession of a proposed shareholder vote on a merger transaction in which Thoma Bravo, LLC ("Thoma Bravo") would acquire defendant PLATO Learning, Inc. ("PLATO") for $5.60 per share. Although in a bench ruling earlier that day the court rejected the plaintiff's argument that an injunction was warranted due to the defendants' alleged failure to comply with their duties under *Revlon* v. *McAndrews & Forbes Holdings, Inc.*[2] and its progeny, in its written opinion, the court found three statements or omissions in PLATO's proxy statement to be materially misleading and so enjoined the merger vote pending the dissemination of corrective disclosures.

I. The Delaware Court of Chancery's Decision

A. Disclosure of Discount Rates Used in Discounted Cash Flow Analysis

The first of the disclosures that the court found to be materially misleading was the proxy statement's description of how Craig-Hallum, the investment bank that provided the PLATO board with a fairness opinion, arrived at its discount rate for its discounted cash flow valuation. The proxy statement indicated that Craig-Hallum chose discount rates "based upon an analysis of PLATO Learning's weighted average cost of capital" (WACC) and that Craig-Hallum used a range of 23% to 27% in conducting its discounted cash flow (DCF) analysis.[3] However, Craig-Hallum's analysis of the WACC, given to the Special Committee, did not yield the 23-to-27 percent range disclosed in the proxy statement. Rather, Craig-Hallum made two estimates of a WACC, one of which utilized a "very loose variation of the capital asset pricing model and one using a comparable companies analysis."[4] These models generated discount rates of 22.5% and 22.6%, which were significantly lower than the range of rates disclosed in the proxy statement. The court rejected the defendants' argument that deposition testimony from Craig-Hallum provided three reasons for the bank's decision to use the 23-to-27 percent range, because (1) there was no evidence that Craig-Hallum verbalized these reasons to the Special Committee, and (2) "the only tangible evidence of any *actual analysis* [performed] by Craig-Hallum" (and given to the Special Committee) was the analysis generating the lower figures.[5] As a result of the proxy statement's disclosure of the higher range of discount rates and the failure to disclose the lower rates, the court explained, "the deal price [was] portrayed as being more favorable than it would have been if Craig-Hallum had used even the girthy 22.5% and 22.6% discount rates derived in its actual calculations."[6] The court concluded that having spoken on the subject of discount rates, the defendants were obligated to provide non-misleading information in that regard, and that

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1 C.A. No. 5402-VCS, 2010 WL 1931084 (Del. Ch. May 13, 2010).

2 506 A.2d 173 (Del. 1986).

3 2010 WL 1931084, at *1.

4 *Id.*

5 *Id.*

6 *Id.*

since discount rates affect the attractiveness of the merger price, this information "bears materially on the decision to be made by PLATO's stockholders."[7]

B. Disclosure of Management's Projected Free Cash Flow

Second, the court was perturbed by the proxy statement's selective disclosure of projections regarding PLATO's future performance. The court found it "odd" that the proxy statement excluded the free cash flow estimates made by PLATO's management and provided to Craig-Hallum.[8] The court opined that "management's best estimate of the future cash flow of a corporation that is proposed to be sold in a cash merger is clearly material information."[9] The court expressed the concern that by "selectively removing the free cash flow estimates from the projections," PLATO's stockholders would not have sufficient information on which to decide whether the merger price they were being offered fairly compensated them for the benefits they would receive from future expected cash flows if the corporation remained independent and delivers on management's expectations.[10]

C. Disclosure Regarding Arrangements with Management

Third, the court found materially misleading the proxy statement's declaration that "'[i]n reaching their decision to approve the merger and the merger agreement,' PLATO's special committee and board considered 'the fact that Thoma Bravo did not negotiate terms of employment, including any compensation arrangements or equity participation in the surviving corporation, with [PLATO's] management for the period after the merger closes.'"[11] Interpreting this statement as implying that the decision to sell PLATO to Thoma Bravo was "unaffected by any understandings" between the two entities regarding "future economic arrangements," the court noted that although formal negotiations may not have taken place, PLATO's CEO had had "extended discussions with Thoma Bravo in which the typical equity incentive package given by Thoma Bravo to management was discussed" and that evidence suggested that PLATO's CEO had been "led to believe that the typical package could be expected and that top management would likely be retained."[12] The court thus held that the proxy statement gave the materially misleading impression that Thoma Bravo did not provide PLATO's management with any indication of the post-merger treatment it would receive, thereby requiring a corrective disclosure before the merger vote could proceed.

The court concluded by explaining that "[o]nce timely and satisfactory disclosures are made in a way that gives the PLATO stockholders adequate opportunity to digest them before a final merger vote, the injunction will be lifted."[13]

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7 *Id*. at *2.

8 *Id*.

9 *Id*.

10 *Id*.

11 *Id*. (citing PLATO Learning, Inc. Proxy Statement (Apr. 20, 2010)) (brackets in original).

12 *Id*.

13 *Id*. at *3.

II. Significance of the Decision

The Delaware Court of Chancery's recent decision in *Maric Capital Master Fund, Ltd.* v. *PLATO Learning, Inc.* underscores that, to avoid the delay and expense of amended solicitation documentation, the order of the day is complete and accurate disclosure in connection with the solicitation of shareholder votes on significant corporate transactions.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or Yafit Cohn at 212.701.3089 or ycohn@cahill.com.