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Directors Denied *Corwin* Protection Due to “Information Vacuum”

The Delaware Court of Chancery recently held in *In re Tangoe, Inc. Stockholders Litigation* that directors who approved a sale of the company were not entitled to business judgment protection under *Corwin v. KKR Financial Holdings LLC* because company stockholders were not adequately informed when tendering into the transaction. This was due to the “information vacuum” created by, among other things, the lack of audited financials, even though neither federal securities nor Delaware law mandates disclosure of audited financials in this context *per se*. The court explained, however, in an opinion by Vice Chancellor Slights, that directors facing difficult decisions amid a “regulatory storm” (such as a restatement of financials) may still receive business judgment protection if they carefully and thoroughly explain all material aspects of a proposed transaction and remain focused on the best interests of stockholders.

Background and Holdings

In March 2016, Tangoe announced that it would have to restate its financials. Thereafter, the company faced pressure to explore a sale from activist stockholders, including Marlin Equity Partners, which held a 10.4% stake in the company and suggested that it would engage in a proxy contest. The Tangoe directors – whose primary source of compensation as directors was equity awards – also faced the possibility that they would receive nothing from the company’s existing equity plan because SEC rules barred equity awards while the restatement was pending. Thus, the board created a new incentive plan with awards that would be triggered only upon a change of control, and as so incentivized, turned its focus to the sale process.

The company struggled to restate its financial statements, leading NASDAQ eventually to delist Tangoe’s stock and the SEC to threaten deregistration. Marlin emerged as the most likely buyer for the company with an initial offer of \$9 per share, which ultimately dropped to \$6.50 per share by the time of delisting (*i.e.*, a 28% negative premium). In April 2017, Tangoe and Marlin announced an all-cash, two-step transaction, and a majority of Tangoe’s stockholders tendered their shares, effectively approving the deal.

In denying the directors’ motion to dismiss a stockholder fiduciary duty suit brought against them, the Court of Chancery held that *Corwin* was inapplicable to the transaction because the stockholders were not fully informed in connection with their decision of whether to tender shares based on the following:

- *Lack of Audited Financial Statements.* Even though neither the Schedule 14D-9 issued in connection with the transaction nor Delaware law *per se* require the disclosure of audited financials, it was reasonably conceivable that a reasonable stockholder would have deemed audited financials important when deciding whether to approve the transaction.
- *Unreliable Financial Information.* The financial information provided to stockholders was sporadic and of questionable reliability, and almost three years had passed since the company's last annual meeting.
- *Inadequate Process Information.* The directors failed to provide stockholders with adequate information about the status of the restatement itself, given the high stakes involved due to the stock's delisting, threatened deregistration and pressure from activists.

The court also agreed with plaintiffs that there was a reasonable inference of a non-exculpated claim against the directors for breach of fiduciary duty in approving the sale because the directors would receive generous equity compensation only if there was a sale of the company.

Takeaways

Tangoe is a reminder for boards wishing to invoke business judgment protection under *Corwin* to provide stockholders with all material information (*i.e.*, information that a reasonable stockholder would consider important in deciding how to vote). This may embody information beyond what is legally required, such as the case here where the court considered the lack of audited financials (that were not required by federal securities or Delaware law in this context *per se*) to be dispositive at the pleadings stage of litigation. Directors may still achieve business judgment rule deference when they make difficult decisions amid any "regulatory storm" (such as the mandated restatement of financial disclosures), but they must show that they "carefully and thoroughly explained all material aspects of the storm to stockholders," including "how the company sailed into the storm, how the company has been affected by the storm, what alternative courses the company can take to sail out of the storm and the bases for the board's recommendation that a sale of the company is the best course." Additionally, the board must demonstrate that throughout the "storm," it remained focused on the best interests of stockholders.

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