DISCLOSURE PROVISIONS OF THE
MODEL BUSINESS CORPORATION ACT

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I
INTRODUCTION

In the past, when a nonpublic corporation sought shareholder approval for a fundamental change (such as a merger), it would provide a notice of the meeting stating its purpose and, if applicable, a statement regarding dissenters’ appraisal rights. That is all the Model Business Corporation Act (MBCA) required, and corporations generally paid little attention to a so-called “duty of disclosure” requiring them to provide additional information to shareholders, if such a duty even existed. Of course, in the case of public corporations subject to the Securities and Exchange Commission’s (SEC) proxy rules, federal law mandated extensive disclosure.

Times have changed. Now, even corporations that are not subject to the SEC’s proxy rules may have to provide robust disclosure under state law. Indeed, in some cases, state law requires public corporations to provide even more disclosure than is mandated by the SEC’s proxy rules. This change has taken place primarily as a result of the development of the corporate common law, although there have been some statutory developments, including those under the MBCA. The development of disclosure requirements through decisional law rather than through statutory prescriptions highlights the important question of when corporate law should be codified legislatively and when it should be left to case-by-case judicial development. The American Bar Association’s Committee on Corporate Laws (“the Committee”) confronted this question when considering disclosure requirements as part of its continuing evaluation of the MBCA.

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II

HISTORICAL CONTEXT

Historically, corporate statutes provided little guidance on the disclosures required when seeking shareholder approval. There was the notice of meeting, stating the meeting’s purpose so that shareholders were alerted to the subject matter to be considered. If the matter triggered appraisal rights, the shareholders would have to be informed of those rights and the procedure to assert them. Little more was required under these statutes.

Similarly, corporate statutes typically did not mandate that information about the corporation be provided to shareholders on a regular basis, except in situations where corporate action required shareholder approval. Rather, shareholders were left to rely on their inspection rights and, beginning in 1960, the ability under the MBCA to request the corporation’s available, recent financial statements. It was not until 1978 that the MBCA required the corporation to provide annual financial statements to shareholders.

This state corporation-law disclosure regime can be contrasted with the federal securities-law regime under which public companies—by statute and SEC regulations—are required to provide detailed information on a regular basis and in connection with shareholder actions. For example, companies subject to the SEC’s reporting requirements must electronically file with the SEC an annual report, quarterly reports, and current reports covering specified events. Companies subject to the SEC’s proxy rules are required to provide annual reports with financial statements and certain other information to shareholders. If corporate action is being taken by shareholders—including election of directors, approval of equity-compensation plans, or approval of fundamental changes like amendments or mergers—additional information, including transaction-specific information, is required.

Beginning about thirty years ago, the courts—especially in Delaware—began to focus on the inability of shareholders to effectively exercise their voting franchise if they were not given adequate information. This translated into a duty for directors, operating under traditional standards of care and loyalty, to ensure that shareholders received adequate disclosure so that they might properly exercise their voting rights on an informed basis. This duty of disclosure was first articulated in the context of controlling shareholder transactions. Over the years, the nature and scope of the duty has been further developed and expanded by the courts—particularly in Delaware—and that development continues to this day.

5. Id. § 52 ¶ 5 (1979).
III

THE COMMITTEE REVISITS MBCA DISCLOSURE PROVISIONS

At the same time, there was little statutory change—with some exceptions. In 2006, the Committee began to look at what changes to the MBCA might be desirable to address disclosure requirements. As noted above, the MBCA already provided for certain information to be available to shareholders upon request, and for limited financial information to be provided annually. The MBCA did not, however, require any specific information to be furnished in connection with corporate actions requiring shareholder approval, and it required only limited information well into the process of exercising appraisal rights.

Through a task force co-chaired by Justice Jack Jacobs of the Delaware Supreme Court and this author, the Committee considered the extent to which it should modify the disclosure requirements in the MBCA. It first considered whether the information required to be provided to shareholders under section 16.20 should be expanded, and concluded that no change was necessary. It then considered the disclosures required when seeking shareholder approval, or when appraisal rights were available. In particular, the Committee considered whether any codification of the disclosure requirements was desirable.

One alternative the Committee considered was to prescribe a list of required information, similar to the SEC’s proxy rules. The Committee chose not to take that approach under a statute designed to be fundamentally enabling. There were several reasons. First, there are a myriad of circumstances requiring various levels of disclosure—a one-size-fits-all, prescriptive statutory approach would be impractical. Second, unlike the SEC’s proxy rules, which can be easily amended and administratively interpreted, legislation is much more rigid and inflexible. Also, necessary disclosure is not a static concept. It evolves over time as new issues surface—consider, for example, identification of enterprise risk—and, absent administrative delegation, there is no mechanism for adaptation. The use of a general “materiality” catch-all did not seem appropriate as a statutory approach because of the uncertainty it would create regarding compliance. In addition, the Committee did not want to replicate a disclosure regime that already existed under SEC rules for public companies, and it did not want to impose a similar regime on nonpublic companies.

Instead, the Committee took a more modest approach. First, it added to the statute some basic, generally applicable disclosure requirements. Second, in the official comment relating to director duties, the Committee identified the ability

7. See infra notes 9 and 10.
of the courts to continue developing disclosure requirements as a matter of corporate common law.\textsuperscript{10}

Specifically, in 2007, the Committee amended the MBCA to require that the financial information provided under section 13.24—which applies at the time of the appraisal payment—also be provided under section 13.20—which applies at the time that notice of the availability of appraisal rights is given—since this earlier time is when shareholders must decide whether to preserve their appraisal rights. In addition, the required annual financial information was tied more-closely to the information required under section 16.20.\textsuperscript{11}

The Committee decided not to specify in the statute what information must be provided at the time of shareholder action. Instead, it recognized—in the official comment to section 8.30 (director duties)—that some courts have found a duty of disclosure owed by directors to shareholders in some circumstances, and that, rather than codifying a duty of disclosure in the MBCA, any such duty should be developed by the courts on a case-by-case basis. Similarly, the official comment to section 13.20(d) recognizes that, although certain financial information must be provided, additional information may be required depending upon applicable case law.

IV

DECISIONAL DEVELOPMENT OF A DUTY OF DISCLOSURE

Delaware provides a good example of the case-by-case development of the duty of disclosure. Although Delaware is not necessarily typical due to its well-developed body of corporate decisional law, the significance of Delaware’s corporate decisions extends well beyond its borders into MBCA states, which look to Delaware for guidance.\textsuperscript{13}

Although there are earlier disclosure cases, the modern Delaware duty-of-disclosure era can be dated to the 1977 Delaware Supreme Court decision in \textit{Lynch v. Vickers Energy Corp.}.\textsuperscript{14} In \textit{Lynch}, the court found disclosure failures in a majority shareholder’s going private tender offer. This was followed by \textit{Weinberger v. UOP, Inc.},\textsuperscript{15} in which there was a failure to disclose material inside information when soliciting shareholder approval for the merger of a subsidiary into the parent. Both of these cases—as well as some later cases, like \textit{In re Tri-Star Pictures, Inc. Litigation}\textsuperscript{16}—involved conflict-of-interest

\textsuperscript{11}. \textit{Id.} at 1062–63.
\textsuperscript{12}. Comm. on Corporate Laws, \textit{Proposed Amendments 2006}, supra note 9, at 1191.
\textsuperscript{14}. 383 A.2d 278 (Del. 1977).
\textsuperscript{15}. 457 A.2d 701 (Del. 1983).
\textsuperscript{16}. 634 A.2d 319 (Del. 1993).
transactions by controlling shareholders, and thus were grounded in breaches of the duty of loyalty.\textsuperscript{17}

The duty of disclosure soon became unlinked from its loyalty base in cases like \textit{Smith v. Van Gorkom}\textsuperscript{18} and \textit{Zirm v. VLI Corp.}\textsuperscript{19} and has remained unlinked since, having taken root as part of a director’s fiduciary duty.\textsuperscript{20} The breadth of this duty is found in the Delaware Supreme Court’s statement, in \textit{Stroud v. Grace},\textsuperscript{21} that fiduciary duty requires directors to disclose all material information within their control when they seek shareholder action. \textit{Stroud} involved shareholder approval of charter amendments in which proxies were not solicited. A limited expansion of the \textit{Stroud} rule can be found in \textit{Malone v. Brincat}\textsuperscript{22} in which the court held that directors can be liable for knowingly providing false information to shareholders, even without seeking shareholder action. However, the nature of that duty differs from the duty of disclosure dealt with by the Committee since it is not based upon shareholder actions,\textsuperscript{23} and thus not easily subject to statutory treatment.

The vitality of Delaware’s application of the duty of disclosure is found in a series of decisions in 2007 and some more-recent cases.\textsuperscript{24} The 2007 cases were \textit{Louisiana Municipal Police Employees’ Retirement System v. Crawford},\textsuperscript{25} \textit{In re Netsmart Technologies, Inc. Shareholders Litigation},\textsuperscript{26} \textit{In re The Topps Co. Shareholders Litigation},\textsuperscript{27} and \textit{In re Lear Corp. Shareholder Litigation}.\textsuperscript{28} In each, the chancery court enjoined acquisition transactions until corrective disclosure was made to shareholders. More-recent examples in which disclosure issues were considered by the court are \textit{In re Cogent, Inc. Shareholder Litigation},\textsuperscript{29} and \textit{Maric Capital Master Fund, Ltd. v. Plato Learning, Inc.}\textsuperscript{30} In these decisions, the Delaware Chancery Court approached disclosure issues from the perspective of satisfying fiduciary duties as they relate to corporate governance—namely, the ability of shareholders to exercise their voting franchise on an informed basis. A

\begin{itemize}
\item \textbf{18.} 488 A.2d 858 (Del. 1985).
\item \textbf{19.} 621 A.2d 773 (Del. 1993).
\item \textbf{21.} 606 A.2d 75, 84 (Del. 1992).
\item \textbf{22.} 722 A.2d 5 (Del. 1998).
\item \textbf{26.} \textit{In re Netsmart Techs., Inc. S’holders Litig.}, 924 A.2d 171 (Del. Ch. 2007).
\item \textbf{27.} \textit{In re The Topps Co. S’holders Litig.}, 926 A.2d 58 (Del. Ch. 2007).
\item \textbf{28.} \textit{In re Lear Corp. S’holder Litig.}, 926 A.2d 94 (Del. Ch. 2007).
\end{itemize}
similar perspective has been applied in a number of cases involving the ability of shareholders to exercise appraisal rights on an informed basis. For example, in Berger v. Pubco Corp., the Delaware Supreme Court fashioned a “quasi-appraisal” remedy when the parent failed to disclose to the minority shareholders—who had to decide whether to assert appraisal rights—how it set the share price in a short-form cash-out merger. These decisions reflect the court’s concern about disclosure issues surrounding conflicts of interest (such as banker’s fees and management participation), bases of valuation used by financial advisers, and financial projections available to the board and interested parties. For example, in the recent Maric decision, the court found the disclosure in a private-equity buyout inadequate in the following respects: (1) the description of how the investment bank calculated the discount rate for its discounted cash flow valuation when rendering its fairness opinion; (2) the use of selective projections regarding the target’s future performance, with the omission of the free cash flow estimates provided to the investment bank for use in its valuation analysis; and (3) mischaracterization of the discussions between management and the buyer regarding future employment and equity arrangements.

The ability to deal with these issues on a case-by-case basis provides flexibility to decide what disclosures are relevant given the type of transaction involved, and to assess the materiality of information in that context. The ability to grant injunctive relief—as opposed to assessing individual damages—has allowed courts to take a pragmatic approach to obtain corrective disclosure when necessary to avoid interfering with the ability of shareholders to make an informed decision about whether to approve a transaction.

This flexibility has a corresponding downside: It increases the indeterminacy of Delaware corporation law and leads to less predictability and reliability. Furthermore, it may be one thing to accept this indeterminacy in Delaware courts, given their experience, expertise, and sophistication with corporate law matters, but another to deal with it in courts that do not meet those standards. Nevertheless, some measure of indeterminacy is the necessary price of a principles-based common-law process that depends on context, in contrast to detailed and prescriptive codification. The Committee’s decision to take a case-by-case approach to disclosure requirements depended in part on the need

32. See Berger, 976 A.2d at 142–44.
33. See Maric, 2010 WL 1931084, at *1–2.
ultimately to vest confidence in the courts to properly address these issues. The willingness of courts outside Delaware to look to Delaware precedents for guidance helped the Committee to make that decision.

V

CONCLUSION

The Committee’s actions regarding disclosure requirements demonstrate the ability of the MBCA to adapt to changing developments in the law. They also demonstrate the importance of determining when, and to what extent, statutory codification is appropriate, and when certain matters—because of their complexity, variability, and dependence on specific facts and circumstances—are better left to judicial determination on a case-by-case basis.