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Chancery Court Calls Plaintiffs' Bet Granting in Part & Denying in Part Partial Motion to Dismiss Breach of Fiduciary Duty Claims in Case Alleging Failure to Disclose Material Facts and Structuring a Transaction for Defendants' Personal Financial Benefit

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The Delaware Court of Chancery granted in part and denied in part Plaintiff's partial motion to dismiss, finding that the standard for breach of fiduciary duty was not met as against certain directors and officers of the Company based on allegations they failed to disclose facts relating to a tender offer, but was met as against the directors and one of the officers on allegations that they approved a tender offer where they were expected to receive a personal financial benefit.

Plaintiffs in Chatham Asset Management, LLC, Chatham Fund, LP, and Chatham Asset High Yield Master Fund, Ltd. v. George Papanier, John E. Taylor, Jr., Soo Kim, Stephen H. Capp, Craig L. Eaton, Glenn Carlin, Phil Juliano, and Jay Minas, C.A. No. 2017-0088-AGB (Del. Ch. January 13, 2020) include Chatham Fund, LP and Chatham Asset High Yield Master Fund, Ltd., both of which own common stock of Twin River Worldwide Holdings, Inc. ("Twin River") and Chatham Asset Management, LLC, their investment advisor (collectively referred to as "Chatham").

Twin River is a holding company that owns businesses in the gaming industry and has its principal place of business in Rhode Island. It is regulated by the Rhode Island Department of Business Regulations ("DBR"), which imposes limitations on Twin River's stock ownership. In particular, it prohibits any stockholder from owning more than 15% of Twin River's stock.

In 2016, Twin River undertook a tender offer to acquire a portion of its outstanding common stock ("Tender Offer") pursuant to the terms of an Offer to Purchase ("OTP"). At the time of the Tender Offer, one of Twin River's stockholders, Standard General, had confirmed with DBR that, by not participating in the Tender Offer, Standard General would not be in violation of a previous DBR approval allowing it to acquire up to 19.9% of Twin River's stock, which had expired two years before the Tender Offer closed. The OTP disclosed what Standard General's pre-tender ownership stock percentage was and that it did not intend to participate in the Tender Offer. It did not disclose the DBR approval that Standard General had obtained.

Relevant to the instant motion to dismiss was Chatham's claim for breach of fiduciary duty based on the failure to disclose the regulatory approval granted to Standard General in the OTP. Chatham claimed that this omission was material because if it had known about the approval it would have sought its own approval and not tendered its shares.

In considering the defendants' motion to dismiss, the Court stated that under controlling precedent, the omission of a fact is material if, there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." In other words, an omitted fact is material if its disclosure would be viewed by a reasonable investor as having significantly changed the "total mix" of available information. Here, the Court found that the OTP had disclosed the total number of outstanding shares of common stock as of the Tender Offer, the number of shares of common stock owned by Standard General and that Standard General did not intend to participate in the Tender Offer. These disclosures, the Court reasoned, would allow any Twin River stockholder to determine the potential impact Standard General's decision not to participate in the Tender Offer would have on its decision to tender. The Court rejected Chatham's claim that the disclosure was "material to Chatham" because it thought it had no choice but to participate in the Tender Offer because of regulatory requirements. The Court made clear that the "adequacy of disclosure is determined by focusing on a *reasonable* investor, and not by considering the attributes of a particular investor at issue." Accordingly, the Court granted defendants' motion to dismiss this claim.

The Court also granted defendants' motion to dismiss claims that the defendant Directors and Officers also breached their fiduciary duties by failing to disclose in the OTP $3.8 million in "Make-Whole Payments" made in November 2016 to certain defendant Directors and Officers that Chatham argued they were not entitled to on two grounds.

First, the Court noted the defendants were not required to describe their conduct in a manner as to admit wrongdoing, as such a disclosure would violate the rule against "self-flagellation." Second, the failure to disclose the Make-Whole Payments in the OTP would not have been a material fact that a reasonable stockholder would have considered important in deciding how to vote. The OTP included references to Twin River's financial statements and other relevant information available on its website. The Court noted that based on the information provided, Twin River's market capitalization at the time of the Tender Offer was in excess of $786 million. As a result, the $3.8 million in Make-Whole Payments amounted to less than 0.50% of Twin River's market capitalization. In response to Chatham's argument that the $3.8 million in Make-Whole Payments should be compared to the Twin River's working capital, total size of the Tender Offer, or even the amount of compensation paid to the directors, the Court remarked the more logical consideration is to look at the overall value of the company as a key factor in deciding the Tender Offer price provided fair value for one's shares.

In granting defendants' motion to dismiss, the Court reasoned that given all of the information available to the stockholders and that the Make-Whole Payments represented less than 0.50% of Twin River's market capitalization, the failure to disclose those payments in connection with the Tender Offer would not have significantly changed the "total mix" of information available to the stockholders.

Finally, the Court addressed Plaintiff's claim that defendants breached their fiduciary duties by structuring the Tender Offer to benefit their own personal financial interests instead of the stockholders generally and by providing one stockholder preferential treatment to the harm of the others. Chatham contended that the Director and Officer defendants structured the Tender Offer to require the other stockholders to sell shares in the Tender Offer to remain below the regulatory ownership limit imposed by the DBR and that they also obtained DBR approval so Standard General would not violate the regulatory limit for not participating in the Tender Offer.

According to the Complaint, defendants Papanier, Taylor, Capp, Eaton, and Juliano were parties to “Put Agreements” and executed put requests in October 2016 to common stock back to Twin River for approximately $9.15 million. However, by purchasing the shares subject to the Put Agreements, the total number of outstanding shares of Twin River would decrease thereby potentially increasing the ownership percentage of the other stockholders beyond their regulatory limits. Chatham alleged the defendants structured the Tender Offer to force stockholders who were close to their regulatory ownership limit, like Chatham, to reduce their shareholdings in Twin River. As a result, Chatham argued they were required to sell shares less than for what they believed they were worth at the time causing them to be harmed.

Papanier, Capp, Taylor, and Eaton all stood to personally benefit financially by selling a number of their shares to Twin River. Kim’s alleged benefit was obtaining DBR’s approval allowing Standard General, a fund he managed, to not participate in the Tender Offer, thereby allegedly allowing it to increase its stockholdings resulting from the others stockholders tending some of their shares in Twin River. The Court also noted that Eaton’s involvement in getting DBR’s approval for Standard General would further his plan to sell some of his shares for his own personal benefit. The Court further noted that the structure of the Tender Offer where the defendant Directors all stood to receive a personal financial benefit rather than a benefit to be received by all the stockholders generally, subjected the transaction to an entire fairness review, requiring more scrutiny to determine whether the Tender Offer was fair to the stockholders. The Court denied defendants’ motion to dismiss against the Director defendants and Eaton. However, the Court granted defendants’ motion to dismiss against Carlin because he was not a party to a Put Agreement and there were no allegations that he intended to obtain or actually obtained any personal benefit from the Tender Offer.

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