Delaware Supreme Court Holds *MFW* Inapplicable Based on Banker Conflict Disclosure Deficiencies

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The Delaware Supreme Court has reversed a Court of Chancery decision dismissing challenges to the acquisition of Inovalon Holdings, Inc. by a consortium led by Swedish private equity firm Nordic Capital[1] in a decision demonstrating the importance of disclosure of financial advisor conflicts in order to obtain the benefit of business judgment rule review under *Kahn v. M&F Worldwide Corp.* – the *MFW* decision. The Supreme Court held that the majority-of-the-minority stockholder vote approving the transaction was not fully informed, based on inadequate disclosure of conflicts of interest on the part of financial advisors to the special committee of Inovalon's board.

As a result of its dual-class capital structure, Inovalon was controlled by its founder and CEO, who held approximately 64% of the Company's voting power. Another 23% of the vote was held by a former Inovalon director. After various discussions led by the founder with financial sponsors and strategic parties, Nordic proposed to acquire Inovalon for $43 per share, specifying both that Nordic typically requests management to "roll over" a portion of their equity and that in the event of any management equity rollover a special committee and majority-of-the-minority approval would be required. Inovalon's board instructed its financial advisor to push for at least $44 per share in exchange for a grant of exclusivity. Nordic agreed to that price and stated that it would fund the deal with a $3.5 billion Nordic equity commitment, $2.55 billion in equity commitments from co-investors, and $1.75 billion in debt. At an ensuing Inovalon board meeting, the founder informed the board that Nordic had requested that he roll over a portion of his equity. The board then formed a special committee.

At its first meeting, the special committee engaged legal counsel, finding that although the firm it hired had been working with Inovalon on the transaction for about a month it was not Inovalon's historic counsel and was independent of Inovalon management and the founder. Three days later, the committee engaged a second financial advisor. Each financial advisor provided relationship disclosure to the special committee, specifying work for Nordic on unrelated matters, although the first advisor's disclosure did not mention prior business with other members of Nordic's equity consortium. Ten

[1] *City of Sarasota Firefighters' Pension Fund et al. v. Inovalon Holdings, Inc. et al.*, No. 305, 2023 (Del. May 1, 2024)

days after the special committee hired counsel, the founder informed the committee that he and the other rollover participants had engaged the same firm to work on the rollover arrangements.

Nordic, having come up short in its equity fundraising, subsequently lowered its price to $40.25 per share, which was rejected by the special committee. Ultimately the parties agreed on a deal at $41 per share, with a $700 million rollover from the founder and a $600 million rollover from the former director. The founder's rollover agreement included an annexed management incentive plan ("MIP") term sheet, which was non-binding but contemplated 8% of the post-transaction fully diluted equity being subject to the MIP, with 5% granted to employees at closing and 3% held in reserve.

Following closing, plaintiffs brought breach of fiduciary claims against the founder and the other Inovalon directors. The Court of Chancery found that the requirements of *MFW* had been satisfied and dismissed the claims. On appeal, the plaintiffs focused on two reasons they claimed the transaction failed to comply with *MFW*. First, they argued that the transaction flunked *MFW*'s "*ab initio*" test because the founder engaged in substantive negotiations before the special committee was formed. Second, they asserted that due to inadequate disclosure of the banker conflicts, the majority-of-the-minority vote was not fully informed. The Court reversed on the basis of the second argument and did not reach the *ab initio* question.

The Court found that the Inovalon proxy statement failed to adequately disclose conflicts of both financial advisors. It found that language stating that the second advisor "may provide" services to Nordic and its co-investors was misleading given that the advisor was in fact providing such services, creating a concurrent conflict. In the case of the first advisor, the Court held that disclosure that the bank would receive "customary compensation" in connection with disclosed concurrent representations was insufficient because it kept stockholders from "contextualizing and evaluating" the conflicts. It also found that the proxy statement failed to disclose the first advisor's fees for prior work for members of Nordic's equity consortium, which amounted to nearly $400 million in the relevant two-year period.

The Court stated that while "there is no hard and fast rule that requires financial advisors to always disclose the specific amount of their fees from a counterparty in a transaction," the question is subject to a materiality standard. The Court found that in this case that materiality standard was met, noting that the undisclosed compensation was roughly 25 times the disclosed fees that the first advisor received from Nordic and 10 times the fees that it received in the transaction, thus creating a misleading picture.

Finally, the Court addressed disclosure about the second advisor's role in the bidder outreach process, which the plaintiffs claimed had been overstated in the proxy. The

Court observed that the disclosures about the second advisor's role "do not sit comfortably" with corresponding accounts in the minutes, and it cautioned boards, committees and their advisors to take care in accurately describing events and roles played by board and committee members and their advisors – but the Court declined to "pile on" another basis for reversal.

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