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Case No. 12912-VCS

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

SAMUEL ZALMANOFF, Plaintiff, v. JOHN A. HARDY, KENNETH I. DENOS, FRASER ATKINSON, ALESSANDRO BENEDETTI, RICHARD F. BERGNER, HENRY W. HANKINSON, ROBERT L. KNAUSS, BERTRAND DES PALLIERES and EQUUS TOTAL RETURN, INC., Defendants.	: : : : : : : : : : : : : : :	**C.A. No. 12912-VCS**

MEMORANDUM OPINION

Date Submitted: October 22, 2018
Date Decided: November 13, 2018

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SLIGHTS, Vice Chancellor

Plaintiff, Samuel Zalmanoff, has brought a single-count complaint (the "Complaint") against the members of the board of directors (the "Board" or "Defendants") of Equus Total Return, Inc. ("Equus" or the "Company") in which he alleges that Defendants breached their fiduciary duty of disclosure when seeking stockholder approval of an equity incentive plan. Defendants have moved for summary judgment (the "Motion"). For reasons explained below, I am satisfied that when the disclosures provided in the operative proxy statement are considered alongside those made in a simultaneously mailed Form 10-K, it is indisputable that Defendants adequately fulfilled their disclosure obligations. Defendants' Motion for Summary Judgment, therefore, must be granted.

I. FACTUAL BACKGROUND

A. Parties and Relevant Non-Parties

Plaintiff, Samuel Zalmanoff ("Plaintiff"), owned Equus common stock at all times relevant to the Complaint. He brings this action on behalf of himself and a class of similarly situated Equus stockholders.

The Defendants—John A. Hardy ("Hardy"), Kenneth I. Denos ("Denos"), Fraser Atkinson, Richard F. Bergner, Henry W. Hankinson, Robert J. Knauss and Bertrand des Pallieres—comprise the Equus Board of Directors at the time of the events giving rise to the Complaint. Hardy is Equus's CEO and Denos is its Chief Compliance Officer.

Equus is a Delaware corporation with its principle place of business in Houston, Texas. At the time this action was filed, Equus was classified as a business development company ("BDC") under the Investment Company Act of 1940, 15 U.S.C. § 80a, et seq.[1] Equus's previous focus was on investments in non-public debt and equity securities. Equus's stock trades on the New York Stock Exchange under the symbol "EQS."

B. Summary of the Dispute

This is a class action challenging the Board's adoption of an Equity Incentive Plan (the "EIP") following overwhelming approval of the EIP by Equus stockholders. Plaintiff, an Equus stockholder, alleges that Defendants breached their fiduciary duty of disclosure by omitting material facts and making false and misleading disclosures in the 2016 Schedule 14A (the "2016 Proxy") that Equus filed with the Security Exchange Commission ("SEC") to solicit stockholder approval of the EIP.

The Board proposed the EIP to stockholders as Equus was in the midst of significant transition. Specifically, in May 2014, Equus disclosed that it was considering a merger or consolidation with MVC Capital, Inc. ("MVC") through a

[1] BDCs are unregistered, closed-end investment companies that tend to invest in small and mid-sized businesses in the initial stages of their development. (Measly Aff., Ex. B, 2015 10-K at 4.)

two-step Plan of Reorganization. In the first step, effected in May 2014, Equus engaged in a share exchange with MVC for 20% of its shares. The exchange ratio was based on respective net asset values ("NAV"). The second step contemplated that MVC and Equus would merge, although this has yet to occur and, according to Defendants, likely will not occur.

According to the Complaint, since the announcement of the Plan of Reorganization, Equus's core investment activity has slowed substantially. Indeed, as disclosed in the company's 2015 Form 10-K (the "2015 10-K"), as of the time it sought to implement the EIP, Equus held 46% of its assets in the form of cash or cash equivalents. As a BDC, reduced investment activity means reduced returns for Equus stockholders.

The 2016 Proxy disclosed that the EIP would allow Equus to grant options to Equus directors and officers to acquire up to 25% of Equus's shares at a price equal to the current market value, which is at a discount to NAV. It also disclosed that the purpose of the EIP was to encourage Equus officers, employees and directors "to remain with and devote their best efforts to the business . . . [and] enhance the ability of the Company and its affiliates to attract and retain the services of individuals who are essential to the growth and profitability of the Fund."[2]

[2] Measley Aff., Ex. J, Proxy Statement.

In his Complaint, Plaintiff alleges the 2016 Proxy failed to disclose and/or misstated five facts that were material to the stockholders' consideration of the EIP: (1) "the reasons why Equus has not merged or consolidated with MVC and the current status of that transaction"; (2) "that Equus no longer engages in any meaningful new investment activities and holds over $32 million or 61% of its assets in cash or cash equivalents, making the claimed premise of needing to compensate Equus's executive or the Board through awarding stock options false or misleading"; (3) "that Equus has previously sold shares to MVC at prices reflecting the Fund's NAV while the EIP seeks to grant options based upon current market value which represents a substantial discount to NAV"; (4) "that Equus is in the process of being acquired by MVC, which acquisition was expected to be commenced and/or completed in 2016, which, at a minimum, raises serious questions as to the necessity of providing additional compensation to Equus's executive and directors through the proposed EIP"; and (5) "that [D]efendant Hardy is a director of Versatile Systems."[3] According to Plaintiff, these omissions were material and ultimately misleading since the stockholders were being asked to approve an EIP that was meant to

[3] Verified S'holder Class Action Compl. ("Compl.") ¶ 38. In ruling on Defendants' previously filed motion to dismiss (D.I. 7), I dismissed the disclosure claim to the extent it rested on the allegation that the Board failed to disclose Hardy's status as a director of Versatile Systems. *See* Tele. Rulings of the Ct. on Defs.' Mot. to Dismiss, Aug. 2, 2017, D.I. 27, at Tr. 17:16–18:11.

incentivize present and future officers of Equus to perform at their best, even as the company's investment activity had slowed to a near halt and even as the Company was on the brink of merging itself out of existence.

II. ANALYSIS

The Defendants move for summary judgment. Their principal argument is that, even if the Court were to assume that the five facts identified by Plaintiff are material, these facts were disclosed to Equus stockholders either in the 2016 Proxy or in the 2015 10-K that was mailed to stockholders along with the 2016 Proxy. Plaintiff opposes the Motion on the ground that Defendants are not entitled to rely upon disclosures in the 2015 10-K as evidence that they discharged their fiduciary duty of disclosure with respect to the EIP. I disagree with Plaintiff and grant summary judgment to Defendants.

A. Summary Judgment Standard

Under Court of Chancery Rule 56, summary judgment shall be granted if "there is no genuine issue as to any material fact and . . . the moving party is entitled to judgment as a matter of law."[4] "The moving party bears the initial burden of demonstrating that even with the evidence construed in the light most favorable to

[4] Ct. Ch. R. 56(c).

the non-moving party there are no genuine issues of material fact."[5] If the moving party carries that initial burden, then the burden shifts to the non-moving party to point to genuine issues of material fact that remain in dispute.[6]

B. The Undisputed Evidence Reveals that Defendants Complied With Their Duty of Disclosure

Our law is settled that, when seeking stockholder approval of a corporate action, a board must disclose all facts that are material to the requested action so that shareholders may cast an informed vote.[7] While Defendants have not conceded the materiality of the information that Plaintiff alleges was missing from the "total mix," they have not sought summary judgment on materiality. Instead, Defendants maintain that the information was adequately disclosed in the 2016 Proxy and the 2015 10-K. The argument rests on two threshold factual predicates and then a single legal proposition: (1) the Equus stockholders received the 2015 10-K along with the 2016 Proxy; (2) the 2015 10-K contained the allegedly omitted information regarding the EIP; and (3) accordingly, the Board was entitled as a matter of law to rely upon disclosures contained in the 2015 10-K (admittedly not the disclosure

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[5] *In re Orchard Enters., Inc. S'holder Litig.*, 88 A.3d 1, 16 (Del. Ch. 2014).

[6] *Id.*

[7] *Crescent/Mach I P'rs, L.P. v. Turner*, 846 A.2d 963, 987–88 (Del. Ch. 2000) ("[T]he standard for determining whether an omission or misrepresentation is material is whether there is a substantial likelihood that a reasonable stockholder would consider the fact as having significantly altered the 'total mix' of information made available.").

document in which stockholder approval was solicited) to fulfill its duty of disclosure with respect to the EIP. I address each point in turn.

1. The 2015 10-K Was Mailed With the 2016 Proxy

Defendants maintain that there is no dispute that, when Equus mailed the 2016 Proxy to its shareholders, a copy of the 2015 10-K was included in the mailing.[8] While not initially clear, Plaintiff has now acknowledged this fact, so it stands undisputed.[9]

2. The 2015 10-K Disclosed the Allegedly Omitted Information

Defendants next maintain that all of the disclosures Plaintiff alleges are missing from the 2016 Proxy can be found in the 2015 10-K. With one exception relating to an alleged omission that Plaintiff ironically chose to omit from his Complaint, Plaintiff now acknowledges this fact as well.[10]

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[8] Broadridge Aff.; Computershare Aff.

[9] Pls.' Answering Br. in Opp'n to Mot. for Summ. J. ("Pls.' Answering Br.") at 15.

[10] Specifically, the 2015 10-K discloses that Equus intended to effect a reorganization pursuant to Section 2(a)(33) of the 1940 Act and that Equus intended to finalize the reorganization by pursuing a merger or consolidation with MVC. Measly Aff., Ex. B, 2015 10-K at 3–4. It also disclosed that, "[a]bsent Equus merging or consolidating with/into MVC or a subsidiary thereof, [Equus's] current intention is for Equus to (i) consummate the Consolidation with a portfolio company of MVC, (ii) terminate its election to be classified as a BDC under the 1940 Act, and (iii) be restructured as a publicly-traded operating company focused on the energy and/or financial services sector." *Id.* at 4. The 10-K also explained that "[Equus] management is currently evaluating these alternatives and expects to commence and/or consummate a Consolidation during 2016." *Id.* As for the status of Equus's investment activities, the 2015 10-K squarely addressed that as well.

The one disclosure identified by Plaintiff that is absent from the 2016 Proxy and the 2015 10-K, identified by the Plaintiff for the first time in his brief opposing the Motion, relates to the "Best Efforts Clause" within the document memorializing the Plan of Reorganization. The Best Efforts Clause appears in Section 4(e) of the Share Exchange Agreement and states "Equus shall undertake its reasonable best efforts to effect the Events of Reorganization, including working expeditiously towards closing each of the Events of Reorganization and taking all reasonable steps to that end."[11] Plaintiff now argues that the Board was obliged to explain that this clause, in application, required Equus to "limit[] its traditional business-related investment operations."[12]

Plaintiff's Best Efforts disclosure claim fails for two reasons. First, as noted, the Best Efforts Clause is nowhere mentioned in the Complaint. Consequently, Defendants received no notice in that pleading that Plaintiff intended to state a

(Measley Aff., Ex. B, 2015 10-K at 4, 35, 40). The allegedly omitted disclosure that would have allowed stockholders meaningfully to compare the pricing methodology for the options contemplated by the EIP to pricing for shares issued to MVS in the exchange is likewise front and center in the 2015 10-K: "As a first step to consummating the reorganization, we sold to [MVC] 2,112,000 newly issued shares of [Equus] common stock in exchange for 395,839 shares of MVC. . . . The Share Exchange was calculated based on [Equus's] and MVC's respective net asset value per share." (Measley Aff., Ex B, 2015 10-K at 3).

[11] Measley Aff. Ex. A at Ex. 10.1 § 4(e).

[12] Pl.'s Answering Br. at 3.

disclosure claim based on a failure to explain that clause to stockholders. The claim is waived.[13] Second, the claim fails on the merits. The Best Efforts Clause speaks for itself; it required no explanation. More to the point, contrary to Plaintiff's characterization, the clause required nothing more than that Board not "actively and affirmatively torpedo" the Proposed Consolidation with MVC.[14]

3. Disclosures Within the 2015 10-K Satisfy Defendants' Disclosure Duty As a Matter of Law

Having acknowledged that the 2015 10-K was mailed to stockholders along with the 2016 Proxy, and that the 2015 10-K contains the facts Plaintiff alleges (in his Complaint) were wrongfully omitted from the 2016 Proxy, Plaintiff's opposition to the Motion reduces to a legal argument: can Defendants rely upon disclosures in the 2015 10-K to discharge their disclosure obligations to stockholders.[15] Defendants argue that information in the 2015 10-K, mailed concurrently with the 2016 Proxy, when considered alongside the 2016 Proxy, adequately informed stockholders of all material facts relating to the EIP as a matter

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[13] *See* Del. Ch. R. 8; *Morgan v. Cash*, 2010 WL 2803746, at *8 n.64 (Del. Ch. July 16, 2010) (holding that plaintiff had waived claim by not raising it in her complaint and that she could not cure the waiver by raising claim for the first time in her brief opposing dismissal).

[14] *Williams Cos. v. Energy Transfer Equity, L.P.*, 2016 WL 3576682, at *18 (Del. Ch. June 24, 2016) (explaining purpose and application of a best efforts clause).

[15] *See* Tr. of Hr'g Oct. 22, 2018 ("Oct. 22 Tr.") at 25:10–23.

of law. Plaintiff's counter position is equally stark. He maintains, as a matter of law, that Defendants were obliged either to disclose the material information at issue in the 2016 Proxy itself or expressly direct stockholders in the 2016 Proxy to consult the 2015 10-K as a supplemental disclosure regarding the EIP.[16]

In support of their argument, Defendants rely heavily upon *Wolf v. Assaf*, a decision of this court that Defendants characterize as directly on point.[17] There, the plaintiff alleged that defendant directors breached their fiduciary duty by inadequately disclosing to stockholders the existence and circumstances of an ongoing federal securities class action involving the corporation and its directors when seeking stockholder approval of an employee stock incentive plan.[18] The directors placed the disclosure regarding the pending litigation in a Form 10-K, which was included in the mailing with the proxy statement relating to the plan, but did not repeat the disclosure or reference it within the proxy statement.[19] After reviewing the proxy and Form 10-K against the plaintiff's disclosure allegations, the court held that "including the disclosures . . . in a Form 10-K made a part of the

[16] *Id.* at 32:19–33:7.

[17] *Wolf v. Assaf*, 1998 WL 326662 (Del. Ch. June 16, 1998).

[18] *Id.* at *1.

[19] *Id.*

proxy mailing rather than in the proxy statement itself adequately informs the shareholder of the material information as a matter of law."[20]

Plaintiff has little to offer by way of distinguishing *Wolf*.[21] Instead, he maintains that *Wolf* cannot be reconciled with this court's jurisprudence to the effect that Delaware does not measure compliance with the fiduciary duty of disclosure against what would have known and understood by a "'super' shareholder."[22] Indeed, our law does not impose a duty on stockholders to rummage through a company's prior public filings to obtain information that might be material to a request for stockholder action.[23] But there was no rummaging required in this case. Equus stockholders were provided with both the 2016 Proxy and the 2015 10-K in

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[20] *Id.*

[21] While not able to distinguish *Wolf*, Plaintiff does argue that Defendants are precluded from relying upon *Wolf* because they failed to cite the decision in support of their previously filed motion to dismiss. The argument is not credible. Unlike the plaintiff in *Wolf*, who acknowledged in his complaint that the defendants had mailed the Form 10-K with the operative proxy statement, Plaintiff made no such acknowledgement in his Complaint. Consequently, neither Defendants nor the Court were permitted on the motion to dismiss to assume that fact as true. With the benefit of the factual record that has been presented with Defendants' motion for summary judgment, the Court may now consider the undisputed fact that the 2015 10-K was part of the 2016 Proxy mailing. In this context, *Wolf* assumes a prominent place in the Court's analysis whereas at the pleadings stage it could not and did not.

[22] Pls.' Answering Br. at 21. (citing *In re Trans World Airlines, Inc. S'holders Litig.*, 1988 WL 111271, at *10 (Del. Ch. Oct. 21, 1998); *Gilliland v. Motorola, Inc.*, 859 A.2d 80 (Del. Ch. 2004); *Sealy Mattress Co. of New Jersey, Inc. v. Sealy, Inc.*, 532 A.2d 1324 (Del. Ch. 1987)).

[23] *In re Trans World Airlines, Inc. S'holders Litig.*, 1988 WL 111271, at *10.

the same mailing. Under these circumstances, where the undisputed record reveals "that the information was in fact delivered to shareholders in a reasonable manner so that it would be a part of the total mix to be considered by them, [this showing] defeats conclusory claims to the contrary."[24]

Plaintiff says the better authority is *ODS Technologies, L.P. v. Marshall*,[25] where, as here, a Form 10-K was mailed to shareholders with the proxy statement. Unlike *Wolf*, however, where the allegedly omitted material information was actually *in* the Form 10-K, the director defendants in *ODS* argued that the material information could be found in materials referred to in the Form 10-K by reference but actually attached to an unrelated distribution provided to shareholders two years earlier.[26] Because the relevant information was neither disclosed in the proxy statement nor the accompanying Form 10-K, *ODS* held that a reasonable shareholder, even after reviewing the proxy statement *and* the Form 10-K, would

[24] *Wolf*, 1998 WL 326662, at *3; *see also Brinckerhoff v. Texas Eastern Products Pipeline Co., LLC*, 2008 WL 4991281 at *6 (Del. Ch. Nov. 25, 2008) (denying the plaintiff's argument that it would take a "super shareholder" to refer back to earlier proxy materials to fill in holes before voting. In reaching its decision to dismiss the plaintiff's disclosure claim, the court found that actual proxy materials filed mere weeks before must be considered as part of the total mix).

[25] 832 A.2d 1254 (Del. Ch. 2003).

[26] *Id.* at 1262.

still not have possessed all material information related to the proposed bylaw amendments they were being asked to approve.[27]

Unlike *Wolf*, *ODS* is distinguishable. The omitted information Plaintiff identified in his Complaint was not mailed to Equus stockholders two years prior to the 2016 Proxy. Nor was it attached to an unrelated distribution to shareholders. Instead, it was disclosed simultaneously in the 2015 10-K sent with the 2016 Proxy.

Plaintiff also alleges that the disclosures were inadequate because the 2016 Proxy's "boilerplate catch all" incorporation by reference clause provides no specific indication that a discussion of the Plan of Reorganization is "buried" within the 2015 10-K.[28] In this regard, Plaintiff cites *Gilliland v. Motorola, Inc.*,[29] where the court held that directors could satisfy their duty of disclosure with disclosures outside the solicitation document *if* they expressly identify the relevant prior disclosure documents and include them with the disclosure in which stockholder approval is solicited.[30] Here again, however, Plaintiff misses a key point of distinction. *Gilliland*'s holding—that broad language is inadequate to effect incorporation by reference for disclosure purposes—was rendered in the context of the defendant's

[27] *Id.* at 1260.

[28] Pls.' Answering Br. at 17.

[29] 859 A.2d 80 (Del. Ch. 2004).

[30] *Id.* at 88.

argument that the proxy's generic incorporation by reference provision effectively pointed stockholders to information outside of the mailing that had been disclosed to stockholders long before the solicitation.[31]

Not only was the 2015 10-K expressly referenced in the 2016 Proxy's "boilerplate catch all" language, it was also provided with the 2016 Proxy. This did not require Equus shareholders to don their "super-shareholder" capes in order to search for material information. That information was right at their fingertips. While, in hindsight, one might have constructed a better-organized disclosure that would have "simplified the shareholders' opportunity to grasp the information," as the court in *Wolf* acknowledged, "the directors mere failure to organize the documents to meet plaintiff's best case scenario . . . does not constitute the kind of omission or misleading half-truth that invokes this [c]ourt's equity jurisdiction."[32]

Moreover, it is intuitive that the information Plaintiff claims was omitted from the 2016 Proxy would be found in the 2015 10-K. Plaintiff's pled omissions relate not to the specifics of the EIP, the subject of 2016 Proxy vote solicitation, but to the Plan of Reorganization, which had been the subject of a previous Form 8-K and was

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[31] *Id.* at 82 ("The court concludes that, even when adequate, current information is found in the "total mix" of publicly available information, the fiduciary duty of disclosure requires that a notice of short-form merger either be accompanied by detailed disclosures or disclose summary financial information and adequately advise stockholders where and how to obtain more detailed information.").

[32] *Wolf*, 1998 WL 326662, at *3.

updated in the 2015 10-K.[33] Under these circumstances, our disclosure law does not require fiduciaries to repackage and restate information in a proxy that they are simultaneously and conspicuously providing to shareholders in another public filing.[34]

III. CONCLUSION

Having found that Defendants' simultaneous mailing of the 2015 10-K with the 2016 Proxy is adequate to inform stockholders of material information as a matter of law, the Motion for Summary Judgment must be GRANTED. The Complaint is dismissed with prejudice.

IT IS SO ORDERED.

[33] Measley Aff., Ex. A, May 14, 2014 8-K at 2; Measley Aff., Ex. B, 2015 10-K.

[34] *Bren v. Capital Realty Gp. Senior Hous., Inc.*, 2004 WL 370214, at *9 (Del. Ch. Feb. 27, 2004) ("All material facts to the action must be disclosed. This does not require, however, that all material information that was previously disclosed be disclosed again with the specific correspondence requesting action.") (citations omitted).