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Anatomy of a Merger Litigation

Douglas J. Clark and Marcia Kramer Mayer[1]

When a press release gives official notice that a public company is to be sold, a lawsuit objecting to the deal is soon filed. There are exceptions to this rule, but as a basic principle, it is a pretty sound one. The lawsuit names as defendants the target company, its board of directors, and the purchaser. The operative theory is that the target is being sold for too little and that the directors breached their fiduciary duties by agreeing to the sale, with the insidious help of the purchaser. The lawsuit seeks to stop the transaction from proceeding on the terms announced.

This article will take the reader on a journey through a particular litigated merger, Broadcom Corporation's purchase of NetLogic Microsystems, Inc., from start to finish. There's nothing exceptional or unique about the deal, the litigation that ensued, or the outcome of that litigation. This is a well-worn path. This journey will be taken with a minimum of commentary or criticism. At the end, the reader can draw his or her own conclusions as to whether this activity creates value for stockholders or advances the cause of corporate governance.

The Announcement

At 7 a.m. EDT on September 12, 2011, NetLogic and Broadcom issued a press release announcing that they had entered into a definitive merger agreement. Under the agreement, NetLogic stockholders would receive $50 per share, a 57% premium over the prior day's closing price. The transaction value was $3.7 billion. The deal was well received by the market, although some analysts intimated that Broadcom may have overpaid. *The Wall Street Journal* stated that "[a]nalysts noted that Broadcom is paying a lot for [NetLogic]. NetLogic's shares have never traded above $44. And the company has mainly reported losses under generally accepted accounting principles, in large part because of charges associated with past acquisitions."[2]

The definitive agreement contained standard terms and conditions, such as the transaction being contingent on obtaining regulatory approvals. The merger also would have to be approved by NetLogic's stockholders.

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[1] Douglas J. Clark is a Partner at Wilson Sonsini Goodrich & Rosati and Co-managing Partner of the firm. Marcia Kramer Mayer, Ph.D., is a Senior Vice President of NERA Economic Consulting and Chair of the firm's Global Securities and Finance Practice. The data referenced in this paper was compiled by Svetlana Starykh of NERA and Molly Arico of Wilson Sonsini. Using the MergerStat database, they identified 731 mergers and acquisitions that were announced from 2006 through 2010, completed by February 2011, involved a U.S. public company target, and had an announced value of at least $100 million. From RiskMetrics, they identified securities class actions objecting to these deals in state or federal court. From RiskMetrics and court dockets, they learned the outcomes of these cases through June 2011. Filing dates and allegations were obtained from RiskMetrics and the complaints.

[2] http://online.wsj.com/article/SB10001424053111904265504576566311807622324.html#ixzz1eYQwBJwo

Finding a Plaintiff

At 10:18 a.m. EDT the same morning, a plaintiffs' securities class action law firm issued a press release concerning the transaction. The text of the release stated:

> Bernstein Leibhard LLP is investigating whether the Board of Directors of NetLogic Microsystems, Inc. ("NetLogic Microsystems" or the "Company") (NASDAQ: NETL) breached its fiduciary duty to its shareholders in agreeing to sell NetLogic Microsystems to Broadcom Corporation.
>
> Under the terms of the agreement, NetLogic Microsystems shareholders will receive $50 in cash for each share they own. The investigation is focused on the potential unfairness of the price to NetLogic Microsystems shareholders and the process by which the NetLogic Microsystems Board of Directors considered and approved the transaction.

The purpose of this press release was simple: the law firm was looking for a client. Despite the considerable ingenuity of plaintiffs' lawyers, they have not yet figured out how to file a lawsuit without a client. Bernstein Leibhard was the first firm to issue a release, but it was far from the last. The following firms issued press releases seeking plaintiffs to protest the potential unfairness of a sale paying a 57% premium over the prior close, its offer price $6 per share higher than the stock had ever traded.

9/12

Bernstein Liebhard LLP
Kendall Law Group
Levi & Korsinsky, LLP
Briscoe Law Firm
Powers Taylor, LLP
Glancy Binkow & Goldberg LLP
Finkelstein Thompson LLP
Holzer Holzer & Fistel
Brower Piven
Robbins Umeda LLP
Law Offices of Vincent Wong

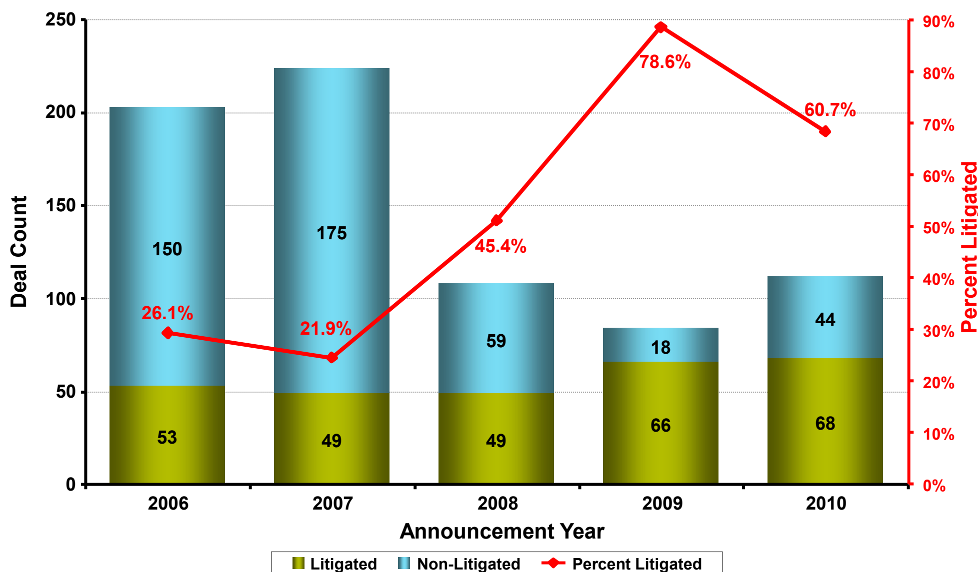
9/13

Ryan & Maniskas, LLP
Law Offices of Howard G. Smith
Murray Frank LLP
Joseph Klein
Faruqi & Faruqi, LLP

9/14 and Beyond

Brodsky & Smith, LLC
Bull & Lifshitz, LLP
Goldfarb Branham Law Firm LLP
Levi & Korsinsky, LLP

So, within hours of the announcement of the transaction, an avalanche of law-firm press releases ensued. Notably, the releases started before NetLogic filed additional information concerning the transaction with the SEC, including the definitive agreement. That occurred at 10:24 a.m. EDT on September 12. With so many law firms looking for a plaintiff, it was all but inevitable that a lawsuit would be filed.

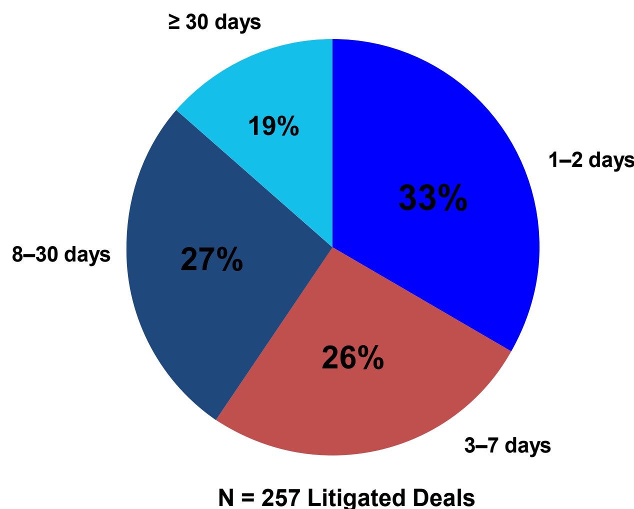


From 2006 through 2010, the percentage of eventually completed $100 million-plus transactions that were challenged in stockholder class actions increased sharply. Practitioners now routinely advise public company clients involved in a public/public sale transaction that a lawsuit will be filed questioning the deal regardless of the terms.

Lawsuit(s) Filed

The first complaint attacking the NetLogic transaction was filed on September 16, 2011, four days after the transaction was announced. The complaint was filed in Santa Clara County Superior Court in San Jose, California. While NetLogic is a Delaware corporation, it is headquartered in Santa Clara, the heart of Silicon Valley. Notably, the complaint—which objected to the deal's announced terms, as discussed in more detail below—was filed before the preliminary proxy was filed (October 5, 2011). That SEC filing contains highly pertinent information, such as the background of the transaction and a summary of the fairness opinion and financial analysis supporting the valuation and the board's decision to sell the company. Is such haste unusual?

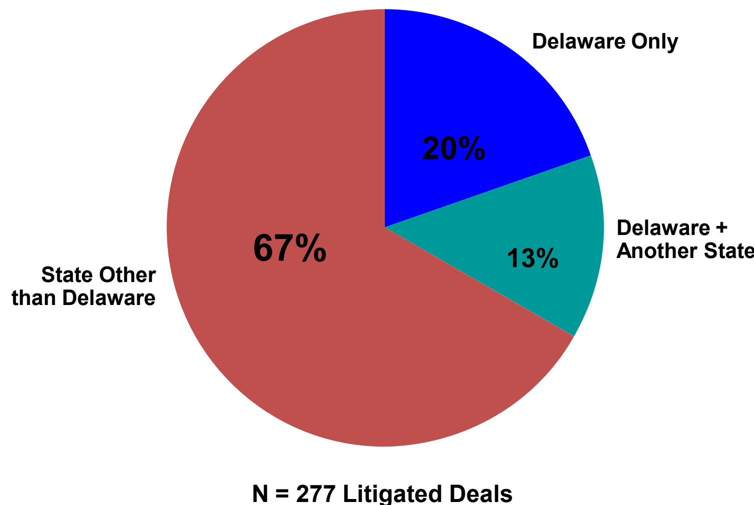
Time from Announcement of Deal to Filing of First Class Action



Not at all. A review of complaints objecting to public company sales announced from 2006 through 2010 with announced values of at least $100 million shows that 59% were filed within seven days of the transaction's announcement.

A second complaint was filed in Delaware Chancery Court on September 16, 2011. It's not crazy to ask why a second suit, in a second location. The answer: A different plaintiffs' firm wanted in on the game. Were this firm to have filed in Santa Clara County, the second complaint would have been consolidated into the first and the attorneys for the second plaintiff would have had little leverage to negotiate separately with defendants for a settlement or anything else. The other choices in this situation were the state of incorporation (Delaware) or a United States district court. State courts are more popular for this type of case because the primary relief sought is injunctive and they tend to move faster than federal courts. That is particularly true of the First State, Delaware. Speed matters because if plaintiffs want to stop a deal, they need to do so before it closes. Another consideration prompting plaintiffs to prefer state court is that it allows them to avoid the tougher standards of federal law, which also entail some unique and time-consuming provisions for class actions.

So, now there were two complaints on file, in two different states. Is this unusual?



It is not. Among $100 million-plus transactions that were announced from 2006 through 2010 and challenged in state court, 33 percent were litigated in Delaware. For 13 percent of the state-litigated deals, Delaware was not the only state addressing the transaction. If the Delaware numbers seem lower than expected, keep a few factors in mind. First, while most companies are incorporated in Delaware, not all are. Second, the Delaware Chancery Court is the most sophisticated and experienced judiciary when it comes to governance questions and that may make it unattractive for a plaintiff with a weak case. Third, the Chancery Court takes a rigorous approach to analyzing the fairness of consideration going to stockholders when granting attorneys' fees after a settlement, further marring its appeal to such plaintiffs.

The Initial Complaints

The California complaint was filed by the New Jersey Carpenters pension fund. A cursory check revealed this was not the Carpenters' first rodeo. They were the plaintiff in a merger litigation assailing InfoGroup, Inc.'s sale, as well as in class actions against NVIDIA Corporation, Residential Capital, and Hansen Natural Corporation.

As is customary in such matters, the Carpenters complaint named as defendants the target, NetLogic, its board of directors, and the buyer, Broadcom. It made three sets of substantive allegations: (1) the merger agreement contained preclusive deal terms (i.e., would inhibit higher offers) such as a break-up fee and a non-solicitation clause; (2) the merger agreement afforded inadequate consideration in light of NetLogic's recent financial results; and (3) the NetLogic board engaged in self-dealing involving such things as acceleration of stock appreciation rights. The complaint asserted two causes of action for breach of fiduciary duty against the NetLogic

defendants and a cause of action against Broadcom for aiding and abetting those breaches of duty.

The Delaware complaint was identical in structure and leveled the same substantive allegations. The plaintiff, Vincent Anthony Danielo, does not appear to have served as a class representative prior to this case.

The Litigation

There is no story of an epic court battle to be told as part of this saga. Very able lawyers on both sides filed a number of well-crafted procedural motions in the two pending matters.

The complaints in both matters were amended, as they always are, to include allegations based on the target's disclosures in its preliminary proxy statement. The California plaintiff amended its complaint on October 7, 2011 (two days after the preliminary proxy was filed) "adding allegations that the preliminary proxy statement . . . contained inadequate and misleading disclosures under Delaware law by failing to provide additional and more detailed disclosure regarding the events leading up to the merger, the analysis and opinion of Qatalyst Partners LP [the target's banker], and the NetLogic financial forecasts."[3] The Delaware complaint was amended on October 19, 2011, to add similar claims.[4]

Defendants moved to stay the California case in lieu of the Delaware matter and moved to dismiss both cases. Those motions were never heard. Plaintiffs sought expedited discovery in California. That request was denied. On October 27, 2011, the California plaintiff moved to enjoin the transaction. Defendants opposed that motion. The motion was never heard.

Such sparse litigation is not unusual. Vice Chancellor J. Travis Laster of the Delaware Chancery Court described the "Kabuki dance" of litigation in these types of cases: "[A] controller made a merger proposal. A series of actions were filed with a brief flurry of activity until the [plaintiff] leadership structure was settled. Real litigation activity then ceased."[5]

Guess What?

The cases settled. Most $100 million-plus litigated deals announced from 2006 through 2010 had settled by June 2011. So, settling is not unusual and this was not an unusual settlement.

On November 11, 2011, NetLogic announced that both litigations had been resolved and issued a Report on Form 8-K summarizing the settlement. The terms of settlement required: (1) additional disclosures concerning the "Selected Companies Analysis" and "Selected Transactions Analysis" in the summary of the fairness opinion; (2) an additional line of disclosure relating to the discounted cash flow analysis; (3) dismissal of the pending litigations; and (4) an agreement that plaintiffs' counsel could seek fees of up to $795,000 in the California action.

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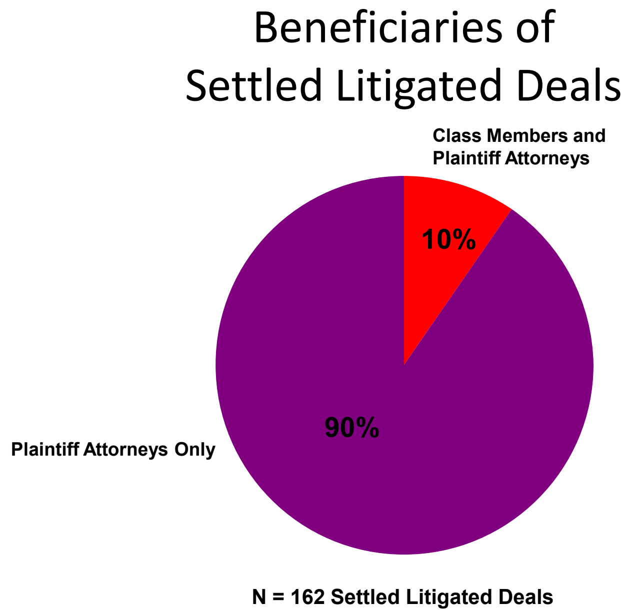
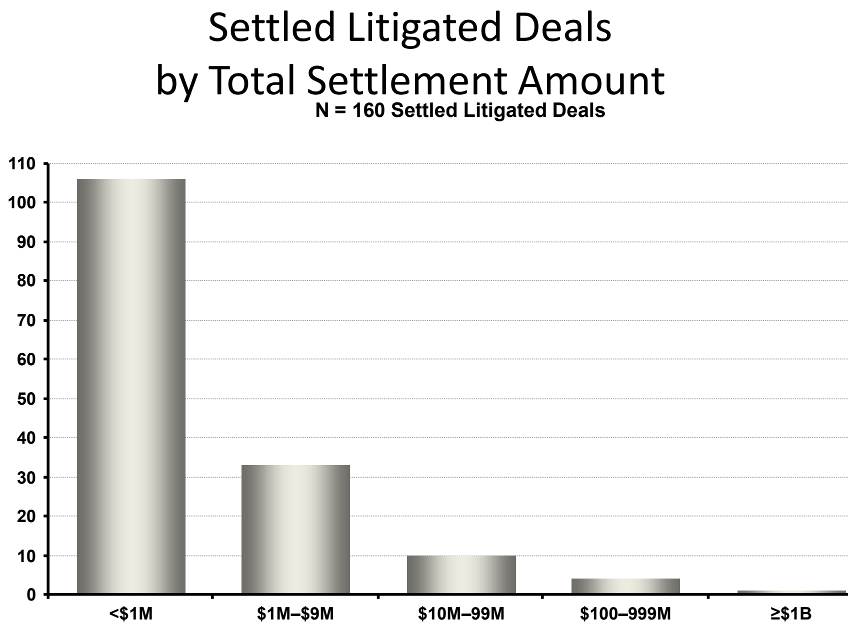
[3] Report on Form 8-K, NetLogic Microsystems, Inc., filed on November 11, 2011.
[4] *Id.*
[5] *In re Revlon, Inc. Shareholders Litigation,* 990 A.2d 940, 946 (Del. Ch. March 16, 2010).

Very standard stuff. The vast majority of merger cases settle for disclosure, as opposed to monetary consideration such as an increase in deal price. The following chart illustrates this point.



So, to put it bluntly, it's not unusual that the only people getting paid in the settlement of a merger case are plaintiff lawyers. Nor is the amount of the payment to them in this case unusual.



Conclusion

That's what happens in a typical merger litigation. The final step (pending as of this writing) will be judicial approval of the settlement, after notice to the class (owners of NetLogic stock at the time of the merger). Outside of Delaware, as will no doubt be the case in this matter, settlements in this type of litigation—including the attorneys' fees—are approved without controversy. Even in Delaware, settlements are usually approved without substantial objection.

A return to a question raised at the beginning of this article is worthwhile. Does this type of litigation provide any real benefit to stockholders, the cause of good corporate governance, or society as a whole? We think the facts speak for themselves, but defer to readers to form their own opinions.

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