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# Delaware reining in deal litigation?

By Katherine Henderson and Brad Sorrels

It is well documented that the past decade has seen a dramatic increase in deal-related litigation, with over 90 percent of announced public deals being challenged by stockholders and multiple class actions filed in multiple forums, sometimes only hours after the announcement of the deal. In recent years, some have devised strategies — including forum selection bylaws — to try to minimize the burden of these often frivolous lawsuits. Last year, the legal community shifted its focus to the prevalence of "disclosure-only settlements" in these cases — where the only consideration flowing to stockholders is additional disclosures, often of additional minutiae of limited value, but where plaintiffs' counsel receive a six-figure fee for securing the additional disclosures.

While many companies historically had looked to disclosure-only settlements as a way to quickly resolve meritless yet potentially time-consuming and expensive litigation, the practice came under fire last year in the Delaware Court of Chancery and caused a lot of uncertainty for companies in what turned out to be a busy year for M&A.

*Disclosure-only settlements come under fire:* First, Vice Chancellor J. Travis Laster denied approval of a disclosure-only settlement and cast doubt on the continued viability of the practice, questioning whether defendants should get a broad release of claims and plaintiffs' counsel a large fee where the only consideration given to shareholders was additional disclosure around the proposed transaction. *Acevedo v. Aeroflex Holding Corp.*, C.A. No. 7930-VCL (Del. Ch. July 8, 2015). Around the same time, a Fordham Law School professor, who had published scholarly pieces questioning the propriety of disclosure-only settlements, began buying stock in companies post-announcement of a deal for the purpose of objecting to the anticipated settlement in his capacity as a stockholder. The first of these objections was filed in *In re Riverbed Technology Inc.*, where Professor Sean Griffith echoed the concerns raised in *Aeroflex* and urged Vice Chancellor Sam Glasscock III to reject the settlement. *In re Riverbed Tech. Inc. Stockholders Litig.,* Consol. C.A. No. 10484-VCG (Del. Ch. Sept. 17, 2015). Vice Chancellor Glasscock ultimately approved the settlement over Professor Griffith's objection, but raised concerns about the continued practice and indicated that he would be much more circumspect in the future in evaluating such settlements.

Vice Chancellor John W. Noble weighed in with similar concerns, questioning whether the practice of disclosure-only settlements coupled with a broad release of claims amounted to Court-sponsored "deal insurance." *In re InterMune, Inc. Stockholder Litig*., Consol. C.A. No. 10086-VCN (Del. Ch. July 8, 2015).

Finally, Chancellor Andre G. Bouchard echoed similar sentiments first in *Telecom* and then, during the initial settlement hearing in *In re Trulia Inc. Stockholders Litigation*, where he asked the parties for additional briefing. *In re TW Telecom, Inc. Stockholders Litig.*, Consol. C.A. No. 9845-CB (Del. Ch. Aug. 20, 2015); *In re Trulia, Inc. Stockholder Litig*., Consol. C.A. No. 10020-CB (Del. Ch. Sept. 16, 2015). These decisions left practitioners uncertain as to the continued viability of disclosure-only settlements in Delaware.

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On Jan. 22, Chancellor Bouchard answered the uncertainty in his written opinion in *Trulia*, rejecting the proposed disclosure-only settlement of claims related to the merger of Trulia and Zillow. Following an interesting, detailed discussion of recent trends in M&A litigation, he held that to support a disclosure-only settlement, additional disclosures would have to be "plainly material" and the related release would have to be "narrowly circumscribed." The case provides more definitive guidance that disclosure-only settlements will not be readily approved in the future and that practitioners and companies will need to re-evaluate their options when faced with deal litigation in Delaware.

*An attempt to control frivolous litigation?*: While many practitioners and companies may mourn the loss of disclosure-only settlements in the short term as an efficient way of eliminating frivolous litigation, this move by the Delaware courts may actually help with the problem in the long term. As Chancellor Bouchard observed in *Trulia*: "It is beyond doubt in my view that the dynamics described above, in particular the Court's willingness in the past to approve disclosure settlements of marginal value and to routinely grant broad releases to defendants and six-figure fees to plaintiffs' counsel in the process, have caused deal litigation to explode in the United States beyond the realm of reason."

The *Trulia* decision is the latest in a series of moves by the Delaware courts that seem designed to address the prevalence of frivolous lawsuits in the M&A context and the resulting burden to corporate defendants. The Delaware Supreme Court, for instance, issued a trilogy of important cases in the last year and-a-half that have made it more difficult for stockholder plaintiffs both to try to enjoin a deal and pursue post-closing claims against directors for breach of fiduciary duty. See *C&J Energy Servs. Inc. v. City of Miami,* 107 A.3d 1049 (Del. 2014) (reversing the lower court's decision to enjoin an M&A transaction under the heightened Revlon standard of review where there was no competing bidder); *In re Cornerstone Therapeutics Inc. Stockholder Litig.*, 115 A.3d 1173 (Del. 2015) (confirming that independent, disinterested directors protected by an exculpatory charter provision under 8 Del. C. Section 102(b)(7) and acting in good faith must be permitted to seek dismissal regardless of the applicable standard of review — whether it be *Revlon, Unocal* or entire fairness); *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 308 (Del. 2015) (holding that a fully informed stockholder vote shifts the standard of review to the more deferential business judgment rule). The combination of these decisions with the Court of Chancery's recent questioning of disclosure-only settlements seems to have had an effect on the prevalence of such suits. Recent reports indicate that filings are down, with as low as 21.4 percent of deals valued over $100 million challenged in the last quarter of 2015. Matthew D. Cain & Steven Davidoff Solomon, "Takeover Litigation in 2015," at 3 (Jan. 14, 2016). There has also been a corresponding increase in stockholder plaintiffs voluntarily dismissing their claims after the company's disclosure documents come out.

*Next steps after Trulia*: Although *Trulia* may help stem frivolous merger litigation in the long term, defendants will still be left with the question of what to do if faced with frivolous merger litigation in the short term. The cases can be burdensome to litigate. For instance, plaintiffs often try to expedite these cases in advance of seeking to enjoin the shareholder vote on the transaction. The standards for expedition are generally low, which means that defendants often have to incur substantial costs engaging in expedited discovery. Those costs increase if the plaintiffs choose to pursue their claims post-closing of the deal (which is becoming more common), because the standards applied on motions to dismiss are also generally plaintiff-friendly and make an early exit from litigation uncertain. Disclosure-only settlements (and the corresponding broad release of claims) historically have helped avoid long and expensive litigation.

Although Chancellor Bouchard acknowledged these issues in *Trulia*, he also indicated that we may see increased scrutiny from Delaware courts at different stages of the litigation. In particular, he noted both that "the Court takes seriously its role to deny expedition in deal litigation when warranted" and that "the Court would be cognizant of the need to 'apply the pleading test under Rule 12 with special care' in stockholder litigation because 'the risk of strike suits means that too much turns on the mere survival of the complaint.'" Moreover, by emphasizing the court's preference that disclosure claims should be adjudicated through the "adversarial process" and "outside the context of a proposed settlement," the court signaled to plaintiffs' counsel that they should think long and hard before pressing disclosure claims of questionable materiality.

Thus, while the Delaware courts will clearly be applying more scrutiny to future disclosure-only settlements (and indeed, the likelihood of such settlements being approved in the future appears low), *Trulia* also seems to signal that the courts will apply more scrutiny to merger-related lawsuits in general and that there may be other avenues for defendants to avoid prolonged and costly litigation. 2016 is likely to see more developments along these lines as the Court of Chancery continues to monitor deal litigation and provide guidance to parties on how they want to see these cases litigated — if at all.

**Katherine Henderson** *is a partner and* **Brad Sorrels** *is of counsel at Wilson Sonsini Goodrich & Rosati. Katherine is in the firm's San Francisco office and Brad is in the Delaware office. The views expressed in this article are those of the authors and are not necessarily those of the firm.*


KATHERINE HENDERSON
*Wilson Sonsini Goodrich & Rosati*


BRAD SORRELS
*Wilson Sonsini Goodrich & Rosati*