

Morgan Lewis

M&A ACADEMY

**The Ever-Changing Nature of Public
Company Litigation**

Michael D. Blanchard and Brian A. Herman

January 15, 2019

The Traditional Path of M&A Cases – Plaintiffs’ “Deal Tax” and Defendants’ “Deal Insurance”

- For years, as soon as a transaction involving a public company was announced, stockholders would file an action – frequently in the Delaware Court of Chancery, often with copycat lawsuits where the target is headquartered
- “Cut and Paste” complaints attacking the process, price, and disclosures as a state law breach of fiduciary duty
- Acquirers named as defendants for aiding and abetting
- In excess of 90% of all deals valued at more than \$100 million attracted litigation
- Plaintiffs would seek expedited discovery (routinely granted) and threaten an injunction based upon inadequate disclosures
- Most cases ended in a “disclosure only” settlement
 - Company files a supplemental disclosure (proxy or Form 8-K)
 - Class action settlement reached releasing claims (Deal Insurance)
 - Attorney fees awarded (\$300,000 – \$500,000 range) (Deal Tax)

The Delaware “Crackdown”

- Over the last several years, the courts of Delaware have issued decisions that have limited the traditional deal-challenge*
- The Court of Chancery began to **deny motions for expedited discovery**, effectively ending the plaintiffs’ challenge to the deal
- Many decisions questioned disclosure-only settlements
- Then came the sea change – ***In re Trulia, Inc. Stockholder Litigation*** – 2016
 - “[T]he terms of this proposed settlement are not fair or reasonable because **none of the supplemental disclosures were material or even helpful** to Trulia’s stockholders” and
 - “[T]hus the proposed **settlement does not afford [stockholders] any meaningful consideration to warrant providing a release** of claims to the defendants”
 - In other words, the “give” – an immaterial supplemental disclosure – did not justify the “get” – a broad release

*Internal citations omitted throughout.

The Delaware “Crackdown”

In re Trulia, Inc. Stockholder Litigation, continued...

- “Disclosure settlements are likely to be met with continued disfavor”
 - To receive court approval, “the supplemental disclosures [must] address a **plainly material** misrepresentation or omission” and “should not be a close call”
- AND
- “the subject matter of the proposed **release is narrowly circumscribed** to encompass nothing more than disclosure claims”

The Delaware “Crackdown”

- Delaware courts have also approved “**forum selection bylaws**”
- Requires all litigation concerning the “internal affairs” of the corporation to be brought in Delaware Court of Chancery
- Ensures that more **sophisticated Delaware courts** adjudicate deal litigation
- Better chances at **defeating motions for expedited discovery**
- Less incentive for plaintiffs to sue due to *Trulia*

Plaintiffs' Bar Response: Chameleons Emerge

- (1) Change the Venue** – Plaintiffs flee Delaware and sue in state or federal court where the target is headquartered
 - Forum selection by laws only apply to state law claims
- (2) Change the Claims**
 - Many lawsuits now proceed under federal proxy solicitation securities laws, Section 14(a) of the Securities Exchange Act of 1934
 - Delaware litigation has shifted to postclosing monetary damages
 - Books and records demands per 8 Del. C. § 220
 - Appraisal claims (and appraisal arbitration) per 8 Del. C. § 262

Current State of M&A Disclosure-Focused Litigation

- Some courts have approved disclosure-only settlements but many have adopted *Trulia's* reasoning:

“Delaware's Court of Chancery sees many more cases involving large transactions by public companies than the federal courts of our circuit do, and so we should heed the recent retraction by a judge of that court of 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.’”

No fee unless disclosures are plainly material.

In re Walgreen Co. Stockholder Litigation, 832 F.3d 718, 725 (7 Cir. 2016)

Current State of M&A Disclosure-Focused Litigation

- This is leading to nonclass “mootness” settlements, with no broad class release
- Unscientific review of articles show mootness fees in \$250,000 neighborhood
- Mootness fees drawing attack
 - Illinois *Akorn* litigation
 - Six actions filed in connection with disclosures of proposed acquisition of Akorn by Frensenius Kabi AG. Company agreed to pay \$322,500 mootness fee.
 - Stockholder moved to intervene to block payment. Transaction fell apart, and several of plaintiffs’ firms dropped but others continued to press for fee.
 - Trial court denied intervention but “the Court will exercise its inherent powers to police potential abuse of the judicial process—and abuse of the class mechanism in particular—and require plaintiffs’ counsel to demonstrate that the disclosures for which they claim credit meet the “*Walgreen* standard.”
 - Litigation is ongoing at trial court and 7 Circuit level.

A Note on Forum

- Delaware courts have previously upheld corporate bylaws requiring fiduciary duty claims, derivative actions, and other actions governing the internal affairs of a Delaware corporation to be brought exclusively in Delaware.
- In 2018, the Supreme Court concluded that claims brought under Section 11 of the Securities Act of 1933 may be brought in state court.
- Certain companies inserted provisions in certificates of incorporation that purported to require any claim brought under the '33 Act to be in federal court.
- In *Sciabacucchi v. Salzberg*, the Delaware Court of Chancery rejected that tactic:

“The constitutive documents of a Delaware corporation cannot bind a plaintiff to a particular forum when the claim does not involve rights or relationships that were established by or under Delaware’s corporate law. In this case, the Federal Forum Provisions attempt to accomplish that feat. They are therefore ineffective and invalid.”

A Case to Watch: *Emulex Corp. v. Varjabedian*

- Section 14(e) tender offer case
- Ninth Circuit has split from every other circuit to hold that shareholders must prove that the company is merely negligent in providing information about the tender offer merger
- The Supreme Court granted certiorari a week ago
- The case is being watched for the potential that the Supreme Court will address whether there is any private right of action at all under Section 14(e)

Controlling Shareholder/Going-Private Transactions

- Delaware courts' default standard of review for going-private mergers is "**entire fairness**"
 - Burden is on the controlling shareholder to show that the "freezeout" is entirely fair to minority shareholders
 - Entire fairness requires fair dealing and fair price
 - The highest level of scrutiny used in takeover challenges
- In 1994, the Delaware Supreme Court held that defendants can shift the burden of persuasion under entire-fairness review to plaintiffs if defendants show that the transaction was *either* (i) negotiated by a well-functioning special committee of independent directors or (ii) conditioned on the approval of a majority of the minority shareholders (*Kahn v. Lynch*)

Controlling Shareholder/Going-Private Transactions

- *Khan v. M&F Worldwide Corp. (MFW)* (2014)
 - Going-private transaction by a controlling stockholder
 - Business judgement review available if and only if:
 - There is a special committee of independent directors. The directors should be fully empowered to decline the transaction and satisfy traditional due-care duties (e.g., financial advisors, legal counsel)
 - The stockholder vote is fully informed and uncoerced
 - There is majority-of-the-minority approval

MFW Expanded

- *MFW* dealt with a situation where a conflicted stockholder is on both sides of the transaction.
- Expanded to apply to single-sided conflict/claims of disparate treatment.
- *In re Martha Stewart Omnimedia, Inc.*
 - Martha Stewart had certain employment and IP agreements with the company.
 - In connection with a potential sale, the company established a special committee. The special committee allowed the buyer to negotiate employment and IP issues with Stewart.
 - Merger approved by 99% of the stockholders who voted.
 - Allegations that the controlling stockholder received disparate consideration.
 - Court dismissed, applying *MFW*.

Corwin: Clarifying the Standard of Review

- *Corwin v. KKR Financial Holdings LLC* (2015)
 - Case involved postclosing claims
 - Court concluded that the “entire fairness” standard of review was inapplicable
 - Stockholders argued that the court should apply *Revlon*

[T]he voluntary judgment of the disinterested stockholders to approve the merger invoked the business judgment rule standard of review and that the plaintiffs’ complaint should be dismissed. For sound policy reasons, Delaware corporate law has long been reluctant to second-guess the judgment of a disinterested stockholder majority that determines that a transaction with a party other than a controlling stockholder is in their best interests.

Unocal and *Revlon* are primarily designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M & A decisions in real time, before closing. They were not tools designed with post-closing money damages claims in mind, the standards they articulate do not match the gross negligence standard for director due care liability under *Van Gorkom*, and with the prevalence of exculpatory charter provisions, due care liability is rarely even available.

- Because directors are typically protected from suit under Section 102(b)(7) absent bad faith or a conflict, *Corwin* provides a very narrow path for claims to survive

Corwin Developments

- *In re Columbia Pipeline Group, Inc.:*
 - “When a transaction has been approved by a majority of the disinterested stockholders in a fully informed and uncoerced vote, the business judgment rule applies and insulates the transaction from all attacks other than on the grounds of waste... When the business judgment rule standard of review is involved because of a vote, dismissal is typically the result.”
 - “A post-closing claim for monetary damages stemming from a failure to disclose information in the proxy materials survives only to the extent that material omissions continued to exist when the [stockholders] voted.”
 - Even though the allegations stated a claim for breach of the duty of loyalty, “if stockholders approved the conflict of interest after full disclosure, the business judgment rule applies.”

Corwin Developments

- *In re Saba Software, Inc. Stockholder Litigation*
 - In *Saba*, the court found that the business judgment rule did not apply because the complaint sufficiently alleged “that the stockholder vote approving the transaction was neither fully informed nor uncoerced”
- *In re Xura, Inc.*
 - Stockholder brought appraisal action and found evidence that CEO had undisclosed communications with the buyer that took place without knowledge of the Board. Court denied motion to dismiss. Plaintiff adequately alleged that deteriorating financial performance “prompted [CEO] to favor Siris over other potential bidders, to feed information to Siris that would fortify its bid and then to negotiate quickly for his transaction-related payout.”
- Three takeaways:
 1. Disclose
 2. Disclose
 3. Disclose!

AES6585

Please save this number; you will need this to receive a Certificate of Attendance. You will be contacted within 30-60 days by our CLE administrative team. We will process your credits for other states where this program has been approved.

Please email Chris Chang at chris.chang@morganlewis.com if you have any questions.

Appraisal Litigation

Statutory Appraisal—Section 262 of the DGCL

- “The right to an appraisal is a narrow statutory right, and dissenting stockholders must comply strictly with section 262.” *Gilliland v. Motorola, Inc.*, 873 A.2d 305, 310 (Del. Ch. 2005)
- Many technical requirements; any misstep negates the appraisal remedy
- Section 262 affords dissenting stockholders of an acquired corporation the right to seek judicially determined “fair value” for their shares
- Stockholder must own stock on the date he or she demands appraisal and continue to hold stock through the effective date of the merger
- A stockholder who votes in favor of the merger cannot seek appraisal

“Appraisal Arbitrage”

- Unlike Delaware jurisprudence in the derivative litigation context, plaintiffs may purchase shares with a view toward litigating appraisal rights. *In re Appraisal of Transkaryotic Therapies, Inc.*, 2007 Del. Ch. LEXIS 57 (Del. Ch. May 2, 2007).
- A cottage industry of hedge funds emerged specializing in “appraisal arbitrage” – purchasing shares after the announcement of the merger to litigate “fair value”
- Appraisal arbitrage was viewed as a no-risk business
 - Statutory prejudgment interest of 5% accrues on the total amount claimed while litigation is pending
 - Traditionally, judicial “fair value” determinations exceeded merger price

The New Landscape for Appraisal Litigation

Responding to criticisms of the growing appraisal arbitrage industry, Delaware adopted two mitigating amendments:

- (1) *DeMinimis* appraisal cases barred – case dismissed unless
 - Total number of shares entitled to appraisal exceeds 1% of outstanding shares eligible
 - Value of the consideration provided in the merger for such total number of shares entitled to appraisal exceeds \$1 million

- (2) Prepayment to mitigate interest accrual:
 - Surviving corporation may voluntarily prepay, to each stockholder seeking appraisal, a cash amount up to the merger price
 - In that event, interest will cease to accrue upon the amount and from the time of the prepayment

The New Landscape for Appraisal Litigation

“Fair Value” Decisions

- Previously, “fair value” litigation was a battle of experts conducting DCF analyses
- *DFC Global*
 - Court of Chancery gave equal weight to deal price, comparable companies analysis, and DCF
 - Reversed: insufficient weight given to deal price given robust and open deal process
- *Dell, Inc.*
 - Court of Chancery held fair value was 22% greater than deal price in a management-led buyout
 - Reversed: where a company is sold in a “clean” auction process, must give the merger price significant weight
- *Veriton Partners v. Aruba Networks*
 - VC Laster relied upon 30-day average unaffected market price for stock, lower than deal price

The New Landscape for Appraisal Litigation

Waiver of Appraisal Rights

- *Manti Holdings, LLC v. Authentix Acquisition Co.*
 - Stockholders lost shares in merger, sought appraisal
 - Stockholders' agreement provided that stockholders were to "refrain from the exercise of appraisal rights with respect to" certain sale transactions
 - Court found language not ambiguous, and that public policy did not preclude enforcement
 - Stockholders are seeking re-argument on the grounds that the DGCL prohibits a corporation from obtaining an advanced waiver or limitation of statutory appraisal rights

The New Landscape for Appraisal Litigation

Court Declines to Expand Appraisal Rights

- *City of North Miami Beach General Employees' Retirement Plan v. Dr Pepper Snapple Group, Inc.*
 - Claims arising out of combination of DPSG and Keurig Green Mountain
 - DPSG stockholders received significant cash dividend but retained their shares in DPSG, now reduced to 13% of combined company
 - Plaintiffs claimed that, even though DPSG was not being merged out of existence, stockholders ought to be considered a constituent corporation to the merger, noting that the transaction “almost entirely cashes out the target’s stockholders and leaves them with nominal equity in a controlled entity”
 - Court declined to look through the transaction, and held that because the DPSG stockholders retained their shares, they were not entitled to appraisal

Non-Employee Director Compensation

- *Investors Bancorp* decision, December 2017, has given rise to a new cottage industry for the plaintiff's bar
- For years, non-employee directors determining their own compensation faced no liability if the decision was made within the context of a shareholder approved plan subject to "meaningful limits"
- In *Investors' Bancorp*, the Delaware Supreme Court held that, irrespective of the limits on the directors' decision, if a plaintiff can plead facts to show that the compensation is excessive in relation to peer firms, the decision will be subject to "entire fairness" review
- Surge in shareholder litigation or books and records demands seeking quick settlements

Biography



Michael D. Blanchard

Hartford, CT

T +1.860.240.2945

F +1.860.240.2800

Michael D. Blanchard is a partner in the Litigation Practice. Michael represents clients in all facets of shareholder litigation, class actions, securities enforcement matters, investigations, and business disputes. Michael has obtained numerous dismissals at the pleading stage, including, for example, the dismissal of a 1933 Act class action which *Forbes* magazine called a “stunning class action victory.” Where dismissal is not achievable, Michael has successfully tried cases to judges and juries alike, and successfully litigated numerous appeals. Michael also counsels clients on litigation avoidance strategies, and is member of Morgan Lewis’s crisis management initiative.

Biography



Brian A. Herman

New York, New York

T +1.212.309.6909

F +1.212-309.6001

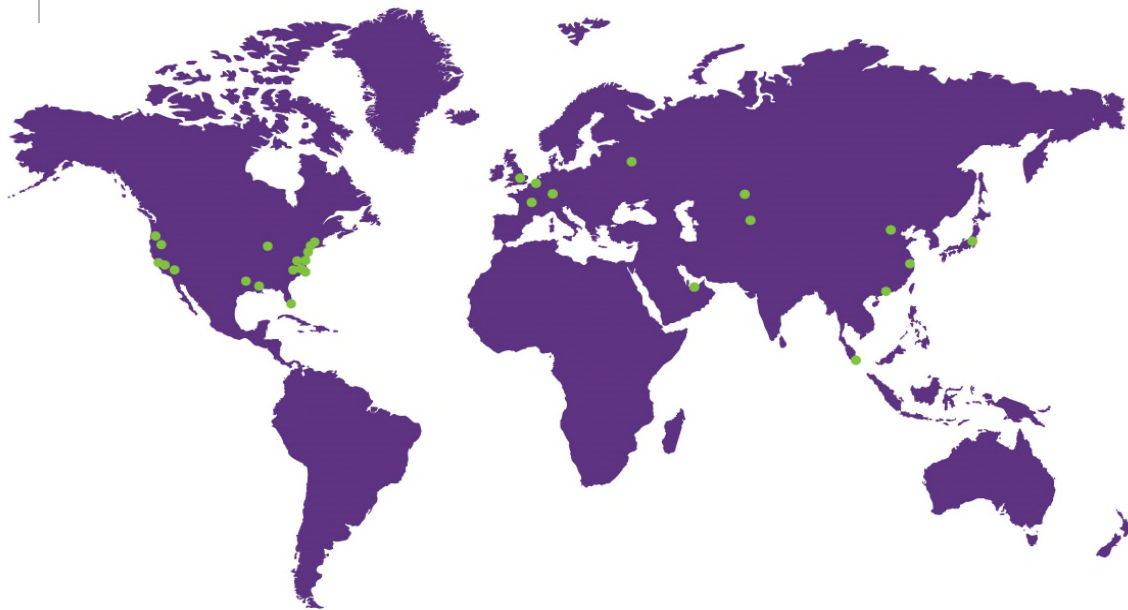
Brian A. Herman is a partner in the Litigation Practice. Brian counsels clients in civil and class action litigation in US state and federal court. He represents banks, broker-dealers, hedge funds, investment advisers, and other complex businesses. Brian also advises clients facing examinations by the US Securities and Exchange Commission (SEC), self-regulatory organizations, state regulators, and other regulatory agencies. Clients also turn to Brian for guidance with internal examinations and enhancing their business practices.

Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

Almaty	Chicago	Houston	Orange County	Shanghai*
Astana	Dallas	London	Paris	Silicon Valley
Beijing*	Dubai	Los Angeles	Philadelphia	Singapore
Boston	Frankfurt	Miami	Pittsburgh	Tokyo
Brussels	Hartford	Moscow	Princeton	Washington, DC
Century City	Hong Kong*	New York	San Francisco	Wilmington



Morgan Lewis

*Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan Lewis operates through Morgan, Lewis & Bockius, which is a separate Hong Kong general partnership registered with The Law Society of Hong Kong as a registered foreign law firm operating in Association with Luk & Partners.

THANK YOU

© 2019 Morgan, Lewis & Bockius LLP
© 2019 Morgan Lewis Stamford LLC
© 2019 Morgan, Lewis & Bockius UK LLP

Morgan, Lewis & Bockius UK LLP is a limited liability partnership registered in England and Wales under number OC378797 and is a law firm authorised and regulated by the Solicitors Regulation Authority. The SRA authorisation number is 615176.

Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan Lewis operates through Morgan, Lewis & Bockius, which is a separate Hong Kong general partnership registered with The Law Society of Hong Kong as a registered foreign law firm operating in Association with Luk & Partners.

This material is provided for your convenience and does not constitute legal advice or create an attorney-client relationship. Prior results do not guarantee similar outcomes. Attorney Advertising.