

**Morgan Lewis**

# **M&A ACADEMY**

**The Ever-Changing Nature of Public  
Company M&A Litigation**

**Michael D. Blanchard and Brian A. Herman**

January 14, 2020

# Brief History 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

- Many 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 has led to nonclass “mootness” settlements, with no broad class release
- 7<sup>th</sup> Circuit is analyzing in the *Akorn* litigation. US Chamber of Commerce amicus:

“There is heavy pressure on the defendants to settle even meritless claims quickly, because they want to be able to close the deal and realize the economic benefits of the merger or acquisition. Leveraging that desire for a speedy resolution, plaintiffs seek to avoid any federal court oversight by using the tactic of an out-of-court settlement—in which the defendant agrees to insignificant additional disclosures, the plaintiffs’ lawyers are paid a “mootness fee,” and the case is dismissed.

Courts should either intervene to stop that practice of extorting blackmail settlements, as the district court did here, or at minimum use active case management techniques to attack the problems they pose and deter the filing of meritless suits.”

# 1933 Act Claims

- The Securities Act of 1933 (the “**Securities Act**” or “’33 Act”) imposes disclosure requirements on companies offering securities to the public and allows private plaintiffs to sue in either state or federal court. Unlike most federal statutes, the Securities Act bars removal of a case from state to federal court.
- The Securities Exchange Act of 1934 (the “**Exchange Act**” or “’34 Act”) regulates not the original issuance of securities but their subsequent trading. The Exchange Act also provides for enforcement through private actions, but federal courts have exclusive jurisdiction over those suits.
- In response to perceived abuses by plaintiffs in bringing cases under these statutes, Congress passed the Private Securities Litigation Reform Act (“**PSLRA**”) in 1995 which imposed new substantive and procedural hurdles. As a result, plaintiffs began bringing securities class actions in state court in an effort to escape the strictures under the PSLRA.
- To stem the shift from federal to state courts, Congress enacted the Securities Litigation Uniform Standards Act of 1998 (“**SLUSA**”) to further amend both Acts. SLUSA amended the Securities Act to eliminate jurisdiction in state court for certain securities class actions and to prohibit certain securities class actions arising under state law, and it empowered defendants to remove those suits to federal court, where they would then be dismissed.
- A **split** arose in federal and state courts as to whether these provisions of SLUSA apply to lawsuits brought *exclusively* under the Securities Act.

# The Supreme Court's Decision in *Cyan*

- In 2014, the Beaver County Employees Retirement Fund, a pension fund that purchased Cyan stock in the IPO, filed a class action in California Superior Court alleging only violations of the Securities Act. Cyan moved to dismiss, arguing that the Securities Act, as amended by SLUSA, deprived the court of jurisdiction over the action. The Superior Court rejected Cyan's argument and denied the motion, and the state appellate court denied review. The United States Supreme Court granted certiorari.
- On March 20, 2018, in *Cyan, Inc. v. Beaver County Employees Retirement Fund, et al.*, 138 S. Ct. 1061 (2018), the Supreme Court unanimously ruled that investors in securities offerings who assert class action claims under the Securities Act can bring those claims in state court if the action asserts only claims under the Securities Act, and defendants cannot remove the actions to federal court.
- The Court found that the petitioner's argument about the legislative history and purpose behind the various amendments to the Securities Act failed to overcome the statutory language (which Justice Alito commented was poorly drafted "gibberish" at argument). The Court acknowledged that SLUSA was a confusing statute and that it did not know why Congress declined to treat Securities Act class actions like Exchange Act class actions which must be brought in federal court, noting that "[i]f further steps are needed, they are up to Congress." *Cyan*, 138 S.Ct. at 1078.

# The Rise of Securities Act Cases in State Courts: By The Numbers

Appendix 3: 1933 Act Filings in State Courts

Year	1933 Act Filings in State Courts						
	California	New York	Texas	Massachusetts	Pennsylvania	Others	All
2010	1	0	0	0	0	0	1
2011	3	0	0	0	0	0	3
2012	5	0	0	0	0	2	7
2013	1	0	0	0	0	0	1
2014	5	0	0	0	1	0	6
2015	15	0	0	2	0	0	17
2016	19	0	1	1	0	6	27
2017	7	0	1	0	1	4	13
2018	16	13	0	0	0	5	34
2019 H1	5	7	2	1	1	3	19
Average (2010–2018)	8	1	0	0	0	2	12

Source: Cornerstone Research and the Stanford Law School Securities Class Action Clearinghouse

# 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.”

# 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 the transaction is conditioned *ab initio*—*i.e.* from the beginning--:
    - 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

# When is “Ab Initio”?

- At what point must a contemplated transaction be conditioned on the MFW factors?
- In *Flood v. Synutra International, Inc.*, the controlling shareholder sent an initial letter without MFW conditions proposing to take the company private
- One week after the proposal, the Board formed a special committee and received advice on its fiduciary duties, but did not discuss the substance of the proposal
- Two weeks after the initial offer, the controller sent a second letter to the special committee reaffirming his interest, proposing the same price, and conditioning his offer on the MFW conditions.
- Price negotiations did not begin until seven months after.
- VC Laster found the MFW conditions were satisfied and the BJR applied -- “[a] process meets the *ab initio* requirement when the controller announces the conditions ‘before any negotiations took place,’” which “ensur[es] that the controller ‘cannot dangle a majority-of-the-minority vote before the special committee late in the process as a deal-closer rather than having to make a price move.’”
- The Supreme Court affirmed, “**before any substantive economic negotiations**” emphasizing the *ab initio* requirement need be flexible, not a “bright line rule”

# *Post-Corwin*

- Three takeaways:

1. Disclose

2. Disclose

3. Disclose!

# HHTY21

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](mailto: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

# ***Verition Partners Master Fund LTD v. Aruba Networks, Inc.,*** **210 A.3d 128 (Del. 2019)**

- In appraisal dispute following HP's acquisition of Aruba for \$24.67/share, the petitioners sought \$32.57/share. The Chancery Court below found the fair value of Aruba was \$17.13 per share, relying principally on company's thirty-day average unaffected market price.
- Delaware Supreme Court found that fair value was the "deal price minus synergies" metric of \$19.10.
- While the Supreme Court took issue with the Chancery Court's use of the unaffected market price, it supported the use of that metric in some circumstances and in awarding "deal price less synergies," supported a valuation which was far less than the fair value sought by Petitioners and the merger price.

# 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

# Material Adverse Effects Clause

- *Akorn, Inc. v. Fresenius Kabi AG*
  - Post-signing, decline in financial performance of target
  - Buyer invoked MAE clause
  - Court of Chancery found MAE
    - Buyer satisfied heavy burden of establishing material decline that was durationally significant
    - R/W with respect to regulatory compliance
    - Post-signing covenant to use commercially reasonable efforts to operate in ordinary course
  - Affirmed

# Material Adverse Effect Clause

- *Channel Medsystems, Inc. v. Boston Scientific Corporation*
  - Post-signing, target determined that VP of Quality had engaged in misconduct; potential false information in FDA submission
  - Disclosed to buyer and FDA; conducted internal investigation
  - Two months after investigation concluded, buyer attempted to terminate for MAE
  - Court of Chancery rejected termination
    - Buyer failed to use commercially reasonable efforts to close
    - Buyer not entitled to terminate based on alleged R/W breaches
    - Specific performance

# Key Takeaways

- Disclosure litigation regarding mergers is facing resistance in the federal courts, and its fate remains to be seen
- 1933 Act cases are being filed in state courts in record numbers, and we will soon know if Delaware will provide a remedy with forum selection by-laws
- Control/going private transactions remain subject to entire fairness absent MFW protections
- Appraisal litigation remains alive, but a clean sale process stands a good chance of the sale price equating to fair value

# 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.