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HOT TOPICS IN M&A PUBLIC COMPANY LITIGATION

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The Traditional Path of M&A Cases – The 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 arbitrage) per 8 Del. C. § 262

Current State of M&A Disclosure-Focused Litigation

- In 2017, there were more federal securities class actions than any year since PSLRA (1995)
- About half of the filings were M&A filings
- Disclosure only settlements outside Delaware receive mixed results
- Many courts 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.'"

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

- Some courts have approved disclosure-only settlements

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 "freeze-out" 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 the 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"
- Three takeaways:
  1. Disclose
  2. Disclose
  3. Disclose!

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
- Merger was approved pursuant to DGCL §253 or §267

(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

Recent "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
- Some recent Court of Chancery decisions give deal price 100% weight

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- Questions? Please email Daniel Gieseke at daniel.gieseke@morganlewis.com

Biography

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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.

Staying abreast of the cutting edge issues in his specialized fields of practice, Michael serves as an adjunct professor of law, teaching courses in securities litigation and business torts. Michael is active in the American Bar Association's Corporate Governance and Business Litigation sections, where he is contributing in the areas of board-driven investigations, special litigation committees and securities litigation. Michael also serves on the Boston Bar Association's Financial Services Committee, focusing on Civil Enforcement and Securities Litigation, and to Connecticut's Securities Advisory Council, a panel of experts on securities matters advising on issues for the Connecticut Securities and Business Investments Division of the Department of Banking.

Michael splits his time between Boston and Hartford, where he serves as litigation practice leader. The Hartford litigation team was recently recognized by the *Connecticut Law Tribune* as the "Litigation Department of the Year," for the third year in a row. Michael has also been recognized as "exceptional" by *The Legal 500*.

Biography

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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.

Brian's practice spans litigation matters involving contract disputes, lending practices, mergers and acquisitions, loan servicing and foreclosure practices, residential mortgage-backed securities (RMBS), collateralized debt obligations, mutual funds, Ponzi schemes, and consumer protection.

Prior to joining Morgan Lewis, Brian served as a law clerk to Judge Ruth Abrams of the Massachusetts Supreme Judicial Court.

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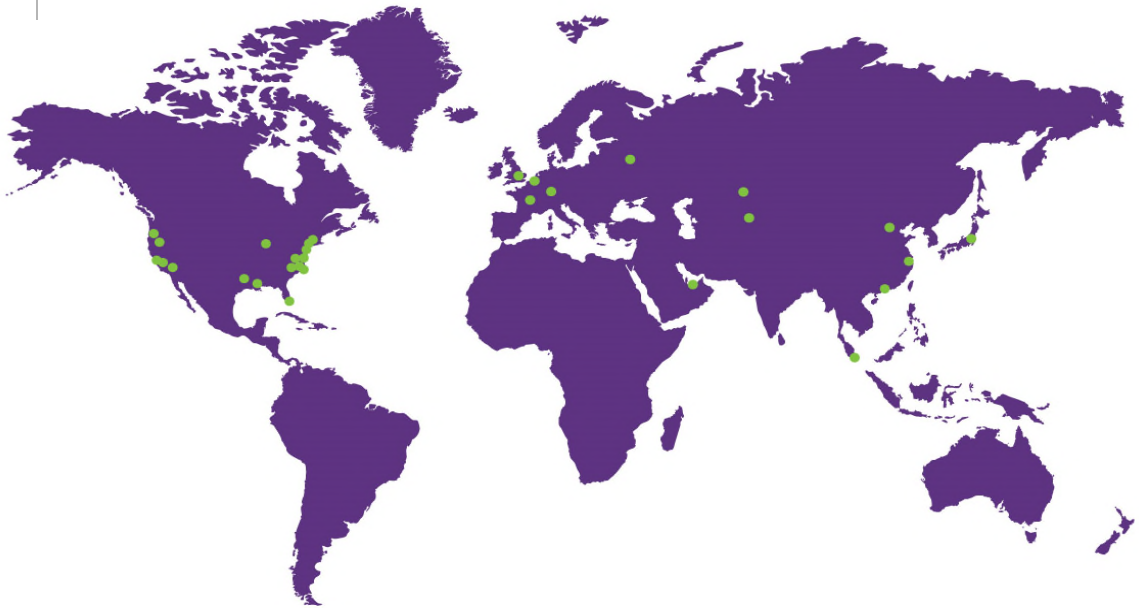

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