Developments in Disclosure-Based Deal Litigation Settlements

Over the last year, the Delaware Court of Chancery has overturned decades of well-settled authority in the area of disclosure-based deal litigation settlements. M&A counsel should be aware of the latest rulings from the court and monitor this evolving area of law.

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Prior to a series of rulings beginning in the summer of 2015, the Delaware Court of Chancery historically approved broad releases in deal litigation settlements covering not only state law fiduciary duty claims, but all claims, known and unknown, arising out of or relating to the deal. Defendants took comfort in the fact that approval of a settlement involving such a release provided certainty and finality.

However, beginning with Vice Chancellor Laster's July 2015 decision in *Acevedo v. Aeroflex Holding Corp.* and culminating in Chancellor Bouchard's January 2016 decision in *In re Trulia, Inc. Stockholder Litigation*, the Court of Chancery reframed the way it will analyze settlements in deal litigation based solely on disclosures or comparable therapeutic measures. This article examines these developments, including:

- How deal litigation settlements were treated before the Court of Chancery's decisions in 2015.
- *Aeroflex* and the subsequent 2015 bench rulings in which the Court of Chancery judges began expressing reservations about disclosure-only settlements.
- *Trulia* and Chancellor Bouchard's introduction of the "plainly material" standard for evaluating supplemental disclosures.
- How the plainly material standard has been implemented to date.
- Key takeaways and strategic considerations for counsel.

PRE-2015 DEAL LITIGATION SETTLEMENTS IN DELAWARE

Historically, when a corporation announced that it would be acquired in a merger, plaintiffs' counsel specializing in class-action deal litigation, representing stockholder plaintiffs, raced to the courthouse to file carbon-copy "strike suits." These lawsuits typically were filed in Delaware, the state of incorporation for many companies, and, in many cases, also in the state in which the corporation is headquartered. It was not uncommon to see multiple actions filed challenging the same transaction, sometimes even reaching double digits.

In virtually every case, plaintiffs alleged certain common claims that the target's directors breached their fiduciary duties in connection with the proposed transaction by:

- Failing to obtain the best price reasonably available for the stockholders.
- Undertaking an unfair or unreasonable process leading up to the transaction.
- Agreeing to preclusive or coercive deal protections in the merger agreement.
- Issuing inadequate disclosures in connection with the transaction.

Delaware courts have long supported the notion that disclosures that are materially misleading or that omit material information pose irreparable harm to a corporation's stockholders because without material disclosures, stockholders are unable to make a fully-informed vote on the transaction. For this reason, plaintiffs had been encouraged to pursue disclosure claims, if at all, prior to the closing of a transaction. To that end, plaintiffs typically sought expedited discovery, and subsequently moved to preliminarily enjoin a transaction pending the issuance of supplemental disclosures.

Corporations defended against these types of claims in several ways. Defendants could oppose a motion for expedited discovery and potentially move to dismiss the action. Or, if the plaintiffs ultimately pursued an injunction, defendants would oppose a motion to preliminarily enjoin the transaction. In some instances, defendants voluntarily issued supplemental disclosures in advance of the stockholders' meeting in order to moot the disclosure claims.

Often, however, the parties would decide early on to settle all claims asserted in the litigation, including disclosure, price, and process claims, in exchange for the target company issuing supplemental disclosures to provide more information to the stockholders about the transaction. Plaintiffs would agree to dismiss the action and release the defendants from liability.

These releases were typically broad, covering any claims, known or unknown, arising out of or relating to the deal. They provided defendants with:

- A tool for combating actions filed in multiple forums arising out of the same transaction.
- Certainty that they had achieved global peace regarding claims related to the transaction.

In connection with these settlements, plaintiffs' counsel sought attorneys' fees based on the purported benefit that the supplemental disclosures provided to the stockholder class.

Until the summer of 2015, Delaware courts routinely approved disclosure-based settlements with broad releases. However, beginning with the July 2015 decision in *Aeroflex*, the Court of Chancery started to express increasing concern about whether the disclosures made to settle all claims in deal litigation supported the corresponding broad releases, even where the parties themselves had agreed to these terms.

Several factors contributed to the Court of Chancery's shift in evaluating disclosure-based settlements, including:

- A perception by the court that the parties had not been sufficiently adversarial when a disclosure-based settlement was reached quickly.
- A growing concern about providing defendants very broad releases without evidence that plaintiffs had thoroughly explored all claims extinguished by these broad releases, including antitrust claims and claims arising under the federal securities laws.
- Recent academic literature arguing that disclosure-based settlements require stockholders to provide broad releases for disclosures that lack any value.
- Concern that stockholders that are not involved in the litigation are "rationally apathetic" and, therefore, will not object to these settlements after receiving notice of them.
- Concern that fees for plaintiffs' attorneys have historically been too high.

For these reasons, the court's approach has evolved in the last year (and continues to evolve), and has ultimately resulted in a revamped standard for evaluating disclosure-based settlements and their releases.

2015 DECISIONS QUESTIONING APPROVAL OF DISCLOSURE-ONLY SETTLEMENTS

In July 2015, Vice Chancellor Laster declined to approve a therapeutic settlement submitted in response to a lawsuit filed in the wake of the acquisition of Aeroflex by Cobham plc (*Acevedo v. Aeroflex Holding Corp.*, 2015 WL 4127547 (Del. Ch. July 8, 2015)). To settle the case, defendants agreed to:

- A $14 million reduction in the termination fee.
- A reduction in the buyer's matching-rights period from four days to three days.
- Supplemental disclosures.

In exchange, plaintiffs agreed to a release of all claims relating to the merger and defendants agreed not to oppose a fee award of up to $825,000.

Despite acknowledging that it had approved this type of settlement "on a relatively routine basis," the court refused to approve the settlement for a novel reason, namely, that the consideration was insufficient to support the broad release. Instead, the court offered three options for alternative resolution of the action:

- Plaintiffs could reframe the issues as a dismissal of disclosure claims on mootness grounds, which would entitle counsel to a modest mootness fee.
- The parties could renegotiate the scope of the release in the settlement to encompass solely Delaware fiduciary duty claims.
- Defendants could move to dismiss the action.

Defendants ultimately moved to dismiss the action, which Vice Chancellor Laster granted without argument.

In the fall of 2015, in *In re Aruba Networks Stockholder Litigation*, Vice Chancellor Laster again refused to approve a settlement, finding that the case was not meritorious when filed and indicating that he was unimpressed by the discovery record. Addressing the scope of the release, Vice Chancellor Laster stated that the practice of exchanging disclosures for an expansive release had "created a real systemic problem." (*In re Aruba Networks, Inc. Stockholder Litig.*, C.A. No. 10765-VCL (Del. Ch. Oct. 9, 2015) (Transcript).)

Vice Chancellor Laster also rejected the "idea of expectations" (meaning, that the court should continue approving disclosure-only settlements because the parties had come to expect them) and the argument that the court had created any sort of reliance interest. Ultimately, Vice Chancellor Laster:

- Determined that he would not certify the class.
- Declined to approve the settlement on "inadequate representation" grounds.
- Dismissed on similar grounds the cases filed by the named plaintiffs involved in the litigation.

The court did not reject all disclosure-based settlements submitted in 2015. However, even in these instances, the other judges on the Court of Chancery joined Vice Chancellor Laster in expressing concern regarding the scope of releases accompanying these settlements. For example:

- ***In re Intermune Inc. Stockholder Litigation.*** In this decision, then-Vice Chancellor Noble questioned why the scope of the release in the settlement should extend to the plaintiffs' process-based claims (which appeared to be weak from the outset) and not a release of the disclosure claims alone. He expressed concern that permitting the parties to settle process claims with supplemental disclosures is a form of "deal insurance" that the court arguably should not be sanctioning. (Consol. C.A. No. 10086-VCN (Del. Ch. July 8, 2015) (Transcript).) Vice Chancellor Noble took the settlement under advisement and, at the end of September 2015, narrowly approved it.
- ***In re Susser Holdings Corporation Stockholder Litigation.*** In this decision, Vice Chancellor Glasscock approved a disclosure-based settlement after receiving assurance from counsel that the release would not extend to certain federal claims. Vice Chancellor Glasscock was satisfied that the scope of the release was limited to the plaintiffs' fiduciary duty claims that arose out of the transaction and emphasized that the release "was negotiated in good faith under the understanding that typically broad releases have been accepted by the Court." (C.A. No. 9613-VCG (Del. Ch. Sept. 15, 2015) (Transcript).)
- ***In re Riverbed Technology, Inc. Stockholders Litigation.*** Two days after *Susser*, Vice Chancellor Glasscock approved another disclosure-based settlement, but used even stronger language concerning the ongoing viability of related broad releases. Over multiple objections, Vice Chancellor Glasscock found that the supplemental disclosures obtained in the settlement represented "a positive result of small therapeutic value to the Class which can support, in my view, a settlement, but only where what is given up is of minimal value." Although Vice Chancellor Glasscock did not reject the settlement based on the scope of the broad release, he did note that its scope was "troubling." He also explained that, while the parties' good faith negotiation of the settlement deserved some judicial credit, the equitable weight of this factor will be "diminished or eliminated going forward." (2015 WL 5458041, at *5, *6 (Del. Ch. Sept. 17, 2015).)
- ***In re CareFusion Corp. Stockholders Litigation.*** Hours after Vice Chancellor Glasscock issued *Riverbed*, then-Vice Chancellor Noble, ruling from the bench, approved a disclosure-based settlement with broad releases. In approving the settlement, Vice Chancellor Noble explained that he was satisfied with plaintiffs' counsel's analysis that there likely would not be any other state or federal claims for the class to pursue, and added that the fact no one had appeared in court to object to the settlement provided some confidence that there was "nothing else worth pursuing." Vice Chancellor Noble added that while theoretically a broad release can be cause for concern, speculation does not justify rejecting or limiting a settlement to which the parties have agreed where

"absolute certainty simply is not a realistic goal." (C.A. No. 10214-VCN (Del. Ch. Sept. 17, 2015) (Transcript).)

- ***In re Vitesse Semiconductor Corp. Stockholders Litigation.*** In *Vitesse*, then-Vice Chancellor Parsons approved a disclosure-based settlement. In doing so, he observed that the court had been paying careful attention to these types of settlements, and that he would therefore consider the give and the get regarding the plaintiffs' underlying claims and the scope of the release being granted. With that background in mind, Vice Chancellor Parsons found the consideration sufficient, and that the scope of the release, though broad, was justified in light of the weakness of the plaintiff's claims under Delaware law. (2015 WL 5724301 (Del. Ch. Sept. 29, 2015).)

THE NEW PLAINLY MATERIAL STANDARD

In the midst of the evolving views expressed during 2015, Chancellor Bouchard approved some disclosure-based settlements, but reserved decision on approval of a disclosure-based settlement arising out of a stock-for-stock merger transaction between online real estate companies Trulia and Zillow. At the time, Chancellor Bouchard had noted that the parties had presented the "underbelly of settlements," but nevertheless requested supplemental briefing, including to address whether disclosures must be material to support a disclosure-based settlement. (*In re Trulia, Inc. Stockholder Litig.*, C.A. No. 10020-CB (Del. Ch. Sept. 16, 2015) (Transcript).)

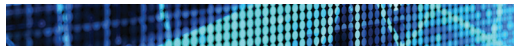
In January 2016, Chancellor Bouchard issued a lengthy opinion in which he ultimately declined to approve the settlement. Regarding disclosure-based settlements in general, Chancellor Bouchard reiterated many of the concerns expressed in the court's 2015 rulings. Among other things, Chancellor Bouchard noted that the court may have an insufficient basis to evaluate a settlement that is entered into early on in the case with no discovery record or motion practice. Chancellor Bouchard also reflected on "the rapid proliferation and current ubiquity of deal litigation, the mounting evidence that supplemental disclosures rarely yield genuine benefits for stockholders, [and] the risk of stockholders losing potentially valuable claims that have not been investigated with rigor." He therefore held that the court's historical practice of approving disclosure-based settlements needed to be reexamined. (*In re Trulia, Inc. Stockholder Litig.*, 129 A.3d 884, 907 (Del. Ch. 2016).)

Against this backdrop, Chancellor Bouchard advised that the court's preferred method of adjudicating the merits of disclosure claims in deal litigation is not in the context of a proposed settlement, but rather, through an adversarial process. He explained that such an adversarial process can occur in two different contexts:

- During a preliminary injunction motion, where the plaintiffs have the burden of demonstrating a reasonable likelihood that the alleged omission or misrepresentation in the company's disclosures is material.
- In a mootness scenario, in which the defendants voluntarily decide to supplement their disclosures (thereby mooting the plaintiffs' claims) and, thereafter, plaintiffs' counsel applies to the court for an award of a mootness fee. The court noted that in this scenario, defendants are incentivized to oppose excessive fee requests.

In the settlement context, however, Chancellor Bouchard indicated that going forward disclosure-based settlements are likely to be met with continued disfavor unless the supplemental disclosures address a plainly material misrepresentation or omission. The court emphasized that under the plainly material standard, it should not be a "close call" as to whether the supplemental information is material under Delaware law. Chancellor Bouchard further explained that the proposed release must be narrowly tailored to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sale process, if those claims have been sufficiently investigated.

Finding that the supplemental disclosures issued in connection with the *Trulia* settlement, which focused on additional details in the target board's investment banker's fairness opinion section of the proxy, were not plainly material, Chancellor Bouchard declined to approve the proposed settlement.



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THE PLAINLY MATERIAL STANDARD IN PRACTICE

Since *Trulia*, the Court of Chancery has had a few occasions to implement the plainly material standard. In February 2016, two weeks after the *Trulia* decision was issued, Vice Chancellor Laster

declined to approve a partial settlement, determining that, although the plainly material standard articulated in *Trulia* was satisfied (based on conflicts-related disclosures), the settlement should nevertheless be rejected because there was too much evidence that raised too many questions about the "decision-makers" and their advisors to do a give-get analysis for a partial settlement of the case. (*Haverhill Retirement System v. Kerley*, C.A. No. 11149-VCL (Del. Ch. Feb. 9, 2016) (Transcript).)

In contrast, in a ruling delivered the following week, Vice Chancellor Noble (in one of his last decisions before leaving the bench) approved a settlement that was entered into pre-*Trulia* involving what he found to be plainly material supplemental disclosures. Vice Chancellor Noble acknowledged the difficulty in having the standard of review change after having entered into a disclosure-based settlement, and indicated that had the settlement hearing occurred prior to the court's decision in *Trulia*, he probably would have relied on the parties' reasonable expectations in approving the settlement. However, Vice Chancellor Noble decided that he could not ignore *Trulia* and, after applying the plainly material standard, held that the additional disclosures were sufficient on the grounds that they supplied information that clearly was important to the financial advisors' discounted cash flow analysis.

The information supplied in the additional disclosures included:

- Risk-adjusted and product-level projections.
- Additional details about the financial advisors' analysis.
- Detail about the board's consideration of strategic alternatives.
- Information about the process leading up to the merger, that "help[ed] the shareholders understand a little bit better what was going on."

(*In re NPS Pharm. Stockholders Litig.*, C.A. No. 10553-VCN (Del. Ch. Feb. 18, 2016) (Transcript).)

The parties had also negotiated a less broad release, ultimately agreeing to release only state law claims that arose out of the transaction and federal securities law claims concerning disclosure related to the deal. The court was comfortable that this release fit within the *Trulia* standard, in that it was "narrowly circumscribed" to encompass both state and federal disclosure claims, as well as price- and process-related fiduciary duty claims. Vice Chancellor Noble added that he was satisfied that plaintiffs' counsel had investigated the fiduciary duty claims and that their decision not to pursue such claims was reasonable. He also approved a negotiated fee award of $370,000.

The same day that Vice Chancellor Noble approved the *NPS* settlement, in *In re BTU International, Inc. Stockholders Litigation*, Chancellor Bouchard (in what appears was his first opportunity to apply the plainly material standard to a disclosure-based settlement since authoring *Trulia*) approved a settlement involving supplemental disclosures and a clarification regarding certain nondisclosure agreements. Similar to Vice Chancellor Noble's ruling in *NPS*, Chancellor Bouchard recognized that the settlement pre-dated the *Trulia* decision, but nevertheless applied the heightened *Trulia* scrutiny and found that the disclosures, which included cash flow projections used in the financial advisors' analyses, satisfied the plainly material standard. (*In re BTU Int'l, Inc. Stockholders Litig.*, 2016 WL 680252 (Del. Ch. Feb. 18, 2016).)

Turning to the scope of the release, Chancellor Bouchard held that the release was consistent with *Trulia* because it was limited to a release of disclosure claims and fiduciary duty claims relating to the merger. Chancellor Bouchard also approved the negotiated fee award of $325,000. During the hearing, however, Chancellor Bouchard emphasized again the court's preference that disclosure claims in deal litigation be resolved in an adversarial process, either through actual litigation or in connection with a mootness fee application, and reiterated that

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counsel "would be wise to pursue the options enumerated in *Trulia* in the future."

KEY TAKEAWAYS AND STRATEGIC CONSIDERATIONS

The Court of Chancery's approach to disclosure-based settlements continues to develop and evolve. The decisions following *Trulia* provide some clarity on how the court expects or prefers parties to resolve disclosure claims in deal litigation.

Among other things, the cases suggest that disclosure-based settlements with narrowly tailored releases are still available in the appropriate circumstances. Nonetheless, they will receive greater judicial scrutiny regarding whether supplemental disclosures are "plainly material" and whether any release relates only to disclosure claims and process claims arising from the underlying transaction that have been "investigated sufficiently." The court has sent a clear message that these settlements should be presented less frequently than in the past.

In addition, deal litigation involving disclosure claims may be resolved more frequently by mootness dismissals. As the court in *Trulia* noted, for the vast majority of these cases, a mootness dismissal, based on supplemental disclosures, effectively ends the litigation.

The court has also made clear that the preferred approach for resolving disclosure claims is no longer through settlement, but through an adversarial process. On one hand, in light of the heightened plainly material standard for disclosure-based settlements, it could mean that more injunction hearings addressing disclosure claims may occur. However, this will likely be tempered by the Delaware Supreme Court's recent decision in *C&J Energy*, where the court stressed that when no competing bid emerges after a deal is announced, it will be difficult for a stockholder plaintiff challenging the deal to demonstrate reasonable success on the merits. (*C&J Energy Serv., Inc. v. City of Miami Gen. Emps' and Sanitation Emps' Ret. Trust*, 107 A.3d 1049 (Del. 2014).)

Another important consideration is how defendants faced with multi-forum deal litigation involving a Delaware corporation will be able to control that tactic. The unavailability of releases through settlements may prompt Delaware corporations to adopt forum selection provisions that require deal litigation (and other claims involving the internal affairs of the corporation) to be filed exclusively in Delaware. In this regard, the *Trulia* court emphasized a corporation's ability to enact a forum selection by-law as an effective way to manage multi-forum deal litigation. Indeed, the Delaware General Corporation Law now permits a board to select, in the certificate of incorporation or by-laws, Delaware as an exclusive forum for "internal corporate claims" (8 Del. C. § 115 (2015)).

It seems that the plaintiffs' bar has begun to file more deal litigation actions outside of Delaware, whether or not a company has an exclusive forum selection provision in their charter or by-laws, in the hopes that it might be easier to pursue a disclosure-based settlement in a non-Delaware forum. Another emerging tactic is for plaintiffs to avoid state law claims altogether, and instead pursue disclosure-related claims under the federal securities laws, such as under Section 14(a) of the Securities Exchange Act of 1934.

It is yet to be seen whether other states will follow Delaware's lead in embracing enhanced scrutiny of disclosure-based settlements. Regarding deal litigation brought solely in other jurisdictions, at least two other forums (courts in North Carolina and California) have acknowledged *Trulia* and requested litigants to provide supplemental information regarding the materiality of the disclosures and how they justified the releases sought. In a recent North Carolina action, the judge approved a disclosure-based settlement over *Trulia*-based objections (*Corwin v. British Am. Tobacco PLC*, 2016 WL 635191 (N.C. Super. Ct. Feb. 17, 2016)). This area of law will undoubtedly continue to evolve not just in Delaware, but in state and federal courts around the country.