Trulia's Impact On Deal Litigation In Delaware And Beyond

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Law360, New York (November 28, 2016, 9:47 AM EST) -- Throughout the second half of 2015, the Delaware Court of Chancery began questioning its long-standing practice of approving deal litigation settlements involving broad releases for defendants in exchange for disclosure (or other similar therapeutic) benefits and analyzed such proposed settlements with increased scrutiny. This culminated in Chancellor Andre G. Bouchard's widely anticipated decision in In re Trulia Inc. Stockholder Litigation, C.A. No. 10020-CB (Del. Ch. Jan. 22, 2016), wherein the chancellor fashioned a new rule for evaluating disclosure settlements — the "plainly material" standard — and expressed a preference for disclosure claims to be either litigated or mooted.

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The Court of Chancery's decision in Trulia has had a clear impact on deal litigation, both in terms of litigation practice and increased scrutiny of disclosure-based settlements, with varied results in terms of approval.[1] This impact has continued throughout 2016, with the ripple effect leading to more contested mootness fee applications and decisions from the Delaware courts. It also has led to several interesting deal litigation settlement rulings from non-Delaware courts.

Mootness Fee Applications on the Rise

Plaintiffs and defendants appear to have taken seriously the Court of Chancery's view expressed in Trulia that disclosure-only settlements should be entered into only in circumstances involving plainly material supplemental disclosures. The court also expressed the view that one of the "preferred" ways to address disclosure claims was to "moot" them with supplemental, corrective disclosure.

Indeed, plaintiffs in many instances have begun to file complaints limited to disclosure claims — and in some instances, only a handful of disclosure claims — in the hope of having defendants moot such claims with supplemental disclosure. This, in turn, opens the door for plaintiffs to make an application for "mootness fees" for creating a disclosure "benefit." Sometimes, the parties are able to negotiate an agreed-upon mootness fee, while other times such fees are contested and require judicial resolution.

For example, on July 21, 2016, Chancellor Bouchard entertained a request for mootness fees in connection with stockholder class actions challenging the acquisition of Receptos Inc. by Celgene Corp. Shortly after litigation was initiated, the parties entered into a memorandum of understanding to settle the litigation in exchange for supplemental

disclosures. However, after the court issued its decision in Trulia, rather than seeking approval of the settlement, the plaintiffs dismissed the actions with prejudice as to the named plaintiffs only and sought a mootness fee award in the amount of $350,000, which the defendants opposed.

Evaluating the benefit conferred on stockholders by the supplemental disclosures, Chancellor Bouchard concluded that one aspect — an additional line of management projections reflecting management's estimated probability of success in obtaining certain regulatory approvals — provided "useful, but not material, information of some value." However, Chancellor Bouchard found that other disclosures were of the "'tell me more' variety that are not material" or added "nothing of meaningful value." Emphasizing that "plaintiffs should not expect to receive a fee in the neighborhood of $300,000 for supplemental disclosures in a post-Trulia world unless some of the supplemental information is material under the standards of Delaware law," Chancellor Bouchard nevertheless granted a fee award in the amount of $100,000.

The next day, Chancellor Bouchard addressed an application for mootness fees in an action arising out of JAB's acquisition of Keurig Green Mountain. In re Keurig Green Mountain Inc. Stockholders Litigation, C.A. No. 11815-CB (Del. Ch. July 22, 2016) (Transcript). Following announcement of the transaction, the plaintiffs moved for expedited discovery, arguing, among other things, that the proxy issued in connection with the transaction and the press release announcing the transaction were inconsistent with respect to their description of management's continuing role with the surviving entity. Chancellor Bouchard granted the motion, and defendants subsequently mooted the claim by providing supplemental disclosures clarifying that JAB may or may not retain existing management, but that management had not discussed its continuing role during negotiations. The plaintiffs dropped their case and sought $300,000 in mootness fees for this disclosure benefit.

Denying the request, Chancellor Bouchard applied a materiality standard and explained that the plaintiffs' "investigation and the supplemental disclosures confirmed that the proxy was correct in the first place in stating that management had no understanding regarding future employment," such that "these supplemental disclosures did not confer any benefit on the corporation because they did not correct a materially misleading disclosure in the original proxy, since there wasn't one, and because they did not provide new information to correct a material omission. Instead, the supplemental disclosures provided purely confirmatory information indicating that the proxy already was correct." As a result, Chancellor Bouchard declined to award any mootness fees to the plaintiffs' counsel.

In May 2016, Vice Chancellor Sam Glasscock III "struggled" over issues arising out of an application for mootness fees under similar circumstances. See In re Xoom Corp. Stockholder Litigation, C.A. No. 11263-VCG (Del. Ch. May 10, 2016) (Transcript). The supplemental disclosures at issue in the case involved disclosures relating to the amount of fees received by Xoom's financial adviser from the acquirer in the two years prior to the merger, the value to Xoom of any potential recovery for a $30 million loss due to fraud, certain elements of the financial analysis performed by Xoom's financial adviser, and details about conversations regarding post-closing employment between Xoom's directors and the acquirer.

At oral argument, the vice chancellor remarked that "we are at a stage of the case law ... where our approach has fundamentally changed [after Trulia]," and noted that he did not "want to act precipitously or in a way that is going to produce incentives that [he has not had] at least attempted to suss out." He further noted that "what we've done in the past, I think everybody would agree, has not been a good system, and I want to do what I can [to not] create more problems going down the road." He acknowledged that the Court of Chancery is "responsible for creating a market here [for fees for mooted disclosure claims], and if we get it wrong, either wrongs against equity holders will go unremedied, or

there will be way too much litigation, and that costs stockholders as well."

Ultimately, in a written decision issued Aug. 4, 2016, Vice Chancellor Glasscock rejected the plaintiffs' counsel's request for $275,000 in fees and awarded $50,000 instead. Expressing a divergent view from Chancellor Bouchard in Keurig, Vice Chancellor Glasscock acknowledged that "[t]his Court in Trulia made clear that, to support a settlement and class-wide release based on disclosures only, the materiality of the disclosures to stockholders must be plain," but found that "[t]he mootness context, in my view, supports a different analysis" because "the individual Plaintiffs have surrendered only their own interests; the dismissal is to them only, not to the stockholder class. ... Therefore, a fee can be awarded if the disclosure provides some benefit to stockholders, whether or not material to the vote. In other words, a helpful disclosure may support a fee award in this context." Applying the factors set forth in Sugarland Industries Inc. v. Thomas, Vice Chancellor Glasscock found that some of the disclosures at issue were "mildly helpful to stockholders" while others were "of minimal benefit." He noted that "[o]f the four disclosures that resulted from the litigation, those involving the banker conflict and post-Merger employment discussions are the most valuable," although "[n]one of the four is particularly strong."

Other State, Federal Courts Consider Trulia

After Trulia, a number of plaintiffs have pursued deal litigation outside of Delaware, sometimes in violation of a target company's charter or bylaws requiring stockholders to pursue such claims, if at all, solely in Delaware courts. In these cases, plaintiffs will sometimes request that defendants waive such "forum selection" charter and bylaw provisions with the goal of reaching a disclosure-based settlement in the non-Delaware forum. Defendants have met these requests with varying approaches, at times insisting on enforcing the charter or bylaw and at other times agreeing to waive it to pursue a disclosure-based settlement in the non-Delaware forum.

In circumstances where parties have entered into disclosure-based settlements outside of Delaware, some courts have relied on Trulia to reject the settlement. For example, on Sept. 26, 2016, the Superior Court of New Jersey issued a ruling rejecting a disclosure-based settlement and awarding an objector to the settlement — Fordham Law professor Sean Griffith, a frequent objector in such cases — attorneys' fees in the amount of $88,274. Vergiev v. Aguero, No. L-2276-15 (N.J. Super. Ct. Law Div. Sept. 26, 2016).2 In contrast, courts in other states have continued to approve disclosure settlements. See, e.g., In re Sigma-Aldrich Corp. Shareholder Litigation, Case No. 1422-CC09684 (Mo. Cir. Ct. Aug. 19, 2015) (Order); Murphy v. Synergetics USA Inc., Case No. 1511-CC00778 (Mo. Cir. Ct. July 29, 2016) (Order) (same).

In some cases, plaintiffs have responded by filing an action in federal district court, repackaging their state disclosure claims as federal disclosure violations, and sometimes adding breach of fiduciary duty claims attacking the board's process and the merger price as separate, additional counts. If the parties choose to go the settlement route, they do so with some amount of uncertainty, as some federal courts have recently rejected such settlements in line with the reasoning in Trulia.

For example, on Aug. 10, 2016, the U.S. Court of Appeals for the Seventh Circuit issued an opinion authored by Judge Richard Posner in which the court adopted the Trulia "plainly material" standard. In re Walgreen Co. Stockholder Litig., No. 15-3799 (7th Cir. Aug. 10, 2016). The case involved a challenge to Walgreens' 2014 acquisition of Alliance Boots and addressed federal securities disclosure claims as well as claims for breach of fiduciary duty under state law. According to Judge Posner, "[w]ithin two weeks after Walgreens filed a proxy statement seeking shareholder approval of the reorganization, the inevitable class action was filed, and 18 days later — less than a week before the shareholder vote — the parties agreed to settle the suit" based on additional disclosures. The settlement involved

six categories of disclosures, including disclosures relating to the recent nomination of a certain director to the Walgreens board; the allocation of stock in the surviving company to two investment groups after the merger; the resignation of Walgreens' chief financial officer prior to the merger; additional risk factors the board considered in determining whether to approve the merger; the reason one director did not vote to approve the merger; and the background of the individual who had been appointed acting CEO of the surviving entity.

The district court approved the settlement and awarded $370,000 to plaintiffs in attorneys' fees. The Court of Appeals reversed, noting that "[t]he value of the disclosures in this case appears to have been nil. The $370,000 paid to class counsel — pennies to Walgreens, amounting to 0.039 cents per share at the time of the merger — brought nothing of value for the shareholders, though it spared the new company having to defend itself against a meritless suit to void the shareholder vote." Echoing many of the sentiments expressed in Trulia, Judge Posner further remarked that "[t]he type of class action illustrated by this case — the class action that yields fees for class counsel and nothing for the class — is no better than a racket. It must end. No class action settlement that yields zero benefits for the class should be approved, and a class action that seeks only worthless benefits for the class should be dismissed out of hand."

Focusing on the district court's decision below, Judge Posner noted that the district court judge found the "supplemental disclosures may have mattered to a reasonable investor." He noted that "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.'" Instead, Judge Posner "endorsed" Trulia's "clearer standard for the approval of such settlements," emphasizing that "the misrepresentation or omission that the supplemental disclosures correct must be 'plainly material.'"

Other Effects on Merger Litigation From Trulia

In addition to mootness fees, Trulia has impacted the development of merger litigation in Delaware beyond settlement practice. For example, after Trulia, defendants have been more resistant to voluntarily producing discovery on disclosure and other claims pre-close, given the reduced likelihood of settlement. Many times, a merger transaction will close with no discovery taking place. This development, in combination with the Delaware Supreme Court's decision in Corwin v. KKR Financial Holdings LLC, 125 A.3d 304 (Del. 2015),3 has prompted some plaintiffs to complain that Delaware courts should not stay discovery pending a dispositive motion because without discovery, plaintiffs cannot fairly assess whether a disclosure violation occurred, rendering the vote "uninformed" for Corwin purposes.

Vice Chancellor J. Travis Laster addressed this argument in a bench ruling on Sept. 6, 2016, in In re Columbia Pipeline Group Inc. Stockholder Litigation, C.A. No. 12152-VCL (Del. Ch. Sept. 6, 2016) (Transcript). In that case, plaintiff stockholders sought to challenge TransCanada's acquisition of Columbia Pipeline. Following the filing of the preliminary proxy, the plaintiffs amended their complaint to add disclosure claims. Following the filing of the final proxy, Columbia Pipeline stockholders voted overwhelmingly in favor of the transaction. The defendants subsequently moved to dismiss and to stay discovery pending resolution of the motions to dismiss, and the plaintiffs opposed the motion to stay discovery. Specifically, the plaintiffs argued that the combination of the Court of Chancery's crackdown on disclosure-based settlements post-Trulia and the Delaware Supreme Court's decision in Corwin has left stockholder plaintiffs facing a "brave new world" in which they have no means of discovery into disclosure claims. The plaintiffs thus advocated for a new rule in which defendants, when raising a Corwin defense, would

be required to produce documents to “provide the basis” for the information disclosed in the proxy in order for plaintiffs to meaningfully be able to challenge it. Vice Chancellor Laster rejected this argument, holding that, notwithstanding any impact Trulia has had on stockholder plaintiffs’ ability to obtain discovery, plaintiffs continue to bear the initial burden to plead facts, without discovery, making it reasonably conceivable that a disclosure violation occurred and the standard in Corwin should not apply.

Key Takeaways

As the above discussion demonstrates, the impact of Trulia continues to have a ripple effect across deal litigation in Delaware and beyond. Disclosure-based settlements before the Court of Chancery have fallen out of favor. However, such settlements continue to obtain approval in some state and federal courts, while others have decided to follow Trulia. Whether the recent post-Trulia trends continue remains to be seen. What is certain, however, is that plaintiffs and defendants in deal litigation will continue to have to navigate the “brave new world” in which they find themselves post-Trulia.

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[1] See Edward B. Micheletti, Jenness E. Parker & Bonnie W. David, “Court of Chancery Continues to Clarify Views of Disclosure-Based Deal Litigation Settlements,” Insights: The Delaware Edition, May 19, 2016; Edward B. Micheletti, Jenness E. Parker & Bonnie W. David, “Delaware Courts Question Long-Standing Practice of Approving Disclosure-Based Deal Litigation Settlements,” Insights: The Delaware Edition, Oct. 22, 2015.

[2] Notably, professor Griffith was awarded only $10,000 in fees for objecting in In re Riverbed Technology Inc., C.A. No. 10484-VCG (Del. Ch. Dec. 2, 2015), late last year.

[3] In that case, the Delaware Supreme Court held that “the business judgment rule is invoked as the appropriate standard of review for a post-closing damages action when a merger that is not subject to the entire fairness standard of review has been approved by a fully informed, uncoerced majority of the disinterested stockholders.”

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