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Continuing Trends in M&A Disclosure Litigation

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Over the past two years, the deal litigation landscape has changed dramatically. In early 2016, the Delaware Court of Chancery announced a new rule for evaluating disclosure-based settlements in deal litigation — the "plainly material" standard — and expressed a preference for disclosure claims either to be litigated or mooted, rather than settled. *In re Trulia, Inc. Stockholder Litigation*, C.A. No. 10020-CB (Del. Ch. Jan. 22, 2016). *Trulia* created a ripple effect across deal litigation in Delaware and beyond, with some interesting, and perhaps unforeseen, results.[1]

Disclosure-based settlements before the Court of Chancery are all but extinct. Litigation has not subsided in Delaware post-*Trulia* but has taken a different form. Instead of preclosing requests for injunctive relief, stockholder plaintiffs have focused instead on post-closing monetary damages and have increased their use of statutory relief, such as books and records and appraisal actions pursuant to 8 Del. C. §§ 220 and 262, to challenge transactions.

Some state and federal courts outside of Delaware have adopted and applied the reasoning in *Trulia*, but a number of disclosure-based settlements involving companies incorporated under different state laws have found favor in other state courts, with some courts distancing themselves from *Trulia*. Also, since *Trulia*, many stockholder plaintiffs appear to be avoiding filing their disclosure claims as state law breach of fiduciary duty claims, instead filing claims relating to a proposed transaction in federal courts pursuant to federal securities laws in order to avoid forum selection bylaws requiring internal corporate state law claims (such as breach of fiduciary duty claims) to be filed in Delaware, and likely in the hopes of extracting higher mootness fee awards with less scrutiny. This proliferation of securities claims has inspired plaintiffs' attorneys to develop new tactics and craft some novel disclosure claims.

Certain State Courts Approve Disclosure-Based Settlements Over *Trulia*-Based Objections

Since *Trulia*, a number of litigants have pursued disclosure-based settlements in non-Delaware forums, with some involving companies incorporated outside of Delaware, where Delaware law did not apply. Several noteworthy decisions from state courts outside of Delaware have approved disclosure-based settlements, often over the objections of a dissenting stockholder seeking to rely on the *Trulia* decision as a basis for rejecting the settlements. In such cases, courts in other states have applied their own law to address arguments by objecting stockholders, as well as grapple with procedural obstacles, including whether such objectors formally must intervene in order to appeal the approval of a settlement.

For example, in *Gordon v. Verizon Communications, Inc.*, 148 A.D.3d 146 (N.Y. App. 2017), the New York Court of Appeals reversed the New York Supreme Court's rejection of a disclosure-based settlement of litigation challenging Verizon Communications, Inc.'s purchase of Vodafone Group

[1] 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); Edward B. Micheletti, Jenness E. Parker & Bonnie W. David, "Forward Momentum: *Trulia* Continues to Impact Resolution of Deal Litigation in Delaware and Beyond," Insights: The Delaware Edition (Nov. 17, 2016).

PLC assets at an allegedly excessive price. The Supreme Court, "moved by the 'strong opposition to the proposed settlement voiced by the objectors [who appeared] at the fairness hearing,'" found that the supplemental disclosures "'individually and collectively fail[ed] to materially enhance the shareholders' knowledge about the merger' and that '[t]hey provide[d] no legally cognizable benefit to the shareholder class,'" and declined to approve the settlement.

The Court of Appeals reversed and ordered that the settlement be approved. At the outset, the court noted that "[a]lthough some commentators have opined that recent decisions, including *Trulia* ... may signal the extinction of 'disclosure-only' settlements ... this conclusion may be premature," and "recent commentators have called for courts to take a more balanced approach in evaluating non-monetary class action settlements."

Although Verizon is a Delaware corporation, the court found that New York, rather than Delaware, law applied, because the proposed settlement included a clause stating that it "'shall be governed by and construed in accordance with the laws of the State of New York.'" Applying New York law, the court analyzed the settlement under five factors set forth in *Matter of Colt Industries Shareholders Litigation*, 155 A.D.2d 154 (N.Y. Sup. Ct. 1990) — "the likelihood of success, the extent of support from the parties, the judgement of counsel, the presence of bargaining in good faith, and the nature of the issues of law and fact" — as well as "two additional criteria: whether the proposed settlement is in the best interests of the putative settlement class as a whole, and whether the settlement is in the best interest of the corporation." The court found that the settlement met this "enhanced standard" and remanded the case to the Supreme Court to determine an appropriate award of attorneys' fees.

In *Delman v. Quality Distribution, Inc., et al.*, Case No. 15-ca-005553 (June 21, 2017 Fla. Cir. Ct.), a Florida state court approved a disclosure-based settlement of litigation challenging the sale of Quality Distribution Inc., a Florida company, to certain funds advised by Apax Partners. Fordham School of Law professor Sean J. Griffith objected to the settlement, arguing that, for the reasons explained by the Delaware Court of Chancery in *Trulia*, the settlement should not be approved because "the underlying suit [was] meritless and the results obtained [in the settlement] [were] valueless. ..."

Noting that it was "a question of first impression" whether the reasoning in *Trulia* should apply under Florida law, the court found that it did not, and instead applied a "heightened scrutiny standard" under Florida law to approve the settlement. In doing so, the court observed that "first, the court must guard against a potentially overbroad release, and second, the court must scrutinize the transaction costs, including payments to class representative and fees to class counsel." The court found that the release in the settlement was "narrowly tailored to match the scope of issues litigated in the case, and pose[d] little risk of unintentionally barring any other claims the individual shareholders may have," and further noted that because "Florida courts have such a strong policy favoring resolution of cases by jury trial," "the consequence of simply refusing to approve the settlement would most likely be to require the case to proceed to jury trial over the course of a year or two." Although it approved the settlement, the court deferred its decision on plaintiff's counsel's application for attorneys' fees, instead instructing that a "true adversarial process" was required and suggesting that "[o]ne possible approach would be to retain independent counsel to protect the shareholders' interests. ..."

Following the court's ruling on settlement approval, the objector moved to intervene in the case for the limited purpose of preserving his rights to appeal the order approving the settlement. In his motion, the objector argued that it was an open question under Florida law whether an objector to a class action settlement must, in addition to filing an objection, intervene in order to become a party for purposes of appealing the approval of the settlement. Although arguing that intervention is not necessary under the U.S. Supreme Court case *Devlin v. Scardelletti*, 536 U.S. 1 (2002), the objector sought to intervene as a "belt-and-suspenders measure." The court reserved judgment on the motion to intervene, and the settlement approval is currently on appeal as a partial final judgment.

In *In re Journal Media Group, Inc. Shareholder Litigation*, Case No. 15-CV-9686 (July 24, 2017 Wis. Cir. Ct.), a Wisconsin state court also approved a disclosure-based settlement of litigation challenging Gannett's acquisition of Journal Media Group. In that case, an objector objected to the settlement for reasons similar to those expressed in *Trulia* and also sought to intervene in the case for the limited purpose of preserving his rights on appeal.

The court denied the objector's motion to intervene, both because it was untimely and because the objector failed to identify any "actual claims that he believe[d] that he ha[d] against th[e] merger." Rejecting the objector's argument that the scope of the release in the settlement was overbroad, the court explained that, under Wisconsin law, the objector was required, but failed, to identify the specific claims being released "to give the plaintiffs and the defendants the ability to assess whether or not the claims are legitimate or not ..." The court then approved the settlement as fair, reasonable and adequate, and awarded plaintiffs' counsel $425,000 in attorneys' fees.

Plaintiff Stockholders Still Prefer to Pursue Disclosure Claims in Federal Court

Another (perhaps unintended) consequence of *Trulia* is that many plaintiff stockholders have elected to pursue deal litigation involving Delaware companies under federal law, rather than Delaware law. In these cases, plaintiffs have repackaged claims once brought as state claims for breach of fiduciary duty as Sections 14(a) and 20(a) claims under the federal securities laws in an effort to avoid forum selection bylaws requiring internal corporate state law claims to be filed in Delaware. Notably, the shift away from state law fiduciary duty claims in favor of federal disclosure claims has resulted not in large numbers of disclosure-based settlements in federal court but in a raft of mootness fee applications.

As these types of federal securities disclosure cases proliferate, certain plaintiffs have injected some creativity into the typical mix of deal litigation disclosure claims. For example, one issue du jour is for plaintiff stockholders to request that the operative disclosure document reconcile the financial measures used in the company's projections that do not comply with generally accepted accounting principles (non-GAAP) with financial measures that do comply with them (GAAP). Many companies are opting to moot this claim with supplemental disclosure that provides a reconciliation. However, two recent cases strongly cast doubt on the viability of the claim.

In *Assad v. DigitalGlobe, Inc.*, No. 17-CV-01097-PAB-NYW, 2017 WL 3129700 (D. Colo. July 21, 2017), the U.S. District Court for the District of Colorado rejected a stockholder plaintiff's argument that a registration statement disseminated in connection with a motion to preliminarily enjoin a proposed merger of DigitalGlobe, Inc. and a subsidiary of MacDonald, Dettwiler and Associates Ltd. was materially misleading because it disclosed non-GAAP projections but did not reconcile those figures to GAAP financial metrics. In its ruling, the court rejected the notion that in all circumstances, "financial projections and their underlying financial information are material or must be disclosed." The court also rejected the plaintiff's argument that, as purportedly evidenced in a June 27, 2016, keynote address by Securities and Exchange Commission (SEC) Chair Mary Jo White, the SEC has "'heightened its scrutiny' of unreconciled, non-GAAP projections" by adopting Regulation G, which places certain conditions on the use of non-GAAP financial measures. In rejecting this argument, the Court observed that "such [non-GAAP] measures have been extensively used in financial disclosures even after Regulation G was finalized in 2003." Because the plaintiff could not show that the omission of GAAP measures "would take on actual significance to a shareholder in determining how to vote," and the non-GAAP projections were "recognized and specifically defined such that they ha[d] less potential to be misleading," the court concluded that the plaintiff had failed to show he was likely to succeed in proving that the non-GAAP financial measures were materially misleading.

Along these lines, in *Bushansky v. Remy Int'l, Inc.*, No. 115CV01343TWPTAB, 2017 WL 3530108 (S.D. Ind. Aug. 16, 2017), the U.S. District Court for the Southern District of Indiana declined to approve a disclosure-based settlement of federal securities claims challenging the disclosures disseminated in connection with a merger between Remy International, Inc. and BorgWarner Inc. An objector appeared to object to the settlement, asserting that the supplemental disclosures were not "plainly material" and provided no real benefit to Remy stockholders. The court agreed with the objector, citing both *In re Walgreen Co. Stockholder Litig.*, 832 F.3d 718 (7th Cir. 2016) and *Trulia*, and concluding that the supplemental disclosures were not plainly material. Among other things, the court found that disclosures reconciling GAAP and non-GAAP financial measures were not material, rejecting the plaintiff's argument that such "reconciliation is important because Regulation G prohibits the use of non-GAAP financial measures, unless they are accompanied by a comparable GAAP accounting measure." Explaining that the projections disclosed in the proxy statement "'were not prepared with a view toward public disclosure [or] the published guidelines of the SEC regarding projections and the use of non-GAAP measures,'" the court found that Regulation G would not apply, and further, that the reconciled GAAP measures were not material information that needed to be disclosed.

More recently, on October 17, 2017, the SEC cast doubt on the viability of this theory. Specifically, the SEC updated its Compliance and Disclosure Interpretations to clarify that financial measures provided to a financial advisor are excluded from the definition of non-GAAP financial measures and therefore not subject to Regulation G, to the extent "the financial measures are included in forecasts provided to the financial advisor for the purpose of rendering an opinion that is materially related to the business combination transaction; and the forecasts are being disclosed in order to comply with Item 1015 of Regulation M-A or requirements under state or foreign law, including case law, regarding disclosure of the financial advisor's analyses or substantive work." "Non-GAAP Financial Measures," SEC.

Key Takeaways

As the above discussion demonstrates, deal litigation has continued to change and adapt to the post-*Trulia* world. The Delaware Court of Chancery has seen a significant drop in preclosing disclosure (or other breach of fiduciary duty) claims, which has resulted in a significant decrease in deal litigation in general. The cases that are being pursued are seeking money damages as opposed to injunctive relief. At the same time, the Court of Chancery has seen a significant increase in books and records and appraisal actions, as stockholder plaintiffs have turned to statutory remedies to seek relief related to transactions post-close. It is clear that there is significantly more preclosing deal litigation activity happening outside of Delaware. While disclosure-based settlements have obtained approval in some state courts outside of Delaware, construing their own state's laws, it appears that deal litigation-based disclosure claims under the federal securities laws have largely replaced state law disclosure claims for breach of fiduciary duty. Whether this trend of filing in the federal courts will continue, and whether new disclosure law theories will develop in those courts as they did for decades under Delaware law, remains to be seen.