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Reg G-Based Merger Objection Claims Face Uncertain Future

By Amy S. Park and Claire A. McCormack

The Delaware Chancery Court's January 2016 decision in *In re Trulia Stockholder Litigation*, 129 A.3d 884 (Del. Ch. 2016), ended shareholder deal litigation as we knew it. While merger objection litigation has continued, the claims, the courts, and in many cases the method of resolution have changed. The Securities and Exchange Commission's recent Compliance and Disclosure Interpretation regarding Regulation G should bring an end to one popular claim that has proliferated in the post-*Trulia* world.

In *Trulia*, the court made clear that to support a deal litigation settlement, supplemental disclosures must be "plainly material." Expressing its disdain for then-common practice, the court also made clear that the preferred way to address disclosure claims is to litigate or moot them, not settle them with flimsy disclosures in exchange for broad releases and payment of plaintiffs' attorney fees.

In the wake of *Trulia*, plaintiffs challenging transactions of Delaware companies largely abandoned the Delaware Chancery Court and the disclosure-based, state law breach of fiduciary duty claims that once flooded that court. To escape the Delaware forum mandated by many companies' bylaws for litigation of internal corporate state law claims, plaintiffs restyled their disclosure claims as ones for violations of Sections 14(a) and 20(a) of the Securities Exchange Act of 1934, and began filing them in federal court. While the months immediately following *Trulia* saw a dip in merger objection litigation, that quickly changed. According to NERA Economic Consulting's latest statistics, securities class action filings in federal courts were up 84 percent in 2017 over the prior five year average, with 46 percent of that increase comprised of merger objection cases.

One interesting trend that emerged post *Trulia* is the assertion of Section 14(a) and Rule 14a-9 claims based on alleged violations of Regulation G. Regulation G requires that public companies disclosing certain non-GAAP financial measures also disclose comparable GAAP financial measures and include a reconciliation of the two. Section 14(a) makes it illegal to solicit a proxy in violation of SEC rules, and Rule 14a-9 prohibits solicitation by means of a disclosure document that contains any statement that is false or misleading with respect to any material fact, or that omits to state any material fact necessary to make the statements therein not false or misleading. The crux of plaintiffs' claims is that, by not including a reconciliation of non-GAAP financial projections with GAAP-compliant projections, companies' disclosure documents violate Regulation G and Rule 14a-9 and thus Section 14(a). Rather than litigate these claims, many companies have elected to moot them by providing the reconciliation and paying (often hefty) mootness fees to plaintiffs' attorneys.

Last October, the SEC issued its updated interpretation bearing directly on these types of claims. The SEC's guidance clarifies that Regulation G does *not* apply to financial measures provided to a financial advisor "for the purpose of rendering an opinion that is materially related to the business combination transaction" and in order to comply with federal regulations or state or foreign law "regarding disclosure of the financial advisor's analyses or substantive work."

One would have expected the SEC's clear statement on the issue to have stemmed the tide of Regulation G-based claims in merger objection litigation. But that has not been the case. Securities defense practitioners continue to regularly see complaints alleging violations of Regulation G based on defendants' failure to reconcile non-GAAP financial measures used in companies' projections with GAAP.

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No courts have addressed the application of Regulation G to merger- related disclosure documents since the SEC's updated guidance was issued last year. But the SEC's guidance is consistent with two federal district court cases decided in the months before its issuance — *Assad v. DigitalGlobe, Inc.*, 17-CV- 01097-PAB-NYW (D. Colo. July 21, 2017), and *Bushansky v. Remy Int'l, Inc.*, 115CV01343TWPTAB (S.D. Ind. Aug. 16, 2017).

Assad arose in the context of a motion for a preliminary injunction. The court denied plaintiffs' motion partially on the basis that plaintiffs failed to show how a GAAP reconciliation would have any significance in a shareholder's valuation of the transaction, particularly in light of the company's other disclosures. The court concluded that plaintiffs were not likely to show that the company's proxy statement was materially misleading on the basis that it lacked a reconciliation between GAAP and non-GAAP financial measures.

Bushanksy arose after the parties had reached a disclosure-only settlement where the company supplemented its disclosures with a reconciliation of non-GAAP financial measures to GAAP. The *Bushansky* court denied plaintiffs' motion to approve the settlement, finding there was no binding authority requiring the company to include the reconciliation in its proxy statement, and that such a reconciliation would not be material to shareholders. The court also opined that Regulation G was inapplicable because the "financial forecasts 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," within the meaning of Regulation G. Citing *Trulia*, the *Bushansky* court declined to approve the settlement, reasoning that the supplemental disclosures were not "plainly material."

Given the relative newness of the SEC's guidance, the lack of post-guidance case law addressing Section 14(a) claims based on alleged failures to reconcile non-GAAP financial measures to GAAP is not surprising. While the ultimate fate of these types of claims remains to be seen, unless and until courts begin rejecting them based on the SEC's updated guidance or following the reasoning in *Assad* and *Bushansky*, plaintiffs appear unlikely to be deterred from asserting them.

Amy S. Park *is a partner in the Complex Litigation and Trials, and Securities Litigation groups at Skadden, Arps, Slate, Meagher & Flom LLP and Affiliates.*

Claire A. McCormack *is an associate in the same group at Skadden, Arps, Slate, Meagher & Flom LLP and Affiliates.*

PARK MCCORMACK

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