In the second half of 2015, the Delaware Court of Chancery seemed to say “enough” with respect to so-called “disclosure-only” settlement in M&A class actions. Having previously voiced concerns over class settlements that provided stockholders with non-monetary consideration in exchange for all-encompassing releases, while compensating plaintiffs’ counsel for what the court considered to be underwhelming results, last year, the court began rejecting such settlements. The question going forward is whether developments in Delaware will simply divert the routine rush of litigation that follows a public company merger announcement to other states or actually stem the tide.

‘Deal Tax’ or ‘Deal Insurance’?

Disclosure-only settlements have become “the most common method for quickly resolving stockholder lawsuits that are filed routinely in response to the announcement of virtually every transaction involving the acquisition of a public corporation.” In such settlements, the company to be acquired typically agrees to “supplement the proxy materials disseminated to its stockholders before they vote on the proposed transaction to include some additional information that theoretically would allow the stockholders to be better informed in exercising their franchise rights. In exchange, plaintiffs drop their motion to preliminarily enjoin the transaction and agree to provide a release of claims on behalf of a proposed class of [the target’s] stockholders.” Last but not least, the plaintiffs’ lawyers get paid some modest fee for their “efforts.”

The disclosure-only settlement is thus sometimes referred to as a “deal tax”—an inevitable annuity paid to plaintiffs’ lawyers—that has simply become part of the “cost of doing business” in getting a public deal to closing. Viewed somewhat more charitably, these settlements constitute economically rational “deal insurance,” since settling on the basis of additional pre-vote proxy disclosures (in exchange for a broad release from liability) both (1) provides deal certainty by avoiding the risk of an injunction of the stockholder vote on the proposed merger and (2) eliminates the risk (however small) of future post-closing damages litigation. In other words, disclosure settlements have their attractions for both plaintiffs and defendants.

Delaware’s ‘Systemic’ Problem

As a result, in Delaware, the country’s leading forum for merger objection litigation, the percentage of M&A class actions settling for supplemental disclosures grew from 45.4 percent in 2005 to a high of 76 percent in 2012. “We have reached a point where we have to acknowledge that settling for disclosure-only and giving the type of expansive release that has been given has created a real systemic problem,” wrote Vice Chancellor J. Travis Laster, a leader among those seeking to eliminate meritless M&A suits.

In other words, the more certain that approval of such settlements—priced right as “deal insurance” for defendants and a fee for plaintiffs’ lawyers—became, the more certain it became that virtually every public company merger would garner a lawsuit and that the court would effectively be relegated to the sidelines in assessing their relative merit. A veritable Catch-22?

2. Id.
Response of the Delaware Courts

Apparently not. Recently, the Delaware judiciary has responded, first by strongly criticizing, and then by outright rejecting, disclosure-only settlements in their conventional form.

As far back as 2013, in Transatlantic Holdings, then-Chancellor Leo Strine Jr. (now Chief Justice of the Delaware Supreme Court) was a harbinger of things to come, finding that “what the class is getting is of so little apparent utility the option value of having some more diligent plaintiff be able to come forward with [a] damages action in the future” exceeded the value for the settlement.6

But the trend began in earnest in July 2015 with Aeroflex.7 It gained momentum with Aruba and Riverbed, and it came to a head in early 2016 with Chancellor Andre G. Bouchard’s decision in Trulia, where the court rejected a disclosure-only settlement in a stockholder suit filed to block Zillow Group’s acquisition of rival online real estate company Trulia, finding that the disclosures were not material “or even helpful to Trulia’s stockholders.”8 Perhaps more importantly, Chancellor Bouchard said that the court’s history of approving these settlements needed to be re-examined and warned that litigants should expect the court to be increasingly vigilant in scrutinizing requests to approve them going forward.9

Cases Provide Roadmap

To avoid putting the court in the position of having to assess the materiality of supplemental proxy disclosures in a non-adversarial context (which, per Trulia, seems increasingly unlikely to end well for anyone), Trulia and other recent cases suggest alternative avenues for the parties in an M&A transaction to pursue in seeking to resolve future deal litigation:

• Use the adversarial process. In weak cases, oppose expedited discovery and, if it comes to it, the injunction motion. Move aggressively for dismissal.

• Alternatively, remove consummation risk (and the burden and expense of litigating at a time when people are trying to get a deal closed) by supplementing proxy materials voluntarily. Reframe what would once have been a settlement as a mootness dismissal. Litigate materiality and the size of plaintiffs’ fee (if any) in the context of plaintiffs’ mootness fee application, having eliminated the threat of an injunction.

• If you settle on a disclosure basis, narrow the release by limiting it to disclosure claims, fiduciary duty claims concerning the decision to enter the merger and other issues and claims raised in the complaint.

The Current Trend in Delaware

Not surprisingly, the Delaware courts’ expressed distaste for disclosure-only settlements has already had a measurable effect: The last quarter of 2015 saw a significant decline in the number of public mergers challenged in the Delaware Court of Chancery. In the first half of 2015, public mergers were challenged 78 percent of the time; that figure dropped to 34 percent in the fourth quarter.10 In fact, as the Chancery Daily observed, this “abrupt decline” in “class action filings in October and the first half of November” 2015 occurred despite the fact that deal volume remained constant.11

8. Trulia, at 41.
9. In re Intermune Stockholder Litig., which involved a disclosure-only settlement entered into before Riverbed and Aruba, Vice Chancellor John Noble, recognizing that “predictability and consistency, especially in a venue such as this one, are to be valued” and that “[c]ounsel were reasonable in proposing the settlement” insofar as “[s]ettlements along these lines have been approved by this Court in many, many instances,” determined to “proceed to evaluate [the] settlement under a more traditional approach” and approved it as proposed, while observing that, following Riverbed and Aruba, “Counsel and their clients are on notice,” Telephonic Bench Ruling on Settlement Hearing at 9:10, C.A. No. 10086-VCN (Dec. 29, 2015); see also In re Silicon Image Stockholders Litig., Settlement Hearing and Rulings of the Court at 8, 54-55, C.A. No. 10601-VCG (approving disclosure-only settlement entered into pre-July 2015, “before the change of the tide,” in light of parties’ “settled expectations … at the time they made the settlement”).
More Eyes Are on New York

Many interested observers are watching other busy forums for merger litigation, like New York, to see if they will now adopt a similar approach to disclosure-only settlements.

In fact, New York has already recently rejected two proposed disclosure-only settlements: Gordon v. Verizon Comm’n,12 and City Trading Fund v. Nye.13 In both cases, New York state court judges criticized the current state of merger litigation and disclosure-only settlements. They then determined that the additional disclosures sought by plaintiffs were immaterial and could not justify class-wide settlements.

Fordham University Professor Sean Griffith (who, among other things, assisted in the objection to the disclosure-only settlement in the Riverbed litigation challenging the acquisition of network equipment manufacturer Riverbed Technology Inc. by private equity firm Thomas Bravo) has predicted that the Trulia analysis likely will be adopted elsewhere, insofar as it provides a “clear roadmap for out-of-state judges on how to apply Delaware law on these points [and] it is extremely clear in its reasoning.”14 Of course, out-of-state courts faced with applying Delaware law is one thing. State courts applying their own law to companies incorporated there is something else.

Will Other States Remain Open To Disclosure-Only Settlements?

Not every state will necessarily follow the examples being set in Delaware and New York. Nevada practitioners, for instance, report that the state's business court routinely approves disclosure-only settlements that award plaintiffs' counsel attorney fees and provide global releases.15 In states where merger objection litigation is less common, the courts may view the policy concerns underlying the Delaware crackdown on disclosure-only settlements as less pronounced and, potentially, outweighed by a policy favoring settlements and encouraging both in-state and out-of-state companies to incorporate there.16 From a policy standpoint, such states may want to offer indigenous companies an “off ramp” when merger litigation is filed that allows them to quickly and cheaply eliminate deal risk. In the short-term, it is likely that merger objection lawsuits will continue to be filed in these states. How the courts will treat disclosure-only settlements remains to be seen.

Is Extinction of Disclosure-Only Settlements Just a Matter of Time?

Regardless of what other states do in the future when presented with disclosure-only settlements, plaintiffs may be unable to avoid the new Delaware precedent in deals involving target companies incorporated in that state. In July 2015—at almost exactly the same time that the Court of Chancery began its crackdown on disclosure-only settlements—the Delaware legislature passed an amendment to the Delaware General Corporation Law expressly permitting boards to adopt forum-selection bylaws or charter provisions requiring stockholders to litigate these cases in Delaware.17 As more boards invoke their power to mandate litigating in Delaware, stockholders (and their counsel) will find their access cut off to “friendlier” forums for disclosure settlements.

Delaware's express authorization of exclusive forum provisions, in conjunction with Chancellor Bouchard's Trulia opinion, may thus turn out to be the “one-two punch” that knocked out or at least severely staggered an entire category of litigation against Delaware-incorporated companies.

16. Note, for example: the proliferation of specialized business courts (modeled on Delaware's Court of Chancery) in various state courts around the country; Nevada's efforts to showcase a statute that, by default, exculpates officers and directors more broadly from liability than DGCL 102(b)(7) permits companies to do in their charter (see NEV. REV. STAT. ANN. §78.138 (2010)) (expressly covering both officers and directors and, in many instances, extending to certain breaches of the duty of loyalty); and Oklahoma’s enactment of a statute expressly permitting companies to adopt precisely the sort of "loser pays" fee-shifting provisions for stockholder litigation that the Delaware Legislature recently prohibited. (see OKLA. STAT. tit. 18, §1126 (2015)).
17. See 8 Del. C. §115. In new §115, the Delaware legislature expressly authorized corporations to implement so-called “exclusive forum” provisions in their corporate charters or bylaws requiring that all suits involving "internal corporate claims" be brought solely and exclusively in a Delaware court. Internal corporate claims are defined as any claims—including derivative claims brought on the corporation's behalf—“based upon a violation of duty by a current or former director or officer or stockholder in such capacity.” Id. At the same time, the amendment prohibits Delaware corporations from selecting any state except Delaware as the exclusive forum for internal corporate claims. In other words, the DGCL allows corporations to mandate an exclusive forum for internal corporate claims, as long as that forum is Delaware.
On the other hand, the recent rulings concerning disclosure-only settlements could actually temper a board’s desire to adopt or retain a forum-selection provision mandating Delaware litigation. Recall that defendants have economically rational incentives to purchase “deal insurance” that requires only supplemental disclosures and modest payments to the plaintiffs’ bar. Among the various remaining-to-be-seen effects of the Delaware cases culminating in *Trulia*, it will be interesting to follow whether some companies actually choose to litigate in forums where they might still obtain relatively “cheap” global releases.¹⁸

¹⁸ One thing, however, seems certain with respect to Delaware-incorporated companies that have already adopted exclusive forum bylaws: Waiving such bylaws in order to settle merger objection litigation on a disclosure-only basis outside of Delaware will not be viewed kindly by shareholder advisory firms like ISS and Glass Lewis (or, presumably, the Delaware courts), though most practitioners discount the possibility that such a practice would become widespread. In fact, the question of whether waiving a forum selection bylaw in order to obtain a broad release is a breach of fiduciary duty is currently before the Delaware courts. See Plaintiffs’ Opposition to the Individual Defendants and Nominal Defendant Cytrx Corporation’s Motion to Stay the Delaware Action, *Neidermayer v. Kriegsman*, C.A. No. 11800-VCMR, 2016 WL 1381595 (Del. Ch. April 1, 2016).

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