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DISCLOSURE-BASED SETTLEMENTS, NOT BUSINESS AS USUAL

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Following a significant increase in the rejection rate for "disclosure-based" settlements by the Delaware Chancery Court, many M&A practitioners wondered if that pathway remained a viable option.[1] Now, the Court's recent ruling in *In Re Trulia, Inc. Stockholder Litigation*[2] appears to have answered that question such that, if not entirely dead, disclosure-based settlements are on life support with only the faintest hint of a pulse. While Chancellor Andre Bouchard did not completely rule out that approach in all cases, he specifically warned that "practitioners should expect that disclosure settlements are likely to be met with continued disfavor in the future."[3]

Chancellor Bouchard went on to elaborate that in being "increasingly vigilant," courts should only consider disclosure-based settlements where the

> supplemental disclosures address a plainly material misrepresentation and the. . . proposed release is narrowly circumscribed to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sales process, if the record shows that such claims have been investigated sufficiently.[4]

However, Chancellor Bouchard recognized that "increase[ed] vigil[ance]" alone would be unlikely to eliminate the ubiquitous challenges to virtually every publicly announced transaction. As an alternative to the "kabuki" dance of "hastily drafted complaints" rapidly settled "on terms that yield no monetary compensation to the stockholders," the Court suggested that dismissal followed by a mootness fee application or a private fee resolution with notice to the putative class was a preferable resolution.[5]

The viability of that alternative mechanism is certainly open to question and, at a minimum should be coupled with other approaches mentioned by the Chancellor in his thorough analysis of the issue. The larger question is whether from a policy perspective it makes sense to set the bar so high for approving disclosure settlements (*e.g.* "plainly material misrepresentations") or whether a case-by-case analysis even with heightened "vigilance" would be a more optimal path.

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Trulia arose out of the company's acquisition by Zillow, Inc. in a stock-for-stock merger.[6] Like night follows day, shortly after the public announcement of the proposed transaction four "essentially identical" complaints were filed, claiming an "unfair exchange ratio."[7]Following the filing of a Registration Statement, which contained the companies' joint proxy statement, plaintiffs filed a motion for expedited discovery and a preliminary injunction.[8] The Court never heard the motion, as the parties submitted a stipulated case schedule.[9]

The Court noted that faced with an injunction motion, "defendants are incentivized to settle quickly in order to mitigate the considerable expense of litigation and the distractions it entails, to achieve closing certainty, and to obtain broad releases as a form of 'deal insurance.' "[10]The Court wryly commented that "these incentives are so potent that many defendants self-expedite the litigation by volunteering to produce 'core documents.'.. obviating the need for plaintiffs to seek the Court's permission to expedite proceedings. . . thereby avoiding the only gating mechanism (albeit one friendly to plaintiffs) the Court has to screen out frivolous cases and to ensure that its limited resources are used wisely."[11]

The Courts Reviews the Settlement

After agreeing to a case management plan, the defendants produced documents and plaintiffs took the deposition of Trulia's Chairman, CEO and co-founder, Pete Flint, and the deposition of Trulia's financial advisor.[12] Following those adversarial depositions, the plaintiffs filed an opening brief in support of their preliminary injunction motion.[13] Shortly thereafter, Trulia and Zillow filed their definitive joint proxy statement.[14] Two days later, plaintiffs and defendants signed a memorandum of understanding (MOU) to settle the case for a variety of supplemental disclosures subject to confirmatory discovery.[15] Several months later, the plaintiffs took the deposition of another Trulia director and thereafter filed a Settlement Stipulation with the Court.[16] Among other things, the Stipulation contained "an extremely broad release" that included claims under the federal securities laws as well as unknown claims related in "any conceivable way to the transaction."[17] The Stipulation also provided for an unopposed fee application for an amount up to $375,000.

Notice of the proposed settlement was sent out and no objections were received.[18] At the fairness hearing, the Court took the matter under advisement and requested supplemental briefing on "whether disclosures must meet the legal standard for materiality in order to constitute adequate benefit to support a settlement," and on the rationale and justifications for including "unknown claims" in the release.[19] The Court also granted the request of Prof. Sean Griffith of Fordham University School of Law to submit an *amicus* brief on the value of disclosure settlements.[20] Following the Court's request for supplemental briefing, the parties modified the proposed release both to remove the references to "unknown claims" and "foreign claims" as well as carve out antitrust claims from the release.[21]

Those modifications were insufficient, however, and the Court rejected the settlement because

> the 'get' in the form of the Supplemental Disclosures does not provide adequate consideration to warrant the 'give' of providing a release of claims. . . in the form submitted or otherwise."[22]

Consequently, the Court ruled that the proposed settlement was "not fair or reasonable to Trulia's stockholders."[23]

In rejecting the settlement, Chancellor Bouchard reviewed at some length the "dynamics that have fueled disclosure settlements of deal litigation."[24] Chancellor Bouchard observed

> the public announcement of virtually every transaction involving the acquisition of a public corporation provokes a flurry of class action lawsuits alleging that the target's directors breached their fiduciary duties by agreeing to sell the corporation for an unfair price.[25]

Although acknowledging that on "infrequent" occasions deal litigation has yielded tangible benefits for stockholders particularly when the "integrity of a sales process has been corrupted by conflicts of interest," the Court noted that "far too often such litigation serves no useful purpose for stockholders" and "serves only to generate fees for certain lawyers" who regularly challenge merger transactions.[26]

Chancellor Bouchard went on to express the view that the approval of disclosure settlements with broad releases and six-figure fees to plaintiffs' counsel in the absence of adversarial discovery that might lead to the unearthing of potentially valuable claims has "caused deal litigation to explode. . . beyond the realm of reason."[27] The Chancellor remarked that scholars had argued against such "deal 'rents' or 'taxes' " and that members of the Delaware Chancery Court were expressing similar concerns as were judges outside of Delaware.[28]

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The Court then turned its attention to the "get" and determined the supplemental disclosures. With respect to the supplemental disclosures regarding expected synergies and the use of two different synergy figures in two different analyses, the Court found that both numbers had already been disclosed and that the mere juxtaposition of the already disclosed numbers was neither material or "even helpful" to stockholders, particularly since the "Market-Based Approach (as opposed to the "Intrinsic Value Approach") was included in the "Other Information Section" of the financial advisor's analysis and presented "merely for informational purposes."[29]

The Court found no more helpful the inclusion of individual company multiples in both the selected transaction analysis and comparable companies analysis, finding that the addition of individual multiples "trivialities."[30] With respect to the addition of EBITDA exit multiple ranges for Trulia and Zillow, the Court found those additions "immaterial" since the proxy already disclosed the financial advisor's methodology and assumptions, which "already provided a more-than-fair summary of the relative discounted cash flow analysis performed."[31]

Disclosure-Based Settlements After *Trulia*

There can be no dispute that Chancellor Bouchard's opinion presents a comprehensive and cogent analysis of the evolution of disclosure settlements in deal litigation. Whether *Trulia*'s cure is the correct approach in every instance is worthy of debate. As an initial matter, while the complete absence of any "adversarial" discovery would make it extremely difficult for a reviewing court to properly exercise its function in reviewing a proposed settlement, that was not the case in *Trulia*. Rather two-of-three depositions were adversarial, including that of the Chairman/CEO of the target as well as the target's financial advisor (both of which were taken in the context or preparing for a preliminary injunction hearing).

To the extent the Court needed to ascertain whether there might be any valuable process claims being released, particularly with respect to "conflicts of interest" that might have "corrupted the process" those depositions along with board books, board minutes and the proxy materials should have been sufficient at least to determine if there was enough of an issue to permit the release of process claims. To the extent both sides need to re-calibrate the amount of adversarial discovery that takes place before settlement discussions take place, that is a manageable development that might even be beneficial in terms of having a more credible process. The amount of discovery and, indeed, the level of a courts' increased "vigilance" should take into account the nature of the transaction (*e.g.* third-party buyer after full auction verses some other transaction).

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While the Court also expressed some apparent concern that defendants voluntarily agreed to certain discovery without waiting for the Court's ruling on plaintiffs' expedition application, that concern (to the extent is was not mere musing) seems misplaced. Given the low threshold of the "colorable claim" standard and the all too often presence of multi-jurisdiction litigation,[32] it simply makes sense to reach an agreement with plaintiffs' counsel on how to move the case forward in an efficient manner. That should not necessarily be a reason for skepticism in evaluating a settlement.

The scope of a release is, of course, always an issue for a court to review in approving any class-wide settlement. That being said, some of the concerns expressed with regard to the scope of releases should be easily addressed. For example, since Delaware law applies the same standard of materiality to disclosure issues as under federal law,[33] there should be no issue in releasing such claims regarding the proxy and any related documents or statements regarding the transaction. Limiting the release in such a fashion does not deprive defendants of the benefit of their bargain as it simply leaves extant any securities claims that might have arisen based on statements made unrelated to the transaction (*e.g.* a prior restatement of financial statements).

The release in *Trulia* even as modified was extremely broad and it is not surprising that the Court took issue with it. The focus on unknown claims also seems overblown. To begin with, a release of unknown claims even in connection with class-wide settlements is not unusual; and, to the contrary, is typically approved, for example, in settlements of securities class actions.

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Public policy does not preclude releases of unknown claims as many states have statutes that expressly recognize their use so long as the release contains certain cautionary language.[34] Limiting such releases to unknown claims arising from, or relating to the transaction and its supporting documents would seem to be a reasonable resolution of the issue. Such action would still allow defendants to have peace with respect to the transaction yet not go beyond ambit of the transaction and extend to other claims stockholders may have.

Finally, it is hard to see the mootness fee mechanism as a particularly attractive approach for resolving deal litigation, and it is likely to significantly increase the burdens on the parties and the courts. If there is a material misstatement then defendants will utilize the traditional approach, which would still be an available option under the *Trulia* regime. If the disclosures at issue are not material, it is unlikely defendants will make additional disclosures, whether helpful or otherwise, simply to pay plaintiffs' counsel a fee completely devoid of any release only to have some other plaintiff subsequently bring a process claim. Far more likely is that defendants will force plaintiffs to an injunction hearing with the consequent misallocation of scarce resources.

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Thus, absent a substantially lower fee structure than that suggested in various cases "valuing" supplemental disclosures[35]—and courts not allowing Delaware's very liberal "reasonable conceivability" pleading standard[36] to undermine the business judgment standard for post-closing damages cases discussed by Chancellor Bouchard as a safeguard for defendants who might opt for the mootness fee route and be left exposed to a post-closing damages claim—the practical value of the mootness fee structure seems virtually nil.

Consequently, a case-by-case approach to disclosure settlements even with enhanced scrutiny seems a better alternative to virtually eliminating that dispute resolution path for deal litigation.[37]

ENDNOTES:

[1]*See e.g. In re Aruba Networks, Inc., S'holders Litig.*, C.A. No. 10765-VCL (Del. Ch., Oct. 9, 2015)(TRANSCRIPT)(rejecting settlement); *Acevedo v Aeroflex Holding Corp.*, C.A. No. 7930-VCL (Del. Ch., July 8, 2015) 3(TRAN-

SCRIPT) (rejecting settlement); *In re Riverbed Technology Inc., S'holder Litig.*, C.A. No. 1084-VCG (Del. Ch., Sept. 17, 2015)(reluctantly approving settlement); *In re TW Telecom, Inc. S'holder Litig.*, C.A. No. 9845-CB (Del. Ch., July, 8 2015)(reluctantly approving settlement).

[2]*In Re Trulia, Inc. Stockholder Litig.,* 2006 WL 325008 (Del. Ch. January 22, 2016).

[3]*In Re Trulia* at *10.

[4] *Id*.

[5]*Id*.

[6]*Id*., at *1.

[7]*Id*.

[8]*Id.,* at *2.

[9]*Id*.

[10]*Id.,* at *6.

[11]*Id*.

[12]*Id.,* at *3.

[13]*Id*.

[14]*Id*.

[15]*Id*.

[16]*Id*.

[17]*Id*.

[18]*Id*., at *4.

[19]*Id*.

[20]*Id.,* at *5.

[21]*Id*.

[22] *Id.,* at *18.

[23]*Id*.

[24]*Id.,* at *5.

[25] *Id*.

[26]*Id*.

[27]*Id*., at *6-7.

[28]*Id*., *8.

[29] *Id.,* at *14.

[30]*Id.,* at *15.

[31]*Id.,* at *17.

[32]While the court mentioned forum selection by-laws in the context of easing concerns that a new disclosure settlement regime might give rise to an increase in deal litigation being filed in jurisdictions other than Delaware (*Id*., at *11) it is far too soon to know how effective such provisions will be in eliminating the scourge of complaints being filed in multiple jurisdictions, all challenging the same transaction, on the same grounds for the benefit of an identical class.

[33]*Id.,* at *11 ("Delaware has adopted the standard of materiality used under the federal securities laws").

[34]*See e.g.* Cal Civ Code Section 1542.

[35]*See generally In Re Sauer-Danfoss Inc., S'holders Litig.*, 65 A3d 1116 (Del. Ch. 2011).

[36]*See Central Mortgage Capital Holdings LLC*, 27 A3d 531(Del. 2011).

[37]There is some indication that a case-by-case approach might be what Chancellor Andre Bouchard intended as opposed to a hard-and-fast rule against disclosure settlements except in the very rare case. On February 18, Chancellor Bouchard approved a settlement in *In re BTU International Inc. S'holder Litig.*, C.A. No. 10310-CB. While the Court reiterated its "preference that disclosure issues in deal litigation be resolved in an adversarial process" and cautioned that counsel would be "wise to pursue the options enumerated in *Trulia"* (*Id*., TRANSCIPT of Settlement Hearing February 18, 2016 at p. 35), the Court approved a disclosure-based settlement with the additional prophylactic of notifying certain potential bidders that their standstill was terminated. (*Id.,* at 35-37). Significantly, the release covered "all claims of every nature" related to the transaction including process and disclosure claims. The release also included claims under the federal securities laws relating to the transaction but contained an express carve-out for certain unrelated claims and also excluded unknown claims. What this may mean for the future is uncertain as the Court expressly noted that the "proposed settlement predates *Trulia"* although the fairness hearing was held after that decision came down and was modified to address some of the concerns expressed in that case regarding releases. (*Id*., at 35, 40).