



## Fighting the Rising Tide of Federal Disclosure Suits

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In the past few years, there has been a dramatic rise in the number of M&A disclosure lawsuits filed in federal court. Recently, courts have begun to fight back against this nuisance litigation using different approaches. This post summarizes those developments.

Recently, many have reported on the increase in the number of lawsuits in Federal Court challenging public company mergers brought by shareholders alleging violations of Section 14(a), which prohibits false and misleading statements in proxy materials. It appears that after the Delaware Court of Chancery cracked down on reflexively filed M&A suits in *In re Trulia Inc. Stockholder Litigation*, 129 A.3d 884 (Del. Ch. 2016), the plaintiffs' bar diverted its flood of litigation following the public announcement of a merger into this previously quiet rivulet. The rush of 14(a) suits continues unabated this year.

Typically, plaintiffs file these suits as class actions after a deal is announced but before it closes. They may seek a preliminary injunction to delay the shareholder vote on the deal until the company makes further disclosures. Wanting to avoid jeopardizing the deal or delaying the vote, a company may agree to issue supplemental disclosures addressing plaintiffs' complaints regardless of whether the claims are meritorious. After the company files these supplemental disclosures, plaintiffs will usually agree to drop the preliminary injunction and dismiss the individual plaintiffs' claims with prejudice, and then seek attorneys' fees for their effort. Plaintiffs will also usually agree to dismiss the class claims without prejudice—meaning that another plaintiff could later file a similar lawsuit asserting claims for the same class, most likely post-closing.

Plaintiffs' dismissal of class claims without prejudice has two consequences. First, it leaves the threat of litigation hanging over the company, because another plaintiff could, at any time, assert his or her own claims on an individual or class-wide basis. Second, it means a court does not have the power to review and potentially reject the settlement as unfair under Federal Rule of Civil Procedure 23, because that provision requires review of settlement of *class*, and not individual, claims. F.R.C.P. 23(e).

Recently, however, two federal courts have questioned these types of settlements in an apparent effort to exercise oversight and curb potential abuse.

In the Southern District of New York, Judge Cote examined the potential for abuse in a suit alleging that Time, Inc. had omitted certain material information in its filings related to a tender offer by Meredith Corporation. Specifically, Judge Cote reviewed whether the Private Securities Litigation Reform Act (PSLRA) required her to review the pleadings to determine if plaintiffs filed the case for an improper purpose, i.e., to harass Time into paying a nuisance-fee settlement. The PSLRA requires this review where a securities claim is adjudicated on the merits. Judge Cote, however, found that dismissal of individual plaintiffs' claims with prejudice was not an adjudication on the merits within the meaning of the statute and, thus, did not merit such a review. Nonetheless, Judge Cote noted the "dangers inherent" in such suits and questioned for another day whether a putative class may, before a lead plaintiff is appointed and a class certified, even obtain preliminary injunctive relief in these types of cases (which would essentially disarm plaintiffs from threatening to delay or halt the deal before the shareholder vote).

More recently, in the Northern District of Illinois, Judge Durkin examined whether the voluntary dismissal of six separate suits against Akorn, Inc. constituted abuse. Each of the suits alleged that Akorn, Inc. had made certain omissions or misstatements in connection with Frensenius Kabi AG's bid to acquire the company. Akorn made the requested disclosures. The parties then agreed to dismiss the lawsuits, and defendants agreed to pay plaintiffs' counsel's fees. But before the court could close the matter, a member of the class sought to intervene and object to the settlement. Although the court denied the motion to intervene, it nonetheless invoked its "inherent powers to police potential abuse of the judicial process—and abuse of the class mechanism in particular—[to] require plaintiffs' counsel to demonstrate that the disclosures for which they claim credit [were plainly material]," the disclosure standard the Delaware Chancery Court applied in *In re Trulia Inc. Stockholder Litigation*. The court noted that should plaintiff fail to meet this standard, the court will order plaintiff's counsel to disgorge the attorneys' fees back to Akorn. The intervenor has appealed the court's denial of his motion to the Seventh Circuit.

And to the extent defendants are still seeking class-wide releases as part of any disclosure-only settlement, Judge Alsup in the Northern District of California has suggested yet another approach to discourage any such settlements. In any class action before him, he issues a standing order, which generally prohibits the parties from "discuss[ing] settlement as to any class claims prior to class certification." The purpose of this rule is to force plaintiffs' counsel to investigate class claims thoroughly, and thus avoid settling for less than the class deserves. He also generally requires that a release only extend to those who receive a monetary payment. The order is currently being challenged in an appeal to the Ninth Circuit as violating the parties' First Amendment rights to free speech. Were the Ninth Circuit to uphold the order, however, it could essentially prevent class-wide disclosure-only settlements in his session.

Given the economic incentives of both the plaintiff and defense bars (one wanting easy money, the other deal security), the courts may need to exercise their authority to stem this tide of nuisance litigation. Judges Cote and Durkin have sent a message with their recent opinions: Federal Courts will not sit idly by as their dockets are swamped with frivolous litigation that the Delaware Chancery Court has already turned away. Let's hope the plaintiffs are listening.