After *In re Trulia*: Increased Scrutiny for the Give and the Get in Disclosure Settlements

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It used to be that boards of public companies being acquired would routinely face one or (likely) more lawsuits alleging the directors breached their fiduciary duties because they had agreed to sell too cheaply or engaged in a flawed sales process. These lawsuits were often resolved through relatively straightforward settlements, in which the company agreed to make supplemental disclosures in exchange for dismissal of the lawsuit, a release of all potential claims, and payment of a fee to plaintiffs' counsel. At the same time, companies funneled deal litigation into the Delaware Court of Chancery through forum selection bylaws requiring that intra-corporate litigation be brought in the company's state of incorporation (typically Delaware) or headquarters in an effort to reduce the costs of multi-forum deal litigation.

Until recently, the Court of Chancery routinely approved such settlements. But the times they are a'changin.

Last year, the Court of Chancery began scrutinizing these types of settlements and rejecting them where it found the claims lacked merit or the releases were too generous. In July 2015, Vice Chancellor Laster refused to approve a settlement in *Acevedo v. Aeroflex Holding Corp.* Settlement Hr'g and Req. for Att'ys' Fees and the Ct.'s Rulings at 74, *Acevedo v. Aeroflex Holding Corp. et al.*, C.A. No. 7930-VCL (Del. Ch. argued Jul. 8, 2015). In his ruling, Vice Chancellor noted that in the past the Court of Chancery approved these settlements out of sympathy for defendants, who absent settlement would likely face costly litigation even in non-meritorious cases. *Id*. at 63-64. But "with easy money to be had, M&A litigation proliferated" and plaintiffs' attorneys' fees climbed. *Id*. at 64. Moreover, shareholders were not receiving any quantifiable benefit and were releasing claims that shareholders' attorneys could never (because of the limited discovery performed and vast breadth of so-called "intergalactic" releases) have investigated closely. *Id*. at 63-65. In the final analysis, Vice Chancellor Laster measured the give (*i.e.*, disclosures and other relief) against the get (*i.e.*, a broad class-wide release), found they did not square, and rejected the settlement. *Id*. at 73. In the following months, other members of the Court of Chancery expressed similar reservations about this type of settlement. *See, e.g.*, Telephonic Bench Ruling on Settlement Hr'g at 7-8, *In re Intermune, Inc. S'holder Litig.*, C.A. No. 10086-VCN (Del. Ch. argued Dec. 29, 2015) (Noble, V.C.); Mem. Op. at 6-11, *In re Riverbed Tech., Inc. S'holders Litig.*, C.A. No. 10484-VCG (Del.

Ch. Sept. 17, 2015) (Glasscock, V.C.).

These decisions introduced considerable doubt as to what types of settlements might pass muster and, as a result, deal litigation declined dramatically. According to a review of filings by *The Wall Street Journal*, just 34% of sales of Delaware companies for more than $100 million from October through December 2015 faced lawsuits—down from 78% for the first nine months of 2015, and 95% for 2014.

The tide truly changed, however, in January when Chancellor Bouchard issued a lengthy opinion that not only echoed the concerns voiced by the other members of the Court of Chancery, but created a framework against which parties can test the adequacy of future proposed settlements. In *In re Trulia Stockholder Litigation*, C.A. No. 10020-CB, 2016 WL 325008 (Del. Ch. Jan. 22, 2016), Chancellor Bouchard was presented with a disclosure settlement arising from the merger between Trulia and Zillow, two online real estate websites. In the suit, plaintiffs (as is typical) alleged the directors had breached their fiduciary duties in negotiating the deal. *Id*. at *2.

Initially, this merger suit proceeded as many others before it. Soon (less than one day) after the Court of Chancery consolidated the cases and appointed lead counsel, plaintiffs and defendants agreed to an expedited discovery schedule. *Id*. Approximately one month later and after just two depositions, the parties entered into a Memorandum of Understanding, agreeing in principle to settle the litigation for certain disclosures to supplement those contained in the proxy. *Id*. at *3. Several months later, after confirmatory discovery, the parties finalized the settlement agreement. *Id*.

The case diverged from the usual script, however, after a settlement fairness hearing in September 2015. Despite not receiving any objections to the settlement, Chancellor Bouchard declined to approve it and, instead, took the decision under advisement. He also requested additional briefing from the parties regarding whether the disclosures must meet the legal standard of materiality in order to constitute an adequate benefit to support a settlement. *Id*. at *4.

In January 2016, Chancellor Bouchard issued his ruling and held not only that disclosures supporting a settlement must be material, but also that there must be no question as to their materiality. *See id*. at *10. Specifically, he stated that in the future such settlements will be met with "disfavor . . . unless the supplemental disclosures address a plainly material misrepresentation or omission, and the subject matter of the proposed release is narrowly circumscribed to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sale process, if the record shows that such claims have been investigated sufficiently." *Id*. Disclosures that are "plainly material . . . should not be a close call," and, if they are, the Court of Chancery may appoint *amicus curiae* to assist it in evaluating the alleged benefits of the supplemental disclosures given the "non-adversarial nature of the typical disclosure settlement hearing." *Id*. Chancellor Bouchard concluded by exhorting sister states, which may very well see an increase in filings of the type of deal litigation that Delaware had seen in the past and is now no longer favorably inclined to consider, to follow a similar approach to such litigation in the future. *Id*. at *11.

Applying this new standard to the settlement at hand, Chancellor Bouchard rejected it because the disclosures, which were limited to supplementing the opinion of Trulia's financial advisor, did not meet the "plainly material" test. Specifically, he found the disclosures added only "additional minutiae" regarding: (1) certain synergy numbers in Trulia's financial advisor's "value creation" analysis; (2) selected comparable transaction multiples; (3) selected public trading multiples; and (4) implied terminal EBITDA multiples for a discounted cash flow analysis. *Id*. at *11, *15. He emphasized that shareholders must receive only "a fair summary" of the advisor's work and dismissed the supplemental disclosures as "extraneous details," which "[did] not contribute to a fair summary and [did] not add value for stockholders." *See id*. at *11-12, *18.

Although it may be premature to declare complete victory over the filing of "deal tax" litigation, Chancellor Bouchard's approach in *In re Trulia* may foreshadow the end to what some snidely referred to as "deal insurance" settlements. Indeed, recent trends suggest the number of suits should continue to fall. But suits outside Delaware and more meritorious suits in Delaware—for example, alleging undisclosed banker conflicts, undisclosed management projections, undisclosed employment discussions between management and the acquirer, or facts triggering an entire fairness standard of review—will remain and may satisfy the "plainly material" standard. *In re Trulia* also noted some alternatives to disclosure-only settlements. *Id*. at *9. Below we discuss some of these alternatives and potential strategies for opposing merger-related lawsuits.

Potential Approaches to Deal Litigation

With disclosure-only settlements facing a hostile reception in Delaware, plaintiffs may pursue deal litigation in other states. Below are some approaches to defending these suits.

- *Adopt exclusive forum bylaws*: Exclusive forum bylaw provisions (which generally can be adopted without shareholder approval) can funnel deal litigation to Delaware, where the Court of Chancery will likely examine the suit more closely. Defendants can then move to dismiss cases filed elsewhere.

- *Oppose expedited discovery/treatment*: The Court of Chancery frequently refuses expedited treatment when a deal is well disclosed and followed a good process. Companies can pursue that approach outside Delaware. Without expedited treatment or after a well-grounded motion to dismiss, plaintiffs may fold their cards and voluntarily dismiss.

- *Stay Delaware litigation in favor of another state*: Alternatively, companies could take their chances outside Delaware, where courts may more willingly approve disclosure-only settlements. However, without the benefit of the Court of Chancery's expertise, another court may be more likely to allow a case to proceed to expedited discovery, may struggle with a preliminary injunction motion, and may be less likely to dismiss even a non-meritorious case.

If the parties choose to settle in Delaware, the options may now be more limited:

- *Negotiate more narrowly tailored releases*: Instead of agreeing to "intergalactic" releases, plaintiffs may now release only disclosure or fiduciary duty claims concerning the sales process. The Court of Chancery has said it would approve such settlements because they would not foreclose other future, potentially meritorious claims.

- *Settle only after more extensive discovery and potentially a preliminary injunction hearing*: Plaintiffs may seek more extensive discovery, instead of the typical expedited discovery that the Court of Chancery has criticized, or may push forward and seek a preliminary injunction. Such efforts may give the Court of Chancery comfort that plaintiffs' counsel has investigated, and the parties have vigorously explored, the existence of potentially meritorious claims before settling.

- *Voluntarily dismiss and pay mootness fee*: Another alternative (endorsed by Chancellor Bouchard as "[t]he preferred scenario") is for plaintiffs to dismiss the case voluntarily after defendants make agreed-upon disclosures. Plaintiffs' counsel will then seek a so-called mootness fee, and the Court of Chancery will likely require some form of notice informing shareholders of the dismissal before considering the fee. This approach, however, does not include a release of claims.

It is not entirely clear how the Court of Chancery will apply the new "plainly material" disclosure standard or whether disclosure-only settlements remain viable. It is clear, however, that although fewer merger suits will be filed, those filed will be subject to more rigorous litigation and may proceed post-closing. *See, e.g.*, Rulings of the Ct. from Telephonic Oral Arg. on Pl.'s Mot. for Expedited Proceedings at 4, *Johnson v. Driscoll, et al.*, C.A. No. 11721-VCL (Del. Ch. argued Feb. 3, 2016) (denying motion for expedition and noting issues of materiality are better decided on motion to dismiss post-closing); Oral Arg. on Pls.' Mot. for Expedited Proceedings and Rulings of the Ct. at 48-50, *In re Keurig Green Mountain Inc. S'holders Litig.*, C.A. No. 11815-CB (Del. Ch. argued Feb. 2, 2016) (granting motion for expedition on limited issues and noting that "[i]t would be best for defendants either to litigate out the disclosure claim or moot it in a way that is satisfactory to the plaintiffs").

Early in the deal process, companies should seek advice on how best to reduce the risk of deal litigation and, if it arises, how best to navigate the realities of deal litigation during these changing times.

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