THE PRACTICE | Commentary and advice on developments in the law

Merger-Litigation Fever Begins to Cool

Delaware decision regarding Zillow-Trulia tie-up increases the likelihood of dismissals at early stages.

BY WILLIAM SAVITT

So it turns out, you can put the genie back in the bottle. About 10 years ago, the merger litigation business exploded. Taking advantage of the nuance of Delaware corporate law, shareholder-plaintiffs discovered that they could bring suit to challenge nearly any public company merger transaction.

Because so-called *Revlon* duties shifted the burden to director defendants to prove they acted reasonably in approving a sale of the company, such suits were difficult to dismiss on the pleadings. And because Delaware recognizes a duty of complete disclosure as part of directors' fiduciary duties, plaintiffs realized they could press for an injunction urging the disclosure of additional facts and details whenever a Delaware company issued a merger proxy statement.

The courts, recognizing the irreparable harm threatened by an inadequately informed stockholder vote and acting with their traditional solicitude for claimants in equity, frequently ordered expedited discovery in support of such injunction applications, handing plaintiffs substantial litigation and settlement leverage.

The result was an astonishing increase in the incidence of merger litigation. For each of the past five years, more than 90 percent of public company transactions drew fiduciary-duty litigation by shareholder-plaintiffs—and usually more than one lawsuit, often in more than one jurisdiction. In 2012, for example, the average merger transaction was challenged by no less than five class actions, and more than 50 percent of deals generated litigation in both the target company's state of incorporation (usually Delaware) and its state of headquarters.

Making matters worse was how this onslaught of cases was resolved. Only a minuscule fraction proceeded to trial.

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The overwhelming majority settled, and as the merger litigation boom wore on, they increasingly settled on a "disclosure-only" basis.

In such settlements, all the stockholders receive is more disclosure in the merger proxy. The plaintiff' attorneys collect a fee, however, often in the hundreds of thousands of dollars, and the defendants receive a broad release of claims by the shareholder class. When the courts signalled a willingness to approve these settlements, parties responded by presenting them in most cases. By 2014, some 80 percent of merger class settlements were for disclosures and nothing else.

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Everyone knew this was a problem. And finally someone has done something about it. In a series of unpublished transcript rulings last year, the Delaware Court of Chancery signaled that it was growing weary and skeptical of "disclosure-only" settlements and warned litigants to expect more searching review of such settlements in the future. Then, in late January, in *In re Trulia Stockholder Litig.*, the Court of Chancery published an opinion conclusively rejecting a disclosure-only settlement.

The *Trulia* case presented a model disclosure-only settlement. The lawsuit challenged an arms'-length stock-for-stock transaction between the Internet real estate companies Trulia Inc. and Zillow Inc. After very little adversarial litigation, the plaintiff agreed to settle the case on a class basis.

In the proposed settlement, Trulia and Zillow provided supplemental disclosures in exchange for what the court called "an extremely broad release" of all known and unknown claims "relating in any conceivable way to the transaction."

The court found that the supplemental disclosures, which consisted of additional details concerning the analysis performed by the selling board's financial advisers, were not "material or even helpful to Trulia's stockholders." In refusing to approve the settlement, the court noted the "current ubiquity of deal litigation" and the "proliferation of disclosure settlements." Because such settlements "rarely yield genuine benefits for stockholders," the court held that its "historical predisposition toward approving disclosure settlements needs to be reexamined."

The court concluded that claims challenging the adequacy of disclosures should generally "occur in an adversarial process," and not in the context of a settlement. Disclosure-only settlements are now "disfavor[ed]," the court declared, and unlikely to be approved absent a "plainly material misrepresentation or omission" and a narrowly tailored release of claims.

The *Trulia* decision marks a significant evolution in merger litigation practice. The court coupled its rejection of the disclosure-only settlement with the observation that fiduciary claims challenging mergers now "may be amenable to dismissal," recognizing that courts should treat motions to dismiss deal claims with "special care" because "the risk of strike suits means that too much turns on the mere survival of the complaint."

Under *Trulia*, disclosure claims quibbling about marginal immaterial omissions in merger proxies can no longer be resolved on a class basis at all, let alone in exchange for broad releases. As the evolving case law suggests, they are not likely to survive a motion to dismiss, either. The likely result is fewer disclosure settlements, more cases dismissed on the pleadings, and ultimately less shareholder merger litigation.

The doctrinal shift is having the intended effect. In recent months litigation rates have tumbled precipitously to less than 25 percent of all announced mergers. The days of sue-on-every-deal shareholder litigation appear to be over. But *Trulia* does not necessarily signal the end of a brisk trade in merger litigation. The possibility of multimillion-dollar judgments will continue to attract plaintiffs firms.

Look for fewer cases to be filed, but more to be litigated and tried, creating a different and in many ways more threatening exposure profile for corporate defendants and directors.

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