



## Federal Court Rejects Claim that Merger Negotiations are Required to be Disclosed

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**Editor's Note:** [Paul Vizcarrondo Jr.](#) is a partner in the Litigation Department of Wachtell, Lipton, Rosen & Katz specializing in corporate and securities litigation and regulatory and white collar criminal matters. This post is based on a Wachtell Lipton client memorandum by Mr. Vizcarrondo and [Jonathon R. La Chapelle](#), associate in Wachtell Lipton's Litigation Department.

The United States District Court in Chicago has granted summary judgment dismissing a class action claiming that statements by Sears about its business that did not also disclose that it was negotiating a merger with Kmart constituted federal securities fraud. *Levie v. Sears Roebuck & Co.*, No. 04C7643 (N.D. Ill. December 18, 2009).

Sears and Kmart had briefly discussed in the spring of 2004 the possibility of Sears acquiring Kmart through a merger, but instead Sears agreed in June 2004 to buy 54 Kmart stores. The complaint alleged that the merger negotiations continued after that, and Sears' failure to disclose their existence made its public statements about its business plans materially misleading. In declining to dismiss the complaint, the Court stated that "[i]f the merger negotiations became material at a point in time when the Sears defendants were making announcements about the purchase of Kmart stores, a jury could find that the existence of the merger negotiations was a material fact necessary to make the store purchase statements not misleading."

After extensive discovery and development of a factual record, Sears moved for summary judgment. The Court found there to be no factual dispute that the discussions that resulted in the merger agreement, announced on November 17, 2004, by which Kmart would acquire Sears (the opposite of the possible transaction that had been briefly discussed in the spring) did not begin until October 31, following Sears' disappointing third quarter earnings announcement. Accordingly, three of the five alleged misstatements, made before that date, could not be misleading for failing to disclose nonexistent negotiations. The merger discussions did not relate directly nor were they sufficiently linked to the fourth statement – a November 5th acknowledgement by Sears of a third party's disclosure that it had acquired an interest in Sears equity – so as to render it inaccurate or misleading, and in any event the negotiations had not yet become material because none of the factual or legal predicates for a merger were then in place. For similar reasons, the fifth statement – Sears' discussions of its capital requirements in the MD&A section of its third quarter 10-Q filed on November 9 – was not inaccurate or misleading and, moreover, the SEC exempts companies from having to discuss the impact of undisclosed merger negotiations in the MD&A when doing so would jeopardize the completion of the transaction.

The plaintiffs also claimed that an investment firm headed by Kmart's Chairman, which held more than a 5 percent interest in Sears stock, should have changed earlier its Schedule 13G filing with the SEC (certifying that its purpose was not to change or influence control of Sears) to a Schedule 13D acknowledging an intent to effect a change in control of Sears. The Court rejected this claim as well, finding that the factual record showed that the Chairman conducted his nego-

tiations with Sears solely in his Kmart capacity and not on behalf of the investment firm. The investment firm filed a Schedule 13D within 10 days, as required, after a proposed contract was first drafted on November 13 for it to support the merger.