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FROM CHANCERY COURT TO FEDERAL COURT: THE OBSTACLES TO A POST-*TRULIA* MIGRATION

In the watershed Trulia *Stockholder Litigation, Chancellor Bouchard of the Delaware Chancery Court — departing from the usual playbook — rejected a disclosure-only settlement on the ground that the supplemental disclosures plaintiffs obtained were not material or even helpful to stockholders. The case has led to a migration of stockholder litigation from Delaware to other states, and to the federal courts under the Exchange Act. The authors describe* Trulia *and follow-on cases, and discuss the obstacles to such litigation in federal court in light of the PSLRA.*

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For many years, shareholder suits challenging corporate mergers and acquisitions stuck to a familiar script. From deal to lawsuit to negotiated settlement, the outcome was invariably swift: defendants gained broad releases from liability; plaintiffs' lawyers won hundreds of thousands of dollars in fees; and shareholders received token disclosures supplementing the proxy statement. The majority of those cases were litigated in the Delaware Court of Chancery, which generally approved the predictable "disclosure-only" settlements. But in early 2016, the Court of Chancery changed course, rejecting such a settlement in *In re Trulia, Inc. Stockholder Litigation*[1] and warning practitioners to expect continued judicial scrutiny in the future. At first glance, the federal courts might seem like the next stop for plaintiffs' attorneys post-*Trulia* — an alternative to the suddenly less-friendly Delaware courts. As we explain here, however, federal securities laws carry their own set of challenges to shareholder-plaintiffs (and their attorneys) seeking to profit from M&A litigation.

In this article, we first discuss the *Trulia* decision and the ensuing shift of M&A suits away from Delaware. Second, we explore the possible migration of such suits to federal courts in the form of federal securities law claims, including the hurdles shareholder-plaintiffs will face under the Private Securities Litigation Reform Act. Third, we discuss a recent Seventh Circuit decision suggesting that disclosure-only settlements may fare no better in federal court than in the Delaware Court of Chancery.

TRULIA

Until recently, shareholder lawsuits were filed as a matter of course after the announcement of virtually every merger or acquisition of a public corporation.

[1] 129 A.3d 884 (Del. Ch. 2016). Unless otherwise noted, all internal citations and quotation marks have been omitted.

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From 2010 to 2014, more than 90% of M&A deals valued at over $100 million resulted in litigation.[2] These suits often sought disclosures related to the proposed transaction that could, in principle at least, affect shareholder approval. They typically resulted in settlements — as they were arguably designed to — in which class counsel received fees and shareholders received supplemental disclosures for the proposed transaction. For their part, defendants obtained what Delaware Supreme Court Chief Justice Leo Strine, Jr., has called an "intergalactic" release, an insurance policy precluding any further liability from the transaction.[3] The settlements usually came quickly, before the deal even closed.[4]

The *Trulia* decision, on January 22, 2016, signaled an end to the era of rubber-stamped disclosure-only settlements. Although *Trulia* has been cited as a watershed decision in this regard, the rumblings had been coming for a while. Justice Strine, then a Chancellor, rejected disclosure-only settlements in 2013 and 2014.[5] Vice Chancellor Laster followed suit, rejecting two disclosure-only settlements in 2014[6] and another in 2015.[7] And Vice Chancellor Noble signaled similar reservations when he withheld approval of a disclosure-only settlement in 2015.[8] When first presented with the disclosure-only settlement in *Trulia* in September 2015, Chancellor Bouchard requested supplemental briefing on whether the disclosures were "an adequate benefit to support a settlement" and whether they justified the broad release.[9] His 42-page opinion presented a well-reasoned indictment of the disclosure-only settlement practice.

The case was brought by Trulia shareholders, who filed suit almost as soon as the company publicly announced its proposed acquisition by Zillow. The parties soon agreed to settle in exchange for the defendants: (1) making "certain disclosures" to the summary of the banker's financial analysis "to supplement those contained in the Proxy" and (2) paying court-ordered attorneys' fees, with no objection, up to $375,000.[10] In rejecting the settlement, Chancellor Bouchard found that the supplemental disclosures the plaintiffs obtained were not "material or even helpful" to stockholders — the proxy statement already sufficiently summarized the banker's financial analysis being supplemented — and the release granted to the defendants was therefore not justified.

Chancellor Bouchard's decision was more than just a rejection of the settlement before him in *Trulia*. He suggested that he was speaking for the entire Chancery Court bench when he explained that "practitioners should expect that the Court will continue to be increasingly vigilant in applying its independent judgment to its case-by-case assessment of the reasonableness of the 'give' and 'get' of such settlements."[11] He acknowledged that this "enhanced judicial scrutiny of disclosure settlements" could trigger

[2] Cornerstone Research, *Shareholder Litigation Involving Acquisitions of Public Companies: Review of 2015 and 1H 2016 M&A Litigation* at 1, Figure 1 ("Cornerstone Research").

[3] *See* Marianna Wonder, *The Changing Odds of the Chancery Lottery*, 84 Fordham L. Rev. 2381, 2388 (2016).

[4] Cornerstone Research at 4 ("From 2009 to 2014, between 74 and 78 percent of M&A litigation was resolved before the deal closed.").

[5] *In re Transatlantic Holdings Inc. S'holders Litig.*, 2013 WL 1191738 (Del. Ch. Mar. 8, 2013); *In re Medicis Pharm. Corp. S'holders Litig.*, 2014 WL 1614336 (Del. Ch. Feb. 26, 2014).

[6] *Rubin v. Obagi Med. Prods., Inc.*, C.A. No. 8433-VCL (Del. Ch. Apr. 30, 2014); *In re Theragenics Corp. Stockholders Litig.*, C.A. No. 8790-VCL (Del. Ch. May 5, 2014).

[7] *In re Aruba Networks, Inc. Stockholder Litig.*, 2015 WL 5924767 (Del. Ch. Oct. 9, 2015) (rejecting settlement and dismissing case with prejudice).

[8] *In re InterMune, Inc. Stockholder Litig.*, C.A. No. 10086-VCN (Del. Ch. July 8, 2015). Chancellor Noble later approved the settlement and determined that the agreed-upon $325,000 in attorneys' fees was "fair, reasonable, and in accordance with applicable law." *In re InterMune, Inc. Stockholder Litig.*, 2015 WL 9481182, at *4 (Del. Ch. Dec. 29, 2015).

[9] *Trulia*, 129 A.3d at 890.

[10] *Id.* at 889-90.

[11] *Id.* at 898.

a migration, leading "plaintiffs to sue fiduciaries of Delaware corporations in other jurisdictions in the hope of finding a forum more hospitable to signing off on settlements of no genuine value."[12]

M&A LITIGATION MIGRATES FROM DELAWARE

Filings in State Court

There is evidence that *Trulia* has already reduced the number of automatic M&A strike suits. And as Chancellor Bouchard anticipated, plaintiffs' attorneys have looked to other jurisdictions. A Cornerstone Research study found that Delaware courts litigated 91 M&A deals in 2015 (the year before *Trulia*), compared to just 22 deals litigated in the second-most-active state, California.[13] In the first half of 2016, however, Delaware M&A litigation had plummeted to only 10 deals, matching the number filed in California during that period. Thus, early findings suggest that Delaware filings are indeed down, with California — where many M&A targets are headquartered — still an attractive forum.

Filings in Federal Court

In addition to filing in states other than Delaware, there has been speculation that plaintiffs might seek to avoid *Trulia*'s reach by filing M&A claims in federal court under the federal securities laws. Although no data on post-*Trulia* federal filings has been compiled, such claims are usually made under Section 14(a) of the Securities Exchange Act of 1934 and its implementing Rule 14a-9, which prohibits material misrepresentations and omissions in proxy statements sent to stockholders of registered securities.[14] To state a claim under this section of the Exchange Act, a plaintiff must establish that (1) a proxy statement contained a material misrepresentation or omission; (2) the defendants were at least negligent in drafting the proxy statement; (3) the misrepresentation or omission caused the plaintiff injury; and (4) the proxy solicitation was an essential link in the accomplishment of the transaction.[15] A misrepresentation or omission is material if there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available."[16] To satisfy the "injury" element, a plaintiff must demonstrate an "actual economic harm."[17] The "essential link" element requires the plaintiff to show causation.[18]

THE PRIVATE SECURITIES LITIGATION REFORM ACT

It is easy to see why plaintiffs' attorneys might look upon Section 14 as an attractive vehicle for challenging mergers and acquisitions outside Delaware. While a state-law fiduciary-duty claim generally requires the plaintiff to show conduct that amounts to bad faith in order to recover damages,[19] Section 14 requires the plaintiff to show only that the defendants were negligent. But Section 14 claims — which can be brought only in federal court[20] — present their own hurdles for shareholder-plaintiffs, attributable largely to the Private Securities Litigation Reform Act (the "PSLRA").[21]

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[12] *Id*. at 899. Although Delaware courts may continue to award plaintiffs' counsel "mootness fees," where the suit leads to supplemental disclosures that "moot" the plaintiffs' claim, these awards tend to be far less lucrative than counsel's fees under pre-*Trulia* settlements. *See, e.g., In re Xoom Corp. Stockholder Litig.*, 2016 WL 4146425 (Del. Ch. Aug. 4, 2016) (awarding plaintiffs' counsel $50,000 mootness fee).

[13] Cornerstone Research at 3.

[14] Rule 14a-9 provides: "No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a

footnote continued from previous column…

proxy for the same meeting or subject matter which has become false or misleading."

[15] *See, e.g., General Elec. Co. by Levit v. Cathcart*, 980 F.2d 927, 932 (3d Cir. 1992); *Herskowitz v. Nutri/Sys., Inc*., 857 F.2d 179, 190 (3d Cir. 1988); *Shidler v. All Am. Life & Fin. Corp*, 775 F.2d 917, 927 (8th Cir. 1985).

[16] *Koppel v. 4987 Corp.*, 167 F.3d 125, 131 (2d Cir. 1999).

[17] *New York City Employees' Ret. Sys. v. Jobs*, 593 F.3d 1018, 1023 (9th Cir. 2010), *overruled on other grounds by Lacey v. Maricopa Cty.*, 693 F.3d 896 (9th Cir. 2012).

[18] *In re NAHC, Inc. Sec. Litig.*, 306 F.3d 1314, 1329 (3d Cir. 2002).

[19] Breaches of the duty of care do not require this showing of course, but such breaches are usually exculpated under D.G.C.L. 102(b)(7).

[20] 15 U.S.C. § 78aa(a).

[21] Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.).

Congress passed the PSLRA in an attempt to "curb [ ] perceived abuses" in securities litigation, including "nuisance filings, targeting of deep-pocket defendants, vexatious discovery requests, and manipulation by class action lawyers of the clients whom they purportedly represent."[22] Given that aim, it is no wonder that the PSLRA yields impediments to pursuing M&A strike suits. Among other things, the PSLRA imposes a heightened particularity requirement on a plaintiff's pleadings and an automatic discovery stay pending resolution of the defendant's motion to dismiss.[23] Because the PSLRA applies to all claims under the Exchange Act, courts routinely hold that it applies to Section 14 claims.[24]

The Particularity Requirement

Under the PSLRA, the plaintiff must specify in the complaint each allegedly false or misleading statement, and explain why it is so. And if an allegation about falsity is made on information and belief, the complaint must "state with particularity all facts on which that belief is formed."[25] This standard is, by design, not easily satisfied, and plaintiffs often find it difficult for their complaints to survive a motion to dismiss.

In *Beck ex rel. Equity Office Properties Trust v. Dobrowski*, for example, the plaintiff brought Section 14 claims challenging the initial and supplemental proxy statements related to The Blackstone Group's acquisition of Equity Office Properties Trust.[26] The plaintiff alleged that the proxy statements contained material misstatements and that they omitted material facts about the sales process and the value of the company. The plaintiff further alleged that the supplemental proxy statements showed the deficiency in the initial proxy statement, yet came too late for shareholders to consider. The district court granted the defendants' motion to dismiss, finding that the complaint failed to satisfy the PSLRA's heightened pleading standard because it did not explain how the alleged omissions rendered a specific statement misleading. The district court also rejected the plaintiff's allegations of affirmatively false or misleading statements because the plaintiff had not specified why the statements were false or misleading, and instead offered only conclusory allegations that shareholders lacked sufficient time to consider the supplemental information before voting.

Similarly, in *Bond Opportunity Fund v. Unilab Corp.*, the plaintiffs brought Section 14 claims related to allegedly misleading statements in a merger-related proxy statement.[27] The plaintiffs complained about the alleged motives of the directors and nitpicked the proxy statement's description of the financial analysis supporting the fairness opinion. Again, the district court granted the defendants' motion to dismiss. In affirming that decision, the Second Circuit explained that the plaintiffs' concerns about director motivation were just speculation and therefore insufficient under the PSLRA's pleading standard. And it rejected as immaterial the plaintiffs' quibbles with the proxy statement's description of the financial analysis.

Section 14 claims have a better chance of surviving a motion to dismiss if plaintiffs can plead a truly incorrect statement, particularly one that concerns something indisputably important to shareholders: the consideration offered. In *Bensinger v. Denbury Resources Inc.*, the shareholder-plaintiff brought Section 14 claims in connection with a merger between target Encore Energy Partners LP and Denbery Resources Inc.[28] Because the joint proxy statement/prospectus "indisputably misstated the method of calculating the merger consideration," the district court found the pleading sufficient without even considering the PSLRA. As the court explained, the misstatements related directly to the shareholders' compensation, so "it cannot be said as a matter of law that those misstatements could not have significantly altered the total mix of information available to a reasonable investor."[29] In short, typical M&A conflict and vagueness accusations do not get plaintiffs far under the PSLRA, but concrete misstatements still do.

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[22] *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006).

[23] 15 U.S.C. § 78u–4(b).

[24] *See, e.g., Knollenberg v. Harmonic, Inc.*, 152 F. App'x 674, 682 (9th Cir. 2005) ("[T]he PSLRA pleading requirements apply to claims brought under Section 14(a) and Rule 14a-9."); *Cal. Pub. Employees' Ret. Sys. v. Chubb Corp.*, 394 F.3d 126, 144 (3d Cir. 2004) ("While claims brought pursuant to section 14(a) of the 1934 Act do not require that scienter be pleaded, any claims brought under the 1934 Act must meet the PSLRA particularity requirements.").

[25] 15 U.S.C. § 78u–4(b)(1).

[26] 2007 WL 3407132 (N.D. Ill. Nov. 14, 2007).

[27] 87 F. App'x 772, 773 (2d Cir. 2004).

[28] 2011 WL 3648277 (E.D.N.Y. Aug. 17, 2011).

[29] *Id.* at *9.

The Automatic Discovery Stay

The PSLRA's automatic discovery stay presents yet another hurdle for shareholder-plaintiffs. Under the PSLRA, "all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds upon the motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party."[30] This puts plaintiffs — whose primary leverage is their ability to threaten the merger's timing — at a significant disadvantage because the merger may proceed while the motion to dismiss is pending.

This disadvantage to bringing suit under the federal securities laws is particularly stark when compared to a fiduciary-duty action. Indeed, although Section 14 claims are based on alleged defects in the final proxy statement mailed to shareholders, fiduciary-duty claims may be brought even before the proxy statement is distributed. In *Trulia*, for example, the first complaint was filed about a week after the deal was announced, more than a month before the preliminary proxy statement was filed with the SEC.[31] Thus, a shareholder-plaintiff bringing claims under Section 14 might already be far behind a state-court plaintiff, only to be further delayed by the PSLRA's automatic discovery stay.

Nor are courts shy about enforcing the stay. For example, the district court in *Baker v. AGL Resources, Inc. et al.*, a case challenging The Southern Company's proposed acquisition of AGL, declined to lift the automatic stay or order expedited discovery.[32] As the court explained, although no motion to dismiss was yet pending, the defendants had "not yet had an opportunity to file" one, because they were awaiting an amended complaint that the court had requested from the plaintiffs. The court further explained that the plaintiffs had failed to be specific in the discovery they sought — much less articulate a justification for it — and therefore could not establish "undue prejudice" from not obtaining it. Notably, the court pointed out that the discovery stay's inherent delay cannot be considered undue prejudice. Nor was the court persuaded by the plaintiffs' purported need for discovery to support their motion for a preliminary injunction enjoining the shareholder vote. After all, the court noted, this argument could apply in every securities-fraud action, and "the statutory exception would swallow the rule."[33] In *Botton v. Ness Techs. Inc.*, the court likewise refused to lift the PSLRA automatic discovery stay in a merger case, despite the plaintiff's protestation that "shareholders will be forced to vote on the Proposed Transaction without adequate information."[34]

WALGREEN AND THE FUTURE OF SECTION 14 CLAIMS

When Chancellor Bouchard recognized in *Trulia* that Delaware's tough new stance on disclosure-only settlements might drive plaintiffs to file elsewhere, he implored other courts to likewise stand firm: "[I]t is the Court's opinion, based on its extensive experience in adjudicating cases of this nature, that the historical predisposition that has been shown towards approving disclosure settlements must evolve . . . . We hope and trust that our sister courts will reach the same conclusion if confronted with the issue."[35]

Although still early, federal courts appear to be heeding the call. In *In re: Walgreen Co. Stockholder Litigation* — a case that reached the Seventh Circuit just months after Chancellor Bouchard's decision in *Trulia* — the plaintiff brought claims under the federal securities laws, including Section 14, related to Walgreens's acquisition of Alliance Boots GmbH.[36] The plaintiff claimed that the proxy statement had omitted a "litany" of allegedly material information, including certain parties' ownership stakes in the new company.[37] As if the outcome were foregone, the parties reached a disclosure-only settlement a mere 18 days later: the defendants were to receive a broad release, the shareholders were to receive some supplemental disclosures, and the plaintiff's lawyers were to receive up to $370,000 in attorneys' fees. Before *Trulia* came down, the district judge approved the settlement, noting that it "would have been very, very helpful" to hear further explanation about why the supplemental disclosures "mattered."[38]

In a 2–1 decision written by Judge Posner, the Seventh Circuit reversed. The court found the supplemental disclosures essentially valueless to

[30] 15 U.S.C. § 78u-4(b)(3)(B).

[31] 129 A.3d at 888.

[32] No. 1:15-cv-3265-WSD at *2 (N.D. Ga. November 4, 2015).

[33] *Id.* at *13.

[34] 2011 WL 3438705, at *3 (D.N.J. Aug. 4, 2011).

[35] *Trulia*, 129 A.3d at 899.

[36] 832 F.3d 718, 721 (7th Cir. 2016).

[37] Complaint ¶ 12, *Hays v. Walgreen Co. et al.*, No. 1:14-cv-09786 (N.D. Ill. Dec. 5, 2014).

[38] *Walgreen*, 832 F.3d at 721-22.

shareholders — providing information that would be obvious to an astute observer or that "could be derived by simple arithmetic from data in the proxy statement."[39] It was "inconceivable," the court concluded, that the additional disclosures had any real impact on the shareholders' decision to support the merger. Like Chancellor Bouchard in *Trulia*, Judge Posner also issued an admonition, warning practitioners to expect this type of scrutiny in future disclosure-only settlements. Indeed, he wrote that the Seventh Circuit would "endorse" and "apply" the *Trulia* decision and its clearer standard for reviewing stockholder litigation settlements. Judge Posner was, of course, not actually applying Delaware law; he was endorsing *Trulia* in the context of a federal securities law claim. But now that *Trulia*'s reach has extended to the Seventh Circuit, the question is whether other circuits will follow Judge Posner's lead.[40]

CONCLUSION

The *Trulia* decision has incentivized plaintiffs and their lawyers to seek more favorable jurisdictions for their M&A litigation. They should not expect success in federal court. Given the PSLRA's heightened pleading standard and automatic discovery stay, Section 14 claims pose formidable obstacles not present in state court. And Judge Posner's analysis in *Walgreen*, if followed by other circuits, probably ensures that federal courts will not replace Delaware as the preferred forum for shareholder M&A litigation. ■

[39] *Id.* at 722.

[40] In *Ross-Williams v. Bennett*, which concerned a failed merger between Sprint and Nextell, the District Court of Kansas considered a settlement agreement providing for changes to corporate governance and Board composition, as well as $4.25 million for plaintiff's attorneys' fees. The court analyzed the settlement agreement's terms "through Judge Posner's suggested lens" and determined that they provided "marginal benefit, if any, to shareholders." The court then approved reduced attorneys' fees of $450,000. 2016 WL 6888094 (Kan. Dist. Nov. 22, 2016).