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DISCLOSURE-ONLY SETTLEMENTS WILL BE SUBJECT TO 'INCREASINGLY VIGILANT' SCRUTINY

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In recent years, the overwhelming majority of U.S. public company mergers have resulted in shareholder litigation. That litigation has typically been resolved through a non-monetary "disclosure-only" settlement - i.e., a settlement in which the defendant company agrees to make additional disclosures to shareholders and pay the plaintiff's attorneys fees. Rather than fight claims against them and put a deal at risk, target companies and their boards were typically willing to enter into quick settlements, provide additional disclosures and pay plaintiffs attorneys' fees as a (comparatively small) tax on completion of the deal in return for a broad release of potential shareholder challenges to the transaction. This practice of disclosure-only settlements, in turn, fueled more M&A litigation, as enterprising plaintiffs lawyers could expect to receive six-figure fees in virtually every merger challenge, irrespective of a case's actual merits. In the past year, however, Delaware courts have expressed increasing skepticism about such settlements, including in several recent decisions in which the courts have rejected disclosure-only settlements outright. These decisions have cast doubt on the previously accepted practice of resolving merger litigation through disclosure-only settlements and should cause plaintiffs' attorneys to become more selective in challenging M&A deals.

First, in In re Riverbed Technology, Inc. Stockholders Litigation, (Del. Ch. Sept. 17, 2015), Delaware Vice Chancellor Glasscock approved a proposed disclosure-only settlement but expressed concern about the practice of settling merger challenges (and releasing shareholders' claims) based on supplemental disclosures. The Court noted that reliance on the Court's previous practice of approving these settlements "will be diminished or eliminated going forward in light of" recent decisions.

Second, at a settlement hearing in In re Aruba Networks, Inc. Stockholder Litigation, (Del. Ch. Oct. 9, 2015), Vice Chancellor Laster not only rejected a proposed disclosure-only settlement-finding there was not "an adequate get for the give" and that "settling for disclosure only and giving the type of expansive release that has been given has created a real systematic problem"-but went even further and dismissed the case in its entirety based on "inadequacy of . . . representation" by plaintiffs' counsel. The court explained that the case appeared to be just a "harvesting-of-a-fee opportunity" for plaintiffs' counsel and that "there wasn't a basis to file in the first place."

Finally, earlier this year, in In re Trulia Stockholder Litigation, (Del. Ch. Jan. 22, 2016), the Delaware Chancery Court rejected a proposed disclosure-only settlement of a shareholder suit challenging the merger between Trulia and Zillow, explicitly confirming the growing skepticism of disclosure-only settlements and articulating a new standard for review of such settlements in Delaware. The Court explained that, in the future, such settlements will face "increasingly vigilant" review and that disclosure-only settlements will not be approved unless the additional disclosures "address a plainly material misrepresentation or omission."

The Trulia merger litigation is fairly typical of the type of merger litigation that has previously been filed, and the court's rejections of the settlement is particularly significant. After the July 2014 announcement of a $3.5 billion merger of real estate websites Zillow and Trulia, shareholder plaintiffs filed four nearly identical class action complaints seeking to enjoin the deal based on alleged breaches of fiduciary duties by Trulia directors in approving the proposed merger. Nearly four months after these challenges, the parties reached an agreement-in-principle to settle the case for additional disclosures in Trulia's proxy materials and payment of attorneys' fees in return for a class-wide release of all Trulia's shareholders' claims and submitted the settlement for court approval.

The Chancery Court rejected the proposed settlement, finding that the additional disclosures did not provide sufficient value to shareholders to justify a release of all shareholders'

claims. As the court explained, in assessing the fairness of a class action settlement, it evaluated "the reasonableness of the 'give' and the 'get,' or what the class members receive in exchange for ending the litigation."

The Court highlighted the difficulties of evaluating the fairness of a proposed settlement when "little or no motion practice has occurred and the discovery record is sparse, as is typically the case in an expedited deal litigation leading to an equally expedited resolution based on supplemental disclosures before the transaction closes." The Court pointed out that "[i]n this case, no motions were decided … , and discovery was limited to the production of less than 3,000 pages of documents and the taking of three depositions …" This "lack of an adversarial process often requires that the Court become essentially a forensic examiner of proxy materials so that it can play devil's advocate in probing the value of the 'get' for stockholders in a proposed disclosure settlement." Ultimately, the Court concluded that the proposed settlement was not fair or reasonable to Trulia stockholders, and none of the four specific supplemental disclosures "were material or even helpful to Trulia's stockholders."

Significantly, the Court warned practitioners of "enhanced judicial scrutiny" of disclosure settlements and 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 [disclosure] settlements …" In particular, counsel can "expect that disclosure settlements are likely to be met with disfavor in the future 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." The Court described a "plainly material" misrepresentation as one that "significantly alters the total mix of information made available" to stockholders and stated that "it should not be a close call that the supplemental information is material."

The court's decision in In re Trulia illustrates the judicial consensus in Delaware that "the historical predisposition that has been shown towards approving disclosure settlements must evolve." As a result, future proposed disclosure-only merger litigation settlements will be met with significant skepticism in Delaware.

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