Delaware Chancery Court Resets the Rules of the Road for Disclosure-Only Settlements

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Warns that courts will be "increasingly vigilant" while outlining two alternative paths to protect stockholder value in disclosure-only settlements

INTRODUCTION

In the current environment, public announcements of change of control transactions involving publicly-traded targets trigger a "flurry of class action lawsuits."[1] These lawsuits typically seek to preliminarily

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1. *In re* Trulia, Inc. Stockholder Litigation, C.A. No. 10020-CB, slip op. at 11 (Del. Ch. Jan. 22, 2016). "In just the past decade, the percentage of transactions of $100 million or more that

enjoin the proposed transaction, based on allegations that the target company directors: (i) breached their fiduciary duties to stockholders in the effectuation and pricing of the transaction and (ii) provided materially misleading disclosures to stockholders.[2] Frequently, the litigants enter into disclosure-only settlements to quickly and affordably resolve this "flurry."[3] Under the terms of the typical settlement, target company stockholders "get" supplemental information to better inform their vote but nothing else.[4] In exchange, these stockholders "give" defendant corporations (both the target and the acquirer) broad releases from future claims.[5] Only the plaintiffs' attorneys receive monetary compensation, in the form of agreed-upon fees and expense reimbursement.

In recent years, the Delaware Court of Chancery has begun to push back on this time-honored practice, recognizing these settlements often leave stockholders with unhelpful information and bound by an overly broad release. This push back culminated in January 2016, when Chancellor Andre G. Bouchard devoted nearly twenty pages of his opinion in *In re Trulia, Inc. Stockholder Litigation* to criticize disclosure-only settlements in general and, perhaps, set the stage for their demise. In the Chancellor's view, these settlements, and the typical perfunctory review process, "have caused deal litigation to explode . . . beyond the realm of reason."[6]

The Chancellor ultimately declined to approve the proposed disclosure settlement at issue in *In re Trulia* on the ground that the informational "get" was not sufficiently material to warrant the "give" of an overly broad release.[7] In his view, the settlement was fatally out of balance: it did "not afford [stockholders] any meaningful consideration to warrant providing a release of claims to the defendants."[8]

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have triggered stockholder litigation in this country have more than doubled, from 39.3% in 2005 to a peak of 94.9% in 2014." *Id.* at 16.

2. *Id.*

3. In Delaware, "the percentage of such cases settled solely on the basis of supplemental disclosures grew significantly from 45.4% in 2005 to a high of 76.0% in 2012 . . . ." *Id.* at 16–17.

4. On occasion, plaintiffs also wrest changes to the deal documentation from the defendants that theoretically may encourage new bids from potential competing bidders.

5. *In re Trulia*, C.A. No. 10020-CB at 8.

6. *Id.* at 16.

7. *Id.* at 41.

8. *Id.* at 2.

I. DISCLOSURE-ONLY SETTLEMENTS AND CALLS FOR CHANGE

A. The Challenges of Disclosure-Only Settlements

M&A litigation generally takes the form of class actions, where one or more named target company stockholders, represented by a familiar coterie of plaintiffs' counsel, seek to enjoin an announced transaction on behalf of an entire class of stockholders whom these named plaintiffs purport to represent. Under Court of Chancery rules, Delaware courts are required to "independently examine the fairness of a class action settlement before approving it,"[9] inasmuch as these settlements "impact the legal rights of absent class members."[10] To satisfy this examination, the proposed settlement must be "reasonable and intrinsically fair."[11] In making this determination, courts are required to "evaluate[ ] not only the claim, possible defenses, and obstacles to its successful prosecution, but also the reasonableness of the 'give' and the 'get' "[12]—in other words, "what the class members receive in exchange for ending the litigation."[13]

The rationale for disclosure-only settlements is that, by obtaining additional disclosures in advance of the stockholders' meeting to approve the transaction, plaintiffs "theoretically" have placed target company stockholders in a position to be "better informed in exercising their franchise rights."[14] As consideration for these supplemental disclosures, plaintiffs typically agree to: (i) terminate their efforts to enjoin the transaction and (ii) "provide a release of claims on behalf of a proposed class of . . . stockholders."[15] However, in actual practice, Delaware courts historically have approved settlements where the disclosures were "of only minor value to the stockholders."[16] As such, these settlements have grown to "serve[ ] only to generate fees for certain lawyers who are regular players in the enterprise of routinely filing hastily drafted complaints on behalf of stockholders on the heels

9. *Id.* at 9; *see also* DEL. CT. CH. R. 23(e) ("[A] class action shall not be dismissed or compromised without the approval of the Court . . . .").

10. *In re Trulia*, C.A. No. 10020-CB, slip op. at 1–2.

11. *Id* at 9 (quoting Rome v. Archer, 197 A.2d 49, 53 (Del. 1964)).

12. *Id.* at 9–10 (quoting *In re* Activision Blizzard, Inc. S'holder Litig., 124 A.3d 1025, 1043 (Del. Ch. 2015) (internal quotation marks omitted)).

12. *Id.* at 10.

14. *Id.* at 1.

15. *Id.*

16. *Id.* at 13.

of the public announcement of a deal and settling quickly on terms that yield no monetary compensation to the stockholders they represent."[17]

Reflecting the views of numerous legal commentators and other members of the Delaware judiciary, in *In re Trulia*, Chancellor Bouchard offered three cogent criticisms of the current settlement review process:

- *The "Get" Rarely Benefits Stockholders.* Chancellor Bouchard emphasized that stockholders usually draw the short straw: the information they receive in exchange for their release of claims too often fails to better inform their votes. Chancellor Bouchard cited one study that "provides empirical data suggesting that supplemental disclosures make no difference in stockholder voting, and thus provide no benefit that could serve as consideration for a settlement."[18]

- *The "Give" Results in the Potential Loss of Valuable Claims.* Stockholders typically release claims "conceivably" related to the transaction, but because their attorneys have focused on a quick settlement that will not interfere with the closing of the transaction, they likely have not sufficiently investigated the potential for additional claims falling under the release's umbrella.[19] To emphasize this point, the Chancellor noted that if the Chancery Court had approved a proposed settlement in the now-famous *Rural Metro* litigation, stockholders would have lost the opportunity of receiving $100 million in future payments from the defendants.[20]

- *Courts Face Unique Challenges Assessing Settlements in a Non-Adversarial Process.* Chancellor Bouchard extensively discussed the unique challenges that a non-adversarial setting poses in settlement reviews. Both sides want the court to approve their settlement: the merger partners want the deal insurance provided

17. *Id.* at 11–12, 24. Frequently, defendant corporations "self-expedite" these lawsuits by voluntarily providing "core documents" to plaintiffs' counsel to facilitate reaching settlement quickly and inexpensively, thereby avoiding one gatekeeping role of the court "to screen out frivolous cases and to ensure that its limited resources are used wisely. *Id.* at 12.

18. *Id.* at 18.

19. *See, e.g.*, *id.* at 6–7.

20. *In re* Rural Metro Corp. Stockholders Litig., 88 A.3d 54 (Del. 2014), *aff'd sub. nom.* RBC Capital Markets, LLC v. Joanna Jervis, No. 140, 2015, opinion (Del. Nov. 30, 2015). For a discussion of the ramifications of *Rural Metro*, see Robert S. Reder & Margaret Dodson, *Delaware Supreme Court Upholds Multi-Million Dollar Damages Award Against Sell-Side M&A Advisor*, 69 VAND. L. REV. EN BANC 27 (2016).

by the release, while plaintiffs' counsel wants the fees the litigation generates.[21] However, aligned incentives leave the court to play "devil's advocate," a role the Chancellor argues is improper in this context.[22] For instance, disclosure settlements in a non-adversarial setting frequently lack "significant discovery or meaningful motion practice to inform the Court's evaluation."[23] As such, courts become "forensic examiner[s]" to value the "get" the stockholders receive, with little to no opposition serving the interests of target company stockholders.[24]

In light of these challenges, Chancellor Bouchard warned future litigants that they will be met with "vigilan[ce]" if they continue utilizing disclosure settlements rather than employing one of his two proposed methods (discussed below) for assessing the value of disclosure claims.[25]

B. Chancellor Bouchard's Proposal

To address these challenges, Chancellor Bouchard suggested that "the optimal means by which disclosure claims in deal litigation should be adjudicated is outside the context of a proposed settlement so that the Court's consideration of the merits of the disclosure claims can occur in an adversarial process."[26] This review could take place in two alternative settings: *first*, when courts review a preliminary judgment motion, or *second*, when plaintiffs' counsel applies for fees after claims are mooted. In essence, the Chancellor would separate assessment of the "get" from that of the "give."

1. Preliminary Judgment Motions

In the setting of a preliminary judgment motion, because a release is not at issue, the defendant corporation is incentivized to oppose the materiality of plaintiffs' disclosure claims. With the defendants actually disputing this motion in court rather than self-expediting the litigation to facilitate settlement, the "adversarial process would remain intact" with plaintiffs having "the burden to

21. *In re Trulia*, C.A. No. 10020-CB, slip op. at 20.
22. *Id.* at 15.
23. *Id.* at 14.
22. *Id.* at 15.
25. *Id.* at 23.
26. *Id.* at 20.

demonstrate on the merits a reasonable likelihood of proving that 'the alleged omission or misrepresentation is material.' "[27]

2. Award of Attorneys' Fees

Once defendants supplement the proxy materials to address plaintiffs' disclosure claims, those claims generally are mooted. Plaintiffs' counsel may then apply to the court for a fee award. Again, because a broad release is not at issue, defendant corporations are incentivized to oppose a high fee, maintaining the adversarial nature of the process and "assist[ing] the Court in its evaluation of the nature of the benefit conferred for purposes of determining the reasonableness of the requested fee."[28] While no formal release would be signed under this scenario, "the filing of a stipulation of dismissal likely represents the end of fiduciary challenges over the transaction as a practical matter."[29]

3. Beware the Status Quo

For litigants who persist in promoting disclosure-only settlements, Chancellor Bouchard warned that Delaware courts will increase the level of scrutiny such that a settlement must be "*genuinely* fair and reasonable."[30] In this context, litigants can expect Delaware courts to assess "the reasonableness of the 'give' and 'get' of such settlements" more closely than in the past:

> To be more specific, practitioners should expect that disclosure settlements are likely to be met with continued 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.[31]

Further, the Chancellor expounded on the meaning of "plainly material," stating it "should not be a close call . . . under Delaware law."[32] Additionally, courts may utilize amici curiae to assist the courts

27. *Id.* (quoting Gantler v. Stephens, 965 A.2d 695, 710 (Del. 2009)).

26. *Id.* at 21.

29. *Id.* at 22. Further, the Chancellor acknowledged that these fee disputes can be settled privately between the litigants. When this occurs, stockholders are afforded notice, which would "guard against potential abuses in the private resolution of fee demands for mooted representative actions." *Id.* at 23.

30. *Id.* at 2 (emphasis added).

31. *Id.* at 24.

32. *Id.* at 24.

in their determination of the materiality of the disclosure claims.[33] In essence, practitioners may now find that courts will demand more proof that the "get" contains sufficient stockholder value to warrant the "give."

After detailing the weaknesses of the current approach and calling for heightened vigilance on the part of Delaware courts, Chancellor Bouchard turned to the case at hand, finding the "get" to be hollow and out of proportion with the overly broad "give."

II. CHANCELLOR BOUCHARD'S ANALYSIS OF THE *TRULIA* SETTLEMENT

A. Factual Background

Close on the heels of the July 28, 2014 public announcement of the proposed $3.5 billion stock-for-stock merger between Zillow, Inc., an online "real estate marketplace," and Trulia, Inc., "an online provider of information on homes for purchase or for rent in the United States,"[34] several Trulia stockholders filed class action complaints with the Delaware Court of Chancery.[35] These suits alleged that Trulia's directors had "breached their fiduciary duties" in connection with their approval of the merger and that the two companies "aided and abetted those breaches."[36] Plaintiffs asked the Court to enjoin the transaction.

In September 2014, the companies filed proxy materials with the SEC in connection with upcoming meetings of the Trulia and Zillow stockholders to approve the merger. Shortly thereafter, the Court consolidated the various class actions, without opposition from either party. The litigants then promptly agreed to expedite the action. At this point, plaintiffs' counsel conducted limited discovery and filed a brief with the Court in support of their complaint. Notably, while this brief mentioned both the breach of fiduciary duty claims[37] as well as claims relating to allegedly misleading disclosures in the proxy materials,

31. *Id.* at 24.

34. The merger was structured so that a newly-formed holding company ("Holdco") would become the parent of both Trulia and Zillow, with the former stockholders of Trulia initially owning 33% of the stock of Holdco and the former stockholders of Zillow initially owning 67% of the stock of Holdco. As such, Zillow was considered the acquiring corporation and Trulia the acquired corporation.

33. This Section contains a summary of the facts surrounding *In re Trulia, Inc. Stockholders Litigation*. For a more detailed account, see *In re Trulia*, C.A. No. 10020-CB, slip op. at 3–9.

36. *Id.* at 4.

37. The fiduciary duty claims included (i) "failing to obtain the highest exchange ratio available," (ii) running a "single-bidder crisis," (iii) "failing to properly value the Company," (iv) and "agreeing to preclusive provisions … that impede the Board's ability to consider and accept superior proposals." *Id.* at 5.

"[t]he discussion of the merits in that brief, however, focused only on disclosure issues."[38]

In November 2014, some four months after the first public announcement of the transaction, the litigants signed a Memorandum of Understanding, agreeing in principle to settle the litigation. Under this settlement, defendants would make "certain disclosures to supplement those contained in the" proxy materials.[39] That same day, Trulia made a filing with the SEC containing the agreed upon disclosures. At meetings held to approve the merger the following month, Trulia and Zillow stockholders voted overwhelmingly in favor. The transaction closed in February 2015.

In June 2015, the litigants finalized their settlement by signing a stipulation containing "an extremely broad release" covering "claims 'arising under federal, state, foreign, statutory, regulatory, common law or other law or rule' . . . relating in any conceivable way to the transaction," as well as to certain "Unknown Claims."[40] In connection with the settlement, plaintiffs' counsel sought fees and expenses not to exceed $375,000, which defendants agreed not to oppose. This was to be "the only money that would change hands" under the terms of the settlement.[41] Nothing would be paid to Trulia stockholders.

Chancellor Bouchard held a hearing "to consider the fairness of the terms of the proposed settlement" but, predictably, none of the defendants or any other Trulia stockholder offered any opposition.[42] Following the hearing, the Chancellor permitted the filing of an amicus curiae brief challenging the settlement and requested supplemental briefing from the litigants.[43] In response, the litigants narrowed the release to exclude both "Unknown Claims" and "foreign" claims as well as claims under any antitrust laws.[44] Notwithstanding these revisions, Chancellor Bouchard rejected the settlement.

36. *Id.*

37. *Id.* at 6.

40. *Id.* at 7. "Unknown Claims" were "any claim that a releasing person does not know or suspect exists in his, her or its favor at the time of the release …, including without limitation those claims which, if known, might have affected the decision to enter into the Settlement." *Id.*

41. *Id.* at 1.

40. *Id.* at 7.

43. The *amicus* brief was filed by Fordham University School of Law Professor Sean J. Griffith, who has written extensively on the current state of M&A litigation and the shortcomings of disclosure-only settlements. *Id.* at 8.

44. *Id.*

B. The Chancellor's Analysis

Chancellor Bouchard noted at the outset that the supplemental disclosures obtained by plaintiffs in the settlement related only to the description in the proxy materials of the financial analysis provided by Trulia's financial advisor. While stockholders must receive a "fair summary" of such a financial analysis, the Chancellor noted that a "fair summary, however, is a *summary*."[45] Further, the Chancellor noted that "a fair summary in not a cornucopia of financial data, but rather an accurate description of the advisor's methodology and key assumptions. In [his] view, disclosures that provide extraneous details do not contribute to a fair summary and do not add value for stockholders." [46]

Against this background, the Chancellor turned to an analysis of the four supplemental disclosures relating to the financial analysis provided by Trulia's financial advisor.[47] In his opinion, "none . . . were material or even helpful to Trulia's stockholders."[48] The proxy materials furnished to Trulia stockholders "already provided a more-than-fair summary of [the financial advisor's] financial analysis in each of the four respects criticized by plaintiffs."[49] As such, the "get" represented by the supplemental disclosures "does not provide adequate consideration to warrant the 'give' of providing a release of claims to defendants and their affiliates . . . ."[50] Further, even as narrowed, "the revised release still would have been too broad to support a fair and reasonable settlement because the revised release was not limited" to the subject matter of the class actions.[51]

On this basis, Chancellor Bouchard declared that the proposed settlement "does not afford . . . [Trulia stockholders] any meaningful consideration to warrant providing a release of claims to defendants."[52] As such, the settlement failed the "fair and reasonable test" and the Chancellor accordingly denied approval.

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45. *Id.* at 27–28.

46. *Id.*

47. The four areas of supplemental disclosure related to the following aspects of the Trulia financial advisor's analysis: (1) synergy numbers in the value creation analysis; (2) selected comparable transaction multiples; (3) selected public trading multiples; and (4) implied terminal EBITDA multiples for the discounted cash flow analysis. *Id.* at 26–27.

45. *Id.* at 2.

46. *Id.* at 41.

47. *Id.*

48. *Id.* at 41 n.89.

52. *Id.*

CONCLUSION

In re Trulia signals a turning point in Delaware jurisprudence regarding disclosure-only settlements. Rejecting the courts' prior practice, Chancellor Bouchard warned that settlements advantageous to plaintiffs' attorneys and defendants, at the expense of target company stockholders, will no longer pass muster. Courts will more closely analyze these settlements to ensure stockholders receive adequate consideration proportionate to any release that may be provided to defendants in return. And, no matter how material the supplemental disclosures, a release that goes beyond the specific claims raised in the complaint will likely be rejected. As such, unless plaintiffs' counsel challenges a plainly material disclosure misstatement or omission, they may find embarking down one of the alternative paths for assessing the value of a disclosure settlement advocated by the Chancellor—either in connection with a preliminary judgment motion or a motion to award plaintiffs' attorney fees—to be a more fruitful approach.