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January 2016

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Delaware Court of Chancery Appears to Sound the Death Knell for Disclosure-Only Settlements in Merger Litigation

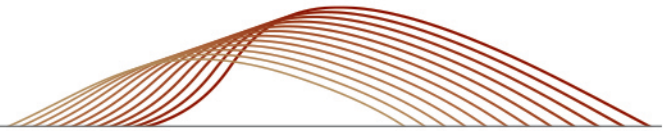
By Peter M. Stone

On January 22, 2016, in *In re Trulia, Inc. Stockholder Litig.,* ("*Trulia*"), Chancellor Andre G. Bouchard of the Delaware Court of Chancery rejected a proposed "disclosure-only" settlement in a shareholder suit challenging a merger involving Trulia.[1] In declining to approve the proposed settlement, the Court warned that "disclosure settlements are likely to be met with continued disfavor in the future[.]"[2] Instead, the Court of Chancery expressed a clear preference for litigating disclosures in contested proceedings. *Trulia* thus appears to substantially threaten if not end the common way of resolving merger litigation by entering into settlements and obtaining "complete peace" concerning a merger via release in exchange for supplemental disclosures and payment of attorneys' fees. At least in the short term it, therefore, appears that defending merger litigation will require much more adversarial process.

Background

The procedural history in *Trulia* follows a familiar pattern. Immediately after the public announcement of the proposed acquisition of Trulia in a stock-for-stock merger, several stockholders filed suit, claiming that Trulia's directors had breached their fiduciary duties in approving the proposed merger and seeking to enjoin the merger. Less than four months later, after limited discovery and few if any real adversarial proceedings in court, the parties reached an agreement-in-principle to settle. In the proposed disclosure-only settlement, Trulia agreed to supplement its proxy filings in exchange for plaintiffs withdrawing their motion for a preliminary injunction and agreeing to release Trulia and the individual defendants from all liability relating to the merger. In addition, defendants agreed not to oppose plaintiffs' motion for attorneys' fees not to exceed $375,000. The settlement did not provide for any payments to Trulia stockholders.

The Court of Chancery found that this proposed settlement was "not fair or reasonable because none of the supplemental disclosures were material or even helpful to Trulia's stockholders, and thus the proposed settlement does not afford them any meaningful consideration to warrant providing a release of claims to the defendants."[3] Specifically, the supplemental disclosures, which provided additional details about the financial analysis performed by Trulia's advisor in the merger, were superfluous given the fact that the original proxy "already provided a more-than-fair summary" of the financial analysis, where the fairness opinion was summarized in ten single-spaced pages.[4] *Trulia* further explained the Court of Chancery's concern that nearly every public company merger draws



litigation,[5] as well as problems with disclosure-only settlements, listing the Court's "doubts about the value of relief obtained in disclosure settlements...reservations over the breadth of the releases sought and the lack of any meaningful investigation of claims proposed to be released."[6]

Trulia follows several other recent Delaware Court of Chancery decisions which have expressed hostility towards lawsuits challenging every public company merger and rejected disclosure-only settlements.[7] Just prior to *Trulia*, in *In re Aruba Networks, Inc. Stockholder Litig.*, Vice Chancellor J. Travis Laster refused to approve a disclosure-only settlement, including proposed attorneys' fees of $400,000, and dismissed the case, stating in part, "[W]e have reached a point where we have to acknowledge that settling for disclosure only and giving the type of expansive release that has been given has created a real systemic problem."[8]

Discussion

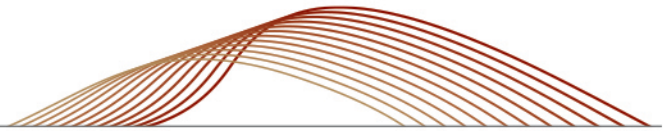
It may seem strange that the Court's approach to the problem of too many public company merger lawsuits is to eliminate the most common way the parties have found to efficiently resolve those cases. It similarly may appear odd that the Court of Chancery's solution to *plaintiffs* filing too many merger cases is to put additional burdens on *defendants* working to efficiently resolve what are likely to be the least meritorious of those cases.

Nonetheless, the Court of Chancery has now opined that disclosure claims in merger litigation should ordinarily be adjudicated outside the context of a proposed settlement where the adversarial process would remain intact, such as in a preliminary injunction motion or a mootness fee application. It would seem that this may deter in many cases supplemental disclosures being made by defendants when inadequate disclosure is less than obvious, since making such "peppercorn" disclosures now could simply place additional burdens on defendants having to contest mootness fee applications and pay attorneys' fees without the corresponding benefits of a settlement. And, in the context of preliminary injunction motions challenging the adequacy of disclosures, while defendants continue to bear the risk that a plaintiff could delay a merger from occurring until supplemental disclosures are made, the Court of Chancery's recent decisions rejecting the value of the most typical supplemental disclosures may make it more common for defendants to fight disclosure claims.

Further, in light of *Trulia* and the other recent similar Court of Chancery decisions, it appears likely that defendants will seek to move to dismiss and, perhaps even more importantly, oppose expedition of many more cases and/or of many more claims. It remains to be seen how successful this may be in eliminating or paring down unmeritorious merger litigation, although Vice Chancellor Laster suggests (in an article cited by Chancellor Bouchard in *Trulia*[9]) that the Court of Chancery should provide greater judicial scrutiny of claims at the motion to expedite stage.[10]

Conclusion

The Delaware Court of Chancery appears to have ended its prior practice of approving most disclosure-only settlements in merger litigation. As the Court of Chancery in *Trulia* stated, "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] While the impact of this decision is yet to be seen, it may mean increased challenges for defendants in efficiently defending merger cases and ultimately in achieving complete peace in merger litigation in Delaware. It may also lead to an increase of cases being litigated outside Delaware -- at least where the company being acquired does not have a Delaware forum selection clause in its bylaws[12] and/or where the company has such a bylaw but chooses to proceed outside



Delaware, where it now might conceivably obtain more "deal certainty" via disclosure-based settlement.

Thus, in the end, while *Trulia* acknowledges that too often the only purpose of merger litigation is "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 of the public announcement of a deal and settling quickly,"[13] its solutions appear to potentially impact not just the lawyers who file these "hastily drafted complaints," but also the defendants who are forced to litigate such cases.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

New York

Douglas H. Flaum
1.212.318.6259
douglasflaum@paulhastings.com

Orange County

Christopher H. McGrath
1.714.668.6244
chrismcgrath@paulhastings.com

Palo Alto

Peter M. Stone
1.650.320.1843
peterstone@paulhastings.com

Kevin C. Logue
1.212.318.6039
kevinlogue@paulhastings.com

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1 C.A. No. 10020-CB, 2016 Del. Ch. LEXIS 8, *60 (Del. Ch. Jan. 22, 2016).

2 *Id.* at *35.

3 *Id.* at *3.

4 *Id.* at *60.

5 *Id.* at *15.

6 *Id.* at *27.

7 *See* Christopher H. McGrath, Howard M. Privette, and Christopher R. Ramos, *The Delaware Court of Chancery May Shake Up the "Sue-On-Every-Deal" Phenomenon*, Orange County Business Journal, Nov. 9-15, 2015, http://paulhastings.com/docs/default-source/PDFs/the-delaware-court-of-chancery-may-shake-up-the-sue-on-every-deal-phenomenon.pdf.

8 C.A. No. 10765-VCL, at 65 (Del. Ch. Oct. 9, 2015) (TRANSCRIPT).

9 *Trulia*, 2016 Del. Ch. LEXIS at *25 n.29 (citing J. Travis Laster, *A Milder Prescription for the Peppercorn Settlement Problem in Merger Litigation*, 93 Tex. L. Rev. 129 (2015)).

10 Of course, where expedited proceedings are granted, discovery may now be more expansive both because of a potential emphasis on damages cases and/or because such discovery could be necessary to support settlements even where "supplemental disclosures address a plainly material misrepresentation or omission." *Id.* at *35.

11 *Id.* at *35 (emphasis added).

12 *See id.* at *38 & n.48.

13 *Id.* at *15.