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Delaware Court of Chancery Rejects Another Disclosure-Only M&A Settlement and Warns of "Increasingly Vigilant" Scrutiny

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The Delaware Court of Chancery dealt another blow to disclosure-only settlements of merger litigation and refused to approve a proposed class-action settlement arising from Zillow, Inc.'s acquisition of Trulia, Inc. Chancellor Andre Bouchard's January 22, 2016 decision in *In re Trulia, Inc. Stockholder Litigation* held that the supplemental disclosures that formed the basis of the settlement were not ”material or even helpful to Trulia's stockholders” and thus did not ”afford them any meaningful consideration to warrant providing a release of claims to the defendants.”

Chancellor Bouchard also surveyed the recent history of merger litigation and disclosure-only settlements and offered "the Court's perspective that disclosure claims arising in deal litigation optimally should be adjudicated outside of 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 without the defendants' desire to obtain an often overly broad release hanging in the balance." Such adjudication could occur either through a preliminary injunction motion or through plaintiffs' counsel's application for an award of attorneys' fees after defendants voluntarily supplement their proxy materials with additional disclosures.

Factual Background

The *Trulia* litigation arose from Zillow's acquisition of Trulia in a stock-for-stock merger. The announcement of the merger triggered the familiar chain of events: four class actions promptly challenged the deal price and process; the merging parties filed a registration statement and preliminary proxy statement; plaintiffs then sought to expedite the proceedings to litigate challenges to the deal documents; the parties stipulated to limited, expedited discovery involving the production of core documents and the deposition of two key deal participants (Trulia's CEO/chairman and its financial advisor); plaintiffs filed a brief in support of their motion for a preliminary injunction, focusing only on the disclosure claims; defendants filed their joint proxy statement; two days later, the parties agreed in principle to settle the litigation for certain supplemental disclosures; the defendants promptly filed the supplemental disclosures with the SEC; the deal closed; and the parties sought approval of the proposed settlement, which included a broad release of claims and a proposed fee for plaintiffs' counsel.

The Court of Chancery's Decision

Chancellor Bouchard rejected the proposed settlement, finding that "none of plaintiffs' Supplemental Disclosures were material or even helpful to Trulia's stockholders" and that, "from the perspective of Trulia's stockholders, the 'get' in the form of the Supplemental Disclosures does not provide adequate consideration to warrant the 'give' of providing a release of claims to defendants and their affiliates, in the form submitted or otherwise." The court therefore concluded that the proposed settlement was not "fair or reasonable to Trulia's stockholders."

The Court's Observations About Deal Litigation

The court began its analysis with observations about deal litigation in general, including that "far too often such litigation serves no useful purpose for stockholders." Instead, such litigation "serves 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 of the public announcement of a deal and settling quickly on terms that yield no monetary compensation to the stockholders they represent." The court recognized that plaintiffs' leverage – "the threat of an injunction to prevent a transaction from closing" – creates an incentive for defendants to settle in order to reduce litigation expenses and distractions, ensure that the deal will close, and obtain broad releases of claims.

Chancellor Bouchard acknowledged that the litigation dynamics, "in particular the Court's willingness in the past to approve disclosure settlements of marginal value and to routinely grant broad releases to defendants and six-figure fees to plaintiffs' counsel in the process, have caused deal litigation to explode in the United States beyond the realm of reason," with 94.9% of transactions of $100 million or more in 2014 generating lawsuits. He also observed that "the Court's historical predisposition toward approving disclosure settlements needs to be reexamined" in light of "the rapid proliferation and current ubiquity of deal litigation, the mounting evidence that supplemental disclosures rarely yield genuine benefits for stockholders, the risk of stockholders losing potentially valuable claims that have not been investigated with rigor, and the challenges of assessing disclosure claims in a non-adversarial settlement process."

Chancellor Bouchard therefore opined 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 where the defendants' desire to obtain a release does not hang in the balance." The Chancellor offered two proposals for such adjudication.

First, disclosure claims could be judicially reviewed in the context of a preliminary injunction motion, "in which case the adversarial process would remain intact and plaintiffs would have the burden to demonstrate on the merits a reasonable likelihood of proving that 'the alleged omission or misrepresentation is material.'"

Second, plaintiffs' counsel could apply for attorneys' fees "after defendants voluntarily decide to supplement their proxy materials by making one or more of the disclosures sought by plaintiffs, thereby mooting some or all of their claims. In that scenario, where securing a release is not at issue, defendants are incentivized to oppose fee requests they view as excessive." And if defendants do not oppose an application for a mootness fee, "the Court would have some indication of the reasonableness of the fee request." Defendants would not receive a release from a mootness dismissal, but – according to the Chancellor – "the filing of a stipulation of dismissal likely represents the end of fiduciary challenges over the transaction as a practical matter."

Chancellor Bouchard warned 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 the 'get' of such settlements in light of the concerns discussed above." Disclosure-only settlements will not be approved unless the supplemental disclosures are truly meaningful and the proposed release of claims is sufficiently narrow:

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. In using the term "plainly material," I mean that it should not be a close call that the supplemental information is material as that term is defined under Delaware law.

The Chancellor also raised the possibility that, "[w]here the supplemental information is not plainly material, it may be appropriate for the Court to appoint an *amicus curiae* to assist the Court in its evaluation of the alleged benefits of the supplemental disclosures, given the challenges posed by the non-adversarial nature of the typical disclosure settlement hearing."

The Court's Rejection of the Proposed Settlement

The proposed settlement in the *Trulia* case involved four types of supplemental disclosures: "(1) certain synergy numbers in [Trulia's financial advisor's] value creation analysis; (2) selected comparable transaction multiples; (3) selected public trading multiples; and (4) implied terminal EBITDA multiples for a relative discounted cash flow analysis." The court held that none of these additional disclosures was meaningful to Trulia's stockholders.

The court began with the well-established principle that stockholders are entitled to only "a fair summary" of the investment banker's work on which the company's board relies. "A fair summary, however, is a *summary*. By definition, it need not contain all information underlying the financial advisor's opinion or contained in its report to the board." Moreover, "the summary does not need to provide sufficient data to allow the stockholders to perform their own independent valuation." "The essence of a fair summary is not a cornucopia of financial data, but rather an accurate description of the advisor's methodology and key assumptions. In my view, disclosures that provide extraneous details do not contribute to a fair summary and do not add value for stockholders."

After reviewing the extensive disclosures already contained in the proxy statement, including a 10-page summary of Trulia's financial advisor's work, the court concluded that the supplemental disclosures were immaterial and not even helpful to Trulia's stockholders.

Trulia's Potential Implications

Chancellor Bouchard's refusal to approve a disclosure-only settlement and his warnings that such settlements could face increased skepticism in the future could help stem the tide of deal litigation that has engulfed virtually all transactions involving public companies. However, the decision raises issues for all parties, not just for plaintiffs.

First, the decision raises the stakes that all parties face in connection with deal litigation. Do plaintiffs take the risk of not filing cases at all – or of dismissing them if plaintiffs begin to realize that their claims lack merit? Do defendants take the risk of fighting meritless litigation and opposing injunction motions, even if doing so might delay or otherwise affect the deal's closing? And do defendants take the risk of making additional disclosures even without a settlement and release, in the hope of mooting plaintiffs' disclosure claims? As Chancellor Bouchard recognized, the current state of affairs – with its "deal tax" on all transactions – benefits plaintiffs' counsel and gives defendants a way to do business, albeit at an undesirable cost. But it does not benefit the judicial system, the financial system, or, in some cases, the classes that plaintiffs and their counsel purport to represent.

Second, defendants might need to learn to accept narrower releases than they have customarily received in deal litigation. In exchange only for supplemental disclosures and payment of plaintiffs' attorneys' fees, and without providing any monetary benefit to the class, defendants have received broad releases covering "unknown claims" and other claims "relating in any conceivable way to the transaction." Courts adjudicating disclosure-only settlements might now require releases to focus more narrowly on ”disclosure claims and fiduciary duty claims concerning the sale process, if the record shows that such claims have been investigated sufficiently." And in mootness dismissals, defendants would not get a release at all. Instead, defendants would need to rely on Chancellor Bouchard's belief (which one hopes is not unduly optimistic) that "the filing of a stipulation of dismissal likely represents the end of fiduciary challenges over the transaction as a practical matter."

Third, Delaware courts' increasing hostility to disclosure-only settlements could cause plaintiffs to sue in other forums that might be more willing to approve such agreements. Chancellor Bouchard observed that "[i]t is within the power of a Delaware corporation to enact a forum selection bylaw to address this concern.” Decisions such as *Trulia* might (and probably should) encourage more Delaware corporations to take advantage of that option.

Fourth, the Chancellor's rumination about the possible appointment of *amici curiae* to help evaluate whether supplemental disclosures are "plainly material" could lead courts to adopt that approach. One hopes, however, that the idea will not incite self-styled *amici* to object to proposed settlements as a way of obtaining court appointment to opine on materiality. Courts will need to exercise appropriate skepticism about such potentially self-serving objections.

Fifth, the *Trulia* decision's emphasis on the meaninglessness of the supplemental disclosures that the plaintiffs obtained can be used to bolster defendants' defense of the adequacy of their proxy materials. Although it breaks no new ground, the decision makes clear that additional details do not necessarily constitute better disclosure and that a "fair summary" of the considerations justifying a fairness opinion does not require a deluge of minutiae.