Securities
Regulation Daily

Wolters Kluwer

December 20, 2019

# The Uncertain Future of M&A Litigation

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Litigation seeking to enjoin pending go-private mergers and acquisitions has been a steady source of business for the plaintiffs' bar. Lawsuits with vague, cookie-cutter allegations complaining of inadequate proxy disclosures are routinely filed when virtually any major deal is announced, and most are quickly resolved in a "disclosure settlement," where plaintiffs walk away for supplemental proxy disclosures and a payment of their legal fees. From the defendants' perspective, it makes eminent sense to pay a nuisance-level sum and eliminate the risk of throwing a billion-dollar deal into disarray.

Antipathy towards these types of lawsuits has grown over time. And as courts' skepticism has increased, plaintiffs have had to find new legal theories under which to make their arguments.

Until recently, M&A lawsuits were often filed in state court—usually Delaware, where most large companies are incorporated—and brought claims for common-law breach of fiduciary duty. Cases were usually resolved by a settlement subject to a formal process in which the court reviewed the supplemental disclosures provided and determined whether the settlement was fair to all shareholders. At the end of the process, the defendants' directors got court-approved releases and the plaintiffs got court-approved attorneys' fees. But the allure of filing these suits in Delaware dissipated in 2016 when the Delaware Chancery Court decided *In re Trulia, Inc. Stockholder Litigation*. In denying a motion to approve a disclosure settlement, the *Trulia* court questioned the value of the additional disclosures being provided and explained that disclosure-only settlements "are likely to be met with continued disfavor in the future unless the supplemental disclosures address a plainly material misrepresentation or omission." 129 A.3d 884 (Del. Ch. 2016).

Following *Trulia*, plaintiffs' lawyers settled on a new strategy of bringing claims in federal court under Section 14 of the Securities Exchange Act, which prohibits false or misleading statements in proxies (Section 14(a)) and tender offers (Section 14(e)). According to data from Cornerstone Research, M&A cases in federal court spiked from 34 in 2015 to 198 in 2017. While there were slightly fewer filings in 2018 (182) and 2019 is on track to be even lower, overall filing numbers are still well above pre-*Trulia* averages. In the last several years, federal courts sitting in the Third Circuit (which includes Delaware, New Jersey, Pennsylvania, and the Virgin Islands) have emerged as the venue of choice for plaintiffs. At present, approximately 70 percent of cases are filed there.

The plaintiff bar's embrace of Section 14 has raised key issues. In the first place, there is a live dispute as to what extent Section 14 provides a private right of action, or what pleading standards attach to

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such an action. Second, it is unclear whether Section 14 presents a viable theory of recovery for most plaintiffs once the transaction has closed and the threat of disruption to the deal has vanished. Third, M&A litigation involving foreign companies remains in a state of flux, particularly where issues of foreign law are involved. Finally, the unsupervised nature of Section 14 settlements raises questions as to what quantum of "mootness fee" is appropriate, and whether they are appropriate at all.

## What standard applies to tender offer claims, and are private lawsuits authorized at all?

Courts have not settled on a uniform standard for evaluating the sufficiency of shareholder complaints under Section 14(e)—which governs statements in tender offers. And further, defense lawyers have raised serious arguments that Section 14(e) does not authorize private lawsuits *at all*.[1]

In a case that went to the U.S. Supreme Court, these precise issues came up but ultimately were not resolved. In *Emulex Corporation v. Verjabedian*, Emulex shareholders filed suit under Section 14(e) in California federal court challenging Emulex's merger with Avago Wireless Technology. The trial court dismissed the case for the plaintiffs' failure to adequately plead scienter, the defendants' knowledge of wrongdoing. 152 F. Supp. 3d 1226 (C.D. Cal. 2016). The Ninth Circuit Court of Appeals reversed that decision, finding that a Section 14(e) claim did not require scienter and instead simply required negligence, a lower bar for a plaintiff to clear. 888 F.3d 399 (9th Cir. 2018). This created a split among appellate courts, as numerous other circuits had already decided that Section 14(e) claims *did* require scienter.

As can happen following a circuit split, the Supreme Court agreed to step in and resolve the conflict. But in the course of the appeal, a more fundamental issue arose: Whether Section 14(e) allows private plaintiffs to file lawsuits *at all*, or whether only the government was permitted to enforce Section 14(e). Emulex, the defendant, argued that there was no express private right of action in the statute, and that lower courts' finding of an inferred right was contrary to law. The plaintiff shareholders argued that an inferred private right of action had been acknowledged in lower courts for decades and need not be disturbed. For its part, the federal government took the position that private lawsuits were not authorized by Section 14(e). The parties and the government briefed both issues, and the court held oral argument on them.

But then, in an unusual move, the Supreme Court dismissed the appeal—meaning that it would *not* resolve the circuit split and would *not* address the new issue of whether private suits were allowed. 139 S. Ct. 1407 (2019). The court's decision ensures that these issues will be fought over in lower courts for the foreseeable future.

## What kinds of Section 14 cases go past closing?

The vast majority of cases challenging proxy disclosures settle before the underlying deal proceeds to closing. It is virtually always cheaper and easier to issue a supplemental proxy and pay the plaintiffs'

[1] In the 1964 decision in *J.I. Case Co. v. Borak,* the U.S. Supreme Court determined that Section 14(a) does provide a private right of action with respect to proxy statements. 377 U.S. 426 (1964).

lawyers a small sum than it is to risk derailment of the deal or engage in protracted litigation over the merits of the plaintiffs' Section 14 claims.

But what happens if the company doesn't settle and doesn't concede any inadequacy in its disclosures—what if the company just closes the deal over the objection of a complaining shareholder? The typical defendant will file a motion to dismiss, asking the court to rule before any evidence is exchanged that the complaint is simply inadequate as a matter of law. The court will then have to determine whether the plaintiff's legal theories could hold water. Many Section 14 complaints—which are typically hastily filed—fail to meet this standard, because they do not identify misstatements or omissions that any shareholder would actually view as material, and because they do not convincingly allege that shareholders suffered any quantifiable monetary loss as a result of whatever disclosure inadequacies are claimed.

The few cases that do proceed post-closing, therefore, are the cases in which there is at least an argument that the plaintiff has identified a particular misstatement or omission that is clearly tied to a possible monetary loss by shareholders. In one such case, filed over Lionbridge Technologies' go-private merger with HIG Capital, a plaintiff was permitted to proceed on a theory that projections contained in Lionbridge's proxy failed to account for acquisition-based growth. That omission, according to the plaintiffs, led the shareholders to approve an undervalued deal. *Laborers' Local #231 Pension Fund v. Cowan et al.*, No. 17-cv-478, 2018 WL 3243975 (D. Del. July 2, 2018). In a similar case concerning Harmon International Industries' acquisition by Samsung, a plaintiff was permitted to proceed on a theory that Harmon's management manipulated its projections to make the deal seem fairer, and that its financial advisor had an undisclosed conflict of interest. *Baum v. Harman Int'l Indus.*, No. 3:17-cv-246, 2019 WL 4889194 (D. Conn. Oct. 3, 2019). Both cases remain pending.

Whether these more specific types of disclosure arguments gain broader traction and start to yield judgments or settlements profitable for the plaintiffs' bar remains to be seen. It is possible that more nuanced theories of Section 14 liability, combined with pushback against the mootness fee "racket" discussed below, will lead plaintiffs to file fewer but more targeted complaints.

## What happens with M&A litigation involving foreign companies?

M&A litigation involving foreign companies can be complicated by the fact that claims may require the application of foreign law, and courts in the United States may decide that the cases are better suited to foreign courts. Such was the case following the acquisition of Dangdang, a Cayman Islands company with its principal place of business in China. The company listed American Depositary Shares (ADS) on U.S. exchanges. The plaintiffs sought damages for breach of common-law fiduciary duties, as well as violations of U.S. securities law. The district court granted the motion on *forum non conveniens*, holding that the Cayman Islands is a more appropriate forum because "[t]he action involves a Cayman Islands company with its principal place of business in China, a merger executed in the Cayman Islands, and a dispute governed principally, if not exclusively, by Cayman Islands law." *Fasano v. Li et al.*, No. 16-Civ-8759, 2017 WL 6764692 (S.D.N.Y. Dec. 29, 2017). In a later appeal, the Second Circuit held that the court evaluated the *forum non conveniens* argument incorrectly, and it sent the case back to the district court to apply the correct analysis. *Fasano v. Yu Yu et al.*, 921 F.3d 333 (2d Cir. 2019). The case remains pending.

A similar *forum non conveniens* argument was made following a litigation challenge to the acquisition of Giant Interactive, another Cayman Islands company with its principal place of business in China and ADSs listed in the United States. Because the complaint brought common-law fiduciary duty claims, the company sought dismissal in favor of litigation in the Cayman Islands. Ultimately, however, the case settled before the motion was decided.

Other cases, however, involve straightforward application of U.S. law to a foreign company. Shanda Games, yet another Cayman Islands company headquartered in China with domestic ADSs, was sued under Exchange Act Sections 10 and 20 (prohibiting false or misleading statements in connection with the sale of a security) following its go-private transaction. The plaintiff did not bring any common-law claims. There, the company moved to dismiss on the merits of the claims—rather than on issues of forum. The court evaluated the complaint under federal legal standards and granted dismissal. *In re Shanda Games Securities Litig.*, No. 1:18-Civ-2463 (S.D.N.Y. Sept. 30, 2019).

Given the choice, it seems that most U.S.-based plaintiffs' lawyers would prefer to litigate at home rather than be sent to a foreign court. While the direction in which *forum non conveniens* law evolves in the M&A context remains to be seen, plaintiffs may simply find it easier to focus their complaints on straightforward U.S. statutory claims, rather than try to assert common law claims that may implicate foreign law.

## What amount of attorneys' fees is appropriate for a disclosure settlement?

When M&A litigation was centered in Delaware Chancery Court, settlements had a degree of transparency and predictability. Proposed settlements were submitted to the court in public filings, and the court exercised a supervisory role by rejecting excessive attorneys' fees claims from plaintiffs and by approving the scope of class-wide releases to the defendants. It was precisely this supervisory function that allowed the court, after years of seeing questionable litigation challenges to virtually every major deal, to reach its decision in *Trulia* shutting down all but the most serious of cases.

Now, that transparency and predictability are largely gone, as settlements are no longer routinely submitted for court approval. Instead, plaintiffs file proposed class-action complaints under Section 14 alleging inadequate disclosure and then, before any class is certified by the court, reach an agreement with the defendants on the additional disclosures that would be required to "moot" their complaint and what "mootness fee" would be required to compensate the plaintiffs for their trouble. The plaintiffs are then free to simply dismiss their own cases with a perfunctory court filing that does not require disclosure of any settlement terms. This means that Section 14 lawsuits are often filed, then quickly and quietly settled, without judicial review.

For their part, companies are still incentivized to pay money to make deal-threatening plaintiffs go away. But now, a payment to one plaintiff does not necessarily mean that the company is free and clear. A privately agreed settlement cannot provide releases on behalf of shareholders who are not participating, so there is no pretense of settling the claims on behalf of the entire shareholder class as was typical before. Worse, because "mootness fees" may never end up being publicly disclosed, it is more difficult for today's defendants to benchmark a specific settlement demand against the broader market.

The removal of public disclosure and judicial involvement from the settlement process has created a situation that at least one judge has called a "racket." Following the proposed acquisition of Akorn, Inc., plaintiff shareholders brought suit in Illinois federal court to challenge the transaction (and specifically, the adequacy of disclosure) and then voluntarily dismissed their claims quickly in exchange for supplemental proxy disclosures and a $322,000 mootness fee paid by the company. Then, a different Akorn shareholder—not a plaintiff—moved to intervene in the lawsuit for the purpose of challenging the payment of this mootness fee, arguing that the supplemental disclosures added no material information of any value. In a decision issued in June of this year, the court agreed with the intervenor. The court said that the supplemental disclosures were "worthless to the shareholders" and further noted that the quick settlement was designed to "avoid . . . judicial review." The court ordered the plaintiffs' attorneys to return the mootness fee to the company. *House v. Akorn, Inc.*, 385 F. Supp. 3d 616 (N.D. Ill. 2019).

In a similar but slightly different case in August, plaintiff shareholders brought a legal challenge to the acquisition of DST Systems in Delaware federal court complaining, again, of inadequate disclosures. Rather than settle for an agreed mootness fee, DST unilaterally issued a supplemental proxy that, as plaintiffs were forced to concede, mooted their complaints. But because there was no settlement, the plaintiffs had no choice but to apply to the court if they wanted their fees reimbursed. They did so, and the court denied their fee request. The court did not agree that the information contained in the supplemental proxy—the information that plaintiffs complained was missing—was material. The court went on to hold that "there is no basis in the record to find that Plaintiffs conferred any benefit on DST stockholders." *Scott v. DST Systems*, No. 1:18-cv-0286, 2019 WL 3997097 (D. Del. Aug. 23, 2019).

While it is early to tell, the freewheeling settlements that have recently become common in Section 14 cases may be facing a backlash from courts. If defendants refuse to voluntarily pay mootness fees and force plaintiffs to instead request their legal fees from the court, this incipient trend may continue.