KIRKLAND & ELLIS

KIRKLANDPEN
Private Equity Newsletter

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Whack-a-Mole: The Evolving Landscape in Pubco M&A Litigation

PENpoints

While a recent Delaware decision on disclosure settlements has not ended public company M&A litigation, it has changed the risk profile of deal litigation and highlighted new ways to manage that risk.

A landmark January 2016 Delaware Chancery Court decision[1] has significantly changed the litigation and settlement landscape in public company M&A transactions.

In that case, the Delaware court rejected a proposed "disclosure only settlement" in which the public company target's shareholders would receive supplemental pre-vote disclosure in exchange for broad liability releases, and plaintiffs' attorneys would receive a fee award, but no monetary or other benefits would flow to the target shareholders (other than the "improved" disclosure). Deal practitioners and M&A principals for years have lamented that every public deal would be followed by an indiscriminately filed nuisance lawsuit, and skeptics complained that only the plaintiff's attorneys benefited by receiving a fee award, usually six figures for obtaining additional disclosures (but no monetary remedy) for the target shareholders. The Delaware court's growing disfavor of this outcome manifested in a clear warning that "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."

This case has led to a dramatic decline in the use of pre-closing disclosure-only settlements in Delaware, but it has not by any means ended public company deal litigation. Instead, it has set in motion a cascading set of developments that change (but do not eliminate) the risk profile of M&A litigation and create new pathways for the management of that risk.

Below we highlight a handful of these noteworthy trends:

Significant reduction in overall deal litigation. Given the large number of public companies incorporated in Delaware and the influence of Delaware courts nationwide, the economic incentive for plaintiffs' attorneys to reflexively file claims and seek a disclosure settlement has been reduced. According to Cornerstone Research, from 2010 to 2014, more than 90% of deals valued at more than $100 million were the subject of at least one lawsuit (and usually multiple filings), with only a handful ever going to full trial and well over 50% being the subject of disclosure-only settlements. By contrast, in the first half of 2016, only 64% of such deals drew a legal challenge.

Many plaintiffs are seeking a "friendlier" forum. Plaintiffs are now looking to file M&A cases in non-Delaware jurisdictions where they may find a more sympathetic audience for the continued pursuit of disclosure settlements. Many states have not yet followed Delaware's new approach to these settlements, and courts in those states may still be willing to approve disclosure settlements and make robust plaintiffs' attorneys' fee awards. This trend is reflected in data from Cornerstone Research. While plaintiffs filed in Delaware in more than 60% of M&A lawsuits in prior periods, in the most recent nine months Delaware was the chosen forum in only 26% of litigated deals. The adoption by a target company of a forum-selection bylaw mandating that breach of fiduciary duty suits

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1 *In re Trulia, Inc. Stockholder Litigation*.

must be filed in Delaware can help mitigate the effect of this forum shopping by plaintiffs.

Increase in federal claims. To evade the Delaware trends as well as the protective benefits of a forum-selection bylaw, which only applies to state law claims, plaintiffs have also sought to recast their deal-related claims as disclosure claims brought in federal court under the proxy or tender offer rules. According to Cornerstone Research, the first half of 2016 showed a 167% increase in the number of federal M&A suits compared to the preceding six months. While disclosure settlements resulting from this uptick in federal claims are now working their way through the federal courts, it is worth noting that just last week a federal appellate court overturned a district judge's approval of a disclosure settlement. The appellate court opinion described the settlement as a "racket" where the "only concrete interest suggested by this litigation is an interest in attorneys' fees, which of course accrue solely to class counsel and not to any class members."

Renewed focus on appraisal claims. Plaintiffs are also focusing more on appraisal claims — in which a target shareholder who did not vote in favor of a merger asks a judge to determine a fair price for its shares — as an alternative avenue to challenge deals. Appraisal claims filed in Delaware have not been impacted by the recent decision and do not necessarily require proof that the board breached its fiduciary duties. After a string of cases where the Delaware Chancery Court determined that the deal price was the best indicator of fair value (i.e., that appraisal claims would *not* lead to a higher value award than the deal price where there was good sale process), in two recent appraisal cases, the Court awarded the claimant shareholders a "fair price" per share that was above the deal price by 28% and 7%, even while acknowledging that the sale processes in those cases were fairly robust.

Focus on getting disclosure right. Delaware courts have also moved to articulate a general principle regarding the "cleansing" effect of a fully informed shareholder approval of a deal on potential target board liability. In particular, the Delaware Supreme Court has held that a board's decisions will be reviewed under the more deferential "business judgment" standard, as opposed to enhanced scrutiny under stricter standards, if a transaction is "approved by a *fully informed*, uncoerced majority of disinterested stockholders." This decision, along with the decline in pre-vote or tender disclosure litigation, have led to perceived disclosure shortcomings more often being litigated post-closing, where the impact of any disclosure deficiencies is magnified by the potential loss of the "cleansing" effect of a fully informed, uncoerced vote. Therefore, parties should place increased emphasis on preparing appropriate disclosure in the first instance, as there will likely not be either pre-closing litigation claims to improve the disclosure or the prospects of a general release of liability received in a pre-closing disclosure settlement.

If you have any questions about the matters addressed in this *KirklandPEN,* please contact the following Kirkland authors or your regular Kirkland contact.

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PENbriefs

IRS Issues Proposed Regulations Affecting Rules Governing Tax-Free Distributions

The IRS recently issued proposed regulations designed to limit a taxpayer's ability to engage in a tax-free distribution or spinoff in situations involving a large amount of non-business assets, such as cash or a minority position in another company. To learn more, see our recent *Alert.*

New EU Market Abuse Regime Now in Force

The European Union's Market Abuse Regulation, which recently became effective, introduces a number of changes impacting a financial sponsor dealing with a company with EU publicly traded securities. To learn more, see our recent *Alert.*

AIM Update

Recently in our *KirklandAIM* newsletter, which is directed toward Chief Compliance Officers and other compliance professionals, we discussed the settlement of an SEC proceeding against an investment adviser for failure to safeguard customer data (click here to access this edition of *KirklandAIM*) and a proposed SEC rule requiring advisers to adopt business continuity and transition plans (click here to access this edition of *KirklandAIM*).

PENnotes

ABA Business Law Section Annual Meeting
Boston, Massachusetts
September 8-10, 2016

The American Bar Association will hold its 2016 Business Law Section Annual Meeting in Boston. Kirkland partner Norm Champ will be a featured speaker. Click here for more information.

Boardroom Forum: Managing Corporate Crises in the Current Environment
Chicago, Illinois
September 22, 2016

Kirkland & Ellis, Kellogg School of Management, Northwestern Pritzker School of Law and PwC will host the inaugural Boardroom Forum: The Intersection of Business and Law for Directors and C-Suite Executives. This annual, invitation-only event is designed to give insights from authoritative experts and facilitate the exchange of perspectives on cutting edge issues confronting directors and C-suite executives.

PLI Understanding the Securities Laws 2016
Chicago, Illinois
September 28-29, 2016

This program will provide an overview and discussion of the basic aspects of the U.S. federal securities laws by in-house and law firm practitioners as well as SEC staff. Emphasis will be placed on the interplay among the Securities Act of 1933, the Securities Exchange Act of 1934, the Sarbanes-Oxley Act, the Dodd-Frank Act, the JOBS Act, the securities-related provisions of the FAST Act and related SEC regulations. Kirkland partner Ted Peto will speak on "Regulation of Proxy Solicitations." Click here for more information.

Northwestern Pritzker School of Law Corporate Counsel Institute
Chicago, Illinois
September 29-30, 2016

This event focuses on the legal concerns of boards of directors and in-house counsel and draws around 150 participants from around the country, a majority of whom are C-suite executives, including general counsel and CFOs, as well as chairs of audit committees and compensation committees. Kirkland partner Robert Hayward will co-moderate "A Conversation with Keith Higgins — Director, Division of Corporation Finance, SEC." Click here for more information.

PLI Hot Topics in Mergers & Acquisitions 2016
Chicago, Illinois
September 30, 2016
New York, New York
October 13, 2016

An expert faculty of lawyers, general counsel, regulators and investment bankers will explore the state of M&A and trends for the year ahead. Kirkland partners Scott Falk and Sarkis Jebejian are co-chairs of the event, and partner Nicole Greenblatt will be a panelist on "Distressed M&A." Click here for more information.

Operations for Alternatives Hedge Fund Compliance
New York, New York
October 6-7, 2016

This event focuses on regulatory, examination and compliance issues for hedge funds, given the evolving examination and compliance landscape, regulatory scrutiny, and ever-increasing risk of cyber-attacks. Kirkland partner Norm Champ will be a featured speaker. Click here for more information.

Securities Enforcement Forum 2016
Washington, D.C.
October 13, 2016

This one-day conference brings together current and former senior SEC and DOJ officials, securities enforcement and white collar attorneys, in-house counsel and compliance executives to discuss the most important issues currently facing attorneys and professionals in the SEC enforcement area. Kirkland partner Robert Khuzami will serve as a panelist. Click here for more information.

The University of Texas at Austin School of Law Mergers and Acquisitions Institute
Dallas, Texas
October 20-21, 2016

This program will examine the latest deal trends, structures, pitfalls and opportunities in M&A. Kirkland partner Christopher Torrente will be a panelist on "Growth Equity." Click here for more information.

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Kirkland & Ellis' nearly 400 private equity attorneys have handled leveraged buyouts, growth equity transactions, recapitalizations, going-private transactions and the formation of private equity, venture capital and hedge funds on behalf of more than 400 private equity firms around the world.

Kirkland has been widely recognized for its preeminent private equity practice. The Firm was named "Private Equity Group of the Year" in each of the last five years by *Law360* and was commended as being the most active private equity law firm of the last decade in *The PitchBook Decade Report*. Kirkland & Ellis was named "Law Firm of the Year" in Mergers and Acquisitions Law by U.S. News Media Group and Best Lawyers in their 2014 "Best Law Firms" rankings. The Firm was named "Best M&A Firm" at *World Finance*'s 2014 Legal Awards, "Law Firm of the Year in North America: Fund Formation" at Private Equity International's 2013 Private Equity International Awards and "Private Equity Deal of the Year" at the 2014 IFLR Americas Awards.

In 2012-2015, Chambers and Partners ranked Kirkland as a Tier 1 law firm for Investment Funds in the United States, United Kingdom, Asia-Pacific and globally. The Firm was ranked as the #1 law firm for both Global and U.S. Buyouts by deal volume in Mergermarket's *League Tables of Legal Advisors to Global M&A for Full Year 2011-2015*, and has consistently received top rankings among law firms in Private Equity by The Legal 500, the Practical Law Company and IFLR, among others.

The Lawyer magazine has recognized Kirkland as one of its "Transatlantic Elite," having noted that the Firm is "leading the transatlantic market for the provision of top-end transactional services ... on the basis of a stellar client base, regular roles on top deals, market-leading finances and the cream of the legal market talent."

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