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End of an Era: The Music Stops for "Disclosure-Only" Settlements in Delaware

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Over the past decade, public company directors and officers have come to accept that litigation is all but certain in M&A transactions. Often, with the risk and distraction of an injunction hanging over targets and acquirors, these lawsuits have resulted in so-called "disclosure-only settlements"—i.e., the plaintiff's agreement to drop its challenge to the transaction in exchange for additional disclosure to the target's stockholders, a broad release of any and all known and unknown claims that the plaintiff (and the class of stockholders the plaintiff purports to represent) might have, and an agreement by the target to pay a relatively modest (compared to the size of the transaction) attorneys' fee award. These lawsuits have rarely resulted in the payment of additional merger consideration to stockholders.

In recent years, however, judges on the Delaware Court of Chancery have become increasingly critical of disclosure-only settlements, recognizing "market imbalance" and "externalities that are being exploited." *Stourbridge Invs. LLC v. Bersoff*, C.A. No. 7300-VCL, at 12 (Del. Ch. Mar. 13, 2012) (Laster, V.C.) (transcript ruling); *see also In re Riverbed Tech. Inc. S'holders Litig.*, 2015 WL 5458041 (Del. Ch. Sept. 17, 2015). And, in a landmark January 2016 decision, *In re Trulia, Inc. Stockholder Litigation*, --- A.3d ---, 2016 WL 325008 (Del. Ch. Jan. 22, 2016), Chancellor Andre G. Bouchard, the chief judge of the Delaware Court of Chancery, rejected a disclosure-only settlement, acknowledging that the "dynamics" driving disclosure-only settlements "have caused deal litigation to explode in the United States beyond the realm of reason."

In *Trulia*, Chancellor Bouchard explained that disclosure-only settlements call upon the Court to weigh the "give" (a broad release of claims) and the "get" (additional proxy disclosure) in determining whether a proposed settlement is fair and reasonable to the target's stockholders. According to Chancellor Bouchard, this practice is "sub-optimal" in that it creates a "non-adversarial" dynamic, leaving the court to become "a forensic examiner of proxy materials so that it can play devil's advocate in probing the value of the 'get' for stockholders in a proposed disclosure settlement." Chancellor Bouchard stated 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."

In that regard, Chancellor Bouchard suggested "at least two ways" for litigants to address disclosure claims. First, as has always been the case, parties can litigate disclosure claims at the preliminary injunction stage, which requires plaintiffs to demonstrate "on the merits a reasonable likelihood of proving that 'the alleged omission or misrepresentation is material.'" Alternatively, defendants can "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," and allow plaintiffs' counsel to apply to the Court for an award of attorneys' fees. "In that scenario, where securing a release is not at issue, defendants are incentivized to oppose fee requests they view as excessive." The Court noted that, although defendants would not obtain a formal release under either scenario, "to the extent fiduciary duty claims challenging the sales process remain in the case, they are amenable to dismissal," and otherwise "the filing of a [voluntary] stipulation of dismissal [in connection with the mooting of the disclosure claims] likely represents the end of fiduciary challenges to the transaction as a practical matter."

Following *Trulia*, litigants who settle disclosure claims should expect the Delaware Court of Chancery to closely scrutinize the materiality of the supplemental disclosures obtained and the scope of the release granted. Settlement disclosures must address "plainly material" misrepresentations or omissions, meaning "that it should not be a close call that the supplemental information is material." Moreover, any proposed release of claims—the greatest incentive for defendants to enter into these settlements—should be "narrowly circumscribed" to include only disclosure claims and fiduciary duty claims regarding the sale process to the extent that the latter have been sufficiently vetted.

As has been the case in recent years, in the short term, we expect that plaintiffs may continue to seek forums other than Delaware for M&A lawsuits in the hope they will be more favorable. Chancellor Bouchard reminded directors, officers and practitioners, however, that Delaware corporations may enact forum-selection bylaws to concentrate this litigation in Delaware and implored courts in other jurisdictions to similarly scrutinize disclosure-only settlements. In time, given the significant influence of the Delaware Court of Chancery on corporate litigation, *Trulia* will likely drive a decline in abusive M&A litigation nationwide.

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