A person in silhouette is pushing a large, heavy boulder up a steep, grassy hill. The scene is set against a dramatic sunset sky with warm orange and yellow tones. The person is leaning forward, using their hands to push the boulder. The boulder is the central focus, and the person's effort is clearly visible.

THE UPHILL BATTLE TO TAKE DOWN THE 'MERGER TAX'

A potential clampdown on meritless merger objection lawsuits hasn't played out as hoped.

BY PATRICK GALLAGHER

Merger objection class-action lawsuits have been the bane of U.S. public companies for nearly a decade. Each year from 2009 through 2015, somewhere between 84 percent and 94 percent of all merger transactions over \$100 million were challenged by at least one shareholder class-action lawsuit, according to the economic and financial consulting firm Cornerstone Research (*see the "The Merger Tax: Do a Deal, Get Sued" chart*). The percentage dropped sharply in 2016 then resurged last year to the 90 percent range. This is the story behind those numbers.

The "strike suits" seek to enjoin the merger, claiming that the target company's disclosures

were insufficient and that the directors breached their fiduciary duty by following a flawed sales process and failing to get the best price. The buyer sometimes gets sued too.

Few corporate defendants want to take a chance on derailing a transaction, so the vast majority of these suits have resulted in quick "disclosure-only" settlements that rarely provide any monetary compensation to shareholders. The defendants agree to make supplemental disclosures – which are often immaterial – in exchange for a global release from all claims related to the deal, and the plaintiffs' lawyers receive a lucrative six-figure fee, often in excess of \$500,000.



Chancery Court Takes Action

Frustrated by the growing volume of deal litigation “beyond the realm of reason,” the Delaware Court of Chancery – where, prior to 2016, most of these cases had been filed – moved to rein in non-meritorious merger suits beginning in late 2015. In its January 2016 rejection of a proposed settlement in the acquisition of Trulia Inc. by Zillow Inc., the court declared that future disclosure-only settlements “are likely to be met with continued disfavor” unless the supplemental disclosures provide a “plainly material” benefit to the shareholders and “the proposed release is sufficiently narrow.”

The *Trulia* decision was widely viewed as likely to make plaintiffs’ law firms more selective in the

cases they chose to file, and make Delaware a less-friendly venue. The early numbers bore out a pullback by plaintiffs’ law firms. According to Cornerstone, the percentage of M&A deals challenged by shareholder litigation fell to 64 percent in the first half of 2016 compared with 84 percent for all of 2015.

A *Law 360* article in May 2016 reported that “some on the plaintiffs’ bar worry that the legal landscape is leading to a place where such litigation is snuffed out altogether.” A May 2016 corporate law firm paper was provocatively titled “The Death of Merger Litigation?”

Corporate-side advocates were further heartened in June 2016 when the influential (now retired) federal judge Richard Posner in the U.S. Seventh Circuit Court of Appeals (which encompasses Illinois, Indiana, and Wisconsin) overturned a lower court’s approval of a \$370,000 disclosure-only settlement in the deal that created Walgreens Boots Alliance Inc. “The type of class action illustrated by this case – the class action that yields fees for class counsel and nothing for the class – is no better than a racket. It must end,” Posner wrote in the majority opinion.

It didn’t end. Plaintiffs’ lawyers simply changed their strategy.

Detour around Delaware

As a result of *Trulia*, says Cliff Brinson, a securities litigator at Smith, Anderson, Blount, Dorsett, Mitchell & Jernigan, LLP, in Raleigh, NC, “Cases that had been funneled into Delaware were now funneling out of Delaware” and into federal courts and courts in other states.

Over the fourth quarter of 2015 and the first two quarters of 2016 combined, just 26 percent of M&A-related litigation was filed in Delaware, down from 61 percent over the first three quarters of 2015, according to Cornerstone. And that trend has continued into 2017. Meanwhile, federal M&A filings quintupled from just 17 cases in 2015 to 85 in 2016, and the number is on track to top 200 in 2017. Presumably, a large number of these cases would have been filed in Delaware if not for *Trulia* (see the “Out of Delaware and Into Federal Courts” chart).

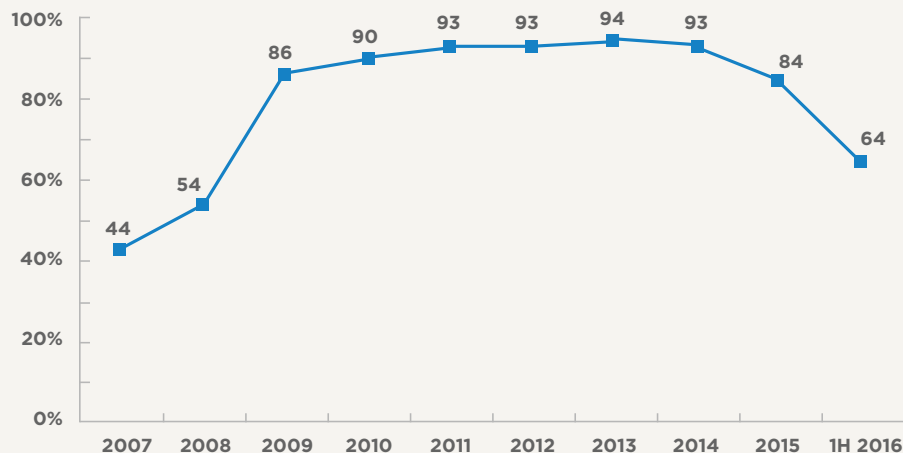
Don Tucker, also a securities litigator with

“Traditionally, plaintiffs’ lawyers have not liked securities law claims because there are all sorts of defenses under federal law against them. But they’d rather do that than take their chances in the Delaware Court of Chancery under a traditional merger law case.”

- Cliff Brinson, securities litigator, Smith, Anderson, Blount, Dorsett, Mitchell & Jernigan, LLP

The Merger Tax: Do a Deal, Get Sued

FIGURE 1 Percentage of M&A Deals Challenged by Shareholders (by deal year)



Source: Cornerstone Research, <https://www.cornerstone.com/Publications/Reports/Shareholder-Litigation-Involving-Acquisitions-2016>

Smith Anderson, explains that litigants have the option of filing these merger lawsuits in the defendant's state of incorporation (often Delaware) or in its principal place of business, or they can recast these state law causes of action as federal securities claims. Many Delaware corporations have adopted forum-selection bylaws designed to force cases to Delaware, but these bylaws cannot prevent plaintiffs from filing under federal securities laws.

"Traditionally, plaintiffs' lawyers have not liked securities law claims because there are all sorts of defenses under federal law against them," says Brinson. "But they'd rather do that than take their chances in the Delaware Court of Chancery under a traditional merger law case."

Since *Trulia*, only a handful of disclosure settlements have been approved by the Delaware Court of Chancery, according to Anthony Rickey of Margrave Law LLC of Georgetown, Del. Meanwhile, outside of Delaware, plaintiffs' lawyers continue to seek, and receive, six-figure fees.

Mum's the Word

"Clearly, what the parties are looking for is a court that will approve their settlement and either disregard or not be aware of *Trulia* in the first place," says Sean Griffith, professor of law at

Fordham Law School and director of the Fordham Corporate Law Center.

Griffith played a key role in the events in Delaware. He filed an amicus brief in *Trulia* and his earlier objection to a 2015 merger settlement that was a precursor to *Trulia* is credited with guiding the court's understanding of the issue.

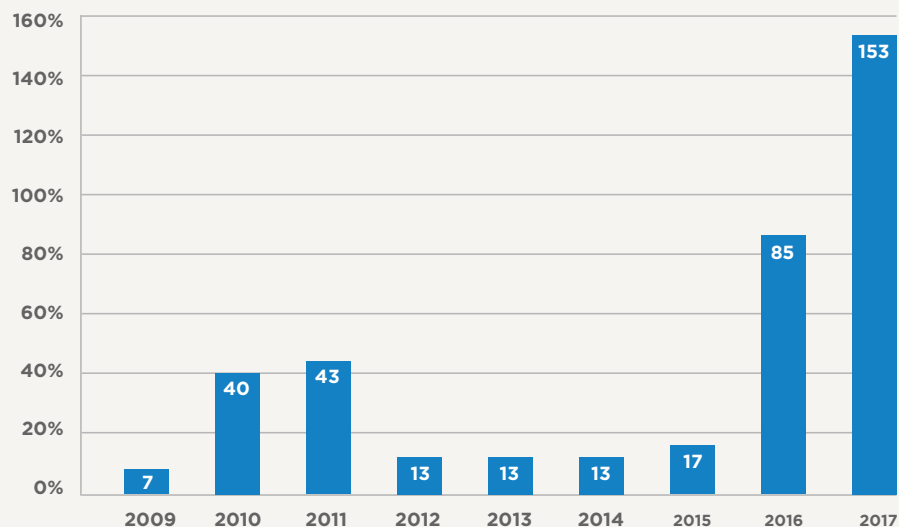
The problem is, as Griffith wrote in a January 2016 paper, "Non-Delaware judges are, after all, plenty busy and have no special reason to remain abreast of developments in the Court of Chancery. They must rely on the parties for information concerning the relevant legal standards. At settlement, however, there is no adversarial process. Because both parties to the settlement want it to be approved, neither has any interest in raising *Trulia* to the non-Delaware judge."

Margrave Law's Rickey, who has represented objectors, including Griffith, in opposition to disclosure settlements across the country, elaborates on these points. "If plaintiff's counsel presents a disclosure settlement outside of Delaware, more often than not, no objector appears, and *Trulia* is, at best, mentioned in passing in plaintiff's papers. Sometimes it isn't mentioned at all. Frequently, the court then gives its approval without discussing *Trulia*," says Rickey.

Opponents of frivolous merger litigation have

Since 2009, the vast majority of M&A transactions exceeding \$100 million have attracted litigation as a matter of course. The drop-off in the first half of 2016 reflects the initial impact of *Trulia*. For 2017, the percentage is expected to return to the 90 percent range.

Out of Delaware and Into Federal Courts



Source: Cornerstone Research

Federal M&A filings quintupled from 2015 to 2016, and the number is on track to top 200 in 2017 (results shown through the first three quarters for 2017). Presumably, a large number of the filings in 2016 and 2017 would have been in Delaware Chancery Court if not for *Trulia*.

made some progress beyond Delaware and the Seventh Circuit. One superior court in New Jersey and one in Connecticut have adopted the *Trulia* rationale, and the North Carolina Business Court warned that it may do so in future disclosure-only settlements that come before it. More recently, California's Santa Clara County Superior Court, whose jurisdiction encompasses much of Silicon Valley, appears to have embraced the *Trulia* standard.

For the most part, however, the plaintiffs' bar's strategy of avoiding Delaware and downplaying *Trulia* has worked. And class plaintiffs' newest tactic – "mootness resolutions" – is proving to be even more effective.

The Mootness Workaround

In mootness resolutions (which are, legally speaking, not settlements), the plaintiffs' complaints are limited to disclosure claims "in the hope of having defendants moot such claims with supplemental disclosure," explained Edward Micheletti and two co-authors all of Skadden, Arps, Slate, Meagher & Flom LLP in a November 2017 article published on *Lexology*. "This, in turn, opens the door for plaintiffs to [voluntarily dismiss the case and then] make an application for 'mootness fees' for creating a disclosure 'benefit.' Sometimes, the parties are able to negotiate an agreed-upon mootness

fee, while other times such fees are contested and require judicial resolution."

These federal mootness cases create a strong incentive for defendants to settle quickly, wrote John A. Neuwirth and three colleagues from Weil, Gotshal & Manges LLP in a November 2017 article in the *New York Law Journal*. In Delaware, they explained, defendants have an opportunity to thwart a frivolous action at the outset by opposing a motion for expedited discovery. But in federal court, more often than not, the first time the parties will appear in front of the judge is at the preliminary injunction hearing. "That increases the stakes for defendants, because, if defendants proceed to a preliminary injunction hearing, there is a risk (however small) that a transaction can be delayed or enjoined."

Mootness cases tend to pay less than disclosure-only class-action settlements, but for the plaintiffs' attorneys, the strategy has a lot of offsetting advantages. Because there is no class-wide release of claims, mootness resolutions do not require court approval or notice to the putative shareholder class. Mootness cases also involve less work, and the shorter process usually means a quicker payout and minimal risk of attracting an objecting shareholder.

"This tactic has spread like wildfire and has

"It ends up being like a game of Whac-a-Mole. You think you're changing a court's mind, and the plaintiffs just go somewhere else."

- Sean Griffith, director, Fordham Corporate Law Center

enabled a dramatic uptick in merger strike suit filings," says Ted Frank, director of the Center for Class Action Fairness (CCAF) at the Competitive Enterprise Institute, a Washington think tank. It was Frank who filed the objection in the *Walgreens* merger case that alerted the court to the *Trulia* precedent. "Instead of settling merger strike suits, plaintiffs dismiss with the understanding they will apply for mootness fees of hundreds of thousands of dollars per merger."

The mootness strategy makes sense for the plaintiffs' lawyers, says Kevin LaCroix, executive vice president of RT ProExec, an insurance intermediary firm in Beachwood, Ohio, and editor of the blog, *The D&O Diary*. "The firms filing the suits are opportunistic. These tend to be small players that have no intention of carrying these cases through. You can make a good living on \$300,000 or \$400,000 at a time."

An Uphill Battle

With the number of federal M&A filings setting new quarterly records during 2017, and with Delaware mostly relegated to the sidelines (Griffith notes that the Chancery Court's low pay-scale for mootness fees is now driving plaintiffs' filings to other courts), any hopes that *Trulia* would quickly turn the tide have faded.

Griffith says that since *Trulia*, he has objected to settlements in federal courts in Boston and Indiana, and state courts in Florida, New York, New Jersey, and California. Some were successful, and some not. Currently, he says, his focus is mostly on cases at the appellate court level and giving talks at judicial conferences. "It ends up being like a game of Whac-a-Mole. You think you're changing a court's mind, and the plaintiffs just go somewhere else," he says.

"It's an uphill battle all over the country," says Frank. "There are so many judges that don't have a lot of experience with these cases. We have to be very selective. We don't have the budget or time to take on every case. What a plaintiffs' law firm gets in one of these cases might be two years of my budget."

Frank believes nothing will really change until the courts crack down on the plaintiffs' lawyers

filing these "abusive" lawsuits. "We're asking for larger relief, for actual sanctions, actual disciplinary proceedings."

Griffith is a bit more optimistic. "There is some evidence that over time, *Trulia* made its way," he says. "And so hopefully judges will get tougher on mootness fees. At some point, the returns on this litigation have to go down so low that the plaintiffs' lawyers are not interested in bringing it anymore. But that hasn't happened yet. There is still a deal tax, deals still get held up, and companies are still paying ransom."

End-run Around Walgreens

Amid new talk of the need for federal legislation, Griffith and Frank continue their quests to drive a national consensus across the federal courts over the next year or two or three. In September, Frank moved to intervene in a federal case in the Northern District of Illinois involving the now-consummated acquisition of Akorn, Inc., by the German drug company Fresenius Kabi AG.

According to a CCAF news release, Frank's filing claims that the award of \$322,500 in mootness fees "constitutes an end-run around *Walgreens'* precedent and also appears to violate the Private Securities Litigation Reform Act (PSLRA) and basic principles of federal class action law."

Frank ultimately hopes a favorable court decision in this case will enjoin or at least discourage the filing of frivolous strike suits nationwide. But the first legal hurdle is whether he even has standing to intervene in a case that has since been dismissed. As a result, pursuing a federal solution may be a better long-term strategy to curb these merger suits.

As Weil's Neuwirth and his co-authors wrote: "Given the practical ease (and relatively modest cost) of mootness resolutions of federal court actions, merger-related securities class actions are not likely to abate unless Congress acts to curb the practice, just as it did in enacting the PSLRA." [IR](#)

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