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Will *Trulia* Drive "Merger Tax" Suits Out of Delaware?

by Anthony Rickey and Keola R. Whittaker

The Delaware Court of Chancery's January 22, 2016 decision, *In re Trulia, Inc. Stockholder Litigation*, 129 A.3d 884 (Del. Ch. 2016), offers a potential solution to the problem of "merger tax" class-action settlements. It remains to be seen, however, whether *Trulia* will reduce the rate of low-value merger litigation, or merely encourage plaintiffs to file such lawsuits elsewhere.

In 2014, plaintiffs challenged almost 95% of deals with publicly-traded targets valued at $100 million or greater.[1] Until recently, the bulk of these lawsuits followed a familiar pattern. Multiple stockholder plaintiffs came in like lions, roaring that directors sought to sell a corporation on the cheap. The plaintiffs then quickly settled like lambs for a handful of additional proxy disclosures and, sometimes, changes in therapeutic deal terms such as lowered termination fees, but no cash compensation. In exchange, corporate defendants obtained broad releases from liability, while plaintiffs' attorneys walked away with six-figure fees.

Skeptics described these suits as a "transaction tax" or "merger tax" based upon the near-certainty of both a lawsuit and a settlement. Ubiquitous deal lawsuits burden the economy, corporations, and shareholders collectively, even if a settlement may be economically rational for any given corporate defendant. As the Court of Chancery has noted, "Absent the rational sifting out of non-meritorious cases, stockholders suffer as the costs of litigation exact an undue toll on … transactions valuable to stockholders and cause a harmful diminution in wealth-generating risk-taking by directors." *In re Topps Co.*, 924 A.2d 951, 961 n.38 (Del. Ch. 2007).

Practical solutions to the problem faced two significant challenges. First, in the settlement context, plaintiffs and defendants almost never contest a motion to approve a settlement, so a court rarely receives adversarial briefing on the value of disclosures to shareholders. Second, plaintiffs can often choose between filing in the state of a company's headquarters and its state of incorporation. If a jurisdiction were to aggressively regulate M&A lawsuits (and resulting attorneys' fees), plaintiffs could respond by simply filing elsewhere. Indeed, an influential article suggested that "closer scrutiny of plaintiff attorney fees encouraged filing outside Delaware…."[2]

As discussed below, *Trulia* addresses the merger-tax issue by setting forth a new process for pre-trial resolution of litigation that restores adversarial processes and enhances scrutiny of class settlements. The decision suggests that the problem of plaintiffs moving to other jurisdictions may be resolved through forum-selection bylaws and the hope that other states' courts will adopt *Trulia*'s reasoning. However, while *Trulia*'s long-term effect remains unknown, courts outside of Delaware have yet to show many signs of adopting the new regime.

Delaware Rejects Fee-Shifting in Favor of Forum Selection

Prior to *Trulia*, Delaware's legislature rejected another potential solution to the merger tax: fee-shifting bylaws. Following a Delaware Supreme Court opinion in 2014 suggesting that bylaws shifting the cost of

[1] *See* Matthew D. Cain & Steven Davidoff Solomon, *Takeover Litigation in 2015* 2 (Jan. 14, 2016), available at http://ssrn.com/abstract=2715890 (hereinafter, "*Takeover Litigation*").

[2] John Armour, Bernard Black, & Brian Cheffins, *Is Delaware Losing Its Cases?*, 9 J. Emp. L. Studies 605, 654 (2012).

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unsuccessful corporate litigation to class plaintiffs were consistent with Delaware law,[3] several publicly-traded companies adopted such fee-shifting measures.[4]

Other observers, however, saw fee-shifting as too drastic a remedy. The Corporate Law Council of the Delaware State Bar Association worried that widespread adoption of these bylaws would "virtually preclud[e]" stockholder litigation.[5] In an explanatory paper concerning proposed legislation to ban fee-shifting bylaws, the Council suggested the alternate solution of forum-selection bylaws, which would allow Delaware corporations to specify that merger-related litigation could occur only in Delaware courts:

> To the extent the prevalence of multi-forum litigation has made Delaware courts reluctant to police stockholder litigation, this proposal's enhanced means to end the multi-forum litigation problem should increase judicial confidence to use the tools available to supervise stockholder litigation more effectively.[6]

The Court of Chancery Cracks Down on Disclosure-Only Settlements

The Delaware legislature banned fee-shifting bylaws and statutorily approved forum-selection bylaws in June 2015. 80 Del. Laws 2015, ch. 40, eff. Aug. 1, 2015. In the ensuing months, the Court of Chancery issued a series of high-profile rulings scrutinizing, and sometimes rejecting, disclosure-only class-action settlements. These decisions took note of the context of ubiquitous deal litigation.[7] As Vice Chancellor Laster described the issue:

> I think that we have reached a point where we have to acknowledge that settling for disclosure only and giving the type of expansive release that has been given has created a real systemic problem. We've all talked about it now for a couple years. … But when you get the sue-on-every-deal phenomenon and the cases-as-inventory phenomenon, it is a … systemic problem.[8]

New York courts also issued sharply-critical decisions rejecting disclosure-only settlements.[9] However, prior to *Trulia*, the cases left unclear *when* and *how* systemic change would come. Indeed, Delaware courts approved disclosure-only settlements in 2015, in part based on settling parties' expectations.[10]

Trulia provided an answer in a case that followed the typical playbook. The *Trulia* plaintiffs challenged Zillow, Inc.'s acquisition of Trulia, Inc. shortly after its announcement, alleging that Trulia's directors approved the transaction at an unfavorable exchange ratio. Plaintiffs initially sought to enjoin the transaction, but quickly settled. *Trulia*, 129 A.3d at 886-87. Under the proposed settlement, the class would receive additional proxy disclosures but no monetary consideration. Plaintiffs' counsel sought fees and expenses of $375,000. *Id*. at 889-890.

Chancellor Bouchard's opinion scrutinized the incentives that inspired a dramatic increase in deal litigation: the leverage plaintiffs wielded in seeking to enjoin a transaction, and the "deal insurance" defendants were receiving in the form of a broad release of claims in addition to increased likelihood that their mergers

[3] *See ATP Tour, Inc. v. Deutscher Tennis Bund,* 91 A.3d 554 (Del. 2014).

[4] *See* Delaware Corporate Law Council, Explanation of Council Legislative Proposal 3 (2015), available at http://www.delawarelitigation.com/files/2015/03/COUNCIL-SECOND-PROPOSAL-EXPLANATORY-PAPER-3-6-15-U0124513.docx.

[5] *Id*. at 7.

[6] *Id.* at 9.

[7] *See, e.g., Acevedo v. Aeroflex Hldg. Corp.*, C.A. No 9730-VCL, at 62-68 (Del. Ch. July 8, 2015) (Trans.) (rejecting settlement and noting that "[o]ne of the things we learned was that with easy money to be had, M&A litigation proliferated."); *In re TW Telecom, Inc.*, C.A. No. 9845-CB at 44 (Del. Ch. Aug. 20, 2015) (Trans.); *In re Riverbed Tech., Inc.*, 2015 WL 5458041, at *4 (Del. Ch. Sept. 17, 2015); *In re Aruba Networks, Inc.*, Consol. C. A. No. 10765-VCL at 73 (Del. Ch. Oct. 9, 2015) (Trans.) (rejecting settlement).

[8] *Aruba*, *supra* note 7, at 65.

[9] *See, e.g.*, Decision and Order, *Gordon v. Verizon Commn's, Inc.*, Index No. 653084/13, (N.Y. Sup. Ct. Dec. 19, 2014) (unreported); *City Trading Fund v. Nye*, 2015 WL 93894 (N.Y. Sup. Ct. Jan. 7, 2015); *In re Allied Health Care*, 2015 WL 6499467 (N.Y. Sup. Ct. Oct. 23, 2015).

[10] *See, e.g.*, *In re Silicon Image, Inc.*, C.A. No. 10601-VCG, at 8 (Del. Ch. Dec. 9, 2015); *Riverbed*, 2015 WL 5458041, at *6.

would close. *Id*. at 892. He lamented that these settlements require a judge to become a "forensic examiner of proxy materials" in the absence of adversarial briefing. He also addressed the Chancery's role:

> It is beyond doubt in my view that the dynamics described above, 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.

Id. at 894. Chancellor Bouchard proposed a solution in *Trulia*: a renewed focus on adversarial procedures instead of settlement. *Id*. at 896. Going forward, parties that cannot agree on disclosure remain able to litigate the substance of their dispute in a preliminary injunction hearing. Parties that wish to avoid the cost of litigation, however, can maintain their adversarial posture through a "mootness" process, by which defendants voluntarily provide supplemental disclosures demanded by plaintiffs and plaintiffs dismiss their disclosure claims (with prejudice to named plaintiffs only). Plaintiffs may then petition the court for a fee, which defendants, no longer at risk of liability, may oppose. Alternatively, the parties may agree on a fee, provide notice to stockholders, and settle the fee issue without the court ruling on the value of the disclosures. *Id*. at 896-98.

Trulia held that if litigants seek the "historically trodden but suboptimal path" of a disclosure-only settlement, they should expect greater scrutiny of the value of the disclosures and the breadth of the release during the settlement approval process. Settlements "are likely to be met with continued disfavor ... 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." *Id*. at 898. Where the disclosures are not "plainly material," the court may consider appointing an *amicus curiae*, with fees taxed to the settling parties, to evaluate the alleged benefits of the settlement. *Id*. at 898-99.

Trulia's Influence Outside of Delaware

Chancellor Bouchard addressed the risk that plaintiffs will flee Delaware for more settlement-friendly jurisdictions by noting the ability of Delaware corporations to adopt forum-selection bylaws and relying on the "hope and trust that our sister courts will reach the same conclusion if confronted with the issue." *Id.* at 899. However, early indications are that Delaware's sister courts continue to approve disclosure-only settlements and award six-figure attorneys' fees. Examples of seven such cases are as follows:

Case	Settlement Approval Date	Target State of Incorporation	Approved Attorneys' Fees and Expenses
Corwin v. British Am. Tobacco PLC, No. 14 CVS 8130 (N.C. Super. Ct.)	February 17, 2016	North Carolina	$415,000.00
Suprina v. Berkowitz, Case No. 1-14-CV-272358 (Ca. Super. Ct.—Santa Clara Cty.)	February 29, 2016	Delaware	$441,792.00
Leitz v. Kraft Foods Group, Inc., Civil Action No. 3:15-CV-262-HEH (E.D. Va.)	March 10, 2016	Virginia	$375,000.00
McGill v. Hake, Case 1:15-cv-00217-TWP-DKL (S.D. Ind.)	March 10, 2016	Indiana	$410,000.00
Li v. Bowers, 1:15CV373 (M.D.N.C.)	March 22, 2016	Delaware	$300,000.00
Saggar v. Woodward, Master Case No. CIV 532534 (Ca. Super. Ct.-San Mateo Cty.)	April 4, 2016	Delaware	$280,460.29
In re Meadowbrook Ins. Grp., Inc., Lead Case No. 5:15-cv-10057-JCO-MJH (E.D. Mich.)	April 7, 2016	Michigan	$425,000.00

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The non-adversarial settlement process may be a factor slowing *Trulia*'s adoption. Plaintiffs rarely cite more recent and unfavorable Delaware case law when filing briefs in support of their settlements.[11] One reply brief argued, based on a 2011 case, that Delaware has often awarded $400,000 to $500,000 for disclosure settlements,[12] without mentioning *Trulia*'s citation to the list of fee awards in the same case as the impetus behind the explosion of deal litigation "beyond the realm of reason." *Trulia*, 129 A.3d at 894, n.25.

Courts have approved settlements even in the few cases where *Trulia* has been mentioned: In one federal case, a self-represented objector submitted an article discussing *Trulia* (but not the ruling itself).[13] In reply, plaintiffs did not mention *Trulia* (while quoting a favorable Delaware case from 1998),[14] and the judge approved the settlement. Also, in a California state court action, Fordham Law School Professor Sean Griffith (represented by the authors) provided a memorandum summarizing recent Delaware authority while seeking appointment as an *amicus curiae*. The California court declined the appointment, however, and approved the settlement without mention of Delaware law.[15]

To date, only North Carolina's business court has cited *Trulia* in written opinions reported in Westlaw or Lexis.[16] That court has also approved a disclosure-only settlement, and held that because North Carolina does not follow the common-benefit doctrine in awarding attorneys' fees, it cannot adopt Delaware's preferred path of mootness fees in the absence of a settlement agreement.[17]

Conclusion

While there are some preliminary indications of a short-term decline in merger litigation,[18] this may not last. *Trulia*'s influence will be clearer once courts outside of Delaware consider its reasoning and explicitly adopt or reject its approach. However, if non-Delaware courts remain willing to approve disclosure-only settlements and generous fee awards, *Trulia* may simply drive weak claims to other jurisdictions.

Given recent trends, enterprising plaintiffs' attorneys may file merger-related shareholder lawsuits outside of Delaware as vehicles for disclosure-only settlements precluded by *Trulia*. In turn, Delaware defendants may decide not to adopt or enforce a Delaware forum-selection clause so that they may obtain a broad release in a more settlement-friendly jurisdiction.

Ultimately, Delaware's rejection of fee-shifting bylaws, which would have fundamentally altered the economics of class-action litigation, led to *Trulia*—a solution that attempts to discourage low-value litigation while preserving cases perceived to hold more merit. It remains to be seen whether *Trulia* will prove strong-enough medicine, or if the epidemic of merger-tax lawsuits will continue by finding new life outside of Delaware.

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[11] *See, e.g.*, Mem. of Law in Support of Pls.' Unopposed Mot. for Final Applic. of Settlement, Cert. of the Settlement Class and Approval of Atty's Fees, *Li v. Bowers,* Case No. 1:15-CV-373 (M.D.N.C. Feb. 12, 2016); Pls.' Mem. of Pts. & Auths. in Support of Mot. for Final Approv. of Settlement, *Saggar v. Woodward*, Master Case No. CIV 532534 (Ca. Super. Ct.-San Mateo Cty. Jan. 29, 2016).

[12] *See* Pls.' Rep. in Further Support of Mot. for Final Approval of Class Action Settlement and Applic. for Award of Attorneys' Fees and Expenses and Response to Objection Filed by Kenneth A. Kuhn, *McGill v. Hake*, Case No. 1:15-cv-00217-TWP-DKL at 7 (S.D. Ind. Feb. 12, 2016) (quoting *In re Sauer-Danfoss Inc.*, 65 A.3d 1116 (Del. Ch. 2011)).

[13] *See* Letter, *Leitz v. Kraft Foods Group, Inc.*, Civil Action No. 3:15-CV-262-HEH (E.D. Vir. Feb. 1, 2016).

[14] *See* Reply in Support of Pls. Mot. for Final Approv. of Class Action Settlement and Applic. for Award of Attys' Fees and Expenses, *Leitz v. Kraft Foods Group, Inc.*, Civil Action No. 3:15-CV-262-HEH at 7 (filed Feb. 11, 2016).

[15] *See* Sean J. Griffith's Mem. of Pts. & Auths. in Support of Ex Parte Applic. for Appt. of *Amicus Curiae*, *Saggar v. Woodward*, Master Case No. CIV 532534 (filed Feb. 18, 2016); Order (filed Mar. 4, 2016); Minute Order (filed April 4, 2016).

[16] *See Corwin*, 2016 NCBC 14; *Strougo v. North State Bancorp*, 2016 NCBC 13 (N.C. Super. Ct. Feb. 16, 2016); *Raul ex. rel. Swisher Hygiene Inc. v. Burke*, 2016 NCBC 8 (N.C. Super. Ct. Jan. 28, 2016).

[17] *See Corwin*, 2016 NCBC 14 ¶ 11(f). However, *Corwin* suggests another means to maintain an adversarial process: partial settlements. The *Corwin* litigants settled only their disclosure claims and proceeded to litigate fiduciary duty claims, losing on a motion to dismiss. *See Corwin v. British Am. Tobacco PLC*, 2015 WL 4628780 (N.C. Super. Aug. 4. 2015). Thus, the *Corwin* court received adversarial briefing prior to approving the settlement.

[18] *See Takeover Litigation*, *supra* note 1, at 3.

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