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M&A Litigation Developments: Where Do We Go From Here?

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Over the last few years, three notable Delaware cases — *C&J Energy*, *Corwin* and *Trulia* — have paved the way for a dramatic shift in the deal litigation landscape. In *C&J Energy Services, Inc. v. City of Miami General Employees' and Sanitation Employees' Retirement Trust* (2014), the Delaware Supreme Court indicated (and the Court of Chancery has generally construed the decision to hold) that an injunction should not be issued where there is no alternative bidder and stockholders therefore risk losing the current deal if enjoined. In *Corwin v. KKR Financial Holdings LLC* (2015), the Delaware Supreme Court clarified that, absent a conflicted controller, a fully informed vote of disinterested, uncoerced stockholders will extinguish breach of fiduciary duty claims, leaving only claims for waste. And finally, in *In re Trulia, Inc. Stockholder Litigation* (2016), the Court of Chancery decided that it will no longer approve disclosure-based settlements unless the disclosures are "plainly material," the release is narrowly tailored to the claims brought in the litigation and the claims are sufficiently investigated.

In practical terms, *C&J Energy* and *Trulia* dramatically reduced the injunction practice that had dominated the M&A litigation process in Delaware for nearly three decades. Faced with no meaningful prospect of an injunction in most cases in the wake of *C&J Energy*, and with increased risk in obtaining a successful disclosure (or other therapeutic) settlement as an alternative to an injunction hearing after *Trulia*, plaintiffs have largely stopped pursuing those avenues. As a result, they no longer find themselves with potential access to a preclosing documentary record to draw from when contemplating a money damages action. At nearly the same time, *Corwin* reduced the chances that post-closing breach of fiduciary duty claims for damages would survive past the pleadings stage, a prospect that was exacerbated by the lack of preclosing discovery that used to come from the diminished preclosing injunction and settlement practices. Overall, these three cases (and resulting developments) have resulted in a marked decrease in M&A-related filings in the Delaware Court of Chancery and, in the case of disclosure claims, a marked increase in such claims in federal court. Also, perhaps taking a cue from *Trulia*, mootness resolutions have become the prevalent way to resolve disclosure-based claims in federal court (and to a far lesser extent, in state court), essentially taking the place of disclosure-based settlements.

The current state of play for M&A litigation — which consists largely of quickly mooted federal securities cases and, to a lesser extent, cases pursued post-closing under Delaware law as damages actions — is a departure from the last several decades. Previously, most judicial guidance to the M&A bar was issued preclosing by the Court of Chancery in connection with a preliminary record, and damages actions were far less frequent and often pursued — if at all — in other jurisdictions. The recent developments and changes have caused both the plaintiffs and defendants that practice M&A litigation to recalibrate their thinking and develop new tactics.

Plaintiffs Recalibrate by Bringing Damages Actions in Federal Court

After *C&J Energy*, *Corwin* and *Trulia*, many plaintiff stockholders began pursuing deal litigation involving Delaware companies under federal law rather than Delaware law, repackaging claims once brought as state claims for breach of fiduciary duty as Sections 14(a) and 20(a) claims under the federal securities laws. The shift away from state law fiduciary duty claims in favor of federal

disclosure claims has resulted in large numbers of "mootness" scenarios, in which companies issue supplemental disclosures to "moot" the disclosure claims, and plaintiffs' attorneys then seek fees based on the supposed disclosure "benefit." The economic and financial consulting firm Cornerstone Research's "Securities Class Action Filings 2017 Year in Review" reported increased dismissal rates in securities class action filings, which likely are symptomatic of the mootness phenomenon.

However, in some recent circumstances, plaintiffs have waited to bring their federal securities disclosure claims until immediately prior to or after a stockholder vote so that the claims cannot be mooted. For example, in *Schwartz v. Silver Bay Realty Trust Corp.*, filed in the U.S. District Court for the District of Minnesota, a stockholder plaintiff filed disclosure claims under Section 14(a) of the Securities Exchange Act two days after the transaction closed. Similarly, in *In re First Potomac Realty Trust*, filed in the U.S. District Court for the District of Maryland, a stockholder plaintiff filed Section 14(a) disclosure claims less than 24 hours before the stockholder vote. In each case, the plaintiffs positioned these claims in order to pursue money damages rather than injunctive relief (and presumably a mootness resolution). The *First Potomac* case was voluntarily dismissed in April 2018, and a motion to dismiss is pending in *Silver Bay*. Whether this tactic gains further traction remains to be seen.

In Delaware, Plaintiffs Pursue Statutory Actions in Aid of Discovery

After *C&J Energy*, *Corwin* and *Trulia*, many plaintiffs have complained that they no longer have access to documents or deposition testimony they once received in expedited discovery as part of an injunction application, and that, as a result, it is often difficult to surmount a *Corwin* defense. Therefore, stockholder plaintiffs have gotten creative in efforts to obtain discovery to attack, post-closing, the adequacy of the disclosures issued in connection with a transaction.

In September 2016, stockholder plaintiffs advocated for a new rule at the pleadings stage pursuant to which defendants, when raising a *Corwin* defense, would be required to produce documents to "provide the basis" for the information disclosed in the proxy; according to the plaintiffs, such a rule was necessary to enable them to meaningfully challenge a *Corwin* defense. The Court of Chancery rejected that argument, holding that, notwithstanding any impact *Trulia* has had on stockholder plaintiffs' ability to obtain discovery, plaintiffs continue to bear the initial burden to plead facts, without discovery, making it reasonably conceivable that a disclosure violation occurred and the standard in *Corwin* should not apply.

In reaction, the plaintiffs again switched gears, with some recent success. One increasingly common approach has been to use Section 220 of the Delaware General Corporation Law to obtain company books and records to aid in drafting a complaint that may withstand a *Corwin* defense.

This practice was recently condoned by the Court of Chancery in *Lavin v. West Co.* In that books-and-records action, the company's primary defense was that the merger had been approved by a disinterested, fully informed stockholder vote, and *Corwin* therefore would limit any post-closing challenge to waste claims, which were not a stated basis for the Section 220 inspection. The Court of Chancery rejected this argument, ruling that a *Corwin* defense was premature in a books-and-records action and would "invite defendants improperly to draw the court into adjudicating merits defenses to potential underlying claims." More recently, in *In re Tesla Motors, Inc. Stockholder Litigation*, plaintiff stockholders used the books and records they obtained through Section 220 to successfully plead that Elon Musk, a 22.1 percent stockholder and director of Tesla, exercised control over the company such that a *Corwin* defense was unavailable to the defendants. Notably, the Delaware Supreme Court has made clear that the *Corwin* doctrine is not new law but rather confirmation of "a long-standing body of [Delaware] case law" that stretches back for decades. However, the practical result of the recent Section 220 decisions that permit plaintiffs to obtain merger-related documents pursuant to the lowest possible burden under Delaware law to withstand a *Corwin* defense is that they depart from equally long-standing precedent that required plaintiffs to first state a claim before obtaining discovery relating to a deal.

Stockholders have also sought documents through appraisal proceedings, which have spiked in the past few years. Petitioners that seek appraisal obtain access to liberal discovery,

which, in light of recent case law suggesting that deal price is often the best evidence of appraisal value, includes discovery regarding the conduct of fiduciaries during the deal process. As a result, in some instances, appraisal actions have become less a valuation exercise and more a defense of the deal process itself. Petitioners can use such discovery not just in support of appraisal claims but potentially also to amend their pleadings to add breach of fiduciary duty claims on a classwide basis. Thus, some members of the plaintiffs' bar have taken to characterize appraisal actions as the "new Section 220," because it provides petitioners with broad access to discovery that can be used to investigate potential fiduciary wrongdoing. This approach has been somewhat tempered, however, by the Delaware Supreme Court's recent decisions regarding the appraisals of DFC Global and Dell. Those cases may disincentivize plaintiffs from bringing appraisal actions at all in situations involving arm's length transactions with good process, given that both *DFC Global* and *Dell* came out strongly in support of relying on deal price as the best evidence of appraisal value in such circumstances.

Plaintiffs Again Pursue Injunctions

Finally, although injunction applications in Delaware have become less frequent in the recent past, they still remain a possibility. For example, in the Court of Chancery's March 2018, decision in *Brigade Leveraged Capital Structures Fund Ltd. v. Kindred Healthcare, Inc.*, Vice Chancellor Sam Glasscock III denied a stockholder plaintiff's request for an injunction until additional disclosures were issued but agreed with the plaintiffs that the stockholders needed additional time to consider certain supplemental disclosures the company had made regarding the conflict of one director and how that conflict was handled. The court therefore provided the company the option to either postpone the stockholder vote by five days or to hold the vote open for an additional five days to afford stockholders additional time to consider whether to pursue appraisal.

In addition, in April 2018, New York Supreme Court Justice Barry Ostrager issued an order preliminarily enjoining Fujifilm's acquisition of Xerox Corp. in *In re Xerox Corp. Consolidated Shareholder Litigation*. On a preliminary record, the court found that the transaction disproportionately favored Fujifilm, which had presented Xerox's CEO with the opportunity to continue in his role after the merger. The court concluded that the two were aligned in consummating a deal entirely in Fujifilm's favor and so that the CEO could retain his position. In addition, relying on Delaware law, the court issued a mandatory injunction requiring Xerox to waive its advance notice bylaws so that Xerox shareholders could nominate a competing slate of directors at the company's upcoming annual meeting.

Notwithstanding the significant decrease in injunction proceedings in recent years, it is possible that others will follow the *Kindred Healthcare* and *Xerox* plaintiffs and take a chance on pursuing injunctions once again. However, at least in Delaware, this will be tempered by the application of *C&J Energy* in circumstances where no alternative bidder has emerged.

Key Takeaways

As litigants continue to navigate cases like *C&J Energy*, *Corwin* and *Trulia*, the deal litigation landscape continues to develop and evolve.

- In federal court, some plaintiffs have brought post-closing Section 14(a) and Section 20(a) actions for money damages in an effort to put greater litigation pressure on companies, thereby potentially extracting a higher settlement value if their claims survive a motion to dismiss.
- In Delaware, despite the decreased availability of discovery, stockholder plaintiffs continue to see new ways to attack the adequacy of the disclosures issued in connection with a transaction as well as the applicability of defenses like *Corwin*. The increase in books-and-records requests, and the resulting case law that recently has developed in cases such as *Lavin*, show that a *Corwin* defense may not necessarily be a cure-all for merger challenges and in any event will not foreclose stockholder plaintiffs from obtaining access to discovery.
- Although the opportunity to seek broad discovery in appraisal actions has, theoretically, always been available to plaintiffs, the recent uptick in appraisal actions, along with the rise of the defense that deal price is the best indication of appraisal value, has prompted the plaintiffs' bar to use appraisal actions as a vehicle for accessing discovery for the purpose of investigating fiduciary duty based claims. Following the Delaware Supreme Court's decisions in *DFC Global* and *Dell*, which may have the effect of reducing the number of appraisal proceedings, it is unclear whether plaintiffs will recalibrate further and seek discovery in additional ways.
- These developments underscore the importance for companies to carefully assess appropriate disclosures issued in connection with any transaction, even if it appears that serious challenges will not be pursued preclosing, to equip them with their best defenses (including a strong *Corwin*-based defense) in any potential post-closing money damages actions.
- Finally, although it may seem as though injunctions are largely a thing of the past, they are not entirely extinct, and it remains to be seen whether a subset of plaintiffs will step in to take advantage of the clear lack of competition for injunctions, either in Delaware or, as in *Xerox*, in state courts outside of Delaware.