BUSINESS LAW TODAY

Delaware Insider:

Trulia and the Demise of "Disclosure Only" Settlements in Delaware

By Peter J. Walsh Jr. and Aaron R. Sims

In *In re Trulia, Inc. Stockholder Litigation*, 2016 WL 270821 (Del. Ch.), the Delaware Court of Chancery announced that it will no longer approve "disclosure only" settlements absent certain conditions. Going forward, the supplemental disclosures supporting a proposed settlement must address material misrepresentations or omissions, and the release defendants obtain in return must be narrowly tailored to the claims relating to the disclosures. Although the court's criticism of disclosure settlements has been intensifying for some time, *Trulia* represents the most definitive statement to date of the court's intention to carefully scrutinize and, when appropriate, reject settlements of stockholder class actions when the settlement consideration does not include any monetary recovery for the class.

The History of Disclosure Only Settlements in Delaware

Historically, the court has routinely approved so-called "disclosure only" settlements in stockholder class actions, in which the company and director-defendants obtain a broad release of known and unknown claims in exchange for their agreement to include in the proxy statement additional disclosures in advance of the stockholder vote on the transaction. Often, these additional disclosures were of questionable value, and only added to already lengthy proxy statements. Nevertheless, this historical treatment of disclosure only settlements created an expectation among counsel that such settlements were appropriate and would continue to be approved by the court. That expectation likely fueled the filing in Delaware of many cases challenging deals that might otherwise have appeared free from criticism. For plaintiffs' counsel, the prospect of a disclosure only settlement presented the opportunity for a hefty fee. Defendants, on the other hand, could avoid the cost and distraction of litigation and, as importantly, obtain a broad release. As the court once noted, this "peppercorn and a fee" approach offered defendants the opportunity to secure so-called deal insurance by paying a relatively small fee in relation to the overall magnitude of the deal. *Solomon v. Pathe Commc'ns Corp.*, 1995 WL 250374, at *4 (Del. Ch.), *aff'd*, 672 A.2d 35 (Del. 1996).

But, as M&A litigation proliferated and disclosure settlements became the norm, the myriad problems associated with this approach became apparent. At the forefront was the issue of what the court has described as "divided loyalties." *In re Riverbed Tech., Inc. S'holders Litig.*, 2015 WL 5458041, at *3 (Del. Ch.). Specifically, plaintiffs' counsel and the putative class representatives were disincentivized from diligently investigating claims on behalf of the class in favor of the pursuit of a generous fee by reaching a quick and virtually painless settlement. Of course, this fee would likely be less than counsel might recover if successful on the merits, but it was far more certain. In addition to paying this fee, defendants would also agree to provide nonmonetary "therapeutic benefits" in the form of (often immaterial) supplemental disclosures to the proxy materials. The real benefit to defendants was the inclusion of a broad release of all claims in the settlement agreement filed with the court. The problem created was that the overall scope of the claims release was largely a mystery because plaintiffs' counsel were highly disincentivized to "dig in" and ferret out real potential claims. See, e.g., *In re Rural/Metro Corp. S'holders Litig.*, 102 A.3d 205, 263 (Del. Ch. 2014), *aff'd sub nom. RBC*

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Capital Mkts., LLC v. Jervis, __ A.3d __, 2015 WL 7721882 (Del.).

The Court Reevaluates Its Approach to Disclosure Only Settlements

It was this great "unknown" that prompted the court to begin reevaluating its approach to disclosure settlements. Unable to gauge the real value of what the class was being asked to surrender, the court struggled with such settlements, as it was effectively deprived of an adversarial venue in which to meaningfully probe the true value of the disclosures. As these settlements became more and more frequent, the court became increasingly unwilling to "take that leap of faith" necessary to approve them. *Haverhill Ret. Sys. v. Asali*, C.A. No. 9474-VCL (Del. Ch. June 8, 2015), transcript at 20. In an early attempt to address this concern and "right the ship" of disclosure settlements, Vice Chancellor Laster articulated an approach to monetize the value of supplemental disclosures based on the significance of the benefits conferred, and thereby "[e]stablish[] baseline expectations" on the fee awards. *In re Sauer-Danfoss Inc. S'holders Litig.*, 65 A.3d 1116, 1136 (Del. Ch. 2011) (citing several earlier Chancery decisions attempting to establish uniformity in fee awards for comparable types of disclosures). While *Sauer-Danfoss* succeeded in creating some uniformity in disclosure settlement fee awards, it did not (nor was it necessarily intended to) strongly discourage disclosure settlements.

Beginning in about 2013, however, the court began to reject disclosure settlements due to its unwillingness to take that "leap of faith," and, even when the court reluctantly approved such settlements, it did so only after expressing grave reservations. See, e.g., *In re Transatlantic Holdings Inc. S'holders Litig.*, 2013 WL 1191738 (Del. Ch.). Slowly, the tide in opposition to disclosure only settlements began to rise and ultimately reached the high water mark in *Trulia*.

Trulia and the New "Plainly Material" Standard

With the issuance of *Trulia*, the court appears to have put its foot down and said "enough is enough." Chancellor Bouchard makes clear in his decision that, going forward, if litigants elect to resolve disclosure claims in stockholder class actions through the "historically trodden but suboptimal path of . . . a Court-approved settlement, [they] should expect that the Court will continue to be increasingly vigilant in applying its independent judgment to its case-by-case assessment of the reasonableness of the 'give' and 'get' of such settlements in light of the concerns" discussed above. *Trulia*, 2016 WL 270821, at *10. The court announced that future disclosure settlements would be scrutinized under a "plain[] material[ity]" standard. Specifically, "disclosure 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 sales process, if the record shows that such claims have been investigated sufficiently." In expounding this "plainly material" standard, the court stated that it "should not be a close call that the supplemental information is material as that term is defined under Delaware law."

It remains to be seen how this "plainly material" standard will be applied in practice and whether some may argue that it differs from the "materiality" standard under which the court would normally analyze disclosure claims outside the context of a settlement. Practitioners can expect, however, that, in applying this plain materiality standard to evaluate proposed supplemental disclosures, the court could request additional briefing or even appoint an amicus curiae. The court could also rely on these tools to aid it in assessing the scope of the releases and the quality of the claims released. See, e.g., *In re Intermune, Inc. S'holder Litig.*, Consol. C.A. No. 10086-VCN (Del. Ch. Dec. 29, 2015), transcript at 7, 8–9.

So, if the *Trulia* decision has put the kibosh on disclosure only settlements, what are the alternatives for presenting potentially meritorious disclosure claims? First, a preliminary injunction motion presents an opportunity for the court to consider the merits of disclosure claims "in an adversarial process where the defendants' desire to obtain a release does not hang in the balance." *Trulia*, 2016 WL 270821, at *9. Plaintiffs are unlikely to pursue such a path all the way to a court decision, however, unless they have confidence in the strength of their claims. Second, defendants can seek to moot disclosure claims by supplementing a proxy statement with additional information, without the agreement of the plaintiff who has raised or asserted the disclosure claims. Although this course of action would not result in defendants obtaining the broad release that they covet, mooting disclosure claims would likely have the practical effect of ending the litigation through the dismissal by plaintiffs of the remaining breach of fiduciary duty claims without prejudice to the other members of the putative class. Plaintiffs' counsel could then elect to petition the court for a mootness fee award, thus preserving for the court an adversarial venue in which to ascertain the merit of the disclosures for purposes of fixing the fee amount.

Trulia's Likely Impact in Delaware

Although *Trulia*'s practical impact has yet to be seen, it likely spells the end of disclosure only settlements in Delaware. The court's increased scrutiny of disclosure only settlements will likely result in a decline in the filing in Delaware of lawsuits that were previously aimed at procuring such settlements. When plaintiffs feel that it is worth their time and effort to initiate class litigation in response to public company M&A deals, such lawsuits will likely be of higher quality than the "routinely fil[ed] hastily drafted complaints" that previously followed on the heels of the public announcement of virtually every deal. Another (perhaps intended) consequence of *Trulia* is that courts, attorneys, and litigants will likely

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focus more on creating tangible benefits or value for the class. Furthermore, defendants in stockholder class actions will no longer be able to purchase "deal insurance" and obtain global releases through issuing supplemental disclosures and paying a fee. Undoubtedly, the court's recognition that stockholders are not served by including in proxy statements the type of minutia that disclosure only settlements often provide is a positive development in the law. And, it is hoped, *Trulia* will help to maintain "Delaware's credibility as an honest broker in the legal realm." *Acevedo v. Aeroflex Holding Corp.*, C.A. No. 7930-VCL (Del. Ch. July 8, 2015), transcript at 66.

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ADDITIONAL RESOURCES

For other materials related to this topic, please refer to the following.

BLS Committee Newsletters

CGC In Sight

Corporate Governance Newsletter
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Deal Points

M&A Newsletter
Vol. 21 No. 1 Winter 2016

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Business Law Today

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By K. Tyler O'Connell, Emily V. Burton, and Julia B. Ripple

Vol. 25 No. 2 October 2015

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