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M&A Shareholder Litigation

Curbing Needless Notice Cost

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Shareholder litigation involving mergers and acquisitions (M&A) has received much attention by courts and commentators. Notwithstanding the increasing scrutiny, especially regarding the propriety and amount of plaintiffs' attorney fee awards, it remains almost inevitable that an entrepreneurial member of the plaintiff's bar will initiate litigation immediately following announcement of a proposed merger or going private transaction by a corporation. *See* Olga Koumrian, Shareholder Litigation Involving Mergers and Acquisitions, Cornerstone Research 1 (March 2014) ("For the fourth consecutive year, shareholders filed suit in more than 90 percent of M&A deals valued over $100 million."), available at http://bit.ly/1nqvwS4 (Cornerstone 2014 Report). Indeed, notwithstanding calls for reform, in some respects transaction-related litigation has increasingly, although begrudgingly, become accepted by companies as part of the cost of doing a public company M&A deal.

Many of these lawsuits are resolved through a so-called "disclosure-only" settlement — meaning that in return for settlement of the lawsuit, shareholders receive supplemental disclosures regarding the proposed transaction and nothing else. According to the most recent available data from Cornerstone Research, in 2012, 81% of the merger and acquisition shareholder suits that resulted in a settlement were disclosure-only settlements. *See* Robert M. Daines & Olga Koumrian, Shareholder Litigation Involving Mergers and Acquisitions, Cornerstone Research 1 (February 2013 Update), available at http://bit.ly/1l7ZKb4.

One practical aspect of disclosure-only settlements that has received little attention, however, is the practice of providing lengthy individual mailed notice of the disclosure-only settlement to class members, which results in additional (and largely unnecessary) costs that, depending on the number of beneficial owners requiring notice, can exceed tens of thousands of dollars.

Shareholder Suits

M&A shareholder suits are brought on behalf of a putative class of the target corporation's shareholders, and typically allege that members of the target's board of directors breached their fiduciary duties to shareholders. Theories of breach in these suits often include inadequate merger consideration, unreasonable deal protection terms, and failure to disclose material information to allow shareholders to cast fully informed votes whether to approve the merger.

Typical alleged material omissions include failure to disclose the criteria for including or excluding potential buyers, failure to disclose previous relationships of the acquiring company or the target company with the target's investment adviser, and failure to disclose details of the financial analysis or data underlying the fairness opinion. Claims also are often asserted against the acquiring company for aiding and abetting the alleged breaches of fiduciary duty based usually on nothing more than having entered into the acquisition transaction.

The typical timing and process followed by the parties to accomplish the disclosure-only settlement of M&A shareholder litigation bears on the question of reasonable notice of settlement to the shareholder class. State law and stock exchange regulations generally require that acquisitions must be approved by the target shareholders who also comprise the putative class of claimants in the M&A shareholder lawsuit. Prior to the scheduled shareholder vote on approval of the merger, the par-

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ties ordinarily will enter into a memorandum of understanding (MOU) setting forth the general terms of a proposed settlement, including the specific additional disclosures that will be provided to the shareholders as their settlement consideration, and providing for some limited discovery for plaintiffs' counsel to confirm the reasonableness of the settlement. Note: According to Cornerstone, M&A shareholder litigation was resolved through settlement or voluntary dismissal before deal closing on average in more than 75% of the challenged transactions over the past five years. *See* Cornerstone 2014 Report at 4.

Disclosure

Depending on the proximity of the MOU to the date of the scheduled shareholder vote, the agreed supplemental disclosures required by the settlement may take the form of a revised proxy statement or a Form 8-K release filed with the SEC (or both). Whatever form the additional disclosures take, the disclosure document typically will also explain that the additional disclosures are: 1) being provided pursuant to the terms of a proposed settlement of a lawsuit or lawsuits; and 2) not considered material by the defendants.

At the conclusion of confirmatory discovery, which often takes the form of limited document discovery and perhaps a deposition or two, the agreement reflected in the MOU will be reduced to a final settlement stipulation. While it is typical and usually non-negotiable that the target company, its merger successor or an insurer will bear the administrative cost of settlement notice to the class, the form and mechanism for providing settlement notice is often not set forth in the initial MOU.

Settlement Notice

The failure to consider the mechanism of settlement notice at this earlier stage usually leads to an incrementally greater cost of notice because the plaintiffs' counsel will often later insist that notice must be provided to the settlement class through individual mailed notice as opposed to some other, less costly, but equally effective notice mechanism. Given that courts routinely approve individual mailed notice of settlements as sufficient it makes sense for plaintiffs' counsel to insist on mailed notice to reduce the risk a court or objector may raise concerns as to the adequacy of notice. Similarly, defendants later may have less incentive to quibble over the form and cost of notice given the comparatively larger dollars involved in the negotiation of the plaintiffs' fee award. Notwithstanding, given limited corporate legal department budgets and the desire by insurers to save unnecessary costs, an early focus on the form of class notice may result in welcome incremental cost savings.

Notice Requirements

Given the typical process and timing of these settlements, there seems to be little incremental benefit to the settlement class to receive traditional individual mailed notice. The conclusion that individual mailed notice presents an unnecessary expense in the disclosure-only settlement context and that a lesser form of notice is both reasonable and defensible under the circumstances is premised on several considerations.

No Mail Notice Required

Individual mailed notice is not required for these types of class settlements under the Federal Rules of Civil Procedure (FRCP) or the rules of the Delaware Chancery Court, where many of these suits are filed. In the federal context, the disclosure-only settlement class is typically provisionally certified as a class under FRCP 23(b)(1) and/or (b)(2) with no opt-out rights. Shareholder notice in the context of a disclosure-only settlement is thus notice of both the certification of a settlement class as well as of the proposed settlement. Because the settlement class is certified as a Rule 23(b)(1) and (b)(2) non-opt out class, the FRCP requires only that the notice be "appropriate," *see* FRCP 23(c)(2)(A), and "reasonable," *see* FRCP 23(e)(1). It is not necessary that the notice meet the higher Rule 23(b)(3) class notice standard requiring the "best notice that is practicable under the circumstances," FRCP 23(c)(2)(B).

Unlike Rule 23(b)(3), where due process concerns are heightened because class members may be foregoing substantive rights to opt out and pursue individual claims, in the merger and acquisition disclosure-only settlement context there is no opt-out right and as a practical matter there is no individual claim to pursue after shareholders have voted and approved the proposed merger. Note, appraisal rights are a statutory remedy available to objecting stockholders in certain transactions to petition for an independent determination of the "fair value" of their stock as an alternative to the offered deal price. Demands for appraisal by stockholders dissatisfied with the terms of a merger are relatively rare. The settlement class notice usually will have no bearing on the decision to assert appraisal rights because notice of intent to do so is required to be made prior to the shareholder vote on merger approval.

Delaware Chancery Rule 23 largely tracks the federal rule concerning class definition and allows for notice of a settlement by "mail, publication or otherwise … as the Court directs[.]" There should be greater latitude for non-traditional notice mechanisms to be considered "appropriate" and "reasonable" in the circumstance of the disclosure-only settlement.

Disclosure-only Settlements

The settlement notice in the disclosure-only settlement context duplicates information that the settlement class has already received as part of the supplemental disclosures forming the basis of the settlement. Prior to class notice being distributed, the

settlement class has already been notified of the pending settlement and has received the settlement consideration — the supplemental disclosures.

Typically, the shareholder approval vote will have taken place, the merger will have been approved by a majority of the shareholders, and the merger transaction will have already closed before settlement notice is mailed to shareholders. Under these circumstances, the redundant disclosures are effectively moot. There is little benefit of mailed notice identifying disclosures concerning a vote that has already taken place on a merger that has closed and for which the shareholder has received consideration (both the merger consideration and settlement consideration). There is thus little practical incentive for a class member to object to the terms of the settlement or adequacy of notice and there exists real potential that the lengthy mailed notice will only serve to confuse former target company shareholders.

New Information

As a practical matter, the only new information to the M&A shareholder class in the settlement notice is the amount of the potential fee and expense award to plaintiff counsel. In practice, and as required by legal ethics, plaintiff counsel attorneys' fees and expenses are negotiated after the substantive terms have been agreed, either as an amount certain or as an agreement not to object to counsel's fees up to a particular amount. Notice of the potential fee and expense award does not justify the extra expense of individual mailing.

Given that the fee and expense award has been negotiated and agreed by the parties there is again little practical incentive for a class member to object to the settlement on this basis. Moreover, the court serves as a check on the reasonableness of the plaintiffs' counsel's fee and expense award. Courts are increasingly scrutinizing plaintiff fee awards. Indeed, some courts have questioned the tangible benefit to the settlement class of disclosures purporting to serve as the basis of fee and expense awards. And Delaware Chancery Court judges have not been shy about voicing their concerns on proposed fees, as evidenced most recently by Chancellor Strine's widely publicized criticism that a disclosure-only settlement presented for his approval concerning the acquisition of Talbots, Inc. benefited the attorneys more than shareholders they represented. *See* http://on.wsj.com/RpgjH5. Chancellor Strine subsequently has been confirmed as the next Chief Justice of the Delaware Supreme Court

Notice of class certification and settlement should be tailored to fit the particular case and circumstances. The FRCP recognizes that "[t]he characteristics of the [(b)(1) and (b)(2)] class may reduce the need for formal notice." Fed. R. Civ. P. 23, Advisory Committee Notes (2003). For instance, "[a] simple posting in a place visited by many class members, directing attention to a source of more detailed information, may suffice. The court should consider the costs of notice in relation to the probable reach of inexpensive methods." *Id*.

Traditional postage mailing and lengthy notice documents can be unduly expensive when considering printing, copying and mailing costs to shareholders. Rather than reflexively opting for the traditional mechanism of individual mailed notice, courts and counsel should consider embracing the flexibility in the rules for disseminating notice in M&A shareholder suits involving disclosure-only settlements.

Courts have increasingly begun to approve settlements that include electronic notice as a supplement to the traditional mechanism of notice. The American Law Institute has observed that electronic methods of notice are a suitable substitute in lieu of direct-mail notice to all identifiable class members when such notice does not make economic sense. *See* American Law Institute, The Principles of the Law of Aggregation, § 3.04 (2010).

M&A shareholder suits settled on a disclosure-only basis meet this criterion because they present an anomaly under the FRCP where notice of settlement is required even though the shareholder class already has been made aware of the information bearing most directly on the shareholders' interests — the fact of the settlement agreement and the disclosures that serve as the basis of the settlement.

Conclusion

The practice of individualized mailing of notice of disclosure-only settlements should be reconsidered by practitioners, parties and courts as uneconomical and impractical for the intended purpose. Indeed, the Securities and Exchange Commission (SEC) increasingly has allowed electronic disclosure of securities materials, and postal mail itself is increasingly an anachronism as a means of notice to security holders.

The bench and bar should consider providing notice of a settlement agreement to shareholders through alternative means that are cost efficient and effective at reaching the class members short of individual mailed notice. One cost effective and equally efficient notice mechanism model could be the issuance of a press release and/or Form 8-K directing shareholders to a website that would provide full details of the settlement. This form of notice would be far more cost efficient to a corporate defendant than individual mailing and is also defensible as reasonable and appropriate notice to shareholders under the circumstances. Enterprising counsel can surely identify other defensible notice mechanisms that present less cost and administrative burden that are consistent with the spirit and purpose of the applicable rules.

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