HUNTON & WILLIAMS

Client Alert

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Delaware Court Rejects Disclosure-Only Settlement of M&A Lawsuit

"'More, More, More' was a pretty bad disco song" and it is "not helpful to stockholders" either.

In one of his last bench rulings before becoming chief justice of the Delaware Supreme Court, Chancellor Leo E. Strine, Jr. recently refused to approve a "disclosure-only" settlement related to a merger in *In re Medicis*.[1] It is unusual for Delaware courts to reject settlements of M&A litigation, most of which are based on supplemental disclosures and do not involve an increase to the merger consideration or other changes to the terms of the merger agreement. In *Medicis*, however, Chancellor Strine refused to approve the settlement because he believed the supplemental disclosures did not support the release of claims being given by the stockholder class. While this means that the plaintiff could proceed with the litigation, Chancellor Strine's comments indicated that the plaintiff's claims had little chance of success. This result is potentially frustrating to defendants, which frequently enter into disclosure-only settlements to avoid the nuisance costs associated with handling these lawsuits post-closing. But it may also signal increased judicial scrutiny over the proliferation of lawsuits challenging M&A transactions from the newest member of the Delaware Supreme Court.

Background

The settlement involved the $2.6 billion acquisition of Medicis Pharmaceutical Corporation, a Delaware corporation ("Medicis"), by Valeant Pharmaceuticals International ("Valeant"). Upon the announcement of the merger, putative class action lawsuits were filed in Arizona and Delaware. After Medicis filed its proxy statement but before its stockholders meeting, it entered into a "disclosure-only" settlement with the plaintiffs. The supplemental disclosures included the following additional information relating to the merger:

- Medicis management's internal "probability-adjusted" projections, which were more optimistic than the internal projections included in the proxy statement but not shared with Medicis's primary financial advisor for purposes of its valuation analysis and fairness opinion;
- that certain standstill agreements with other potential buyers terminated upon the execution of the Valeant-Medicis merger agreement;
- that Medicis engaged an additional financial advisor in connection with a separate transaction discussed in the proxy statement;
- an explanation with respect to the emphasis placed by Medicis's primary financial advisor on certain valuation multiples;

[1] *See In re Medicis Pharm. Corp. S'holders Litig.*, Consol. C.A. No. 7857-CS, trans. ruling (Del. Ch. Feb. 26, 2014).

- clarification that Medicis's primary financial advisor would obtain a "financial" benefit in connection with the merger under a previously disclosed note hedge transaction that it entered into with Medicis; and

- that Valeant expected to realize cost synergies at an annual run rate of at least $225 million within six months of closing.

After the transaction was completed, the parties sought court approval of the settlement. Plaintiffs' counsel requested an attorneys' fee award of $400,000.

Court's Ruling

In his bench ruling rejecting the settlement, Chancellor Strine emphasized a point he has previously made about the materiality of disclosures.[2] In order to "alter the total mix of information," he said, a supplemental disclosure should "contradict[], not reinforce[], management's recommendation"[3]:

> As I've said before, most people would not employ lawyers to just … help them sleep better at night. Like, I thought I got a really good deal. Now I know I got an excellent deal, and I got to pay the people who sued saying I got a stinky deal.[4]

Put differently, he asked "How did this [disclosure] change the game?"[5]

Chancellor Strine noted that none of the supplemental disclosures resulting from the settlement had altered the total mix of information available to stockholders. Among other things, he explained that the new "more optimistic" projections did not suggest that the merger was underpriced. Similarly, he said the clarification that the hedge transaction would create a "*financial* benefit" for its counter-party was already evident in the proxy statement.[6] In addition, he noted that the buyer's estimated synergies were not available to Medicis's board of directors when it approved the transaction and seemed to question why the plaintiff had sought such disclosure.[7] Chancellor Strine also observed that Medicis stockholders voted overwhelmingly in favor of the merger.

Chancellor Strine did "applaud the candor" of plaintiffs' counsel for admitting that, following discovery, there was no basis to pursue claims that the board of directors had breached its *Revlon* duties.[8] He also acknowledged the "punishing effect" that his rejection of the settlement would have on the defendants,[9] which had settled the litigation to avoid the nuisance value of the lawsuit.

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[2] *See In re Coventry S'holders Litig.*, C.A. No. 7905-CS, trans. ruling (Del. Ch. Aug. 29, 2013); *In re Transatlantic Holdings Inc. S'holders Litig.*, Consol. C.A. No. 6574-CS, trans. ruling (Del. Ch. Feb. 28, 2013).

[3] *Medicis*, trans. ruling at 22.

[4] *Id.* at 8.

[5] *Id.* at 19.

[6] *See id.* at 10 ("What other kind of benefit would it have been when it was a derivative transaction?").

[7] *See, e.g., id.* at 15 ("I'm trying to figure out how it got into being something that you demanded. Did you allege in your complaint that the absence of the buyer's synergies was somehow a flaw?"); *see also id.* at 14 ("this isn't a … stock-for-stock merger …. And you can't go around and ask for reciprocal due diligence in a cash deal because they were cash buyers. The only thing you need to know is that we can write the check.").

[8] *Id.* at 18.

[9] *Id.* at 25.

> I recognize that there are costs to just dealing with these suits and that there are uncertainty factors, and that none of the information that was disclosed is anything that the defendants would have been worried about disclosing because it didn't contradict anything they had already told the stockholders.[10]

Nevertheless, Chancellor Strine concluded that the supplemental disclosures did not "alter the total mix of information" and, therefore, failed to support the release of claims being given by the stockholder class. In doing so, he observed that plaintiffs' ever-increasing demands for disclosure in M&A litigation needs to have limits: " 'More, More, More' was a pretty bad disco song," he said, and it is "not helpful to stockholders" either.[11]

Conclusion

Delaware courts do not typically reject settlements of M&A lawsuits, at least in the absence of an objector. But recently, several Delaware rulings suggest that the Court of Chancery is taking a closer look at M&A "strike suits" and disclosure-only settlements. For example, in *Talbots*, Chancellor Strine was quite skeptical of the value of the supplemental disclosures obtained by the plaintiffs, noting that the alleged disclosure violations would probably not have survived a motion to dismiss.[12] In awarding attorneys' fees of $237,500, he emphatically rejected the notion that Delaware law starts with the assumption that plaintiffs are generally entitled to at least $400,000–$500,000 in attorneys' fees for supplemental disclosures.

Similarly, Vice Chancellor J. Travis Laster recently stated that attorneys' fees awards for disclosure-only settlements may need to be "recalibrated."[13] In doing so, he noted that attorneys' fees awarded for disclosure-only settlements appear disproportionate to those given to plaintiffs' counsel who obtain monetary benefits for a stockholder class. Of course, it should also be noted that Vice Chancellor Laster has replaced class counsel where he believed meritorious claims were not being pursued aggressively.[14] He has also rejected a disclosure-only settlement based on an objection, which litigation ultimately led to a post-trial adjudication of liability.[15]

The widespread proliferation of M&A litigation has been clearly documented.[16] This litigation imposes costs on the transaction parties, stockholders, insurance carriers, and courts.[17] Plaintiffs have leverage in these cases through the threat of obtaining an injunction, but most of these cases simply have a nuisance

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[10] *Id.* at 18-19.

[11] *Id.* at 20-21.

[12] *See In re Talbots, Inc. S'holders Litig.*, C.A. No. 7513-CS, trans. ruling (Del. Ch. Dec. 16, 2013).

[13] *See In re Gen-Probe S'holders Litig.*, Consol. C.A. No. 7495-VCL, trans. ruling (Apr. 10, 2013); *see also In re Complete Genomics S'holders Litig.*, Consol. C.A. No. 7888-VCL, trans. ruling (Del. Ch. Oct. 2, 2013) (reducing requested fee award of $1.4 million to $315,000 and observing that "when I contrast this to the $500,000 that I awarded for a real money case that went through trial to an actual judgment … it is impossible for me to equate [this supplemental] disclosure with that type of benefit").

[14] *See In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940 (Del. Ch. 2010).

[15] *See In re Rural Metro Corp. S'holders Litig.*, C.A. No. 6350-VCL, mem. op. (Del. Ch. Mar. 7, 2014).

[16] *See* Cornerstone Research, *Shareholder Litigation Involving Mergers & Acquisitions: Review of 2013 M&A Litigation* (reporting that 94% of M&A transactions valued over $100 million involved stockholder litigation).

[17] *See generally* Steven M. Haas, *Little Deals, Big Fees? Addressing Attorneys' Fee Awards in Small-Cap M&A Litigation*, M&A LAWYER, May 2013 at 1.

cost if they are not settled before closing. From the defendants' perspective, providing additional information eliminates any threat of an injunction and provides closure on the litigation. Moreover, even minor supplemental disclosures (i.e., a "peppercorn") have typically provided sufficient consideration for releasing "weak" claims against defendants.[18] Thus, a rejection of a disclosure-only settlement can be frustrating to defendants.

Still, the plaintiffs' bar should take note of Chancellor Strine's remarks over the likely merits of the lawsuit. This was not a case where he believed strong claims were being settled for inadequate consideration. It is also important to remember that last year he upheld the legality of "exclusive forum" bylaws, which are intended to prohibit multiple plaintiffs from challenging the same transaction in different forums.[19] As more companies adopt these bylaws, Delaware courts will be better positioned to police abusive stockholder litigation. Also of relevance, a new academic paper concludes that there is no significant evidence that disclosure-only settlements affect stockholder voting.[20] All this may suggest that Delaware's newest chief justice might take a more aggressive approach in dealing with M&A lawsuits, the vast majority of which are viewed by companies and the defense bar as being without merit.

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[18] *See, e.g., Talbots*, trans. at 11.

[19] *See Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013).

[20] *See* Steven M. Davidoff et al., *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform* (Feb. 1, 2014 draft).