IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE TRULIA, INC. STOCKHOLDERS LITIGATION	Consolidated C.A. No. 10020-CB

BRIEF OF SEAN J. GRIFFITH AS *AMICUS CURIAE*

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I. PRELIMINARY STATEMENT

The Court has asked for supplemental briefing on two issues. The first is what standard to apply in evaluating the relief in a disclosure-only settlement. The second is how to evaluate the scope of the release granted in such settlements.

These issues cannot be considered in isolation or without reference to the broader context in which they have arisen: the explosion of lawsuits filed in the wake of merger announcements and the devolution of those claims into "ritualized quasi-litigation."[1] The ritual is now well known. Virtually every deal is challenged in litigation.[2] The vast majority of these cases end in settlement, but the payment of additional consideration to the shareholder class is vanishingly rare.[3] Instead, the typical settlement results in a package of supplemental disclosures for

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1 *In re Activision Blizzard, Inc. S'holder Litig.*, 2015 WL 2438067, at *34 (Del. Ch. May 21, 2015) (describing the problem of "routine disclosure-only settlements, entered into quickly after ritualized quasi-litigation, that plague the M & A landscape").

2 Matthew D. Cain & Stephen M. Davidoff, *Takeover Litigation in 2014* (Feb. 20, 2015), *available at* http://ssrn.com/abstract=2567902 (finding that 94.9% of mergers in 2014 attracted litigation).

3 Robert M. Daines & Olga Koumrian, *Shareholder Litigation Involving Mergers and Acquisitions* (Feb. 2013), at 6 (in 81% of merger cases filed in 2012, the only product of the settlement was additional disclosure).

which defendants receive a broad release, variously characterized by this Court as "global," "intergalactic," "solar-systemic," and "Jovian."[4]

The ritual is a problem for the shareholders of Delaware corporations, for the corporations themselves, and for the Court. Through it, shareholders are forced to trade potentially meaningful rights for essentially meaningless consideration and bear the cost through a deadweight loss to the cost of capital. Corporate defendants are faced with a "deal tax" on every transaction. And the credibility of the Court is undermined as it is transformed from a public forum for deciding cases and controversies on the basis of clear substantive and procedural rules into an agency charged with endorsing the product of an opaque private bargaining process, a role Lon Fuller characterized as "contract parasitic on adjudication."[5] It is only "when a party has a genuine claim of injury" that the "judicial process should be invoked."[6] The ritual undermines the integrity of Delaware law, implying that not only must judicial process be invoked in every

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[4] *Haverhill Retirement Sys.* v. *Asali*, C.A. No. 9474-VCL, at 38-39 (Del. Ch. Jun. 8, 2015) (Transcript) ("These global releases are always expansive by definition. The parties . . . are trying to make them global. They're trying to make them, as the Chief Justice calls them, intergalactic."); *In re Riverbed Tech. Inc., S'holders Litig.*, 2015 WL 5458041, at *14 n. 20 (Del. Ch. Sept. 17, 2015) ("Whether this particular release is indeed inter-galactic, or only, say, solar-systemic, Jovian or just global, it is a broad release of existing claims arising from the merger, known and unknown.").

[5] Lon L. Fuller, *The Forms and Limits of Adjudication*, 92 HARV. L. REV. 353, 408-409 (1978).

[6] *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 643 (Del. Ch. 2005).

announced merger, but also that there is no exit from such claims except settlement.

The devolution of merger litigation is not random or accidental. It is the systematic response of rational actors to the set of choices put before them. This choice set was created by practices that have effectively removed any substantial merit screen from merger cases. These practices can be summarized in two rough heuristics. First, if disclosure violations are alleged, then expedition is necessary to protect the shareholder franchise.[7] Second, if the parties have agreed to a settlement without obvious, smoky-room collusion, a "peppercorn" is sufficient consideration to approve the settlement and provide defendants a broad release.

The interaction of these two heuristics turns every merger case into a strong candidate for expedition and, because of the risk thereby created to the underlying transaction, a strong candidate for settlement. However, because no vigorous litigation has preceded settlement, it is highly unlikely that the resulting settlement will correlate to the untested merits of the case. "Sweetheart settlements," in which class counsel sell out meritorious claims to harvest an easy fee, and "strike

[7] As frequently noted, the ritual has become so expected in this respect that many cases are self-expedited by the parties even without the Court making such a determination.

suit settlements," in which class counsel file non-meritorious claims for nuisance fees, are equally likely.[8]

To address this nest of problems the Court should: First, recognize that changed circumstances no longer support present practices. Second, apply existing Supreme Court precedent to inject a meaningful merits filter at the time of settlement. Third, fashion a rule of proportionality between relief and release. Fourth, consider further procedural correctives to move the merit filter forward and encourage earlier termination of non-meritorious claims.

II. CHANGED CIRCUMSTANCES WARRANT RECONSIDERATION OF CURRENT PRACTICES IN MERGER CASES

Delaware courts must strike a balance between protecting shareholder rights through litigation while also providing corporate defendants with an early exit from non-meritorious claims. Although the relevant caselaw was designed with this balance in mind, current practices have lost this balance and resulted in a perversion of incentives in merger class actions.

Judicial involvement in class action settlements is a reflection of the fact that the party striking the settlement bargain—that is, class counsel—does not

[8] Bruce Hay & David Rosenberg, *"Sweetheart" and "Blackmail" Settlements in Class Actions: Reality and Remedy*, 75 NOTRE DAME L. REV. 1377 (2000).

in fact own the commodity that they are trading—shareholder rights.[9] The Court, therefore, is required to ensure the fairness of the settlement exchange from the perspective of the class interest.[10]

When approving class action settlements of merger litigation, this Court has frequently invoked Chancellor Allen's dictum in *Solomon* v. *Pathe Communications Corp.*[11] for the proposition that a "peppercorn" can be sufficient consideration for the class-wide release of claims.[12] But this invocation flips

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[9] Howard Erichson, *The Problem of Settlement Class Actions*, 82 GEO. WASH. L. REV. 951, 958 (2014) ("[A] lawyer negotiating a settlement class action is selling something that she does not have.").

[10] Ct. Ch. R. 23; *In re Activision Blizzard, Inc. S'holder Litig.*, 2015 WL 2438067, at *31 n. 26 (Del. Ch. May 21, 2015) (collecting cases framing the Court's role in reviewing and approving settlements for substantive fairness); William B. Rubenstein, *The Fairness Hearing: Adversarial and Regulatory Approaches*, 53 UCLA L. Rev. 1435, 1444 (2006) ("If class action attorneys sell out their clients, the judge should perceive that the settlement does not live up to the value of the claims and reject it accordingly. Conversely, if class action attorneys file a frivolous case, the judge should perceive that the settlement is merely a nuisance payment, reject it for that reason, and dismiss the case.")

[11] 1995 WL 250374, at *4 (Del. Ch. Apr. 21, 1995), *aff'd*, 672 A.2d 35 (Del. 1996).

[12] *Riverbed*, 2015 WL 5458041, at *5 ("To use the expression first made in this context by Chancellor Allen, the Plaintiffs have achieved for the Class a peppercorn, a positive result of small therapeutic value to the Class which can support, in my view, a settlement, but only where what is given up is of minimal value."); *In re Amylin Pharm., Inc. S'holders Litig.*, C.A. No. 7673-CS, at 28, 30 (Del. Ch. Feb. 5, 2013) (Transcript) ("I remember [Chancellor Allen] once approving a settlement that basically he approved it because virtually any peppercorn of value to the class would support the release because the claims were so insubstantial. . . . This settlement is skating through on the barest of margins."); *In re Talbots, Inc. S'holder Litig.*, C.A. No. 7513-CS, at 11, 15 (Del. Ch. Dec. 16, 2013) (Transcript) ("I'll approve this settlement on

Chancellor Allen's reasoning on its head and leads to the precise set of consequences that the Chancellor took pains to avoid. *Solomon* should no longer be invoked to support current practice in merger settlements. In fact, properly understood, *Solomon* provides the basis for a vital correction to current practice.

Solomon did not involve a settlement of any kind. Rather, the peppercorn dictum emerged in connection with the grant of a motion to dismiss.[13] The fact that the Chancellor granted the motion notwithstanding the applicable entire fairness standard demonstrates the broader context of the remark.

> It is a fact evident to all of those who are familiar with shareholder litigation that surviving a motion to dismiss means, as a practical matter, that economical rational defendants … will settle such claims, often for a peppercorn and a fee.[14]

Understood in context, the dictum highlights the Chancellor's concern that advancing litigation too easily beyond the motion to dismiss will result in pressure

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the Chancellor Allen peppercorn theory. . . . This is also, to be honest, the kind of case where I could have simply not approved the settlement . . . because the social utility of cases like this continuing to be resolved in this way is dubious.").

[13] *Solomon*, 1995 WL 250374, at *5 ("In my opinion the amended complaint weaves together a tangle of conclusions about fairness and coercion, etc., but the facts it alleges fail to state a claim.").

[14] *Id.* at *4. The Chancellor also cited an empirical study to the effect that stockholder litigation was "rare" at such time. *Id.* at n. 4 (citing Roberta Romano, *The Shareholder Suit: Litigation Without Foundations?*, 7 J. LAW, ECON. & ORG. 55, 59 (1991) ("Litigation frequency is one shareholder suit [for each sample company] every 48 years.")).

for defendants to settle without regard to merit, often for a simple payment to the lawyers on the other side.[15]

Solomon sought to arrest the advancement of non-meritorious litigation, not potentiate it. The Chancellor directly connected the approval of settlements involving non-meritorious claims with the "risk of strike suits."[16] Because "too much turns on the mere survival of the complaint," the Court must be careful to "apply the pleading test under Rule 12 with special care in such suits."[17] Thus, even under entire fairness, Chancellor Allen applied the dismissal standard with such "special care" that the complaint was dismissed, putting a damper on "strike suits."

The current usage of the peppercorn dictum is diametrically opposed to its origins. *Solomon* counseled special care to prevent non-meritorious suits from being settled for nuisance value. Yet the peppercorn dictum is now used to validate the settlement of merger litigation in precisely this context. *Solomon* did

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[15] *Solomon* did not address a system where, not only would there be a payment to plaintiffs' counsel without regard to merit, but also that the class would suffer a detriment in the form of a global release of the type common today. Chancellor Allen's searching inquiry at the motion to dismiss stage has a vibrant lineage in Delaware. Lawrence Hamermesh & Michael L. Wachter, *The Importance of Being Dismissive: The Efficiency Role of Pleading Stage Evaluation of Shareholder Litigation*, Widener University Delaware Law School Legal Studies Research Paper Series no. 15-16 (Working Paper Draft of August 19, 2015), *available at* http://ssrn.com/abstract=2646861.

[16] *Solomon,* 1995 WL 250374, at *4.

[17] *Id.*

not validate a peppercorn as fair consideration for a global release. Yet the peppercorn dictum is recited as though it did. *Solomon* emphasized the role of the Court in injecting a meaningful filter for merit in the litigation process. Yet the peppercorn dictum, as now deployed, sidesteps any searching review of the merits of the claims being settled.

It may be that in a world where not every transaction is challenged and the parties have the time and inclination to actually litigate the motion to dismiss that the Court can trust that the parties have distilled the case to something correlating to its merits before reaching the settlement stage. This, however, is not our world. Nearly every deal is challenged and virtually all cases are settled before the motion to dismiss because of timing pressures created by the underlying transaction.[18] Being true to *Solomon* means recognizing how litigation is being used to extract nuisance settlements and taking "special care" to inject a meaningful filter for merit to prevent it. This means adapting the law to changed circumstances as we discuss below.

[18] Daines & Koumrian, *supra* note 3, at 5 (noting that, in their study, "settlements occurred before the deals closed and an average of 42 days after the lawsuit was filed").

III. THE LAW SHOULD ADAPT TO THE CHANGED CIRCUMSTANCES BY REFINING THE TWO ISSUES IDENTIFIED BY THE COURT

Given the changed circumstances, revisiting the two issues on which the Court has requested this supplemental briefing is critical to ensuring that this Court is not used for ritualized quasi-litigation.[19] As to the first issue, the Court should (in fact is required by existing Supreme Court precedent to) apply a substantial merits filter at settlement. As to the second issue, releases should follow an equitable rule of proportionality. Finally, the Court should consider further procedural correctives to move the merits filter forward in the litigation process.

A. Existing Supreme Court Precedent Requires a Substantial Merits-Filter at Settlement

1. *Dann* Is Applicable

The Supreme Court has provided the necessary framework to ensure that the Delaware Courts will only be used to further legitimate stockholder interests in representative litigation by ensuring a merits review even in settled cases. This rule requiring substantial merits review at settlement and usually

[19] *Cox*, 879 A.2d at 643 ("Particularly in the representative litigation context, where there are deep concerns about the agency costs imposed by plaintiffs' attorneys, our judiciary must be vigilant to make sure that the incentives we create promote integrity and that we do not, by judicial doctrine, generate the need for defendants to settle simply because they have no viable alternative, even when they have done nothing wrong.").

attributed to *Chrysler* v. *Dann*[20] is still good law, both in the technical sense and in the sense that it promotes the right policy balance. The Supreme Court anticipated the issues that could arise if representative litigation could be brought and settled without a substantial merits filter and decisively imposed such a filter by setting a "bottom guardrail" that claims must have a reasonable probability of success to form the basis of a settlement.[21] In a disclosure-only settlement, that filter means the Court must determine in connection with settlement approval that there was a reasonable likelihood of success on the merits—that is, an injunction would have issued to force disclosure of the material information.

The *Dann* action (which term we use to refer to the entire action, encompassing all nine decisions) that ultimately resulted in the *Chrysler* v. *Dann*[22] decision ("*Chrysler*") was bifurcated into the approval of the settlement and the analysis of attorneys' fees. The approval of the settlement led to the Supreme Court decision of *Hoffman* v. *Dann* ("*Hoffman*")[23] while *Chrysler* announced the

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[20] 223 A.2d 384 (Del. 1966). The rule requiring merits review at settlement that is often attributed to *Chrysler* v. *Dann* must be understood as part of the series of decisions issued in that case, most notably, *Hoffman* v. *Dann*, 205 A.2d 343, 345 (Del. 1964), *cert. denied* 380 U.S. 973 (1965). In all, there are eleven decisions involving the same set of facts, nine of which are from the same consolidated civil action.

[21] The Supreme Court in *Rome* v. *Archer*, 197 A.2d 49 (1964), had already set a "top guardrail" such that, if strong claims were being sacrificed for inadequate consideration, then a settlement would be rejected.

[22] 223 A.2d 384 (Del. 1966).

[23] 205 A.2d 343, 345 (Del. 1964), *cert. denied* 380 U.S. 973 (1965).

decision on fees. Read together, the cases clearly demonstrate that the Supreme Court established a rule requiring robust merits review in representative litigation and required the rule to be applied before a case could be a candidate for settlement.

In the settlement approval phase of *Dann*, the parties and the Court of Chancery went through an extensive process to make the determination that there was at least one meritorious claim that could be settled. The plaintiffs engaged in "fairly extensive discovery" before settlement which was followed by confirmatory discovery which also "proved to be elaborate."[24] After confirmatory discovery, the settlement was put to a stockholder vote and approved.[25] Then "the Chancellor appointed an *amicus curiae* to report to him on the relevant issues to be tendered at the hearing on the proposed settlement."[26] The *amicus* "filed an elaborate report with the Chancellor analyzing the evidence of record and suggesting other areas in which additional proof might be desirable."[27] The Court compelled "certain of the knowledgeable defendants and other witnesses . . . to appear [at the settlement hearing] for the purpose of testifying."[28] In light of this collective investigation,

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[24] *Id.*
[25] *Id.*
[26] *Id.*
[27] *Id.*
[28] *Id.* at 447.

the Court "concluded that the record is sufficient for present purposes."[29] With the exception of the pre-settlement discovery, all of this incredibly extensive investigation and review was designed to help the Court make the necessary findings that at least one meritorious claim had been made that could provide a basis for the settlement and that no claims were too strong to give up in the release.[30]

At the settlement hearing, the Chancellor reviewed the fairness of the settlement with input from the parties, the *amicus* and various objectors, evaluating "the probability of success if these issues were ultimately litigated" and not "mak[ing] a final determination."[31] Various objectors argued that since none of the claims had any merit, the settlement should not be approved.[32] With respect to these objections, the Chancellor assessed the merits of each of the claims made in the complaints, finding all but one "worthless" and thus incapable of forming the basis of a settlement.[33] One objector attacked the settlement from the other

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[29] *Dann* v. *Chrysler*, 198 A.2d 185, 193 (Del. Ch. 1963).

[30] We are not suggesting this level of investigation would be required in today's merger litigation. In fact, a merits review of disclosures at settlement will not require any more record development than is created in the ordinary course, as discussed further in Section III.A.3 below.

[31] *Dann* v. *Chrysler*, 198 A.2d at 193 (Del. Ch. 1963).

[32] *Id.* at 190 ("[This group of objectors] contend[s] that the proposed modification of the incentive compensation plan is merely a device agreed upon by the proponents by which the defendants may avoid what plaintiffs' attorneys are said virtually to concede are worthless claims.").

[33] *Hoffman*, 205 A.2d at 351.

direction, arguing that valuable claims were not being pursued and the Court applied the same standard, finding none had a reasonable probability of success.[34] Thus, the Chancellor found that the settlement was in the Goldilocks zone where there was at least one claim that had enough merit to form the basis of a settlement and none that were too valuable to be released for the proffered consideration.

In *Hoffman*, the appeal of the Chancellor's decision approving the settlement (but reserving judgment on attorneys' fees), the only matter in play was merit. The litigants took the whole range of positions available: (i) all of the objectors except one argued there was no merit to any claims and thus should be no settlement; (ii) the plaintiffs and defendants took the position that one claim had sufficient merit to justify the settlement;[35] and (iii) the remaining objector argued that there were many claims with substantial merit that outweighed the settlement consideration. Following an "extensive hearing upon the fairness of the proposed settlement," the Chancellor found merit in only one claim, without which the Supreme Court held that the settlement would have been "nothing more than a

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[34] *Id.* at 346.

[35] Defendants later changed their position and tried to argue in *Chrysler* that even the one claim forming the basis of the settlement had no merit. *Chrysler*, 223 A.2d at 388 ("This argument is made in the face of Chrysler's position at the hearing on the settlement to the effect that the change in the Plan was the primary consideration for the settlement."). It is in part because of this switch that the Court in *Chrysler* takes the step of highlighting the necessity of finding merit in the settlement phase and reiterating the fact that it had done so in *Hoffman*.

buying-off of the plaintiffs for the dismissal of worthless claims . . . an undesirable [practice that] Rule 23(c)[36] . . . was, we think, specifically designed to end."[37]

Thus, the Supreme Court in *Hoffman* held that in order to discourage non-meritorious claims, a finding of merit was required in all settlements analyzed under Rule 23. This essential finding of merit was reiterated in *Chrysler*,[38] where the Supreme Court put a further gloss on the applicable merits standard, holding that "[a] claim is meritorious within the meaning of the rule if it can withstand a motion to dismiss on the pleadings if, at the same time, the plaintiff possesses knowledge of provable facts which hold out some reasonable likelihood of ultimate success."[39] In the context of claims underlying disclosure settlements, directed at

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[36] The Rule referred to outlines the Court's role in supervising the class action process as a fiduciary with respect to voluntary terminations of the litigation through dismissal or settlement. The then-effective Rule 23(c) is analogous to today's Rule 23(e). *Hutchison* v. *Bernhard*, 220 A.2d 782, 783 (Del. Ch. 1965) ("[T]o allow a dismissal in this situation without court control would make possible one of the very abuses sought to be controlled by the notice requirement of [Rule 23(c)], i.e., the buy-off of an objector without regard to the rights of the stockholders generally."); *cf.* Ct. Ch. R. 23(e).

[37] *Hoffman*, 205 A.2d at 352. This point was renewed in *Allied Artists Picture Corp.* v. *Baron*, 413 A.2d 876, 879 (Del. 1980) ("[T]his Court has been concerned with discouraging baseless litigation (see [*Chrysler*]) and has adhered to the merit requirement.").

[38] *Chrysler*, 223 A.2d at 388 ("[T]he settlement was approved by the Chancellor and by this Court on appeal . . . a holding that at the time of suit the cause of action with respect to the Plan had merit.").

[39] *Id.* at 387.

achieving an injunction, the disclosures would have resulted in the imposition of an injunction because it was reasonably probable that the disclosures were material.[40]

This standard, employed in the *Hoffman* approval of a settlement under Rule 23 and phrased in this way in the subsequent fees context in *Chrysler*, has never been overruled by the Delaware Supreme Court. There are many cases where the "bottom guardrail" does not come into play and the Supreme Court (or Court of Chancery) is tasked only with reviewing whether the "top guardrail" is an issue, such as the still oft-cited *Rome* v. *Archer*[41] and *Polk* v. *Good*.[42] In those cases, where it is not a question that the claims had merit and the issue is whether the claims are so strong they should have resulted in a greater settlement, the Court naturally does not address the bottom guardrail put at issue in *Dann* by the objectors who argued that the settlement could not be justified if there were no underlying meritorious claims. *Dann* is, so far as we are aware, the only Supreme Court adjudication of the bottom guardrail.

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[40] *Stroud* v. *Grace*, 606 A.2d 75, 85 (Del. 1992) (holding that the board is required to disclose only material information and "is not required to disclose all available information"). The materiality standard requires that the facts in question "would have been viewed by the reasonable investor as having significantly altered the total mix of information available." *Id.* (internal citations and quotations omitted).

[41] 197 A.2d 49 (Del. 1964).

[42] 507 A.2d 531 (Del. 1986). In *Polk*, the suit had already passed the merits screen of a motion to dismiss prior to the stockholder vote. *Id.* at 535.

Rome v. *Archer* in particular should not be read to be inconsistent with *Dann*. *Rome* is cited favorably in *Hoffman*.[43] Moreover, *Rome* and *Hoffman* were decided by the same Court (C.J. Wolcott and J. Carey being two of the three justices in each case) just ten months apart.[44] *Hoffman* and *Chrysler* (both decided by the same three justices) make it clear that the omission of a bottom guardrail in *Rome* was not meant to validate the settlement of non-meritorious cases.

Cox Communications[45] is consistent with applying a bottom guardrail in today's merger litigation. *Cox* contains an analysis of *Chrysler*, arising from the Court's request for supplemental briefing as to its applicability.[46] Unfortunately, the parties and the objector in *Cox* did not analyze the critical *Hoffman* decision and bring the fuller context to the attention of the Court in their supplemental briefing, and the Court did not discuss it in its reasoning.[47] This was probably because *Cox*, like *Chrysler*, involved the fees aspect of a bifurcated analysis in which the settlement had been approved separately. The objector, the litigant most likely to raise the issue and argue that the claims failed the "bottom guardrail" was

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[43] *Hoffman*, 205 A.2d at 352.

[44] *Rome*, 197 A.2d at 49, was decided January 14, 1964; *Hoffman*, 205 A.2d at 343, was decided November 17, 1964.

[45] 879 A.2d 604 (Del. Ch. 2005).

[46] *Id.* at 634-640.

[47] *See* C.A. No. 613-N, Letter from Kevin G. Abrams to VC Strine (May 16, 2005); Letter from Norman M. Monhait to VC Strine (May 16, 2005); Letter from Stephen E. Jenkins (May 16, 2005). The Abrams letter cites *Hoffman*, but only in service of the argument that *Chrysler* did not require a merits filter at settlement because *Chrysler* only addressed fees.

not in an equitable position to do so because the objector had already "concede[d] that the settlement was favorable" and thus had no equitable standing to allege there was no merit to the claims favorably settled.[48] If the claim had no "pleading-stage viability" that issue should have been raised at the settlement approval stage and not acquiesced in by the objector.[49] Instead of applying the merits review only with respect to attorneys' fees in such a situation, the Court held, the interest in ensuring that the system did not generate "windfalls to attorneys . . . is protected in two other ways that are sufficient. Most important, of course, is the requirement that the court examine the substantive fairness of a proposed settlement itself."[50] In other words, issues of merit should be addressed at the settlement approval stage and not only the fee aspect.

Perhaps most importantly, the type and frequency of merger litigation today was unknown at the time of *Cox* and its relatively recent arrival requires a flexible approach to this new variety of suit.[51] Further, the objector in *Cox* identified no harm to stockholders flowing from high fees paid to plaintiffs'

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48 *Cox*, 879 A.2d at 639.

49 *Id.* at 639 ("To have an objector come forward and concede that the settlement was favorable but contest the fee under [*Chrysler*] would be inequitable and serve no proper purpose.").

50 *Id.* at 639.

51 Matthew D. Cain & Steven M. Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465, 475 table I (2015) (showing that in 2005, just 39.3% of mergers faced a suit, staying around 40% until 2009, when the explosion occurred and 84.9% of transactions faced a suit).

counsel for unmeritorious litigation.[52] But today it has become clear that merger litigation has the deleterious effects noted above (cost of capital, release of unexplored claims, undermining the integrity of the judicial process).

2. *Dann* Is Balanced and Flexible

The *Dann* standard imposes the right balance. Under it, settlements can be lacking either because (i) the claims are too weak—that is, they have no reasonable probability of success and are thus being settled only for nuisance value or (ii) the claims are too strong and have a reasonable probability of success and recovery that is substantially greater than the relief received by the class in the settlement. In *Hoffman*, the settlement came under attack by objectors from both directions and the Chancellor only approved the settlement because it fell in the middle of these two guardrails -- the claims were not all too weak and none were too strong. Most settlements today would not pass the first test. It is also likely that some claims that would raise concerns under the second test do not see the light of day because of the speed with which they are ushered to settlement and shrouded from scrutiny by a broad release.[53]

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[52] *Cox*, 879 A.2d at 605 (approving fees in part because the objector had not identified any "plausible injury to the class from a fee award").

[53] The argument that objectors will come forward to assume leadership of the class in each case that could have strong claims assumes and blindly relies on the existence of a completely efficient market in the review of such claims such that in every case the unknown claims being released are accurately "priced." The *sine qua non* of an efficient market is efficient proliferation of information,

The standard applied in *Hoffman* and reiterated in *Chrysler* is flexible enough to address the current environment. The standard is couched as equal parts of a motion to dismiss and a reasonable likelihood of ultimate success, but was employed by both the Chancellor and the Supreme Court in a manner that more closely resembled the reasonable likelihood of success standard. In *Hoffman*, when the Court analyzed whether the objector who believed there were viable claims had shown the settlement to be unfair, it did not find each claim to be wholly without merit as would be required in a motion to dismiss setting.[54] While it found some of such claims to be so clearly without merit that they would not state a claim, it found that other claims having "doubtful merit" and "extremely doubtful probability" could be released fairly.[55] On the other hand, with respect to the one claim that supported a settlement, the Court found that it had "raised an

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so certainly there can be no efficient market in unknown claims about which there is no information.

[54] In fact, contrary to the Supreme Court's occasional intimation otherwise in *Hoffman*, the Court of Chancery had already noted in the decision below regarding the settlement phase that the claims would have withstood a motion to dismiss. "There is no doubt that in the technical sense many of the asserted claims would survive a motion to dismiss, assuming the defendants chose to press such a motion." *Dann* v. *Chrysler Corp.*, 198 A.2d 185, 201 (Del. Ch. 1963). In other words, even claims that could withstand a motion to dismiss were not necessarily meritorious enough to support the settlement. Instead only the one claim that had a greater, reasonable prospect of ultimate success formed the basis and allowed the settlement to not run afoul of the bottom guardrail.

[55] *Hoffman*, 205 A.2d at 348, 350.

issue of fairness" that had some "possibility of ultimate recovery."[56] Thus, the applicable standard is akin to a preliminary injunction merit standard and can be flexibly applied to take into account that settlements involve a compromise and not a final adjudication.

3. Applying *Dann* Is Efficient

The standard enunciated in *Chrysler* is efficient in balancing the state of the evidentiary record, the need for an effective merits screen and the importance of maintaining the efficiency of settlement. Merits review at settlement would not require a "mini-trial." The evidentiary record is sufficiently developed for the Court to make the merits assessment at the settlement stage without requiring further development of evidence. In a disclosure-only settlement, the plaintiffs have admitted that the vote was fully informed, leaving only the question whether the total mix of public information was substantially altered by the supplemental disclosures such that a preliminary injunction would have been necessary without the disclosures.[57] It is unlikely that more evidence would be pertinent to the relevant question.[58] The record is at least as developed at

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[56] *Id.* at 351.

[57] In this way, it is actually easier for the Court to look retrospectively and judge materiality as compared to the necessarily somewhat speculative judgment of materiality in a preliminary injunction context.

[58] Perhaps it would be useful for the defendants to produce to the Court a record of the proxy advisor's periodic vote tallying reports which could indicate whether supplemental disclosures had any effect on the vote as it came in.

the settlement stage is it would be at the preliminary injunction stage, and in those cases where there is confirmatory discovery, the record is more developed than it was at the preliminary injunction stage.

The reasonable probability of success standard is imposed by *Dann*, flexibly sets the right balance for the review of settlements and is efficient.

B. The Court Should Apply a Rule of Proportionality between the Settlement Release and Class Relief

The fiduciary character of the settlement exchange dictates that the exchange be substantively fair and, thus, proportional. But in today's merger litigation the relief and the release are far out of proportion. Bringing them back into an equitable balance would do a great deal to bring merger litigation to a socially useful equilibrium.

1. A Role for the Court in Evaluating the Release is Required by Rule 23

Rule 23 requires the Court to approve the settlement exchange and in that connection "the Court of Chancery must" find "that the settlement is intrinsically fair and reasonable."[59] The "give" (what is traded away by the class to the defendants) is not proportional to the "get" (what the class receives in settlement) in today's disclosure-only litigation, making it intrinsically unfair and unreasonable.

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[59] Ct. Ch. R. 23(e); *Goodrich* v. *E.F. Hutton Group, Inc.*, 681 A.2d 1039, 1045 (Del. 1996).

(a) The Customary Release is Overbroad

The rationale that weak claims can be released for weak consideration is flawed because in the typical release, unknown claims are released along with weak claims. The crux of knowing a claim is weak is having investigated the claim. One cannot investigate claims that are unknown. Accordingly, there is no sense in which unknown claims have been investigated.[60] One can have confidence only about the vetting of the disclosure claims in the typical case.

The scope of the release has historically been based on the idea that defendants are entitled to achieve complete peace, but this argument is flawed. In almost every case, there is no battle raging with respect to any other claims beyond disclosure and, perhaps, *Revlon*. In fact, if there were an ongoing skirmish, the plaintiffs in the other case would almost certainly act to carve out their litigation and the defendants would accede to the carve-out because it could not be substantively justified.[61] No Delaware Court is likely to approve the release of,

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[60] Here the Court must be mindful not to fetishize the volume of discovery as a good proxy for investigation. Validating settlements on the basis of a magic number of documents reviewed and depositions taken will incentivize parties to "teach/advocate to the test" and result in wasteful discovery. In other words, it would be inefficient to broaden the scope of investigation to match the scope of the release. Instead, the scope of the release should be narrowed to match the scope of the typical investigation which only vets disclosure issues.

[61] *See, e.g.*, *Shaev* v. *Adkerson*, 2015 WL 5882942, at *1 (Del. Ch. Oct. 5, 2015) ("The settlement [in a related case arising out of the same facts] purported to release all claims but, when Plaintiff objected to the settlement to the extent that

say, antitrust or securities claims that were the subject of an ongoing litigation in connection with a typical disclosure/*Revlon* suit. But this is precisely what happens in every case where a global release is approved.

A global release does not buy any current peace in the typical case because there are no other battles raging; in those cases where there are other battles, defendants are not entitled to roll those other claims into the Delaware litigation. The same should hold true for future battles on unexplored fronts. If defendants are entitled to peace on anything it is on the claims that have been asserted, not unfought battles.

Finally, the breadth of the typical release is far greater than the *res judicata* effect of a dismissal.[62] This has the perverse result that defendants can be better off for being sued and settling the claims as compared to not being sued at all or obtaining a dismissal through vigorous defense. This is effectively a windfall to defendants that should not be validated in a court of equity.

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it released her claims, Defendants agreed to 'carve out that claim from the release.'").

[62] "A standard global release also encompasses claims that could not have been litigated in the settled action, such as federal securities claims." *Brinckerhoff* v. *Texas E. Prods Pipeline Co., LLC*, 986 A.2d 370, 385 (Del. Ch. 2010) (citing *Matsushita Elec. Indus. Co.* v. *Epstein*, 516 U.S. 367, 386 (1996); *Nottingham Partners* v. *Dana*, 564 A.2d 1089, 1105 (Del. 1989)).

(b) The Customary Relief Is Illusory

The settlement bargain is frequently characterized as an exchange of supplemental disclosures for the release, but this is misleading. Even when plaintiffs' counsel does not trade away the release, there is a good chance that defendants will make any potentially important disclosures demanded by plaintiffs.[63] Material disclosures will either be mooted by defendants to remove the risk of injunction or, failing that, result in an injunction. The class, therefore, has vanishingly little to gain by their provision through settlement, especially when the concomitant tradeoff is netted out.

It is more accurate to say that the typical settlement relief consists of the provision of additional immaterial disclosures. Because they do not pose a serious risk of injunction, immaterial disclosures may not be provided voluntarily by defendants. As a result, plaintiffs can legitimately claim to have "won" these

[63] *See, e.g.*, *In re Novell, Inc. S'holder Litig.*, C.A. No. 6032-VCN (Del. Ch. Jun. 11, 2015) (Transcript) (argument over fees in relation to disclosures in situation in which defendants made demanded disclosures without release and case thereafter continued with respect to non-disclosure claims). Even in the absence of a settlement there is effectively no downside to the defendants to making such disclosures and a high upside in the form of eliminating the risk of an injunction and reducing the risk of quasi-appraisal to near zero. Given the ubiquity of supplemental disclosures there is also no reputational downside and given the nil impact of supplemental disclosures on voting outcomes, no risk that the disclosures will jeopardize the vote outcome.

disclosures in settlement.[64] But because immaterial information provides no benefit to the plaintiff class, allowing them to serve as consideration for a global release means approving a substantively unfair trade. In this context, it is unreasonable for the provision of disclosures to absolve defendants for any and all claims. Instead, providing disclosures can, at most, pay for the release of disclosure claims.

2. Releases Should Be Tailored to the Relief the Class Receives

The obvious way to correct the foregoing problems is to allow a disclosure-only settlement to release only disclosure claims. The scope of release is likely the most important variable to bringing merger litigation to a socially useful equilibrium. If the release is narrowed to Delaware disclosure claims only,[65] there will be no windfall to defendants in the form of a release that is broader than the *res judicata* effect of winning the litigation. The benefit of a settlement to defendants would be limited to eliminating injunction risk and reducing quasi-appraisal risk.

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[64] *See Bird* v. *Lida, Inc.*, 681 A.2d 399 (Del. Ch. 1996) (finding that a plaintiff could claim corporate benefit compensation for causing the resolution of a corporate problem without litigation, but only if the problem stated a legal claim not subject to Rule 12(b)(6) dismissal). If plaintiffs caused the resolution of immaterial disclosure violations without a lawsuit and settlement, they could never hope to be paid under *Bird*.

[65] We recognize the Court cannot actually "blue-pencil" particular releases. To reach the right equilibrium, parties would have to present narrowed releases that the Court could approve and the Court would have to reject overly broad releases.

In addition, under *Dann*, the parties can expect that even their disclosure settlement will face a real merits filter. That filter will mean that unless the settled disclosure claims had the requisite merit, defendants will lose even the limited scope of the disclosure release and plaintiffs' counsel will have no hope of payment. Understanding that a substantial merits filter awaits them at settlement anyway, defendants can be expected to impose the adversarial merits filter of an opposed motion to expedite or expedited motion to dismiss rather than rushing to settle.

Combined application of a proportionality rule with the *Dann* merit filter will nip many non-meritorious merger cases in the bud. This in turn will lead the parties to file fewer cases and to present fewer still for settlement, ultimately relieving the Court from wasting its resources on so many cases of dubious merit.

C. A Merits Filter at the Motion to Expedite Stage May Also Be Necessary

Timing exigencies in merger litigation may require further adjustment of other aspects of the merger litigation process in order to achieve the optimal set of litigation incentives. Because most merger litigation settles prior to closing, without briefing of a motion to dismiss, the only real opportunity to review the merits of a claim prior to settlement is at the motion to expedite stage. Unfortunately, the current standard applied at this procedural stage transforms most merger cases into excellent candidates for expedition, so much so that

defendants are self-expediting in recognition that they are unlikely to succeed in opposing the motion to expedite. In order to provide for a meaningful review of merits prior to settlement, the Court should consider revisiting the standard for a motion to expedite in merger cases.[66]

Currently, plaintiffs seeking an expedited hearing on the preliminary injunction motion need only demonstrate a "colorable claim and . . . a possibility of . . . irreparable injury."[67] This standard is even lower than a motion to dismiss.[68] When merger cases include disclosure claims, as they always do, plaintiffs will argue that failure to award expedition will subject shareholders to the irreparable harm of acting on the merger, either through voting or tendering their shares, without corrective disclosures. Acceptance of this argument without a tightened merits review all but guarantees expedition in merger cases.

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[66] *See* J. Travis Laster, *A Milder Prescription for the Peppercorn Settlement Problem in Merger Litigation*, 93 TEX. L. REV. SEE ALSO 129, 154 (2015) (advancing this argument as a proposal to correct the deficiencies of merger litigation) [hereinafter Laster, *Milder Prescription*].

[67] *Giammargo* v. *Snapple Beverage Corp.*, 1994 WL 672698, at *2 (Del. Ch. Nov. 15, 1994).

[68] *In re BioClinica, Inc. S'holder Litig.*, 2013 WL 5631233, at *4 n. 46 (Del. Ch. Oct. 16, 2013) ("The standard for a motion to expedite is 'colorability' and the standard for a motion to dismiss under Rule 12(b)(6) is 'reasonable conceivability[']–in my view, a higher, although still minimal, pleading burden.") (citations omitted); *Sinchareonkul* v. *Fahnemann*, 2015 WL 292314, at *1 n. 1 (Del. Ch. Jan. 22, 2015) ("'[T]he standard for expedition, colorability, which simply implies a non-frivolous set of issues, is even lower than the 'conceivability' standard applied on a motion to dismiss.'") (quoting *In re BioClinica*, 2013 WL 5631233, at *1 n. 1).

The "if there are disclosure allegations, then expedite" rubric, however, is no longer warranted because the threat of irreparable harm in merger cases is overstated. Empirical research demonstrates that supplemental disclosures do not affect shareholder voting.[69] One plain implication of this finding is that shareholders are not irreparably harmed when they do not receive these disclosures. Moreover, the availability of quasi-appraisal damages post-closing means that a remedy remains for material disclosure deficiencies and that failure to expedite the proceeding does not therefore result in "irreparable harm."[70]

Apart from the fact that irreparable harm is dubious in disclosure cases, many cases may still be resolved pre-closing. Confronted with a claim that does identify potentially material deficiencies in the proxy statement, defendants may choose to amend their disclosures in light of plaintiffs' complaint, potentially entitling plaintiffs to a mootness fee. This is a desirable outcome. Resolving

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[69] Jill E. Fisch, Sean J. Griffith & Steven M. Davidoff Solomon, *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 957 (2015) (demonstrating lack of correlation between disclosure settlements and voting outcomes).

[70] *Steiner* v. *Sizzler Rests. Int'l, Inc.*, 1991 WL 40872, at *2 (Del. Ch. Mar. 19, 1991) (stating that because quasi-appraisal remedy remained available, plaintiff would not be irreparably injured by closing of exchange offer); *In re Ocean Drilling & Exploration Co. S'holders Litig.*, 1991 WL 70028, at *7 (Del. Ch. Apr. 30, 1991) (holding that "the 'irreparability' of any harm caused by the defendants' conduct is limited to a large extent by the availability of the quasi-appraisal remedy"); *Taylor* v. *LSI Logic Corp.*, 1995 WL 405737, at *3 (Del. Ch. Jun. 19, 1995) (denying motion to expedite because quasi-appraisal remained available, as a result of which "the injury complained of by plaintiff may not be irreparable").

disclosure claims in a mootness hearing is preferable to resolving them at settlement for several reasons. First, mootness dismissals are significantly narrower than the scope of the typical settlement release. Mootness dismissals are confined to claims that have been finally resolved and, unlike settlements, do not purport to release any and all claims, known or unknown, arising from the underlying facts. Second, the mootness fee application is more likely to be adversarial,[71] which should help prevent windfall gains from being awarded to plaintiffs' counsel for immaterial disclosures, thereby reducing the incentive to file suits designed to harvest fees for insubstantial disclosures.

To accomplish this goal, the Court should consider raising the standard for expedition in merger litigation at least to the level that the Court customarily applies at the motion to dismiss.[72] The standard for expedition for a

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[71] When there is a settlement, if defendants dispute the benefit aspect of a fee application too vigorously, they run the risk of simultaneously showing the settlement to lack consideration, which would jeopardize their release. This quandary is not present in a mootness context.

[72] As described by Vice Chancellor Laster:

> [A] court can and should make a preliminary determination regarding the significance of the claimed disclosure violation…. [W]here the strength of the disclosure claim is dubious, a court is not required to bestow the leverage of an expedited proceeding on a stockholder plaintiff. A court rather can deny the motion to expedite and allow the defendants to evaluate the strength of the disclosure claim and, if they choose, moot it. If the defendants choose not to moot the claim, then the court can adjudicate the issue post-closing, with compensatory or rescissory damages as a potential

typical disclosure claim would thus require "plaintiffs [to] provide some basis for a court to infer that the alleged violations were material. For example, a pleader must allege that facts are missing from the statement, identify those facts, state why they meet the materiality standard and how the omission caused injury."[73] Moreover, in applying this heightened standard to merger litigation at the motion to expedite stage, the Court should be guided by the same considerations as Chancellor Allen in *Solomon*. Because so much depends upon the mere survival of the claim past this point, the Court must apply the merits test with special care in order to avoid encouraging strike suits. Indeed, it is likely that were the Court to apply this test with sufficient rigor at the motion to expedite phase, a point at which the Court benefits from adversarial briefing, it would be spared the task of making a merits determination later, at settlement, when it is usually deprived of it.

IV. CONCLUSION

The de-ritualization of merger litigation requires the injection of a meaningful merits filter. Although controlling Delaware Supreme Court precedent supplies the basis for such a filter at the time of settlement, recent practices have drifted away from applying it. Both doctrine and public policy provide compelling

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> remedy if the plaintiff succeeds in pleading and eventually proving an actionable breach of fiduciary duty.

Laster, *Milder Prescription*, 93 TEXAS L. REV. SEE ALSO at 156-157.

[73] *Malpiede* v. *Townson*, 780 A.2d 1075, 1086-87 (Del. 2001) (quoting *Loudon* v. *Archer Daniels Midland Co.*, 700 A.2d 135, 142 (Del. 1997)) (internal quotations omitted).

reasons for the Court to return to *Dann* in evaluating the relief received by the class in the settlement of merger litigation. The Court would also take important steps in de-ritualizing merger litigation if it fashioned a rule of proportionality between the relief received by the class and the scope of the settlement release and if it considered procedural nodes at which a meaningful merits filter might be inserted in the litigation process prior to settlement, such as at the motion to expedite.

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