Vindicating the Duty of Loyalty: Using Data Points of Successful Stockholder Litigation as a Tool for Reform

*By Joel Edan Friedlander**

The stockholder litigation reform agenda is currently shaped by the felt necessity of the time to eliminate forms of stockholder actions that typically had been settled for nominal relief soon after filing. The empirical rationale for this agenda gives insufficient attention to recent cases in which stockholder plaintiffs have obtained significant relief. This article discusses data points of successful stockholder actions and argues that commonalities among them suggest an alternative agenda for reform. In particular, these cases suggest that reform should focus on rejecting early settlements that lack the hallmarks of adequacy of representation—vigorous, adversarial litigation and arm's-length bargaining. These cases also illustrate the danger of under-deterrence from altering generally applicable legal rules to make it more difficult to finance, plead, or prove claims for breach of the duty of loyalty.

INTRODUCTION

It is well recognized that stockholder class actions challenging corporate transactions are often unproductive. Judge Richard Posner begins a recent opinion by observing that the term "deal litigation" is used "disapprovingly" to refer to cases challenging a public company acquisition that are brought "for the sole purpose of obtaining fees for the plaintiffs' counsel."[1] Stephen Bainbridge contends in a recent law review article that stockholder litigation involving mergers and acquisitions is a "problem [that] has reached crisis proportions."[2]

Judge Posner's opinion and Professor Bainbridge's article both seek to reform stockholder litigation. In reversing a district court's approval of a disclosure settlement (i.e., a form of class action settlement in which immaterial supplemental disclosures are the settlement consideration), Judge Posner writes that such cases are "no better than a racket" and "must end."[3] Bainbridge argues against stockholder litigation generally. He criticizes a recently enacted Delaware statute pro-

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1. *In re* Walgreen Co. S'holder Litig., 832 F.3d 718, 721 (7th Cir. 2016) [hereinafter *Walgreens*].
2. Stephen M. Bainbridge, *Fee-Shifting: Delaware's Self-Inflicted Wound*, 40 DEL. J. CORP. L. 851, 852 (2016).
3. *Walgreens*, 832 F.3d at 724.

hibiting fee-shifting bylaws because widespread adoption of fee-shifting bylaws might have "substantially reduced the volume and settlement value of shareholder litigation."[4]

Bainbridge relies heavily on two empirical studies of litigation outcomes. The first was published by Roberta Romano in 1991.[5] Bainbridge notes that Romano "found that shareholder-plaintiffs almost invariably lose those few suits that go to trial," that only half of the cases in her sample settled for a monetary recovery, and that the median monetary settlement was "only $2 million."[6] The second study, published by Cornerstone Research in early 2014, reported that "none of the 612 suits they studied went to trial and 'all judgments . . . were granted to the defendants.'"[7] According to Bainbridge, these results "suggest that the pervasive problem in this area is not breaches of duty by directors and officers but rather strike suits filed by the plaintiffs' bar."[8]

Cornerstone's 2014 data set cannot bear the weight of Bainbridge's conclusion. The data set is not all-encompassing, as it excludes certain forms of stockholder actions, such as derivative claims. The time period of Cornerstone's 2014 data compilation is problematic. Prior to 2014, judicial solicitude toward disclosure settlements incentivized the mass filing and quick settlement of cases without adequate investigation into whether breaches of fiduciary duty occurred. By the time Bainbridge published his article in 2016, that judicial solicitude in Delaware had collapsed. Additionally, subsequent to 2014, a number of stockholder actions resulted in significant damage awards for breach of fiduciary duty and/or aiding and abetting such breaches, or settled on terms sufficiently substantial to suggest a real risk of such judicial findings.

Consider the following results obtained in the Delaware courts in 2015:

(i) a $275 million settlement was approved in a class and derivative action challenging the transaction by which Vivendi S.A. divested its controlling stake in Activision Blizzard, Inc.;[9]

(ii) a $171 million post-trial judgment was entered in favor of limited partners challenging a "dropdown" transaction involving El Paso Pipeline Partners, L.P.;[10]

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4. Bainbridge, *supra* note 2, at 868.

5. *See id.* at 852–53, 861 (discussing Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. Econ. & Org. 55 (1991).

6. *Id.* at 861.

7. *Id.* (quoting Olga Koumrian, Cornerstone Research, Shareholder Litigation Involving Mergers and Acquisitions: Review of 2013 M&A Litigation 4 (2014)).

8. Bainbridge, *supra* note 2, at 861.

9. *In re* Activision Blizzard, Inc. S'holder Litig., 124 A.3d 1025 (Del. Ch. 2015) [hereinafter *Activision*].

10. *In* re El Paso Pipeline Partners, L.P. Derivative Litig., C.A. No. 1741-VCL, 2015 WL 1815846 (Del. Ch. 2015), *rev'd on other grounds sub nom.* El Paso Pipeline GP Co. v. Brinckerhoff, 152 A.3d 1248 (Del. 2016). Despite reversing the judgment due to the plaintiff's post-trial loss of standing, the Delaware Supreme Court noted that the Court of Chancery had issued a "well-reasoned" decision on the merits that "undertook a detailed analysis explaining why $171 million was a conservative estimate of the overpayment approved by the committee." 152 A.3d at 1250.

(iii) a $153.75 million settlement was approved in a derivative action arising out of two acquisitions by Freeport-McMoran Inc.;[11]

(iv) a $148 million post-trial settlement was approved after the Court of Chancery found in favor of stockholders challenging the going-private merger of Dole Food Company, Inc.;[12]

(v) $97.9 million was paid by a financial advisor to satisfy an affirmed post-trial judgment, on top of pre-trial partial settlements totaling $11.6 million paid on behalf of director defendants and a second financial advisor, in a class action that arose out of the acquisition of Rural/Metro Corporation;[13]

(vi) a $70 million settlement (net of attorney's fees) was approved in a class action arising out of the acquisition of Jefferies Group, Inc.;[14]

(vii) a $39.5 million settlement was approved in a class action arising out of the acquisition of Primedia, Inc.;[15] and

(viii) a $32.5 million settlement was struck in a class action arising out of a business combination involving Globe Specialty Metals, Inc.[16]

Other large monetary recoveries by stockholder plaintiffs are of recent vintage. In 2012, the Delaware Supreme Court affirmed a $1.263 billion post-trial judgment in a derivative action challenging Southern Peru Copper Corporation's acquisition of an affiliate, Minera Mexico.[17] In 2011 and 2012, the Delaware Court of Chancery approved large settlements in actions challenging the acquisitions of Del Monte Foods Company ($89.4 million),[18] El Paso Corporation ($110 mil-

11. *In re* Freeport-McMoran Copper & Gold Inc. Derivative Litig., C.A. No. 8145-VCN, 2015 WL 1565918 (Del. Ch. Apr. 7, 2015).

12. *In re* Dole Food Co., Inc. S'holder Litig., Cons. C.A. No. 8703-VCL, 2015 WL 5052214 (Del. Ch. Aug. 27, 2015) [hereinafter *Dole*].

13. *See In re* Rural/Metro Corp. S'holders Litig., C.A. No. 6350-VCL (Del. Ch. Jan. 12, 2016) (ordering distribution of funds in full satisfaction of final judgment); RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816 (Del. 2015) (affirming *In re* Rural/Metro Corp. S'holders Litig., 88 A.3d 54 (Del. Ch. 2014) (post-trial liability opinion); *In re* Rural/Metro Corp. S'holders Litig., 102 A.3d 205 (Del. Ch. 2014) (post-trial damages opinion)); *In re* Rural/Metro Corp. S'holders Litig., C.A. No. 6350-VCL, 2013 WL 6121822 (Del. Ch. Nov. 20, 2013) (approving partial settlement) [collectively, *Rural/Metro*].

14. *In re* Jefferies Grp., Inc. S'holder Litig., C.A. No. 8059-CB, 2015 WL 1414350 (Del. Ch. Mar. 26, 2015) [hereinafter *Jefferies*].

15. *In re* Primedia, Inc. S'holders Litig., C.A. No. 6511-VCL, 2015 WL 3401283 (Del. Ch. May 26, 2015).

16. Stipulation and Agreement of Settlement, *In re* Globe Specialty Metals, Inc. S'holders Litig., C.A. No. 10865-VCG (Del. Ch. Oct. 30, 2015) (subsequently approved Feb. 15, 2016).

17. *In re* S. Peru Copper Corp., 30 A.3d 60 (Del. Ch. 2011), *revised & superseded by* 52 A.3d 761 (Del. Ch. 2011), *aff'd sub nom.* Ams. Mining Corp. v. Theriault, 51 A.3d 1213 (Del. 2012).

18. *In re* Del Monte Foods Co. S'holder Litig., C.A. No. 6027-VCL, 2011 WL 6008590 (Del. Ch. Dec. 1, 2011) [hereinafter *Del Monte*].

lion),[19] and Delphi Financial Group, Inc. ($49 million).[20] Bainbridge's article does not note any of these twelve litigation outcomes.

Data points of successful outcomes for stockholder plaintiffs evidence the existence of a parallel universe of stockholder deal litigation that does not fit the characterizations of Posner and Bainbridge. This article proposes that stockholder litigation reforms be evaluated in light of data points of successful stockholder litigation, rather than by exclusive reference to aggregations of unproductive cases.

An obscure opinion by former Chancellor William T. Allen informs this article's approach. In 1993, he presided over a settlement hearing in a class action challenging two successive reverse stock splits at a small family-controlled company, Standard Industries, Inc.[21] The parties reached a proposed settlement four days before a scheduled trial. Under its terms, class members received $1,600 per share (instead of $600 per share) for the first reverse stock split and $25,600 per share (instead of $8,000 per share) for the second reverse stock split. The total settlement fund was approximately $2.5 million.

Chancellor Allen took the unusual step of issuing an opinion memorializing his approval of the unopposed settlement. He did so in order to inform academic empirical inquiry questioning the utility of stockholder litigation:

> I take the time now, after the fact, to briefly record the pertinent aspects of the case and of that ruling, simply to provide a data point for those occasional studies that attempt to estimate whether stockholder actions provide net social benefits. *See, e.g.*, Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. & ECON & ORG. 55, 58 (1991). Often our decision on a proposed class or derivative litigation is rendered orally from the bench. Insofar as the empirical study of the legal system is concerned such rulings are as words written on water. While there is no tragedy in this, I did suppose that this case represents one of those instances in which the judicial remedy afforded by Rule 23 worked to prevent abuse and to protect the set of investor expectations that encourage investment. Thus, while surely not conclusive of any system-wide generalization concerning the utility of shareholder suits, this case does present a paradigmatic example of the utility that this remedial device can have.[22]

Chancellor Allen's observation serves as a cautionary tale about how empirical analysis of litigation outcomes can be incomplete and misleading. Absent his written opinion, an empirical analyst might not notice the *Standard Industries* settlement, or might erroneously interpret the $2.5 million settlement fund as the payment of nuisance value to resolve a meritless suit.

19. *In re* El Paso Corp. S'holder Litig., C.A. No. 6949-CS, 2012 WL 6057331 (Del. Ch. Dec. 3, 2012) [hereinafter *El Paso*].

20. *In re* Delphi Fin. Grp. S'holder Litig., C.A. No. 7144-VCG, 2012 WL 3113652 (Del. Ch. July 31, 2012).

21. J.L. Schiffman & Co., Inc. Profit Sharing Trust v. Standard Indus., Inc., C.A. No. 11267, 1993 WL 271441 (Del. Ch. July 19, 1993) [hereafter *Standard Industries*].

22. *Id.* at *1.

Chancellor Allen's *Standard Industries* opinion also illustrates how successful stockholder cases share certain characteristics that provide insight into potential litigation reforms. Chancellor Allen noted a distinguishing characteristic of the case before him and other successful stockholder actions—the class representatives owned a relatively large stake in the company:

> It is notable that here as in other cases in which the class action mechanism works well (and steers safely between the rocks of a strike suit and the whirlpool of a sell-out) relatively substantial investors acted as real parties to the litigation and real clients to the attorneys prosecuting the suit. . . . Together, the three named plaintiffs will receive approximately 23 percent of the total estimated cash payment to the class . . . .[23]

This dicta suggested a path for reform, namely that corporate law should differentiate between suits filed by stockholders holding nominal stakes and suits filed by relatively large stockholders.

In this article, I focus on eight particular data points of successful deal litigation.[24] I have selected these eight cases because I know the underlying facts and procedural history, due to my personal involvement as plaintiff's counsel, and because seven of them were principally litigated in the Delaware Court of Chancery since 2001 and received an express judicial imprimatur respecting the result. The eight cases are:

- *Activision*, which settled less than one month before trial for $275 million and restrictions on the voting power and board influence of the CEO and the Chairman. In his opinion approving the settlement, Vice Chancellor Laster wrote: "The monetary consideration of $275 million is the largest cash recovery ever achieved [in a settlement] on stockholder derivative claims. The magnitude of the Settlement reflects that Lead Counsel advanced strong claims for breach of the duty of loyalty."[25] If the case had not settled, a "logical and plausible outcome" would have been an order disgorging gains with an estimated present value of $253.1 million.[26]

- *Rural/Metro*, a post-trial judgment against a financial advisor found to have aided and abetted a board of directors' breach of fiduciary duty. Damages were based on a determination that the target company's fair value was 24 percent above the merger price.[27]

- "*Chaparral*," a post-trial settlement of a consolidated appraisal and class action challenging a going-private transaction that recovered $41 million,

23. *Id.* at *3.

24. For another article that similarly argues that legal reform should take into account the full range of stockholder litigation outcomes, see Mark Lebovitch & Jeroen van Kwawegen, *Of Babies and Bathwater: Deterring Frivolous Stockholder Suits Without Closing the Courthouse Doors to Legitimate Claims*, 40 Del. J. Corp. L. 491 (2016).

25. *In re* Activision Blizzard, Inc. S'holder Litig., 124 A.3d 1025, 1064 (Del. Ch. 2015).

26. *Id.* at 1065.

27. *See In re* Rural/Metro Corp. S'holders Litig., 102 A.3d 205, 226 (Del. Ch. 2014) (post-trial damages opinion).

the equivalent of 45 percent above the transaction price.[28] When approving the settlement, Vice Chancellor Lamb stated: "because of the work [plaintiffs' counsel] had done, liability questions were quite clear," and the settlement was "an excellent result" that represented "a very large percentage of the amount . . . that I would have awarded in a post-trial judgment, if not as much as I would have awarded."[29]

- "*Sterling Chemicals*," a settlement reached two months before a scheduled trial of a consolidated appraisal and class action challenging the sale of a controlled company to a strategic buyer. The settlement recovered $17.5 million for stockholders who had received $3.1 million in the challenged transaction. Vice Chancellor Laster characterized the stockholders' claims as "quite strong" and stated: "It's hard to be understated about this recovery. This amounts to a 565 percent premium over what the common stock received in the merger."[30]
- "*Telecorp*," a class action settlement reached less than one month before trial that recovered $47.5 million, 4.4 percent more than the merger consideration. When approving the settlement, then-Vice Chancellor Strine described it as "a very, very, high-quality result."[31]
- "*Websense*," a post-closing settlement of litigation pursued mostly in California that challenged a $985 million acquisition; the class obtained $40 million,[32] of which $28 million was paid by the financial advisor upon a claim that was briefly litigated in the Delaware Court of Chancery.[33]
- "*Prime Hospitality*," a post-closing settlement in which the class obtained $25 million in a challenge to a $570 million acquisition, which Chancellor Chandler described as a "significant achievement."[34]

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28. Settlement Hearing at 3, *In re* Chaparral Res., Inc. S'holders Litig., C.A. No. 2633-VCL (Del. Ch. Mar. 13, 2008) [hereinafter *Chaparral*].

29. *Id.* at 8.

30. Settlement Hearing and Rulings of the Court at 43–44, Virtus Capital L.P. v. Eastman Chem. Co., C.A. No. 9808-VCL (Del. Ch. Dec. 9, 2016); *see also* Virtus Capital L.P. v. Eastman Chem. Co., C.A. No. 9808-VCL, 2015 WL l5805553 (Del. Ch. Feb. 11, 2015) (motion to dismiss opinion) [collectively, *Sterling Chemicals*].

31. Settlement Hearing, Plaintiff's Motion for Class Certification and Award of Attorneys' Fees and Expenses, and Rulings of the Court at 33, 90, *In re* TeleCorp PCS Inc. S'holders Litig., C.A. No. 19260 (Del. Ch. Aug. 20, 2003) [hereinafter *TeleCorp*].

32. Laborers Local #231 Pension Fund v. Websense, Inc., No. 37-2013-00050879-CU-BT-CTL (Cal. Super. Ct. Dec. 8, 2016) (order) [hereinafter *Websense*].

33. Letter from Joel Friedlander to the Court, Laborers Local #231 Pension Fund v. Merrill Lynch, Pierce, Fenner & Smith Inc., C.A. No. 12350-VCL (Del. Ch. June 27, 2016) (advising of settlement terms).

34. Settlement Hearing and Objections at 42–43, *In re* Prime Hospitality, Inc. S'holders Litig., C.A. No. 652-CC (Del. Ch. Sept. 19, 2007) [hereinafter *Prime Hospitality*].

- "*Gardner Denver*," a post-closing settlement of $29 million in a challenge to a $3.9 billion acquisition, which Vice Chancellor Noble described as "an outstanding result."[35]

These eight data points contrast sharply with the many other cases that were filed in the same time period and settled early for nominal relief. Counsel for stockholder plaintiffs were able to file suits indiscriminately and settle them, knowing that (i) enhanced judicial scrutiny of certain forms of transactions made the cases hard to dismiss; (ii) the filing of stockholder actions in multiple jurisdictions challenging the same transaction created difficulties and uncertainty for defendants, (iii) deal participants wanted to resolve litigation prior to a transaction closing, (iv) deal participants wanted to obtain broad releases as part of a settlement, and (v) longstanding judicial policy favored settlement.

In Part I of this article I discuss my support for reforms that would expand the scenarios in which courts reject nominal, early settlements. In Part II of this article, I question certain recent reforms that impede the prosecution of meritorious stockholder actions, by changing generally applicable rules respecting the financing or pleading of stockholder claims.

Part I uses data points of successful stockholder litigation to discuss why the public policy favoring settlement is misplaced in the context of early settlements of representative litigation. A number of the above litigation outcomes would not have occurred if competing plaintiff's counsel had gained control of the litigation. Competing counsel likely (or certainly) would have settled for much less, soon after filing. *Rural/Metro* and *Prime Hospitality* began as objections to proposed disclosure settlements, and there were contested leadership hearings in *Activision*, *TeleCorp*, *Chaparral*, and *Gardner Denver*.

Part II uses data points of successful stockholder litigation to argue against the following proposed or actual reforms to legal rules: (i) authorizing fee-shifting bylaws; (ii) procedural reforms that make duty of loyalty cases easier to dismiss, particularly if a majority of stockholders voted in favor of the transaction; and (iii) broadening the application of the business judgment rule in controller transactions. These reforms have been justified as necessary to limit meritless lawsuits, but they also operate to prevent investigation into, and prevent redress for, disloyal conduct.

Specifically, Part II.A discusses how *Activision* and *Sterling Chemicals* illustrate why plaintiffs would be well advised not to file potentially meritorious cases if it means assuming the contingent liability of paying defendants' litigation costs. Multiple sets of defendants spend much more money defending an action than plaintiffs spend prosecuting it, and plaintiffs have limited access at the outset of litigation to the underlying facts.

Part II.B discusses how all eight data points illustrate the importance of early access to discovery material in order to forestall or defeat a motion to dismiss and

35. Settlement Hearing at 24, *In re* Gardner Denver, Inc. S'holders Litig., C.A. No. 8505-VCN (Del. Ch. Sept. 3, 2014) [hereinafter *Gardner Denver*].

place a meritorious case on the track toward trial. Recent rulings restricting the availability of expedited discovery, and allowing for dismissal of stockholder actions in the face of evidence of disloyalty, encourage insiders and financial advisors to steer transactions in a disloyal manner.

Part II.C discusses how business judgment rule protection recently has been recognized for certain controlling stockholder freeze-outs[36] and certain mergers affording pro rata treatment to controlling stockholders.[37] *Activision*, *Chaparral*, and *Sterling Chemicals* all involved controlling stockholders, and *TeleCorp*, *Prime Hospitality*, and *Rural/Metro* involved directors who represented significant stockholders. These cases demonstrate why it is problematic to extend business judgment rule protection to transactions involving stockholder/directors who may have unique agendas, such as a desire to obtain liquidity for illiquid blocks. Such persons are compromised in their ability to monitor the conflicts of others, and their own conflicts and high status can influence others to act against the interests of public stockholders. Enhanced judicial scrutiny is essential to investigate facts and obtain redress for disloyal conduct.

I. Reforms Directed to Restricting Nominal, Early Settlements of Stockholder Litigation

Criticism of stockholder litigation is most potent when it is directed to cases filed in high volume that are typically settled early on terms by which plaintiff's counsel get paid a substantial sum upon releasing stockholder claims for no significant benefit. In this part, I endorse recent restrictions on disclosure settlements and, along similar lines, suggest stricter judicial enforcement of the requirement that class counsel demonstrate adequacy of representation when settling seemingly non-adversarial litigation.

The recently adopted restrictive standards for approving disclosure settlements in the Delaware Court of Chancery and in federal court are a paradigmatic example of how data points of successful stockholder litigation can be a tool for reform. As I have discussed at length elsewhere, plaintiff's success at trial in *Rural/Metro*, a case that began as a successful objection to a disclosure settlement, exposed how disclosure settlements are systemically problematic, and how the elimination of disclosure settlements can facilitate the pursuit of meritorious stockholder class actions.[38] Elimination of early non-adversarial settlements in other contexts, such as controlling stockholder freeze-outs, can have a similar salutary effect.

36. *In re* MFW S'holders Litig., 67 A.3d 496 (Del Ch. 2013), *aff'd*, Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014).

37. *In re* Synthes, Inc. S'holder Litig., 50 A.3d 1022 (Del. Ch. 2012).

38. Joel E. Friedlander, *How* Rural/Metro *Exposed the Systemic Problem of Disclosure Settlements*, 40 Del. J. Corp. L. 851 (2016).

A. Restricting Disclosure Settlements

In January 2016, Chancellor Bouchard issued an opinion in *In re Trulia, Inc. Stockholder Litigation*[39] that authoritatively halted the Court of Chancery's "historical practice of approving disclosure settlements when the additional information is not material."[40] *Trulia* established conditions for the future approval of disclosure settlements: "the supplemental disclosures [must] address a plainly material misrepresentation or omission, and the subject matter of the proposed release [must be] narrowly circumscribed to encompass nothing more than the disclosure claims and fiduciary duty claims concerning the sale process, if the record shows that such claims have been investigated sufficiently."[41] Several months later, the court in *Walgreen* endorsed *Trulia*'s "plainly material" standard for approving disclosure settlements in federal court.[42]

Restricting disclosure settlements is fully consistent with a due respect for the potential of stockholder litigation to generate important outcomes for stockholders. Historically, disclosure settlements granted defendants broad releases from future claims without any meaningful investigation into, or adversarial litigation of, those claims. Withholding approval of a disclosure settlement preserves the ability of stockholders to litigate damages claims that otherwise would be released.

The court in *Trulia* recognized this issue. The opinion collected authorities for the following proposition: "On occasion, although it is relatively infrequent, [stockholder] litigation has generated meaningful economic benefits for stockholders."[43] The court in *Trulia* noted that significant economic benefits were obtained in *Rural/Metro* and *Prime Hospitality* by litigants who had successfully objected to proposed disclosure settlements and then pursued post-closing damages claims.[44]

Trulia's limitations on disclosure settlements restrict frivolous stockholder litigation without impeding meritorious stockholder litigation. *Trulia* represents a paradigmatic instance of the Court of Chancery addressing the problem of indiscriminate stockholder litigation "that serves no useful purpose for stockholders"[45] in a manner duly informed by data points of successful stockholder litigation.

B. Withholding Approval of Other Forms of Early Settlements

The restrictions *Trulia* placed on disclosure settlements suggest the need for broader-reaching reform. Disclosure settlements are a leading example of the larger phenomenon of stockholder class actions that are resolved before a transaction closes without adversarial litigation or arm's-length bargaining. Any such

39. 129 A.3d 884 (Del. Ch. 2016).
40. *Id.* at 893.
41. *Id.* at 898.
42. *In re* Walgreen Co. S'holder Litig., 832 F.3d 718, 725 (7th Cir. 2016).
43. 129 A.3d at 891 (citing *Rural/Metro*, *Dole*, *Jefferies*, *Del Monte*, as well as *In re Emerging Communications, Inc. S'holders Litig.*, C.A. No. 16415, 2004 WL 1305745 (Del. Ch. May 3, 2004) [hereinafter *Emerging Communications*]).
44. *Id.* at 895 & n.34 (citing a draft of Friedlander, *supra* note 38).
45. *Id.* at 892.

proposed settlement deserves close scrutiny by the courts about whether the absent class members have been adequately represented by plaintiffs' counsel.

Parties to litigation challenging a pending transaction often share an interest in seeing the litigation promptly resolved and work toward that end. Counsel for the stockholder plaintiffs want to get paid, and the defendants want their transaction to close with all post-closing claims released. In the words of Chancellor Bouchard, "defendants are incentivized to settle quickly in order to mitigate the considerable expense of litigation and the distraction it entails, to achieve closing certainty, and to obtain broad releases as a form of 'deal insurance.'"[46]

Immaterial supplemental disclosures are just one form of cheap currency for merger parties. Material supplemental disclosures can be another form of cheap currency, as can immaterial modifications to deal protections, such as lowering break-up fees when there is no prospect of a competing bid. An immaterial increase in the deal price may also be suspect, if it is anticipated in advance that the price will be immaterially increased before a transaction closes in order to resolve litigation claims.

Approving any nominal settlement struck when a transaction is pending raises constitutional concerns because the Due Process Clause requires a finding of adequacy of representation in order to bind absent class members to a settlement.[47] The Delaware Supreme Court stated a generation ago in *Prezant v. De Angelis* that arm's-length bargaining and vigorous, adversarial litigation are central to the necessary finding of adequacy of representation:

> We therefore reject defendants' assertion that notice and the opportunity to opt-out without adequate representation[] satisfies due process requirements. Notice is no substitute for extensive document examination, depositions of adverse witnesses, securing expert advice on complicated issues, and *aggressive negotiation at arms-length*. The same holds true for opt-out rights. . . .
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> We also reject defendants' assertion that the Court of Chancery's use of heightened scrutiny in its evaluation of the merits of the settlement was a proper substitute for an adequate class representative. . . . This is so because an adequate representative, *vigorously prosecuting an action without conflict and bargaining at arms-length,* may present different facts and a different settlement proposal to the court than would an inadequate representative.[48]

Trulia does not discuss the constitutional problem posed by disclosure settlements. The proposed disclosure settlement in *Trulia* was rejected on the ground that the settlement consideration was "not fair or reasonable to Trulia's stock-

46. *Id.*

47. *See* Matsushita Elec. Indus. Co. v. Epstein, 516 U.S. 367, 388 (1996) (Ginsburg, J., concurring in part and dissenting in part) ("In the class action setting, adequate representation is among the due process ingredients that must be supplied if the judgment is to bind absent class members.").

48. 636 A.2d 915, 924 (Del. 1994) (emphasis added).

holders," without the court reaching "the issue of class certification" and thus without reaching the sub-issue of adequacy of representation.[49]

Judicial inquiry into adequacy of representation and the presence of adversarial litigation and arm's-length bargaining should precede inquiry into the fairness of a settlement's terms. As stated in *Prezant*, "[c]onsideration of the merits of the settlement can occur only after the requisites of Rule 23 have been satisfied."[50] In *Walgreens*, Judge Posner rejected a proposed disclosure settlement under *Trulia*'s "plainly material" standard and then proceeded to find lack of adequacy of representation, stating: "Certainly class counsel, if one may judge from their performance in this litigation, can't be trusted to represent the interests of the class."[51]

The question raised by *Prezant* and *Walgreens* is whether the Court of Chancery's historic willingness to approve early, nominal settlements is constitutional, absent record evidence of "vigorous[] prosecut[ion] [of] an action without conflict and bargaining at arms-length."[52] The same question is raised by a separate category of early deal litigation settlements historically approved by the Court of Chancery—challenges to going-private transactions initiated by controlling stockholders.

Whenever a controlling stockholder makes a negotiable proposal to buy out the minority, a special committee of the board of directors is typically appointed to negotiate against the controller, and lawsuits are typically filed challenging the proposed transaction. Historically, most plaintiffs' counsel have looked for an opportunity to make a presentation to the special committee, acquiesced to the price negotiated by the special committee, taken confirmatory discovery in support of the proposed transaction negotiated by the special committee, and applied for a fee award.

A law review article discussing this phenomena is aptly titled *File Early, Then Free Ride: How Delaware Law (Mis)Shapes Shareholder Class Actions*.[53] Soon after the article's publication, one of its co-authors represented an objector who challenged a fee application in connection with a pre-closing settlement of a challenge to a going-private transaction, in *In re Cox Communications, Inc. Shareholders Litigation*.[54]

In his opinion in *Cox* resolving the objection, then-Vice Chancellor Strine described the free-riding problem in colorful terms:

> [T]he ritualistic nature of a process almost invariably resulting in the simultaneous bliss of three parties—the plaintiffs' lawyers, the special committee, and the controlling stockholders—is the jurisprudential triumph of an odd form of tantra . . . .[55]

49. 129 A.3d at 907 & n.90.
50. 636 A.2d at 926.
51. *In re* Walgreen Co. S'holder Litig., 832 F.3d 718, 726 (7th Cir. 2016).
52. *Prezant*, 636 A.2d at 924.
53. Elliott J. Weiss & Lawrence J. White, *File Early, Then Free Ride: How Delaware Law (Mis)Shapes Shareholder Class Actions*, 57 VAND. L. REV. 1797, 1833 (2004).
54. 879 A.2d 604, 613 (Del. Ch. 2005) [hereinafter *Cox*].
55. *Id.* at 621.

In the same opinion, Vice Chancellor Strine approved an attorney's fee award of $1.275 million ($500 per hour for 2,000 hours worked, plus expenses).[56] The Vice Chancellor noted: "Although I have no reason to believe that the plaintiffs' efforts were responsible for the bulk of the increase in price, I do suspect that the desire of the defendants to get rid of the litigation had some useful role in the ultimate price attained."[57] The court did not address adequacy of representation, which apparently was not raised by the objector.

A searching judicial examination for evidence of true adversity between litigants who strike disclosure settlements or early going-private settlements could cause the Court of Chancery to conclude, in the words of Judge Posner, that both categories of settlements are "no better than a racket" and "must end."[58] Such an inquiry would serve the purpose of limiting unproductive stockholder litigation while not restricting potential meritorious actions seeking damages. Restricting non-arm's-length settlements should make it easier for stockholders seeking damages to get control of a case and pursue it.

The *Chaparral* litigation is instructive. Chaparral Resources, Inc. ("Chaparral"), a Delaware corporation majority owned by Lukoil, owned an interest in an oil field in Kazakhstan. The transaction structure was one step removed from the ritualistic process described above, in that Lukoil did not publicize its buyout offer. A special committee of Chaparral directors negotiated the going-private transaction without any prior public announcement or any prior filing of lawsuits. Class actions were quickly filed after the transaction terms were announced. Counsel for the original stockholder plaintiffs attempted to negotiate with Lukoil for an increased price before taking any depositions. Several weeks after the transaction was announced, but before any preliminary proxy statement was filed, a second group of stockholders with significant stakes, represented by my law firm, filed suit and sought to intervene. The original plaintiffs attempted to negotiate a settlement of the litigation during the pendency of the motion to intervene.[59]

Our law firm was appointed co-lead counsel. Upon learning about a discrepancy between the number of projected oil wells disclosed in Chaparral's Form 10-K (which was relied upon by the special committee) and the number disclosed in the immediately prior Form 10-Q, we pursued expedited discovery, including depositions in New York, Houston, and London.[60] We learned that a Lukoil "special project team" had been exploring ways to expand production from the oil field (unbeknownst to the special committee and the consultants they were relying upon), and that Lukoil's director designees made undisclosed

56. *Id.* at 642.
57. *Id.*
58. *In re* Walgreen Co. S'holder Litig., 832 F.3d 718, 724 (7th Cir. 2016).
59. Argument and Ruling on Motion for Intervention, Argument of Order of Consolidation, and Appointment of New Lead Counsel at 25, 40–41, *In re* Chaparral Res., Inc. S'holders Litig., C.A. No. 2001-N (Del. Ch. May 17, 2006).
60. Affidavit of Joel Friedlander at paras. 3–4, 8, *In re* Chaparral Res., Inc. S'holders Litig., C.A. No. 2001-VCL (Del. Ch. Mar. 6, 2008).

threats to the special committee to shut-in the field if a buyout deal was not struck.[61] Even so, Lukoil was not willing to raise the transaction price. Co-lead counsel proceeded to litigate the case for damages after the transaction closed, which involved analyzing Russian-language drilling plans and constructing new operational and financial projections and reserve estimates.[62] The case ultimately settled after trial for an amount equivalent to 45 percent above the merger price.[63]

Had Lukoil publicly announced its proposed buyout price, it is easy to imagine replication of the well-trod path, as in *Cox*, whereby special committee negotiations are accompanied by non-adversarial litigation, resulting in a pre-closing settlement at the price negotiated by the special committee. The *Chaparral* litigation raises the possibility that other going-private transactions settled in routine fashion pre-closing may have presented damages claims worthy of being litigated after a transaction closes.

Cox-type settlements should be discouraged, and *Cox* recognized as much. Then-Vice Chancellor Strine suggested that one way to discourage "non-meritorious, premature suits attacking negotiable going-private proposals"[64] was to dismiss such challenges for lack of ripeness.[65] A potential problem with that approach is one of multi-jurisdictional judicial administration. If the Delaware Court of Chancery dismissed these actions as unripe (or withheld judicial approval of settlements for lack of adequacy of representation), identical challenges might be brought and settled in another jurisdiction.

Vice Chancellor Laster confronted this issue at the earliest stage of the *Dole* litigation. Multiple challenges to a going-private proposal were brought in Delaware and California. Vice Chancellor Laster cancelled a scheduled leadership hearing on the ground that it was premature.[66] Upon being advised that class leadership was appointed in California, Vice Chancellor Laster directed a series of ten questions to defense counsel about their position on the ripeness of any of the actions filed in Delaware or California, whether settlement negotiations with the California class counsel were ongoing, whether a *Cox*-type settlement was sought, and whether a *Cox*-type settlement in California would be binding on a Delaware court, given the issues of ripeness and adequacy of representation.[67]

61. *Id.* at paras. 6, 8.

62. *Id.* at paras. 5, 11, 12.

63. Settlement Hearing at 3–7, *In re* Chaparral Res., Inc. S'holders Litig., C.A. No. 2633-VCL (Del. Ch. Mar. 13, 2008).

64. *In re* Cox Commc'ns S'holder Litig., 879 A.2d 604, 605 (Del. Ch. 2005).

65. *See id.* at 605, 637 ("I conclude that complaints challenging fully negotiable, all cash, all shares merger proposals by controller stockholders are not meritorious . . . . The complaints were . . . unripe and without merit."); *In re* Revlon, Inc. S'holders Litig., 990 A.2d 940, 956 (Del. Ch. 2010) ("Old Counsel seemingly recognized that they filed their complaints prematurely and that the consolidated case was subject to a motion to dismiss. I infer that the defendants did not challenge the premature litigation because they wanted the case to stay alive to support a settlement.").

66. City of Providence Cent. Laborers Pension Fund v. Murdock, C.A. No. 8703-VCL (Del. Ch. July 16, 2013) (order).

67. Letter from the Court to Counsel, *In re* Dole Food Co., Inc. S'holder Litig., C.A. No. 8703-VCL (Del. Ch. Aug. 9, 2013).

The transaction was soon announced without a *Cox*-type settlement having occurred.[68]

Such active judicial management served the twin goals of deterring litigation filed with the intention of reaching a quick settlement and preventing the early release of potentially meritorious damages claims. *Dole* itself later became a data point of a successful stockholder action.[69]

Rural/Metro, *Prime Hospitality*, *Chaparral*, and *Dole* suggest the appropriateness of rigorously enforcing adequacy of representation in order to withhold approval of early settlements. Significant monetary settlements generally require the threat of an imminent adverse judgment. A pending preliminary injunction application seeking disclosures or a delayed closing is generally insufficient to yield significant results. Screening settlements struck pre-closing for the presence of adversarial litigation and arm's-length bargaining properly targets the problem of early, nominal settlements of stockholder litigation.

II. Reforms Directed to the Financing and Pleading of Duty of Loyalty Claims

The current stockholder reform agenda is focused on limiting stockholder litigation by changing generally applicable legal rules. As discussed below, these reforms are problematic when examined from the perspective of data points of successful stockholder litigation.

A. Authorizing Fee-Shifting Bylaws

Bainbridge argues that the Delaware Supreme Court's decision in 2014 authorizing fee-shifting bylaws[70] "opened the door to a viable private ordering solution to the shareholder litigation crisis."[71] Bainbridge laments Delaware's recent legislative ban on fee-shifting bylaws and charter provisions.[72] He believes that a "process of give and take between directors and officers would have resulted in bylaws whose terms were broadly acceptable to the corporation's key constituencies."[73] The lost benefit, according to Bainbridge, is that "widespread adoption of fee-shifting bylaws would have substantially reduced the volume and settlement value of shareholder litigation," while the potential cost of deterring meritorious suits "might have been a price worth paying given the pervasive defects of shareholder litigation."[74]

In a paper titled *Optimal Fee-Shifting Bylaws*, Albert Choi uses law and economics scholarship and mathematical modeling to support his contention that

68. Letter from the Court to Counsel, *In re* Dole Food Co., Inc. S'holder Litig., C.A. No. 8703-VCL (Del. Ch. Aug. 13, 2013).
69. *See supra* text accompanying note 12.
70. ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 556 (Del. 2014).
71. Bainbridge, *supra* note 2, at 875.
72. *See* Del. Code Ann. tit. 8, §§ 102(f), 109(b), 115 (2015).
73. Bainbridge, *supra* note 2, at 875.
74. *Id.* at 868.

fee-shifting bylaws "can facilitate the screening function: encouraging meritorious lawsuits while discouraging frivolous ones."[75] Choi's optimal fee-shifting bylaw is "symmetric"; it shifts the cost of prosecution to the defendants if the plaintiff prevails, and it shifts the cost of the defendants' litigation expenses to the plaintiff if the plaintiff loses.[76] There are potential variations for which side bears the costs in the event of a partial recovery.[77]

Choi identifies two potential models for an optimal fee-shifting bylaw: (i) the fee-shifting provision in the Model Stock Purchase Agreement published by the American Bar Association, which allows the "prevailing party" to recover reasonable attorney's fees and costs; and (ii) section 315(e) of the Trust Indenture Act of 1939, which governs disputes between public bondholders and corporations, and provides that the "court may in its discretion assess reasonable costs, including reasonable attorneys' fees."[78] Choi suggests "leaving a certain amount of drafting freedom to the directors and the shareholders" and supports judicial validation of any symmetric fee-shifting provision.[79]

The real-world examples of *Activision* and *Sterling Chemicals* suggest that Choi's quest for an optimal fee-shifting bylaw is misconceived. *Activision* was litigated contingently. *Sterling Chemicals* was funded by an investor with a substantial stake in the outcome. Both cases settled on highly favorable terms that reflected their underlying merit. Yet, given the economic structure of stockholder litigation, I would not have counseled prosecuting either case in the face of a symmetric fee-shifting bylaw.

In *Activision*, four sets of defendants retained separate counsel. Activision Blizzard, Inc. ("Activision") was represented by Skadden, Arps, Slate, Meagher & Flom LLP; Activision's Co-Chairman and its CEO were represented by Sullivan & Cromwell LLP and Delaware counsel; the directors who served on Activision's special committee were represented by Wachtell, Lipton, Rosen & Katz and Delaware counsel; Vivendi S.A. and its director designees were represented by Gibson, Dunn & Crutcher and Delaware counsel. The litigation involved the production of over 800,000 pages of documents, the depositions of twenty-three fact witness and four expert witnesses, and significant motion practice.[80] For purposes of this discussion, I would assume that the aggregate cost of the litigation defense was over $20 million, and that litigating the case through trial and post-trial briefing would have cost the defendants over $25 million.

If Activision had adopted a valid, symmetric fee-shifting bylaw, the possibility of recouping the plaintiff's litigation costs from defendants would not have been a material inducement in bringing the case. Potential damages were hundreds of millions of dollars, with a tremendous range of potential outcomes, given the po-

75. Albert H. Choi, *Optimal Fee-Shifting Bylaws* 9 (Va. Law & Econ. Research Paper No. 2016-15, Feb. 20, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2840947.

76. *Id.* at 4.

77. *Id.* at 13–14.

78. *Id.* at 23–30.

79. *Id.* at 30, 33.

80. *In re* Activision Blizzard, Inc. S'holder Litig., 124 A.3d 1025, 1072–73 (Del. Ch. 2015).

tential for equitable relief or damages. Assuming that the most likely final relief would have been worth $250 million to $300 million, and that such relief would have been considered a full victory rather than a partial recovery, the incremental value of recovering plaintiff's contingent fee award from the defendants would have increased the common fund by, at most, an additional 33 percent,[81] or $100 million. Yet, from the perspective of plaintiff's counsel, recouping from defendants the cost of class counsel's court-awarded fee might not increase the fee award by a single dollar. Absent a case or bylaw stipulating that fee shifting redounds in part to the benefit of plaintiff's counsel, rather than the class members exclusively, a symmetrical fee shifting provision creates no positive incentive to file a meritorious contingently compensated suit.[82]

But in the event plaintiff's counsel were to have lost the *Activision* action, and plaintiff's counsel were forced to pay defendants' litigation expenses, the additional out-of-pocket cost to plaintiff's counsel would have been massive. In *Activision*, plaintiff's litigation effort "was a largely undiversified, entrepreneurial undertaking."[83] Two small law firms created a lean litigation team that included four partners who took or defended all of the depositions and were deeply involved in all stages of the litigation.[84] In settling less than a month before trial, those firms expended 7,363 hours of attorney time, most of which was partner time, and incurred out-of-pocket costs of $1,182,375.[85] This manner of litigating was both cost-efficient and effective.[86] We could have litigated the entire case through judgment for out-of-pocket costs in the vicinity of $1.5 million. But if we also had to pay defendants' litigation costs in the event of defeat, the total out-of-pocket cost could have been an additional $25 million or more.

If required at the outset of the *Activision* litigation to decide whether to assume the contingent liability of paying defendants' legal expenses, we would have declined to sue. We would have reasonably expected that defendants' collective staffing of the litigation would be extensive and face no real budget constraint. Additionally, we had very little non-public information about the challenged transaction at the outset or even after a limited books and records inspection. By the time we learned much about the merits of the case, we would have accrued substantial contingent liabilities.

Put differently, there are asymmetries embedded in stockholder litigation that overwhelm the formal symmetry of Choi's proposed optimal fee-shifting bylaw.

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81. "33% is the very top of the range of percentages" for a common fund fee award. Ams. Mining Corp. v. Theriault, 51 A.3d 1213, 1260 (Del. 2012).

82. In *Rural/Metro*, plaintiff's counsel sought imposition of fee shifting for bad-faith litigation conduct, and we did not argue that its imposition would increase the size of our fee award. *See* Plaintiff's Opening Brief in Support of Application for Fees and Expenses, *In re* Rural/Metro Corp. S'holders Litig. (Del. Ch. Oct. 29, 2014) (Cons. C.A. No. 6350-VCL).

83. *Activision*, 124 A.3d at 1074.

84. *Id.*

85. Plaintiff's Opening Brief to Approve the Settlement, Recertify the Class, Approve the Fee Application, and Approve the Special Award to Plaintiff at 64, *In re* Activision Blizzard, Inc. S'holder Litig. at 64 (Del. Ch. Feb. 18, 2015) (Cons. C.A. No. 8885-VCL).

86. *Activision*, 124 A.3d at 1074.

Defense counsel's out-of-pocket costs are much higher than plaintiff's. Plaintiff's access to information at the outset is much more limited than defendants'. Recouping defendants' legal expenses does not redound to the benefit of contingently compensated plaintiff's counsel, who must nevertheless bear the full cost of defense counsel in the event of defeat.

The absence of a fee-shifting bylaw allowed *Activision* to be litigated in an effective manner. By identifying an aspect of the transaction that impacted voting rights, we succeeded in scheduling a prompt trial and avoiding any stay of discovery.[87] The consequence of those preliminary rulings was that motions to dismiss were briefed and argued after defendants had already spent millions of dollars producing documents. The absence of a fee-shifting provision also afforded us time to develop a damages theory, which was based on alternative ways to structure the challenged transaction that were suggested by the discovery record.[88]

Even in the absence of a fee-shifting bylaw, few firms undertook the risk associated with filing suit to challenge the Activision/Vivendi transaction, perhaps because Activision's stock price rose when the transaction was announced.[89] No other firm that filed suit displayed the intention of building a factual case of disloyalty. If Activision had a valid fee-shifting bylaw, it is difficult to imagine that any entrepreneurial law firm would have undertaken the risk of challenging the transaction, even if liability issues appeared strong at the outset.[90] A plaintiff operating in the shadow of a fee-shifting bylaw would be disincentivized to pursue the successful strategy we undertook. Instead, any contingently compensated plaintiff's counsel willing to file suit in the shadow of a fee-shifting bylaw would probably only do so with the intention of settling early for nominal relief, before defense counsel incurred significant cost.

Sterling Chemicals illustrates how a stockholder plaintiff who is willing to incur the cost of pursuing a meritorious action likely would be deterred by a fee-shifting bylaw. The case challenged the sale in 2011 of Sterling Chemicals,

87. *Id.* at 1040.

88. *See id.* at 1041.

89. *See id.* at 1035, 1037–40.

90. *Activision* illustrates a problem with a related proposed reform, a ""no pay" charter or bylaw provision, which would bind a corporation not to pay any fee award in all or specified types of corporate benefit cases. *See* Sean J. Griffith, *Private Ordering Post-*Trulia*: Why No Pay Provisions Can Fix the Deal Tax and Forum Selection Provisions Can't* (Fordham Law Legal Studies Research Paper No. 1855950, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2855950; A. Thompson Bayliss, *"No Pay" Provisions: The Forgotten Middle Ground in the Fee-Shifting Battle*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (June 1, 2015), https://corpgov.law.harvard.edu/2015/06/01/no-pay-provisions-the-forgotten-middle-ground-in-the-fee-shifting-battle/. Adoption of broad "no pay" provisions would eliminate the incentive to bring meritorious duty of loyalty claims in situations where corporate governance is at stake and the availability of significant damages is not clear. In *Activision*, we obtained a reduction of the CEO's voting power from 24.9 percent to 19.9 percent, plus the appointment of two new outside directors, which created "a facially independent Board majority." 124 A.3d at 1067. Vice Chancellor Laster reasoned that "[e]stablishing an independent Board majority and reducing the stockholder-level of control of insiders at a corporation with a market capitalization in excess of $15 billion" could justify a fee award "of $5–10 million." *Id.* at 1071 (citing fee awards in three corporate governance cases of $8.5 million plus expenses, $8.4 million, and $5.4 million). Such relief would not be obtained in the face of a ""no pay" provision.

Inc. ("Sterling") for $100 million. Notwithstanding the ubiquity at that time of class action litigation challenging M&A transactions valued at over $100 million,[91] no breach of fiduciary duty suits were filed to challenge the Sterling transaction until 2014, when Virtus Capital L.P. ("Virtus") added class claims for breach of fiduciary duty and aiding and abetting to its preexisting appraisal action.[92]

Sterling's stockholder profile helps explain why no prior class action was filed. Sterling was controlled by a fund complex whose investors owned 100 percent of Sterling's preferred stock and 56 percent of Sterling's common stock.[93] The total preferred stock liquidation preference was $114.1 million. Even though the sale price was below the liquidation preference, the transaction allocated $7.1 million to the common stock, approximately $3.1 million of which was allocated to common stock held by holders unaffiliated with the controlling stockholder. Given the terms and holdings of the preferred stock, it would have been necessary to prove that Sterling was worth far more than the sale price in order to obtain a sizeable recovery for the unaffiliated common stockholders. A valuation of approximately $153.5 million would have translated into a recovery of approximately $20 million (including five years of prejudgment interest) for the unaffiliated common stockholders. Damages did not rise proportionately with the valuation, due to the conversion feature of the preferred stock. A valuation of $250 million, for example, would have translated into a recovery of approximately $35 million (including five years of prejudgment interest) for the unaffiliated common stockholders.[94]

Virtus owned approximately 20 percent of the total common shares owned by unaffiliated public stockholders. From appraisal discovery, Virtus learned about potentially valuable claims for breach of fiduciary duty and aiding and abetting. Nevertheless, filing class claims could have only made economic sense if Virtus controlled its own litigation costs and was not exposed to paying defendants' litigation costs.

Virtus sued seven sets of defendants. Each set retained separate Delaware counsel, and three sets of defendants separately retained Kirkland & Ellis LLP, Alston & Bird LLP, and Wachtell, Lipton, Rosen & Katz. To illustrate the economics of the fee-shifting debate, I assume defendants spent at least $10 million in the aggregate defending the litigation through settlement, and that the total defense cost through trial would have been at least $15 million.

91. *See* Robert M. Daines & Olga Koumrian, Cornerstone Research, Shareholder Litigation Involving Mergers and Acquisitions: Review of 2012 M&A Litigation 3 (2013) (noting that suits were filed challenging 93 percent of announced transactions valued at over $100 million in 2011).

92. Virtus Capital L.P. v. Eastman Chem. Co., C.A. No. 9808-VCL, 2015 WL 5805553, at *2 (Del. Ch. Feb. 11, 2015). Had a class case been filed and settled quickly in 2011 for supplemental disclosures or other nominal relief, then the global release accompanying the disclosure settlement would have foreclosed the ability of an appraisal petitioner to subsequently assert class claims based on information learned during appraisal discovery.

93. *Id.*

94. Affidavit of Jeffrey M. Gorris at para. 35, Virtus Capital L.P. v. Eastman Chem. Co., C.A. No. 9808-VCL (Del. Ch. Nov. 11, 2016).

Virtus recovered $17.5 million for the class. To obtain that result, Virtus incurred a total out-of-pocket cost of $2,942,651.99 prosecuting the litigation and defending a related action in Florida asserting claims against Virtus's principal that overlapped with the affirmative defenses asserted in Delaware.[95] At the settlement hearing, Vice Chancellor Laster granted a request for a special award to Virtus of $350,000, reasoning that the payment was appropriate given, among other factors, the financial incentives associated with filing suit:

> [T]he law wants to incent good class representatives to bring valuable cases. It's no coincidence that real cases have historically involved real clients. . . . I think it's particularly important in small market cap situations where the size of the company alone, if you think of it from an attorney's fee perspective working on contingency, might not be enough to drive monitoring. . . . This is a situation where, but for Virtus and Mr. Gidumal, there simply wouldn't have been an enforcement mechanism. . . . [What is required] is some type of additional incentive for an individual of sophistication to put that amount of time and effort in, particularly on a small cap company where it's unlikely that enforcement would otherwise happen.[96]

The rationale for the $350,000 incentive award shows why a plaintiff would be unwilling to assume a $15 million contingent liability to pay the defendants' litigation costs in the event of a loss. Defendants with the resources to spend $10 million to $15 million in their own defense, plus the cost of a $17.5 million settlement, can afford the risk of paying an additional $3 million to $4 million to cover the plaintiff's litigation cost. A stockholder plaintiff who may be willing to spend $3 million to $4 million to recover a comparable amount plus reimbursement of expenses cannot be expected to file suit if it might require underwriting the aggregate cost of the defense.

Activision and *Sterling Chemicals* illustrate the endemic asymmetries in stockholder litigation. A plaintiff's costs can be much less than defendants' costs, and plaintiff's initial knowledge about the challenged transaction is much less. Given these asymmetries, permitting the use of fee-shifting bylaws would operate as a deterrent to pursuing the most meritorious cases and would not operate as a screening mechanism between meritorious and frivolous cases.

Proponents of fee-shifting bylaws offer no solution to the problem of their deterrent effect on bringing potentially meritorious cases for breach of the duty of loyalty. A recent article co-authored by former Chancellor (and current defense practitioner) William B. Chandler III advocates fee-shifting bylaws as a means to address the "tide of socially unwholesome M&A litigation [that] has only partially abated."[97] That article cites a draft of this article without addressing the deterrent effect of fee shifting on bringing cases such as *Activision* and *Sterling Chemicals*. Chandler suggests that post-hoc, case-by-case judicial review of the

95. Settlement Hearing and Rulings of the Court at 17, Virtus Capital L.P. v. Eastman Chem. Co. (Del. Ch. Dec. 9, 2016).

96. *Id.* at 51–54.

97. William B. Chandler III & Anthony A. Rickey, The Trouble with *Trulia*: Re-evaluating the Case for Fee-Shifting Bylaws as a Solution to the Overlitigation of Corporate Claims 75 (Apr. 4, 2017) (unpublished manuscript available at https://ssrn.com/abstract=2946477).

reasonableness of the extent of fee shifting may prompt entrepreneurial plaintiffs to "react strategically to bring a different, and perhaps more efficient and focused, paradigm of deal litigation."[98] Yet, *Activision* and *Sterling Chemicals* were efficiently litigated in proportion to the gravity and scope of the alleged wrongdoing, and the mere possibility of post-hoc judicial review at the margins would not vitiate the *in terrorem* effect of a fee-shifting bylaw. Authorizing such bylaws is an invitation to disloyalty and impunity.

B. Restricting Procedural Paths for Post-Closing Damages

Prior to 2015, the procedural path for pursuing a case for post-closing damages for breach of the duty of loyalty in connection with a sale of a public company was clear. A stockholder plaintiff would file suit while the transaction was pending, move for expedited discovery and a preliminary injunction, argue the merits at a preliminary injunction hearing, and then, if the case for damages appeared promising based on the discovery record and dicta by the Court of Chancery in an opinion denying injunctive relief, file an amended complaint after the closing of the transaction containing allegations of an unexculpated breach of the duty of loyalty (or aiding and abetting).

Del Monte and *El Paso* may be the most prominent examples of the recovery of significant sums from that litigation path. More frequently, proceeding on that path results in the voluntary dismissal of the case[99] or the granting of a post-closing motion to dismiss for failure to plead an unexculpated claim for damages. Of course, the far more well-trod path for stockholder plaintiffs was to move for expedited discovery and a preliminary injunction and promptly enter into a disclosure settlement.

Over the last two years, the backlash against disclosure settlements has prompted the Delaware courts to adopt a series of reforms of procedural law that have all but eliminated the main path for seeking post-closing damages. The Delaware courts have also signaled judicial disfavor with post-closing damages claims.

One such reform is to limit access to expedited discovery. In 2015, Vice Chancellor Laster responded to a law review article written by three professors who advocated that the Court of Chancery stop awarding attorney's fees for disclosure settlements. Vice Chancellor Laster argued that the professors' proposed reform, if implemented by the Court of Chancery, "would eliminate disclosure-only settlements," and would therefore "invit[e] a substantial risk of reversal and sharp criticism" by the Delaware Supreme Court.[100] Vice Chancellor Laster argued for

98. *Id.*

99. Two notable examples from personal experience are the unsuccessful injunction applications in *In re Toys "R" Us, Inc., Shareholder Litigation*, 877 A.3d 975 (Del. Ch. 2005), and *In re Dollar Thrifty Shareholder Litigation*, 14 A.3d 573 (Del. Ch. 2010), both of which were followed by voluntary dismissals.

100. J. Travis Laster, *A Milder Prescription for the Peppercorn Settlement Problem in Merger Litigation*, 93 Tex. L. Rev. *See also* 129, 130 (2015) (discussing Jill E. Fisch et al., *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 Tex. L. Rev. 557, 130, 151–52 (2014)).

a "milder" reform: re-examining the Court of Chancery's historical solicitude to expediting challenges to M&A transactions. Denying applications for expedition would shift the focus of litigation to post-closing, a stage at which stockholder plaintiffs can seek damages and defendants can file motions to dismiss.[101]

Vice Chancellor Laster's proposed reform might appear anachronistic, given the court's subsequent restriction of disclosure settlements in *Trulia*. But Vice Chancellor Laster explained in a recent transcript ruling that eliminating routine expedition is an appropriate complement to *Trulia* because it can eliminate lawsuits filed with the objective of obtaining attorney's fees for immaterial supplemental disclosures:

> If we go back to expediting those [weak disclosure] claims . . . we walk right back into the M&A explosion and right back to where we were. . . . Personally, I think the old system was broken. I think it resulted in over-litigation of non-claims and under-litigation of real claims. So personally, I'm not inspired and I have no desire to facilitate a return of the *ancien* regime. . . . [P]eople shouldn't be using disclosure claims . . . as the pretext for expedition, which then facilitates a ready resolution of the case and the channeling of a fee to plaintiffs' counsel, historically through disclosure-only settlements and now through mootness fees. We have been trying to fix that.[102]

The availability of expedited discovery has also been limited by judicial disfavor with preliminary injunction applications aimed at seeking modification of merger agreements, such as the blue penciling of deal protections. In December 2014, in a case involving C&J Energy Services, Inc. ("C&J"), the Delaware Supreme Court reversed the grant of a preliminary injunction, stating: "To blue-pencil a contract as the Court of Chancery did here is not an appropriate exercise of equitable authority in a preliminary injunction order."[103] This holding eliminates a basis for seeking expediting discovery.

A related reform is to allow defendants to confront an amended complaint that uses the fruit of expedited discovery with a motion to dismiss supported by additional documents, such as board minutes, proxy statements, or deposition transcripts. A recent article by Lawrence Hamermesh and Michael Wachter, titled *The Importance of Being Dismissive: The Efficiency Role of Pleading Stage Evaluation of Shareholder Litigation* explains how broadening the permissible record on motions to dismiss aims at reducing plaintiffs' settlement leverage by allowing class actions to be headed off at the motion to dismiss stage, prior to full merits discovery. They write:

> As we explain more fully below, the role served by the motion to dismiss in Delaware representative shareholder litigation has come to more closely resemble the

101. *Id.* at 152–58.

102. Oral Argument on Cross Petitions for Appointment as Lead Plaintiffs and Lead Counsel and Rulings of the Court at 22–24, *In re* Columbia Pipeline Grp. Inc. S'holder Litig., C.A. No. 12152-VCL (Del. Ch. May 25, 2016).

103. C&J Energy Servs., Inc. v. City of Miami Gen. Emps' & Sanitation Emps.' Ret. Trust, 107 A.3d 1049, 1054 (Del. 2014).

> role of the motion for summary judgment: it has evolved into a procedure in which, despite occurring at the pleading stage and before formal discovery, the court often evaluates the merits with the benefit of a substantial record, assembled from publicly available information or provided by defendants, consisting of facts essentially beyond dispute . . . .[104]

A far more powerful tool for obtaining dismissal is new Delaware case law about the effect of a favorable stockholder vote approving a transaction. In 2014, Vice Chancellor Laster wrote a law review article arguing that "if a fully informed, uncoerced and disinterested stockholder majority votes in favor of a merger otherwise subject to enhanced scrutiny, then the business judgment rule should become the operative standard of review."[105] This position was adopted by the Court of Chancery in *In re KKR Financial Holdings LLC Shareholder Litigation*[106] and expressly adopted by the Delaware Supreme Court on appeal, in a case now known colloquially as *Corwin*.[107]

Corwin gives defendants a strong hand when seeking dismissal of a challenge to a transaction otherwise subject to enhanced scrutiny under *Revlon*.[108] The reach of *Corwin* is unclear at present, but Vice Chancellor Laster went so far as to dismiss a claim under *Corwin* after observing: "The allegations of the complaint . . . are sufficiently detailed to state a pleadings-stage claim for breach of the duty of loyalty against the defendants."[109]

One doctrinal limitation of *Corwin* is that the stockholder vote approving the transaction must have been fully informed. The practical limitation of that constraint is not obvious, for several reasons.

First, in the absence of pre-closing expedited discovery, a stockholder plaintiff will lack the strongest tool for uncovering an evidentiary basis to challenge the veracity of a proxy statement on a post-closing motion to dismiss.

Second, if a stockholder plaintiff obtains expedited discovery and identifies false disclosures when presenting a motion for a preliminary injunction, the defendants can make supplemental disclosures to not only moot the disclosure issue, but also to set up a *Corwin* defense. Post-*Corwin*, the procedural posture of *El Paso*—public dissemination of a judicial opinion criticizing fiduciaries

104. Lawrence A. Hamermesh & Michael J. Wachter, *The Importance of Being Dismissive: The Efficiency Role of Pleading Stage Evaluation of Shareholder Litigation* 8–9 (Penn. Law & Econ. Research Paper No. 15-32, 2015), http://scholarship.law.upenn.edu/faculty_scholarship/1588/ (footnotes omitted); *see also* Leo E. Strine, Jr., *Documenting the Deal: How Quality Control and Candor Can Improve Boardroom Decision-making and Reduce the Litigation Target Zone*, 70 Bus. Law. 679, 706 (2015) ("You and your clients get to write the play. Not only is there nothing wrong with that, but done properly and with integrity, there is everything right with that. If the play is one where your clients appear to have made sensible, good faith judgments for legitimate well-documented reasons, those judgments are likely to withstand judicial scrutiny.").

105. J. Travis Laster, *The Effect of Stockholder Approval on Enhanced Scrutiny*, 40 Wm. Mitchell L. Rev. 1443, 1446 (2014).

106. 101 A.3d 980, 1001–02 (Del. Ch. 2014).

107. Corwin v. KKR Fin. Holdings, LLC, 125 A.3d 304 (Del. 2015).

108. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

109. *In re* Columbia Pipeline Grp., Inc. S'holder Litig., C.A. No. 12152-VCL, slip op. at para. 7 (Del. Ch. Mar. 7, 2017) (order).

and a financial advisor but denying a motion for preliminary injunction in the absence of a superior alternative transaction[110]—would lead to a motion to dismiss, not to a settlement of $110 million.

Third, the litigation-reducing spirit of *Corwin* appears to have impacted rulings on materiality. In a later phase of the C&J litigation, the Delaware Supreme Court affirmed a post-closing dismissal under *Corwin*, despite the failure to disclose in the proxy statement terms of a competing bid, or disclose that the investment bank running the solicitation process was recruited by the conflicted CEO, who told the banker "it would be a 'solid in with the company' if he accepted the financial advisor role."[111]

Additionally, cases applying *Corwin* have evinced judicial disfavor with post-closing damages claims premised on lack of full disclosure. Vice Chancellor Glassock has described preliminary injunction motions as the "preferred method for vindicating truly material disclosure claims," and he stated that a "salutary incentive" for bringing disclosure claims pre-closing, rather than post-closing, is to deem disclosure claims that are "pled but not pursued pre-close, to be waived."[112] Similarly, Chancellor Bouchard has described a motion for a disclosure-based preliminary injunction as the "appropriate" means of challenging the adequacy of disclosure, "if a stockholder representative truly believes the disclosure claims have merit and truly wishes to obtain meaningful relief for the benefit of the putative claims of stockholders he represents."[113]

This sentiment represents a reversal of judicial policy. Before *Corwin*, recovering significant monetary relief in post-closing litigation was considered the highest object of plaintiffs' counsel in stockholder class action litigation. After *Corwin*, there is no clear path to do so.

As noted at the outset of this section, expedited discovery has been the critical weapon in the plaintiffs' arsenal. Expedited discovery can uncover e-mails that reveal facts that contradict or are not disclosed in a proxy statement or board minutes. If such facts are uncovered in expedited discovery, and if they are not corrected or disclosed in a supplement to the proxy statement, then defendants cannot take advantage of the legal edifice built around the significance of an informed stockholder vote.

Absent a path for obtaining expedited discovery and using it to challenge the integrity of a stockholder vote, potentially meritorious damages claims for breach of the duty of loyalty or aiding and abetting will either be dismissed or will not be filed.

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110. *In re* El Paso Corp. S'holder Litig., 41 A.3d 432 (Del. Ch. 2012).

111. City of Miami Gen. Emps. & Sanitation Emps.' Ret. Trust v. Comstock, C.A. No. 9980-CB, 2016 WL 4464156, at *16 (Del. Ch. Aug. 24, 2016), *aff'd*, No. 482, 2016, 2017 WL 1093185 (Del. Mar. 23, 2017) (en banc).

112. Nguyen v. Barrett, C.A. No. 11511-VCG, 2016 WL 5404095, at *7 (Del. Ch. Sept. 28, 2016).

113. Vento v. Curry, C.A. No. 2017-0157-AGB, 2017 WL 1076725, at *1 (Del. Ch. Mar. 22, 2017).

The eight data points of successful stockholder actions suggest the stakes involved in the new restrictions on pleading duty of loyalty claims. In each case, early access to discovery material was essential. We uncovered undisclosed facts and forestalled or defeated motions to dismiss that otherwise might have succeeded.

In *Rural/Metro* and *Prime Hospitality*, the original plaintiffs obtained expedited discovery and entered into disclosure settlements. We used the expedited discovery record to object to the settlements and craft amended complaints.

In *Rural/Metro*, the discovery record allowed us to identify an abnormality in the discounted cash flow ("DCF") analysis of a co-financial advisor (Moelis) that was hidden by the proxy statement's opaque description of the DCF range.[114] The discovery record also included e-mails that helped us, as plaintiff's counsel, establish that both the CEO and the chair of the special committee had pursued a premature sale process for self-interested reasons.[115] No defendants moved to dismiss the amended complaint. Full merits discovery uncovered internal e-mails of the other co-financial advisor (RBC) that allowed us to prove that it had self-interestedly misled Rural/Metro's directors and stockholders.[116]

In *Prime Hospitality*, the discovery record revealed inconsistencies between the board minutes and the proxy statement. Chancellor Chandler's opinion rejecting the disclosure settlement discussed how, "if a more fully developed record elucidates what the current record suggests, the Proxy Statement, even with the supplemental disclosures, does not adequately disclose what happened."[117] Only one defendant, the buyer, moved to dismiss our client's amended complaint. The case settled while that motion was pending.

In *Websense*, a plaintiff unsuccessfully sought expedited discovery in the Court of Chancery and then agreed to dismiss his action. Our client filed suit in California state court and conducted extensive discovery after the transaction closed. Discovery unearthed information about undisclosed conflicts of interest of the financial advisor. Our client settled with the director defendants and the buyer in California, and then used discovery obtained in California to file suit in Delaware against the financial advisor. But for access to discovery in California, our client would not have learned about the undisclosed conduct of the financial advisor.

We filed suit in *Gardner Denver* largely because we were intrigued by sparse disclosures in the proxy statement about how the former CEO of the target company, whose resignation as CEO led to the sale process, had been retained as a consul-

114. Settlement Hearing and Rulings of the Court at 101–03, 131–32, *In re* Rural/Metro Corp. S'holders Litig. (Del. Ch. Jan. 17, 2012) (Cons. C.A. No. 6350-VCL).

115. *See In re* Rural/Metro Corp. S'holders Litig., 88 A.3d 54, 65–66 (Del. Ch. 2014).

116. After the Delaware litigation was over, RBC agreed to entry of an SEC cease-and-desist order fining it $2.5 million and finding that it caused Rural/Metro to make materially false and misleading disclosures about RBC's valuation analysis. Press Release, U.S. Sec. & Exch. Comm'n, RBC to Pay $2.5 Million for Proxy Statement Disclosure Violations (Aug. 31, 2016), https://www.sec.gov/news/pressrelease/2016-174.html.

117. *In re* Prime Hospitality, Inc. S'holders Litig., C.A. No. 652-N, 2005 WL 1138738, at *13 (Del. Ch. May 14, 2005).

tant by the winning bidder. Expedited discovery was unopposed. Our post-closing amended complaint alleged that the winning bidder exploited contractually protected confidential information obtained from the former CEO. The case settled during the pendency of motions to dismiss, after the Court of Chancery ruled that the deposition transcripts from expedited discovery could be considered for purposes of deciding the motions to dismiss, but that all reasonable inferences from allegations based on the deposition testimony must be viewed in plaintiffs' favor, and no conflicting inferences may be drawn from the testimony.[118]

In *TeleCorp*, defendants agreed in principle with a competing plaintiff to expedite discovery, which we feared was a prelude for them to settle the case while the transaction was pending.[119] After we obtained leadership of the case on behalf of our clients, we learned in expedited discovery a narrative nowhere found in the proxy statement—that the venture capital investors who controlled the board of directors had been looking for an orderly way to liquidate their shares amidst a free fall in telecom and technology valuations. Given post-announcement declines in telecom valuations, we did not move for a preliminary injunction. After the transaction closed, two of the defendants moved to dismiss our amended complaint, and that motion was denied.[120]

As discussed in Part I.B above, expedited discovery in *Chaparral* revealed undisclosed facts about fraudulent cash flow projections and coercion during the buyout negotiations.

In *Activision* and *Sterling Chemicals*, we relied on statutory alternatives to expedited discovery to gain access to documents supporting our clients' breach of fiduciary duty claims. In *Activision*, a books and records request pursuant to 8 *Del. C.* § 220 during the pendency of the challenged transaction yielded board minutes that allowed us to plead the undisclosed fact that the CEO credibly threatened to resign if his proposed transaction structure to buy out Vivendi, in which he would invest as a principal, was not supported by the special committee of directors.[121]

Sterling Chemicals began as an appraisal case. Appraisal discovery contained e-mails and deposition testimony that allowed us to allege the following, as summarized by Vice Chancellor Laster at the settlement hearing, none of which was disclosed in the proxy statement:

> The gist of the complaint was that Resurgence breached its duty of loyalty by causing Sterling to be sold at a fire sale price to address a liquidity crisis at the Resurgence

118. Settlement Hearing at 3–7, *In re* Gardner Denver, Inc. S'holders Litig., C.A. No. 8505-VCN (Del. Ch. Sept. 3, 2014); *see In re* Gardner Denver, Inc. S'holders Litig., C.A. No. 8505-VCN, 2014 WL 715705, at *7 (Del. Ch. Feb. 21, 2014).

119. Hearing on Motion for Appointment of Plaintiffs' Lead Counsel and Rulings of the Court at 5–8, 39–40, *In re* TeleCorp PCS, Inc. S'holders Litig., C.A. Nos. 19158, 19159, 19161, 19162, 19177, 19190, 19202 & 19260 (Del. Ch. Dec. 6, 2001).

120. Oral Argument on Defendants' CTIHC, Inc. and Gary C. Wendt's Motion to Dismiss and Ruling of the Court at 90–96, *In re* TeleCorp PCS, Inc. S'holders Litig., C.A. No. 19260 (Del. Ch. June 17, 2002).

121. Oral Argument Motion to Appoint Lead Plaintiff and Lead Counsel and the Court's Ruling at 20, 23, 27, *In re* Activision Blizzard, Inc. S'holder Litig. (Del. Ch. Dec. 3, 2013) (C.A. No. 8885-VCL).

> funds. The complaint contained numerous e-mails between Sass and others that corroborated this allegation. The complaint also identified various procedural deficiencies in the negotiation process that had been led by a special committee. These included allegations that one of the Sterling directors, who was a member of the committee and had close ties to Sass, was, in fact, conflicted in that role and was seeking to serve Resurgence's liquidity needs. It was alleged that the special committee's financial advisor met with the acquirer to discuss future work while representing the special committee. It was alleged that disclosures were made by the committee and other sell-side fiduciaries to the effect that Resurgence needed to sell, thereby undermining their negotiating position. It was further alleged that Moelis aided and abetted breaches of fiduciary duty by manipulating its fairness opinion to undervalue Sterling and make the merger appear fair. And, finally, Eastman was alleged to have aided and abetted the breaches of fiduciary duty by exploiting the conflicts that the sell-side fiduciaries had and Moelis' desire for future work.[122]

None of the above cases involved contested motions for expedited discovery or motions to dismiss under the logic of *Corwin*. During the years when these cases were initiated, access to discovery material was rarely a significant hurdle for a plaintiff serious about litigating over potential conflicts of interest in a sale process. The substance of the discovery material, rather than gaining access to it, was of critical importance when assessing a case. In this new era in which post-closing stockholder litigation is discouraged, and pleading the absence of an informed vote is a prerequisite to proceeding with merits discovery, there is no practical issue more important than obtaining access to e-mail at a time and in a manner that can preclude dismissal.

At present, there is no clear path for pleading a case that a sale process has been disloyally manipulated by an insider or a financial advisor. There are no longer disclosure settlements to object to. Bringing a preliminary injunction motion is self-defeating in light of *Corwin*. Seeking expedited discovery in the absence of an injunction application is an uncertain proposition. Section 220 inspections are a pale substitute for expedited discovery. Appraisal petitioners must have significant holdings[123] and are not incentivized to pursue classwide relief. The types of alleged misconduct adjudicated or compromised in the cases mentioned above (or in *Del Monte* or *El Paso*) may never be brought in the Court of Chancery as claims for breach of the duty of loyalty.

C. Extending the Business Judgment Rule to Transactions Involving Controlling Stockholders or Significant Stockholder/Directors

In recent years, substantive law has developed to make the business judgment rule applicable to two classes of transactions involving controlling stockholders. One such reform, adopted by the Delaware Supreme Court in *Kahn v. M&F*

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122. Settlement Hearing and Rulings of the Court at 42–43, Virtus Capital L.P. v. Eastman Chem. Co. (Del. Ch. Dec. 9, 2016) (C.A. No. 9808-VCL).

123. Del. Code Ann. tit. 8, § 262(g) (2015).

Worldwide Corp.,[124] makes the business judgment rule the operative standard of review for going-private transactions negotiated by a special committee and subject to a majority-of-the-minority stockholder vote. A second reform, articulated as dicta in *In re Synthes, Inc. Shareholder Litigation*,[125] would make the business judgement rule the default standard of review when a controller sells a company and receives pro rata merger consideration, including in certain circumstances where a controller desires liquidity for its illiquid control block. Both rules facilitate the dismissal of meritless challenges. The reforms are problematic, however, when viewed from the perspective of successful challenges to similar transaction structures.

1. An Omitted Data Point on the Road to *MFW*

In *In re Cox Communications, Inc. Shareholders Litigation*[126] addressed in Part I.B above, then-Vice Chancellor Strine discussed at length the empirical results of challenges to negotiable, going-private proposals. He discussed how, "in every instance, the plaintiffs' lawyers have concluded that the price obtained by the special committee was sufficiently attractive, that the acceptance of a settlement at that price was warranted."[127] He noted the counter-example of *In re Emerging Communications, Inc. Shareholders Litigation*, a case in which a "large holder represented by a very large firm that more usually represents corporate defendants than stockholders" (i.e., Skadden) objected to a proposed class settlement and obtained an award of damages at nearly four times the deal price.[128]

After discussing at length the failings of "the traditional plaintiffs' bar"[129] in this class of case, and after determining that the appropriate fee award in the case before him was $1.275 million, Vice Chancellor Strine appended a coda to his opinion in which he advocated eliminating the problem by adopting a new rule of substantive corporate law.

Vice Chancellor Strine proposed making the business judgment rule the operative standard of review in situations where a going-private merger is negotiated by

124. 88 A.3d 635 (Del. 2014).

125. 50 A.3d 1022 (Del. Ch. 2012).

126. 879 A.2d 604 (Del. Ch. 2005).

127. *Id.* at 621 (citing Weiss & White, *supra* note 53).

128. *Id.* at 632 (citing *In re* Emerging Commc'ns, Inc. S'holders Litig., C.A. No. 16415, 2004 WL 1305745 (Del. Ch. May 3, 2004, revised June 4, 2004)).

129. *Id.* at 641. The phrase "traditional plaintiffs' bar" was apparently taken from Weiss & White, *supra* note 53, who use it throughout their article to characterize law firms engaged in "free riding" and distinguish them from plaintiffs' counsel in five cases in their data set that did not fit that characterization (including *TeleCorp*). Weiss & White note that they lifted the phrase "traditional plaintiffs' bar" from Chancellor Chandler's decision in *TCW Technology Ltd. Partnership v. Intermedia Communications, Inc.*, C.A. Nos. 18336, 18289, 18293, 2000 WL 1654504 (Del. Ch. Oct. 17, 2000), the first contemporary decision adjudicating a class leadership dispute. White & Weiss, *supra* note 53, at 1841 n.130. Chancellor Chandler noted, in turn, that Grant & Eisenhofer, P.A. used the phrase "traditional plaintiffs' bar" in its leadership brief to distinguish itself from the other contestants. *TCW Tech.*, 2000 WL 1654504, at *2. I have elsewhere discussed the "two-tier plaintiff bar," which I think better describes an industry structure in which certain firms frequently file cases destined to be resolved for nominal relief, and other firms sometimes obtain substantial relief. Friedlander, *supra* note 38, at 904–10.

a special committee of a board of directors and is subjected to a majority-of-the-minority stockholder vote.[130] Under this new standard of review, a complaint challenging such a transaction would be subject to dismissal

> unless: 1) the plaintiffs plead particularized facts that the special committee was not independent or was not effective because of its own breach of fiduciary duty or wrongdoing by the controller (e.g., fraud on the committee); or 2) the approval of the minority stockholders was tainted by misdisclosure, or actual or structural coercion.[131]

The Vice Chancellor noted that nuisance suits would only be eliminated if a new standard of review "permits an attack on the pleading by the defendants" and does not "enable[] plaintiffs to get discovery simply by alleging financial unfairness by notice pleading."[132]

Eight years later, in *In re MFW Stockholders Litigation*, then-Chancellor Strine adopted that rule of law in the context of a motion for summary judgment and advocated for its application at the pleading stage.[133] The Delaware Supreme Court affirmed, and it held that the business judgment rule applies if the controller satisfies the following six elements:

> (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitely; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.[134]

That standard now applies at the pleading stage.[135]

In support of this new rule of pleading, Chancellor Strine in *MFW* cited Weiss & White's *File Early, Then Free Ride* as well as a more recent empirical study by practitioners who "examin[ed] twenty-seven going private transactions worth over $50 million between 2006 and 2010, and [drew] conclusions consistent with Weiss & White."[136] Chancellor Strine summarized the empirical data as establishing that a stockholder plaintiff had never succeeded in obtaining more value through litigation than a special committee had negotiated:

> [W]hat evidence exists suggests that the systemic benefits of the possibility of [entire fairness] review in cases like this are slim to non-existent. Indeed, the evidence that the possibility of [entire fairness] review provides real benefits to stockholders even in cases where a special committee is the only procedural protection is very slim at

130. *Cox*, 879 A.2d at 642–48.

131. *Id.* at 642.

132. *Id.* at 642 n.84.

133. 67 A.3d 496, 535 (Del. Ch. 2013).

134. Kahn v. M&F Worldwide Corp., 88 A.3d 635, 645 (Del. 2014).

135. *See, e.g.*, *In re* Books-A-Million, Inc. S'holders Litig., C.A. No. 11343-VCL, 2016 WL 5874974, at *8 (Del. Ch. Oct. 10, 2016) ("Compliance with the *M&F Worldwide* structure can be tested on a motion to dismiss."), *aff'd sub nom.*, Rousset v. Anderson, 2017 WL 2290066 (Del. May 22, 2017).

136. *MFW S'holders Litig.*, 67 A.3d at 534 n.177 (citing Weiss & White, *supra* note 53; Suneela Jain et al., *Examining Data Points in Minority Buy-Outs: A Practitioners' Report*, 36 DEL. J. CORP. L. (2011)).

> best, and there is a good case to be made that it is negative overall. . . . In fact, it is easier to find a case where a special committee got more than the price at which plaintiffs were willing to settle than it is to find the opposite.[137]

Chancellor Strine's summary omits the unpublished counter-example of *Chaparral*, which satisfies the criteria of the cited practitioner empirical study, but is mistakenly omitted from it. His summary also omits the counter-example of *Emerging Communications*. In both cases, plaintiffs litigated through trial, obtained far more value than a special committee had negotiated, and established that the special committee had been defrauded during the negotiation process.[138] The subsequent counter-example of *Dole* shares the same characteristics.[139]

The counter-examples of *Emerging Communications*, *Chaparral*, and *Dole* complicate the rationale for placing on the plaintiff the burden of pleading that the stockholder vote was not fully informed. In each case, the controller acted disloyally and committed fraud. That opportunity and temptation exists in any going-private transaction. *MFW*'s creation of a roadmap for business judgment rule review without fact discovery operates as an incentive for controllers to defraud special committees and public stockholders.

A heightened pleading standard can prevent disloyalty from being uncovered. In *Chaparral*, a consulting expert noticed an apparent discrepancy in the company's public filings about the number of projected oil wells. That discrepancy prompted us to seek discovery into the subject, which is how we learned about the controller's undisclosed plan to accelerate production.[140] In the absence of the disclosed discrepancy, the fraud might have gone undetected.

Emerging Communications, *Chaparral*, and *Dole* reveal the true stakes of changing the pleading standard for going-private transactions with a majority-of-the-minority vote. Imposing a burden of pleading a material omission increases the odds that a fraud will not be uncovered. That cost must be weighed against the incremental benefit of a new means of eradicating the unripe, free-riding settlements discussed in *Cox* and *MFW*. If free-riding settlements can be eradicated by a different means, such as the reform of withholding approval of them, as discussed in Part I.B above, then the rationale for changing the pleading standard is less compelling. A reform that focuses directly on eliminating non-adversarial, early settlements is preferable to a reform that creates an incentive for controllers to commit fraud.

137. *Id.* at 534 (footnotes omitted).

138. In *Chaparral*, the special committee defendants defended the case at trial on the basis that they had no knowledge of Lukoil's plans to accelerate and enhance production at the oil field prior to plaintiff's discovery of Russian-language documents to that effect; they requested additional information from Lukoil, which Lukoil did not provide; and they caused these facts to be disclosed in a proxy supplement. Special Committee Defendants' Pretrial Brief at 2, 25–27, 43, *In re* Chaparral Res., Inc. S'holders Litig., C.A. No. 2001-VCL (Del. Ch. Oct. 15, 2007).

139. *In re* Dole Food Co., Inc. S'holder Litig., Cons. C.A. No. 8703-VCL, 2015 WL 5052214, at *2 (Del. Ch. Aug. 27, 2015) ("But what the Committee could not overcome, what the stockholder vote could not cleanse, and what even an arguably fair price does not immunize, is fraud.").

140. *See supra* notes 60–61 and accompanying text.

2. The Uncertain Breadth of *Synthes*'s Safe Harbor

The role of stockholder/directors has an ambiguous place in corporate governance. In 2000, Franklin Balotti, Charles Elson, and then-practitioner J. Travis Laster co-authored an article advocating for a rebuttable presumption that directors who are substantial stockholders "acted with due care."[141] The authors made clear that their proposed equity-based presumption should only apply to the duty of care. They criticized judicial decisions "suggest[ing] that the incentives created by substantial equity ownership will be sufficient to overcome and sterilize competing influences that could create self-interested behavior," and they noted that other judicial decisions properly recognized that "the incentives created by substantial equity ownership may themselves cause duty of loyalty problems."[142]

Several months later, the Delaware Supreme Court issued *McMullin v. Beran*, in which the court reversed the dismissal of a complaint alleging that the majority stockholder had initiated a sale process and "insisted upon a cash only transaction" due its need for immediate cash to fund a pending multi-billion dollar acquisition.[143] The court reasoned that it was reasonably inferable that the board "compromised its deliberate process by seeking to accommodate [the majority stockholder's] immediate need for cash."[144]

Based on the strength of that 2000 law review article and *McMullin*, I argued in subsequent cases that the liquidity needs of stockholder/directors bore scrutiny. In *TeleCorp*, then-Vice Chancellor Strine denied a motion to dismiss on this ground, reasoning:

> Usually we take confidence in the fact that a large investor like Conseco has blessed a deal at the same price as the public. . . . [B]ut at the pleading stage, [plaintiffs have] raised a number of plausible reasons why certain of the large investors were willing to take less than a fair price for their shares to accomplish other objectives, lack of liquidity being the primary one and, in Conseco's case, its urgent need for cash. . . . [These large stockholders] weren't entitled to use their influence as fiduciaries to procure liquidity from AT&T Wireless on the backs of public stockholders in an unfair merger.[145]

When denying summary judgment in *TeleCorp*, the court noted that the stockholder/directors had "substantial interests in liquidity" and their holdings "had very different liquidity and had a very different basis than the public common

141. R. Franklin Balotti et al., *Equity Ownership and the Duty of Care: Convergence, Revolution, or Evolution?*, 55 Bus. Law. 661, 662 (2000).
142. *Id.* at 691, 692.
143. *Id.* at 921.
144. *Id.* at 922.
145. Oral Argument on Defendants' CTIHC, Inc. and Gary C. Wendt's Motion to Dismiss and Ruling of the Court at 95, *In re* TeleCorp PCS, Inc. S'holders Litig., C.A. No. 19260 (Del. Ch. June 17, 2002).

stockholders."[146] At the settlement hearing, the court observed that the case had a "big tailwind from McMullin versus Beran."[147]

A decade later, after having criticized *McMullin* in two prior decisions, then-Chancellor Strine issued *In re Synthes, Inc. Shareholder Litigation*,[148] which criticized *McMullin* at length[149] and discussed why a controlling stockholder's receipt of pro rata treatment in a merger "remains a form of safe harbor under our law."[150] Chancellor Strine articulated a default rule based on a policy judgment that controlling stockholders should be incentivized to obtain liquidity through sale transactions in which all stockholders are treated equally:

> Generally speaking, a fiduciary's financial interest in a transaction as a stockholder (such as receiving liquidity for her shares) does not establish a disabling conflict of interest when the transaction treats all stockholders equally, as does the Merger. . . . Controlling stockholders . . . have a natural incentive to obtain the best price for their shares. As a general matter, therefore, if one wishes to protect minority stockholders, there is a good deal of utility to making sure that when controlling stockholders afford the minority pro rata treatment, they know they have docked within the safe harbor created by the business judgment rule.[151]

This default rule is subject to an exception that Chancellor Strine described as a "very narrow" and "sort of uncommon scenario"; it "would have to involve a crisis, fire sale" in which "the controller forced a sale of the entity at below fair market value in order to meet its own idiosyncratic need for immediate cash" "(such as a margin call or default in a larger investment)."[152] Rather than cite *TeleCorp*, Chancellor Strine cited a denial of a motion to dismiss in a case in which it was alleged that a stockholder/director was in desperate need of liquidity, had been fired from his job, had no other discernable sources of cash flow or other liquid assets, and had threatened to sue his fellow directors if they did not take action to sell the company.[153]

Several months prior to writing *Synthes*, then-Chancellor Strine issued *Southern Peru*, which contains a long footnote discussing his "struggle with" the "close question" whether a "director would be considered interested because he (or in this case, his employer) desired the liquidity available to other stockholders."[154] Chancellor Strine stated that a desire for liquidity should not trigger liability "absent a showing that the director [acted] in bad faith," and he proclaimed his re-

146. Telephone Conference at 4, *In re* TeleCorp PCS, Inc. S'holders Litig., C.A. No. 19260 (Del. Ch. Mar. 6, 2003).

147. Settlement Hearing, Plaintiff's Motion for Class Certification and Award of Attorneys' Fees and Expenses, and Rulings of the Court at 39, *In re* TeleCorp PCS Inc. S'holders Litig., C.A. No. 19260 (Del. Ch. Aug. 20, 2003).

148. 50 A.3d 100 (Del. Ch. 2012).

149. *Id.* at 1041 n.91.

150. *Id.* at 1024.

151. *Id.* at 1035 (footnote omitted).

152. *Id.* at 1036.

153. *Id.* at 1036 n.67 (discussing N.J. Carpenters Pension Fund v. Infogroup, Inc., C.A. No. 5334-VCN, 2011 WL 4825888 (Del. Ch. Sept. 30, 2011)).

154. *In re* S. Peru Copper Corp., 30 A.3d 60, 87 n.68 (Del. Ch. 2011), *revised & superseded by* 52 A.3d 761 (Del. Ch. 2011), *aff'd sub nom.* Ams. Mining Corp. v. Theriault, 51 A.3d 1213 (Del. 2012).

luctance "to call a stockholder's desire for liquidity an interest, because there is likely utility in having directors who represent stockholders with a deep financial stake that gives them an incentive to monitor management and controlling stockholders closely."[155]

Chancellor Strine's dicta in *Southern Peru* and *Synthes*, if authoritatively adopted as law, would narrow the circumstances in which a claim for disloyalty could be pled and proven against a stockholder/director who desires liquidity. Vice Chancellor Laster's subsequent rulings in *Rural/Metro*, *Activision*, and *Sterling Chemicals* suggest the stakes involved in how the law treats liquidity-based duty of loyalty claims.

An important issue in *Rural/Metro* was the legal standard applicable to Christopher Shackelton, who was Chairman of the Board, Chair of the Special Committee, and operated a hedge fund that owned 12 percent of Rural/Metro. Vice Chancellor Laster held that the board had not acted reasonably under *Revlon* and that Shackelton would not have been entitled to exculpation if he had not settled on the eve of trial. Shackleton was deemed to have had a conflict of interest, based on a "desire for liquidity."[156] "[T]he evidence at trial established that Shackelton and his fund had unique reasons to favor a near-term transaction that caused their interests to diverge from those of Rural's equity as a whole."[157] There was no finding that Shackelton acted with subjective bad faith or that his hedge fund had an immediate need for cash. Nevertheless, the Delaware Supreme Court affirmed, including the factual finding that "Shackelton had personal reasons for pushing a near-term sale."[158]

In *Activision*, a critical legal ruling at the motion to dismiss phase was that entire fairness applied to the transaction by virtue of controlling stockholder Vivendi obtaining liquidity for its stake. Vice Chancellor Laster stated: "This is a challenged transaction that confers a benefit on a controlling stockholder that was not shared with the rest of the stockholders. That benefit was liquidity. . . . I do think it is accepted in our cases that differential liquidity is a unique benefit that creates self-interest. That's *McMullin*. . . . That's *TeleCorp*."[159] The complaint pled that Vivendi was burdened with over $17 billion in debt and needed liquidity.[160] Vivendi's strong desire for liquidity was clear, as was its ill effect on the transaction process, but it could not be proven at trial that Vivendi faced a desperate need for immediate cash to the extent described in *Synthes* (i.e., "a margin call or default in a larger investment").

Sterling Chemicals challenged a controlling stockholder's sale of a company, as in *Synthes*. The controlling stockholder allocated additional merger consideration

155. *Id.*
156. *In re* Rural/Metro Corp. S'holders Litig., 102 A.3d 205, 257 (Del. Ch. 2014).
157. *Id.*
158. RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816, 826 (Del. 2015).
159. Oral Argument on Defendants' Motion to Dismiss the Verified Third Amended Class and Derivative Complaint, Plaintiff Benston's Motion for Appointment as Co-Lead Counsel for the Purpose of Bringing Brohy-Related Claims and the Court's Rulings at 114–15, *In re* Activision Blizzard, Inc. S'holder Litig. (Del. Ch. June 6, 2014) (C.A. No. No. 8885-VCL).
160. *In re* Activision Blizzard, Inc. S'holder Litig., 124 A.3d 1025, 1031 (Del. Ch. 2015)

to the unaffiliated common stockholders, so that the controller obtained less than pro rata treatment. Vice Chancellor Laster observed for purposes of a jurisdictional motion to dismiss by controlling stockholder Martin Sass that "[t]he complaint contains detailed allegations that Sass breached his duty of loyalty by causing Sterling to be sold at a fire-sale price to alleviate a liquidity crisis that Sass was facing at his investment funds."[161] The factual evidence about Sass's motivation for liquidity and its negative effect on the sale process was abundant, but it was far from clear that plaintiffs could prove at trial a desperate need for immediate cash as described in *Synthes*.

In other words, if the dicta in *Synthes* and *Southern Peru* were clearly the law, and if, as a public policy matter, Delaware law considered it important to reduce legal risk for controlling stockholders and stockholder/directors who pursue sale transactions in a manner that serves their unique desire for liquidity, then litigations similar to *TeleCorp*, *Rural/Metro*, *Activision*, and *Sterling Chemicals* would not succeed and might not be pursued. The factual findings and detailed factual allegations in those cases and in *Southern Peru* make clear the policy significance of adopting the dicta of *Synthes* and *Southern Peru* as legal rules.

Conclusion

The generation since the demise of hostile takeovers has tested the tolerance of the Court of Chancery to oversee seemingly ubiquitous, meritless challenges to merger and acquisition transactions filed by stockholders-plaintiffs with little stake in the outcome. It is not surprising that the volume of this docket created pressures to approve settlements, and then created pressures to find ways to reduce the incidence of both the filings and the settlements. What is discouraging is that various reform measures appear to presume the necessity of under-deterrence of fiduciary disloyalty, without apparent regard for the relative recent abundance of successful stockholder litigation. This article aims to focus the reform agenda in a manner that better subserves the duty of loyalty, and allows the Delaware Court of Chancery to reclaim its historic role of enforcing it.

161. Virtus Capital L.P. v. Eastman Chem. Co., C.A. No. 9808-VCL, 2015 WL 5805553, at *1 (Del. Ch. Feb. 11, 2015).