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**Confronting the Peppercorn Settlement in  
Merger Litigation: An Empirical Analysis  
and a Proposal for Reform**

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## **Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform**

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### *Abstract*

*Shareholder litigation challenging corporate mergers is ubiquitous, with the likelihood of a shareholder suit exceeding 90%. The value of this litigation, however, is questionable. The vast majority of merger cases settle for nothing more than supplemental disclosures in the merger proxy statement. The attorneys that bring these lawsuits are compensated for their efforts with a court-awarded fee. This leads critics to charge that merger litigation benefits only the lawyers who bring the claims, not the shareholders they represent. In response, defenders of merger litigation argue that the lawsuits serve a useful oversight function and that the improved disclosures that result are beneficial to shareholders.*

*This Article offers a new approach to assessing the value of these claims by empirically testing the relationship between merger litigation and shareholder voting on the merger. If the supplemental disclosures produced by the settlement of merger litigation are valuable, they should affect shareholder voting behavior. Specifically, supplemental disclosures that are, in effect, “compelled” by settlement should produce new and unfavorable information about the merger and lead to a lower percentage of shares voted in favor of it. Applying this hypothesis to a hand-collected sample of 453 large public company mergers from 2005-2012, we find no such effect. We find no significant evidence that disclosure-only settlements affect shareholder voting.*

*These findings warrant a reconsideration of Delaware merger law. Specifically, under current law, supplemental disclosures are viewed by courts as providing a substantial benefit to the shareholder class. In turn, this substantial benefit entitles the plaintiffs’ lawyers to an award of attorneys’ fees. Our evidence suggests that this legal analysis is misguided and that supplemental disclosures do not in fact constitute a substantial benefit. As a result, and in light of the substantial costs generated by public company merger litigation, we argue that courts should reject disclosure settlements as a basis for attorney fee awards.*

*Our approach responds to critiques of merger litigation as excessive and frivolous by reducing the incentive for plaintiffs’ lawyers to bring weak cases, but it would have an additional benefit. Current practice drags state court judges into the task of indirectly promulgating disclosure standards in connection with the approval of fee awards. We argue, instead, for a more efficient specialization between state and federal courts in the regulation of mergers: public company merger disclosure should be policed by the federal securities laws while state corporate law focuses on substantive fairness.*

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## Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform

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

Chancellor Allen in *Solomon v. Pathe*<sup>1</sup>

### Introduction

Deal litigation is pervasive in the United States. Multiple teams of plaintiffs file lawsuits challenging virtually every public company merger,<sup>2</sup> often in multiple jurisdictions.<sup>3</sup> Moreover, the frequency of merger litigation has risen sharply over the last several years.<sup>4</sup> In 2012, 92% of deals over \$100 million and 96% of deals over \$500 million were challenged in shareholder litigation.<sup>5</sup> In 2013, the frequency was even higher – 97.5% of deals were challenged through litigation, and each transaction triggered an average of seven separate lawsuits.<sup>6</sup>

Although deal litigation is pervasive, these lawsuits rarely result in a monetary recovery for the plaintiff class. Rather, the vast majority end in settlement or dismissal. In most settled cases, the only relief provided to shareholders consists of supplemental disclosures in the merger proxy statement.<sup>7</sup> In compensation for the benefit produced by these settlements—often worth no more, in the words of a famous jurist, than a “peppercorn”—plaintiffs’ attorneys receive a fee award.<sup>8</sup>

The dynamic, in which every deal is challenged but only the lawyers get paid, has led to widespread skepticism concerning the value of public company merger litigation among both academic

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<sup>1</sup> *Solomon v. Pathe Commc’ns Corp.*, 1995 Del. Ch. LEXIS 46, 1995 WL 250374, at \*4 (Del. Ch. Apr. 21, 1995).

<sup>2</sup> Both our empirical analysis and the policy proposals in this paper are limited to mergers involving publicly-traded target companies. We do not address the role of litigation in policing mergers involving private companies.

<sup>3</sup> See *infra* notes -- and accompanying text (finding a litigation rate of 72% across our sample period 2004-2012 but a significantly higher rate recently—95% in 2012).

<sup>4</sup> See Matthew D. Cain & Steven M. Davidoff, *A Great Game: The Dynamics of State Competition and Litigation*, (Working Paper, Jan 2013) (reporting that although only 39.3% of transactions incurred litigation in 2005, the frequency of litigation had risen to 92.1% by 2011) [hereinafter, Cain & Davidoff, *Great Game*].

<sup>5</sup> See Matthew D. Cain & Steven M. Davidoff, *Takeover Litigation in 2012*, at 2-3 (Feb. 1, 2013) (unpublished manuscript), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2216727](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2216727); Robert M. Daines & Olga Koumrian, *Shareholder Litigation Involving Mergers and Acquisitions*, Cornerstone, Feb. 2013, <http://cornerstone.com/Publications/Reports/Shareholder-Litigation-Involving-Mergers-and-Acqui>.

<sup>6</sup> Matthew D. Cain & Stephen M. Davidoff, *Takeover Litigation in 2013* (January 9, 2014), available at <http://ssrn.com/abstract=2377001>.

<sup>7</sup> See Cain & Davidoff, *Great Game*, *supra* note 4, at Table II (finding that 76.9% of merger litigation settlements from 2005 through 2012 were disclosure settlements); Daines & Koumrian, *supra* note 5, at 2 (“in more than 80% of settlements, the only relief to shareholders was additional disclosures”); Ann Woolner, *et al.*, *When Merger Suits Enrich Only Lawyers*, Bloomberg, Feb. 16, 2012, <http://www.bloomberg.com/news/2012-02-16/lawyers-cash-in-while-investor-clients-get-nothing-in-merger-lawsuit-deals.html> (reporting that, according to data compiled by Bloomberg News, 70 percent of merger lawsuits concluded in Delaware during 2010 and 2011 resulted in payments for plaintiffs’ lawyers, but not their clients). The supplemental disclosure may be a part of the target company’s proxy statement or prospectus or, in some cases, the target’s Schedule 14D-9. For brevity, we will refer to all of these collectively as the “proxy.”

<sup>8</sup> See *supra* note 1 and accompanying text.

and professional commentators.<sup>9</sup> The view underlying much of this skepticism is that litigation that returns no monetary recovery to the plaintiff class must be without merit. Equating merit and monetary recovery, however, implicitly dismisses the value of non-pecuniary relief. Such non-pecuniary relief may be valuable to shareholders, but it is hard to determine its value.

Importantly, Delaware law explicitly recognizes the potential value of non-pecuniary relief in its litigation incentive structure. Delaware courts award legal fees to plaintiffs' attorneys on the basis of lawsuits that provide non-pecuniary relief to the plaintiff class as long as that relief constitutes a corporate benefit.<sup>10</sup> Nevertheless, Delaware courts recognize that the value of non-pecuniary benefits is difficult to quantify. Courts refer to the value of amendments and supplemental disclosures as "qualitative" and "intangible," meaning essentially, that they cannot be measured.<sup>11</sup> Without a metric for the value of non-pecuniary relief, it is difficult to determine the utility of the litigation and, in particular to determine the extent to which courts, by awarding fees, should encourage the pursuit of litigation that tends to result in non-pecuniary settlements.<sup>12</sup>

In this Article, we offer a way out of the impasse. We propose that the value of non-pecuniary relief in merger settlements be measured by its effect on shareholder voting. Because non-pecuniary relief takes three basic forms in the context of merger litigation—settlements that amend the terms of the merger (amendment settlements), settlements that provide only supplemental disclosures (disclosure-only settlements) and settlements which provide for an increase in the merger consideration (consideration increase settlements) -- we separate each and test their effect on how shareholders vote on the deal.<sup>13</sup> Our core hypotheses are as follows. First, because amendments should improve the terms of the merger or the quality of the procedures used in reaching a final agreement, amendment settlements should increase

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<sup>9</sup> See, e.g., David H. Webber, *Private Policing of Mergers and Acquisitions: An Empirical Assessment of Institutional Lead Plaintiffs in Transactional Class and Derivative Actions* (June 24, 2013), 7th Annual Conference on Empirical Legal Studies Paper, available at SSRN: <http://ssrn.com/abstract=1879647> (describing the debate); Robert M. Daines & Olga Koumrian, *Merger Lawsuits Yield High Costs and Questionable Benefits*, N.Y. TIMES DEALBOOK, Jun. 8, 2012, <http://dealbook.nytimes.com/2012/06/08/merger-lawsuits-yield-high-costs-and-questionable-benefits/> (stating that deal litigation may "impose excessive costs on the companies involved and their shareholders" while delivering uncertain benefits); Ann Woolner, Phil Milford & Rodney Yap, *When Merger Suits Enrich Only Lawyers*, Bloomberg.com (Feb. 16, 2012, 1:59 PM), <http://www.bloomberg.com/news/2012-02-16/lawyers-cash-in-while-investor-clients-get-nothing-in-merger-lawsuit-deals.html> (quoting John C Coffee, Jr., of Columbia University as stating, "[t]he greatest benefit is for the plaintiffs' attorneys."); JOEL C. HAIMS & JAMES J. BEHA, II, MORRISON & FOERSTER, LLP, RECENT DECISIONS SHOW COURTS CLOSELY SCRUTINIZING FEE AWARDS IN M&A LITIGATION SETTLEMENTS 4 (2013), available at <http://www.mofo.com/files/Uploads/Images/130418-In-the-courts.pdf>; Phillip R. Sumpter, *Adjusting Attorneys' Fee Awards: The Delaware Court of Chancery's Answer to Incentivizing Meritorious Disclosure-Only Settlements*, 15 U. PA J. BUS. L. 669, 688-91 (2013) (describing four types of criticism the court has expressed).

<sup>10</sup> Delaware law provides that the court may award plaintiffs' counsel a fee, payable by the corporate defendant, when the litigation produces a benefit to the corporation and its shareholders. See *Sugarland Indus., Inc. v. Thomas*, 420 A.2d 142, 149-50 (Del.1980).

<sup>11</sup> See *Sauer-Danfoss S'holders Litig.*, C.A. No. 5162-VCL (Apr. 29, 2011).

<sup>12</sup> See, e.g., Transcript of Settlement Hearing at 44, *In re Gen-Probe Shareholders Litigation*, No. 7495-VCL (Del. Ch. Apr. 10, 2013) [hereinafter GEN-PROBE TRANSCRIPT] ("I recognize that the policy is to encourage stockholder champions to bring meritorious litigation but not to confer unwholesome windfalls that result in excessive and unwarranted lawsuits.").

<sup>13</sup> Some settlements provide for a combination of relief. We treat settlements that both amend the merger agreement and provide supplemental disclosures as "amendment settlements." See *infra* note -.

shareholder voting in favor of the merger. In contrast, because forced disclosures should produce negative information about the merger, we hypothesize that disclosure-only settlements should decrease shareholder voting in favor of the merger.

Our empirical tests draw upon a hand-collected sample of 453 mergers involving publicly-traded target companies announced from 2005 and completed through 2012 along with proxy-voting statistics provided to us by ISS over the same period. Although in theory it would be best to test the effect of non-pecuniary relief by comparing shareholder votes before and after the settlement, such a comparison is not possible because shareholder votes are tallied only once, when the polls are closed at the meeting to approve the merger agreement. As a result, our tests take the form of regressions. Our regression analyses compare votes cast in cases involving amendment settlements and disclosure-only settlements to votes in other mergers.

Our tests yield two main empirical results. First, we find weak support for our first hypothesis—that is, that amendment settlements increase shareholder voting in favor of a transaction. Second, and more importantly, we find no support for the second hypothesis – that is, disclosure-only settlements do not appear to affect shareholder voting in any way. We also find only weak evidence that consideration increase settlements increase shareholder voting in favor of a transaction. To gauge the significance of our findings, we also tested the effect of several other variables on shareholder voting, including transaction size and premium paid, the proxy advisors’ recommendation and institutional ownership, and the jurisdiction of settlement. We find that transaction value and the proxy advisors’ recommendation have a significant effect on shareholder voting; the other variables do not.

The implication of these findings is clear. If disclosure settlements do not affect shareholder voting, it is difficult to argue that they benefit shareholders. Accordingly, the basis upon which courts are awarding fees to plaintiffs’ counsel disappears. Moreover, the illusory benefit of supplemental disclosure must be weighed against the clear cost of merger litigation—including litigation expense as well as delay and uncertainty. Accordingly, our article proposes that the Delaware courts stop awarding fees for disclosure-only settlements. This reform would reduce the incentive for plaintiffs’ attorneys to bring weak merger cases. To the extent that merger disclosures are meaningfully deficient, we argue that plaintiffs should be required to litigate challenges to disclosure quality under the federal securities laws. This would have the effect of efficiently specializing litigation challenges while reducing plaintiffs’ counsel’s ability to use disclosure as a negotiating point to justify a fee award.

We also argue that state court merger litigation has had the perverse effect of creating a substantive state law of disclosure that is litigated almost exclusively within the artificial context of settlement approval rather than in truly adversarial proceedings. This state law exists within the shadow of federal regulation of mergers, which imposes extensive and explicit disclosure obligations on publicly-

traded companies. We suggest that the duplication is unnecessary and problematic. Specifically, federal law is expressly tailored to achieving an appropriate balance in disclosure requirements and addressing disclosure deficiencies that are substantially likely to influence the voting decision—that is, material misrepresentations or omissions. In contrast, Delaware law creates an incentive for litigants to generate, and judges to reward, throwaway disclosures that are designed simply to end litigation and generate a release.<sup>14</sup> These settlements produce disclosures that do not matter to shareholders but are instead simply, “useful gravy.”<sup>15</sup>

Our recommendation would restore merger litigation to the balance articulated by the United States Supreme Court in *Santa Fe v. Green*.<sup>16</sup> In *Santa Fe v. Green*, the Court limited the federal securities law cause of action to challenges to disclosure quality. Holding that challenges to the adequacy of the merger consideration should be litigated under state law.<sup>17</sup> We argue that the Delaware courts should reach a similar result – a type of consensual preemption – by concluding that claims about the adequacy of merger disclosure should be litigated under federal law and subject to the materiality threshold and other procedural requirements associated with federal litigation. This efficient specialization would leave for state law issues concerning the fairness of the merger terms.

This Article fits within the body of scholarly literature on representative litigation generally and shareholder litigation in particular.<sup>18</sup> This literature has frequently questioned the extent to which representative litigation produces meaningful value for plaintiffs.<sup>19</sup> Although many articles criticize merger litigation, to our knowledge none supports its conclusion with empirical evidence upon the relationship between merger litigation and shareholder voting.

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<sup>14</sup> See Sean J. Griffith & Alexandra Lahav, *The Market for Claims Preclusion in Merger Litigation*, 66 VAND. L. REV. 1053 (2013) (describing this dynamic).

<sup>15</sup> GEN-PROBE TRANSCRIPT, *supra* note -, at 27.

<sup>16</sup> *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977).

<sup>17</sup> See *id.* at 477-78 (holding that application of federal law would improperly depart from state fiduciary standards that should “govern the internal affairs of the corporation” (citation omitted)).

<sup>18</sup> See generally John C. Coffee, *Understanding the Plaintiff’s Attorney: The Implications for Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669 (1986) (characterizing plaintiffs’ lawyers in representative litigation as “private attorneys general” and theorizing that the litigation and settlement patterns will reflect their private incentives). Much empirical work on shareholder litigation is devoted to securities fraud class actions. See, e.g., Stephen J. Choi, *The Evidence on Securities Class Actions*, 57 VAND. L. REV. 1465 (2004); Jim D. Cox & Randall Thomas, *Mapping the American Shareholder Litigation Experience: A Survey of Empirical Studies of the Enforcement of the U.S. Securities Laws*, 6 EUR. CO. FIN. L. REV. 164 (2009).

<sup>19</sup> See, e.g. Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 84-85 (1991); Steven B. Hantler & Robert E. Norton, *Coupon Settlements: The Emperor’s Clothes of Class Actions*, 18 GEO. J. LEGAL ETHICS 1343, 1347-48 (2005) (describing coupon settlements of dubious value including one where attorneys received \$1.75 million and consumers received a free box of Cheerios if they kept the original grocery receipt to prove purchase). See also Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133 (2004) (finding that significant monetary awards were paid to shareholders, especially in “controlling shareholder” cases, and that these settlements involved a substantially lower ratio of attorneys’-fee to plaintiff-recovery than securities fraud class actions); Elliott J. Weiss & Lawrence J. White, *File Early, Then Free Ride: How Delaware (Mis)Shapes Shareholder Class Actions*, 57 VAND. L. REV. 1797 (2004) (examining 104 merger class actions filed in Delaware between 1999-2000, and finding that merger litigation is lawyer-driven, resulting in opportunistic filing and settlement of claims).

The remainder of this Article proceeds as follows. In Part I we describe the dynamics of merger litigation and note, in particular, the role that courts have played in encouraging litigation challenges through the terms on which they approve settlements and fee awards. Part I explicitly identifies the motivation for our empirical tests: the assumption that these settlements provide a benefit to plaintiff shareholders. In Part II we report our empirical results. Most significantly, we find that amendment settlements affect shareholder voting but that disclosure settlements do not. In Part III we consider the public policy implications of our findings. Part IV identifies and responds to possible objections to our proposal and, in Part V, we briefly sketch out possible methods for implementation. We conclude that Delaware courts should abandon the practice of compensating plaintiffs' lawyers for disclosure-only settlements.

## **I. Merger Litigation and Disclosure-only Settlements**

### **A. The Anatomy of a Merger Claim**

State court merger litigation is premised upon the traditional fiduciary duties that target company officers and directors<sup>20</sup> owe to the company's shareholders in connection with an acquisition, merger, or other business combination.<sup>21</sup> In recent years this type of claim has proliferated.<sup>22</sup> State law fiduciary duties encompass several types of claims. In friendly deals,<sup>23</sup> the typical claims are a breach of the duty of care and a failure to act in good faith, based on allegations that the board failed to work diligently to maximize the merger price.<sup>24</sup> The transaction may also trigger a related *Revlon* claim.<sup>25</sup> Claims in the

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<sup>20</sup> Although the shareholders of both target and acquiring companies may be unhappy about a planned merger, target shareholders are the typical plaintiffs in merger litigation. In part, this is because target company shareholders can typically bring a direct action, while the acquirer's shareholders can only bring a derivative suit in the name of the corporation, which is subject to a variety of procedural limitations. Notably Delaware law has imposed distinctive duties on target company boards in the merger context. See *Paramount Commc'ns Inc. v. QVC Network, Inc.*, 637 A.2d 34, 42 (Del. 1993) (enhanced scrutiny in a stock transaction in which the target company went from being diffusely held to coming under the influence of a controlling shareholder); *Revlon v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 180 (Del. 1986) (enhanced scrutiny in a cash transaction involving a break-up of the target company). But see J. Travis Laster, *Revlon is a Standard of Review: Why It's True and What It Means*, 19 FORDHAM J. CORP. & FIN. L. 1 (2013) (criticizing the "Paramount doctrine" and seeking to articulate a new basis for enhanced scrutiny). See also *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711–15 (Del. 1983) (requiring fair dealing and fair price in non-arm's length transactions).

<sup>21</sup> For the sake of brevity, we refer to all of these transactions collectively as "mergers."

<sup>22</sup> See *supra* notes - and accompanying text.

<sup>23</sup> Our analysis does not focus on hostile litigation which raises independent bases for litigation. See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985) (articulating legal standard for challenge to board's adoption of defensive measures in response to takeover attempt).

<sup>24</sup> See, e.g., *Thompson & Thomas*, *supra* note -, at 146-47 (2004) (analyzing legal basis of state law challenges to friendly mergers).

<sup>25</sup> See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (recognizing board duty to maximize shareholder value when selling the company).

context of a controlling shareholder add more traditional allegations of duty of loyalty violations.<sup>26</sup> Finally shareholders can allege violations of the board's state law duty of disclosure.<sup>27</sup>

The Delaware courts developed the scope of directors' state law disclosure obligations fairly recently.<sup>28</sup> Although the courts have long recognized that the board in a merger is responsible for providing shareholders with sufficient information to approve or reject the transaction on an informed basis,<sup>29</sup> the suggestion that directors have an independent duty of disclosure and that directors can breach that duty by failing to provide shareholders with information material to the vote is of recent vintage.<sup>30</sup>

Plaintiffs in merger litigation typically ask for equitable relief—most often in the form of an injunction barring consummation of the transaction or a substantial revision of its terms such as a higher price.<sup>31</sup> The suits are filed during the pendency of the transaction—usually within days of the public announcement of the merger. Most of the litigation effort, motions practice and expedited discovery, takes place during the relatively brief window between the merger filing and its closing. Because claims that are not resolved on motions or settled prior to closing can theoretically be litigated long after closing, creating a potentially significant contingent liability, defendants have a strong incentive to resolve merger

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<sup>26</sup> Thompson & Thomas, *supra* note - .

<sup>27</sup> A target board has a disclosure obligation under Delaware law that stems both from the statute and from the board's fiduciary duty. *See In re Primedia, Inc. Shareholders Litigation*, 67 A.3d 455, at 491 (Del. Ch., May 10, 2013) (VC Laster) (distinguishing “the statutory obligation to maintain a current and candid merger recommendation . . . and the fiduciary duty to disclose material information when seeking stockholder action”). The statutory duty to disclose in connection with merger transactions arises from the requirement that the board make a recommendation concerning the advisability of an intended merger transaction to the shareholders entitled to vote thereon. *See* 8 D.G.C.L. 251(b) (requiring that the board adopt the agreement and declare its advisability prior to the shareholder vote). *See generally* Lawrence A. Hamermesh, *Calling Off the Lynch Mob: The Corporate Director's Fiduciary Disclosure Duty*, 49 VAND. L.REV. 1087, 1163 (1996) (describing “an obligation to use reasonable care in presenting a recommendation for stockholder action and in gathering and disseminating corporate information in connection with that recommendation”). Because shareholders cannot act without information, courts have interpreted the statute to require that the board “disclose fully and fairly all material information within the board's control when it seeks shareholder action.” *Stroud v. Grace*, 606 A.2d 75, 84 (Del.1992).

<sup>28</sup> It is likely that the source is the Delaware Supreme Court's decision in *Stroud v. Grace*, 606 A.2d 75 (Del. 1992). *See* Lawrence A. Hamermesh, *Calling Off the Lynch Mob: The Corporate Director's Fiduciary Disclosure Duty*, 49 VAND. L. REV. 1087 (1996) (describing the development of the duty of disclosure under Delaware corporation law). Seeds of a broader disclosure duty under Delaware law appear much earlier. For example, Elliott Weiss and Lawrence White characterize the Court's decision in *Lynch v. Vickers Energy Corp.*, 383 A.2d 278 (Del. 1977) as moving “Delaware law from a posture of requiring less disclosure than federal law requires to a posture of requiring more.” Elliot J. Weiss & Lawrence J. White, *Of Econometrics and Indeterminacy: A Study of Investors' Reactions to Changes in Corporate Law*, 75 CALIF. L. REV. 551, 572 (1987).

<sup>29</sup> *See supra* notes -- and accompanying text. The seminal case for this proposition is *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985) which held that a board had breached its fiduciary duty by failing to disclose the parameters of the negotiations leading to the company's sale.

<sup>30</sup> Delaware's focus on disclosure can be traced to a series of cases in the last decade which have required enhanced disclosure concerning investment banker fairness analysis, as well as in private equity and other conflicted interest transactions. *See, e.g., In re Pure Res., Inc., S'holders Litig.*, 808 A.2d 421, 448–50 (Del. Ch. 2002) (requiring that a target disclose in a tender offer the underlying information used in preparation of a fairness opinion received by its board). *See generally* Blake Rohrbacher & John Mark Zeberkiewicz, *Fair Summary: Delaware's Framework for Disclosing Fairness Opinions*, 63 BUS. LAW. 881, 882 (2008); Lloyd L. Drury III, *Private Equity and the Heightened Fiduciary Duty of Disclosure*, 6 N.Y.U. J. LAW & BUS. 33 (2010).

<sup>31</sup> *See, e.g., Schacher v. Clausen, et al.*, C.A. No. 8396-VCL, Complaint at 27, March 21, 2013 (hereinafter SAUER-DANFOSS COMPLAINT) (seeking to have the proposed merger permanently enjoined or, in the alternative rescinded or an award damages).



claims before the merger closes.<sup>32</sup> Empirical studies confirm these incentives, finding that nearly 70% of merger claims settle while the rest are dismissed.<sup>33</sup> The vast majority of the settlements are concluded prior to the closing of the underlying transaction.<sup>34</sup>

Although the complaints in merger cases typically allege that the merger is substantively unfair,<sup>35</sup> few cases result in any monetary recovery for the plaintiff class.<sup>36</sup> Some suits result in amendments to the merger agreement, often to the transaction's deal-protection provisions.<sup>37</sup> The vast majority of suits, however, settle exclusively for supplemental disclosure in the form of additional information in the merger proxy statement.<sup>38</sup> The specific disclosures can vary – they may include details of the negotiating process, the manner in which the investment bankers are being compensated in connection with the deal, or specifics about the manner in which the deal or the target company has been valued, either by the board or its advisers.<sup>39</sup> The supplemental disclosures are provided in an amended proxy statement (Schedule 14A) and are generally disclosed in an 8-K report as well. Commentators typically refer to such settlements, when they are not combined with some other form of relief, as “disclosure-only” settlements, a terminology that we will employ in this Article.<sup>40</sup>

The practical explanation for disclosure-only settlements lies in the financial structure of US shareholder litigation. Although parties to litigation normally must finance their own costs, shareholder suits – both derivative suits and class actions – operate under a long-recognized exception to this so-called “American Rule.” Instead the courts have determined that plaintiffs’ lawyers in shareholder litigation can have their fees paid directly by the defendant corporation if the litigation results in a “corporate benefit.”<sup>41</sup> The key to plaintiffs’ counsel recovering fees is the portrayal of the settlement relief as a corporate

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<sup>32</sup> See, e.g. *In re Southern Peru Copper Corp. Shareholder Derivative Litigation*, 52 A.3d 761, 784, 819 (Del. Ch. 2011) (merger litigation resulted in \$1.347 million damages, an award made six years after the deal closed).

<sup>33</sup> Cain & Davidoff, *Great Game*, *supra* note - (“[L]itigation with respect to transactions is dismissed by the court 28.4% of the time. The other 71.6% of transaction litigations result in some type of settlement.”).

<sup>34</sup> See Daines & Koumrain, *supra* note -, at 9 (“Of the 190 unique settlements we identified, 180 were reached before the merger closed. Most of these were reached shortly before a hearing on the plaintiffs’ motion for preliminary injunction ... or shortly before the shareholder vote. The median time between lawsuit filing and settlement in this sample was forty-four days.”).

<sup>35</sup> See, e.g., SAUER-DANFOSS COMPLAINT, *supra* note -, at ¶76 (alleging that, as a result of defendants’ breach of fiduciary duty, plaintiffs “have not and will not receive their fair portion of the value of Sauer-Danfoss’s assets and will be deprived of a fair process.”).

<sup>36</sup> In a small number of cases, however, merger litigation can result in substantial damage awards. For example, in 2012, two cases were settled for large money damages -- \$110 million in the deal between El Paso and Kinder-Morgan, and \$49 million in the acquisition of Delphi Financial Group, Inc. by Tokio Marine Holdings, Inc. See Daines & Koumrain, *supra* note -, at 6.

<sup>37</sup> Non-disclosure settlements declined to only 12.5% of settlements in 2012. Cain & Davidoff, *supra* note -, at 4.

<sup>38</sup> Cain & Davidoff, *supra* note -, at 16 (“Settlements which only require disclosure constitute 55.1% of the settlement types in the sample and are the most common type of settlement.”); Daines & Koumrain, *supra* note -, at 6 (in 81% of merger cases filed in 2012, the only product of the settlement was additional disclosure).

<sup>39</sup> See *infra* notes -- and accompanying text (discussing typical supplemental disclosures).

<sup>40</sup> See Sumpter, *supra* note -, at 678.

<sup>41</sup> See *In re Dunkin’ Donuts S’holders Litig.*, No. 10825, 1990 WL 189120, at \*1451 (Del. Ch. Nov. 27, 1990) (“[T]he corporate benefit doctrine comes into play when a tangible monetary benefit has not been conferred, but some other valuable benefit is realized by the corporate enterprise or the stockholders as a group.”) (internal quotation marks omitted). See also *infra* Part I.B.2.

benefit.<sup>42</sup> In a negotiated settlement, defendants will typically not oppose this characterization, nor will they oppose the sought-after fee award, an important element of the bargain.<sup>43</sup>

Average fee awards for the settlement of merger litigation vary widely. In *Del Monte*, plaintiffs' counsel received one of the largest fee awards - \$22.3 million for a case that generated a recovery to the plaintiff of \$89.4 million.<sup>44</sup> At the low end of the scale is the recent award of \$100,000 in *Gen-Probe*.<sup>45</sup> Given this wide range, reports of average fee awards can easily be misleading. Because most cases settle for disclosure-only, however, focusing on disclosure settlements may provide a more realistic view of the incentives under which most plaintiffs' attorneys are operating. In disclosure-only settlements, the average fee award has declined over the past several years, from an average of \$730,000 in 2009 to an average of \$540,000 in 2012.<sup>46</sup> Studies show that the average fee awarded in disclosure settlements in Delaware is approximately \$500,000.<sup>47</sup>

## **B. Approving Settlement**

Because of the representative nature of merger litigation, the termination of a merger suit by voluntary dismissal or settlement requires court approval.<sup>48</sup> For most cases that are settled, the court's role at a settlement hearing is threefold: the court must approve the certification of the class;<sup>49</sup> the court must assess whether the settlement is fair and reasonable;<sup>50</sup> and the court must decide on the amount of the fee to be awarded to plaintiffs' counsel. While these steps are independent in theory, as a practical matter, they often collapse. If the court determines that the benefits provided by a settlement are illusory, the plaintiff class will not have received any consideration for the releases that accompany a settlement, and the settlement will not be seen as fair.<sup>51</sup> In such a case, the court might properly refuse to approve the settlement. This decision might, however, raise questions about the adequacy with which the class has

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<sup>42</sup> See *supra* notes -- and accompanying text (noting the impetus to settle for "a peppercorn and a fee"). The corporate benefit doctrine is actually a variant of earlier collective decisions awarding attorneys' fees out of a common fund in cases in which the litigation produced a common fund for the benefit of the corporation or plaintiff class.

<sup>43</sup> See Griffith & Lahav, *supra* note -, at 1093 ("The approval process that courts follow in determining fees awarded to class counsel is, in an important sense, nonadversarial."). *Accord* Alleghany Corp. v. Kirby, 333 F.2d 327, 347 (2d Cir. 1964) (Friendly, J., dissenting) ("Once a settlement is agreed, the attorneys for the plaintiff stockholders link arms with their former adversaries to defend their joint handiwork.") (quoted in *In re Sauer-Danfoss Inc. S'holders Litig.*, 65 A.3d 1116, 1137 (Del. Ch. 2011)). See also Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 46 (1991) (describing settlement hearings as "pep rallies jointly orchestrated by plaintiffs' counsel and defense counsel") (quoted in *Sauer-Danfoss*, 65 A.3d at 1137).

<sup>44</sup> Transcript of Settlement Hearing at 58-59, *In re Del Monte Foods Company S'holders Litig.*, No. 6027-VCL, (Del. Ch. Dec. 12, 2011).

<sup>45</sup> GEN-PROBE TRANSCRIPT, *supra* note -, at 49.

<sup>46</sup> Daines & Koumrian, *supra* note -, at 9.

<sup>47</sup> Cain & Davidoff, *supra* note -, at 4.

<sup>48</sup> FED. R. CIV. P. 23(e); DEL. CH. R. 23(e) (requiring judicial approval for dismissal or compromise of a class action).

<sup>49</sup> At certification, the judge is charged with determining that the class meets the requirements of the class action rule, including adequacy of representation and of class counsel. See *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 617-20 (1997).

<sup>50</sup> *In re Triarc Cos. Class & Derivative Litig.*, 791 A.2d 872, 876 (Del. Ch. 2001) (asking whether the settlement is "fair and reasonable in light of all relevant factors"). See also *In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940 (Del. Ch. 2010) (finding counsel was inadequate and therefore declining to approve settlement).

<sup>51</sup> The settlement agreement typically requires the plaintiffs to release all claims arising out of the merger. Note how this precludes all related claims as a result of full faith & credit clause. See Griffith & Lahav, *supra* note -.

been represented, suggesting that the court should deny class certification.<sup>52</sup> Similarly, if the court approves the settlement, it has implicitly concluded that the plaintiff class has received something of value, making it difficult to decline to award a fee to class counsel. Notably, the judges in the Delaware Chancery Court are conscious of the incentives that their decisions create with respect to future litigation. As a result, their opinions frequently seek to benchmark their judgments about settlement value and an appropriate fee level by reference to comparable cases.<sup>53</sup>

In determining whether a proposed settlement is fair and reasonable, the court attempts to weigh the consideration received by the plaintiff class against the strength of the claims that are being released as part of the settlement. As Chancellor Allen explained in *Caremark*, a motion seeking judicial approval of a proposed settlement requires the court “to assess the strengths and weakness of the claims asserted in light of the discovery record and to evaluate the fairness and adequacy of the consideration offered . . . in exchange for the release of all claims made or arising from the facts alleged...”<sup>54</sup> This is more easily said than done.

The courts’ task in reviewing and approving settlements is complicated by three factors. First, the settlement hearing is likely to be non-adversarial in nature. Second, the factual record presented to the court will be relatively undeveloped. Third, in the absence of an intervening bid, the intended transaction will likely be highly beneficial to shareholders, causing the judge to hesitate to throw additional obstacles in its path. With regard to the non-adversarial nature of the hearing, both plaintiffs and defendants will have a strong incentive to have their agreed-upon settlement approved by the court. Hence, in the absence of objectors, information indicating that the settlement is unfair or unreasonable will not be brought to the court’s attention. Second, at a settlement hearing, the court is reviewing a stipulated statement of facts rather than hearing trial testimony or reviewing other direct evidence. Counsel’s development of the factual record through discovery may be limited both because of the short window within which merger litigation is conducted and because, once a settlement appears likely, neither side wishes to expend unnecessary resources on additional fact-finding.<sup>55</sup> As a result, even without the potential for collusion inherent in a non-adversarial proceeding, the court is likely to lack all information necessary to evaluate the settlement. Moreover, the counterfactual analysis required to evaluate the strength of plaintiffs’ claims is generally impractical. Third and finally, the court is in a difficult position since experience shows that the vast majority of proposed mergers are approved by shareholders, usually by an overwhelming vote, due to the premium mergers provide shareholders over the current market price. Without an intervening

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<sup>52</sup> See Transcript of Settlement Hearing at 10-11, *In re Transatlantic Holdings S’holders Litig.*, No. 6574-CS (Del. Ch. Mar. 8, 2013) [hereinafter *TRANSATLANTIC HOLDINGS TRANSCRIPT*].

<sup>53</sup> See, e.g., *In re Sauer-Danfoss Inc. S’holders Litig.*, 65 A.3d 1116, 1137 (Del. Ch. 2011).

<sup>54</sup> *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 861 (Del. Ch. 1996).

<sup>55</sup> See, e.g., *In re Revlon, Inc. Shareholders Litigation*, 990 A.2d 940, 945-46 (Del. Ch. 2010) (describing “kabuki dance” of deal litigation in which once the litigation leadership structure is established, “real litigation activity [ceases]”).

bidder, the court is unlikely to throw additional obstacles in the way of a transaction that offers plain benefits to shareholders.<sup>56</sup> As a result, there is good reason to doubt the ability even of expert jurists to assess the fairness and adequacy of settlements reliably in this context.

Despite these limitations, Delaware judges take seriously their obligation to safeguard the interests of the class by reviewing settlement quality. Evaluating a settlement that provides increased consideration or damages to the plaintiffs is relatively straightforward. Amendment settlements may benefit the shareholders by increasing the likelihood that a third party will make a topping bid. Thus, in *Compellent*,<sup>57</sup> Vice Chancellor Laster explained that the value of therapeutic changes to a merger agreement “can be estimated as a function of the incremental amount that stockholders would receive if a higher bid emerged times the probability of the higher bid.” The court went on to consider empirical data in order to quantify the potential frequency and size of a topping bid.<sup>58</sup>

Disclosure-only settlements can benefit the shareholder class if the required disclosures allow the shareholders to exercise their voting rights in a more meaningful manner. In *Sauer-Danfoss*, for example, Vice Chancellor Laster evaluated the eleven supplemental disclosures called for by the settlement agreement and weighed the extent to which each provided meaningful new information to shareholders.<sup>59</sup> He concluded that, of the eleven, only one was material. Similarly in *PAETEC*, Vice Chancellor Glasscock considered each individual disclosure required by the proposed settlement and concluded that, except for one, each was of doubtful materiality, trivial or of marginal utility to shareholders.<sup>60</sup>

To the extent that a court finds a proposed settlement to be of dubious value or, more problematically, inconsistent with its own assessment of the strength of the case,<sup>61</sup> the court may view the settlement as the product of collusion between plaintiffs’ counsel and defense counsel.<sup>62</sup> In *Scully v.*

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<sup>56</sup> See, e.g., *In re El Paso Corp. S’holder Litig.*, 41 A.3d 432 (Del. Ch. 2012) (noting the court’s reluctance to enjoin merger, despite finding of unfair practices, where an injunction might deprive the shareholders of an attractive opportunity to sell their stock).

<sup>57</sup> *In re Compellent Techs., Inc.*, 2011 Del. Ch. LEXIS 190 (Del. Ch. Dec. 9, 2011).

<sup>58</sup> *In re Celera Corp. S’holders Litig.*, No. 6034-VCP (Del. Ch. Mar. 23, 2012) (discussing the process of valuing therapeutic benefits).

<sup>59</sup> *In re Sauer-Danfoss Inc. S’holders Litig.*, 65 A.3d 1116, 1137 (Del. Ch. 2011).

<sup>60</sup> *In re PAETEC Holding Corp. S’holders Litig.*, No. 6761-VCG, 2013 BL 72377, at \*6 (Del. Ch. Mar. 19, 2013).

<sup>61</sup> This determination might be assisted through the participation of objectors to the settlement. See, e.g., *Prezant v. De Angelis*, 636 A.2d 915, 926 (Del. 1994) (remanding settlement for more rigorous inquiry into inadequacy of representation based on objector appeal). See also Griffith & Lahav, *supra* note -, at 1084-86 (emphasizing the role of objectors in reinvigorating “the adversarial process in an otherwise collusive environment”). The objection rate in class action settlements is low, however. See Theodore Eisenberg & Geoffrey P. Miller, *The Role of Opt-Outs and Objectors in Class Action Litigation: Theoretical and Empirical Issues*, 57 VAND. L. REV. 1529, 1533–34, 1550 (2004); N. Browning Jeffries, *The Plaintiffs’ Lawyer’s Transaction Tax: The New Cost of Doing Business in Public Company Deals*, BERKELEY BUS. LAW J. (Forthcoming), at 4 (“these fee awards are rarely objected to . . .”).

<sup>62</sup> The principal factors identified by commentators in identifying collusive settlement practices—fees awarded on top of a settlement that involves limited bargaining and non-pecuniary relief—are present in the settlement of virtually every merger claim. See, e.g., Jonathan R. Macey & Geoffrey P. Miller, *Judicial Review of Class Action Settlements*, 1 J. LEGAL ANALYSIS 167, 191–92 (2009) (listing “yellow flags” for collusion, including “settlement bargaining limited to one of the competing groups of plaintiffs’ attorneys; settlement with the group of attorneys who present a less substantial threat of carrying the case forward to trial . . . award of lucrative and potentially justified attorneys’ fees. . .”).

*Nighthawk*, Vice Chancellor Laster appointed special counsel to inquire into the possibility of collusion when the litigants concluded a disclosure-only settlement in an alternative forum after the Vice Chancellor in an earlier hearing had found no colorable disclosure claim but a potentially serious process issue.<sup>63</sup> The special counsel’s brief defined the issue narrowly,<sup>64</sup> ultimately concluding that collusion had not in fact occurred because the *Nighthawk* settlement was broadly comparable to other cases.<sup>65</sup>

Although not framing his analysis in terms of collusion, Chancellor Strine expressed similar concerns in *Transatlantic Holdings*.<sup>66</sup> Having been asked to certify the plaintiffs’ class, approve the settlement, and award a fee, the Chancellor refused to do all three.<sup>67</sup> In that case, the two class representatives that had been put forward, one of whom held only two shares, either did not vote on the transaction or did not recall how he had voted.<sup>68</sup> Class counsel did not perform “any real investigation.”<sup>69</sup> The disclosures amounted merely to additional background information,<sup>70</sup> and the vote was 99.85% in favor of the deal with 93% of the total electorate casting votes.<sup>71</sup> On the basis of these facts, the court concluded that the plaintiffs had “achieved noting substantial for the class” and therefore the proposed settlement did not justify releasing the claims of absent parties.<sup>72</sup>

Current settlement practices raise a broader concern. As noted earlier, upwards of 90% of mergers in recent years faced litigation challenges. Of the lawsuits filed, 71.6% settled and more than 77% of the settlements were disclosure-only settlements.<sup>73</sup> In short, plaintiffs negotiate, and courts approve, corrective disclosure in more than 60% of all transactions. It is implausible to think that 60% of all mergers (more like 80% in the last several years) with public company targets and a transaction value of more than \$100 million, deals that are staffed by top quality lawyers and investment bankers, involve

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<sup>63</sup> *Id.* at 27–28.

<sup>64</sup> Brief of Special Counsel at 26, *Scully v. Nighthawk Radiology Holdings, Inc.*, C.A. No. 5890-VCL (Del. Ch. Mar. 11, 2011). The special counsel summarized the issue as follows:

[A] collusive settlement in the context of stockholder deal litigation appears to involve, at its core, an explicit or implicit agreement between counsel for plaintiffs and counsel for defendants to require less consideration for the settling class in exchange for (1) exclusive dealings with particular plaintiffs’ counsel and/or (2) more consideration for plaintiffs’ counsel. Factors that should give rise to heightened scrutiny for collusiveness include the following: settlement consideration disproportionately weak in comparison to the strength of the claims asserted; settlement with a plaintiff’s firm that typically does not litigate aggressively when other, more formidable, firms are involved in the litigation; and an agreement to pay attorneys’ fees significantly higher than are typical given the settlement consideration.

*Id.* at 26–27.

<sup>65</sup> *See id.* at 28–29 (“With the exception of the parties’ move to settle away from a jurisdiction that had made merits rulings, review of the parties’ negotiations revealed a fairly typical arm’s-length negotiation. . . . Nothing in the negotiations themselves was outside the bounds of similar negotiations in similar cases.”).

<sup>66</sup> TRANSATLANTIC HOLDINGS TRANSCRIPT, *supra* note 52, at 5–6. The ruling—treating class certification, settlement approval, and the fee award together—is an example of how courts may collapse the analysis of settlement approval, corporate benefit, and the ultimate fee award. *See supra* note - and accompanying text.

<sup>67</sup> TRANSATLANTIC HOLDINGS TRANSCRIPT, *supra* note 52, at 5.

<sup>68</sup> *Id.* at 6.

<sup>69</sup> *Id.* at 8.

<sup>70</sup> *Id.* (“it’s just more”).

<sup>71</sup> *Id.* at 10–11.

<sup>72</sup> *Id.* at 10.

<sup>73</sup> Cain & Davidoff, *Great Game*, *supra* note -.

materially deficient disclosures. It is far more likely that merger lawsuits are not filed to correct disclosure problems. The structure of disclosure-only settlements is likely about something else – justification of a few award to plaintiffs’ counsel.

### C. The Fee Award

Once the court has approved the settlement, it must independently consider the fee award. “[A] litigant who confers a common . . . benefit upon an ascertainable stockholder class is entitled to an award of counsel fees and expenses for its efforts in creating the benefit.”<sup>74</sup> The Delaware courts have repeatedly explained that the court has an independent obligation to determine an appropriate fee award, even in a case in which the defendant has agreed not to oppose the plaintiffs’ fee request. As the court explained in PAETEC, “This Court has unambiguously held that in both [contested and uncontested fee applications], the Court has an independent duty to award a fair and reasonable fee”<sup>75</sup> The court’s determination of what constitutes a reasonable fee is based on consideration of the *Sugarland* factors:

(i) the amount of time and effort applied to the case by counsel for the plaintiffs; (ii) the relative complexities of the litigation; (iii) the standing and ability of petitioning counsel; (iv) the contingent nature of the litigation; (v) the stage at which the litigation ended; (vi) whether the plaintiff can rightly receive all the credit for the benefit conferred or only a portion thereof; and (vii) the size of the benefit conferred.<sup>76</sup>

“Among these factors, the last two receive the greatest weight.”<sup>77</sup> Thus, although judicial analysis of the fee award frequently includes a discussion of hours expended, the quality of plaintiffs’ counsel, and the complexity of the case, the key consideration is typically the size of the benefit conferred. Additionally, the Delaware Supreme Court has repeatedly noted that, where the benefit provided by the litigation is quantifiable, “*Sugarland* calls for an award of attorneys’ fees based on a percentage of that benefit.”<sup>78</sup>

The determination of corporate benefit in the context of a fee award is obviously closely related to the assessment of settlement quality described above. Specifically, enhanced disclosure has long been recognized as a potential benefit.<sup>79</sup> Because of the prevalence of disclosure settlements, the Delaware courts have had frequent occasion to consider the circumstances under which such a settlement justifies a fee award and the relationship between the quality of the disclosures and the size of the reward. As the

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<sup>74</sup> *United Vanguard Fund, Inc. v. Takecare, Inc.*, 693 A.2d 1076, 1079 (Del. 1997).

<sup>75</sup> *In re PAETEC Holding Corp. S’holders Litig.*, No. 6761-VCG, 2013 BL 72377, at \*6 (Del. Ch. Mar. 19, 2013), quoting *In re Sauer-Danfoss Inc. S’holders Litig.*, 65 A.3d 1116, 1137 (Del. Ch. 2011).

<sup>76</sup> *In re Plains Res. Inc. S’holders Litig.*, 2005 Del. Ch. LEXIS 12, 2005 WL 332811, at \*3 (Del. Ch. Feb. 4, 2005) (citing *Sugarland Indus., Inc. v. Thomas*, 420 A.2d 142, 149-50 (Del. 1980)).

<sup>77</sup> *In re Celera Corp. S’holder Litig.*, 2012 Del. Ch. LEXIS 66, 114 (Del. Ch. Mar. 23, 2012). See also *In re Anderson Clayton S’holders Litig.*, 1988 WL 97480, at \*3 (Del. Ch. Sept. 19, 1988) (“this court has traditionally placed greatest weight upon the benefits achieved by the litigation.”).

<sup>78</sup> *Ams. Mining Corp. v. Theriault*, 51 A.3d 1213, 1259 (Del. 2012).

<sup>79</sup> See, e.g., *Tandycrafts, Inc. v. Initio Partners*, 562 A.2d 1162, 1165 (Del. 1989) (“a heightened level of corporate disclosure, if attributable to the filing of a meritorious suit, may justify an award of counsel fees”) (citing *Chrysler Corp. v. Dann*, 223 A.2d 384, 386 (1966); *Allied Artists Pictures Corp. v. Baron*, 413 A.2d 876, 878 (Del.1980)).

Court noted in *Sauer-Danfoss* “[a]ll supplemental disclosures are not equal.”<sup>80</sup> The courts have sought to achieve relative parity across cases, observing that “[s]imilar disclosures merit similar fee awards.”<sup>81</sup> In addition, the courts have expressly acknowledged the incentive effect of fee decisions on future litigation and stated that fee awards should encourage counsel to bring meritorious cases.<sup>82</sup>

Recent Delaware decisions display an increasing tendency to apply a common heuristic for awarding fees in disclosure-only cases. The court starts with a fee range based on precedent for the quantity and quality of disclosures provided.<sup>83</sup> A threshold requirement is that the supplemental disclosure be material.<sup>84</sup> One or two “meaningful” disclosures merit an award in the range of \$400,000 to \$500,000. Lower quality (less valuable) disclosures resulting a downward departure from this benchmark and “particularly significant or exceptional disclosures” being entitled to more.<sup>85</sup> The fee may then be adjusted further based upon the other “*Sugarland* factors.”<sup>86</sup>

The question of what types of disclosures are “meaningful” is a critical aspect of the courts’ analysis. Meaningful disclosures will be rewarded (incentivized) with more generous fee awards. Trivial or unhelpful disclosures will be compensated less generously or, in the extreme case, may lead to disapproval of the settlement or denial of any fee award. In his opinion in *Sauer-Danfoss*, Vice-Chancellor Laster provided three appendices summarizing prior settlements and fee awards in the high, low, and normal fee ranges.<sup>87</sup> A review of these appendices demonstrates that the most “meaningful” disclosure, for purposes of the courts’ analysis, tends to focus on “previously withheld projections or undisclosed conflicts faced by fiduciaries or their advisors.”<sup>88</sup> Significantly, the Delaware courts have stressed the importance of information regarding the investment banks’ compensation and potential

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<sup>80</sup> *In re Sauer-Danfoss Inc. S’holders Litig.*, 65 A.3d at 1136.

<sup>81</sup> *Id.*

<sup>82</sup> *See, e.g.*, *Dias v. Purches*, 2012 Del. Ch. LEXIS 227 n. 29 (2012) (collecting cases). The Delaware courts’ concern that fee awards provide appropriate incentives, include strong incentives in meritorious cases, is not confined to merger litigation. *See, e.g.*, *Ams. Mining Corp. v. Theriault*, 51 A.3d 1213, 1252 (Del. 2012) (approving Chancery Court’s award of \$300 million fee on the ground that it “creates a healthy incentive for plaintiff’s lawyers to actually seek real achievement for the companies that they represent in derivative actions and the classes that they represent in class actions.”, quoting Chancery Court opinion, Revised Final Order & Judgment at 3, *In re S. Peru Copper Corp. S’holder Derivative Litig.*, 52 A.3d 761 (Del. Ch. 2011) (No. 961-CS)),

<sup>83</sup> *See In re Sauer-Danfoss Inc. S’holders Litig.*, 65 A.3d at 1136-38 (using three similar cases to arrive at a base range of \$75,000 to \$80,000).

<sup>84</sup> “To provide a compensable benefit, the supplemental disclosures obtained must be material to stockholders.” *In re Celera Corp. S’holder Litig.*, 2012 Del. Ch. LEXIS at 118, *accord In re PAETEC Holding Corp. S’holders Litig.*, 2013 BL 72377, at \*8 (commencing fee analysis by determining that, because the package of settlement disclosures contained at least one material disclosure, the settlement was fee eligible).

<sup>85</sup> *Id.* at 35 (“This court has often awarded fees of approximately \$400,000 to \$500,000 for one or two meaningful disclosures.... Disclosures of questionable quality have yielded much lower awards. Higher awards have been reserved for plaintiffs who obtained particularly significant or exceptional awards.”).

<sup>86</sup> *In re Sauer-Danfoss Inc. S’holders Litig.*, 65 A.3d at 1135-35.

<sup>87</sup> *Id.* at apps. A, B, & C.

<sup>88</sup> *Id.* at 1133.

conflicts.<sup>89</sup> As Vice Chancellor Glasscock recently explained, “The materiality of a disclosure of a conflicted financial advisor does not necessarily depend on whether the conflict actually harmed the sales process.”<sup>90</sup> Less meaningful disclosures, by contrast, include minor corrections or disclosure of further details concerning, for example, discount rates, negotiation process, and valuation opinions.<sup>91</sup>

#### **D. A Framework for Measuring the Value of Non-Pecuniary Relief**

As we have summarized, virtually every merger currently faces a litigation challenge. The vast majority of cases settle, but monetary recoveries for shareholder plaintiffs are rare. Courts attempt to evaluate the benefit produced by the proposed settlements, and to compensate counsel on the basis of that benefit, but the procedural disadvantages that they face in the process render their judgments highly suspect, especially in the context of disclosure-only settlements. The Delaware courts seem to share this skepticism, given their own oft-repeated characterization of supplemental disclosures as being of marginal utility at best.

We therefore suggest an alternative way of testing the value of supplemental disclosures. Because the purpose of merger disclosure is to inform shareholder voting, it is reasonable to view supplemental disclosure as meaningful if it changes the way reasonable shareholders vote.<sup>92</sup> Furthermore, it is reasonable to hypothesize that merger litigation is only effective if it produces the disclosure of new *negative* information about the merger. This is because the defendant corporation, without the prod of shareholder litigation, already has an incentive to disclose *positive* information in order to win approval of the transaction and minimize dissent.<sup>93</sup> However, the transacting parties might prefer to conceal *negative* information to reduce the risk that shareholders will refuse to approve the transaction. Putting these two insights together, it seems clear that for supplemental disclosures to be meaningful, they must have a negative impact on shareholder voting in favor of the merger. This leads to a testable hypothesis—disclosure-only settlements should reduce shareholder votes in favor of the deal.

Amendment settlements are different. The principal benefit of an amendment is its potential to increase the value of the merger. An amendment that increases the merger price is of obvious value to shareholders without regard to its effect on the vote. Most amendment settlements do not increase the

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<sup>89</sup> See, e.g., David P. Simonetti Rollover IRA v. Margolis, 2008 Del. Ch. LEXIS 78, 2008 WL 5048692, at \*8 (Del. Ch. June 27, 2008) (“[I]t is imperative for the stockholders to be able to understand what factors might influence the financial advisor’s analytical efforts”).

<sup>90</sup> *In re PAETEC Holding Corp. S’holders Litig.*, 2013 BL 72377, at \*8.

<sup>91</sup> *In re Sauer-Danfoss Inc. S’holders Litig.*, 65 A.3d app. B.

<sup>92</sup> See, e.g., *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976) (“an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.”). Accord *TRANSATLANTIC HOLDINGS TRANSCRIPT*, *supra* note 52, at 4 (noting that the real question in evaluating a disclosure settlement is whether the supplemental disclosures are “in [some] meaningful way of utility to someone voting on the merger”).

<sup>93</sup> Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 683 (1984).



merger consideration but instead alter an agreement's deal protection provisions, perhaps reducing a termination fee or increasing a go-shop period.<sup>94</sup> The value of these amendments is in their potential to increase the chance of a subsequent higher bid.<sup>95</sup> Concededly amendment settlements rarely lead to higher bid prices.<sup>96</sup> Nevertheless, reducing deal protections arguably improves the quality of the market check. As a result, even when amendments do not result in a higher bid, they arguably should increase shareholder confidence in the economics of the deal. Our second core hypothesis then is that merger litigation resulting in an amendment settlement should increase shareholder support for the merger.

In the Part that follows, we identify and test our core hypotheses. We also test a number of ancillary hypotheses relating to shareholder voting. High premium deals, for example, should lead to more favorable votes than low premium deals. Deals recommended by proxy advisory firms ought to result in more favorable votes than deals for which those firms recommend a vote against the transaction. Additionally, building upon the discussion above, we hypothesize that attorney's fees are an ex-post facto assessment of merits in merger litigation and thus that, at least in disclosure cases, for the reasons articulated above, higher fees should correspond to fewer votes in favor of the merger.

## **II. Empirical Analysis of Merger Settlements and Shareholder Voting**

### **A. Our Sample Set**

Our sample contains all of the transactions listed in the FactSet MergerMetrics<sup>97</sup> database and announced from 2005 through 2012 that meet the following criteria: 1) the target is a U.S. firm publicly traded on the New York Stock Exchange, American Stock Exchange or NASDAQ stock exchanges, 2) the transaction size is at least \$100 million, 4) the offer price is at least \$5 per share, 5) a merger agreement is signed and publicly disclosed through a filing with the Securities and Exchange Commission (SEC), and 6) the transaction has been completed as of the end of 2012.

From MergerMetrics we obtain data on the transaction value, offer price, consideration offered, form of acquisition (tender offer/merger), competing bids, target industry, and offer price. We also obtain from MergerMetrics transaction terms, including the presence or absence of a go-shop, the type of transaction (management buy-out, going-private, or private equity acquisition), sale process, and state of incorporation of targets. For litigation, we review by hand merger proxy statements and tender offer documents filed with the SEC to determine if litigation is brought with respect to the transaction. We

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<sup>94</sup> On deal protections generally see Steven M. Davidoff & Christina Sautter, *Lock-up Creep*, 38 IOWA J. CORP. L. 681 (2013).

<sup>95</sup> *In re Compellent Techs., Inc.*, 2011 Del. Ch. LEXIS 190 (Del. Ch. Dec. 9, 2011).

<sup>96</sup> See Daines & Koumrian, *supra* note -, at 6 and accompanying text. In any event, we would lose what overbids would occur from our data set as a result of the research design described below. See *infra* Part II.A.

<sup>97</sup> Source: FactSet Research Systems, Inc. MergerMetrics database (<https://www.mergermetrics.com>).

document all class action litigation brought in connection with a merger. For litigation outcomes, attorneys' fees and settlement terms, we review public filings and obtain actual court filings. Court filings are obtained directly from the court, from public filings on the Lexis/Nexis File and Serve Database or Bloomberg Law and are also reviewed by hand.<sup>98</sup>

For shareholder voting outcomes and meeting dates we obtain information from the Factset Proxy Data service. We supplement this with information provided by Institutional Shareholder Services (ISS) and by hand review of public filings. We also search press wire services and news databases. ISS recommendations are obtained from ISS itself. We then merge in institutional ownership data from the Thomson Reuters database and stock price information from the Center for Research in Security Prices (CRSP) database. We also search by hand in the Bloomberg Law database to determine if appraisal rights were exercised for Delaware incorporated targets. We drop duplicate variables and variables for which we have no voting results information. A substantial number of transactions do not report any voting results even though such a reporting is required under the securities laws.<sup>99</sup> We arrive at a sample size of 453 deal observations.

## B. Descriptive Statistics

Set forth in Table I.A are statistics on the number of transactions in our sample set, the value of these transactions and transaction offer premia.

	<u>N</u>	<u>Mean</u>	<u>Std Dev</u>	<u>25th %</u>	<u>50th %</u>	<u>75th %</u>
Transaction Value (\$mm)	453	\$3,119	\$6,902	\$328	\$957	\$3,065
Enterprise Value (\$mm)	453	\$4,272	\$9,827	\$399	\$1,245	\$3,697
Initial Premium	453	32.73%	34.03%	14.86%	26.45%	41.30%
Final Premium	453	33.37%	34.47%	15.17%	26.97%	41.95%

Median transaction value across our sample size is \$957 million. Mean transaction size is a significantly higher \$3.119 billion showing that the sample is right skewed with a standard deviation for transaction value of \$6.902 billion. The median initial offer premium as calculated thirty days prior to

<sup>98</sup> The data collection here is taken from a database compiled for a prior study by one of the co-authors. See Cain & Davidoff, *supra* note -.

<sup>99</sup> Effective as of February 8, 2010 the SEC changed its disclosure rules to require that the outcome of shareholder votes be reported on a Form 8-K filed within 4 business days after the end of the meeting at which the vote occurred. Previously, these results were only required to be disclosed on the issuer's next-filed Form 10-Q or Form 10-K. See *Proxy Disclosure Enhancements*, Exchange Act Release No. 34-61175, 74 Fed. Reg 35,076 Jul. 17, 2009). However, a takeover is often completed and the issuer's shares deregistered before this four business day period has elapsed. In those circumstances a Form 8-K filing is not required. This was true even before the rule revisions when a 10-Q or 10-K could be due weeks or months after the acquisition's completion. Even when the acquisition occurs more than four business days after the shareholders' meeting, issuers sometimes appear to ignore the filing requirements and do not report results. The result is that of our sample size of merged transactions of 822 we have voting data for approximately half of 453. We were unable to find reported voting results for the remaining issuers. We thank Jennifer Shotwell of Innisfree for explaining why we could not find voting results for so many mergers in our sample. In addition, we excluded transactions where the reported results were approximate rather than exact.

announcement of the transaction is 26.45%. Final offer premium is calculated identically and is a slightly higher 26.97% showing that there is some increase in offer premium over announced and completed transactions. These statistics are comparable to prior studies which have found a similar range of size and premiums for transactions.<sup>100</sup>

Table I.B sets forth characteristics of the transactions in our sample.

<i>Panel I.B: Transaction Characteristics</i>		
	<u>N</u>	<u>% All Transactions</u>
Total # Transactions	453	100%
Merger Consideration = Cash	303	66.89%
Auction	187	41.28%
Go Shop	58	12.80%
Going Private	22	4.86%
Management Buy-Out	14	3.09%

We focus here on transaction characteristics which may affect premium and shareholder voting. 303 or 66.89% of transactions were all cash consideration, meaning that shareholders were losing a stake in the future combined entity. 41.28% or 187 transactions involved companies being sold by auction as opposed to a single bidder negotiation. Auction transactions may be less prone to shareholder objection and therefore receive higher votes because the target company has been more fully shopped to a wider array of possible bidders. 12.8% of transactions contained a go-shop, a provision for a target to solicit bidders after announcement of a merger agreement. These are largely private equity transactions, which themselves comprise 15.89% of the sample. Conflicted transactions involving management or a controlling shareholder were a smaller part of the sample. Going private transactions comprise 4.86% of transactions and management buy-outs comprise 3.09% of transactions. Because of the potential these transactions present for self-dealing, it may be that shareholder support levels are lower.

Table I.C examines litigation rates for our sample.

<sup>100</sup> See Leonce L. Barger et al., *Why do private acquirers pay so little compared to public acquirers?*, 89 J. FIN. ECON. 375 (2008).

*Table I.C.: Litigation*

	<u>N</u>	<u>% of Total Litigation</u>
Litigation	319	100.00%
Settled	221	69.28%
Dismissed	65	20.38%
Multi-State	133	41.69%
Delaware Filing	142	44.51%
Delaware Settlement	67	21.00%

Litigation is brought in an average of 70.42% of transactions across the time period of our study. The rate of litigation increased substantially over the course of our sample period; one recent study found that litigation rates have risen to 92.1% in 2012.<sup>101</sup> Our sample matches these findings; the litigation rate in our sample rises from 48.57% in 2005 to 95.12% in 2012. For the transactions with litigation, 221 or 69.28% result in some type of settlement, 65 or 20.38% are dismissed, and the remainder are still pending or are abandoned.<sup>102</sup>

Table II.A sets forth information on voting outcomes for our sample.

*Table II.A: Voting Outcomes*

	<u>N</u>	<u>Mean</u>	<u>St. Dev.</u>	<u>25th %</u>	<u>Median</u>	<u>75th %</u>
% Yes Votes Per Votes Cast	393	96.73%	6.41%	97.13%	99.00%	99.70%
% Yes Votes Per Outstanding Shares	436	75.82%	8.77%	70.65%	76.00%	81.64%
% Yes Votes Per All Yes & No Votes	294	97.65%	5.25%	98.03%	99.52%	99.85%

Table II.A reports shareholder voting outcomes by three different metrics: 1) yes votes as a percentage of all votes cast, 2) yes votes as a percentage of all outstanding shares, and 3) yes votes as a percentage of all yes and no votes cast. The difference between the first and third measurements is that the first measurement includes abstentions and broker non-votes. In our regressions and data analysis below we employ we separately run regressions using all three metrics. We believe that yes votes measured as a percentage of votes cast best captures shareholder sentiment for a transaction. The reason is that it captures the sentiment of those shareholders who choose to be present at the meeting and cast a ballot or abstain. Shareholder failure to vote at all can indicate a lack of support for a transaction, but it may also be caused by a variety of factors that are independent of the merits.<sup>103</sup> However, by examining all three metrics we provide a robustness check to our results.

<sup>101</sup> Cain & Davidoff, *Great Game*, *supra* note -. As noted earlier, the rate of litigation continues to increase, and litigation was filed in 97.5% of transactions in 2013, meaning that virtually every deal was challenged. Cain & Davidoff, *supra* note -. (Takeover Litigation in 2013)

<sup>102</sup> *Id.*

<sup>103</sup> For example, retail investors typically engage in very low levels of voting. See, e.g., Press Release, *Broadridge and PwC Announce New Data on 2013 Proxy Voting Trends*, June 4, 2013, <http://www.broadridge.com/news-events/press->

The percentage of median yes votes per shares outstanding is 75.82% with a standard deviation of 8.77%. However, the median percentage of yes votes as a percentage of votes cast is 99.00% meaning that half of all transactions get an even higher number of yes votes. The statistics show that shareholder voting in takeover transactions is largely a yes game among shareholders who do cast votes. There is some dispersion among transactions however and the standard deviation for transactions as a percentage of votes cast is 6.41%. We note that the median percentage of yes votes when measured against outstanding shares is significantly lower, meaning that a significant number of shares in any contest are not voted. When shares are voted, it is almost always overwhelmingly in support of the transaction.

Table II.B. sets forth descriptive statistics on types of litigation settlements and voting outcomes based on percentage of yes votes per votes cast.

	<u>N</u>	<u>Mean</u>	<u>St. Dev.</u>	<u>25th %</u>	<u>Median</u>	<u>75th %</u>
Disclosure Only Settlements	153	97.25%	5.60%	97.80%	99.10%	99.70%
Amendment Settlement	26	97.90%	5.78%	98.54%	99.43%	99.84%
Increase Consideration Settlement	<u>12</u>	95.64%	7.40%	96.42%	98.84%	99.50%
Total	191					

The number of observations drops to 191 because we do not have voting information as a percentage of yes votes per votes cast for all observations with litigation, and not all litigation ends in settlement. The median percentage of yes votes for disclosure-only settlements is lowest among the types of settlement at 97.80, with a standard deviation of 5.60%. Amendment settlements had a higher median percentage of yes votes at 99.43% with a standard deviation of 5.78%. Finally, settlements involving an increase in consideration had a standard deviation of 7.40% with a median percentage of yes votes at 98.84%.

Table II.C. sets forth voting information by yes votes cast, sorted by ISS recommendations.

	<u>N</u>	<u>Mean</u>	<u>St. Dev.</u>	<u>25th %</u>	<u>Median</u>	<u>75th %</u>
ISS Rec = No	15	81.72%	12.23%	70.00%	80.90%	97.08%
ISS Rec = Yes	376	97.31%	5.29%	97.36%	99.03%	99.70%

As the table shows, there is a large disparity in voting outcomes between a positive ISS recommendation and a negative one.<sup>104</sup> A transaction with a “yes” ISS recommendation has a median

[releases/Broadridge-and-PwC-Announce-New-Data-on-2013-Proxy-Voting-Trends.html?show=2013+Press+Release](#) (reporting that 70 percent of shares held by retail investors were not voted).

<sup>104</sup> The potential for ISS recommendations to affect voting outcomes has been discussed extensively in the literature. See, e.g., Stephen Choi, Jill Fisch & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869, 873–74 (2010)

percentage of yes votes per votes cast of 99.03%. A transaction with a “no” ISS recommendation has a median percentage of yes votes per votes cast of 80.9%. In unreported statistics we find that the median percentage of yes votes as a percentage of the outstanding shares for a transaction with an ISS “no” recommendation is 66.88% compared to 76.51% for a “yes” recommendation. We also find similar results when we examine yes votes as a percentage of total yes and no votes. In those circumstances the median percentage of yes votes as a percentage of yes and no votes is 82.01% for a “no” recommendation compared to 99.55% for a “yes” recommendation. We discuss further the possible effect and issues around ISS recommendations below in our regression analysis.

### **C. Regression Analysis**

Our regression analysis uses ordinary least squares regression. We regress yes votes against the three types of voting metrics: yes votes per 1) votes cast, 2) per outstanding shares, and 3) yes and no votes. We include in our regressions a number of transaction variables, including final premium paid, the proxy advisors’ recommendation and institutional ownership. In the text of our paper we discuss the main findings from our regressions. The full regressions with all variables are set forth in the Appendix. Table III examines how shareholder voting outcomes are affected by the three types of settlements – disclosure-only settlements, amendment settlements and settlements that produce increased merger consideration.

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(identifying various possible reasons for the relationship). As we discuss below, our findings demonstrate a strong correlation between ISS recommendations and voting outcomes, but do not provide evidence of causation.

**Table III. Shareholder Voting Outcomes and Litigation Settlements<sup>105</sup>**

<u>Yes Votes Per</u>	<u>Votes Cast</u>	<u>Outstanding</u>	<u>Yes and No Votes</u>
	(1)	(2)	(3)
Final Offer Premium	0.105 ** (0.03)	0.022 (0.74)	0.095 ** (0.04)
ISS Position	0.155 *** (0.00)	0.113 *** (0.00)	0.124 *** (0.00)
Disclosure Only Settlement	0.000 (0.98)	0.011 (0.22)	0.003 (0.58)
Amendment Settlement	0.008 (0.51)	0.045 *** (0.01)	0.017 (0.12)
Consideration Increase Settlement	0.005 (0.80)	0.057 ** (0.022)	0.004 (0.809)
Observations	391	423	293
R-squared	0.2658	0.1228	0.2252

The variable with the strongest relationship to voting outcomes is the recommendation made by ISS. The ISS variable which is a dummy variable representing whether ISS recommends yes or no vote to its clients is positive and significant at the one percent level in all columns. In our regressions, an ISS yes recommendation is associated with an increase in the number of yes votes by anywhere from 11.3 to 15.5 percentage points. The significance of an ISS “yes” recommendation explains in part why there is furious lobbying of ISS for its recommendations. It also explains why ISS occupies a controversial role as a proxy adviser.<sup>106</sup>

It is unclear whether our findings with respect to the ISS recommendation reflect causation or simply correlation. In other words, as one of us has observed elsewhere, ISS recommendations may directly influence shareholder votes; alternatively they may simply reflect how shareholders were going to vote anyway.<sup>107</sup> Furthermore, at least in our sample, ISS “no” recommendations are infrequent. We have only

<sup>105</sup> Includes Year Fixed Effects. P-values are in parentheses, with \*\*\*, \*\*, and \* denoting statistical significance at the 1%, 5%, and 10% levels, respectively. The following variables are omitted from the table: Initial Offer Premium, Transaction Value (Log), Cash, Auction, Take Private, Go-Shop, and Super Majority State. The results for these variables and their definitions are set forth in the Appendix. *Final Offer Premium* is measured over target’s trading price 30 days prior to merger announcement and is the final price paid by the buyer. *ISS Position* = 0 means ISS recommended that its’ client shareholders do not vote or vote against the transactions. *ISS Position* = 1 means that ISS recommended that its’ client shareholders vote for the transaction. *Disclosure Settlement* requires the target to make additional disclosure concerning the transaction; *Amendment Settlement* requires the terms of the transaction to be revised and includes settlements which are both Disclosure and Amendment settlements; and *Consideration Increase Settlement* provides for an increase in the consideration payable to target shareholders. *Consideration Inc. Settlement* also includes settlements that have as a component Amendment or Disclosure Settlements. The sample is defined in Section II.A. *supra*.

<sup>106</sup> Nasdaq recently filed a petition for rulemaking seeking to have the SEC adopt greater rules regulating proxy advisors. See Letter from Edward S. Knight to Elizabeth M. Murphy, Secretary, US SEC dated Oct. 8, 2013, avail. at [www.sec.gov/rules/petitions/2013/petn4-666.pdf](http://www.sec.gov/rules/petitions/2013/petn4-666.pdf).

<sup>107</sup> See Choi, Fisch & Kahan, *The Power of Proxy Advisors*, *supra* note -, at 881.

17 “no” recommendations and 423 “yes” recommendations for the transactions in which we have voting information.<sup>108</sup>

Our variable for final offer premium measures the difference between the final offer price and the target’s trading price thirty days before the announcement of the merger. We might expect that mergers involving a higher premium would generate a higher approval rate, and our regressions are consistent with this hypothesis. The variables for final offer premium are significant for the models examining yes votes as a percentage of votes cast and yes and no votes as a percentage of votes. The coefficients on the final offer premium in these models are also positive meaning that the higher the final offer premium the higher the number of yes votes. We note that our results are not significant in the models for yes votes as a percentage of outstanding. We think it is likely that, in these models, the significance of the offer premium is affected by the noisiness of the non-votes. In addition, it is likely that the premium does not drive the issue of whether or not shareholders vote, although it does drive whether they cast a yes or no vote once they have decided to vote.<sup>109</sup> This is consistent with our earlier intuition that shareholders fail to vote largely for reasons that are independent of the merits of the issue on which they are being asked to vote.

In terms of our primary hypothesis -- that disclosure-only settlements would have a negative effect on shareholder voting because they reflect the introduction of additional negative information about the merger – our regression results do not support this hypothesis.<sup>110</sup> Rather we find a non-effect. The coefficient for the variable Disclosure Settlement is not significant in any columns, meaning that, in none of our models is a disclosure-only settlement correlated with a significantly different level of shareholder support for the merger. The lack of a significant relationship between disclosure-only settlements and

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<sup>108</sup> For shareholder voting results reported where the results are per yes and no votes there were 9 ISS “No” recommendations and 284 “Yes” recommendations, and for yes votes per outstanding shares there are 16 “No” recommendations and 407 “Yes” recommendations.

<sup>109</sup> In order to exercise appraisal rights shareholders must vote no and so the intention to exercise appraisal rights may affect shareholder voting. 8 Del. Gen. Corp. Law § 252 (2013). However, in regressions reported in the appendix containing other settlement variables we do not find the inclusion of a variable reflecting whether shareholders to seek appraisal percentage to be consistently significant.

<sup>110</sup> As a robustness test we also run time series analysis to examine if there are any excess returns upon the announcement of a disclosure settlement. We hypothesize two alternative hypotheses based on the fact that once a takeover is announced, the main driver of a stock price is whether or not the takeover will be completed at the price paid. Our first hypothesis is that disclosure settlements will have no or a positive effect on share prices. The reason why is that the information is unlikely to significantly affect shareholder voting to an extent significant enough to cause shareholders to vote down the transaction. In this regard, the settlement of the litigation may actually cause a target’s share price to increase because any possible delay that may be caused by the litigation, such as an injunction, has been removed. Alternatively, if disclosure settlements are valued by shareholders to the extent that the disclosures in a disclosure settlement may influence the outcome of a transaction or otherwise to cause them to agitate to increase the share price or against the transaction, then the share price should go down. In light of these hypotheses, we run time series analysis using 2, 3, 4 & 5 day annual returns as measured against the S&P 500 index. We find no significant results for 2 & 4 day compounded annual returns though mean returns are positive, but do find significant results at the ten percent level for 3 & 5 day returns with mean excess returns of .0073 and .009 and p-values of .0921 and .0718, respectively. The results provide support for our first hypothesis, that disclosure settlements have either no effect with some evidence that they may be seen as providing deal certainty because of the settlement of the litigation on favorable returns. We find no support for the second hypothesis that disclosure settlements provide information materially affecting the shareholder vote.



shareholder voting suggests that shareholders may not value the additional information from these disclosures at least in a way that affects their vote.<sup>111</sup>

We note the tension between this finding and the general practice of the courts in accepting supplemental disclosure as a benefit to shareholders. Chancellor Chandler appears to have been correct in concluding in *National City* that “No evidence exists that the additional disclosures significantly affected the outcome of the shareholder vote.”<sup>112</sup> The court nonetheless awarded the attorneys who conducted the litigation that produced these “modest” disclosures a \$400,000 fee. In contrast, our findings suggest that Chancellor Strine’s similar conclusion in *Amylin* was correct: “none of the disclosures anybody got changed the vote.”<sup>113</sup> Similarly, to the extent that courts characterize supplemental disclosures as material, meaning information that a reasonable shareholder would consider important in deciding how to vote, our regressions suggest that shareholders do not, in fact, consider the disclosures important.

In contrast, the coefficient on amendment settlements is positive and significant in column (2). The coefficient is .045 which means that the shareholder yes vote as measured against outstanding shares increases an average of 4.5% points for amendment settlements relative to other transactions. We do not find these results for other measurements of shareholder voting in columns (1) and (3). The reason for the difference may be that yes votes as a measure of outstanding votes picks up whether shareholders vote or not while the other metrics are whether shareholders vote yes or no. We do not have an explanation why an amendment settlement may pick up more shareholder votes as opposed to more yes votes. Nonetheless, the value of amendment settlements may come in the possibility of a topping bid, rather than the information imparted through shareholder voting, something we do not measure here.<sup>114</sup> We note that of settlements in our sample involving an amendment to the merger agreement, 55 percent involved a reduction of the termination fee.<sup>115</sup>

The variable for consideration increase settlements is also statistically significant but not significantly more than amendment settlements and again only in column (2). This result may seem counterintuitive – if a deal has been “litigation-tested” and that litigation generated a higher price, one might think shareholder approval rates would be significantly higher. One possible explanation is that

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<sup>111</sup> We acknowledge that there also may be some unobserved factor present in these transactions that produces more negative votes. However, we also note the relatively high R-squared for our regressions in columns (1) and (2) indicating that we appear to account for many of these variables in our regressions.

<sup>112</sup> *In re Nat'l City Corp. S'holders Litig*, 2009 Del. Ch. LEXIS 138.

<sup>113</sup> *Id.* at \*10 (making the further point that “not one [of the supplemental disclosures] would any rational investor think was materially important”).

<sup>114</sup> *In re Compellent Techs., Inc.*, 2011 Del. Ch. LEXIS 190 (Del. Ch. Dec. 9, 2011).

<sup>115</sup> In unreported regressions, we do not find any significance when we include a disclosure plus variable. These are settlements which are disclosure plus an amendment settlement. This is supportive of one hypothesis for these settlements that the disclosure component is an add-on which does not significantly contribute value to the settlement. This finding also jibes with judge and practitioner criticism that these settlements simply change a term or two of the merger agreement and add on a disclosure component simply to maximize attorneys’ fees. In other words, our findings support that these settlements may not be valued by shareholders who may also view them similarly as neither value-enhancing or value-destroying.

deals in which the litigation produces a higher price are deals that were suspect to begin with – deals that raise serious issues about process or conflicts of interest. While these concerns warrant an economically meaningful settlement, the price increase negotiated as a result of the settlement may still be lower than the reserve price of some shareholders.

Hypothesizing that, because courts attempt to award attorneys’ fees in cases that produce meaningful benefits to shareholders, we next test the significance of the attorneys’ fee award in predicting the percentage of yes votes.

**Table IV. Shareholder Voting, Attorneys’ Fees and Settlements<sup>116</sup>**

<u>Yes Votes Per</u>	<u>Votes Cast</u>	<u>Outstanding Shares</u>	<u>Yes and No Votes</u>
	(1)	(2)	(3)
Final Offer Premium	0.172 *** (0.00)	0.08 (0.37)	0.18 *** (0.00)
ISS Position	0.195 *** (0.00)	0.14 *** (0.00)	0.169 *** (0.00)
Attorney Fee > 500	0.006 (0.54)	0.01 (0.52)	-0.003 (0.74)
Attorney Fees (Log)	-0.013 ** (0.03)	-0.005 (0.57)	-0.005 (0.36)
Disclosure Only Settlement	0.006 (0.67)	-0.010 (0.64)	0.016 (0.21)
Amendment Settlement	0.027 * (0.09)	0.029 (0.27)	0.034 ** (0.03)
Consideration Increase Settlement	0.035 (0.11)	0.046 (0.19)	0.024 (0.23)
Observations	175	190	144
R-squared	0.4259	0.1558	0.3354

Contrary to the hypothesis that attorneys’ fees are ex post facto assessments of the merit of merger litigation, we do not find any consistent relationship between the fee and the shareholder vote. In column (1) we find a slight relationship between attorneys’ fees and the percentage of yes votes per vote cast. The coefficient is significant and negative meaning the lower the attorney’s fee the lower the number of yes votes as a percentage of votes cast. But the models measuring yes votes as a percentage of outstanding shares and yes and no votes are not significant for this variable. In addition, we do not find

<sup>116</sup> Includes Year Fixed Effects. The following variables are omitted from the table: Initial Offer Premium, Transaction Value (Log), Cash, Auction, Take Private, Go-Shop, and Super Majority State. The results for these variables and their definitions are set forth in the Appendix. *Attorneys’ Fees (Log)* is the log value of attorneys’ fee awarded in the litigation. *Attorneys Fee > 500* coded =1 if the attorneys’ fees awarded in the litigation are greater than \$500K and =0 if the attorneys’ fees awarded are less than \$500K. The sample and all other variables are defined in footnote -.

significance when we include a dummy variable for whether attorneys' fees are above or below five hundred thousand dollars, a threshold which some scholars have found to be the approximate average for disclosure settlements and which has been cited by the courts as a starting point in determining the appropriate award for a meritorious settlement.<sup>117</sup>

These findings are cause for concern. To the extent that courts are making fee determinations to incentivize litigation that is valuable to shareholders, there does not appear to be a significant relationship between the size of the award and the subsequent shareholder vote. Yet if the disclosure does not affect the shareholder vote, it is difficult to see how shareholders benefit from it.<sup>118</sup> Notably, the coefficients for ISS Position in this model become more significant, implying that a "yes" recommendation for this sample correlates with a percentage change in votes ranging from 14% to 19.5%.<sup>119</sup>

We note that in columns (1) and (3) the coefficient on amendment settlements is positive and significant, meaning those transactions with such a settlement obtain a higher percentage of yes votes. In contrast, the variable consideration increase settlement is not significant in any model. We are not certain of the reason for the differences in this model for amendment settlements and increased consideration settlements from our prior model in Table III. We note that in this model we include only settlements with attorneys' fees meaning that we have a smaller sample than in Table III and that, in addition, our sample sizes for both these categories are substantially smaller than for disclosure-only settlements. It may also be the case that outlier cases, in which the merger is substantively unfair, may be driving the results in these categories.

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<sup>117</sup> See Cain & Davidoff, *supra* note 5, at 4. See also GEN-PROBE TRANSCRIPT, *supra* note 12, at 46 (statement by Vice Chancellor Laster that "I try to stick to the ranges, and I have said repeatedly about the 450 to \$500,000 range as being something that I start on.")

<sup>118</sup> One could hypothesize that shareholder voting rights, like voting rights of citizens, implicate autonomy considerations such that a shareholder derives some value from voting in the same way but while in possession of better information about the choice. Even if this were true, it is not clear that merger litigation is intended to foster these democratic values as opposed to shareholders' economic interests.

<sup>119</sup> We also note that in the Appendix in models including the appraisal variable, the disclosure variable is also not significant and negative meaning that in the presence of a disclosure settlement there are fewer yes votes as a percentage of outstanding shares. However the variables for amendment settlement and consideration increase settlement are significant in all models.

**Table V. Shareholder Voting Outcomes & Institutional Ownership<sup>120</sup>**

	<i>Shareholder Yes Votes Per Votes Cast</i>		
	All Transactions		Transaction Value
	(1)	(2)	<\$500M (3)
Institutional Ownership %	0.041 ** (0.01)	0.023 (0.52)	-0.043 (0.74)
Top 5 Institutional Ownership		-0.108 (0.56)	0.086 (0.84)
Top 10 Institutional Ownership		0.086 (0.58)	0.141 (0.74)
ISS Position		0.154 *** 0.00	0.232 *** 0.00
Disclosure Only Settlement		(0.00) (0.68)	-0.021 (0.19)
Amendment Settlement		0.01 (0.47)	-0.035 (0.31)
Consideration Increase Settlement		0.00 (0.91)	0.025 (0.75)
Observations	393	391	140
R-squared	0.0543	0.2642	0.3439

In our final table we regress shareholder yes votes as a percentage of votes cast against various institutional ownership variables. We hypothesize that institutional shareholders may be better able to assess merger litigation settlements, particularly any additional disclosure made upon a disclosure settlement. If this hypothesis is true, we would expect to see settlements have a greater effect on merger votes in companies with high levels of institutional ownership. Measured in a variety of ways, however, we find no effect of institutional ownership on shareholder assessment of merger litigation settlements. However, the R-squared in column (1) is relatively low meaning that the drivers of voting in this model are attributable to other variables. This implies that while the institutional investor ownership percentage does affect voting, it may be captured by these other variables.

To further test the effect of institutional ownership on shareholder voting, we theorize that in smaller transactions (<500MM), institutional shareholders may affect the outcome more greatly. In

<sup>120</sup> Includes year fixed effects. The following variables are omitted from the table: Initial Offer Premium, Final Offer Premium, and Transaction Value (Log). In models (2) and (3) the variable Maximum Institutional Ownership is also omitted. The results for these variables and their definitions are set forth in the Appendix. *Institutional Ownership %* is the percentage of total institutional ownership. *Top 5 Institutional Ownership* is the percentage ownership of the largest 5 institutional owners. *Top 10 Institutional Ownership* is the percentage ownership of the largest 10 institutional owners. Institutional ownership for each of these variables is as of the quarter-end immediately prior to the shareholder meeting date. The sample and all other variables are defined in footnote 105.

column (3) we do not find this to be the case; the institutional shareholder variable is not significant. We also do not find any significance in these smaller transactions for institutional ownership variables.

We run the same regressions in unreported models using the dependent variable percentage of yes votes per yes and no votes. We find in all models that the disclosure settlement variable is insignificant. Again, the most significant variable for institutional investors is the ISS recommendation, which is positive and significant at the one percent level. Similar to our earlier findings, institutional investors do not appear to find disclosure settlements to be significant.

### **III. Policy Implications: Ending Fees for Disclosure Settlements**

The findings in Part II raise serious concerns about the existing state of merger litigation, in which the vast majority of mergers are challenged, the resulting litigation produces a disclosure-only settlement, but the disclosures do not seem to affect shareholder voting on the merger. Insofar as disclosure-only settlements do not provide shareholders with useful information, they are wasteful, clogging the courts and increasing transaction costs for no reason. Nevertheless, the current practice of treating disclosure-only settlements as a shareholder benefit sufficient to entitle plaintiffs' attorneys to a fee award incentivizes attorneys to file claims in order to win those settlements. On the basis of our empirical findings, we argue that this incentive is misplaced.

The fundamental claim in state court merger litigation is based on allegations that the merger process and the merger price are unfair.<sup>121</sup> It appears that, when plaintiffs' attorneys are unable to demonstrate unfairness, they turn to supplemental disclosures to justify an award of fees for their time and expense. In contrast, private litigation under the federal securities laws focuses precisely on material deficiencies in disclosure against a backdrop of extensive disclosure regulation. In our view, this is a form of efficient specialization that ought to be recognized as a matter of law. Merger litigation, under state law, should address substantive and procedural fairness. Merger litigation, under federal law, should address disclosure quality.

The US Supreme Court has already taken the first step in this direction, holding in *Santa Fe v. Green* that the federal antifraud provisions do not address issues of merger fairness.<sup>122</sup> In this Part, we propose that Delaware cooperate by limiting the role of state law in regulating merger disclosure. Specifically, we propose that the courts reject disclosure-only settlements as providing a benefit to shareholders sufficient to justify the award of attorneys' fees, at least in cases involving publicly-traded target companies. The sections that follow develop this proposal in greater detail, explaining how the

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<sup>121</sup> Weinberger v. UOP, Inc., 457 A.2d 701, 711–15 (Del. 1983) (defining substantive fairness as involving issues of process and price).

<sup>122</sup> *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977).

federal securities laws are better suited to regulating merger disclosure, anticipating and answering objections and then offering specific suggestions on how the solution might be implemented.

### A. Federal Regulation of Merger Disclosure

The federal securities laws are all about disclosure.<sup>123</sup> The public offering process has, as its central feature, a detailed disclosure document, the Registration Statement, the role of which is established by section 5 of the Securities Act of 1933.<sup>124</sup> The applicable rules concerning subjects such as pre-filing offers, prospectus delivery, liabilities, and due diligence, are all designed to enhance the effectiveness of the disclosure mandate. Following an initial public offering, federal law subjects public companies to continued periodic disclosure obligations through the reporting requirements of the Securities Exchange Act of 1934, as amended, and the rules promulgated thereunder.<sup>125</sup>

Federal law also mandates disclosure in connection with shareholder voting through the federal proxy rules.<sup>126</sup> As a result, the federal securities laws have long been the primary source of explicit disclosure obligations in connection with mergers and acquisitions involving public companies.<sup>127</sup> The Securities and Exchange Commission mandates certain disclosures in the Schedule 14A proxy statement,<sup>128</sup> and it supplements these requirements with particularized additional disclosures in connection with tender offers and going private transactions.<sup>129</sup> Thus in most cases, the disclosure deficiencies challenged in state merger litigation are located within a federally-mandated disclosure document. In addition, the supplemental disclosures that are agreed upon in the settlement of state court litigation are ultimately incorporated into the federally-mandated form.

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<sup>123</sup> LOUIS LOSS ET AL., FUNDAMENTALS OF SECURITIES REGULATION 10 (6th ed. 2011) (observing federal securities law is about “disclosure, again disclosure, and still more disclosure”).

<sup>124</sup> 15 U.S.C. § 77e(c).

<sup>125</sup> 15 U.S.C. § 78a *et seq.* What it means to be a public company is somewhat different for purposes of the registration requirements of the Securities Act and the periodic reporting requirements of the 1934 Act. See generally Donald C. Langevoort & Robert B. Thompson, “Publicness” in *Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337, 343-344 (2013) (describing “bifurcation” in the concept of “publicness”).

<sup>126</sup> See Securities Exchange Act of 1934 § 14(a), [15 U.S.C. § 78n\(a\)\(1\) \(2012\)](#) (“It shall be unlawful for any person ... in contravention of such rules and regulations as the Commission may prescribe ... to solicit or to permit the use of his name to solicit any proxy or consent or authorization.”).

<sup>127</sup> State corporation law does require corporations to disclose shareholder appraisal rights. See, e.g., Del. Gen. Corp. L. § 262(d) (2013) (requiring corporation to provide shareholders with notice of the option to exercise appraisal rights and to include in such notice a copy of the appraisal statute); *Gilliland v. Motorola, Inc.*, C.A. No. 411-N (Del. Ch. Nov. 3, 2004) (explaining that a notice of merger and appraisal rights must contain sufficient information to allow a shareholder to decide whether to exercise his or her appraisal rights).

<sup>128</sup> 17 C.F.R. § 240.14a-101 (2013).

<sup>129</sup> 17 CFR § 240.14d-100 (2013) (Schedule TO); 17 CFR § 240.13e-100 (2013) (Schedule 13e-3).

The federal disclosure requirements are primarily rule-based.<sup>130</sup> The federal statutes and the SEC rules thereunder require the disclosure of information concerning many of the same items that are frequently the subject of state law disclosure-only settlements, including valuation procedures, financial advisor opinions and potential conflicts of interest.<sup>131</sup> For example, the proxy rules require detailed transaction information, including information relating to reports, opinions or appraisals given by financial advisors.<sup>132</sup> Disclosure concerning the selection and compensation of outside financial advisors is likewise required in going-private transactions, along with disclosure of any other material relationships between the company and the advisor.<sup>133</sup>

The disclosure requirements of federal law reflect a delicate balance. On the one hand, some commentators argue that, in general, more information is better.<sup>134</sup> Other commentators view disclosure of too much information as counterproductive and argue that even some material disclosures might be counterproductive if they overwhelm investors with too much information that cannot be used properly.<sup>135</sup> The SEC's disclosure requirements are subject to ongoing debate, public scrutiny and, on occasion, legal challenge, as the SEC seeks to strike an appropriate balance both in terms of providing useful information and imposing reasonable costs on market participants.<sup>136</sup> As some commentators have noted, the SEC's rule-making process offers particular advantages in evaluating the costs and benefits of proposed disclosure requirements such as the opportunity for affected market participants to provide input.<sup>137</sup>

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<sup>130</sup> See Hillary A. Sale, *Public Governance*, 81 GEO. WASH. L. REV. 1012, 1023 (2013) (describing how Sarbanes-Oxley replaced flexible state law standards with "firm rules"). See generally Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 621-24 (1992) (articulating distinction between using rules versus standards to regulate).

<sup>131</sup> See Joel Seligman, *The New Corporate Law*, 59 BROOK. L. REV. 1 (1993) (discussing disclosure obligations under 13e-3 for going private transactions); *Wilson v. Great Am. Indus., Inc.*, 855 F.2d 987, 993-94 (2d Cir. 1988) (in merger between corporations A and B, failure to disclose that general counsel of corporation A personally represented senior executives of corporation B and that he and his firm served as counsel to several entities controlled by these executives constituted material omissions); *Kas v. Fin. Gen. Bankshares, Inc.*, 796 F.2d 508, 513 (D.C. Cir. 1986) ("The violation arising from the failure to disclose such a potential conflict of interest does not turn on the failure to disclose a director's true motivations but rather stems from the failure to disclose a fact that puts the shareholder on notice of a potential impairment of the director's judgment.").

<sup>132</sup> See 17 CFR § 240.14a-101 (2013).

<sup>133</sup> See 17 CFR § 229.1015 (2013) (Item 1015 - Reports, opinions, appraisals and negotiations).

<sup>134</sup> See Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L.Q. 417, 418 (2003) (explaining that "Securities regulation is motivated, in large part, by the assumption that more information is better than less"). See, e.g., Joan MacLeod Heminway, *Personal Facts about Executive Officers: A Proposal for Tailored Disclosures to Encourage Reasonable Investor Behavior*, 42 WAKE FOREST L. REV. 749, 759 (2007) (arguing for codification of disclosure rules relating to executives' private facts).

<sup>135</sup> Paredes, *supra* note \_\_ at 485. See also Steven M. Davidoff & Claire Hill, *Limits of Disclosure*, 36 SEATTLE U. L. REV. 599, 603 (2013) (arguing that "the role of disclosure in investment decisions is far more limited, and far less straightforward, than is typically assumed.")

<sup>136</sup> See, e.g., *Going Private Transactions by Public Companies or Their Affiliates*, Exchange Act Release No. 14,185, 42 Fed. Reg. 60,090, 60,091 (Nov. 23, 1977) (proposing SEC Rule 13e-3). (describing and defending proposed new disclosure requirements in connection with going private transactions); *Petition for Review, National Association of Manufacturers v. SEC*, No. 12-1422, Oct. 19, 2012, avail. at

[http://www.srz.com/files/upload/Conflict\\_Minerals\\_Resource\\_Center/Petition\\_for\\_Review.pdf](http://www.srz.com/files/upload/Conflict_Minerals_Resource_Center/Petition_for_Review.pdf) (challenging SEC's conflict minerals disclosure requirement as failing cost/benefit analysis).

<sup>137</sup> See David Friedman, Note, *The Regulator in Robes: Examining the SEC and the Delaware Court of Chancery's Parallel Disclosure Regimes*, 113 COLUM. L. REV. 1543, 1553 (2013) (arguing that the SEC should codify Delaware's disclosure rules through notice and comment rulemaking and eliminate the existence of two different sets of disclosure requirements).

The principal difference between state and federal disclosure mandates in connection with merger transactions is that federal law involves proscriptive rules of general application, whereas Delaware judges articulate disclosure requirements in the fact-specific context of individual transactions.<sup>138</sup> Under federal law, the failure to disclose even material information is not actionable unless SEC rules specifically mandate disclosure of that information or unless the omission renders other disclosures misleading.<sup>139</sup> The failure to include all material information in a proxy statement does not violate federal law.<sup>140</sup> As the Third Circuit explained, “omission of information from a proxy statement will violate [§ 14(a) and Rule 14a-9] if either the SEC regulations specifically require disclosure of the omitted information in a proxy statement, or the omission makes other statements in the proxy statement materially false or misleading.”<sup>141</sup>

The distinction is perhaps best illustrated with respect to the disclosure of compensation and conflicts of financial advisors. The SEC requires a descriptive summary of the financial advisors’ compensation. Staff interpretations have often required a breakdown of how much of the advisors fee was fixed versus contingent,<sup>142</sup> Delaware precedent, in contrast, requires disclosure of “substantial contingent fees” without clearly articulating the standard by which a fee is judged to be substantial.<sup>143</sup> Likewise, federal law requires the disclosure of “material relationships” existing between the advisor and the other party in the transaction over the prior two years,<sup>144</sup> but several Delaware decisions have compelled considerably more detailed disclosure about investment banker relationships and potential conflicts.<sup>145</sup> Finally, Delaware has recently required the disclosure of a financial advisor’s interest in a deal, through institutional or personal holdings, while SEC rules are silent on this issue.<sup>146</sup> Thus, in *El Paso*, Chancellor Strine termed Goldman’s lead banker’s failure to disclose a personal \$340,000 ownership interest in the buyer’s stock “very troubling” although it was unclear that disclosure of this interest was required under federal law.<sup>147</sup>

Shareholders can enforce their disclosure rights under federal law through litigation. Rule 14a-9 prohibits fraud in connection with the solicitation of proxies, and the U.S. Supreme Court has held that it

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<sup>138</sup> See generally *id.* at 1553 (noting, with respect to rule-making on financial advisor disclosures that “the fact-specific nature of Chancery decisions differentiates them from the broad, prospective rules typically generated by regulatory agencies”).

<sup>139</sup> See, e.g., *Smith v. Robbins & Myers, Inc.*, 2012 U.S. Dist. LEXIS 157294, \*6 (S.D. Ohio) (“there is no duty to disclose background details regarding potential alternate transactions not pursued by the company”).

<sup>140</sup> See, e.g., *Seinfeld v. Becherer*, 461 F.3d 365, 369 (3d Cir. 2006).

<sup>141</sup> *Id.*

<sup>142</sup> See 17 CFR § 229.1015(b)(4) (2013). For more on staff interpretations of the rule, see Steven M. Davidoff, *Fairness Opinions*, 55 AM. U. L. REV. 1557, 1592–93 (2006).

<sup>143</sup> Friedman, *supra* note 137, at 1554–1556 (reviewing decisions and noting that although Delaware consensus seems to be that “substantial” contingent fees need to be disclosed, at what point the contingent portion of a total fee structure becomes “substantial” remains ambiguous).

<sup>144</sup> See 17 CFR § 229.1015(b)(4) (2013). See also *Self-Regulatory Organizations: National Association of Securities Dealers, Inc.*, Exchange Act Release No. 34-53598, 71 Fed. Reg. 18,395, 18,397 (proposed Apr. 11, 2006).

<sup>145</sup> Friedman, *supra* note -, at 1556-1558 (reviewing decisions and noting ambiguity in Delaware law on this point).

<sup>146</sup> *Id.* at 1559-1561.

<sup>147</sup> *In re El Paso Corp. S'holder Litig.*, 41 A.3d 432, 442 (Del. Ch. 2012).



provides a private right of action for false and misleading proxy statements.<sup>148</sup> In addition, to the extent that shareholders sell their stock in connection with a merger, they have a cause of action under SEC rule 10b-5.<sup>149</sup> The elements of proxy fraud and securities fraud are quite similar. Both require a material misstatement or omission, damages and a causal relationship between the two.<sup>150</sup>

Importantly, liability under federal law turns on materiality.<sup>151</sup> Misstatements and omissions in federally-mandated disclosure documents are actionable if and only if they are material. In the context of the proxy statement, the Supreme Court stated that a fact is material "if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."<sup>152</sup> Critically, as Richard Booth has explained, this means that some investors must react to the information.<sup>153</sup>

The federal courts have developed an extensive jurisprudence concerning the materiality requirement.<sup>154</sup> Courts consider the role of specific statements within the context of the document in which they are contained, the relevance of other disclosures and general information environment applicable to the issuer, the nature of the information involved, including its capacity to affect the market and the degree to which it is speculative or subjective, the importance of the speaker's identity to the materiality determination and a host of other factors. Although the legal definition of materiality is broadly inclusive,<sup>155</sup> courts have also adopted various qualifications to evaluate the specific disclosures in the context of the particular document in which it is contained, the transaction that it involves and the overall amount of information present in the market.<sup>156</sup>

Private litigation is a viable remedy for truly deficient disclosures in a proxy statement. Federal litigation offers two potential mechanisms for redress. First, federal courts will provide expedited proceedings and issue an injunction mandating corrective disclosure prior to the shareholder vote.<sup>157</sup> Second, federal courts can provide ex post money damages. That these remedies are meaningful is

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<sup>148</sup> J.I. Case Co. v. Borak, 377 U.S. 426 (1964).

<sup>149</sup> See 17 CFR § 240.10b-5 (2013). See Frank Josselson, Note, *Corporations--Mergers and Rule 10(b)-5--Vine v. Beneficial Finance Company*, 374 F.2d 627 (2d Cir. 1967), 1968 WIS. L. REV. 265 (1968);

<sup>150</sup> See, e.g., *Tracinda Corp. v. DaimlerChrysler AG*, 502 F.3d 212, 228 (3d Cir. 2007) ("To prevail on a § 14(a) claim [for a violation of Rule 14a-9], a plaintiff must show that (1) a proxy statement contained a material misrepresentation or omission which (2) caused the plaintiff injury and (3) that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction."). The Supreme Court has reserved the question of whether scienter, which is required in a private action under Rule 10b-5 is also required under Rule 14a-9. See *Va. Bankshares v. Sandberg*, 501 U.S. 1083, 1091 n. 5 (1991).

<sup>151</sup> Notably, the federal courts have interpreted the materiality requirement analogously with respect to proxy fraud and federal securities fraud. See *Heminway*, *supra* note -, at 759 (2007) (explaining that the Supreme Court adopted the same legal standard of materiality under both Rule 14a-9 and Rule 10b-5).

<sup>152</sup> *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

<sup>153</sup> Richard A. Booth, *The Two Faces Of Materiality*, 38 DEL. J. CORP. L. 517, 519 (2013) ("Not all investors need react to the new information, but some investors must.").

<sup>154</sup> See *Heminway*, *supra* note -, at 756-57.

<sup>155</sup> See, e.g., Dale A. Oesterle, *The Overused and Under-defined Notion of "Material" in Securities Law*, 14 U. PA. J. BUS. L. 167 (2011).

<sup>156</sup> See *id.* at 185-86 (identifying examples such as the bespeaks caution doctrine and truth on the market).

<sup>157</sup> See, e.g., *Gillette Co. v. RB Partners*, 693 F. Supp. 1266 (D. Mass. 1988) (addressing allegations of proxy fraud on an expedited basis).

illustrated by the fact that federal litigation frequently settles for meaningful monetary consideration. For example in the merger of Bank of America and Merrill Lynch, it was later revealed that Bank of America had learned of massive losses at Merrill Lynch just before the Bank of America shareholder vote on the transaction.<sup>158</sup> Shareholders filed a federal claim under 14a-9 in the Southern District of New York and subsequently settled, not for a form of non-pecuniary relief, but rather for \$2.4 billion in money damages.<sup>159</sup>

Notably, federal litigation also addresses the potential for frivolous litigation. In the Private Securities Litigation Reform Act (PSLRA),<sup>160</sup> Congress adopted a variety of substantive and procedural reforms designed to discourage meritless cases while retaining meaningful litigation challenges. For example, the PSLRA imposes a heightened pleading standard for the allegation of disclosure violations. “Pursuant to the PSLRA, to state a claim, a complaint must ‘1) specify each statement alleged to have been misleading, [and] the reason or reasons why the statement is misleading, and 2) state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.’”<sup>161</sup> This standard applies to claims under Rule 14a-9 as well as Rule 10b-5.<sup>162</sup> Courts have also concluded that many of the procedural reforms of the Private Securities Litigation Reform Act, for example, apply to proxy fraud litigation such as the stay of discovery pending the resolution of a motion to dismiss.<sup>163</sup> Similarly, courts have noted that the causation requirement prevents every disclosure failure from constituting a violation of Rule 14a-9.<sup>164</sup> Accordingly, both federal regulation and federal litigation attempt to strike a balance in terms of the scope of disclosure that they mandate and the extent to which violations of the regulatory requirements can be challenged through litigation.

## B. State Law Disclosure Litigation

Although, as noted above, the core concern of state fiduciary duty litigation with regard to mergers is the substantive fairness of the transaction, state law merger complaints often include disclosure claims. Delaware courts have adopted a materiality requirement that is akin to the federal standard.

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<sup>158</sup> See, e.g., Halah Touryalai, *Bank Of America Will Pony Up \$2.4 Billion To Investors Over Merrill Lynch Merger*, Forbes.com, Sept. 28, 2012, available at <http://www.forbes.com/sites/halahtouryalai/2012/09/28/bank-of-america-will-pay-investors-2-4-billion-over-merrill-lynch-merger/> (describing case).

<sup>159</sup> *Id.*

<sup>160</sup> Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995).

<sup>161</sup> *In re NVE Corp. Sec. Litig.*, 527 F.3d 749, 751 (8th Cir. 2008) (citations omitted).

<sup>162</sup> *Little Gem Life Scis. LLC v. Orphan Med., Inc.*, 537 F.3d 913, 917 (8th Cir. 2008).

<sup>163</sup> See, e.g., *Smith v. Robbins & Myers, Inc.*, 2012 U.S. Dist. LEXIS 157294, at \*4; *Dipple v. Odell*, 870 F. Supp. 2d 386 (E.D. Pa. 2012).

<sup>164</sup> See, e.g., *Lane v. Page*, 649 F. Supp. 2d 1256, 1289 (D. N. Mex. 2009) (“Omissions that might ultimately be minor in a particular factual scenario, but which contravene an SEC regulation . . . must satisfy causation requirements, preventing insubstantial violations of disclosure requirements from becoming actionable claims for damages.”)

According to the court in *Sauer-Danfoss*, in order for supplemental disclosures to constitute a substantial benefit sufficient to justify an award of attorneys' fees, the disclosures must be material.<sup>165</sup> This standard was applied by Chancellor Strine in *Amylin* to deny a fee request on the basis of the finding that the supplemental disclosures amounted only to "additional meaningless disclosures that did not materially change the mix of information."<sup>166</sup> Noting that not all information can be disclosed<sup>167</sup> and that all details, even of a financial advisor's analysis, are not required,<sup>168</sup> the Chancellor reaffirmed the materiality standard.<sup>169</sup> The Chancellor emphasized that materiality is best demonstrated by a comparative analysis showing how a set of supplemental disclosures meaningfully altered the information previously available.<sup>170</sup>

Nevertheless, materiality analysis operates differently in Delaware merger litigation from the way it operates in federal securities law cases. First, courts decide Delaware merger cases on an expedited basis, according to the lifecycle of the underlying transaction.<sup>171</sup> If a case is not disposed of through a motion during the pendency of the transaction, it will most likely be settled prior to the transaction's close so that the transacting parties can eliminate it as a contingent liability.<sup>172</sup> This means that Chancery Court judges reviewing merger disclosures always do so under substantial time pressure, either in the context of a motion to dismiss or in the context of approving a disclosure settlement. As a result, most of the court's rulings on materiality come in the form of transcript opinions.<sup>173</sup> Delaware's release of transcript opinions seeks to strike a balance between efficiency of time, on the one hand, and clarity of precedent, on the other. By contrast, federal cases are more frequently litigated post-closing and can offer the more formal, precedent-driven consideration of materiality described above.<sup>174</sup>

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<sup>165</sup> *Sauer-Danfoss*, C.A. No. 5162-VCL, at 17 ("For a disclosure claim to be meritorious when filed and provide a compensable benefit to stockholders, the supplemental disclosure that was sought and obtained must be material.") (citing *Campell v. The Talbots, Inc.*, 5199-VCS, at 19-35 (Del. Ch., Dec. 20, 2010) (Transcript). Under the federal definition, a disclosure is material if "the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *TSC Indus., Inc. v. Northway, Inc.* 426 U.S. 438, 449 (1976), quoted in *Sauer-Danfoss* C.A. No. 5162-VCL, at 18.

<sup>166</sup> *In re Amylin Pharmaceuticals S'holders Litig.*, C.A. 7673-CS, at 9 (Transcript, February 5, 2013) [hereinafter *AMYLIN TRANSCRIPT*].

<sup>167</sup> *Id.* ("[N]o one would describe all information concerning the process. That would be impossible.").

<sup>168</sup> *Id.* ("You don't have to disclose details. You have to disclose the material information relevant to understanding the banker's thing.").

<sup>169</sup> *Id.* at 11 ("[T]here's absolutely nothing here... that a reasonable investor would conclude materially affected the total mix of information...").

<sup>170</sup> *Id.* at 12 ("If we're going to rely on disclosures, there ought to be a comparison between the original disclosures that were given to stockholders and what ultimately came out and some assessment of the difference in the mix of information that results.").

<sup>171</sup> Griffith & Lahav, *supra* note -, at 1063 ("Merger litigation asks existential questions on an expedited basis.")

<sup>172</sup> See *supra* notes 32-34 and accompanying text

<sup>173</sup> *Id.*, at 1125-26 (discussing transcript opinions and comparing them to the traditional judicial opinion).

<sup>174</sup> See Section III.B.1., *supra*.

Second, Delaware courts analyze the materiality of disclosures in connection with the review and approval of settlements, a judicial act that is typically, as we emphasized above, non-adversarial.<sup>175</sup> As a result, defendants generally do not oppose and often tacitly support plaintiffs' assertions concerning the materiality of disclosures.<sup>176</sup> To put this into context, the courts in Delaware are rarely faced with arguments on both sides of questions such as whether a proffered supplemental disclosure is largely duplicative of other information already disclosed to the market or is insufficiently factual or too tentative to be useful. By contrast, federal judges rule on materiality as a critical element establishing fraud.<sup>177</sup> As a result, the issue is fully briefed and argued by both sides to the dispute. Hence, federal judges routinely receive better information in connection with each materiality determination. When federal judges articulate the basis of their materiality determination in formal judicial opinions, this information produces a higher quality body of precedent that judges can draw upon in future determinations. By contrast, unopposed settlements, as even the Delaware judiciary acknowledges, make poor reference points.<sup>178</sup>

In addition, the structure of state court litigation claims creates an odd bifurcation. The primary allegations of the complaint challenge the merger's substantive and procedural fairness, typically encompassing possible conflicts of interest, failure to shop the company adequately or otherwise maximize the sales price, or concerns about provisions in the merger agreement such as termination fees. In contrast, the incidental disclosure claims are generally not well developed in the complaint, nor, because they are incidental, are disclosure claims subjected to careful scrutiny at the pleading stage pursuant to a motion to dismiss. What all of this reveals, of course, is that state court litigation really is not about disclosure.

Consider, for example, the *Sauer-Danfoss* complaint.<sup>179</sup> Count III, alleges a breach of the defendants' fiduciary duty of disclosure in that "The Recommendation Statement fails to disclose material information, including financial information and information necessary to prevent the statements contained therein from being misleading"<sup>180</sup> The complaint does not identify a single piece of omitted information as a basis for this claim. Nor does the complaint identify a basis upon which the allegedly

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<sup>175</sup> See *supra* Section I.B. In a minority of proceedings there are objectors, but these are often pro se litigants, and their objections while noted do not interfere with the main settlement. See Jeffries, *supra* note 9, at 4 ("these fee awards are rarely objected to and thus rarely appealed.").

<sup>176</sup> Griffith & Lahav, *supra* note -, at 1093 (discussing potential for collusion between litigants in seeking to win judicial approval of settlements).

<sup>177</sup> See Section III.B.1 *supra*.

<sup>178</sup> *In re Sauer-Danfoss Inc. S'holders Litig.*, 65 A.3d 1116, 1137 (Del. Ch. 2011). ("In actuality, when reviewing an uncontested fee application, the Court suffers from an informational vacuum created when the adversity of interests that drives the common law process dissipates.")

<sup>179</sup> SAUER-DANFOSS COMPLAINT, *supra* note -,

<sup>180</sup> *Id.* at 26, ¶88,

omitted information was required to be disclosed. Simply put, the allegations fall woefully short of the pleading standard that would be required to file a federal claim under Rule 14a-9.<sup>181</sup>

Most problematically, perhaps, the merits of the materiality question are not squarely before the state court in merger litigation. State courts address materiality not in connection with deciding fraud claims, but rather in connection with approving negotiated settlements. In this context, the court is not asked to decide whether the proxy would have been materially misleading to investors without the supplemental disclosure, but rather, whether a negotiated package of supplemental disclosures, once added to the proxy statement, benefits shareholders. Put in these terms, it is difficult for a court to say that shareholders would not like to know an additional piece of information, especially when there is no adverse party briefing the court on why the additional information provides no real benefit.<sup>182</sup> Our empirical results, however, are fairly clear that supplemental disclosures do not in fact change shareholder behavior and, in that sense at least, provide no real benefit. The next section addresses what ought to be done about it.

### **C. Eliminating the State Law Claim for Disclosure**

Delaware courts provide a bounty for plaintiffs' lawyers to settle for disclosure by requiring the defendant corporation to pay their fees. This bounty is based on the premise that disclosure-only settlements provide a "substantial benefit" to the shareholder class. Our findings demonstrate that this premise is misguided. The benefit produced by disclosure-only settlements is anything but substantial. Indeed, it would be closer to the truth to say that it is imaginary.

The cost of these suits, however, is very real. These suits generate litigation costs—specifically the attorneys' fees on both the plaintiff and defense sides—as well as court costs and the uncertainty and risk created by subjecting every merger to litigation, often in multiple jurisdictions. The cases also may distort Delaware law, if the Delaware courts seek to accommodate these claims and keep them from migrating to other jurisdictions.<sup>183</sup> Basic cost-benefit analysis therefore suggests that something ought to be done to significantly reduce these settlements. Our suggestion is simple. We propose that Delaware stop recognizing disclosure-only settlements as a substantial benefit for the purposes of a fee award in class litigation involving public company mergers.<sup>184</sup>

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<sup>181</sup> See note \_\_\_ *infra* and accompanying text.

<sup>182</sup> See Oesterle, *supra* note - (describing how judicially imposed limits on the duty to disclose provide framework for limiting requirement to disclose sensitive business information that would presumably have been of interest to investors).

<sup>183</sup> Cain & Davidoff, *supra* note -.

<sup>184</sup> We confine our proposed rule to public company mergers because our empirical evidence is limited to that context and also because the proxy rules regulate only publicly traded companies. Delaware courts have recognized a difference between the disclosure obligations of public and private companies in other contexts as well. *Compare* Skeen v. Jo-Ann Stores, Inc., 750 A.2d 1170 (2000) (limiting disclosure obligations in appraisal case involving publicly held corporation) *with* Erickson v. Centennial

Our rule would have the effect of eliminating the financing for disclosure-only settlements, but only disclosure-only settlements, in state court merger litigation. Our proposal explicitly recognizes that that merger litigation can produce substantial shareholder benefit – the *Grupo Mexico* decision, for example, clearly shows that it can – and we do not limit the right of shareholders to sue in connection with mergers. Nor do we seek to address the scope of the duty of disclosure under state law.<sup>185</sup>

Delaware courts have been struggling for several years to accomplish a similar outcome by more modest means – a searching and case-specific inquiry into whether the supplemental disclosures are really “meaningful.”<sup>186</sup> Nevertheless, our empirical results suggest that the inquiry in the context of the settlement approval decision is ineffective. The vast majority of cases settled for supplemental disclosures, cases in which the lawyers receive a non-zero fee award, appear to have no effect on the shareholder vote. We can find no statistically significant relationship between the amount of attorneys’ fees awarded and the quality of the resulting disclosure as measured by its effect on the shareholder vote.<sup>187</sup> To the extent that the courts are trying to award nominal fees in weak cases in order to discourage non-meritorious litigation, the practice does not seem to be effective – litigation rates have been consistently increasing even as the average fee award declines in size. It is simply implausible to explain the growth in litigation challenges by a decline in the quality of merger disclosures. Rather, existing doctrine, which treats a disclosure-only settlement as providing shareholders with a substantial benefit, is creating bad incentives.

#### **D. Elimination of Disclosure-Only Fee Awards as Conceptual Preemption**

The obvious objection to our proposal is that by eliminating fee awards in disclosure-only settlements we reduce the incentive for litigation in cases in which the proxy statement is truly deficient. Moreover, removing the threat of shareholder litigation in these cases might lead to an increase in materially deficient disclosure by eliminating the deterrent effect of disclosure claims. Barring disclosure settlements may open the door to materially deficient disclosure.

Our proposal does not eliminate litigation challenges to merger disclosure, however; it simply relegates those challenges to a highly developed body of law and regulation and a forum specialized in applying that law – litigation under the federal securities laws in federal courts. Federal law is, as we

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Beuregard Cellular LLC, 2003 WL 1878583 (2003) (expanding disclosure obligation in appraisal case involving privately held corporation).

<sup>185</sup> Others have questioned the utility of a state law duty of disclosure that differs from the duties applicable under the federal securities laws. *See, e.g.*, Friedman, *supra* note - (advocating unification of the legal standard through SEC rulemaking adopting the Delaware duty of disclosure).

<sup>186</sup> *See infra* Part I.C.

<sup>187</sup> *See* Table IV (the quality of the resulting disclosure as measured by shareholder voting behavior)

explained, better designed to address merger disclosure standards than Delaware’s duty of disclosure, and federal courts are well situated to enforce that law efficiently. Delaware law and Delaware courts, by contrast, are well suited to pass on the substantive fairness of merger transactions. We would reserve for state courts the promulgation of legal standards for evaluating the substantive and procedural fairness of mergers, and we would reserve for federal law the regulation of merger disclosure.

Our proposal borrows from and extends the fundamental balance of regulatory authority between Delaware, on the one hand, and the SEC, on the other, as articulated by the United States Supreme Court in 1977. In *Santa Fe Indus. v. Green*, the Supreme Court considered a challenge under Rule 10b-5 to a short form merger pursuant to Delaware law.<sup>188</sup> The plaintiffs’ claim was that the merger was fraudulent because it deprived plaintiffs of the fair value of their stock at an inadequate price. The Court concluded that this allegation failed to state a claim under federal law. Substantive fairness, the Court held, is not the same as deception, and federal law provides a remedy only for the latter. With respect to substantive fairness, the Court stated that this was an issue for state corporate law. The Court refused to federalize this body of law and override state regulatory policies. The Court thus drew a line with respect to the regulation of mergers: federal law would regulate disclosure quality, and state law would address substantive fairness.

The expansion of directors’ disclosure duties under Delaware state law encroaches upon the line articulated by the Court in *Santa Fe*. Concededly, nothing in the *Santa Fe* decision or the federal securities laws precludes states from imposing disclosure duties in connection with mergers that supplement those imposed by federal law.<sup>189</sup> But the broader message of *Santa Fe* is a message about the balance of power and the specialization of expertise. Indeed, the Court in *Santa Fe* explicitly noted that the plaintiffs had an appraisal remedy available to them, which would have given them the opportunity to have the Chancery Court conduct a valuation of their stock, but that they had chosen not to pursue that remedy.<sup>190</sup> By implication, the Court’s decision was based in part on the existence and perhaps superiority of state court as a forum for adjudicating claims about merger fairness. Since *Santa Fe*, the Delaware Courts have developed considerable expertise in understanding and applying complex principles of valuation<sup>191</sup> as well as in analyzing the procedures by which mergers and other control transactions are conducted and negotiated.<sup>192</sup>

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<sup>188</sup> 430 U.S. 462 (1977).

<sup>189</sup> Indeed, the Exchange Act expressly preserves rights and remedies available under state law, leaving room for federal and state disclosure regimes to exist side by side. *See* Securities Exchange Act of 1934 § 28(a), 15 U.S.C. § 78bb(a)(2) (2012) (“the rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity”). *Cf.* Securities Litigation Uniform Standards Act, Pub. L. No. 105-353, 112 Stat. 3227 (codified at 15 U.S.C § 78bb) (1998) (preempting state court litigation for “covered class actions”).

<sup>190</sup> *Santa Fe Indus. v. Green*, 430 U.S. 462, 467 (1977).

<sup>191</sup> *See, e.g.,* *In re Emerging Communications, Inc. Shareholders Litig.*, 2004 Del. Ch. LEXIS 70 (2004).

<sup>192</sup> *See, e.g.,* *America’s Mining Corp. v. Theriault*, 51 A.3d 1213 (Del. 2012).

In contrast, the federal courts have developed expertise both in evaluating disclosure quality and in evaluating the quality of litigation challenging that disclosure. This expertise is enhanced within the subject of merger disclosure because the substantive content of a proxy statement in connection with a shareholder vote on a merger is largely determined by the SEC’s disclosure requirements. Thus the federal courts’ analyses of disclosure challenges are informed by the choices that the SEC has made in formulating affirmative disclosure requirements and balancing those requirements against competing values. This makes the federal courts particularly well suited to evaluate the extent to which supplemental disclosures add material value to the information provided in a specific proxy statement.

We argue here that the Delaware courts should follow a similar approach to that taken by the Supreme Court in *Santa Fe* and restore the conceptual boundary between state and federal regulation. We propose that the courts conclude that claims about the adequacy of merger disclosure should be litigated under federal law (and subject to the materiality threshold established therein), leaving state law to focus on the fairness, both procedural and substantive of the merger terms.

Our proposal locates merger litigation within the space in which federal and state law potentially overlap and in which both Wilmington and Washington should consider the possibility of upsetting a “well-tuned balance” through greater regulatory intervention.<sup>193</sup> Federal and state law take very different approaches to the regulation of mergers and, in the same manner that the Supreme Court has recognized the superiority of state mechanisms for evaluating substantive merger fairness, state courts might do well to rethink the intrusion into disclosure duties.

#### **IV. Objections and Responses**

##### **A. Multi-Forum Litigation**

The core objection to our proposal may be that the hands of the Delaware courts are tied. While they might prefer to refuse to award attorneys’ fees in disclosure-only settlements, they face a real risk that, in doing so, they will drive merger litigation outside of Delaware and into other states in which the judges subject proposed settlements to lower levels of scrutiny.<sup>194</sup> Recall that not only has the percentage of mergers facing a litigation challenge risen, but that mergers today typically face multiple litigation challenges in different fora. If Delaware courts do not pay plaintiffs’ lawyers, they will file and settle their cases elsewhere.<sup>195</sup> Indeed there is evidence that litigants have done precisely that, engaging in forum-

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<sup>193</sup> See, e.g., Mark Roe, *Delaware and Washington as Corporate Lawmakers*, 34 DEL. J. CORP. L. 1, 15 (2009).

<sup>194</sup> See, e.g., See John Armour, et. al., *Is Delaware Losing its Cases?*, 9 J. EMPIRICAL LEGAL STUD. 605 (2012). See also Cain & Davidoff, *supra* note -.

<sup>195</sup> See John Armour, et al., *Delaware’s Balancing Act*, 87 IND. L.J. 1345 (2012); Cain & Davidoff, *supra* note -; Griffith & Lahav, *supra* note -.



shopping and then, on occasion, entering into reverse auctions in which they agree to settle cases for limited value as long as they receive a fee award.<sup>196</sup>

It is unquestioned that forum-shopping has traditionally limited the ability of Delaware to reduce the volume of low-value merger litigation. Since the judicial acceptance of forum-selection bylaws, however, the problems associated with multi-forum litigation have entered a new phase.<sup>197</sup> Forum selection bylaws allow a corporation to select, in advance, Delaware court as the exclusive forum for corporate governance disputes. The bylaws are expressly intended to apply to merger litigation. Hence, a corporation can effectively opt-in to the Delaware approach to merger litigation by adopting a forum-selection bylaw and, provided that the out-of-state court likewise defers to the bylaw provision, Delaware law will be applied by Delaware courts.<sup>198</sup>

We note that we do not, in this Article, address the question of whether or to what extent courts should defer to forum selection clauses. Although the Delaware Chancery Court has ruled that such clauses are facially valid,<sup>199</sup> the Delaware Supreme Court has not spoken to the question.<sup>200</sup> Nonetheless, to the extent that courts accept such clauses, they enable our proposed rule to operate as a form of private-ordering. Were our proposal to be enacted, shareholders of corporations that adopted forum-selection bylaws would effectively be opting into a rule that barred the funding of disclosure settlements from the corporate treasury. By contrast, shareholders of corporations that did not adopt forum-selection bylaws would effectively be electing to keep open the possibility of paying for a disclosure settlement in an alternative jurisdiction.<sup>201</sup> Were Delaware to choose the clear rule we propose over its current haphazard approach, shareholders could decide for themselves, via the mechanics of forum-selection clauses, which rule was optimal for them.

Notably, even if other states do not uniformly defer to forum selection provisions, the cases that our proposal would exclude from the Delaware courts are the weakest<sup>202</sup> – those in which the Delaware

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<sup>196</sup> See *Scully v. Nighthawk*, C.A. No. 5890-VCL (Del. Ch. Oct. 11, 2010).

<sup>197</sup> *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934, 942, 963 (Del. Ch. 2013), (concluding that such bylaws were facially valid under the statute as applied to cases arising under the internal affairs doctrine).

<sup>198</sup> Unfortunately the extent to which non-Delaware courts will defer to forum selection bylaws remains unclear. See, e.g., *Galaviz v. Berg*, 763 F.Supp.2d 1170 (N.D. Cal. 2011) (refusing to defer to a board-adopted forum selection bylaw for a Delaware corporation).

<sup>199</sup> See *Boilermakers*, 73 A.3d at 934.

<sup>200</sup> The defendants in a case pending in a California federal district court recently filed a motion asking the court to certify the question of whether a forum selection bylaw was valid to the Delaware Supreme Court. See Defendants' Notice of Motion, Motion and Memorandum in Support of Motion to Certify Question of State Law to Delaware Supreme Court, *Bushansky v. Armacost*, Case No. 12-CV-01597-JST (Jan. 31, 2014).

<sup>201</sup> This assumes, of course, that the alternative jurisdiction does not itself have a rule barring the payment of plaintiffs' attorneys' fees for disclosure settlements, an assumption that may not be warranted for every jurisdiction. See, e.g., *In re Kazman v. Frontier Oil Corp.*, No. 14-12-000320-CV, 2013 WL 1244376 (Tex. Ct. App. Mar. 28, 2013).

<sup>202</sup> The message courts appear to be sending in many of these disclosure-only cases is that the plaintiffs' bar should stop bringing such weak cases. See, e.g., *AMYLIN TRANSCRIPT*, *supra* note 166; *In re Sauer-Danfoss Inc. S'holders Litig.*, 65 A.3d 1116 (Del. Ch. 2011); *In re PAETEC Holding Corp. S'holders Litig.*, No. 6761-VCG, 2013 BL 72377 (Del. Ch. Mar. 19, 2013). The effect appears to be limited though given the continued high rate of litigation.

courts have the least interest in channeling deal-makers' conduct by critiquing the actions of the parties who are brought before them.<sup>203</sup> As some commentators have observed, these critiques and exhortations are as vital to the development of Delaware law as the holdings themselves because they guide the conduct of transaction-planners in future cases.<sup>204</sup> We suggest, however, that the Delaware courts can perform these "teaching moments" most effectively not in the cases that settle for disclosures and small attorneys' fee awards but rather those that, like *El Paso* and *Del Monte*, produce substantial damage awards and attorneys' fees.<sup>205</sup> As a result, our proposal should not affect the pedagogical content of Delaware law in any meaningful way and instead sends a message to plaintiffs' counsel to concentrate their efforts on the most problematic cases.

An alternative to the use of forum selection bylaws would be for the Delaware courts to adopt the restriction on attorney fee awards in disclosure-only cases as a part of Delaware's substantive corporate law. As a substantive rule, this limitation would preclude other state or federal courts from awarding fees in these cases under *Erie*<sup>206</sup> and the internal affairs doctrine. We note that a substantive law approach would have the salutary effect of preserving the incentive for Delaware courts to continue their leadership role by maintaining the potential for competition with respect to the "good" merger cases.

## **B. The Litigation Response to Barring Disclosure-only Fee Awards**

We have focused in this article on the incentive effect of settlement-only fee awards. We recognize, however that our proposal creates an alternative set of incentives that may, in turn, impact future merger litigation. Possible such effects include: (1) reducing merger litigation to the point that it allows bad deals to proceed unchallenged; (2) creating negative spillover effects in other forms of corporate litigation, such as appraisal actions; and (3) shifting to an alternative type of low value settlements in merger litigation. We address each of these in turn.

One challenge to our proposal is that it would undercut what is often seen as the basic value of merger litigation—that is, its ability to serve as a screen for deal quality. According to this view, the real purpose of merger litigation is to identify and prevent bad deals from being consummated. However, because litigants cannot necessarily evaluate deal quality until the case gets into discovery—*Del Monte* is

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<sup>203</sup> A good recent example of such an opinion is *El Paso*, *In re El Paso Corp. S'holder Litig.*, C.A. No. 6949-CS (Del. Ch. Oct. 19, 2011), in which Chancellor Strine declined to enjoin the merger but excoriated the conduct of the parties involved. Because the court did not issue an injunction, the opinion is technically all dicta, but the critique of the parties' conduct gives transaction planners a clear sense of what to avoid in future deals.

<sup>204</sup> See Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009 (1997).

<sup>205</sup> The settlement amount in *El Paso* was \$110 million (with \$26 million going to legal fees and expenses) while the settlement amount in *Del Monte* was \$89.4 million (with \$22.3 million going to legal fees and expenses). *In re El Paso Corp. S'holders Litig.*, C.A. No. 6949-CS (Dec. 3, 2012); *In re Del Monte S'holders Litig.*, C.A., C.A. No. 6027-VCL (Dec. 1, 2011).

<sup>206</sup> *Erie R.R. v. Thompkins*, 304 U.S. 64 (1938).

an example of a transaction that did not show its flaws until shareholder claimants reached discovery<sup>207</sup>—merger litigation must be over-inclusive at the filing stage in order to get potentially good cases into discovery. Hence, the argument goes, our proposal inhibits the screening function of merger litigation because it is likely to result either in fewer claims being brought or in fewer claims being pursued with any real vigor. Because fewer claims are being pursued, the screening function of merger litigation may not function optimally—that is, it may allow bad deals to proceed unchallenged.

First, we acknowledge that our proposal is likely to lead to a reduction in merger litigation overall. This is because the inability to win fees for disclosure settlements will reduce the profitability of merger litigation for plaintiffs' firms on a portfolio basis, creating an incentive to curtail claims activity. This is not necessarily a bad thing. Indeed, in light of the ubiquity of litigation challenges to mergers, we view this as a virtue of our proposal.<sup>208</sup> What we are advocating simply is a return to the state of merger litigation circa 2003 before the current litigation explosion. In that year, 25 cases were brought or approximately 28.7% of deals using the same sample criteria that we use in this paper.<sup>209</sup> We have little reason to believe that this level of litigation exposure was insufficient to deter misconduct.

In addition, the Delaware courts can offset the effect of our proposal completely by simply paying higher attorneys' fees for meritorious cases. Tailoring the fee award more closely to case quality would provide more appropriate incentives than paying counsel a nominal fee in every case, no matter how weak. In contrast, current law seems to encourage plaintiffs' firms to bring weak cases in the hope of winning fees for supplemental disclosures. We would be happy if our proposal resulted in these claims not being brought.

Moreover, a reduction in claims activity is problematic only if good claims and bad claims are equally deterred—in other words that it is impossible to identify good and bad cases early in the process. We doubt the accuracy of this proposition. There are strong reasons to believe that plaintiffs' firms are able to screen for case quality early in the litigation process and to expend their resources in the highest quality cases. Litigation experience under the federal securities laws subsequent to the adoption of the PSLRA strongly suggests both that plaintiffs' lawyers respond to incentives and that, when the law structures incentives to reward only high quality cases, plaintiffs' lawyers respond.<sup>210</sup>

Alternatively, a ban on fee awards in disclosure-only settlements might lead plaintiffs' counsel to shift the nature of the cases they file. One possibility is a shift from fiduciary duty claims to appraisal

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<sup>207</sup> *In re Del Monte Foods Company S'holders Litig.*, No. 6027-VCL, (Del. Ch. Feb. 14, 2011) (noting that “[d]iscovery revealed a deeper problem” with the sale process).

<sup>208</sup> See Section III.A. *supra*.

<sup>209</sup> See Steven M. Davidoff, Randall Thomas & CNV Krishnan, *Zealous Advocates or Self-interested Actors? Assessing the Value of Plaintiffs' Law Firms in Shareholder Litigation*.

<sup>210</sup> See, e.g., Stephen J. Choi, *Do the Merits Matter Less After the Private Securities Litigation Reform Act?*, J. L. ECON. & ORG. 598, 617 (2006) (empirically testing effect of PSLRA on filing decisions by plaintiffs' attorneys and finding significant effect on the choice of cases filed).

proceedings. At least one empirical study has found that investors are making growing use of the appraisal remedy and, at least in some cases, recovering substantially more than the merger consideration.<sup>211</sup>

To the extent our proposal generates a shift to appraisal proceedings, we would view that shift as an unmitigated benefit for two reasons. First, the Delaware courts are expert in valuation methodology and continue to refine the appraisal proceeding to modernize the mechanism for shareholders to challenge merger price. Second, appraisal focuses directly on the issue that is most central to a merger challenge – are shareholders receiving fair value for their stock? At the end of the day, whatever disclosure or process issues are involved, the primary issue from a shareholder perspective is the merger price.<sup>212</sup> By focusing exclusively on that question, we view appraisal as the optimal method for providing shareholders with redress. Indeed, as the Delaware courts have explained, the appraisal proceeding may provide shareholders with a better remedy than the standard fiduciary duty claim if the true concern is merger consideration because an appraisal proceeding requires a judicial determination of “fair value: while a court will reject a fiduciary duty claim so long as the merger price is within “the range of fairness.”<sup>213</sup> The difference is illustrated by the *Cede v. Technicolor* litigation in which the court determined, in ruling on a breach of fiduciary duty claim that the merger consideration of \$23/share was fair,<sup>214</sup> yet, in an appraisal proceeding, awarded the plaintiffs \$28.41/share.<sup>215</sup> Accordingly, we view the appraisal proceeding as creating appropriate litigation incentives for both shareholders and their counsel to bring challenges if and only if they have a reasonable chance of recovering additional consideration.

A third possible concern is that our proposal eliminates only one pathway to wasteful settlement while leaving several others, notably amendment settlements and securities claims, completely unaffected. The predictable result of this change, then, is that litigants with weak claims will seek to channel their rent-seeking efforts along these other paths, seeking fees in exchange for meaningless amendments to the merger agreement or, alternatively, seeking to conclude a meaningless disclosure settlement of their securities claim.

Our first response is that we should not allow the perfect to become the enemy of the good. If disclosure-only settlements do not benefit shareholders, they should not be incentivized. This conclusion holds regardless if our proposal does not, at the same time, eliminate other opportunities for rent-seeking

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<sup>211</sup> See Charles R. Korsmo & Minor Myers, *The Law & Economics of Merger Litigation: Do the Merits Matter in Shareholder Appraisal* (draft dated 2013).

<sup>212</sup> Cf. *In re Trados Inc. Shareholder Litig.*, 73 A.3d 17 (Del. Ch. 2013) (finding no breach of fiduciary duty where merger price was determined to be fair).

<sup>213</sup> See *Trados*, 73 A.3d at 78.

<sup>214</sup> *Cinerama, Inc. v. Technicolor, Inc. (Technicolor III)*, 663 A.2d 1156 (Del. 1995).

<sup>215</sup> *Cede & Co. v. Technicolor, Inc.*, 884 A.2d 26, 30 (Del. 2005).

by plaintiffs' lawyers. Our second response is to question the extent to which these alternatives provide effective substitutes for disclosure-only settlements. We have reasons to think they do not.

At first glance, amendment settlements seem to be the most promising alternative pathway for plaintiffs' lawyers' rent-seeking efforts. It may be possible for plaintiffs' lawyers to negotiate very small modifications to the merger agreement and then to argue that these modifications benefit the shareholder class. Indeed, this happens today. Studies find that the many common merger agreement amendments involve modest changes to deal protections, such as a slightly longer go-shop period or a slightly smaller termination fee, generally with no observable effect, such as the subsequent appearance of an intervening bidder.<sup>216</sup> Such changes might become more common were our proposal to be implemented. Moreover, to prevent such amendments from disturbing their bargain, transacting parties could anticipate them in the terms of the original agreement by agreeing to a shorter go-shop period or a higher termination fee at the outset.

While some such behavior may take place, we believe it is generally far less easy to settle for an amendment to the merger agreement than to settle for supplemental disclosures. Our empirical results clearly support this view—in our sample, 13.6% of settlements are amendment settlements while 80% are disclosure-only settlements. One explanation is that before plaintiffs' lawyers and the target company can agree to amend the merger agreement, they must get the approval of a significant party at interest—namely, the acquiring company. By this point in the process, the acquiring company will have invested considerable effort and expense in the merger agreement and, having achieved agreement, will likely be loath to alter it. In addition, even if the amendments are minor, the acquiring party arguably has something meaningful to lose from them, leading the settlement negotiation to be more adversarial in nature. Simply put, the involvement of a third party with something to lose in the transaction inhibits collusion between the plaintiffs' attorney and the defendant.<sup>217</sup> In contrast, the negotiation of a disclosure settlement involves only the plaintiffs' lawyers and the target corporation, enabling low-value disclosures to be traded more freely.<sup>218</sup>

Furthermore, should the involvement of the counterparty to the merger agreement not be sufficient to prevent litigants from concluding low-value amendment settlements, the Delaware courts could once again become involved. Chancery Court judges have a comparative advantage in evaluating merger agreements generally and deal protection provisions in particular. There is a large and well-

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<sup>216</sup> See Daines & Koumrian, *supra* note 4; Cain & Davidoff, *supra* note 3.

<sup>217</sup> Simply put, the acquiring company is unlikely to go along with whatever the target company and the shareholders lawyers suggest, potentially viewing these as negotiating gambits, and insisting instead upon the deal as agreed.

<sup>218</sup> It is true that insofar as the plaintiffs' attorneys' fees are paid by D&O insurance, as indeed they typically are, that there is theoretically a third party at the table—namely, the D&O insurers—who could constrain the ability of plaintiffs and defendants to collude much as the acquiring company would constrain the parties in the context of an amendment settlement. That the D&O insurer frequently does not live up to this role, however, is well documented. See TOM BAKER & SEAN J. GRIFFITH, ENSURING CORPORATE MISCONDUCT: HOW LIABILITY INSURANCE UNDERMINES SHAREHOLDER LITIGATION (2010).

developed body of substantive jurisprudence on the gamut of deal protection devices—from poison pills and crown-jewel lock-ups to termination fees and no-talk/no-shop provisions. The judges of the Chancery Court regularly evaluate how a given provision affected a particular deal and would be especially well-suited to determine whether a given amendment produced “substantial benefit” to the shareholder class.<sup>219</sup>

The other obvious litigation alternative is for plaintiffs’ lawyers to file disclosure claims under the federal securities laws and to resolve those claims through disclosure-only settlements. As noted earlier, we do not view this alternative as problematic, largely because of the existing body of procedural and substantive requirements designed to limit the potential for frivolous litigation. Substantively, a federal cause of action is more limited than a state law duty of disclosure claim, both because of the threshold materiality analysis and because of the fact that omissions are actionable only in the context of an affirmative duty to disclose. As we have noted, federal courts have developed expertise in the application of these legal standards. Procedurally, the pleading standard of the PSLRA requires plaintiffs to identify specific misstatements and omissions at the outset rather than filing a boilerplate claim of inadequate disclosure, and the discovery stay prohibits plaintiffs from using the cost of discovery as leverage to induce a settlement. Studies suggest that the federal courts have been diligent in applying these standards to dismiss weak disclosure claims at an early stage.<sup>220</sup>

## V. A Roadmap to Implementation

Having laid out our proposal, we briefly consider possible methods of implementation. Because of Delaware’s leadership role in corporate litigation and because of the high percentage of merger targets that are incorporated in Delaware, we look to Delaware to set the standard. We believe that the likely proliferation of forum selection bylaws will enhance Delaware’s ability to do so. We note, however, that our proposal is available to other states and well and indeed that the state of Texas has adopted an approach that is analogous to what we suggest, albeit not focused specifically on the context of merger litigation.<sup>221</sup>

Perhaps the most straightforward approach for eliminating fee awards in disclosure-only settlements would be for courts to stop recognizing disclosure-only settlements as producing a shareholder benefit sufficient to entitle plaintiffs’ lawyers to a fee award. Because the corporate benefit doctrine is a judicially created doctrine,<sup>222</sup> courts could implement this change themselves. We note that some Delaware judges seem to be moving in this direction on a case-specific basis. However, we

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<sup>219</sup> See *In re Compellent Techs., Inc.*, 2011 Del. Ch. LEXIS 190 (Del. Ch. Dec. 9, 2011).

<sup>220</sup> See, e.g., Michael Klausner, *et al.*, *When Are Securities Class Actions Dismissed, When Do They Settle, and For How Much? – An Update*, PLUS Journal 7 (April 2013) (reporting, based on a study of all securities class actions filed between 2006 and 2010, that “38% of cases ended relatively quickly and painlessly for the defendants.”).

<sup>221</sup> See *infra* notes – and accompanying text.

<sup>222</sup> See *supra* notes 79-82 and accompanying text.

recognize that judges are accustomed to applying discretion on a case by case basis and generally prefer rules that preserve rather than restrict their discretion. As a result, the courts may be unwilling to adopt a per se rule that binds their own hands.<sup>223</sup>

An alternative would be for the courts, again as a matter of common law, to cut back on the breadth of the substantive duty of disclosure. As we noted earlier, the Delaware duty of disclosure is of relatively recent origin, arguably broader than the federal law course of action, and somewhat imperfectly articulated because of the procedural context in which it is most frequently applied. We suspect that the emergence of the duty of disclosure and the articulation by several courts of broad disclosure obligations, particularly with respect to the work and incentives of investment bankers in connection with control transactions, has contributed to the proliferation of merger litigation, especially because, under the existing obligation, disclosure challenges cannot readily be resolved on a motion to dismiss. A substantive change to Delaware fiduciary duty law is a more ambitious response than our proposal requires, but it would be an effective solution as well. Notably, a modification to the substantive duty of disclosure would reduce the ability of plaintiffs to evade the change through forum shopping.

A third option would be for the Delaware legislative to adopt our proposed solution. The most straightforward mechanism would be a statute that bars the award of attorney's fees in disclosure-only settlements of merger litigation. As an example of such an action, the Texas legislature recently instructed the Texas Supreme Court to amend the rules of civil procedure to prohibit the award of cash attorneys' fees in class actions that are settled for coupons or other non-pecuniary benefits, a rule that goes farther than our own proposal.<sup>224</sup> A recent decision of the Texas court of appeals, *Kazman*, held that this provision precluded the trial court from awarding monetary fees to class counsel in a connection with a proposed disclosure-only merger settlement.<sup>225</sup>

An important distinction between the Texas provision and our proposal is that the Texas legislation is not confined to merger cases. The motivation for the Texas law was a concern about coupon settlements in class litigation generally.<sup>226</sup> This concern has been raised in other substantive contexts such as consumer and antitrust class actions.<sup>227</sup> Yet from a political economy perspective, enacting

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<sup>223</sup> On the other hand, members of the Chancery Court might be relieved not to have to wade into the morass of fee disputes for what is now a large category of cases. See Daniel Fisher, *Delaware Judge Strine: 'I'm Not Going To Give Big Fees For Junk*, FORBES, Oct. 24, 2012 available at <http://www.forbes.com/sites/danielfisher/2012/10/24/delaware-judge-strine-im-not-going-to-give-big-fees-for-junk/> (quoting Chancellor Strine as stating "I'm not going to give big fees for junk " and that "What does trouble me is the hundreds and hundreds of lawsuits where the only beneficiary is the trial lawyer . . . .")

<sup>224</sup> Tex. Civ. Prac. & Rem. Code § 26.001(a) (2013).

<sup>225</sup> *In re Kazman v. Frontier Oil Corp.*, No. 14-12-000320-CV, 2013 WL 1244376 (Tex. Ct. App. Mar. 28, 2013).

<sup>226</sup> See Michael Northrup, *Restrictions on Class-Action Attorney-Fee Awards*, 46 S. TEX. L. REV. 953, 961 (2005) ("The adoption of the coupon rule evidences the legislature's dissatisfaction with the practice of leveraging the class-action device into settlements that provide insignificant recoveries (or effectively no recovery) to class members, while the class attorneys recover large cash awards.").

<sup>227</sup> James Tharin & Brian Blockovich, *Coupons and the Class Action Fairness Act*, 18 GEO. J. LEGAL ETHICS 1443 (2005) (citing examples of abusive coupon settlements). See also Class Action Fairness Act, S. REP. NO. 109-14, at 16 (2005) (barring coupon

merger-specific legislation is a logical approach for Delaware given its interests in protecting target corporations incorporated within the state from unfounded and excessive litigation challenges.<sup>228</sup> Delaware also benefits by removing unnecessary obstacles to the merger of Delaware corporations because such an action increases the expected value of corporations incorporated in the state.<sup>229</sup>

A deeper question occasioned by our proposal is whether Delaware will willingly cede some of the authority it now possesses in merger regulation to federal courts. Our proposal would have the effect of making federal courts, rather than Delaware, the central authority for evaluating the quality of disclosures in public company mergers.<sup>230</sup> Ceding this role would go against the state's seeming incentive to maximize its authority over businesses incorporated within the state.<sup>231</sup> We argue that our empirical findings provide convincing evidence that the power conferred on the Delaware courts by ubiquitous and weak merger litigation challenges is illusory. The cases resolved through disclosure-only settlements do not provide the Delaware courts with a meaningful role in implementing merger standards. Freeing the courts from these cases would empower the courts to do what they do best – deciding real cases and setting substantive and procedural standards that matter from the perspective of business practices and shareholder value.

## Conclusion

We have examined the value of non-pecuniary relief in merger litigation from a heretofore neglected angle—its effect on shareholder voting. We find that amendment settlements have some demonstrable effect on shareholder voting but that disclosure-only settlements do not. The clear implication of these findings is that disclosure-only settlements do not produce a corporate benefit.

Because disclosure-only settlements produce costs but no benefits, we argue that they should be eliminated. An easy way to accomplish this is removing the judicially-created incentive for plaintiffs' attorneys to bring these cases by rejecting the claim that a disclosure-only settlement is a corporate benefit for purposes of Delaware law. This approach would not leave shareholders without recourse if merger

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settlements unless court makes written findings that the settlement actually benefits the class and limiting attorneys' to require redemption of the coupons).

<sup>228</sup> Delaware derives over \$500 million in annual revenue from fees paid by corporations and other business association. Mark Roe, *Delaware's Shrinking Half Life*, 62 STAN. L. REV. 126, 136 (2009) (in 2008 Delaware derived \$543,236,586 from corporate chartering revenue). See generally ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (Aei Press 1993) (describing political economy reasons for Delaware legislature's responsiveness to corporate interests).

<sup>229</sup> See Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525 (2001) (hypothesizing that the value of Delaware firms reflect, in part, their amenability to a takeover under a balanced regulatory regime).

<sup>230</sup> This would encompass a reallocation of authority to the federal government after a long period of quiescence. See Steven M. Davidoff, *The SEC and the Failure of Federal Takeover Regulation*, 34 FLA. ST. U. L. REV. 211 (2007).

<sup>231</sup> See Sean J. Griffith, *Good Faith Business Judgment: A Theory of Rhetoric in Corporate Law Jurisprudence*, 55 DUKE LAW J. 1 (2005); Marcel Kahan & Edward B. Rock, *How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware and the Strategic Use of Comity*, 58 EMORY L. J. 713 (2009); Steven M. Davidoff, *A Case Study: Air Products v. Airgas and the Value of Strategic Judicial Decision-Making*, 2012 COLUM. BUS. L. REV. 502 (2012).



disclosures are materially deficient; instead they would be required to litigate true disclosure claims under the federal securities laws, preserving state merger litigation for challenges to the substantive and procedural fairness of the merger terms. The effect of adopting this policy would be to eliminate much wasteful litigation while still preserving the ability of Delaware courts to decide more substantial challenges to deals.

## Appendix

### Table III (All Variables)

Table III.A. reports ordinary least squares regressions in which the dependent variable in columns (1) & (2) is *% Yes Votes Per Votes Cast*; columns (3) & (4) is *% Yes Votes Per Outstanding Shares*; and columns (5) & (6) are *% Yes Votes Per All Yes & No Votes*. *% Yes Votes Per Votes Cast* is the percentage of Yes votes out of all votes cast at the meeting, including abstentions. *% Yes Votes Per Outstanding Shares* is the percentage of Yes votes out of the total outstanding voting shares of the target and eligible to vote as of the record date for the meeting. *% Yes Votes Per All Yes & No Votes* is the percentage of Yes votes out of the total number of Yes and No votes cast at the meeting. The sample is as described in Part II.A. *infra*. *Initial Offer Premium* is the initial offer price over target's trading price 30 days prior to merger announcement. *Final Offer Premium* is the final price paid over target's trading price 30 days prior to announcement. *Cash* indicates the consideration paid is all cash, *Auction* indicates the transaction is initiated as an auction among multiple bidders instead of a privately-negotiated sale, *Go-shop* indicates that the merger agreement includes a provision that allows the target company to actively solicit other potential bidders for a specific limited period of time after the merger agreement has been signed, *Going Private* indicates that a *Schedule 13E-3* has been filed with the SEC for the transaction due to the buyer being an affiliated party and *Management Buyout* is an acquisition with management participation. *ISS Position* = 0 means ISS recommended that its' client shareholders do not vote or vote against the transactions. *ISS Position* = 1 means that ISS recommended that its' client shareholders vote for the transaction. *Appraisal Exercise* =1 if any shareholder exercised appraisal rights and zero otherwise. *Disclosure Settlement* requires the target to make additional disclosure concerning the transaction; *Consideration Increase Settlement* provides for an increase in the consideration payable to target shareholders; *Amendment Settlement* requires the terms of the transaction to be revised. *Amendment Settlements* also include settlements that have as a component a Disclosure Settlement. *Consideration Increase Settlements* also include settlements that have as a component Amendment or Disclosure Settlements. *Super-Majority State* = 1 if the state of incorporation of the target requires greater 50 percent of shareholders to approve a merger and zero otherwise. P-values are in parentheses, with \*\*\*, \*\*, and \* denoting statistical significance at the 1%, 5%, and 10% levels, respectively. The models in columns (1), (3) and (5) include only targets incorporated in Delaware and where the acquisition is all cash. All models include year fixed effects. P-values are in parentheses, with \*\*\*, \*\*, and \* denoting statistical significance at the 1%, 5%, and 10% levels, respectively.

Yes Votes Per	Votes Cast		Outstanding		Yes and No Votes	
	(1)	(2)	(3)	(4)	(5)	(6)
	Initial Offer Premium	-0.177 *** (0.00)	-0.089 * (0.07)	-0.096 (0.28)	-0.013 (0.85)	-0.216 *** (0.00)
Final Offer Premium	0.21 *** (0.00)	0.105 ** (0.03)	0.073 (0.40)	0.022 (0.74)	0.241 *** (0.00)	0.095 ** (0.04)
Transaction Value (Log)	0.005 * (0.07)	0.007 *** (0.00)	-0.002 (0.64)	0.001 (0.82)	0.003 (0.27)	0.005 ** (0.01)
Cash	0.006 (0.49)	0.003 (0.64)	-0.005 (0.71)	-0.013 (0.16)	0.017 * (0.06)	0.002 (0.76)
Auction	0.010 (0.17)	0.008 (0.23)	0.001 (0.96)	0.005 (0.55)	0.002 (0.75)	0.005 (0.45)
Go-Shop	-0.008 (0.39)	-0.002 (0.83)	0.001 (0.95)	0.005 (0.68)	-0.009 (0.33)	0.000 (0.96)
Take Private	-0.008 (0.61)	-0.005 (0.74)	0.066 *** (0.01)	0.073 *** (0.00)	-0.014 (0.38)	-0.009 (0.50)
ISS Position	0.231 *** (0.00)	0.155 *** (0.00)	0.153 *** (0.00)	0.113 *** (0.00)	0.184 *** (0.00)	0.124 *** (0.00)
Appraisal Exercise	0.033 ** (0.05)		0.030 (0.22)		0.020 (0.16)	
Disclosure Settlement	0.008 (0.31)	0.000 (0.98)	0.023 * (0.06)	0.011 (0.22)	0.009 (0.20)	0.003 (0.58)
Amendment Settlement	0.018 (0.13)	0.008 (0.51)	0.068 *** (0.00)	0.045 *** (0.01)	0.03 ** (0.01)	0.017 (0.12)
Consideration Increase Settl	0.036 * (0.07)	0.005 (0.80)	0.100 *** (0.00)	0.057 ** (0.022)	0.025 (0.15)	0.004 (0.809)
Supermajority State		-0.015 ** (0.05)		0.014 (0.17)		-0.010 (0.19)
Observations	215	391	237	423	168	293
R-squared	0.5007	0.2658	0.21	0.1228	0.4401	0.2252

**Table IV.A (All Variables)**

Table IV.A. reports ordinary least squares regressions in which the dependent variable in columns (1) & (2) is % Yes Votes Per Votes Cast; columns (3) & (4) is % Yes Votes Per Outstanding Shares; and columns (5) & (6) are % Yes Votes Per All Yes & No Votes. % Yes Votes Per Votes Cast is the percentage of Yes votes out of all votes cast at the meeting, including abstentions. *Attorneys Fee > 500* is coded =1 if the attorneys' fees awarded in the litigation are greater than \$500K and =0 if the attorneys' fees awarded are less than \$500K. *Attorneys Fee (Log)* is the log value of the attorneys' fees awarded in the settlement. All other variables are as defined in Table III.A. All models include year fixed effects. P-values are in parentheses, with \*\*\*, \*\*, and \* denoting statistical significance at the 1%, 5%, and 10% levels, respectively.

Yes Votes Per	Votes Cast		Outstanding Shares		Yes and No Votes	
	(1)	(2)	(3)	(4)	(5)	(6)
Initial Offer Premium	-0.456 *** (0.00)	-0.170 *** (0.00)	-0.337 ** (0.03)	-0.107 (0.26)	-0.413 *** (0.00)	-0.175 *** (0.00)
Final Offer Premium	0.479 *** (0.00)	0.172 *** (0.00)	0.294 * (0.06)	0.08 (-0.374)	0.436 *** (0.00)	0.18 *** (-1E-04)
Transaction Value (Log)	0.008 ** (0.01)	0.009 *** (0.00)	-0.012 * (0.07)	-0.006 (0.23)	0.008 ** (0.04)	0.007 ** (0.02)
Cash	0.005 (0.62)	0.010 (0.29)	-0.006 (0.78)	-0.015 (-0.336)	0.014 (0.20)	0.007 (-0.438)
Auction	0.012 (0.15)	0.005 (0.51)	0.006 (0.72)	0.009 (0.47)	0.008 (0.42)	0.008 (0.31)
Go-Shop	-0.019 * (0.06)	-0.004 (0.70)	0.015 (0.44)	0.012 (0.44)	-0.010 (0.37)	0.004 (0.71)
Take Private	-0.014 (-0.42)	-0.01 (-0.54)	0.079 ** (-0.02)	0.076 *** (0.00)	-0.016 (-0.41)	-0.015 (-0.39)
ISS Position	0.216 *** (0.00)	0.195 *** (0.00)	0.223 *** (0.00)	0.14 *** (0.00)	0.201 *** (0.00)	0.169 *** (0.00)
Attorney Fee > 500	-0.001 (0.95)	0.006 (0.54)	-0.01 (0.62)	0.01 (0.52)	-0.006 (0.55)	-0.003 (0.74)
Attorney Fees (Log)	-0.009 * (0.09)	-0.013 ** (0.03)	0.002 (0.86)	-0.005 (0.57)	-0.007 (0.25)	-0.005 (0.36)
Appraisal Exercise	0.012 (0.47)		0.026 (0.40)		-0.002 (0.89)	
Disclosure Settlement	0.009 (0.45)	0.006 (0.67)	0.000 (1.00)	-0.010 (0.64)	0.017 (0.19)	0.016 (0.21)
Amendment Settlement	0.03 ** (0.05)	0.027 * (0.09)	0.054 * (0.09)	0.029 (0.27)	0.037 ** (0.02)	0.034 ** (0.03)
Consideration Increase Settlement	0.054 *** (0.01)	0.035 (0.11)	0.08 ** (0.05)	0.046 (0.19)	0.047 ** (0.03)	0.024 (0.23)
Supermajority State		-0.037 *** (0.00)		0.006 (0.72)		-0.024 ** (0.03)
Observations	109	175	118	190	93	144
R-squared	0.6473	0.4259	0.318	0.1558	0.553	0.335

**Table V.A (All Variables)**

Table V.A. reports ordinary least squares regressions in which the dependent variable in columns (1) & (2) is % Yes Votes Per Votes Cast; columns (3) & (4) is % Yes Votes Per Outstanding Shares; and columns (5) & (6) are % Yes Votes Per All Yes & No Votes. % Yes Votes Per Votes Cast is the percentage of Yes votes out of all votes cast at the meeting, including abstentions. Columns 1-4 include all transactions in the sample, and columns 5 & 6 include only mergers with a transaction value less than \$500MM. Institutional Ownership % is the percentage of total institutional ownership. Top 5 Institutional Ownership is the percentage ownership of the largest 5 institutional owners. Top 10 Institutional Ownership is the percentage ownership of the largest 10 institutional owners. Maximum Institutional Ownership is the percentage ownership of the largest institutional owner. Institutional ownership for each of these variables is as of the quarter-end immediately prior to the shareholder meeting date. All other variables are as defined in Table III.A. All models include year fixed effects. P-values are in parentheses, with \*\*\*, \*\*, and \* denoting statistical significance at the 1%, 5%, and 10% levels, respectively.

<i>Shareholder Yes Votes Per Votes Cast</i>						
	<u>All Transactions</u>				<u>Transaction Value &lt;\$500M</u>	
	(1)	(2)	(3)	(4)	(5)	(6)
Institutional Ownership %	0.041 ** (0.01)	0.033 (0.41)	0.023 (0.52)	0.008 (0.89)	0.062 (0.14)	-0.043 (0.74)
Initial Offer Premium	-0.062 (0.24)	-0.062 (0.25)	-0.098 ** (0.04)	-0.151 ** (0.04)	-0.158 (0.11)	-0.173 ** (0.04)
Final Offer Premium	0.086 (0.10)	0.085 (0.11)	0.113 ** (0.02)	0.186 *** (0.01)	0.175 * (0.07)	0.182 ** (0.03)
Transaction Value (Log)	0.004 * (0.10)	0.004 (0.19)	0.004 (0.14)	0.007 (0.20)	-0.034 * (0.07)	-0.001 (0.94)
Top 5 Institutional Ownership		-0.124 (0.55)	-0.108 (0.56)	-0.128 (0.65)		0.086 (0.84)
Top 10 Institutional Ownership		0.085 (0.62)	0.086 (0.58)	0.151 (0.53)		0.141 (0.74)
Maximum Institutional Ownership		0.056 (0.64)	0.031 (0.78)	0.031 (0.83)		-0.191 (0.44)
ISS Position			0.154 *** 0.00			0.232 *** 0.00
Disclosure Settlement			(0.00) (0.68)	0.01 (0.48)		-0.021 (0.19)
Amendment Settlement			0.01 (0.47)	0.01 (0.67)		-0.035 (0.31)
Consideration Increase Settlement			0.00 (0.91)	-0.03 (0.20)		0.025 (0.75)
Appraisal Exercise				(0.01) (0.68)		
Observations	393	393	391	216	140	140
R-squared	0.0543	0.055	0.2642	0.0897	0.063	0.3439