Pepper Hamilton LLP
Attorneys at Law

Disclosure-Only Settlements Will Be Subject to Increasing Scrutiny

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Joanna J. Cline | clinej@pepperlaw.com
Douglas D. Herrmann | herrmannd@pepperlaw.com
Christopher B. Chuff | chuffc@pepperlaw.com
James H.S. Levine | levinejh@pepperlaw.com

THE TRULIA DECISION WILL LIKELY REDUCE THE NUMBER OF DISCLOSURE-ONLY SETTLEMENTS PRESENTED TO THE COURT, AS THE DECISION MAKES IT MORE DIFFICULT FOR THE PLAINTIFFS TO SECURE QUICK SETTLEMENTS INVOLVING MINIMAL DISCOVERY AND LITIGATION.

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The Delaware Court of Chancery's January 22 opinion in *In re Trulia Inc. Shareholder Litigation* (available at http://courts.delaware.gov/opinions/download.aspx?ID=235370), C.A. No. 10020-CB, follows the recent trend of judicial skepticism of disclosure-based settlements by rejecting a proposed class-action settlement arising from Zillow Inc.'s acquisition of Trulia Inc., under which Trulia agreed to provide certain supplemental disclosures in exchange for a broad release of all known and unknown claims against the defendants. The court rejected the parties' proposed settlement because the supplemental disclosures bargained for by the plaintiffs were immaterial and therefore did not afford Trulia's stockholders any meaningful consideration to warrant providing the defendants with such a broad release of claims. In so holding, the court made clear that, going forward, disclosure-based settlements will be subject to "increasingly vigilant" scrutiny and will only be approved where the supplemental disclosures are "plainly material," the proposed releases are "narrowly circumscribed," and the claims being released have been "investigated sufficiently."

Background

The *Trulia* litigation involved a proposed settlement of a stockholder class action challenging Zillow's acquisition of Trulia in a stock-for-stock merger, pursuant to which each share of Trulia stock would be exchanged for 0.44 shares of Zillow stock. After the merger was announced, Trulia stockholders, in four nearly identical class-action complaints, sought to enjoin the proposed merger, alleging that the Trulia directors breached their fiduciary duties by approving the proposed merger at an unfair exchange ratio. After minimal discovery, the parties agreed in principle to a settlement in which Trulia agreed to provide certain supplemental disclosures in its proxy statement in exchange for a broad release of liability from all known and unknown claims that could be brought against the defendants by any member of the putative class. The parties' proposed stipulation and agreement further provided that plaintiffs counsel intended to seek an award of attorney fees and expenses not to exceed $375,000, which the defendants agreed not to oppose.

The Court's Analysis

Following the lead of a number of other recent Court of Chancery decisions admonishing disclosure-based settlements, Chancellor Andre G. Bouchard rejected the parties' proposed settlement, holding that the proxy statement already provided a fair summary of the financial adviser's analysis and that the supplemental disclosures agreed to by the parties were extraneous, immaterial and not helpful to Trulia's stockholders.

In doing so, the court highlighted the problematic effects of disclosure-only settlements, including the proliferation of hastily filed class-action lawsuits and resulting settlements that do not "yield genuine benefits for stockholders." The court explained that the "public announcement of virtually every transaction involving the acquisition of a public corporation provokes a flurry of class action lawsuits that the target's directors breached their fiduciary duties by agreeing to sell the corporation for an unfair price" and that "far too often such litigation serves no useful purpose for stockholders." Instead, the court explained, such litigation often "serves only to generate fees for certain lawyers who are regular players in the enterprise of routinely filing" such actions, while providing the stockholders with immaterial disclosures and no monetary compensation.

Given the rapid proliferation and ubiquity of such litigation, and the mounting evidence that supplemental disclosures rarely yield genuine benefits for stockholders, the court announced that it would be "increasingly vigilant" in assessing the reasonableness of the "give" and the "get" of disclosure settlements and that it will only approve disclosure settlements going forward where:

- The supplemental disclosures address a "plainly material" misrepresentation or omission in the proxy statement.

- The subject matter of the proposed release is "narrowly circumscribed" to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sale process.

- The record demonstrates that the claims being released as part of the settlement have been "investigated sufficiently."

Under this standard, a disclosure is "plainly material" only where it is not "a close call that the supplemental information is material as that term is defined under Delaware law." The court ruled that, where a proposed disclosure settlement is not able to meet the above criteria, the "optimal means" to resolve the plaintiffs' disclosure claims is "outside the context of a proposed settlement so that the court's consideration of the merits of [the plaintiffs'] disclosure claims can occur in an adversarial process where the defendants' desire to obtain a release does not hang in the balance."

Potential Implications

Bouchard's decision in *Trulia*, including his espousal of the new "plainly material" standard for evaluating disclosure-based settlements, has a number of potential implications on M&A litigation in Delaware. Most notably, the decision should significantly decrease the number of hastily filed strike suits brought in the days (and sometimes hours) after the announcement of a public merger or acquisition. The decision will also likely reduce the number of disclosure-only settlements presented to the court, as the decision makes it more difficult for the plaintiffs to secure quick settlements involving minimal discovery and litigation.

The *Trulia* decision could also prompt class-action plaintiffs to seek to bring such lawsuits in jurisdictions other than Delaware in the hope that such jurisdictions will be more hospitable to signing off on disclosure-based settlements. Indeed, the court addressed such a possibility by noting that Delaware corporations could preclude such forum-shopping by adopting forum selection bylaws mandating Delaware as the exclusive jurisdiction to hear such disputes. The court also expressed its "hope and trust" that courts in other jurisdictions will reach the same conclusion as the Court of Chancery if confronted with the issue.