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‘No Better Than a Racket’—Seventh Circuit Critical of Mootness Fees for Merger Disclosures

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This April, the U.S. Court of Appeals for the Seventh Circuit took aim at what are typically referred to as “mootness fees” in *Alcarez v. Acorn,* 99 F.4th 368 (7th Cir. 2024). Mootness fees arise when companies are sued for allegedly incomplete corporate disclosures, most often in the context of proposed or pending mergers. In response to these lawsuits, companies agree with plaintiffs counsel to make additional disclosures, thus mooting the plaintiffs’ claims. They also agree to pay a fee to plaintiffs counsel for their garnering a supposed benefit for the class/shareholders. Judge Frank Easterbrook, disenchanted with the current “federal practice” of plaintiffs attorneys extorting fees in disclosure cases without conferring a meaningful benefit on stockholders, penned the opinion for a two-judge panel rejecting such fee agreements and empowering shareholders and federal courts alike to scrutinize these fees going forward.

Factual Background

Alcaraz consolidated six separate lawsuits related to Akorn, Inc.’s proposed merger with Fresenius Kabi AG. According to the plaintiffs, Akorn failed to provide information in a proxy statement in violation of the Securities Exchange Act of 1934. In response, Akorn amended its proxy statement to include the allegedly required disclosures and ultimately paid $322,500 to plaintiffs’ counsel (mootness fees) to divide among themselves. The suits were dismissed as moot.

One of Akorn’s shareholders, Theodore Frank, filed motions to intervene in a number of the cases after having learned of the mootness fees, contending that plaintiffs counsel should be forced to disgorge the fees and enjoined from filing similar lawsuits in the future. While the district judge denied Frank’s motions, the judge nevertheless reopened the suits, found the complaints frivolous (and the extra disclosures worthless) and ordered the plaintiffs’ attorneys to return the mootness fees. Frank and two of the plaintiffs then appealed.

The Court of Appeals’ Decision

On appeal, Easterbrook discussed the problematic nature of these fees. A significant amount of mootness fee litigation has migrated to the federal courts from Delaware state courts in recent years, as Delaware has expressed its “disfavor” for such fees “unless the supplemental disclosures address a plainly material misrepresentation or omission,” (quoting *In re Trulia Stockholder Litigation,* 129 A.3d 884, 898 (Del. Ch. 2016);

(Delaware already had limited the payment of mootness fees unless the suit was meritorious" (citing *In re Sauer-Danfoss Shareholders Litigation,* 65 A.3d 116, 1123 (Del. Ch. 2011))). Federal courts like the Seventh Circuit have been critical of similar fees in the class context. (Indeed, this court has remarked that litigation 'that yields fees for class counsel and nothing for the class is no better than a racket. It must end," (quoting *In re Walgreen Stockholder Litigation,* 822 F.3d 718, 724 (7th Cir. 2016))). However, plaintiffs increasingly have filed merger disclosure cases in federal court to avoid Trulia and its progeny.

Federal courts are faced with a number of challenges when reviewing such litigation. For example, where mootness fee cases are brought as class actions, a judge's role is limited where the parties settle prior to class certification under Fed. R. Civ. P. 23(e). Similarly, potentially relevant statutes may not come into play in the mootness fee context as those fees are privately agreed to rather than awarded by the court, (quoting the Private Securities Litigation Reform Act (PSLRA) at 15 U.S.C. Section 78u-4(a)(6) (Total attorney fees and expenses awarded by the court to counsel for the plaintiff class shall not exceed a reasonable percentage of the amount of damages and prejudgment interest actually paid to the class.))

While Easterbrook seemed poised to give courts (and shareholders) a way to challenge mootness fees, he was unwilling to grant Frank's requested relief of disgorgement or injunction. Instead, Easterbrook looked to the PSLRA and its mandatory review provision requiring the court, upon final adjudication of an action brought under the federal securities laws, to make findings regarding each party's compliance with Rule 11(b). As dismissal is considered a "final adjudication of the action," the statute "obliges the judge to determine whether each suit was proper at the moment it was filed."

Easterbrook noted that in order to trigger the court's authority under the PSLRA to review compliance with Rule 11 in this case, a Rule 60(b) motion was necessary. Of course, in Frank's case, the district court could only entertain a Rule 60(b) motion if Frank were permitted to intervene. According to the Judge, "when the representative plaintiffs and defendants strike a deal, intervention by a member of the class may be essential to protect the class's interests." Intervention may be appropriate, Easterbrook found, even where mootness fees result in a small diminution in value of a shareholder's shares, (noting that "the Supreme Court tells us that an 'identifiable trifle' suffices for standing).

With this in mind, the Seventh Circuit vacated the district court's orders denying Frank's motions to intervene and remanded the six actions with instructions to treat him as an intervenor, permit him to make an appropriate Rule 60(b) motion, and decide whether relief should be granted.

Conclusion

In sum, the Seventh Circuit gave shareholders an avenue, and courts a tool, to challenge mootness fees in federal cases. While only time can tell its ultimate effect, the specter of Rule 11 scrutiny may cause some lawyers to reconsider filing disclosure cases altogether. If not, active shareholders and courts nonetheless now have a roadmap to challenge mootness fees in the future.

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