WIB Publication

Directors Digest

Issue #101 - November 2015

The M&A Vampire – Groundless Class Action Lawsuits

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With Halloween just behind us, drawing an analogy between baseless shareholder litigation in announced M&A transactions to vampires sucking blood from a harmless victim is tempting and easy. However, putting aside imagination for a bit and focusing on the number of recent complaints filed opposing mergers on the grounds of breach of fiduciary duty can be quite frightening. A review of *Cornerstone Research's Shareholder Litigation Involving Acquisitions of Public Companies, Review of 2014 M&A Litigation*, reveals the following about litigation initiated in 2014 challenging publicly announced M&A transactions:

1. 93% of M&A deals valued over $100 million were litigated
2. Almost 80% of settlements reached in 2014 provided only some additional disclosure to shareholders, and zero additional consideration
3. Only one M&A case went to trial

Perhaps the vampire analogy is spot on for the vast majority of cases. Class action litigation challenging an announced merger tends to follow a similar pattern:

1. Within hours of deal announcement, any number of plaintiff''s firms announce an "investigation" into the selling company's process to determine if any breach of fiduciary duty occurred; and the race to find a plaintiff begins.
2. Once the plaintiff is found, a complaint is filed naming the selling company and its officers and directors individually. At this point, the bank's D&O carrier must be put on notice of the claim.
3. The plaintiff's firm will then seek class certification – important for plaintiff's counsel so they can purport to represent all shareholders and retain any attorney fees that become part of the settlement.
4. The company and its directors must then respond to the complaint, and discovery likely will ensue on an expedited basis.
5. The plaintiff's firm will try to force a delay of the shareholder meeting, possibly through injunctive relief.
6. At some point after a minimal amount of discovery is completed – and perhaps a preliminary injunction motion has been filed and is pending – a demand letter proposing some form of settlement is typically received by company counsel. The demands

typically include increased consideration for the selling company's shareholders, waiver by the acquirer of certain provisions in the definitive agreement, some modification to the definitive agreement and changes to the proposed proxy statement language for the shareholder meeting.

Notwithstanding the demand for additional consideration, we tend to see settlements that include: (1) some waiver of, or modification to, certain provisions in the definitive agreement, (2) some change to the proxy statement language, and (3) payment of attorney fees. The unfortunate reality is that it is often not worth the time and expense of fighting such lawsuits through trial and holding an acquisition in limbo. *Cornerstone Research's Review of 2014 M&A Litigation* is consistent with our general experience – only 8%, or 6 out of 78, settlements for which public information is available provided additional consideration to shareholders. However, nearly 80% of settlements provided for modified proxy disclosure. "What is the benefit to shareholders of selling companies?" you might ask. It seems Delaware Courts are now asking the same question, and this should give the plaintiff's bar some pause for concern.

The Delaware Chancery Court in *In re Transatlantic Holdings Inc. S'holders Litig.*, denied a motion to certify a class and approve a proposed settlement, a strikingly unusual position to take on an unopposed motion. In *Transatlantic*, the shareholder meeting for the selling company took place, but only after implementing the requested proxy statement disclosure changes and agreeing to pay the plaintiff's counsel $500,000 in attorney fees. However, the Delaware Chancery Court took direct aim at the plaintiffs' suitability as class representatives and the disclosure-only nature of the settlement concession. After noting the high percentage of votes for the transaction (99.85% of shares voting) the Court stated:

"So a suit without any real investigation or depth was immediately traded away by plaintiffs for simply more information which did not contradict the mix of information that was already available. And the only checkpoint on the approval of that by counsel are a couple of stockholders who own, frankly, amounts of shares which suggest it was irrational for them to cause a suit to be brought in the first instance, and who can't even recall how they voted or if they vote on the merger." *Transatlantic*, 2013 Del. Ch. Lexis 90, 6. (One plaintiff stockholder held only two shares.)

While the decision in *Transatlantic* may not fully drive a wooden stake through the heart of all such litigation, plaintiff's counsel would be wise to take notice. More importantly for banks and bank holding companies, officers and directors who follow an appropriate process in considering M&A transactions should sleep a little better tonight. We hope the steps taken by Delaware to rein in baseless suits alleging breaches of fiduciary duty continues as a trend. Finally, we suggest that the best defense to such suits is an appropriate process on the front-end of the transaction to be in a position to justify a quick dismissal or settlement of the case, thus minimizing defense costs and enabling the acquisition to proceed as planned.

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