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CORPORATE DEPARTMENT

ALERT

9TH CIRCUIT'S GLAZER RULING ON PUBLIC COMPANY DISCLOSURES COULD CHILL M&A DEALS

By David A. Jaffe

In a case arising out of the U.S. Court of Appeals for the Ninth Circuit, the court has implied the disclosure rules under the Securities and Exchange Act of 1934, as amended (Exchange Act), may require public companies that have entered into merger agreements to publish the exhibits to such agreements, notwithstanding their confidential, non-public nature. As a result, representations made solely for the benefit of private merger partners may form the basis for future securities fraud claims by disgruntled shareholders who were not privy to the disclosures. If this case is followed widely, it will result in the imposition of new disclosure burdens on M&A participants. This could reduce merger and acquisition activity due to the reluctance of public target companies to publicize disclosures that, but for this case, would have remained outside the public domain.

In *Glazer Capital Management LP v. Magistri*[1], InVision Technologies, Inc. (InVision) announced in March 2004 it had entered into a merger agreement under which it was to be acquired by General Electric (GE).[2] Immediately following the merger agreement, InVision filed the agreement as an exhibit to its Form 10-K.[3] However, as is customary for public reporting companies, the disclosure schedule to the merger agreement was not included in the 10-K filing. The disclosure schedule contained important exceptions to the publicly disclosed representations and warranties in the merger agreement.

Several months later, in July 2004, InVision issued a press release stating that an internal investigation had revealed possible violations of the Foreign Corrupt Practices Act of 1997 (FCPA) in connection with some of InVision's foreign sales transactions.

The press release disclosed that investigations by the Securities and Exchange Commission and the U.S. Department of Justice might jeopardize the merger transaction with GE. Following the announcement of the investigations, InVision's stock price plummeted.[4] Ultimately, the investigations were settled and the merger transaction with GE was consummated.[5]

InVision shareholders, who purchased the stock during the period between the merger announcement and the announcement of the possible FCPA violations, filed suit seeking damages relating the stock price's decline during that period of uncertainty. The suit alleged material misrepresentations and omissions in violation of Section 10(b) of the Exchange Act and Rule 10b-5. The crux of the plaintiffs' case was the FCPA investigations were a clear indication that InVision's representations and warranties in the merger agreement (particularly that it

[1] 549 F. 3d 736 (9th Cir. 2008).
[2] *Id*. at 739-40.
[3] *Id*. at 740.
[4] *Id*. at 739-40.
[5] *Id*.

was "in compliance in all material respects with all laws" and with "the provisions of Section 13(b) of the Exchange Act") were manifestly untrue at the time they were made.[6]

Although the Court of Appeals affirmed the district court's holding in favor of InVision on other grounds (relating to the plaintiffs' failure to prove the requisite knowledge or intent of wrongdoing), the case may have wider implications. This is due to the reasoning behind the court's opinion regarding the public disclosure of material exceptions contained in a non-public disclosure schedule to representations and warranties made by an issuer in a publicly disclosed merger agreement for purposes of Rule 10b-5 liability.

InVision defended the claim by arguing a reasonable investor would not have relied upon the representations and warranties in the publicly disclosed agreement as factual communications in making an investment decision with respect to the purchase or sale of InVision's stock. The facts offered in support of that argument were:

1. The statements in the representations and warranties section of the merger agreement were directed solely to GE;
2. The representations and warranties section of the merger agreement was made expressly subject to a disclosure schedule not available to the public; and
3. The merger agreement itself clearly stated it was not intended to confer any rights or remedies upon any third party.[7]

The Court of Appeals rejected InVision's "reasonable investor" argument, stating the context in which the statements were made (e.g., as part of the public disclosure of private merger negotiations) was not sufficient justification to bar a legitimate, legal claim by shareholders.[8] The court reasoned that since the merger transaction was a significant event, the company should have expected the transaction would receive a high level of investor scrutiny. The court indicated the mere fact the company chose to communicate the details of the deal in the form of an exhibit to the 10-K rather than in the body of the document itself could not work as a *per se* bar to securities law liability.[9] In the court's view, even though the merger agreement cross-referenced another private document (the non-public disclosure schedule), these facts did not prevent, as a matter of law, a reasonable investor from relying on the agreement. Consequently, the court would not grant InVision's motion to dismiss the claims on this basis.[10]

This particular aspect of the *Glazer* case represents a potential impediment for merger and acquisition transactions involving public target companies. Given the general aversion of reporting companies to make gratuitous disclosures, it is unlikely the case will result in greater reporting transparency. Further, since post-closing indemnification is not a typical, customary or functional risk allocation device in public merger transactions, the most likely outcomes will be:

1. Renewed emphasis on pre-closing due diligence;
2. Longer periods between signing and closing; and
3. Reduced valuations for public targets as acquirers take discounts in anticipation of disclosure related strike suits brought by shareholders.

For more information on this alert, please contact David A. Jaffe at 412.391.6410 or djaffe@foxrothschild.com, or any member of Fox Rothschild's Corporate Department.

[6] *Id*. at 740-42.
[7] *Id*. at 741.
[8] *Id*.
[9] *Id*.
[10] *Id*.

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