Court Rejects "Merger Tax" Litigation Settlements That Benefit Primarily Plaintiffs' Attorneys and Plaintiffs Who Do Not Represent Shareholder Interests

> It is no secret that when a public company announces a merger, lawsuits follow. There is nothing inherently wrong with this phenomenon. If the merger price is woefully unjustifiable or if shareholders are not given adequate disclosure to cast an informed vote, a lawsuit is very much the proper way to redress these matters. However, the ubiquity and multiplicity of merger lawsuits, colloquially known as a "merger tax," has caused many to view such lawsuits with a certain degree of skepticism. *City Trading Fund v. Nye,* No. 651668/2014 46 Misc.3d 1206(A), at *13 (Sup. Ct. N.Y. Cnty. Jan. 7, 2015).

In two recent decisions, *Gordon v. Verizon Commn's*, No. 653084/13, 2014 WL 7250212 (Sup. Ct. N.Y. Cnty. Dec. 14, 2014) and *City Trading Fund v. Nye*, No. 651668/14, 46 Misc.3d 1206(A) (Sup. Ct. N.Y. Cnty. Jan. 7, 2015), the New York Supreme Court (New York's trial court) has continued a promising trend of scrutinizing settlements that benefit plaintiffs' lawyers and plaintiffs, but not the shareholders they purport to represent. Long term, this enhanced scrutiny will benefit companies, their directors, and shareholders. If it continues, companies and their directors—who satisfy their fiduciary duties—should experience fewer lawsuits from plaintiffs' lawyers and their clients who, at times, seem motivated more by their own financial interests than out of a concern for the shareholder class they supposedly represent.

More than 97 percent of significant mergers involving public companies in the United States are challenged by at least one lawsuit. The suits are often brought as class actions by a shareholder who purports to represent the interests of all shareholders. The suits often are filed by a small contingent of plaintiffs' law firms which has turned such litigation into a cottage industry.

In the two cases cited above, the putative class representatives alleged the directors of the acquiring companies breached their fiduciary duties by failing to make material disclosures in the proxy statements provided to shareholders before the shareholder vote. As is typical, the plaintiffs' lawyers and their clients filed these cases before the shareholder vote. Thus, the defendant companies and their directors faced the risk the court would delay the transactions. Such delays can threaten closings or, at a minimum, significantly increase transaction costs. As is often the case, even though the defendants believed the plaintiffs' allegations to be groundless, they understandably decided it was cheaper to settle than continue to litigate.

A common characteristic of merger-related litigation settlements is that shareholders receive no money in return for their release of claims and rights. Rather, in these "disclosure-only settlements" the shareholders often receive nothing more than supplemental disclosures. Courts have become increasingly suspicious of settlements where shareholder rights are extinguished, the shareholders are paid nothing in return, and the additional disclosures are of dubious materiality, yet plaintiffs' counsel receives a hefty attorneys' fee award.

In *Gordon*, the proposed settlement required the defendants to make additional, supposedly material, disclosures and to obtain fairness opinions in certain future transactions. Under the terms of the proposed settlement, the shareholders would receive no money; plaintiff's counsel, on the other hand, would receive $2 million in attorneys' fees. The court rejected the settlement, finding it was not in the shareholders' best interest. The court determined the fairness opinion brought no value to the shareholders and the supplemental disclosures would be immaterial. *Gordon*, 2014 WL 7250212, at *3 ("Merely providing additional information—unless the additional information offers a contrary perspective on what has previously been disclosed—does not constitute material disclosure.").

The *Gordon* court concluded:

> An increasing body of commentary has decried the tsunami of litigation, and attendant suspect disclosure-only settlements, associated with public acquisitions today. . . . A body of law meant to protect shareholder interests from the absence of due care by the corporation's managers has been turned on its head to diminish shareholder value by divesting them of valuable rights via the broad releases that plaintiffs have fashioned at the demand of concerned defendants and their counsel and imposing additional gratuitous costs, *i.e.,* attorneys' legal fees on the corporation. *Id.*

A different trial judge of the New York Supreme Court rejected the proposed settlement in *City Trading Fund*. In return for supplemental disclosures that the court concluded would be immaterial to investors, the plaintiffs' lawyers would have pocketed $500,000. In refusing to approve the settlement, the court stated:

> Approving the settlement in this case would both undermine the public interest and the interest of [the purchasing company's] shareholders. It would incentivize the plaintiffs to file frivolous disclosure lawsuits shortly before a merger, knowing they will always procure a settlement and attorneys' fees under conditions of duress—that is, where it is rational to settle obviously frivolous claims. Without the court serving as a gatekeeper, plaintiffs who file such litigation will continue to unjustifiably extract money from shareholders, who get no benefit from litigation but nonetheless end up paying two sets of attorneys, both plaintiffs' and defendants.' This is a perverse result. 46 Misc.3d 1206(A), at *20.

It is of course an exaggeration to state that companies and their directors can now make reasonable business judgments without fear of being targeted by frivolous lawsuits. Nevertheless, perhaps now more than ever, courts are suspicious of parties and their counsel who come to court purporting to represent abused shareholders, when in fact their claims are suspect and they appear motivated more by their own self-interest than the interests of those they represent. In the short term, parties to mergers may find it more difficult to buy their way out of litigation to eliminate the risk—albeit low—such lawsuits pose to a transaction's timely closing. Nevertheless, we urge companies and their directors to resist these frivolous lawsuits to discourage future lawsuits of this kind, promote shareholder rights, align shareholder and corporate interests and, in turn, maximize shareholder value.

This document is intended to provide you with general information regarding "merger tax" litigation settlements. The contents of this document are not intended to provide specific legal advice. If you have any questions about the contents of this document or if you need legal advice as to an issue, please contact an attorney listed in the link provided below or your regular Brownstein Hyatt Farber Schreck, LLP attorney. This communication may be considered advertising in some jurisdictions.

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