M&A Litigation 2019

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LEXOLOGY
Getting The Deal Through

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Published by
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Tel: +44 20 3780 4147
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First published 2018
Second edition
ISBN 978-1-83862-120-9

Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112

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2019

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Lexology Getting The Deal Through is delighted to publish the second edition of *M&A Litigation*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Australia, Austria and China.

Lexology Getting The Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, William M Regan, Jon M Talotta and Ryan M Philp of Hogan Lovells US LLP, for their continued assistance with this volume.

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London
May 2019

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United States

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TYPES OF SHAREHOLDERS' CLAIMS

Main claims

1 Identify the main claims shareholders in your jurisdiction may assert against corporations, officers and directors in connection with M&A transactions.

The claims typically asserted by shareholders in connection with M&A transactions arise out of the fiduciary duties owed by boards of directors to companies and their constituents. Corporate directors owe a corporation and its shareholders two principal fiduciary duties: the duty of care and the duty of loyalty. These two duties generally encompass a number of related duties, such as the duty of disclosure (or can-dour), the duty of oversight and the duty of good faith.

After an M&A transaction is announced, the seller's shareholders frequently assert breach of fiduciary duty claims alleging that the board of directors agreed to sell the company for an inadequate price following the conclusion of an unfair or conflicted sales process, or both. In addition, shareholders often challenge the adequacy of the seller's disclosures in connection with a transaction, including, in particular, disclosures provided in the materials used to solicit shareholder votes on the transaction.

The law governing a board of directors' fiduciary duties is the law of the state where the company is incorporated. In the United States, the majority of large public companies are incorporated in Delaware, which has a well-developed and widely followed body of case law concerning M&A transactions. Other states have broadly similar fiduciary duty rules, but may differ on particular points of law. In the interest of brevity, this chapter discusses the most common or generally applicable US legal concepts in the context of an M&A litigation and not the law of any particular state.

Requirements for successful claims

2 For each of the most common claims, what must shareholders in your jurisdiction show to bring a successful suit?

To successfully bring a breach of fiduciary duty claim, shareholders generally must show the existence of a fiduciary duty and a breach of that duty. For claims alleging a breach of the duty of care, shareholders must show that the defendant did not use the amount of care that an ordinarily careful and prudent person would use in similar circumstances. For claims alleging a breach of the duty of loyalty, shareholders must show that the defendant failed to act in the best interest of the corporation and its shareholders. To successfully bring a disclosure claim under state law, shareholders must show that the defendant failed to disclose fully and fairly all information that is material to a shareholder's decision.

In recent years, many courts have become increasingly sceptical of disclosure claims brought under state fiduciary duty law. As a result, many shareholders now bring disclosure claims under the US federal securities laws. Such claims require shareholders to demonstrate that a disclosure document failed to accurately disclose material information relating to an M&A transaction. In certain cases, the false or misleading statement must be intentional and not merely negligent or inadvertent.

Publicly traded or privately held corporations

3 Do the types of claims that shareholders can bring differ depending on whether the corporations involved in the M&A transaction are publicly traded or privately held?

Yes. In the context of public M&A transactions, shareholder claims typically are brought derivatively, on behalf of the corporation, or as a class action, and the claims are premised on the fiduciary duties owed by the company's directors to the company or the requirements of US federal securities laws governing disclosures to shareholders. By contrast, in the context of privately held corporations, claims typically are brought by the buyer or buyers, or the seller or sellers, and arise out of the parties' contract or direct dealings. Claims in private M&A transactions most frequently involve purchase price adjustment or earn-out disputes, indemnification disputes arising from contractual representations and warranties, and fraud claims based on alleged misstatements or omissions that induced one party to enter into the contract.

Form of transaction

4 Do the types of claims that shareholders can bring differ depending on the form of the transaction?

In certain cases, yes, but not in others. For example, in the public M&A context, shareholder claims alleging state law breach of fiduciary duty will not necessarily differ if a transaction is structured as a merger instead of a tender offer. For disclosure claims brought under federal law, however, shareholder claims vary depending on the structure of the transaction. For example, certain US courts have held that shareholders challenging disclosures in connection with a tender offer under section 14(e) of the Securities Exchange Act of 1934 must show that the speaker acted with scienter or the intent to deceive investors and satisfy heightened pleading standards. In contrast, in a merger structure where shareholders challenge proxy disclosures under section 14(a) of that same statute, most courts hold that shareholders do not need to establish that a false or misleading statement was intentional.

Negotiated or hostile transaction

5 Do the types of claims differ depending on whether the transaction involves a negotiated transaction versus a hostile or unsolicited offer?

As a general matter, the fiduciary duties of a board of directors do not differ depending on whether the transaction is negotiated or is the result of a hostile or unsolicited offer. In both circumstances, the board is required to act in a fully informed manner, with the requisite level of care, and in the best interests of the company and its shareholders. In the context of a hostile or unsolicited offer, it is generally accepted that a target board may, in appropriate circumstances, act consistently with its fiduciary duties by resisting or rejecting a hostile or unsolicited offer. However, where shareholders challenge affirmative conduct by a company to resist a hostile or unsolicited offer, such as the implementation of a 'poison pill' or shareholder rights plan, the board's conduct will be evaluated under more rigorous standards of review designed to ensure that the board is acting to protect shareholder interests.

Party suffering loss

6 Do the types of claims differ depending on whether the loss is suffered by the corporation or by the shareholder?

Yes. Claims for losses suffered by a corporation typically belong to the corporation. Therefore, for the shareholder to bring claims on behalf of the corporation – that is, derivatively – the law imposes several threshold requirements that a shareholder must satisfy to have standing to bring corporate claims. Shareholder derivative actions seek recovery for the benefit of the corporation as a whole. In contrast, where the loss is suffered by shareholders, as distinct from the corporation itself, one or more shareholders may seek to pursue direct recovery from the alleged wrongdoers (including recovery from the corporation). Such 'direct' actions frequently seek recovery on behalf of a group (or class) of shareholders, and thus must satisfy different procedural requirements that apply to class actions. Recovery in a class action belongs to the shareholders, not the corporation.

In M&A transactions, courts typically hold that shareholders have direct claims when asked to vote based on misleading disclosures or when forced to exchange shares for inadequate consideration.

COLLECTIVE AND DERIVATION LITIGATION

Class or collective actions

7 Where a loss is suffered directly by individual shareholders in connection with M&A transactions, may they pursue claims on behalf of other similarly situated shareholders?

Yes. In instances where a loss is suffered directly by individual shareholders, as distinct from losses suffered by the corporation, shareholders may seek to bring a class action lawsuit on behalf of themselves and other similarly situated shareholders. To commence a class action lawsuit, the named plaintiff must meet several requirements designed to ensure that prosecution of claims on a class-wide basis is necessary and practical, and that the named plaintiff is properly situated to act on behalf of the class.

Among other things, a proposed class representative must show that:

- the class members are so numerous that it would be impracticable to join them all in a single litigation;
- there are common questions of law or fact applicable to all class members;
- the proposed representative's claims are typical of all class member claims; and
- the proposed representative will adequately represent the interests of the absent class members.

In addition, the proposed class representative must show that common questions predominate over any individualised issues applicable to the class members.

Derivative litigation

8 Where a loss is suffered by the corporation in connection with an M&A transaction, can shareholders bring derivative litigation on behalf or in the name of the corporation?

Yes. Where a loss is suffered by the corporation, rather than shareholders individually or as a group, shareholders may bring derivative actions on behalf of the corporation. To have standing to bring a derivative claim on behalf of the corporation, a shareholder must meet strict requirements intended to determine whether it is appropriate to vest the shareholder with authority to bring claims belonging to the corporation. One threshold issue is whether the shareholder makes a demand on the corporation to take action in response to allegedly improper conduct. To proceed with a derivative action, a shareholder must either make a demand on the board that is wrongfully refused, or demonstrate in the complaint that any such demand would have been futile. Further, a derivative plaintiff must remain a shareholder from the time of the challenged transaction until the conclusion of the litigation.

Derivative claims arise more frequently in connection with failed M&A transactions (eg, where a board of directors terminates a deal or changes its recommendation and thereby causes the company to pay a substantial termination fee to the counterparty).

INTERIM RELIEF AND EARLY DISMISSAL

Injunctive or other interim relief

9 What are the bases for a court to award injunctive or other interim relief to prevent the closing of an M&A transaction? May courts in your jurisdiction enjoin M&A transactions or modify deal terms?

Due to the impracticability of unwinding a transaction after it has closed, US courts have the discretion to issue an injunction to prevent the closing of an M&A transaction in certain circumstances, including where the disclosures fail to provide shareholders with adequate information, or the deal protection provisions in the M&A agreement improperly preclude other potential bidders from coming forward or coerce shareholders into voting in favour of the transaction. Although the injunction standard differs slightly from jurisdiction to jurisdiction, most courts consider whether there is a reasonable probability that the movant will succeed on its claim, whether the movant will suffer imminent and irreparable harm, and the balance of the equities. Rather than enjoin a transaction, courts also in limited circumstances may strike objectionable deal terms.

Early dismissal of shareholder complaint

10 May defendants seek early dismissal of a shareholder complaint prior to disclosure or discovery?

Yes. Defendants may seek early dismissal of a shareholder complaint by filing a motion to dismiss. Defendants may seek dismissal of shareholder derivative and class actions on the ground that the shareholder plaintiffs fail to meet one or more of the procedural requirements for commencing such an action. Defendants also may seek dismissal of shareholder claims on the ground that the complaint fails to adequately state an actionable claim.

ADVISERS AND COUNTERPARTIES

Claims against third-party advisers

11 Can shareholders bring claims against third-party advisers that assist in M&A transactions?

Yes. The most common claims against third-party advisers are based on financial advisers' undisclosed conflicts of interest. Typically, such claims have been asserted on the theory that conflicted financial advisers aided and abetted breaches of fiduciary duty by the board of directors. For example, shareholders have asserted claims against financial advisers who provided fairness opinions to the target, but had undisclosed financial incentives related to the buyer. However, aiding and abetting liability only will be imposed based upon knowing misconduct.

Claims against counterparties

12 Can shareholders in one of the parties bring claims against the counterparties to M&A transactions?

Yes. Generally, efforts to achieve a better deal through arm's-length negotiations will not give rise to liability, but liability for aiding and abetting may arise in very limited circumstances where, for example, a party intentionally creates or exploits a conflict of interest. In addition, shareholders may bring claims against a counterparty based upon allegedly false or misleading disclosures, such as where a joint proxy is issued or in connection with a tender offer.

LIMITATIONS ON CLAIMS

Limitations of liability in corporation's constitution documents

13 What impact do the corporation's constituting documents have on the extent board members or executives can be held liable in connection with M&A transactions?

Many state corporation statutes permit corporations to include in their charter a provision eliminating director monetary liability for breaches of the duty of care. Such provisions make it difficult for shareholders to prevail in post-closing damages cases where the core contention is that the directors should have or could have obtained a better price when selling the company.

However, exculpatory provisions of this kind do not eliminate director monetary liability for breaches of the duty of loyalty or for actions undertaken in bad faith. Nor do these provisions prevent a shareholder from pursuing a claim for non-monetary relief (eg, an injunction against consummation of an M&A transaction), or from pursuing a claim for monetary damages for actions undertaken by an officer of the corporation.

Statutory or regulatory limitations on claims

14 Are there any statutory or regulatory provisions in your jurisdiction that limit shareholders' ability to bring claims against directors and officers in connection with M&A transactions?

As a general matter, there are no statutory or regulatory provisions precluding such claims, but as noted above there are procedural rules applicable to shareholder class and derivative actions challenging M&A transactions. A shareholder class action asserting claims under the federal securities laws also must comply with the requirements of the Private Securities Litigation Reform Act of 1995.

Common law limitations on claims

15 Are there common law rules that impair shareholders' ability to bring claims against board members or executives in connection with M&A transactions?

Under traditional common law, most decisions by disinterested directors receive the protections of the business judgement rule. This doctrine provides a presumption that directors making a business decision acted on an informed basis, in good faith and in the honest belief that the action was taken in the best interests of the company. A plaintiff can rebut the business judgement rule by demonstrating a breach of the directors' obligations of good faith, loyalty or due care (eg, by proving corporate waste). When the business judgement rule applies and is not rebutted, a court will not second-guess director decisions.

STANDARD OF LIABILITY

General standard

16 What is the standard for determining whether a board member or executive may be held liable to shareholders in connection with an M&A transaction?

There are three primary standards for assessing director conduct in M&A transactions: the business judgement rule, enhanced scrutiny and entire fairness.

Business judgment rule
As discussed above, when the business judgement rule applies, courts generally will not second-guess the decisions of directors.

Enhanced scrutiny
An intermediate standard of review applicable to M&A transactions involving control of a company that requires directors to satisfy certain conditions before they will enjoy the benefits of the business judgement rule. For example, forms of enhanced scrutiny apply to transactions involving a break-up of a corporation and to defensive measures adopted by directors in response to a potential change in control.

Entire fairness
Courts will require directors to prove the entire fairness of an M&A transaction in which a majority of directors are interested or that involves a controlling shareholder. The defendants bear the burden of proving entire fairness.

In many litigations involving M&A transactions, the standard of review that the court chooses to apply will be dispositive. Where a court applies the business judgement rule, decisions made by a board of directors are upheld in the vast majority of cases. In contrast, an entire fairness review strongly favours plaintiff shareholders because it switches the burden of proof by forcing the defendant directors to affirmatively prove that all aspects of the process and price were fair.

Type of transaction

17 Does the standard vary depending on the type of transaction at issue?

Yes, in certain cases. For example, enhanced scrutiny applies and '*Revlon* duties' are implicated when a company initiates an active bidding process involving a clear break-up of the company; when, in response to an offer, a target abandons its long-term strategy and seeks an alternative transaction; or when approval of a transaction results in a 'change of control'.

Interested transactions (eg, a going private transaction with a controlling shareholder) are subject to the entire fairness test. Other

M&A transactions (eg, a merger of equals between two public corporations with no controlling shareholder) generally are subject to the business judgement rule.

Type of consideration

18 Does the standard vary depending on the type of consideration being paid to the seller's shareholders?

Yes, in certain cases. In a cash-out merger where shareholders will have their investment in the ongoing enterprise terminated, *Revlon* duties will apply and courts will consider whether directors have taken reasonable steps to provide shareholders with the best transaction reasonably available. A stock-for-stock merger in which control of the combined entity will remain in a fluid market, by contrast, generally will not trigger enhanced scrutiny. Transactions involving a mixture of cash and stock are assessed on a case-by-case basis, although enhanced scrutiny will generally apply when 50 per cent or more of the consideration that shareholders receive is in cash.

Potential conflicts of interest

19 Does the standard vary if one or more directors or officers have potential conflicts of interest in connection with an M&A transaction?

A transaction in which a majority of directors are interested will be subject to the entire fairness test. Under the entire fairness test, the burden of proof is on the board of directors to show that the transaction was the product of a fair process that resulted in an objectively fair price. The entire fairness test is fact-intensive by nature and often requires resolution by trial (and not pretrial motion practice).

Controlling shareholders

20 Does the standard vary if a controlling shareholder is a party to the transaction or is receiving consideration in connection with the transaction that is not shared rateably with all shareholders?

Yes. A transaction in which a controlling shareholder is a party or has an interest different from other shareholders ordinarily will be scrutinised under the entire fairness test. However, the business judgement rule can apply to a transaction with a controlling shareholder if the transaction is conditioned upon approval by a fully empowered special committee of disinterested and independent directors; and the transaction is conditioned upon approval by an informed and non-coerced vote by a majority of the minority shareholders.

Where only one of these two conditions is met, the entire fairness test will continue to apply, but the burden will shift to the plaintiff to prove the unfairness of the transaction.

INDEMNITIES

Legal restrictions on indemnities

21 Does your jurisdiction impose legal restrictions on a company's ability to indemnify, or advance the legal fees of, its officers and directors named as defendants?

Indemnification may be required, permitted or prohibited depending on the facts and circumstances of a particular case. To the extent a director or officer has been successful on the merits in connection with an M&A litigation, indemnification for attorneys' fees and expenses is typically mandatory. At the other extreme, directors and officers may not be indemnified for a claim, issue or matter in which they are found to be liable to the corporation (eg, a shareholder derivative action) absent court approval. In all other cases, directors and officers may be indemnified if it is determined that they acted in good faith in a manner reasonably believed to be in, or not opposed to, the best interests of the corporation and, in a criminal action or proceeding, where there is no reasonable cause to believe the person's conduct was unlawful.

Corporations may advance legal fees to a director or officer if the person receiving advancement furnishes an undertaking agreeing to repay the corporation if it is ultimately determined that the standard for indemnification has not been met.

M&A CLAUSES AND TERMS

Challenges to particular terms

22 Can shareholders challenge particular clauses or terms in M&A transaction documents?

Yes, shareholders challenging an M&A transaction often will focus on deal-protection devices (eg, termination fees, matching rights, 'no-shop' clauses). These devices will be evaluated under the enhanced scrutiny standards described above. Courts generally allow parties to include such devices in their M&A transaction agreements provided that they do not, separately or in the aggregate, preclude other bidders from making offers to acquire the seller or coerce shareholders into approving a transaction favoured by management.

PRE-LITIGATION TOOLS AND PROCEDURE IN M&A LITIGATION

Shareholder vote

23 What impact does a shareholder vote have on M&A litigation in your jurisdiction?

In a transaction that does not involve a controlling shareholder, a fully informed and uncoerced shareholder vote approving the transaction will result in the irrebuttable application of the business judgement rule. Courts conclude that such a vote will 'cleanse' any breach of fiduciary duty that took place in connection with the deal approval process.

In transactions involving a controlling shareholder, and absent satisfaction of the other prerequisites described above, shareholder approval will shift the burden to a plaintiff to prove the unfairness of a transaction.

Insurance

24 What role does directors' and officers' insurance play in shareholder litigation arising from M&A transactions?

Companies typically have insurance for their directors and officers that will cover the types of claims generally asserted in shareholder litigation arising from M&A transactions. The most important role of directors' and officers' insurance is minimising the risk that a director or officer will be subject to personal liability in connection with shareholder litigation. Directors' and officers' insurance also can influence the parties' willingness or ability to settle shareholder claims. Insurers generally play a small role in the preliminary phases of litigation, but may become more involved if a matter progresses or enters into formal settlement negotiations, such as mediation.

In recent years, many insurance carriers have substantially increased the deductible or retention applicable to M&A litigation such that a significant part of defence costs and early-stage settlement payments are made by the insured.

Burden of proof

25 Who has the burden of proof in an M&A litigation – the shareholders or the board members and officers? Does the burden ever shift?

The business judgement rule protects the decisions of officers and directors of a corporation if those decisions are made in good faith, informed and believed to be in the best interests of the corporation. Where the business judgement rule applies, the plaintiff has the burden to rebut the presumption. The plaintiff may do so by showing, for example, that the board of directors failed to consider relevant material information or rushed to a decision without a legitimate business justification. If a plaintiff is able to overcome the business judgement rule presumption, then the burden shifts to the defendants, who must demonstrate 'entire fairness', which requires that the transaction be entirely fair to the corporation and its shareholders.

Pre-litigation tools

26 Are there pre-litigation tools that enable shareholders to investigate potential claims against board members or executives?

Shareholders have a qualified, statutory right to inspect a corporation's books and records. To do so, a shareholder must make a demand that includes a proper purpose for the inspection. A proper purpose is one reasonably related to an individual's interest as a shareholder, such as investigating alleged mismanagement or corporate waste. If the shareholder can state a proper purpose, then he or she may seek books-and-records that are necessary to accomplish that proper purpose. The scope of documents available to a shareholder pursuant to a books and records demand is narrower than is available during discovery between litigation parties, although recent court decisions have taken a broader view and permitted email files, among other things.

Shareholders increasingly are making books-and-records demands in response to M&A transactions (rather than proceeding directly to litigation) for two reasons. First, Delaware courts have encouraged shareholders to obtain books and records to plead more detailed complaints. Second, to successfully proceed with a post-closing damages case, shareholders need to show that a vote or tender was not made on an informed basis or was the product of material conflicts.

Forum

27 Are there jurisdictional or other rules limiting where shareholders can bring M&A litigation?

A shareholder must bring M&A litigation in a forum that has subject matter jurisdiction over the claims as well as personal jurisdiction over the parties. A federal court generally may exercise subject matter jurisdiction over state law claims if a shareholder also asserts valid federal claims or if the parties' citizenship is diverse. A state court generally does not have subject matter jurisdiction over federal claims. Personal jurisdiction over a corporation exists, at a minimum, in its state of incorporation and principal place of business, and may exist elsewhere depending on the corporation's business contacts with the jurisdiction. Whether a court has personal jurisdiction over a director or officer is a more detailed inquiry, and turns on the contacts between that director or officer and the forum. A corporation also may control where suits can be brought by adopting a forum selection clause in its by-laws or articles of incorporation.

Expedited proceedings and discovery

28 Does your jurisdiction permit expedited proceedings and discovery in M&A litigation? What are the most common discovery issues that arise?

Shareholders may seek expedited proceedings for the purpose of setting expedited discovery deadlines and the date for an injunction hearing. The court generally has broad power to permit expedited proceedings, and the plaintiff's burden is relatively minimal, that is, the plaintiff need only demonstrate a colourable claim and a sufficient possibility of irreparable harm to obtain expedition. When expedited discovery is allowed, the seller typically is required to produce presentations from its financial adviser, board minutes relating to the transactions, and management projections or forecasts, among other things.

The most common discovery issues concern attorney–client privilege. Some jurisdictions recognise a fiduciary exception to the attorney–client privilege, which, under certain circumstances, allows shareholders to invade the corporation's attorney–client privilege to prove fiduciary breaches by officers and directors upon a showing of good cause. In addition, if the corporation is based outside of the US, issues may arise regarding applicable blocking or privacy statutes.

DAMAGES AND SETTLEMENTS

Damages

29 How are damages calculated in M&A litigation in your jurisdiction?

In class actions, damages typically are designed to restore the shareholder to the position he or she would have been in if the alleged misconduct had not occurred. In M&A litigation, shareholders generally seek the difference between the deal price and what the deal price would have been absent the alleged misconduct. To litigate damages, plaintiffs and defendants usually retain experts, who typically employ one or more generally accepted valuation methodologies (eg, discounted cash-flow analysis, an analysis of comparable transactions) to support an opinion that the deal price should have been higher or lower (on the plaintiffs' side) or that the deal price was fair and reasonable (on the defendants' side).

Settlements

30 What are the special issues in your jurisdiction with respect to settling shareholder M&A litigation?

Settlements of shareholder class actions and derivative cases generally require court approval. Typically, the plaintiff shareholder, through counsel, will file a motion seeking the court's preliminary approval of the proposed settlement. The motion will request that the court approve, among other things, a process for providing notice to the shareholders; the content of a notice to be mailed or published in a newspaper or trade journal, or both; and the deadline for shareholders to object in writing, at a final approval hearing, or both.

Often, the lawyers for the shareholder plaintiff also will seek the court's approval of an attorneys' fees award to be paid from the common settlement fund. At a final settlement hearing, the court will assess whether the settlement is fair and reasonable, subject to any objections it receives.

Over the past decade, M&A litigation has become increasingly common. At one point, complaints were filed in connection with approximately 95 per cent of public company deals valued at more than US$1 billion. These filings often were followed by what became known as 'disclosure-only' settlements in which the seller's shareholders received supplemental disclosures prior to a vote or tender, the defendants received a broad class-wide release covering all claims relating to the transaction and plaintiffs' counsel received a substantial fee award.

US courts have become increasingly sceptical of disclosure-only settlements, concluding that shareholders receive no real benefit in the majority of cases. As a result, courts now prefer in most instances that parties pursue mootness resolutions without court involvement in which the defendants agree to address the shareholders' disclosure claims, the release given to defendants is narrowed and the attorneys' fees paid to shareholders' counsel are lower.

THIRD PARTIES

Third parties preventing transactions

31 Can third parties bring litigation to break up or stop agreed M&A transactions prior to closing?

Third parties – increasingly, activist hedge funds – can employ a variety of strategies to stop or break up proposed M&A transactions, some of which involve filing litigation (in their capacity as shareholders) and some of which do not (such as publicly criticising the transaction or soliciting shareholder proxies opposing the transaction). Activist investors may seek to enjoin a proposed transaction by, among other things, attacking the motives and financial interests of the target company's board of directors and management team, challenging deal-related disclosures or asserting that deal protection measures agreed to with the buyer interfere with or preclude a superior bid. In certain circumstances, activist investors may pursue one or more of these strategies in collaboration with other financial or strategic buyers.

In addition, potential purchasers have in the past pursued M&A litigations to break up agreed transactions and acquire the target away from the preferred buyer. Purchasers in such situations typically need to be shareholders in the target company to have standing. Such cases have become less common in recent years as courts have clarified the law concerning permissible anti-takeover and deal-protection measures.

Third parties supporting transactions

32 Can third parties in your jurisdiction use litigation to force or pressure corporations to enter into M&A transactions?

Activist investors also may pursue litigation or other tactics to force or pressure corporations to enter into unsolicited transactions. Generally, defensive measures taken by a board of directors to resist unsolicited offers are subject to enhanced judicial scrutiny, and thus are subject to challenge by shareholders who wish to see the transaction proceed. In addition, activist investors may pursue non-litigation alternatives to exert pressure, such as instituting a proxy contest to obtain board control or making an unsolicited offer in the hopes that additional, superior offers will emerge.

UNSOLICITED OR UNWANTED PROPOSALS

Directors' duties

33 What are the duties and responsibilities of directors in your jurisdiction when the corporation receives an unsolicited or unwanted proposal to enter into an M&A transaction?

As a general matter, the fiduciary obligations of a target company's management and directors in response to an unsolicited or unwanted proposal are to act in good faith, with due care and loyalty, in what they believe to be the best interests of the corporation. A board of directors has no fiduciary duty to negotiate or sell in response to an unsolicited offer – the board may 'just say no'. In appropriate circumstances, the board of directors may implement defensive measures to resist an offer that the board believes represents a threat. However, to be upheld by a court, such defensive measures must be in response to a legitimate threat to corporate interests, and must be reasonable and proportional in relation to the threat. Once a company elects to consider an alternative involving a break-up of the company or initiates an active bidding process, the board is required to take steps reasonably calculated to obtain the best price available.

COUNTERPARTIES' CLAIMS

Common types of claim

34 Shareholders aside, what are the most common types of claims asserted by and against counterparties to an M&A transaction?

In the context of private M&A transactions, the most common claims arise out of the terms of the purchase agreement, including claims for breaches of contractual representations, covenants and warranties. These claims often are subject to indemnity provisions, and may be made against merger consideration held in escrow. In addition, purchase agreements frequently contain a mechanism for a post-closing purchase price adjustment whereby the purchase price may be adjusted to account for variations in the target's value or a depletion of its working capital. These claims typically are resolved by arbitration. In addition, buyers may assert claims premised on fraud, including claims for fraud in the inducement.

Differences from litigation brought by shareholders

35 How does litigation between the parties to an M&A transaction differ from litigation brought by shareholders?

Shareholder litigation arising out of M&A transactions generally is commenced in a representative capacity, that is, by an individual shareholder as a class action (on behalf of a larger class of shareholders) or as a derivative action (on behalf of the company), and seeks to enforce fiduciary duties owed by a company's board of directors to the company. In contrast, litigation between parties to an M&A transaction is brought directly between the parties. Private M&A litigation typically relates to the terms of the negotiated agreements and the veracity of the representations made by the parties prior to closing. Contractual counterparties do not owe each other fiduciary duties.

UPDATE AND TRENDS

Key developments

36 What are the most current trends and developments in M&A litigation in your jurisdiction?

M&A litigation in the US continued to evolve in significant ways in 2018. As widely reported, stockholders file lawsuits challenging the vast majority of US public company M&A transactions. Prior to 2016, many of these cases were resolved through 'disclosure-only' settlements – ie, settlements whereby the defendants agree to provide supplemental disclosures to stockholders in advance of the approval vote; the stockholder plaintiffs agree to dismiss the complaint and provide the defendants with a release; and plaintiffs' counsel, through agreement or via an application to the court, receives an attorneys' fee award for having caused the defendants to provide the supplemental disclosures to the stockholders.

In 2016, the Delaware Court of Chancery issued its landmark decision in *In re Trulia, Inc Shareholder Litigation*. The Court of Chancery concluded that many disclosure-only settlements provided limited value to stockholders while benefitting plaintiffs' counsel (in the form of fee awards) and deal parties (in the form of broad releases). For that reason, the Chancery Court held that, going forward, it would approve disclosure-only settlements only where the supplemental disclosures provided to stockholders were 'plainly material'. As a result of the *Trulia* decision, many disclosure-related cases instead are resolved through mootness fees – ie, after supplemental disclosures are made by the company that moot the plaintiff's disclosure-related claims, the plaintiff agrees to voluntarily dismiss the case in exchange for an agreed attorneys' fee amount paid to plaintiff's counsel. Depending on the jurisdiction, mootness fees may not require court approval. In addition, to avoid the impact of *Trulia*, many stockholder plaintiffs began filing M&A lawsuits in federal court asserting disclosure-related claims under the Securities Act of 1934 (the Exchange Act), rather than in state court.

In 2018, the United States Court of Appeals for the Ninth Circuit issued its decision in *Varbajedian v Emulex Corp* in which it held that claims under section 14(e) of the Exchange Act, which prohibits the making of false or misleading statements in tender offer communications, require only that the defendants negligently misled investors and not, as other courts had long held, that defendants acted with scienter, or the intent to deceive investors. The United States Supreme Court agreed to hear an appeal of the Ninth Circuit's decision, but recently dismissed the appeal as improvidently granted. As a result, the United States Supreme Court did not resolve the conflict between United States federal courts on this issue. Thus, until the United States Supreme Court takes this issue up again, there will continue to be a lack of uniformity among United States federal courts regarding the standard for claims under Section 14(e) of the Exchange Act.

A second notable development concerns the material adverse effect (MAE) clauses common in M&A agreements (also known as material adverse change (MAC) clauses). Although MAE clauses vary significantly from agreement to agreement, these provisions typically give the buyer the option not to close an M&A transaction if, during the period between signing and closing, the seller experiences events or changes that adversely and materially impact its financial condition. Prior to 2018, merger parties often raised the possibility of invoking MAE clauses, and there were a handful of litigated cases, but no Delaware court ever had held that a buyer justifiably declined to close or terminated a transaction on the basis of an MAE clause. That changed with the Court of Chancery's 246-page decision in *Akorn, Inc v Fresenius Kabi AG*, which was later affirmed by the Delaware Supreme Court. Among other things, the *Akorn* court found that, during the post-signing period, the seller lost hundreds of millions of dollars in value due to pervasive regulatory issues while experiencing year-over-year earnings declines of more than 55 per cent. Although the facts leading to the *Akorn* court's MAE conclusion are extreme, the case provides important guidance for MAE standards generally, as well as with respect to the manner in which buyers should proceed with closing efforts while evaluating whether or not to invoke an MAE clause.

A third significant development relates to the power of a corporation to choose where it will be sued by its stockholders. In recent years, many US corporations adopted 'forum selection' by-laws providing that breach of duty claims filed by company stockholders against board members must be brought in a stated jurisdiction (often Delaware). Delaware courts have approved these forum selection by-laws to the extent they address fiduciary duty and other claims involving the 'internal affairs' of the company. Several companies attempted to expand these by-laws to cover claims filed by stockholders against the corporation under the federal securities laws. In *Sciabacuccho v Salzberg*, the Delaware Court of Chancery invalidated these expanded by-laws on the ground that rights under the federal securities laws were not part of the internal affairs of a corporation, nor were they within the 'corporate contract' between investors and other corporate constituents.

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Another trend concerns appraisal actions. Following the Delaware Supreme Court's 2017 decisions in *Dell, Inc v Magnetar Global Event Driven Master Fund Ltd*, and *DFC Global Corp v Muirfield Value Partners LP*. Delaware courts determined in several 2018 cases that 'fair value' for the stockholder in an appraisal action was significantly less than the amount the stockholder would have received in the transaction. In the recent cases, the Delaware Court of Chancery emphasised that in an appraisal action, stockholders are not entitled to any value arising from synergies created by the transaction at issue, and that the best indicator of fair value in public company cases often may be the unaffected (pre-deal announcement) stock market price. The recent case law substantially increases the risks for investors pursuing an appraisal arbitrage strategy.

Finally, courts in 2018 continued to develop and apply the Delaware Supreme Court's ruling in *Corwin v KKR Financial Holdings*. Several decisions confirmed that *Corwin* ratification can be a powerful defence to breach of fiduciary duty claims that helps resolve stockholder litigation at the pleading stage. Other recent cases, however, illustrate that *Corwin* is not without limits and that a stockholder complaint will survive a motion to dismiss where the plaintiff can plead facts indicating that stockholder approval was not obtained on the basis of a fully informed vote.


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