SECURITIES

What's the Deal with Deal Cases?

By Jordan Eth

For years, litigation in most "deal" cases — involving negotiated, as opposed to hostile, acquisitions — has followed a rather predictable pattern.

A proposal was announced publicly. Lawsuits were filed, usually in Delaware or in the state in which the acquired company was headquartered. Maybe, there would be some skirmishing. There would be a few changes in disclosures or adjustments to minor deal terms. Plaintiffs would receive a (relatively) modest fee; defendants would obtain a release; the deal would go through; and all would go home.

This practice has been subject to criticism. Some say plaintiffs' counsel file knee-jerk strike suits to recover a fee that benefitted themselves and only themselves. Others point out that plaintiffs should, instead, litigate at least some of these cases more vigorously.

Defendants have been criticized for "paying off" plaintiffs' counsel, which winds up encouraging still more suits. Others go further and accuse defendants and plaintiffs of papering over occasional problematic transactions.

Despite these criticisms, this practice had its benefits — principally predictability. Tell a lawyer experienced in this area the type of case and overall fact pattern and you could get a good read on the "value" of the case. The litigation would not genuinely threaten the deal or the time and pocketbooks of defendants. And cases would disappear from the court's docket not long after filing, promoting "judicial economy" if nothing else.

Three recent cases, however, show that things may be changing, presenting new challenges — and less predictability — to all involved in corporate acquisitions.

In March of this year, Vice Chancellor Laster of the Delaware Court of Chancery issued *In re Revlon, Inc. Shareholders Litigation*, 990 A.2d 940 (Del. Ch. 2010). Revlon involved a special species of deal case — one with a controlling shareholder. The court criticized a proposed settlement and appointed new co-lead counsel to pursue claims on behalf of the class.

The case is most noteworthy for the way in which the court reached its ruling. In memorable language, the court referred to the "steps" in the "Kabuki dance" that characterizes this type of litigation. Id. at 945. The court criticized plaintiffs' counsel for not "litigating anything" (and for misrepresenting the amount of their activity to the court). Id. at 945, 950. It cited the "minor tweaks" that provided a "convenient way to settle the litigation." Id. at 947.

Defense counsel came in for some criticism, too, as the court noted that defendants supported the settlement despite the "highly problematic transaction." Id. at 954.

In replacing lead counsel, the court appointed a firm that had "built up reputational capital with the Court and have proven willing to engage in the hard work of actual litigation," as opposed to those firms described as "pilgrims" (i.e. "early settlers") Id. at 945, 962-63.

The court noted that its ruling could cause plaintiffs to file suit outside of Delaware to avoid the risk of this type of judicial oversight of their behavior. Id. at 960. It offered a way for companies to prevent this from taking place through "charter provisions" specifying an exclusive forum, presumably Delaware, for intra-entity disputes.

Revlon thus prods plaintiffs' counsel to pursue cases more aggressively, both to support settlements and to deter attempts by others to replace them as counsel. It also may lead plaintiffs, as the Vice Chancellor noted, to file suit in other jurisdictions.

The second case is *Fox v. Jamdat Mobile Inc., et al* 2010 WL 2016180 (Cal. App. 2 Dist. May 21, 2010). The case involved the 2005 acquisition of JAMDAT by Electronic Arts. Plaintiffs filed the usual breach of fiduciary duty claim, alleging an "unfair process and unfair process." Less typically, the parties litigated a motion to enjoin the transaction (defendants won), and the case continued after the deal closed. Defendants demurred and ultimately won at the Superior Court level. The appellate court, however, five years after the complaint was filed, reversed based in part on its rejection of a "ratification" defense in light of recent Delaware law.

The interesting part of the decision is "unpublished" and therefore not precedent, id. at *11, but it does provide a glimpse at how a California appellate court may address these issues.

One key question was whether defendants had adequately disclosed the negotiating process. Plaintiffs pointed to alleged omissions; defendants argued that the disclosures were adequate. The court said that the adequacy of disclosure raised a "factual question" not suitable for resolution on a demurrer. Id. at *22-23.

Similarly, plaintiffs argued that defendants agreed to the deal so that they and the funds they represented could "monetize" the value of their stock holdings. Defendants argued that any transaction — and not just this one — would have accomplished that goal. The court here, too, found a factual issue not suitable for demurrer.

Perhaps a different panel in California or a court in Delaware would have upheld the dismissal of the complaint. Perhaps there were unique allegations in this complaint that permitted it to survive. But the decision does point out the risk to defendants of relying on a California state court to sustain without leave to amend a demurrer to a complaint.

S. Todd Rogers, Daily Journal

Jordan Eth is co-chair of the Morrison & Foerster's Securities Litigation, Enforcement and White-Collar Defense Group. He is a nationally recognized litigator, representing public companies and their officers and directors in securities class actions, SEC investigations, derivative suits and internal investigations.

At the same time, this is a mixed blessing for plaintiffs, who must then dig in for the long haul and expense of litigating these cases.

The third case, *Brown v. Brewer, et al.*, 2010 U.S. Dist. LEXIS 60863 (C.D. Cal. June 17, 2010), also involved a 2005 acquisition. In *Brown*, the parties went all the way through discovery and up to a summary judgment motion. The court, applying Delaware law, denied the motion, finding triable issues of fact.

Plaintiffs alleged that the target, through its CEO, favored one bidder over another. The court found "evidence" of the CEO's motivation for favoritism in his e-mails, citing as "particularly revealing" his "excited" e-mail that after the acquisition he would become "Fox Internet Grand Puba!!!" Id. at *36. As for the other directors, there was "evidence in the record suggesting that no one on the board asked any questions" about valuation, treatment of competing bidders, or other similar issues. Id. at *51. This evidence could support a claim that these directors "consciously abdicated their responsibilities." Id. at *48, 51.

In light of the changed environment, what should counsel do? Here are a few suggestions:

1. Prepare your clients for what's coming.

There's now a greater chance that a case will not settle quickly at previously understood "market rates." Plaintiffs may take more aggressive actions and demand higher settlements. Defendants may push back. And more conventional litigation — through discovery and motions — may ensue. The long slog (and expense) of litigation is hardest to take when unexpected, especially if clients have been advised otherwise.

2. Staff your cases accordingly.

The dance steps have become so routine in these cases that sometimes counsel who have not seen the inside of a courtroom for decades (or ever) handle them. With actual litigation, and potentially trial, looming, that type of staffing makes little sense.

3. Protect the record.

Having your board take the right substantive steps is not enough. The success of your litigation strategy will turn in part on the documentary record. Do your board minutes reflect active participation by board members or do they say "discussion ensued?" Do your executives understand that "excited e-mails" will wind up as Exhibit A? Is your proxy drafted so that it addresses issues that the plaintiffs will otherwise claim are "omitted?"

4. Understand potential "conflicts of interest."

Plaintiffs will always look for conflicts of interest. An executive gets a job with the acquiring company. Plaintiffs will allege a conflict. Executives get to sell stock that they otherwise couldn't. Another alleged conflict. Directors (or entities with which they are affiliated) wind up with advantages; another alleged conflict. Careful planning (and documentation) can identify these potential conflicts and protect the negotiating process from any taint associated with them.

It is especially useful to make sure that at least one outside director is actively involved in the negotiations.

5. Check the applicable insurance policies (and indemnification while you're at it).

Insurance coverage in merger cases can be complicated. Almost always, the relevant insurance is the acquired company's directors and officers policy. What is the retention amount? Does it cover these types of cases at all? What is the carrier's reputation? These are questions often neglected in acquisitions, but they can wind up as multimillion dollar issues down the road.