The Courts' Changing View on Disclosure-only Settlement Agreements

By James T. Shearin and Amanda Gurren

After nearly a decade of prominence in takeover litigation, so-called "disclosure-only" settlements are now being scrutinized more so than ever. Shareholder plaintiffs and corporations should note the change in Connecticut's corporate jurisprudent landscape.

In two recent decisions, *Bushansky v. Phoenix Cos.* and *Stein v. UIL Holdings Corp.*, the Connecticut Superior Court has followed the trend of other jurisdictions by deliberating proposed disclosure-only settlements, thus departing from the prior practice of "rubber-stamping" such agreements with little regard to their terms. These cases indicate that settlements that are advantageous to plaintiffs' attorneys (by approving high legal fees) and to the corporate management defendants (who receive broad releases of liability), all at the expense of the company's stockholders, will no longer pass muster. Instead, Connecticut courts will now more closely analyze these settlements to ensure that what stockholders "get" in the way of additional disclosures is proportionate to what they "give" in the form of a release of liability of their corporate managers. In addition, courts will require that the plaintiffs' counsel fees are awarded with due consideration for the benefit that their lawsuit provided to the stockholders. As such, prospective shareholder-plaintiffs and their counsel might well reconsider the merits underlying their disclosure-related claims before rushing to the nearest courthouse to file suit. The days of quick settlements providing for generous attorneys' fees are most likely over.

Disclosure-only Settlements: An Overview

Disclosure-only settlements occur in class action cases, which are initiated following the announcement of a merger or acquisition.[1] Typically, the plaintiff class alleges that the company and its management team failed to adequately disclose to the shareholders the details of the pending transaction.[2] Rather than endure the cost, delay, and distraction of litigation, the parties often opt to settle the suit soon after its commencement. Such settlements typically require the defendants to make additional disclosures in advance of the stockholder vote on the transaction and to pay the substantial legal fees of the plaintiff class attorney.[3] In exchange, the plaintiff class agrees to terminate the suit and grant the defendants a broad release from other disclosure-related claims as well as breach of fiduciary duty claims that the shareholders may have against them, including claims that are unknown at the time of settlement.[4]

The Superior Court Reevaluates Its Approach to Disclosure-only Settlements

Two recent cases, both decided by Judge Robert Genuario of the Superior Court in Stamford, strictly scrutinized the proposed settlement of the class action challenges to the respective proposed mergers. In both cases, the putative class representatives alleged that the directors of the acquired or merged company breached their fiduciary duties by failing to make material disclosures in the proxy statements provided to shareholders before the shareholder vote.

The first, *Bushansky v. Phoenix Cos.*, Superior Court, Judicial District of Stamford, Docket No. X08 FST-CV-15-6027891-S (February 23, 2017), 64 Conn. L. Rptr. 24 (February 23, 2017), represents a typical stockholder lawsuit challenging a mergers and acquisitions (M&A) deal. The shareholder-plaintiff, on behalf of himself and all other public stockholders of the Phoenix Companies, Inc. ("Phoenix"), brought suit against Phoenix and individual members of its board of directors and against Nassau Reinsurance Group Holdings, L.P. ("Nassau") in an effort to enjoin a proposed merger transaction pursuant to which Nassau would acquire the publicly held shares of stock of Phoenix.[5] The action, which was instituted less than 30 days after the plan of merger was announced, challenged the adequacy of the consideration that the shareholders were to receive from the transaction, alleging that its inadequacy was a result of a flawed sales process and, in addition, included allegations that the preliminary proxy statement filed with the U.S. Securities and Exchange Commission (SEC) failed to disclose all material information necessary for the Phoenix shareholders to make an informed and knowledgeable decision.[6] Just two months after the action was instituted, the parties reached a settlement, the terms of which included: a dismissal with prejudice of the subject action and a release of all claims "that were or could have been asserted in the action," an acknowledgment that the company had made supplemental disclosures to its shareholders as requested by the plaintiff-shareholder, and a commitment on the part of the defendants not to object to an award of attorney fees to plaintiff's counsel that did not exceed $340,000.[7]

Presented with the proposed settlement, and taking note of objections raised by a class member, the court approved, but noted its relatively limited value to the company's stockholders, especially in light of the "cost"—i.e., the broadness of the release of the claims, "[w]hen all is said and done the stockholders received the same consideration for their shares as the acquiring party offered prior to [this] litigation. Moreover, the supplemental disclosures provided information, which while material, primarily confirmed the conclusions of Phoenix's merger consultants which conclusions had already been disclosed."[8] Based on this conclusion, and concern for how much the shareholders "gave" in relation to what they "got," the court took issue with the requested attorney fees, finding the value of the legal representation actually provided, if any, was questionable.[9]

In making its finding, the court set forth the relevant factors to determine an appropriate award of attorneys' fees: (1) the amount of time and effort applied to the case by plaintiffs' counsel; (2) the complexities of the litigation; (3) the standing and ability of counsel; (4) the contingent nature of the litigation; (5) the stage at which the litigation ended; (6) whether the plaintiff can rightly receive all, or only a portion of, the credit for the benefit conferred by the challenge; and (7) the size of the benefit conferred.[10] The court observed that while the first three factors worked in favor of approving the requested fee award, the fifth, sixth, and seventh factors pertaining to the benefit actually received by the shareholders persuaded the court to reduce the legal fees requested by the attorney by nearly a third—from $340,000 to $230,000.[11]

In *Stein v. UIL Holdings Corp.*, the court was again asked to approve a settlement of a class action challenge to a proposed merger.[12] Unlike the Bushansky case, however, in Stein there was no objection raised to the motion to approve the settlement.[13] Notwithstanding, the court stated that, because the settlement would certify the class and bind all class members, the court was required under Connecticut law to make an independent determination as to whether or not the proposed settlement, "with due regard to what the shareholders have received as compared to what they are giving up," is fair, reasonable, and adequate.[14] The proposed settlement provided that, in consideration for additional disclosures by UIL to its shareholders prior to their vote on the plan of merger, the defendants would obtain a broad general release of virtually all claims the UIL former stockholders may have had against the defendants or other persons that were included as "released parties."[15] Additionally, the settlement provided that the defendants would not object to the plaintiffs' counsel's request for attorney fees that did not exceed $425,000.[16]

The amended complaint (which included the allegations of several class actions that had been commenced by different plaintiffs and ultimately consolidated into a single action) alleged, inter alia, that the proposed transaction would result in less than adequate consideration to the UIL shareholders resulting from an "utterly flawed sales process," that there were breaches of fiduciary duties by UIL board members based on conflicts of interest, and that the disclosures to shareholders failed to provide material information necessary to allow them to make an informed decision on the merger.[17] Less than two months after the amended complaint was filed, the parties entered into a Memorandum of Understanding ("MOU"), which set forth the terms of a proposed settlement agreement, provided for certain additional disclosures that would be made in a further SEC filing, and set forth the form of a broad general release that would bind all class members.[18] The merger was completed (after the positive vote of the shareholders) a month after the MOU was signed.[19] Thereafter, the parties sought the court's approval of the settlement by motion which was signed by all parties and, as mentioned earlier, was unopposed.[20]

The court noted that "disclosure settlements"—referring to those settlements ending shareholder lawsuits in which the "primary, if not sole, benefit to stockholders is the provision of additional disclosures as a supplement to previously filed proxy statements in exchange for a release of claims"—have come under scrutiny in other jurisdictions and by commentators.[21] The court cited favorably the Delaware Chancery decision *In re Trulia, Inc. Stockholder Litig.*, 2016 WL 270821 (Del. Ch. Jan. 22, 2016), which detailed the concerns over disclosure settlements adding little value to shareholders by virtue of supplemental disclosures while at the same time providing broad general releases to defendants—thereby posing the risk that shareholders might lose valuable, uninvestigated claims—and paying out large fees to plaintiff counsel. While the court noted that rather than rejecting disclosure settlements outright, the focus in Trulia and other cases has been to focus on the "give" and the "get" in each case.[22]

Applying Connecticut law, the court explained that the Trulia analysis was consistent with the Connecticut requirement that a class action litigation settlement may be approved only if it is found to be fair, reasonable, and adequate.[23] In this regard, the court adopted the test set forth in Trulia that, in reviewing the disclosure settlement, the court must be satisfied that the supplemental disclosures address a material misrepresentation or omission and that, "the proposed release is narrowly circumscribed to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sales process, if the record shows that such claims have been investigated sufficiently."[24] Applying this test to the UIL facts, the court explained that the supplemental disclosures added little, but more importantly, the breadth of the proposed release was clearly not "narrowly circumscribed" to cover only the disclosure and fiduciary duty claims involved in the merger.[25] Observing that the "settlement provides the defendants with too much by way of release and the plaintiffs with too little by way of additional disclosure," the court denied the motion to approve the settlement and for the negotiated attorneys' fees.[26]

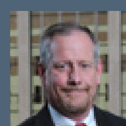
Changing View toward Disclosure-only Settlements

Although legal scholars and policymakers have long questioned the merits of claims that underlie disclosure-only settlement agreements, prior to very recently, courts have readily approved them.[27] In fact, these settlements with shareholders of a target company had become so popular that they began to be perceived as being a "transaction tax" or the cost of doing business that comes with an M&A deal.[28] In fact, some would say, that plaintiffs' counsel—presented with the opportunity of making easy, quick, and almost guaranteed legal fees of somewhere in the mid-six-figure-range—enthusiastically and vigorously pursue bringing such disclosure claims against corporations and their directors, capitalizing on the courts' seemingly unbridled willingness to approve such settlements.[29] From 2005 to 2014, for example, disclosure-only settlements in cases arising from a merger or acquisition with a value in excess of $100 million increased from 40 percent to nearly 95 percent.[30]

However, as M&A litigation continued to proliferate and disclosure settlements became the norm, the myriad problems associated with this approach became increasingly apparent and troubling to the courts resulting in an important shift in their disposition of these cases.[31] The Connecticut cases are in line with the trend of decisions from other jurisdictions and recent treatises on disclosure-only settlements, both concluding that the additional disclosures obtained as a result of the disclosure-only settlements are often of questionable value to the plaintiff class.[32] Frequently, they are found to be either trivial and/or unrelated to the issues the plaintiff class alleges were not adequately disclosed in the first place.[33] As one Delaware court explained, these disclosures tend to "fix something that didn't need fixing."[34] The marginal benefit the plaintiff class receives is even more troubling when considering the cost. As noted, often as part of these disclosure-only settlements, the company and director defendants obtain a broad release of known and unknown claims. The claims being released, however, have extended well beyond those of failure to disclose material aspects of a pending transaction by additionally encompassing breaches of fiduciary duties, which claims traditionally have served as an invaluable monitoring system over those who might use the corporate structure for personal gain or otherwise in a manner inimical to the interests of the company's stockholders.[35]

Conclusion

The Bushansky and Stein decisions represent the culmination of years of increasing concern over the profusion of disclosure-only settlements and their potential for abuse. Although the practical impact of these cases has yet to be seen, it is expected that there will be a decline in Connecticut in the filing of lawsuits that were previously aimed at procuring such settlements. **CL**



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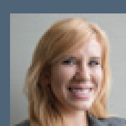

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Notes

1. See Matthew D. Cain, et. al., The Shifting Tides of Merger Litigation, Penn Law: Legal Scholarship Repository, at *9 (2017).
2. *Id.*
3. *Id.*
4. *Id.*
5. *Id.* at *2.
6. *Id.*
7. *Id.* at *3.
8. *Id.* at *7.
9. *Id.*
10. *Id.*
11. *Id.* at *8.
12. *Stein* v. *UIL Holdings Corp.*, Superior Court, judicial district of Stamford, Docket No. X08 FST CV-15-6025536-S 64 (April 10, 2017), 64 Conn. L. Rptr. 261 (April 10, 2017).
13. *See Id.* at *2.
14. *Id.* at *4.
15. *Id.*
16. *Id.*
17. *Id.* at *3.
18. *Id.*
19. *Id.*
20. *Id.*
21. *Id.* at *4.
22. *Stein, supra*, at *4.
23. *Id.* at *5.
24. *Id.*
25. *Id.* at *6.
26. *Id.*
27. Robert S. Reder & Lauren Messonnier Meyers, *Delaware Chancery Court Resets the Rules of the Road for Disclosure-Only Settlements*, 69 VAND. L. REV. 41, 43 (2016); *see also Delaware Court of Chancery Issues Definitive Ruling on Disclosure-Only Settlement Approvals*, Practical Law Legal Update w-001-3714, at 2 (accrediting the historically favorable treatment of disclosure-only settlements to U.S. courts' long-standing preference for a voluntary settlement of disputes).
28. *Id.*
29. See *Id.*
30. Matthew D. Cain, et al., *Takeover Litigation* in 2015 (Jan. 14, 2016), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2715890.
31. *See* Robert S. Reder & Lauren Messonnier Meyers, supra, at 44.
32. *See Id.*
33. *Id.*
34. *See Acevedo v. Aeroflex Holding Corp.*, C.A. No. 7930-VCL (Del. Ch. Jul. 8, 2015).
35. *See* Robert S. Reder & Lauren Messonnier Meyers, supra, at 42.