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202.588.0302 wlf.org

Absent Reform, Little Relief in Sight from Chronic "Merger Tax" Class-Action Litigation

by Anthony Rickey

For a brief moment in early 2016, the wave of mergers and acquisitions (M&A) litigation that was swamping American corporations seemed like it might recede. In recent years, plaintiffs greeted the announcement of almost every large merger with class-action complaints alleging that directors sought to sell a company too cheaply. By 2014, almost 95 percent of deals with publicly-traded targets valued at $100 million or more drew at least one lawsuit.[1] Plaintiffs usually settled for a handful of additional proxy disclosures that rarely affected the stockholder vote and a six- or seven-figure fee to class counsel. These predictable payments to the plaintiffs' bar became known as a "merger tax."

The Delaware Court of Chancery, in a widely-heralded January 2016 opinion, declared that this deal litigation had exploded "beyond the realm of reason."[2] Within eight months, Judge Richard Posner of the United States Court of Appeals for the Seventh Circuit echoed the sentiment in a ruling: "The type of class action illustrated by this case—the class action that yields fees for class counsel and nothing for the class—is no better than a racket. It must end."[3] It seemed as if judicial scrutiny might finally abolish the merger tax.

Today, however, critics of the merger tax have little reason for optimism. In 2016, class plaintiffs continued to subject almost three-fourths of large mergers and acquisitions to litigation.[4] To evade the Delaware Court of Chancery, plaintiffs now routinely recast state law causes of action as federal securities claims, leading the number of federal merger cases filed just in the first half of 2017 to exceed the total filed in 2016.[5] Even in Delaware, merger-tax collection remains a viable enterprise, with more than a dozen six-figure payouts to class plaintiffs for supplemental disclosures in 2016 and 2017. *See* Table 1.

Far from eliminating unwarranted merger litigation, Delaware has adopted a "mootness fee" practice that provides plaintiffs' counsel with quicker payouts while largely evading judicial or public scrutiny regarding their

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[1] *See In re Trulia, Inc. S'holder Litig.*, 129 A.3d at 884, 894 (Del. Ch. 2016).

[2] *Id*. at 894.

[3] *In re Walgreen Co. S'holder Litig.*, 832 F.3d 718, 724 (7th Cir. 2016).

[4] *See* Matthew D. Cain, *et al*., *The Shifting Tides of Merger Litigation*, Working Paper No. 17-19, Vanderbilt U. L. S. 21 (rev'd Mar. 29, 2017), *available at* http://ssrn.com/abstract_id=2922121 (73 percent of deals subject to litigation in 2016).

[5] *See* Kevin LaCroix, *First Half 2017 Securities Suit Filings Continue at Exceptional Levels*, The D&O Diary (July 5, 2017), http://www.dandodiary.com/2017/07/articles/securities-litigation/first-half-2017-securities-suit-filings-continue-exceptional-levels/ (noting that even in 2017 the "flood of merger objection lawsuit filings seems to be increasing"); Cornerstone Research, *Securities Class Action Filings—2017 Midyear Assessment* 5, *available at* https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2017-Midyear-Assessment (July 25, 2017) (showing 95 federal M&A class actions filed in 1H 2017 and 85 in all of 2016); Stefan Boettrich and Svetlana Starykh, *Securities Class Actions: 2016 Full-Year Review and Mid-2017 Flash Update*, Harv. L. S. Forum on Corporate Governance and Financial Regulation (July 24, 2017), https://corpgov.law.harvard.edu/2017/07/24/securities-class-actions-2016-full-year-review-and-mid-2017-flash-update/ (noting doubling of M&A-related federal securities lawsuits in 2016, despite 13% drop in M&A deals targeting US companies).

Anthony Rickey is a solo practitioner at Margrave Law LLC in Georgetown, DE.

fees. Given that litigation remains profitable, there is little reason to believe the majority of large mergers will not continue to face lawsuits. With no cure for the merger-tax problem in sight, and with cases spreading far beyond Delaware's borders, the time may be ripe for a federal legislative approach.

The Problem of Mootness Dismissals. The Delaware Court of Chancery's decision in *In re Trulia, Inc. Stockholder Litigation* attempted to address the merger-tax problem by emphasizing adversarial context in the resolution of M&A class actions.[6] After *Trulia*, parties seeking court-approved settlements would find their agreements subject to continued disfavor unless defendants provided supplemental disclosures that were plainly material under Delaware law.[7] As an adversarial alternative, the court proposed the "mootness fee" process: defendants could voluntarily disclose information and the plaintiffs would then drop their cases without prejudice to other stockholders. Plaintiffs' counsel could seek a mootness fee for the purported benefit to other members of the never-certified class, subject to challenge by defendants.[8]

Following *Trulia*, litigated mootness fees often led to less generous awards. For instance, the Delaware Court of Chancery awarded $50,000 to plaintiffs' counsel, rather than the requested $275,000, for eliciting supplemental disclosures that provided only a "modest benefit."[9] However, *Trulia* also offers a non-adversarial escape clause: parties to merger-tax litigation may agree on the amount of a mootness fee and, so long as they provide notice to stockholders (often through a filing with the Securities and Exchange Commission), end a case without formal court approval of the fee.[10] As Table 1 demonstrates, these mootness-fee agreements have become a common process for resolving merger-tax class actions in Delaware. Since *Trulia*, there have been at least seventeen such agreements concerning mootness fees, as opposed to three approved disclosure settlements.[11]

The availability of lucrative mootness fees contributes to the problem of merger-tax litigation. Negotiated fee agreements can exceed $300,000, not much less than the average fee available in post-*Trulia* court-approved settlements in the Delaware Court of Chancery. While agreed mootness fees are, on average, lower than settlement fees, the less burdensome process may mitigate the impact on the profits that go to plaintiffs' counsel. The parties typically do not provide individualized notice to the class. Plaintiffs' counsel never file for class certification or settlement approval. The parties are not obliged to endure confirmatory discovery in order to prove the value of the case to a court, or risk the appearance of an objecting stockholder. Ultimately, the shorter process means that plaintiffs are likely to receive payment more quickly.

Agreements for mootness fees, although streamlining the process of collecting the merger tax, suffer from a lack of transparency when compared to settlement practice. Plaintiffs who settle cases typically provide affidavits describing the nature of the work performed, the number of hours spent on behalf of the class, and plaintiffs' counsels' hourly rates. Stockholders and the public can use these filings to compare the final contingency award with what plaintiffs' counsel would have received on an hourly basis. Mootness dismissals ensure that this information is no longer public.

Although intended to restore adversarial scrutiny to resolution of corporate class actions, the mootness process instead enables a hybrid form of non-adversarial quasi-class litigation. Plaintiffs charge into court asserting claims on behalf of an allegedly injured class, dismiss actions as individuals, yet receive payment as if representing absent stockholders. This tactic circumvents processes meant to ensure that class claims are not pursued for private benefit, and that other stockholders may review actions undertaken in their name.

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[6] 129 A.3d 884 (Del. Ch. 2016).

[7] *See id*. at 898.

[8] *See id.* at 897-98.

[9] *In re Xoom Corp. S'holder Litig.*, 2016 WL 4146425, at *5 (Del. Ch. Aug. 4, 2016).

[10] *See Trulia*, 129 A.3d at 898.

[11] *See* William B. Chandler III and Anthony A. Rickey, *The Trouble with* Trulia*: Re-evaluating the Case for Fee-Shifting Bylaws as a Solution to the Overlitigation of Corporate Claims*, SSRN 43-45 & n.107 (last modified Apr. 4, 2017) (listing approved Delaware disclosure cases and noting fees between $300,000 and $375,000).

Mootness Dismissals in Federal Court. As M&A litigation has migrated to federal jurisdictions, mootness dismissals have followed, though not always with approval from reviewing federal courts. Parties to a merger lawsuit in the US District Court for the District of Minnesota recently stipulated to a $350,000 mootness fee for supplemental disclosures.[12] In another case in the same jurisdiction, the parties agreed to a $237,500 mootness fee to resolve merger litigation, although the court in that case declined to act on the stipulation, finding that no court approval was necessary.[13] More recently, three separate challenges to the same merger ended with different results. While the Northern District of Ohio entered one plaintiff's order dismissing the action while retaining jurisdiction to hear a fee request, two separate judges in the Southern District of Indiana refused, with one magistrate judge noting that the court was not willing to let a case "linger on the docket ... for the mere purpose of giving the plaintiff leverage in his attempt to negotiate the payment of an attorneys' fee."[14]

Federal mootness agreements stand in tension with the intent, if not the letter, of the Private Securities Litigation Reform Act of 1995 (PSLRA),[15] passed by Congress to restrain frivolous securities lawsuits. The PSLRA promotes transparency by forbidding parties from filing settlements to securities class actions under seal without prior court approval, and by requiring specific matters to be disclosed in notices of class settlements. By filing merger-tax cases as class actions but dismissing them as individual lawsuits, however, plaintiffs appear to bypass these requirements while receiving fees.

Little Relief in Sight. Merger-tax litigants retain a path to profit, and the prospects for a continued decline in these cases appear bleak. Delaware shows little appetite for reform. The Delaware General Assembly has not proposed responsive legislation following *Trulia*, and given that Delaware courts do not pass judgment on agreed fees in mootness dismissals, avenues for judicial relief appear limited.

Federal solutions may hold more promise, especially as merger-tax cases proliferate on federal courts' dockets. SEC Commissioner Michael Piwowar recently indicated that the Commission may be open to allowing companies to include mandatory shareholder-arbitration provisions in corporate charters when they contemplate initial public offerings.[16] Such provisions could restrict a plaintiff's options in merger-tax litigation. Similarly, though the Fairness in Class Action Litigation and Furthering Asbestos Claim Transparency Act of 2017, passed by the House of Representatives, does not directly consider mootness dismissals or fee agreements, similar legislation might address the problem.[17] The bill contains provisions limiting fee awards for class-action settlements based on equitable relief to a reasonable proportion of the value of such relief.[18] Similar legislation could specify that this restriction applies to mootness fee agreements as well as settlements. Better still, Congress could simply forbid payments to counsel for plaintiffs who file purported class actions but settle without certifying a class.

The mootness fee loophole contributes to the proliferation of merger-tax lawsuits. As these cases continue to plague federal courts, however, pressure for a federal solution should increase.

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[12] *See* Stipulation Regarding Closure of the Action, *Scarantino v. Silver Bay Trust Corp., et. al.*, Case No. 0:17-cv-01066-PAM-TNL (D. Minn. June 8, 2017). As of August 20, 2017, the proposed order accompanying the stipulation has not been approved by the Minnesota district court.

[13] *See* Docket Entry, *Pajnigar v. Arctic Cat Inc., et al.*, Case No. 0:17-cv-00443-WMW-HB (D. Minn.) (Mar. 28, 2017).

[14] Report and Recommendation to Dismiss the Plaintiff's Complaint, *Parshall v. Stonegate Mortgage Corp., et al.*, Case No. 1:17-cv-711-JMS-DML (S.D. Ind. Aug. 11, 2017) (noting that "the plaintiff's catalyst theory for obtaining a fee may be foreclosed" by Supreme Court authority). *Compare* Entry of Dismissal, *Feinstein v. Stonegate Mortgage Corp.*, Case No. 1:17-cv-794-WTL-DML (S.D. Ind. June 2, 2017) (dismissing case as moot without retaining jurisdiction for award of attorneys' fees) *with* Notice and Order, *Dubinsky v. Stonegate Mortgage Corp.*, Case No. 1:17-cv-478-DCN (N.D. Ohio June 12, 2017) (dismissing case and retaining jurisdiction to hear Plaintiff's counsel's request for attorneys' fees).

[15] Pub. L. 104-67, 109 Stat. 737 (1995).

[16] *See* Alison Frankel, *Shareholder Alert: SEC Commissioner Floats Class-Action-Killing Proposal*, REUTERS, https://www.reuters.com/article/us-otc-arbitration-idUSKBN1A326T (July 18, 2017).

[17] H.R. 985, 115th Cong. (2017).

[18] *Id.* § 1718 (b)(3).

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Figure 1: Selected Mootness Fees Post-*Trulia* (Delaware Court of Chancery)

Case	Date	Stipulated Mootness Fee	Delaware Plaintiffs' Counsel
MSS 12-09 Trust v. Colligan, et al., C.A. No. 12133-VCL	July 18, 2016	$350,000	Andrews & Springer LLC; Friedman Oster & Tejtel PLLC; Pomerantz LLP; O'Kelly & Ernst, LLC; Levi & Korsinsky, LLP
Akerman v. United Online, Inc., et al., C.A. No. 12321-VCS	Oct. 13, 2016	$275,000[SS]	Rigrodsky & Long, P.A.; Levi & Korsinsky, LLP; Weisslaw LLP; Biggs & Battaglia; Stull, Stull & Brody
Houston v. Carty, et al., C.A. No. 12235-CB	Nov. 21, 2016	$250,000[MDL]	Faruqi & Faruqi, LLP; Monteverde & Associates PC
Nahas v. Everbank Fin. Corp., et al., C.A. No. 12824-VCS	Nov. 22, 2016	$300,000[MDL]	O'Kelly & Ernst, LLC; Levi & Korsinsky, LLP
In re Sizmek Inc. S'holders Litig., C.A. No. 12718-VCMR	Dec. 19, 2016	$200,000	Andrews & Springer LLC; Rosenthal, Monhait Goddess, PA; Wolf Popper LLP
Hale v. Blue Nile, Inc., et al., C.A. No. 2017-0025-SG	Feb. 15, 2017	$125,000	Rigrodsky & Long, P.A.; Levi & Korsinsky, LLP
Anderson v. Sanger, et al., C.A. No. 12561-CB	Mar. 24, 2017	$300,000[MDL]	Faruqi & Faruqi, LLP; Monteverde & Associate PC
Mitsopoulos v. The Valspar Corp., et al., C.A. No. 12373-VCS	Mar. 13, 2017	$140,000	Rigrodsky & Long, P.A.; Levi & Korsinsky, LLP
Parshall v. DTS, Inc., et al., C.A. No. 12870-CB	Apr. 7, 2017	$100,000	Rigrodsky & Long, P.A.; RM Law, P.C.
Scheiner v. Ingram Micro Inc., et al., C.A. No. 12380-VCMR	Apr. 24, 2017	$142,500	Rigrodsky & Long, P.A.; Weisslaw LLP
Parshall v. Derma Sciences, Inc., C.A. No. 2017-0074-TMR	Apr. 25, 2017	$225,000[MDL]	Rigrodsky & Long, P.A.; RM Law, PC
In re PMFG, Inc. S'holder Litig., C.A. No. 11223-VCS[ML]	May 31, 2017	$75,000	Rigrodsky & Long, P.A.; Levi & Korsinsky, LLP; Brodsky & Smith LLC
In re B/E Aerospace, Inc. S'holder Litig., C.A. No. 12957-VCS	June 6, 2017	$150,000	Rigrodsky & Long, P.A.; Levi & Korsinsky, LLP
In re Intersil Corp. S'holder Litig., C.A. No. 12861-VCG	June 6, 2017	$150,000	Rigrodsky & Long, P.A.; Levi & Korsinsky, LLP
Charles v. Golden, et al., C.A. No. 12552-VCS	June 8, 2017	$87,500	Andrews & Springer LLC
In re Harman Int'l Indus., Inc. S'holder Litig., C.A. No. 13001-CB	July 26, 2017	$195,000	Faruqi & Faruqi, LLP; Monteverde & Associates PC; Levi & Korsinsky LLP
Parshall v. Lionbridge Techs., Inc., et al., C.A. No. 2017-0022-AGB	July 31, 2017	$100,000	Rigrodsky & Long, P.A.; RM Law, PC

[SS] Plaintiffs claimed credit both for eliciting supplemental disclosures and securing waiver of certain "don't-ask-don't-waive" standstill agreements.
[MDL] Order closing case indicates termination of multi-district litigation.
[ML] Indicates Margrave Law LLC involvement in case.

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