SULLIVAN & CROMWELL LLP

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In re Trulia, Inc. Stockholder Litigation

Delaware Chancery Court Rejects Proposed Disclosure-Only Settlement as Inadequate and Makes Clear That Disclosure-Only Settlements Will Only Be Approved if the Supplemental Disclosures Are "Plainly" Material and the Releases Narrowly Drawn

SUMMARY

In a decision[1] continuing the trend over the past year of increased judicial scrutiny of proposed settlements of stockholder merger litigation, the Delaware Court of Chancery (Bouchard, C.) rejected a disclosure-only settlement as inadequate, finding that the supplemental disclosures obtained by the plaintiffs were not "plainly" material and, thus, insufficient to support the release of stockholder claims against the defendants. The Court's decision makes clear that disclosure-only settlements will be met with "continued disfavor" unless the "get" of supplemental disclosures is "plainly" material in a way that "significantly alters the total mix of information made available" to stockholders (i.e., addressing a material misrepresentation or omission). In its decision, the Court expounds upon the pitfalls of non-adversarial disclosure-only settlements that have proliferated in the last decade despite the fact that many perceive them to lack any real benefit to stockholders, especially when combined with the loss of potentially valuable claims against targets and their directors that "have not been investigated with rigor," emphasizing that Delaware courts will be much more vigilant in their review of disclosure-only settlements in the future. Acknowledging that the plaintiffs' bar may attempt to reach disclosure settlements in other jurisdictions as a result of Delaware's stance, the Court, noting the availability of forum selection clauses, expressed its "hope and trust" that, if litigation were to move to other courts, those courts would reach the same conclusion as the Chancery Court on the issue.

BACKGROUND

Stockholders of Trulia, Inc. sought a preliminary injunction against the stockholder vote to approve a stock-for-stock merger transaction with Zillow, Inc., asserting breach of fiduciary duty claims against the Trulia directors and aiding and abetting claims against Trulia, Zillow and the ultimate Zillow holding company. The plaintiffs focused their claims on alleged material misstatements and omissions in the proxy statement, with only a cursory reference to alleged defects in the sale process and unreasonable deal protection measures. The parties agreed to expedited discovery, which entailed the production of less than 3,000 pages of documents and two depositions.

Shortly thereafter, the plaintiffs entered into a memorandum of understanding with the defendants to settle the litigation: the plaintiffs agreed to withdraw their injunction motion and to grant the defendants, on behalf of the putative class, a release of all claims (known or unknown) against the released parties relating to the transaction in exchange for certain supplemental disclosures relating to the description of the fairness opinion provided by the company's financial advisor, as well as the defendants' agreeing to not oppose the plaintiffs' counsel's fee request of up to $375,000. After the merger, which received the approval of 99% of the Trulia shares that voted, the parties submitted their proposed settlement for judicial approval. Following a request for supplemental briefing from the Court, the parties narrowed the claims release to remove unknown, foreign and federal and state antitrust claims from its ambit.

THE COURT'S DECISION

A. THE COURT'S HISTORICAL APPROVAL OF DISCLOSURE-ONLY SETTLEMENTS MUST EVOLVE.

The *Trulia* Court concluded that it was time for its "historical predisposition" of approving disclosure-only settlements that do not involve material supplemental disclosures to "evolve."[2] It held that, to support a release in a settlement, the supplemental disclosures must be "plainly" material, meaning "that it should not be a close call" that the supplemental information "significantly alters the total mix of information made available" to stockholders, and that even then, the release must be narrowly circumscribed to encompass solely the disclosure claims and, only if investigated sufficiently, any fiduciary claims related to the sale process.[3] Further, the Court announced that practitioners should expect that the Chancery Court will be "increasingly vigilant" in scrutinizing the "give" and "get" of settlements to ensure that they are fair and reasonable.[4]

In framing its analysis, the Court devoted considerable attention to the dynamics of disclosure settlements (where the sole or predominant consideration obtained by plaintiffs is supplemental disclosures), particularly in the context of the historical willingness of the Court to approve disclosure settlements of "marginal value" that contain broad releases and award six-figure attorneys' fees. Noting that "far too often" litigation in the acquisition context "serves no useful purpose for stockholders"[5] and may release unexplored but valuable fiduciary claims, which almost occurred in the high-profile *Rural/Metro* litigation,[6] the Court explained that there are powerful incentives working to self-expedite litigation and avoid the one point (the motion to expedite) where the Court can screen out frivolous claims before preliminary discovery. From the Court's perspective, the combination of (a) defendant boards' and companies' wanting to avoid an injunction and receive "deal insurance" in the form of broad releases and (b) plaintiffs' lawyers' wanting to earn a low-risk fee makes supplemental disclosures an "easy give" for a settlement that both sides advocate to a Court with a sparse record to evaluate its fairness.

In the Court's view, the "optimal" consideration of the merits of disclosure claims should be in an adversarial setting, whether in the context of a request for a preliminary injunction or in a request for an award of attorneys' fees after a target voluntarily supplements its proxy materials with the information sought by the plaintiff, thereby mooting the plaintiff's claims. As the Court noted, the mootness fee application process, which has become increasingly prevalent in Delaware merger litigation over the last year, provides defendants the opportunity, unaffected by a desire to obtain a release, to oppose attorneys' fees they view as excessive. And, because notice to stockholders is required as part of the mootness fee application, stockholders have an avenue to object to excessive fees as corporate waste. Moreover, the Court noted, even though defendants have not received formal releases in the mootness scenario, where plaintiffs dismiss their case with prejudice (but without prejudice to the other members of the putative class), that dismissal "likely represents the end of fiduciary challenges over the transaction as a practical matter,"[7] presumably a reference to the deferential business judgment standard applicable to a post-closing damages suit involving a merger transaction that is not subject to the entire fairness standard and that has been approved by a fully informed, uncoerced majority of the disinterested stockholders.[8]

The Court also suggested that to the extent fiduciary sales process claims remain in the case in either the preliminary injunction or mootness scenarios, "they may be amenable to dismissal," as the Court would continue to approach its analysis at the motion to dismiss stage "with special care" because "the risk of strike suits means that too much turns on the mere survival of the complaint."[9]

B. THE PROPOSED SETTLEMENT WAS NOT REASONABLE OR FAIR.

Turning to the proposed settlement, the Court concluded that it was not reasonable or fair because the "get" of supplemental disclosures supplying "additional minutiae" relating to the financial analysis presented to the Trulia board by its financial advisor in connection with the transaction was immaterial and not sufficient to support the "give" of the release in favor of the defendants. The Court held that Trulia's proxy statement had met the "fair summary" standard of disclosure regarding the substantive work of the company's bankers. Noting that a fair summary "is not a cornucopia of financial data, but rather an accurate description of the advisor's methodology and key assumptions,"[10] the Court concluded that the supplemental disclosures—such as including the publicly available multiples of each of the selected comparable transactions, which purportedly "supplemented" the previously disclosed high and low multiples for the group—were not material or "even helpful" to Trulia's stockholders. Moreover, the Court viewed the release as overbroad because it was not limited to the disclosure and fiduciary claims related to the Trulia board's decision to enter into the transaction, even though the parties had, prompted by the Court's questioning at the hearing, renegotiated the release to exclude unknown, foreign and antitrust claims.

IMPLICATIONS

The *Trulia* opinion confirms what other recent decisions from the Chancery Court have suggested about settlements of merger litigation: Delaware courts will be loath to approve disclosure-only settlements in the absence of compelling misstatements or omissions. Plaintiffs will need to show that any supplemental disclosure truly alters the total mix of information available to stockholders regarding the transaction to be voted on, and releases will need to be narrowly tailored to release only the claims that the record reflects were prosecuted and sufficiently investigated. Whether the amount of merger-related litigation will diminish further or simply move to a different jurisdiction is an open question, and will depend on the range of mootness fees awarded by the Chancery Court as well as the prevalence of Delaware forum selection clauses in corporate charters and bylaws. Without access to easy fee awards, the plaintiffs' bar may seek other, friendlier venues unless they are foreclosed from doing so by Delaware forum selection clauses, which Delaware targets are increasingly including in their bylaws at the time they approve transaction agreements. However, without the "insurance" of easy settlements, directors (and acquirors) will need to evaluate the benefits of keeping litigation in Delaware or risking the results of litigation in other jurisdictions, and it remains to be seen whether the price of a mootness fee provides any real benefit to defendants who wish to avoid litigation through voluntary disclosures. Finally, the Court's suggestion in *Trulia* that it might be more amenable to weeding out weak claims through dismissals at the motion to dismiss stage might present greater opportunities for companies and their boards to dispense with meritless merger litigation without resorting to uncertain settlements or attempts to moot claims through voluntary disclosures, and may continue to make Delaware the venue of choice.

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ENDNOTES

[1] *In re Trulia, Inc. Stockholder Litigation*, C.A. No. 10020-CB (Del. Ch. Jan. 22, 2016) [hereinafter *Slip. Op.*].

[2] *Slip. Op.* at 25.

[3] *Slip. Op.* at 24, 26.

[4] *Slip. Op.* at 2.

[5] *Slip. Op.* at 11.

[6] *See RBC Capital Markets, LLC* v. *Jervis*, -- A.3d --, 2015 WL 7721882 (Del. Nov. 30, 2015). For a discussion of the *Rural/Metro* litigation, see our publication, dated December 7, 2015, entitled "*RBC Capital Markets LLC* v. *Jervis*."

[7] *Slip. Op.* at 22.

[8] *See Corwin* v. *KKR Fin. Hldgs. LLC*, 125 A.3d 304, 308 (Del. 2015). For a discussion of the *Corwin* case, see our publication, dated October 5, 2015, entitled "*Corwin* v. *KKR Financial Holdings LLC*."

[9] *Slip. Op.* at 21.

[10] *Slip. Op.* at 29.

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