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Stamping Out Merger Objection Cases Expedited Proceedings: A Privilege Not a Right

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Since 2010, shareholders have sued to enjoin nearly every proposed merger involving a public corporation. Companies bemoan these lawsuits as a waste of resources but ultimately settle most of them, even if they believe that they have no merit, because the relevant standard (in the disclosure context, whether the omitted fact would ''significantly alter the total mix of information available'') is so amorphous that there can be no certainty that an injunction will not issue even in the most unmeritorious case.[1] Similarly, the buyers often prefer to settle because the monetary costs of a settlement are usually a small fraction of the deal price and the costs of settlement are often covered by the target's insurance company. And the insurance companies have duties to their insureds and generally prefer the certainty of a settlement rather then the risk of continued litigation. With each additional settlement, the momentum of further filings increases and the cycle continues. We propose a legislative solution that will halt this cycle by depriving plaintiffs of the ability to obtain expedited discovery on weak claims.

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Eliminating expedited discovery effectively erases plaintiffs' primary leverage to force pre-closing settlements. If plaintiffs do not get expedited discovery then they cannot build a record for their expected motion for a preliminary injunction to enjoin the transaction and the risk of such an injunction becomes significantly less likely or close to zero. In a recent case in the Delaware Court of Chancery, we opposed expedited discovery arising out of allegations that the directors of our client, the target corporation, had breached their fiduciary duties by recommending that the shareholders accept the tender offer and tender their shares of common stock

[1] *See, e.g., In re 3Com S'holders Litig.*, 2009 BL 281639 2009 WL 5173804 (Del. Ch. Dec. 18, 2009).

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pursuant to the offer. The plaintiffs claimed that the transaction resulted from an unfair process, was at an unfair price and that certain of the disclosures in the recommendation statement were materially misleading. In a hearing on plaintiffs' request for expedition, Vice Chancellor Parsons found that plaintiffs had not met their burden of pleading a ''colorable'' claim and thus declined to order expedited proceedings. Following the Vice Chancellor's decision, plaintiffs chose not to move for a preliminary injunction and ultimately dismissed the case.[2]

The law, however, often times makes it difficult for defendants to oppose expedited discovery successfully. Delaware courts allow expedited discovery if the plaintiff has asserted a ''colorable'' claim. This standard is lower than ''plausible'' (the Rule 8 standard for pleading a claim in federal court)[3]; ''specific'' (the standard for pleading demand futility in a fiduciary duty action)[4]; ''particularized'' (the Rule 9 standard for pleading fraud in federal court); or ''cogent and compelling'' (the standard in securities class actions governed by the Private Securities Litigation Reform Act of 1995 (the ''Reform Act'')).[5]

The solution we propose is thus elevation of the present standard for expedition (''colorable'') to the Rule 8 standard for pleading a claim (''plausible'') in any merger objection lawsuit. This would strike an appropriate balance between allowing expedited proceedings in potentially meritorious claims while sparing corporations the time and expense of defending unmeritorious claims.[6] It could be accomplished in a number of ways. Congress could make merger objection lawsuits subject to the exclusive jurisdiction of the federal courts and impose a heightened standard for expedited proceedings in such cases. This solution, however, would be contrary to the long standing principle that the law of the company's place of incorporation governs the fiduciary obligations of the company's directors and the broad body of law on these issues in Delaware where most public companies are incorporated. Alternatively, Congress and the legislatures of all 50 states could raise the standard for expedited proceedings in cases challenging merger transactions. This, however, seems logistically impossible.

We thus propose that Congress provide that federal courts have jurisdiction (including removal jurisdiction) over merger objection cases and that such cases will be subject to a heightened standard for expedited discovery. Recognizing Delaware's expertise in these issues, we do not propose to make all merger cases removable but just those brought in a jurisdiction other than a company's principal place of incorporation. We would then hope that the Delaware courts and legislature themselves would enact and/or apply a heightened standard before permitting expedited proceedings and retain jurisdiction over the vast majority of merger suits. This combination, if adopted, should result in most merger objection cases being filed in Delaware and proceeding to expedited discovery only if they meet the heightened standard.

Of course, companies do incorporate in states other than Delaware. Under our proposal, merger class actions could still be brought in those other states, but we believe any elevated standard for expedited discovery adopted by Delaware and Congress would be quickly emulated in other jurisdictions which, for the most part, already follow Delaware in interpreting corporate law. If the other states did not follow Delaware, then companies seeking to avail themselves of the heightened standard for expedited discovery could reincorporate in Delaware and, if they chose not to, would have at least decided for themselves to be subject to a lower expedited discovery standard if sued in connection with a merger.

We recognize that there have been other proposed solutions to the exponential increase in merger objection lawsuits such as amending the company's articles of incorporation and/or bylaws to require that cases get filed in the state of incorporation (usually Delaware). These efforts, however, have been subject to tremendous push back and such solutions only take care of the problem of cases being filed in multiple jurisdictions. They do not deal with the incentives that result in multiple plaintiffs filing or the incentives to file frivolous cases with the expectation that defendants will ultimately have to settle. In contrast, we believe that our solution is more comprehensive and also allows public companies to work together to solve this problem rather than do so only on a piecemeal, company-by-company basis.

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[2] *Coyne v. Kensey Nash Corp., et al.*, No. 7508-VCP (Del. Ch. June 5, 2012).

[3] *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007); *Ashcroft v. Iqbal*, 556 U.S. 662 (2009).

[4] *Aronson v. Lewis*, 473 A.2d 805 (1984); *Rales v. Blasband*, 634 A.2d 927 (1991).

[5] *Tellabs Inc. v. Makor Issues & Rights*, 551 U.S. 308 (2007).

[6] It is obviously possible to raise the standard for expedited discovery even higher such as the ''specific'' standard applied in cases alleging demand futility and/or the Reform Act standard in cases alleging securities fraud. Such higher standards, however, apply in situations where there is no real reason under any circumstances for the cases to proceed quickly. In contrast, legitimate merger objection lawsuits must move quickly because shareholder votes are often scheduled to occur shortly after a merger is announced.

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