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Corporate Litigation:

Judicial Scrutiny of Mootness Fees in Merger Litigation

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In recent years, courts in Delaware and elsewhere have scrutinized attorney fees sought in connection with shareholder challenges to proposed mergers where the relief to a putative class of shareholders is limited to additional disclosures in the proxy statement of the terms, financials, or circumstances of the transaction. Federal district courts, in particular, are increasingly skeptical of so-called "mootness fees" sought by plaintiffs' counsel when, prior to a motion to dismiss, the defendant addresses alleged misrepresentations or omissions in its proxy by providing additional disclosures.

A recent pair of decisions in federal court—*House v. Akorn*, 385 F. Supp. 3d 616 (N.D. Ill. 2019), and *Scott v. DST Systems, Inc.*, 2019 WL 3997097 (D. Del. Aug. 23, 2019)—highlight courts' willingness to probe supplemental disclosures to ascertain whether shareholders received a material benefit warranting an award of attorney fees, as part of a settlement or otherwise.

Background

In its influential decision in *In re Trulia, Inc.*, 129 A.3d 884 (Del. Ch. 2016), the Delaware Court of Chancery admonished judges to be "increasingly vigilant in applying [their] independent judgment" when evaluating disclosure-only settlements and to evaluate the "reasonableness of the 'give' and 'get' of such settlements." Under, *Trulia* such settlements should be approved only where the supplemental disclosures address a "plainly material" misrepresentation or omission and any proposed release is "narrowly circumscribed." The *Trulia* standard has been adopted by a number of courts, including the U.S. Court of Appelas for the Seventh Circuit in *In re Walgreen Co. S'holder Litig.*, 832 F.3d 718 (7th Cir. 2016).

In the wake of *Trulia*, it is has become more common for plaintiffs' counsel to seek more modest "mootness fees" directly from the defendant as part of a negotiated agreement to voluntarily dismiss the litigation with respect to the named plaintiffs only, or to move the court for an attorney fee award following plaintiffs' own voluntary dismissal. In *Trulia* and subsequent decisions, the Delaware Chancery Court has endorsed private mootness fee settlements that do not require court approval as long as shareholders are put on notice of the expenditure of corporate funds to resolve the litigation.

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And, under Delaware law, where a defendant will not agree to pay a mootness fee and the plaintiff instead moves for one, the plaintiff need not show that the supplemental disclosures made in response to the lawsuit were "plainly material," but that they were at least "helpful" or provided "some benefit." E.g., *In re Xoom Corp. Stockholder Litig.*, No. CV 11263-VCG, 2016 WL 4146425, at *3 (Del. Ch. Aug. 4, 2016). Outside of Delaware, however, courts increasingly scrutinize the propriety of mootness fees awards under the more exacting "plainly material" standard.

'House v. Akorn'

In 2017, a number of shareholders filed suit in the Northern District of Illinois challenging Akorn's disclosures about its proposed acquisition by Frensenius Kabi AG under Section 14 of the Securities Exchange Act. In response, defendants made supplemental disclosures mooting plaintiffs' claims, and agreed to pay plaintiffs' counsel $322,500 in exchange for voluntary dismissal of the lawsuits. Thereafter, shareholder Theodore Frank—a repeat objector to class action settlements—moved for permission to intervene to challenge the mootness fee. The district court denied leave to intervene, holding that the putative class (and Frank) were unharmed by the settlement because it did not include any release of claims by the class. But, clearly troubled by the quick albeit private settlement, the court invoked its "inherent powers to police potential abuse of the judicial process" and ordered briefing on whether the settlement should be abrogated under the "plainly material" *Trulia /Walgreens* standard, permitting Frank to participate as amicus curiae. See *House v. Akorn, Inc.*, 2018 WL 4579781 (N.D. Ill. Sept. 25, 2018).

In June, the district court abrogated the settlement agreements and ordered plaintiffs' counsel to return their attorney fee payment to Akorn. Although the parties' briefing focused on whether Akorn's supplemental disclosures were "plainly material," the court focused instead on whether the putative class action should have been "dismissed out of hand" on the basis of the disclosures *sought* by the plaintiffs in their pleadings, not what Akorn subsequently disclosed. The court parsed plaintiffs' allegations seeking further disclosure of GAAP reconciliation of the proxy's projections regarding the merged company; certain components of the analysis performed by J.P. Morgan, Akorn's merger adviser; the compensation received by J.P. Morgan from Akorn and Fresenius; other potential buyers considered by the board; and pending litigation against the Board of Directors. Concluding that these requested disclosures were "worthless to shareholders" and thus that the plaintiffs' suit should have been "dismissed out of hand," the district court "exercise[d] its inherent authority to rectify the injustice that occurred" as a result by unwinding the settlement: "The settlements provided Akorn's shareholders nothing of value, and instead caused the company in which they hold an interest to lose money."

'Scott v. DST Systems'

Another federal district court recently reached a similar result in a Section 14 disclosure challenge in connection with the 2018 merger of DST Systems with SS&C Technologies. Scott v. DST Systems, Inc., No. 1:18-CV-00286-RGA, 2019 WL 3997097 (D. Del. Aug. 23, 2019). Following commencement of litigation by three plaintiffs, DST voluntarily supplemented its proxy statement, mooting the lawsuits and prompting plaintiffs' counsel to seek $100,000 in attorney fees. In analyzing the fee application, the Court applied Third Circuit law permitting an award of attorney fees as an equitable matter only where the plaintiff conferred a "substantial benefit" to class members. Further, where, as in DST Systems, the litigation is mooted prior to final judgment, attorney fees will be awarded where the suit was meritorious when filed, i.e., could have survived a motion to dismiss.

The court denied the attorney fee application based solely on the plaintiffs' failure to demonstrate a "substantial benefit," without reaching the question whether the suits had merit to begin with. Thus, unlike the Akorn court, the court in DST Systems analyzed the supplemental disclosures actually made, not the allegedly misleading omissions identified by the plaintiffs in their complaints. But, like in Akorn, the court invoked the standard for materiality set out in Trulia and Walgreens. After addressing supplemental disclosures concerning certain analyses of cash flow and comparable transactions, the court concluded that the plaintiffs had failed to meet their burden to show they had provided a substantial benefit entitling them to attorney fees. In so holding, the court rejected the plaintiffs' reliance on case law, law review articles, and attorney argument, faulting them for failing to "develop a factual record or proffer expert opinions" in support of their assertions the supplemental proxy disclosures were material.

Conclusion

Delaware courts have declined to apply the same exacting inquiry to mootness fees the they have required in the disclosure-only settlement context post-*Trulia*. The recent decisions in *Akorn* and *DST Systems* reflect an emerging trend in federal court to permit mootness fees only where the disclosures sought (as in *Akorn*) or obtained (as in *DST Systems*) are particularly strong and useful to shareholders. The divergent approaches may reflect, in part, differing levels of comfort with private settlements some may perceive as business-as-usual. While the *Trulia* court reiterated "the right of a corporation's directors to exercise business judgment to expend corporate funds" to settle a mooted lawsuit, with notice to its shareholders, 129 A.3d at 898, the *Akorn* court saw settlements made "to avoid the nuisance of ultimately frivolous lawsuits" and "to avoid [] judicial review" as part of a "racket" of strike suits that must end, 385 F. Supp. at 623. In rejecting plaintiffs' fee motion, the court in *DST Systems* was not presented with the specter of a possibly coercive settlement, but nonetheless betrayed impatience with the plaintiffs' conclusory assertions that the supplemental disclosures were, in fact, material.

The *Akorn* plaintiffs have appealed to the Seventh Circuit, with briefing to commence later this month. It remains to be seen whether the Seventh Circuit will agree with the district court that the "plainly material" standard should apply to private as well as class action settlements.
