Simpson Thacher

Securities Law Alert

KEY DEVELOPMENT IN M&A LITIGATION

# Seventh Circuit: Raises the Possibility of Sanctions Against Class Counsel Seeking Mootness Fees

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On April 15, 2024, the Seventh Circuit issued a long-awaited opinion addressing a would-be intervenor's objection to mootness fees paid in connection with M&A strike suits brought challenging proxy disclosures in a public company merger transaction. *Alcarez v. Akorn*, 2024 U.S. App. LEXIS 9070 (7th Cir. 2024) (Easterbrook, J.). The Seventh Circuit vacated an order denying the shareholder's motion to intervene and remanded, instructing the district court to treat him as an intervenor.[1] Notably, the Seventh Circuit raised the possibility of sanctions against plaintiffs' counsel pointing out that a district judge has discretion under Federal Rule of Civil Procedure 11(c)(4) over the choice of sanction, and stating that "the court would be entitled to direct counsel who should not have sued at all to surrender the money they extracted from [the U.S. company]." The Seventh Circuit's decision is notable as it is believed to be the first federal appellate court review of mootness fee payments to resolve M&A strike suits.

## Background and Procedural History

This litigation arose when plaintiffs brought six lawsuits claiming that the target company's proxy statement failed to make certain disclosures in violation of Section 14(a) of the Securities Exchange Act. Subsequently, the company made some supplemental disclosures, and all six plaintiffs voluntarily dismissed their claims. Plaintiffs later told the district court that any claim to attorneys' fees and costs (the so-called mootness fees) had been resolved by a payment of $322,500. After learning of the mootness fees, a company shareholder filed a motion to intervene and asked the court to require counsel to disgorge the mootness fees—asserting that the attorneys had not achieved any benefit for investors—or issue an injunction blocking mootness fees in future cases. Before the district judge could rule, some of plaintiffs' attorneys disclaimed their portions of the $322,500. The district judge denied the shareholder's motion to intervene. The shareholder appealed and the Seventh Circuit put the appeals on hold pending the disposition of the three remaining cases, in which some attorneys still sought the $322,500. In these three cases, the district judge again denied the shareholder's motion to intervene but permitted him to

[1] The Seventh Circuit pointed out that in a class action when the representative plaintiffs and defendants reach a deal, "intervention by a member of the class may be essential to protect the class's interests." Furthermore, the court noted that it has "told judges to grant intervention freely when a class member contends that the representatives (or, more realistically, their lawyers) are misbehaving."

participate as *amicus curiae*. Reopening the suits, the district judge concluded that the complaints were frivolous, and found that the extra disclosures were worthless to investors. The judge then ordered counsel to return the $322,500 to the company. *House v. Akorn*, 385 F. Supp. 3d 616 (N.D. Ill. 2019). Two of the plaintiffs appealed this decision, seeking an order that would allow two of the attorneys to retain the $322,500. The shareholder also appealed, seeking both to intervene and additional relief.

## The Seventh Circuit Weighs the Available Remedies

The Seventh Circuit concluded that disgorgement was not a satisfactory remedy because the district judge had ordered the money returned and that an injunction against the attorneys was not satisfactory because they were not parties, and therefore not the proper objects of injunctive relief. Instead, the Seventh Circuit turned to the applicability of 15 U.S.C. §78u–4(c)(1) of the PSLRA. The statute states that in any private action arising under the Securities Exchange Act, the court shall include in the record, upon final adjudication of the action, specific findings regarding compliance by parties and their attorneys with each requirement of FRCP 11(b).[2] The Seventh Circuit then noted that the six suits invoked Section 14(a) of the Securities Exchange Act, the dismissal of each suit was a "final adjudication of the action" and then stated that the statute "obliges the judge to determine whether each suit was proper at the moment it was filed."

The Seventh Circuit stated that it was inclined to agree with the district court's analysis, which concluded that plaintiffs' cases "should have been dismissed out of hand" based on its findings that the disclosures were worthless to shareholders, that the company paid the attorneys' fees to avoid the nuisance of ultimately frivolous lawsuits, and that the settlements caused the company to lose money. Critiquing the district court's reliance on its "inherent authority" to abrogate the settlement agreements and order plaintiffs' counsel to return the mootness fees, the Seventh Circuit stated that the district court should have relied on §78u–4(c)(1) and Rule 11. The Seventh Circuit then observed that "because Rule 11(c)(4) gives the district judge discretion over the choice of sanction, the court would be entitled to direct counsel who should not have sued at all to surrender the money they extracted from [the company]. But selecting an appropriate remedy (if any) should await resolution of the proceedings under §78u–4(c)(1) and, derivatively, Rule 11."

[2] FRCP 11(b) generally provides that an attorney certifies that a pleading, written motion, or other paper is not being presented for any improper purpose (such needlessly increasing the cost of litigation); that the claims, defenses, and other legal contentions are warranted by existing law; that the factual contentions have or will have evidentiary support; and that the denials of factual contentions are warranted.

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