CORPORATE LITIGATION:

MOOTNESS FEES IN DISCLOSURE-FOCUSED DEAL LITIGATION

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"Mootness fees" to plaintiffs' counsel after a voluntary dismissal have become a standard feature of deal litigation resolved before a stockholder motion to enjoin a transaction based on alleged proxy disclosure deficiencies is decided. After the sudden but widespread adoption in Delaware and elsewhere of sharp limitations on "disclosure-only" settlements—where the parties agree to settle solely on the basis of supplemental proxy disclosures in exchange for comprehensive class-wide releases of all claims relating to the transaction (followed by class counsel's fee application for contributing to the disclosure benefit)—mootness fees have replaced disclosure-only settlements as the ordinary method of resolving disclosure-focused deal litigation. This column explains the important differences between these two approaches to resolving deal litigation. It also examines a recent federal decision currently on appeal to the Seventh Circuit in which the court, unlike Delaware courts, when addressing a negotiated mootness fee decided to "exercise its inherent powers to police potential abuse of the judicial process—and abuse of the class mechanism in particular—and require plaintiffs' counsel to demonstrate that the disclosures for which they claim credit" were "plainly material" to stockholders—a standard Delaware reserves for disclosure-only class-wide settlements. *House v. Akorn.*, 2018 WL 4579781, at *3 (N.D. Ill. Sept. 25, 2018). The continuing migration of deal litigation from Delaware to other fora (usually federal court to avoid Delaware forum selection clauses) makes *Akorn* an important read.

Background

Non-monetary benefits provided by a settlement, such as corporate governance and other therapeutic changes, additional disclosures in a proxy statement, or modifications to a merger agreement can provide fair, reasonable and adequate consideration for the release of class claims. The availability of disclosure-only settlements to obtain a classwide release in transaction litigation, however, has receded dramatically. In the seismic Court of Chancery decision *In re Trulia, Inc.*, 129 A.3d 884 (Del. Ch. 2016), Chancellor Bouchard cautioned courts 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." *Trulia* directed that disclosure-only settlements be approved only where the supplemental disclosures address a sufficiently material misrepresentation or omission, "and the subject matter of the proposed release is narrowly circumscribed to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sale process, if the record shows that such claims have been investigated sufficiently." With a broad classwide release of "any and all claims" arising from a transaction no longer

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obtainable on the basis of supplemental disclosures to shareholders, almost overnight the disclosure-only settlement which was once the norm in transaction litigation became scarce and the "mootness fee" became ascendant.

It has long been the case that, settlement or no settlement, plaintiffs' counsel is entitled to a reasonable fee where "the suit was meritorious when filed; action producing benefit to the corporation was taken by the defendants before a judicial resolution was achieved; and the resulting corporate benefit was causally related to the lawsuit." *Allied Artists Pictures Corp. v. Baron*, 413 A.2d 876, 878 (Del. 1980). Mootness fees are paid under one of two scenarios: (1) a negotiated fee agreement in which the defendant agrees to pay a specific amount to class counsel, or (2) a court-awarded sum on a contested fee motion where class counsel seeks monetary credit for contributing to the defendant taking action that mooted class action or derivative claims. It bears emphasis that under either scenario, defendants do not obtain a classwide release; only the named plaintiffs are bound by the voluntary dismissal that precedes a mootness fee (a limitation that ordinarily translates into a substantially reduced fee than was obtainable when accompanied by a broad settlement release).

In Delaware, when defendants agree to pay a negotiated mootness fee in recognition of a benefit conferred on stockholders, the court does not decide any question of mootness or the amount of the fee. The payment is a matter between the named plaintiffs-only and the defendants; the decision to pay is a "business judgment of the board, as in any expenditure of corporate funds." *Swomley v. Schlecht*, 2015 WL 1186126, at *2 (Del. Ch. March 12, 2015). To safeguard against potential collusion, the court will require that any payment of fees be disclosed to shareholders (typically in a Form 8-K filing and on plaintiffs' counsel's website) before any voluntary dismissal of putative class or shareholder derivative claims. When the claims include putative derivative claims, notice also is required by rule when "compensation in any form has passed directly or indirectly from any of the defendants to the plaintiff or plaintiff's attorney." Ct. Ch. R. 23.1(c). The notice should describe the claims that were rendered moot and how the action taken by the defendants rendered them moot. The notice must disclose the amount of the fee and identify the payor, state that the court has not passed on the fee amount, and provide contact information for plaintiffs' counsel and defense counsel. In Delaware, that ends the court's involvement with the fee. If any stockholder objects to payment of a mootness fee, "the question of mootness and the propriety of the action taken to moot the claims or the payment of the fee can be challenged in a later [presumably shareholder derivative] case." *Swomley*, 2015 WL 1186126, at *2.

If the parties do not reach agreement on a mootness fee, plaintiffs needs to move for a fee and prove entitlement to one, and that the amount sought is reasonable in relation to the purported benefit their action conferred. The key difference between contested fee applications made in the disclosure-settlement and mootness fee contexts is the less exacting standard applied in evaluating entitlement to a mootness fee. A Delaware court will award a fee in a disclosure settlement only if class counsel's actions contributed to defendants' decision to make "plainly material" supplemental proxy disclosures. A mootness fee may be awarded at a lower threshold than the *Trulia* settlement standard: a disclosure that is "helpful"or provides "some benefit" is sufficient. Pre-*Trulia*, "[m]eaningful supplemental disclosures" often yielded contested fee awards in the range of $400,000 to $500,000, but Delaware courts do not confer "unhealthy windfalls," and therefore will award "minimal fees" when litigation efforts confer only "minimal benefits." *In re Sauer-Danfoss S'holders Litig*., 65 A.3d 1116, 1136-37, 1141 (Del. Ch. 2011). More recently, median mootness fees are closer to $250,000.

'House v. Akorn'

Akorn departed from the Delaware framework, under which any stockholder challenge to a negotiated mootness fee occurs in separate derivative litigation. Six suits were filed in the Northern District of Illinois challenging Akorn's disclosures about its proposed acquisition by Frensenius Kabi AG. The parties agreed that defendants mooted plaintiffs' claims of inadequate disclosure by making supplemental disclosures. Defendants agreed to pay plaintiffs' counsel $322,500 for contributing to the additional disclosures, and all plaintiffs filed voluntary dismissal stipulations. More than two months after voluntarily dismissals, frequent class action settlement objector Theodore Frank moved to intervene to assert a breach of fiduciary duty claim against class counsel and object to the mootness fee as "a misuse of the class action device for private gain." In response, plaintiffs' counsel in three of the cases disclaimed any fees, which the court ruled mooted Frank's motion to intervene in those cases. Plaintiffs' counsel in the remaining cases opposed Frank's bid to intervene, and the district court denied leave to intervene on standing grounds because Frank alleged no harm to the putative class: while class counsel owes fiduciary duties to the class even pre-certification, a mootness dismissal does not prejudice any rights of the class (which releases no claim and makes no payment to counsel). Akorn made the settlement payment, making any claim of loss a derivative claim belonging to the corporation.

In Delaware, that would be the end unless a stockholder initiated derivative litigation to pursue that claim. The *Akorn* court, however, determined that the Seventh Circuit's oft-expressed criticism of fee awards in the context of class settlements of weak disclosure claims—which the court acknowledged was inapplicable because Akorn involved no class settlement—nevertheless warranted extending to the mootness fee context the "plainly material" disclosures standard adopted in *In re Walgreen Co. S'holder Litig.*, 832 F.3d 718 (7th Cir. 2016) for disclosure settlements. The court justified grafting this requirement onto a private settlement (which did not require court approval) as an exercise of "inherent powers to police potential abuse of the judicial process—and abuse of the class mechanism in particular—and require plaintiffs' counsel to demonstrate that the disclosures for which they claim credit meet the *Walgreen* standard." The court invited Frank to be heard on the issue as amicus curiae in further proceedings to determine if plaintiffs' counsel's negotiated fees should be disgorged. Frank is pursuing a parallel appeal from the intervention denial to the Seventh Circuit, where plaintiffs will seek its dismissal for lack of standing and untimeliness of proposed intervention.

Conclusion

Shareholder litigation upon announcement of a significant corporate transaction remains a near-certainty, making uniform rules for their prosecution and resolution important. Delaware takes the view that if the corporation agrees to pay plaintiffs' counsel attorney fees as part of a mootness dismissal, that is a private transaction between the corporation and plaintiffs' counsel. A Delaware court's involvement is limited to ensuring that any payment of fees is disclosed to shareholders before any dismissal, so that if class members object to the payment of a mootness fee they may challenge the payment in subsequent derivative litigation. *Akorn* has opened the door in federal court to judicial review of the appropriateness of a mootness fee in relation to the strength of the supplemental disclosures. *Akorn* is before the Seventh Circuit, with merits briefing to begin next month. It also remains to be seen how the district court, applying the *Walgreen* standard, will address the attorney fee disgorgement request. Last week, the district court directed the parties to file briefs addressing whether it should stay consideration of fee disgorgement pending resolution of the Seventh Circuit appeals.