2017 DEVELOPMENTS IN SECURITIES AND M&A LITIGATION

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Overview

The trend of increased securities class action filings in federal courts continued from 2016 to 2017. Federal court filings of class actions related to M&A transactions again contributed to the increase. Foreign issuers remained frequent targets of federal securities class actions.

In 2017, the federal courts issued a number of important securities law decisions. Addressing the application of statutory time-bars applicable to securities law violations, the Supreme Court ruled in CalPERS that the Securities Act’s repose period is not subject to class action tolling and held in Kokesh that disgorgement in SEC proceedings is subject to the five-year statute of limitations for penalties. The Court granted cert petitions on the effect of SLUSA’s amendments to the Securities Act, the application of American Pipe tolling to subsequent class actions and, in January 2018, the status of SEC administrative law judges. The circuit and district courts issued decisions on several contested securities law topics, including insider trading liability, Rule 23’s predominance requirement, rebuttal of the fraud-on-the-market presumption and the due diligence defense.

With respect to M&A litigation, the Delaware Supreme Court issued key rulings on appraisal issues in DFC Global and Dell, and is expected to provide further guidance in the coming months. The Court of Chancery continued to extend business judgment protections to controlling stockholder transactions that are conditioned on the approval of an independent special committee that meets its duty of care and a fully informed, uncoerced vote by minority stockholders. The trend of increased M&A litigation filed outside the Court of Chancery, in an apparent response to these recent developments, as well as the Trulia and Corwin decisions, has also continued.

2 Id.
3 Id.
Securities Litigation

Supreme Court Rules on Statutes of Repose and SEC Disgorgement

Effect of Statutes of Repose.

In California Public Employees’ Retirement System (CalPERS) v. ANZ Securities, Inc., the Supreme Court clarified that the class action tolling rule established in American Pipe & Construction Co. v. Utah is a rule of equitable tolling and held that class action tolling does not apply to the three-year statute of repose in Section 13 of the Securities Act. Cleary Gottlieb served as co-counsel to the respondents in CalPERS.

As the Court asserted, “the object of a statute of repose, to grant complete peace to defendants, supersedes the application of a tolling rule based in equity.” The Court confirmed that the three-year period in Section 13 is a statute of repose, based on Section 13’s language, operation and two-sentence structure, as well as the Securities Act’s legislative history. Analyzing American Pipe, the Court concluded that the decision’s holding and reasoning were based on traditional equitable powers.

Statute of Limitations for SEC Disgorgement.

The Supreme Court unanimously held in Kokesh v. Securities and Exchange Commission that disgorgement in SEC proceedings operates as a penalty and is thus subject to the five-year limitations period for enforcement proceedings seeking a penalty, reasoning more broadly that a sanction is a penalty if its purpose is (1) to redress an offense against the state, rather than a private injury, and (2) punishment and deterrence, as opposed to compensation. Significantly, the Court also suggested, in a footnote, that the authority to order disgorgement in SEC proceedings as well as the application of disgorgement principles in this context may

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1 137 S. Ct. 2042 (2017).
3 CalPERS, 137 S. Ct. at 2051-52.
4 Id. at 2052.
5 Id. at 2049-50.
6 Id. at 2051-52.
7 137 S. Ct. 1635 (2017).
8 Id. at 1639, 1642.
be subject to challenge. Cleary Gottlieb submitted an amicus brief supporting the petitioner on behalf of the American Investment Council.

Since the decision, courts have grappled in other contexts with how to apply the standard set forth in Kokesh for assessing whether a sanction is a penalty. In one case, the Eighth Circuit held that an injunction from acting as an unregistered broker in violation of Section 15(a) of the Exchange Act was not a penalty, reasoning that the injunction only required compliance with the law, was based on evidence of likely violations of the law and was imposed for the purpose of protecting the public from future violations by the defendant, rather than for punishment. The court explained that the deterrent effect of the injunction did not make it a penalty, noting that deterrence was an incidental effect of the injunction, not its primary purpose, and that an injunction may have specific deterrent effects on an individual without being punitive. In another case, Saad v. Securities and Exchange Commission, a fractured panel of the D.C. Circuit remanded a case to the SEC to consider whether, in light of Kokesh, a permanent bar on a broker-dealer’s registration with FINRA was remedial or “impermissibly punitive.” In a concurrence, Judge Kavanaugh concluded that, after Kokesh, “expulsion or suspension of a securities broker is a penalty, not a remedy,” because it does not compensate victims or remedy their losses. By contrast, Judge Millett, who authored the majority opinion remanding the case, wrote separately to express her view that Kokesh has no bearing on the SEC’s decision to sustain FINRA’s permanent bar against a securities broker. Judge Millett explained that the SEC was exercising supervision over FINRA rather than enforcing laws, that prior Supreme Court cases have held that “occupational debarment” is “nonpunitive” and that the SEC’s decision was designed to protect investors.

As expected, defendants have invoked the footnote in Kokesh to challenge courts’ authority to order disgorgement in SEC enforcement proceedings. Thus far, courts have not accepted those arguments, although they have recognized that Kokesh has introduced uncertainty into the field.

**Supreme Court Expected To Decide Several Securities Cases This Term**

**State Court Securities Act Class Actions.**

On November 28, the Supreme Court heard oral argument in *Cyan, Inc. v. Beaver County Employees Retirement Fund* concerning the effect of amendments made by the Securities Litigation Uniform Standards Act of 1998 (SLUSA) to the Securities Act’s removal and jurisdictional provisions. Cleary Gottlieb submitted an amicus brief supporting the petitioners on behalf of former SEC Commissioners.

While some courts have held that SLUSA deprives state courts of jurisdiction over class actions asserting Securities Act claims and have permitted such actions to be removed to federal court on that basis, others have held that such cases are not removable or that state courts possess jurisdiction over such suits. The Acting Solicitor General, in an amicus brief, took a middle-ground position that SLUSA does not strip state courts of jurisdiction over class actions to enforce the Securities Act, but separately allows defendants to remove such actions to federal court.
During argument in the Supreme Court, the Justices highlighted how difficult it was to discern Congress’s intent from the text of the relevant provisions, with Justice Alito referring to the language as “gibberish” and asking whether any meaning could be drawn from the text. Justices Kennedy and Ginsburg questioned whether the Court could consider the government’s proffered middle-ground position since the case had never been removed, and the issue was therefore not squarely before the Court.

The Supreme Court’s decision should provide guidance on the effect of SLUSA’s amendments to the Securities Act. The question of whether SLUSA made federal courts the exclusive venue for class action litigation under the Securities Act matters in particular because the procedural protections of the Private Securities Litigation Reform Act of 1995 are available in federal courts, but not necessarily in state courts. A decision is expected before the end of June.

Class Action Tolling.

The Supreme Court granted a cert petition in *China Agritech, Inc. v. Resh* on December 8 to resolve a circuit split on whether *American Pipe* tolling applies to subsequent class actions, or is limited to subsequent individual actions. Appellate courts have divided over whether and in what circumstances class actions may also benefit from *American Pipe* tolling.

As we discussed in our Mid-Year Review, the Ninth Circuit in the decision below joined the Sixth and Seventh Circuits in holding that class actions may benefit from class action tolling after the expiration of the applicable statute of limitations. These circuits are in conflict with the First, Second, Fifth and Eleventh Circuits, which have rejected *American Pipe* tolling for class actions based on the potential for abuse and considerations of judicial economy, including to avoid serial re-litigation of adverse decisions and indefinite extensions of statutes of limitations. They are also in conflict with the Third and Eighth Circuits, which have held that *American Pipe* tolling can apply to subsequent class actions “where class certification has been denied solely on the basis of the lead plaintiffs’ deficiencies as class representatives, and not because of the suitability of the claims for class treatment.”

*China Agritech* presents another opportunity, after *CalPERS*, for the Court to address the outer bounds of the class action tolling rule and protect against serial class actions. Oral argument and a decision are expected before the end of this term.

SEC Administrative Law Judges.

On January 12, 2018, the Supreme Court granted a cert petition in *Lucia v. Securities and Exchange Commission* to resolve a circuit split on whether SEC Administrative Law Judges (ALJs) are inferior officers whose appointment failed to satisfy, as would be required, the Appointments Clause, or employees outside the scope of the provision.

Over the past year, fractured circuit courts have divided on the status of SEC ALJs. In the decision below, a panel of the D.C. Circuit concluded that SEC ALJs are employees because their decisions do not become final unless “the politically accountable Commissioners have determined that an ALJ’s initial decision is to be the final action of the Commission.” An evenly divided court denied the petition for review after rehearing en banc.

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26 See id. at 37, 45.
29 Basch v. Ground Round, Inc., 139 F.3d 6 (1st Cir. 1998); Korwek v. Hunt, 827 F.2d 974 (2d Cir. 1987); Salazar-Calderon v. Presidio Valley Farmers Ass’n, 765 F.2d 1334 (9th Cir. 1985); Griffin v. Singletary, 17 F.3d 356 (11th Cir. 1994).
30 Yang v. Odom, 392 F.3d 97, 111 (3d Cir. 2004); see also Great Plains Tr. Co. v. Union Pac. R.R. Co., 492 F.3d 986, 987 (8th Cir. 2007).
33 Raymond J. Lucia Cos. v. United States Sec. & Exch. Comm’n, 868 F.3d 1021 (D.C. Cir. 2017) (per curiam) (entering new judgment affirming the decision under review pursuant to D.C. Cir. Rule 35(d)).
In contrast, in Bandimere v. Securities and Exchange Commission, a divided panel of the Tenth Circuit reached the opposite conclusion, holding that SEC ALJs—even if they may not have final decision-making power—are inferior officers because they “exercise significant discretion” in carrying out “important functions,” including the authority to shape the administrative record and issue initial decisions, and whose appointment are therefore subject to the requirements of the Appointments Clause. The Tenth Circuit set aside the SEC order under consideration, and denied the government’s petition for rehearing en banc over the dissent of two judges.

The Lucia defendants filed a cert petition in the Supreme Court, which the Court ultimately granted. The SEC also filed a petition in Bandimere, which it asked the Court to hold pending consideration of the Lucia petition due to concerns about Justice Gorsuch’s ability to participate in Bandimere because he was on the Tenth Circuit when the SEC filed a petition for rehearing en banc.

While the cert petitions were pending, the government took a different position from the one it had adopted below, asserting in Lucia that SEC ALJs are inferior officers because they exercise significant authority. The government nevertheless asked the Supreme Court to grant the Lucia petition to resolve the circuit split and appoint an amicus curiae to defend the judgment below. The SEC subsequently issued an order purporting to ratify the appointment of its ALJs in an effort to address challenges based on the Appointments Clause. Nonetheless, if the Court agrees with the defendants in Lucia, prior SEC decisions could be overturned as unconstitutional exercises of authority.

**Item 303 Liability.**

The Supreme Court had previously granted cert in Leidos, Inc. v. Indiana Public Retirement System to resolve a circuit split on whether the failure to make a disclosure required by Item 303 of SEC Regulation S-K can give rise to claims under Section 10(b) and Rule 10b-5 of the Exchange Act, but stayed proceedings after the parties announced a settlement, following full merits briefing. In the case on appeal, the Second Circuit relied on its previous holding that a failure to make a disclosure required by Item 303 is an omission that can give rise to a Section 10(b) claim, which conflicts with the Ninth Circuit’s decision in In re NVIDIA Corporation Securities Litigation that such omissions cannot create liability under Section 10(b). Cleary Gottlieb filed an amicus brief in the Supreme Court on behalf of the Society for Corporate Governance in support of the petitioner.

As a result of the proposed settlement, the Supreme Court likely will not resolve the circuit split this term. We expect that plaintiffs will continue to file Section 10(b) claims in the Second Circuit based on alleged Item 303 omissions. The Supreme Court has indicated its interest in the issue and may soon have another opportunity to address it.

**Insider Trading**

In United States v. Martoma, the Second Circuit addressed an important question concerning insider trading liability that the Supreme Court left open last year in its decision in Salman v. United States, and held in a 2-1 decision that its prior requirement of a

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34 844 F.3d 1168 (10th Cir. 2016).
35 Id. at 1179-91, 1184.
36 Id. at 1188.
38 Id. at *9.
39 Br. of Resp’t at 9-10, Lucia (Nov. 29, 2017).
40 Id. at 10.
42 See Reply Br. of Pet’rs at 6-8, Lucia (Dec. 13, 2017).
45 768 F.3d 1046 (9th Cir. 2014).
46 869 F.3d 58 (2d Cir. 2017).
47 137 S. Ct. 420 (2016).
“meaningfully close personal relationship” between the tipper and tippee was no longer good law.\(^48\)

In *Salman*, the Supreme Court rejected the Second Circuit’s prior holding in *United States v. Newman* that a gift of inside information to family or friends could support an insider trading conviction only if the tipper received something of a “pecuniary or similarly valuable nature” in exchange.\(^49\) *Salman* left open whether, as the Second Circuit also held in *Newman*, an insider trading conviction based on a gift of inside information required proof of a meaningfully close personal relationship between the tipper and tippee.\(^50\)

Invoking the Supreme Court’s decisions in *Salman* and *Dirks v. Securities and Exchange Commission*,\(^51\) the Second Circuit held that “an insider or tipper personally benefits from a disclosure of inside information whenever the information was disclosed ‘with the expectation that [the recipient] would trade on it,’ and the disclosure ‘resemble[s] trading by the insider followed by a gift of the profits to the recipient,’ whether or not there was a ‘meaningfully close personal relationship’ between the tipper and tippee.”\(^52\) The majority thus rejected the defendant’s challenge to the jury instructions, which was based principally on a failure to comply with *Newman*.\(^53\) The dissent argued that because the definition of a “gift” is vague and subjective, the court’s decision expanding the situations in which a gift of insider information could result in liability had “radically alter[ed] insider-trading law for the worse.”\(^54\)

The defendant filed a petition for rehearing or rehearing en banc, which is currently pending before the Second Circuit.\(^55\)

**Predominance and Ascertainability Requirements for Class Certification**

In a decision with significant consequences for the certification of classes asserting claims concerning securities that do not trade on domestic exchanges, the Second Circuit held in *In re Petrobras Securities*\(^56\) that the district court was required to consider whether individualized questions regarding the location of putative class members’ purchases of securities traded over-the-counter defeated the predominance requirement of Rule 23(b)(3).\(^57\) Cleary Gottlieb served as counsel to Petrobras on this appeal.

Addressing the application of the predominance requirement to claims regarding “domestic transactions” under *Morrison v. National Australia Bank Ltd.*\(^58\) the Second Circuit stated that the district court was required to consider whether the determination of the domestic nature of the transactions is (1) material to the class claims and (2) “susceptible to generalized class-wide proof.”\(^59\) The Second Circuit held that the nature of the transactions was material to the class claims and that the district court therefore erred by failing to meaningfully address the second issue.\(^60\) The Second Circuit vacated and remanded the class certification order with respect to predominance.\(^61\)

The Second Circuit also held that to satisfy Rule 23’s ascertainability requirement, a proposed class only needs to be definite and defined by objective criteria,
and it does not need to be administratively feasible. The decision deepened a split between the Third, Fourth and Eleventh Circuits, which require plaintiffs to establish a reliable method for identifying class members prior to class certification, and the Sixth, Seventh and Ninth Circuits, which have permitted class actions to proceed without a proposed reliable means of identifying class members.

**Fraud-on-the-Market Presumption**

In *Petrobras*, the Second Circuit also held that evidence of empirical data showing that a company’s stock price moved in the appropriate direction in response to news (directional event studies) is not always a necessary condition for proving market efficiency to invoke the fraud-on-the-market presumption of reliance, pursuant to *Basic Inc. v. Levinson*. According to the court, such evidence was not required at the class certification stage where the plaintiffs submitted other empirical and non-empiric evidence of market efficiency. The *Petrobras* defendants filed a cert petition in the Supreme Court challenging the Second Circuit’s rulings on ascertainability and the fraud-on-the-market presumption. Following an agreement by the parties to settle the lawsuit, the Supreme Court granted a joint motion to defer consideration of the petition pending the district court’s approval of the proposed settlement.

Building on its decision in *Petrobras*, the Second Circuit held in *Waggoner v. Barclays PLCC* that to show market efficiency, as required to invoke the presumption of reliance, plaintiffs need not offer any direct evidence of price impact in certain circumstances. The court declined to provide clear guidance on the specific circumstances where such evidence would be necessary, but indicated that it may be required where other indirect factors—such as trading volume, market capitalization and volume of analyst coverage—are less persuasive in showing market efficiency. The court held further that to rebut the presumption at the class certification stage, defendants must “demonstrate a lack of price impact by a preponderance of the evidence . . . rather than merely meet a burden of production.”

*Waggoner* created a circuit split with the Eighth Circuit, which has held that defendants can defeat the Basic presumption by “com[ing] forward with evidence showing a lack of price impact.”

In *Arkansas Teachers Retirement System v. Goldman Sachs Group, Inc.* the Second Circuit reaffirmed its holding in *Waggoner* that the burden for rebutting the Basic presumption is a preponderance of the evidence, but clarified that to meet this standard, defendants need not provide “conclusive evidence” that there was no link between the price decline and the alleged misrepresentation. Because it was unclear whether the district court had correctly applied the evidentiary standard, the Second Circuit vacated the class certification decision and remanded the case to the district court. The Second Circuit also held that the district court, in determining whether the defendants successfully rebutted the Basic presumption, erred in refusing to consider the defendants’ event study showing that there was no price decline in response to earlier disclosures.

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62 Id. at 264.
64 See, e.g., *Rikos v. Procter & Gamble Co.*, 799 F.3d 497, 524-25 (6th Cir. 2015); *Mullins v. Direct Dig., LLC*, 795 F.3d 654, 672 (7th Cir. 2015); *Briones v. CanAgra Foods, Inc.*, 844 F.3d 1121, 1123 (9th Cir. 2017).
65 In re *Petrobras Securities*, 962 F.3d at 278.
67 In re *Petrobras Securities*, 962 F.3d at 277-78.
69 See Docket for No. 17-664, Supreme Court of the United States.
70 875 F.3d 79 (2d Cir. 2017).
The appeals court disagreed with the district court’s characterization that the evidence was an “inappropriate truth on the market defense” or evidence of the statements’ immateriality, which could not be considered at the class certification stage. Although the Second Circuit “espouse[d] no views as to whether the [defendants’] evidence is sufficient to rebut the Basic presumption,” it held that “the District Court should consider it on remand.” The decision therefore indicates that defendants may be able to rebut the presumption by identifying earlier disclosures of the alleged fraud that did not have any impact on the securities’ price.

**District Court Finds Defendants Successfully Rebutted Fraud-on-the-Market Presumption**

The Northern District of California found that defendants in *In re Finisar Corp. Securities Litigation* successfully rebutted the presumption of reliance through evidence of a lack of a statistically significant increase in the stock price following the alleged misstatements. The court asserted that in the absence of controlling caselaw from the Supreme Court or the Ninth Circuit on the relative importance of the date of the alleged misstatement compared to the alleged corrective disclosure date in analyzing price impact, defendants could rebut the presumption by showing no front-end price impact. Remarking that a “stated rationale” for focusing on the corrective disclosure date is based on the so-called price maintenance theory, the court noted that plaintiff had not proceeded on that theory, and also observed that because the alleged misstatements had no price impact, “it cannot be presumed that the [later corrective] disclosures revealed a latent price impact” of the statements. Based on defendants’ rebuttal of the presumption of reliance, the court denied plaintiff’s motion for class certification because plaintiff had not shown that common questions of reliance would predominate over individual questions. *Finisar*, like the Eighth Circuit’s 2016 *IBEW Local 98 Pension Fund v. Best Buy Co.* decision, shows one way for rebutting the presumption that courts have accepted.

**Second Circuit Affirms $806 Million Judgment in RMBS Trial**

In a decision addressing several issues under the Securities Act, the Second Circuit in *Federal Housing Finance Agency for Federal National Mortgage Ass’n v. Nomura Holding America, Inc.* affirmed an $806 million judgment, following a bench trial, against Nomura, RBS and certain affiliates in connection with the sale of residential mortgage-backed securities (“RMBS”) to Freddie Mac and Fannie Mae in the years before the financial crisis. The Second Circuit affirmed the district court’s finding that defendants violated Sections 12(a)(2) and 15 of the Securities Act, and analogous state securities laws, by falsely stating that the loans underlying the RMBS “were originated generally in accordance with the pertinent underwriting guidelines.”

Among other rulings, the Second Circuit affirmed the district court’s summary judgment decision that no reasonable jury could find that defendants had exercised “reasonable care,” as required to establish Section 12(a)(2)’s due diligence defense. The court determined that Nomura, which served as the sponsor, depositor and occasional underwriter of the RMBS, “could not be reasonably sure of the truth” of the representations regarding the loans’ adherence to underwriting guidelines because, among other reasons, the diligence conducted was limited to a sample of loans, an “audit Nomura commissioned . . . raised serious red flags about the efficacy of its due diligence procedures” that Nomura did not correct, and Nomura failed to...
increase the size of its sample even after observing problems with “nearly double the normal amount of loans.”\footnote{Id. at 132-33.} With respect to two transactions, RBS, as the lead or co-lead underwriter, “did not adequately discharge [its] responsibility as an underwriter to verify independently the representations in the offering documents,” the Second Circuit concluded, because it “relied entirely on Nomura’s diligence.”\footnote{Id. at 104, 133.} RBS’s diligence for two other transactions fell short, according to the Second Circuit, in part because the bank reviewed about 6% of the underlying loans, “even though it believed the loans in [one] Securitization were ‘crap,’” and overrode nearly all of the failing grades in the samples.\footnote{Id. at 133-34.} The Second Circuit rejected defendants’ arguments that their diligence comported with industry practices at the time, characterizing their conduct as “scattershot compliance with industry custom.”\footnote{Id. at 134.} Describing the RMBS industry in the period before the financial crisis as a “textbook example of a small set of market participants racing to the bottom to set the lowest possible standards for themselves,” the court suggested that defendants could not have satisfied the reasonable care standard even if their conduct on the whole had complied with industry customs.\footnote{Id.}

The Second Circuit also rejected defendants’ “negative loss causation” argument that the losses in security value were entirely attributable to macroeconomic factors related to the financial crisis, rather than the challenged misstatements.\footnote{Id.} The court agreed with the district court that the financial crisis, the misstatements and the securities’ losses were linked in the same causal chain, determining that the record suggested that loan origination practices of the sort concealed by the misstatements had contributed to the crisis.\footnote{Id. at 153-56.} The Second Circuit discounted defendants’ argument that any contribution that the misstatements had made to the crisis was “[t]iny.”\footnote{Id. at 155-56 (alteration in original).} The court acknowledged that it was difficult to separate loss attributable to misstatements from loss attributable to macroeconomic factors, but that this difficulty benefited the plaintiff since defendants bore the burden of proof on loss causation for the Section 12 claims.\footnote{Id. at 155.}
M&A Litigation

Appraisal Actions

In the first of two highly anticipated decisions in appraisal cases, the Delaware Supreme Court in *DFC Global Corp. v. Muirfield Value Partners, L.P.*\(^\text{100}\) concluded that the Court of Chancery’s determination that the company’s fair value was 7.5% higher than the deal price was not supported by the record, which showed a robust and conflict-free sale process.\(^\text{101}\) The court explained that the standard for deferring to the trial court’s determination of fair value is whether it “has a reasonable basis in the record and in accepted financial principles relevant to determining the value of corporations and their stock.”\(^\text{102}\) Applying that standard, Chief Justice Strine concluded that neither the regulatory risks facing the company nor the mere fact that a private equity buyer won the transaction made the deal price any less reliable an indication of fair value.\(^\text{103}\) Nonetheless, the court declined to establish a bright-line rule in favor of deferring to the deal price in arm’s-length mergers, reasoning that the text of the appraisal statute empowers the Court of Chancery to determine fair value by taking “all relevant factors” into account.\(^\text{104}\) The court reversed and remanded the case, noting that the Chancellor “may conclude that his findings regarding the competitive process leading to the transaction, when considered in light of other relevant factors,...suggest that the deal price was the most reliable indication of fair value.”\(^\text{105}\)

In *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*,\(^\text{106}\) the Delaware Supreme Court applied the standard set forth in *DFC* to hold again that the record did not support the Court of Chancery’s decision to assign no weight to the deal price in determining the company’s fair value.\(^\text{107}\) As the court explained, it appeared instead that “the deal price deserved heavy, if not dispositive, weight” based on the record, which included “evidence of market efficiency, fair play, low barriers to entry, outreach to all logical buyers, and the chance for any topping bidder to have the support of [the CEO’s] own votes.”\(^\text{108}\) The court disagreed with the trial court’s conclusion that the deal price does not reflect fair value in management-led buyouts due to (1) structural issues, (2) risks resulting from asymmetries in information and (3) management’s inherent value to the company, noting based on the record that those features were absent from the transaction in question.\(^\text{109}\) As in *DFC*, the court in *Dell* also rejected a “private equity carve out” from using the deal price as a reliable indication of

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\(^{100}\) 172 A.3d 346 (Del. 2017).

\(^{101}\) Id. at 349.

\(^{102}\) Id. at 348-49.

\(^{103}\) Id. at 372-76.

\(^{104}\) Id. at 348-49.

\(^{105}\) Id. at 351.


\(^{107}\) Id. at *16.

\(^{108}\) Id. at *16, *26.

\(^{109}\) Id. at *22-25.
Remanding the case, the court noted that the Vice Chancellor has the discretion “to enter judgment at the deal price if he so chooses, with no further proceedings.”

We expect that *Dell* and *DFC* will continue to reduce appraisal risk for most arm’s-length mergers going forward, including management-led buyouts and deals with financial sponsors. These decisions may also support an argument that deal price should be given some weight in an appraisal action involving a controlling stockholder buyout if the transaction complied with the requirements set forth in *Kahn v. M&F Worldwide Corp.* (“*MFW*”).

Another appraisal case, *ACP Master, Ltd. v. Sprint Corp.* (“*Clearwire*”), is pending before the Delaware Supreme Court. Plaintiffs, minority stockholders in a company acquired by its controlling stockholder, appealed the Court of Chancery’s ruling that the fair value of the company was less than half of the actual deal price. The Court of Chancery did not consider the deal price in determining the company’s fair value because the transaction involved a buyout by a controlling stockholder, the deal price was inflated by synergies from the transaction, the parties had not asked the court to give weight to the deal price and the record contained other reliable evidence of fair value.

We expect that the Delaware Supreme Court’s decision in *Clearwire* will provide further guidance on the determination of fair value in controlling stockholder transactions.

### Controlling Stockholder Transactions

In *In re Martha Stewart Living Omnimedia, Inc. Stockholder Litigation*, the Court of Chancery extended the standard set forth in *MFW* to transactions involving the sale of a controlled company to a third party, even when the controlling stockholder receives disparate consideration for its shares. *MFW* held that in buyouts by controlling stockholders, the business judgment rule applies at the pleadings stage if the transactions are conditioned on the approval of both an empowered, independent special committee that meets its duty of care and a fully informed, uncoerced vote by a majority of the minority stockholders.

The court disagreed with the controlling stockholder’s arguments that “the risks and incentives differ significantly as between two-sided controller transactions and one-sided controller transactions where the controller is alleged to have competed with the minority for consideration” and that strict adherence with the *MFW* conditions is not required in the latter circumstance for the business judgment rule to apply at the pleadings stage. But the court also rejected the plaintiffs’ position that the *MFW* procedural protections must be in place at the outset of negotiations between the controlled company and the third party, holding instead that the trigger for the *MFW* protections is the beginning of negotiations between the controlling stockholder and the third party for additional consideration, which is when the potential conflict with the minority stockholders emerges.

The *Martha Stewart* decision shows that significant incentives exist for controlling stockholders and directors to insist on procedural protections that allow the parties to replicate arm’s-length bargaining.
Trends in Merger Litigation

In 2017, stockholders challenged 85% of completed deals over $100 million, following a substantial decrease in the volume of merger litigation in 2016.122 Plaintiffs’ attorneys have continued to file merger litigation in federal courts and other states in an apparent response to the recent developments in Delaware, including the In re Trulia, Inc. Stockholder Litigation123 decision enhancing scrutiny of disclosure-only settlements and the Corwin v. KKR Financial Holdings124 decision enhancing the stockholder ratification defense.125 We will watch these cases as they proceed to evaluate the extent to which other courts will follow the precedent set in Delaware.

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123 129 A.3d 884 (Del. Ch. 2016).

124 125 A.3d 304 (Del. 2015).

125 Cain, supra note 122, at 3-6.
Looking Ahead

In the coming months, we will be watching for decisions by:

The Supreme Court on SLUSA, *American Pipe* tolling and SEC administrative law judges.

The Second Circuit on the petition for rehearing regarding insider trading.

The Delaware Supreme Court on appraisal.

Federal and state courts on disclosure-only settlements.
## Contacts

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