Delaware's Retreat: Backing Away From Private Enforcement

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U.S. Dispersed Ownership System

- Public corporations in the US generally have dispersed ownership
- This results in management control over the firm and can lead to excessive agency costs unless shareholders engage in monitoring of corporate management
- Monitoring can come in different forms – voting, selling and suing are the three principal ones
- Shareholder litigation can serve a monitoring function, deterring bad behavior and compensating shareholders for losses from managerial misconduct, but can also generate litigation agency costs as plaintiffs' lawyers' incentives diverge from those of their shareholder clients

Public Securities Law Enforcement

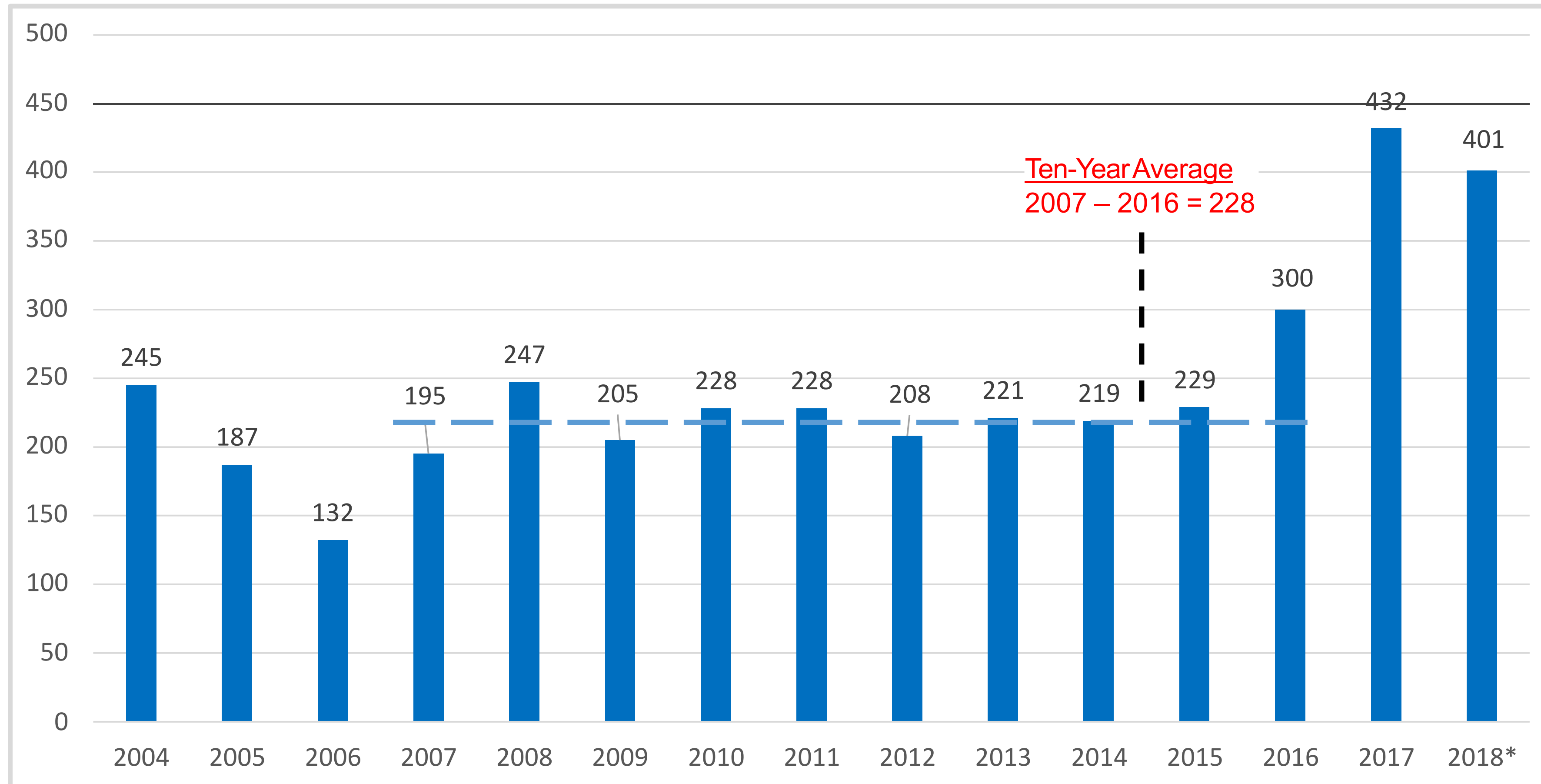
- SEC seeks to enforce the federal securities laws
- SEC has broad regulatory and enforcement authority over securities transactions.
- Division of Enforcement and the Justice Department are the parties responsible for initiating the suits
- Generally effort level and targeting varies with ruling political appointees
- In many countries, these are the only enforcers

Overview of Private Shareholder Litigation

- Federal securities fraud class actions – approximately 230 cases a year; substantial dollar settlements; hotly litigated. Also significant government enforcement efforts.
- State law acquisition-oriented class actions: in 2000s, about 100 consolidated actions per year in Delaware
- Derivative law suits: about 35 public company cases per year in Delaware state court – 1999-2000 data
- Derivative law suits in federal court: weaker cases that follow securities class actions – about the same level as state court

Private Enforcement -- U.S. Federal Securities Class Action Filings

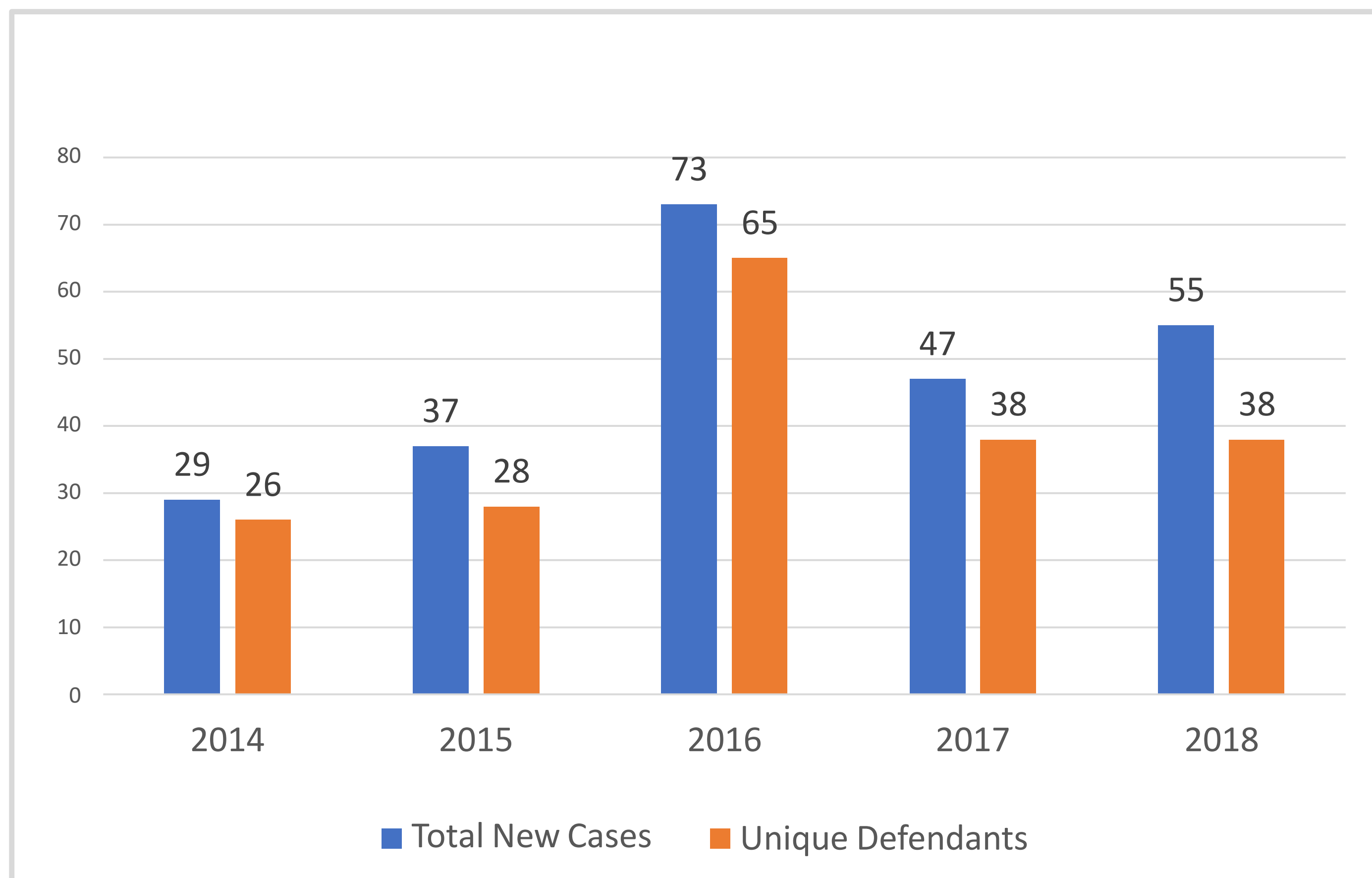
January 1, 2004 – November 15, 2018



*2018 on track for 458 newly filed cases

Global (Non-North American) Securities Fraud Class Action Activity

January 1, 2014 – November 15, 2018

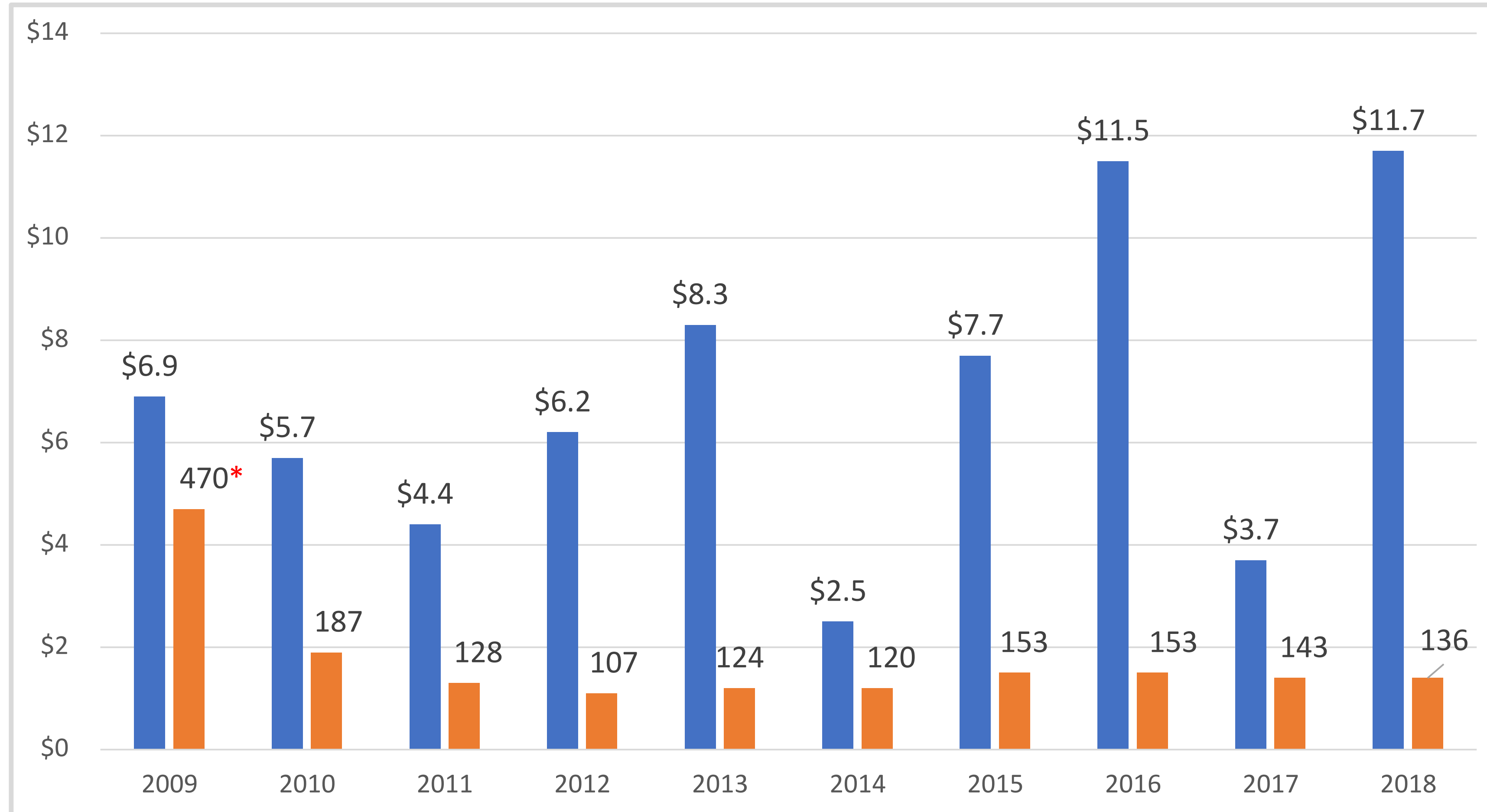


Most Active Countries	
• Taiwan	74
• Australia	72
• Israel	25
• Germany	16
• United Kingdom	15
• Netherlands	14
• Denmark	5
• Japan	5
• South Korea	4
• Brazil	2
• Italy	2
• Portugal	2

Greece, Luxembourg, Russia, Spain, South Africa – 1 Each

Private Securities Class Action Settlements

10 Year Overview – Includes All Settlements (U.S. Federal, State, SEC; Non-U.S.)



*Includes 300 IPO Laddering Settlements

Federal Reforms in Private Securities Litigation Reform Act (1995)

- Lead plaintiff provision – investor with the largest financial interest is presumed to be most qualified to be class representative. Designed to induce public pension funds to participate in this capacity – greater shareholder monitoring
- Heightened pleading requirement for scienter, the intent to deceive element of a Rule 10b-5 action
- Discovery stay until after resolution of the motion to dismiss the complaint is resolved
- Safe Harbor for forward looking statements

Corporate Law Shareholder Litigation: Two Major Forms are Derivative and Class Action

- U.S.Supreme Court once saw derivative suits as “the chief regulator of corporate management” Cohen v. Beneficial Loan Corp., 337 U.S. 541, 548 (1949)
- Merger and Acquisition Cases – some big plaintiff victories
- Example: $2 billion in damages (and $300 million in attorneys’ fees) in class action suit alleging corporation overpaid in purchasing a company 99.15% owned by its controlling shareholder. In re Southern Peru

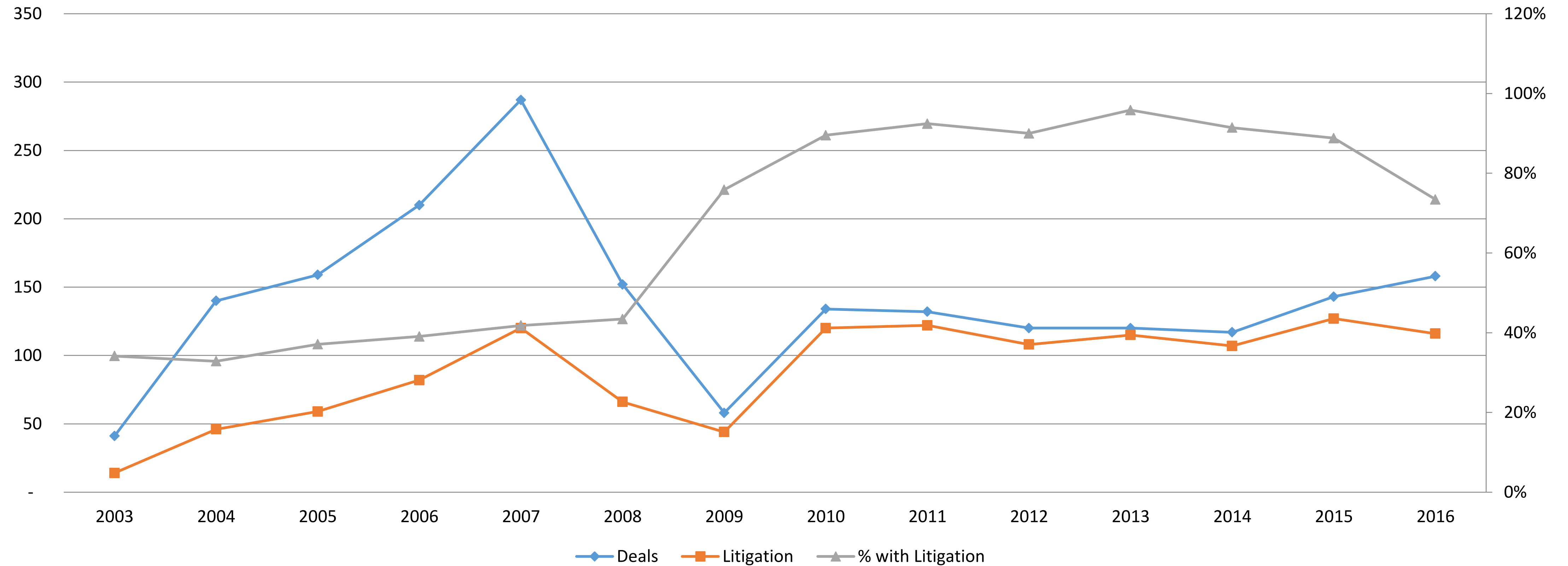
Deriviative Suits Reform Efforts

- 1940s: Concerns about frivolous small claims lead many states to require plaintiff to post bond for defense costs when bringing derivative suit
- 1960s: Demand required on directors prior to shareholder bringing derivative suit
- 1980s: Special Litigation Committees endorsed by key state courts

Mergers and Acquisitions: The New Problem

- Shareholders claim directors sold the company for too little
  - Usually a matter of state corporate law with internal affairs doctrine (state of incorporation)
  - Prior to 2015, generally file cases in state of incorporation
  - Plaintiff can also file in state court in headquarters' state of target firm
  - Can also file in federal court
  - Choice of filing venue is critical to the story

Merger Litigation Exploded in mid-2000's



What happened?

- Small number of high value cases with $100+ million in damages awarded – cadre of top plaintiffs' firms litigate these cases
- Most cases challenge board actions in Revlon sales of the company, but those claims are hard to win so instead they focus on alleged disclosure violations
- Disclosure-only cases settle without any monetary damages but with attorneys' fee award for plaintiffs' counsel and release for defendants of all claims arising out the transaction
- How did Delaware respond?

Act 1--Forum Selection Bylaws (2015)

- First the Delaware courts and later the Delaware legislature approve of forum selection bylaws.
- Boards retain the power to waive them.
- The net effect of these bylaws is to funnel state court deal litigation to Delaware.
- By August 2014, 746 US public companies have adopted them.

Act 2– Crackdown on Disclosure Only Settlements

- In response to a perception that disclosure only settlements are being abused, the Delaware Chancery Court starts rejecting them or reducing the requested fee awards in 2015.
- Shortly thereafter, Chancellor Bouchard decides In Re Trulia (2016): need plainly material disclosures and tailored release to get court approval of settlement
- Bouchard also holds out the possibility that plaintiffs can dismiss their cases after defendants supplement their disclosures and then seek a "mootness" fee award approved by the Court or privately negotiated by parties without court approval

Act 3-- Delaware Substantive Law Changes

- In a major shift, the Delaware Supreme Court in 2016 decides in Corwin case that for Revlon cases, informed shareholder approval of a deal in an uncoerced vote will result in BJ rule review.
- This allows bidders in a contested sale or hostile takeover to still seek injunctive relief prior to a shareholder vote on a deal, but effectively eliminates post-closing damage actions unless the deal disclosures are defective or there is express conflict of interest for directors.

Act 1+2+3 Lead to Shifts in Filing Patterns

- The net effect of these changes is that Delaware has become a less attractive venue for filing deal litigation. The 2017 data show that plaintiffs have responded by moving to federal courts.
- Delaware filings drop -- % deals challenged in Delaware goes from 61% in 2015 to 9% in 2017.
- Filings in other state courts decrease -- % deals challenged in other states goes from 51% in 2015 to 18% in 2017.
- **Federal filings increase** -- % deals challenged in federal court goes from 20% in 2015 to 87% in 2017.

Table 1: Filings by Deal Completion Year						
	Deals	% with_Litigation	% Delaware*	% Other_States*	% Federal*	% Filed in Multiple Jurisdictions
2003	41	34%	7%	100%	7%	7%
2004	140	33%	43%	78%	0%	33%
2005	159	37%	39%	66%	7%	14%
2006	210	39%	21%	82%	12%	17%
2007	287	42%	28%	86%	13%	35%
2008	152	43%	23%	92%	21%	31%
2009	58	76%	34%	98%	20%	50%
2010	134	90%	49%	88%	26%	53%
2011	130	92%	51%	88%	39%	63%
2012	118	90%	56%	88%	34%	69%
2013	120	96%	52%	83%	32%	61%
2014	117	91%	55%	73%	15%	41%
2015	142	89%	60%	51%	20%	31%
2016	166	73%	34%	61%	39%	33%
2017	127	85%	**9%**	**18%**	**87%**	22%
Total	2,101	64%	41%	74%	28%	42%

*** Note: Percentages sum to > 100% each year due to multijurisdictional filings.**

Changing Litigation Outcomes

- Settlement rates are down -- 63% in 2014 to 11% in 2017.
- Dismissal rates are up – 38% in 2014 to 89% in 2017.
- **Mootness cases --** arise when the plaintiffs file a complaint making disclosure claims, the defendants later amend their disclosure to include information about the alleged disclosure violations and it moots the plaintiffs' claims. The plaintiff can then either apply to the court for a fee or privately negotiate a fee agreement with the defendants. In neither case is there a release of the class claims.
- Mootness fees usage is up – virtually nonexistent prior to 2014 to 75% of dismissals in 2017.
- Disclosure-only settlements up to 90% of all settlements

Table 2: Litigation Outcomes by Deal Completion Year

	Deals with Litigation*	Settled	Dismissed	Settlement Rejected**	Mootness Fees***	% of Settlements that are Disclosure-Only
2003	11	55%	45%	0	0%	83%
2004	44	66%	34%	0	0%	41%
2005	56	54%	46%	1	0%	63%
2006	78	71%	29%	0	0%	58%
2007	109	68%	32%	0	0%	68%
2008	65	69%	31%	0	0%	82%
2009	41	73%	27%	0	0%	90%
2010	111	82%	18%	0	0%	78%
2011	110	80%	20%	0	0%	69%
2012	100	78%	22%	1	1%	85%
2013	109	77%	23%	1	0%	76%
2014	104	63%	38%	2	3%	74%
2015	117	45%	55%	2	14%	85%
2016	97	43%	57%	1	22%	98%
2017	91	**11%**	**89%**	0	**75%**	90%

*** Total number of deals with litigation for which data on the case outcome (settled or dismissed) is available.**
**** Subset of dismissals. Includes effective rejections due to out-of-court mootness fee settlements.**
***** Percentage of all cases. Subset of dismissals.**

Impact on Plaintiffs' Attorneys' Fees

- Fee awards dropping --medians reported to limit effect of outliers
- Fee awards in disclosure-only cases are dropping over time: $435 thousand in 2014 down to $300 thousand in 2017.
- Mootness fee awards appear to be much less than disclosure-only case fee awards.
- Lagged reporting for consideration-based settlements because they take more time so 2017 and 2016 likely to underreport them.

Table 3: Median Attorneys' Fees by Deal Completion Year and Litigation Outcome (in Thousands)

	# of Non-Zero Fees	All Non-Zero Fees		Nondisclosure Settlement	Disclosure-Only Settlement	Mootness Fee
2003	4	$425		$450	$499**	N/A
2004	25	$785		$1,050	$350	N/A
2005	30	$400		$588	$395	N/A
2006	52	$505		$1,118	$435	N/A
2007	68	$643		$2,925	$525	N/A
2008	41	$500		$893	$485	N/A
2009	29	$575		$3,050	$575	N/A
2010	89	$600		$1,375	$531	N/A
2011	78	$600		$1,750	$500	N/A
2012	73	$500		$1,940	$450	$4,000*
2013	57	$490		$2,400	$450	N/A
2014	49	$500		$900	$435	$450
2015	54	$373		$825	$400	$200
2016	20	$263		N/A	$320	$238
2017	11	$280		N/A	$300	$265

* Note: $4 million mootness fee in 2012 for Ancestry.com.
** Note: Disclosure-only fees in 2003 are higher than nondisclosure settlement fees.

Deal Litigation Moves to Other Forums – Lawyers Respond to Changes in the Law

- Plaintiffs' attorneys adjust their litigation filing patterns and strategies and defendants' counsel respond by adjusting theirs as well
- Trulia plus forum selection bylaws at many corporations restricts state court plaintiffs in those instances largely to Delaware Chancery Court – leads many to file in federal district court
- Changes to Delaware substantive law reduce plaintiffs' likelihood of success when they file in Delaware so more cases move to federal court or if the corporation has no forum selection bylaw to the company's headquarters state

Throwing the Baby Out With the Bath Water

- Delaware's push to eliminate frivolous deal litigation leads to an increased risk of cutting out good cases that challenge real corporate misconduct and will have adverse effects on Delaware bar
- Delaware rejected suggestions that it go further and permit fee shifting bylaws thereby closing all of the courthouse doors and encouraging managerial wrongdoing -- decreased deterrence!
- The dramatic shifts in litigation patterns that our data counsel caution in making further major changes to Delaware law in the near future