M&A Litigation: Tips for Dealmakers Who Might Be Sued

By LeMar Moore
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The ubiquity of class action and derivative lawsuits following the announcement of M&A transactions means that directors and officers should take extra precaution during the sale process.

2014 saw the largest spike in M&A activity in seven years, with global deal volume topping $2 trillion.¹ More recently, the large-cap deals that initially fueled this boom have given way to numerous middle-market transactions, which will continue to dominate M&A activity into 2015.² Many of these mid-cap transactions will involve new entrants seeking to close on strategic, synergistic deals while market conditions are favorable.³ Accompanying the recent boom in deal activity, however, has been an even greater boom in class action lawsuits challenging these transactions. Every year since 2010, more than 90% of corporate mergers valued above $100 million have been met with shareholder lawsuits.⁴ Presently, deals of this size have a 94% chance of being challenged by shareholders in court, regardless of whether the transaction is friendly or hostile.⁵ Moreover, nine-figure transactions spark an average of five separate class action complaints, filed in courts across multiple states.⁶ These complaints typically allege that the target board, aided and abetted by the acquirer, conducted a flawed sales process, failed to maximize shareholder value and/or acted in self-interest.⁷ Once filed, these cases often proceed at a rapid-fire pace, with the bulk of the litigation — which includes document discovery and depositions of director, officer, and/or financial advisor witnesses — taking place in the brief period between announcement of the deal and the close.⁸

Given the pace and ubiquity of these lawsuits, directors and officers would be wise to structure pipeline transactions in a manner sufficient to withstand legal scrutiny. Fortunately, there are some relatively painless steps dealmakers can take to ease the burden, expense and uncertainty inherent in the shareholder disputes that are sure to follow.

Adopt a Forum Selection Clause

Multi-forum litigation can significantly increase the cost, labor and risk associated with defending shareholder challenges. Duplicative pleadings or motions, an increased risk of expedited discovery, heightened insurance costs, and risk of inconsistent rulings from multiple courts are all concerns when multiple shareholder complaints are

¹ Ed Hammond, M&A Deals in 2014 Eclipse Levels in Past 5 Years, Financial Times (Sept. 30, 2014).
² Danielle Fugazy, The race is on to close deals while favorable conditions prevail - and before interest rates rise, Closing Time, 2015 WLNR 16196439
⁶ Olga Koumrian, supra note 4
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Directors of target corporations can reduce the risk of a multi-forum battle by adopting bylaws that specify one jurisdiction where an intra-corporate dispute may be litigated. These provisions are commonly enforced when actions are brought in foreign states, since courts will often dismiss complaints when such exclusive-forum clauses are invoked.

**Document Rationale for Important Decisions**

Important business decisions regarding the transaction should be carefully documented in board books and minutes. Similarly, the rationale for changes made to management projections, or (perhaps more importantly) for changes made to a financial advisor’s valuation model, should be carefully documented as well. In addition to creating a cleaner record of the sales process, such documentation helps protect against the inconsistent (if not entirely absent) recollection that sometimes arises among various participants due to fading memory.

**Establish Procedures to Protect Against Conflicts of Interest**

M&A complaints often allege that directors, officers or advisors made business decisions for self-interested reasons rather than acting in the best interest of shareholders. For this reason, in addition to documenting rationale for important decisions, dealmakers should also implement and enforce protocols to protect against potential conflicts of interest. Furthermore, management and advisors should be carefully monitored and controlled from the inception.

**Examine Don’t-Ask-Don’t-Waive Provisions in Standstill Agreements**

A final issue that has come under judicial scrutiny in recent years is the validity of so-called “don’t ask, don’t waive” (DADW) agreements. Corporate auctions with multiple bidders often involve standstill agreements, wherein potential buyers are contractually prohibited from bidding for a target company at the conclusion of the sales process without the target board’s prior consent. Such agreements can assure potential buyers that they will not be used as stalking horses, in addition to forming a more orderly sales process. A DADW agreement makes the standstill stricter by prohibiting bidders from seeking the target board’s consent to waive the standstill. Since DADW provisions are likely to be targeted by plaintiffs, and to be closely scrutinized by courts, dealmakers employing them should be especially careful to consider and document the legitimate, value-maximizing reason for their use (e.g., to incentivize bidders to submit their best offers).

In sum, the number of shareholder challenges to M&A transactions shows no sign of diminishing in the near future. Deal participants, particularly members of target boards, should take proactive steps to strengthen and document the process, such that it will withstand numerous shareholder complaints.

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10 See Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 951 (Del. Ch. 2013) (holding that such bylaws are facially valid under 8 Del. C. § 109(b)); City of Providence v. First Citizens BancShares, Inc., 99 A.3d 229, 236 (Del. Ch. 2014) (upholding forum selection bylaw adopted the same day as deal announcement). Beware, however, that the adoption of such bylaws, if done for inappropriate reasons, may itself form the basis of a legal challenge.
11 Alison Frankel, Delaware judge Oks forum selection clause adopted on same day as deal, Reuters (Sept. 9, 2014) (“Since Strine’s Chevron ruling, all but one of the non-Delaware judges who have ruled on dismissal motions based on forum selection clauses have refused to permit shareholder cases to move forward in their jurisdictions.”)
13 Id.
14 Id. at 5 (“If conflicts were surfaced, contained, and addressed, and a strong hand was given to the impartial members of the board, the plaintiffs’ ability to suggest that those conflicts infected the [sale process] is impaired.”)
About the author

LeMar Moore is an associate in the New York office. He focuses his practice on complex commercial litigation.