Is 'Peppercorn' No Longer Sufficient To Settle M&A Suits?

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In Acevedo v. Aeroflex Holding Corp. (Del. Ch. Jul. 8, 2015), the Delaware Court of Chancery intentionally departed from the long-developing trend of mergers and acquisitions litigation settlements based only on merger agreement modifications and/or supplemental disclosures. The case is related to the acquisition by Cobham PLC of Aeroflex Holding Corp. Vice Chancellor J. Travis Laster declined to approve a proposed settlement in a class action, finding that modifications to certain deal protections (e.g., reduction in breakup fee and change in matching rights period) and supplemental disclosures were not sufficiently beneficial to the class to warrant an “intergalactic release” of claims for the defendants.

The transcript of the settlement hearing is fascinating reading, particularly for M&A practitioners who are accustomed to the customary series of steps that occur following the announcement of nearly every public company merger. Following announcement, plaintiffs typically file one or more class actions asserting breaches of fiduciary duty, and then, after a short discovery period, the parties enter into a court-approved settlement that includes a global release from the certified class. To be clear, this is not the case with all M&A class actions, particularly if the entire fairness standard is at issue. But it happens in the vast majority of public company M&A transactions. The plaintiffs' attorneys benefit because they receive a fee, and the parties to the proposed merger benefit because the global release from the class provides significant protection and closure to stockholder litigation prior to the closing of the M&A transaction.

What is interesting about the Aeroflex settlement hearing was the detailed analysis by the vice chancellor of whether the plaintiffs (not just their attorney) actually benefited from any of the merger agreement changes or the supplemental disclosures. For example, even though the termination fee was reduced by $14 million (a 40 percent reduction) and the matching rights period was reduced from four days to three, Vice Chancellor Laster noted that neither change addressed the real reason why the most likely competing bidder did not try to make a topping bid. In this case, the issue was that the competing bidder needed a nondisclosure agreement waiver so that it could try to find a buyer for the portion of Aeroflex’s business that it did not want to buy.

Furthermore, Aeroflex’s 73 percent stockholder was receiving the same terms as the other stockholders and was supportive of the transaction. Vice Chancellor Laster explained that fixing the termination fee and the matching rights did not increase the likelihood of a topping bid if the NDA was not waived:

[I]f I am telling you that my car won't drive and we agree that it's because of the transmission — and you've agreed that it was because of the NDA; that was very helpful — then the fact that you have changed my oil and given me a new air filter has not increased the chances that my car will drive.

In denying approval of the settlement, Vice Chancellor Laster noted that the trend of settling M&A class actions for a "peppercorn and a fee" has the effect of "undercut[ting] the credibility of the litigation process" and "undercut[ting] Delaware's credibility as an honest broker in the legal realm." In addition to raising the possibility of a dismissal motion, the vice chancellor did leave the door open for the parties to come back with a more limited release, tied only to the breach of fiduciary duty claims, or for plaintiffs to seek a "mootness" fee based on the supplemental disclosures.

The facts that were stipulated by the plaintiffs, after discovery, were compelling in favor of the defendants. Therefore, it will be interesting to see if this result is a fact-specific blip in the trend of M&A settlements or instead the start of a new trend. If it is a new trend, it could have a chilling effect on suits with fact patterns that do not raise enhanced scrutiny issues.

But the ruling does underscore that care should be given in structuring settlements to make clear that any merger agreement changes address the particular transaction dynamics of the deal at hand and that any supplemental disclosures fix material disclosure deficiencies that have caused harm to the stockholders. Finally, consideration should be given to the scope of the release, with attention to whether the claims that are being released are sufficiently connected to the claims that were or could reasonably have been asserted in the litigation.

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