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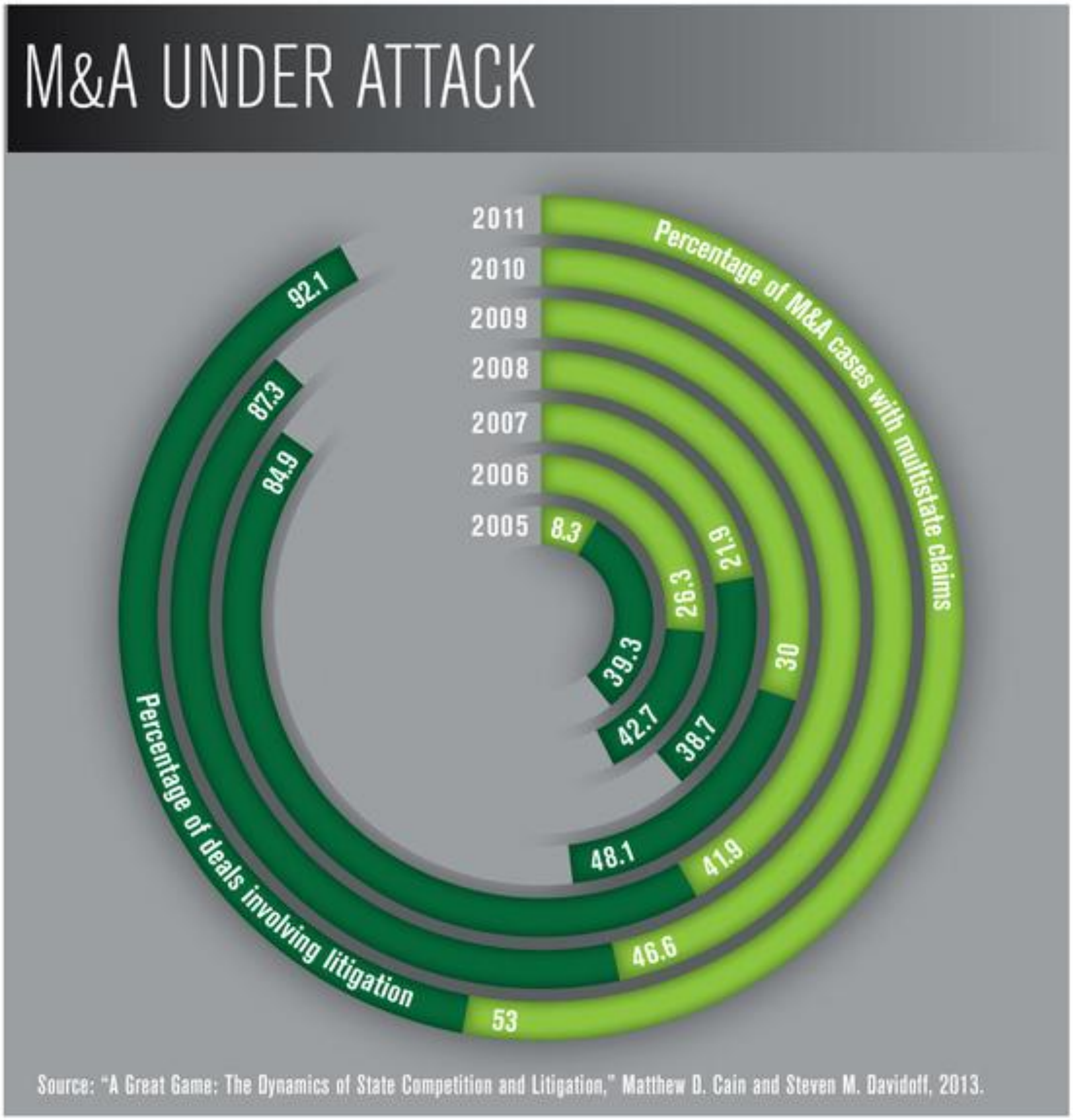
State Courts — The New M&A Battleground

Law360, New York (February 21, 2014, 2:10 PM ET) -- With the growth in mergers and acquisitions activity over the past few years, there has been commensurate growth in a new “cottage industry” whose practitioners file class action suits aimed at holding up nearly every deal involving a public company. The bankers and lawyers who put together these deals now have to expect this all-but-certain hurdle to deal execution.

Today, smaller plaintiff class action firms that once focused on securities litigation in federal courts are regularly filing these strike suits in state courts (other than in Delaware) shortly after nearly every public company merger is announced. They are doing so because federal procedures and standards have made it difficult for smaller firms to get lead counsel appointments in such cases, and the seasoned judges of the Delaware Chancery Court have exhibited increasing skepticism toward M&A strike suits.

Smaller firms routinely post trolling notices on the Internet within hours or even minutes after an M&A deal is announced. They then race to file putative class actions in state courts. In essentially cookie-cutter fashion, they assert state law breach of fiduciary duty claims, typically claiming that the sale process was deficient, the proxy disclosures are inadequate or misleading, and the agreed share price is inadequate. Thus, it is not uncommon for merging companies to quickly find they are facing multiple suits in several states.

The deal parties typically settle these cases quickly to avoid delaying the closing of their deal — typically with only very minor amendments of the proxy statement. There is usually no change in the deal price or in any cash payments made to the putative shareholder class. There are, of course, stipulated fee awards for the plaintiffs’ counsel. In essence, these suits have become a virtual private "tax" on public company M&A deals.



Class action plaintiffs' firms are quickly attacking newly announced mergers in multiple state courts—a fact that financial services firms need to consider as they put together deals.

Recession Reverberations

In 2008 and 2009, companies that just a few years earlier had been the subjects of highly leveraged acquisitions found themselves buried in debt and facing a tough economy — conditions that in many cases would have pointed to bankruptcy or foreclosure.

However, stakeholders of some overleveraged companies pushed through only light forms of restructuring that did not address the fundamental fact that the debt loads were just too large. In essence, investors in these companies or their debt didn't want to take the hit, so they kicked the can down the road on the chance that things might get better in the not-too-distant future.

For some, the much better times they needed did not materialize quickly enough. Thus, while on an operating basis their current businesses might be sustainable in downsized forms, a slow, modest recovery has meant that some companies have not been able to grow enough to support their still-outsized debt loads.

In the last year or so, some companies have started to hit the wall and are now pursuing the type of heavy restructuring they tried to avoid in 2008 and 2009 — some consensually and others through foreclosures or bankruptcy filings. Financial services institutions and funds hold much of the debt in question, and will be involved in shaping these second-round restructuring solutions, or the filings or litigation that can follow.

—By Edwin M. Baum, Crowell & Moring LLP

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This article was adapted from the firm's "Litigation Forecast 2014."

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