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Enforcing the Bargain v. Materiality Requirement: The Future of Disclosure-Only Settlements Post-Trulia

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Enforcing the Bargain v. Materiality Requirement The Future of Disclosure-Only Settlements Post-Trulia

By Hao Jiang*

Abstract

In In re Trulia, Inc. Stockholder Litigation, the Delaware Court of Chancery broke away from its tradition of routinely approving disclosure-only settlements and required disclosures to be material in order to cure the conflict of interest between plaintiff's counsel and the plaintiff class. I argue that fairness of settlement is the only standard in approving class action settlements and fairness will not be achieved by requiring materiality. Shareholders are legally entitled to all material information, as the board's fiduciary duty dictates. Thus, material disclosures are enforcement of a legal duty that is no consideration for the release of shareholder claims. On the other hand, fairness could be achieved by enforcing the bargain if the bargaining process was conducted fairly and in good faith. The agency problem and the conflict of interest between the plaintiff's counsel and the plaintiff class can be resolved by judicial assessment on whether there was adequate representation based on the effort of the plaintiff's counsel and the appropriate attorney fee award according to the well-established three-scale system in quantifying the appropriate attorney fees. In addition, overbroad releases can be rescinded under the contract doctrines of fraud and unconscionability if such settlements were fraudulently induced or the release is overbroad compared to the benefit that the disclosures conveyed.

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I. Introduction

A settlement agreement is a contract, and its terms are usually enforced by courts as such. In contract law, normative doctrines and theories are not concerned about the fairness of the terms so long as they were freely negotiated in the marketplace. Delaware courts, as the *de facto* national business lawmaker, have an even stronger desire to respect freedom of contract and favor the terms in the voluntary settlement.[1]

In approving class action settlements in Delaware, just as in other states, the law is more paternalistic to protect the weaker party, the plaintiff class. The court has to assume the fiduciary duty to independently examine the fairness of the class action settlement before approving it.[2] Such an approval "'requires more than a cursory scrutiny by the court of the issues presented.' The [c]ourt must exercise its own judgment to determine whether the settlement is reasonable and intrinsically fair."[3] In determining the fairness of the settlement, the court also has to evaluate "'the reasonableness of the "give" and the "get,"' or what the class members receive in exchange for ending the litigation."[4] Supposedly, when it is clear that there is gross disparity between the two sides of the proposed class action settlement, it is the Court's statutory duty to disapprove it.

A disclosure-only settlement is a non-monetary form of settlement where the plaintiffs, a class of stockholders, release any breach of fiduciary duty claims they may have against a company in connection to the sale of a company. In return, they receive supplemental disclosures. Meanwhile, the only money changing hands would be the plaintiff's attorney fees, which are paid by the corporations under the corporate benefit

1. Rome v. Archer, 197 A.2d 49, 53 (Del. 1964) (Explaining Delaware has long favored the voluntary settlement over litigation).

2. Kahn v. Sullivan, 594 A.2d 48, 58-59 (Del. 1991). *See also* DEL. CH. CT. R. 23.

3. *In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 891 (Del. Ch. 2016). *See also* DEL. CH. CT. R. 23.

4. *In re Trulia*, 129 A.3d at 891.

doctrine.[5] Such settlements are often described as "a peppercorn and a fee[,]"[6] a peppercorn for the plaintiff class and a sizeable fee for the plaintiff's counsel. Supposedly, so long as the settlement is not one sided, the Court has no reason to disapprove the settlement. The Court's fiduciary duty is to ensure the fairness of the bargain in the class action settlement rather than to police the minimum price. Therefore, if information is the only consideration, the release of meritorious claims deserves meaningful disclosure, or even material disclosure. The broad release of meritorious claims deserves material information, or information that has value that equals the release of the claims. On the other hand, it should not offend a court that non-meritorious claims were released for disclosures that have basically no value or only therapeutic value.

Traditionally, the Delaware Court of Chancery routinely approved such settlements as they were proposed. In recent years, virtually all major merger transactions in Delaware have resulted in shareholder litigation. The percentage of shareholder litigation arising out of transactions of $100 million or more increased from 39.3% in 2005 to 94.9% in 2014.[7] Such litigation would be filed right after the announcement of a proposed transaction and its existence would pose a threat to the closing of such transaction. Half of such transactions result in disclosure-only settlements. Given the proliferation of litigation, the Chancery Court is now concerned that approving disclosure-only settlements and awarding fees as proposed will result in court-approved, overbroad release of liabilities for the contracting parties, directors, officers, and advisors for disclosures that did not convey any benefits to the plaintiff class. This is due to the agency problem between the plaintiff's counsels and the

5. When a plaintiff pursues a cause of action relating to the internal affairs of a Delaware corporation and generates benefits for the corporation or its stockholders, Delaware law calls for the plaintiff to receive an award of attorneys' fees and expenses determined based on the factors set forth in *Sugarland Indus. v. Thomas*, 420 A.2d 142 (Del. 1980).

6. This term was coined by former Chancellor Allen. Solomon v. Pathe Commc'ns Corp., CIV. A. 12563, 1995 WL 250374, at *4 (Del. Ch. Apr. 21, 1995).

7. *In re Trulia*, 129 A.3d at 894.

plaintiff class.

The Chancery Court has grown wary of the divergent or conflicted incentives plaintiff firms might have in reaching a disclosure-only settlement. Once they reach a disclosure-only settlement, they would normally be awarded a six-figure attorney's fee. If the market were perfect, and plaintiff firm's incentive was compatible with the plaintiff, the court would not have to worry about the fairness of the settlement as a contract. If it were a monetary settlement, the Court would pay less attention to the adequacy of the consideration and simply give deference to the settlement terms.[8] When there is no monetary award to the shareholders, the Court is troubled by the plaintiff counsel's divergent incentive to quickly deliver a settlement that does not confer any benefits to the plaintiff class.

In the notable recent case, *In re Trulia, Inc. Stockholder Litigation*, the Delaware Court of Chancery broke away from the tradition of approving non-monetary disclosure-only settlements and made it clear that such disclosure settlements "[will] be met with continued disfavor" unless supplemental disclosures are "plainly material" and the scope of release is proportionate to the claims.[9] Materiality turns on whether "there is a substantial likelihood that a reasonable shareholder would consider [the disclosure] important in deciding how to vote."[10] "It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote."[11] But the disclosure of omitted facts "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of

8. *See In re* Cox Radio Inc. S'holders Litig., Civil Action No. 4461-VCP, 2010 WL 1806616, at *1, (Del. Ch. May 6, 2010) (only a one dollar increase in the tender offer price resulted from the settlement, but the Court approved the settlement despite objector's claim that it was only a modest benefit).

9 *In re Trulia*,129 A.3d at 898 ("To be more specific, practitioners should expect that disclosure settlements are likely to be met with continued disfavor in the future unless the supplemental disclosures address a plainly material misrepresentation or omission, and the subject matter of the proposed release is narrowly circumscribed to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sale process, if the record shows that such claims have been investigated sufficiently.").

10. Tsc Indus. v. Northway, 426 U.S. 438, 449 (1976).

11. *Id.*

information made available."[12]

The triggering event of this policy change was the patently inadequate representation the Court found in *In re Rural Metro Corp. Shareholders Litigation*. In that case, the board of directors were found liable for breach of fiduciary duty and the bankers were found to have aided and abetted the breaches in the sale of corporation.[13] The original plaintiff firm sought to secure a $475,000 attorney fee award by accepting supplemental disclosure after a low-cost investigation, which only incurred less than $15,000 in out-of-pocket expenses, including expert fees.[14] Things got turned around when the objector surfaced and the replacement counsels took over and investigated the facts vigorously. The new counsels incurred over $1.1 million in expert expenses and 6953 hours of attorney time.[15] As a result, a partial settlement was reached at $11.6 million.[16] An attorney fee award of $2.9 million was awarded based on the benefit of $11.6 million in "cold hard cash."[17]

A lot has been written on how to resolve the agency problem.[18] In *In re Trulia*, the court adopted the materiality

12. *Id. See also* Unanue v. Unanue, No. Civ. A. 204-N, 2004 WL 2521292, at *10 (Del. Ch. Nov. 3, 2004).

13. *See generally In re* Rural Metro Corp. Stockholders Litig., 88 A.3d 54 (Del. Ch. 2014).

14. Joel Edan Friedlander, *How Rural/Metro Exposed the Systemic Problem of Disclosure Settlements*, 40 DEL. J. CORP. L. 877, 907 (2016) [hereinafter *Rural/Metro*].

15. *Id.* at 908.

16. *Id.*

17. *Id.* at 892 (quoting Transcript of Settlement Hearing at 27-28, *In re* Rural/Metro Corp. Stockholders Litig., 2013 WL 7137206 (Del. Ch. Nov. 19, 2013) (No. 6350-VCL)).

18. *See, e.g.*, *Rural/Metro*, *supra* note 14; Sean J. Griffith, *Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees*, 56 B.C. L. REV. 1 (2015) [hereinafter *Correcting Corporate Benefit*]; Sean J. Griffith, *Private Ordering Post-Trulia: Why No Pay Provisions Can Fix the Deal Tax and Forum Selection Provisions Can't*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES (Steven Davidoff Solomon & Randall S. Thomas eds., forthcoming 2017) [hereinafter *Private Ordering Post-Trulia*], https://ssrn.com/abstract=2855950; Mark Lebovitch & Jeroen van Kwawegen, *Of Babies and Bathwater: Deterring Frivolous Stockholder Suits without Closing the Courthouse Doors to Legitimate Claims*, 40 DEL. J. CORP. L. 491 (2016); Phillip R. Sumpter, *Adjusting Attorneys' Fee Awards: The Delaware Court of Chancery's Answer to Incentivizing Meritorious Disclosure-Only Settlements*, 15 U. PA. J. BUS. L. 669 (2013).

requirement proposed by one article.[19] In *Of Babies and Bathwater*, the authors provide a two-part test that aims to "eliminate the weakest two-thirds of all stockholder litigation."[20] The first test is that the disclosure must be material, without which there cannot be consideration to support a disclosure-only settlement.[21] The second part, is that the Court shall not approve an overbroad release.[22] The release shall instead be limited to the benefit of the disclosures obtained.[23] The first part was adopted by *Trulia*; the second part has also been part of the Court's practice[24] and set out to protect meritorious claims that were not "properly vetted" from being released.[25] This test "would require a demonstration that the proposed release is directly related to the claims pursued in the litigation and proportionate to the supplemental disclosures . . . ."[26]

After *Trulia,* practitioners and commentators predicted that disclosure-based agreements, "if not entirely dead . . . are on life support with only the faintest hint of a pulse."[27] Sean Griffith, an academic who has been following the development of disclosure-only settlements, concluded that the heightened standard of materiality is now a "condition for the approval of disclosure settlements" in Delaware.[28] Seemingly, the Court put its foot down and established a new rule in approving disclosure-only settlements. Now, it is required that disclosures be material.

In this article, I would like to examine whether the new materiality requirement in approving disclosure-only settlements is doctrinally coherent with contract law doctrines,

19. *See generally* Lebovitch & Kwawegen, *supra* note 18.

20. *Id.* at 492.

21. *Id.* at 491-92, 498.

22. *Id.* at 492.

23. *Id.*

24. *See* Transcript of Settlement Hearing and the Court's Ruling, *In re* Medicis Pharm. Corp. S'holders Litig., 2014 WL 1614336 (Del. Ch. 2014) (No. 7857-CS).

25. Lebovitch & Kwawegen, *supra* note 18, at 492.

26. *Id.* at 538.

27. Eric Waxman, *Disclosure-Based Settlements, Not Business as Usual*, WALL STREET LAW., Mar. 2016, at 1.

28. *Private Ordering Post-Trulia*, *supra* note 18 at 5.

operates to resolve the agency problem, and ensures fairness in class action settlements. I will argue that enforcing the bargain as agreed to is a better approach, and that the requirement of materiality would be contradictory to the doctrine of consideration by giving the board of directors policy incentives to withhold material information, instead of disclosing it in the first place. Market competition among plaintiff firms and judicial assessment of appropriate attorney fee awards can realign the interest between the plaintiff's counsel and the plaintiff class. Lastly, the concern about the overbroad release of liabilities by approving disclosure-only settlements can be resolved by challenging the finality of the settlement. I will discuss how such settlements can be rescinded by contract law doctrines of fraudulent misrepresentation and unconscionability. In the end, I will conclude that enforcing the bargain is a better approach than the judicial mandate of materiality in approving disclosure-only settlements and should be the future.

II. Doctrinal and Policy Defects in Requiring Materiality

A. Performance of Legal Duty is No Consideration

As we have discussed, the threshold in approving disclosure-only settlements has become that the supplemental disclosures must "address a plainly material misrepresentation or omission."[29] In *Of Babies and Bathwater*, the influential article that promoted the heightened standard, the authors reasoned that, in disclosure-only settlements, "[a] disclosure that is not material as a matter of law is not consideration as a matter of fact. Without consideration, there should be no settlement."[30] However, such an argument would open itself up to two doctrinal objections.

First of all, as the Restatement (Second) of Contracts put it, performance of legal duty is no consideration.[31] Meanwhile,

29. *In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 898 (Del. Ch. 2016).

30. Lebovitch & Kwawegen, *supra* note 18, at 498.

31. *See* RESTATEMENT (SECOND) OF CONTRACTS § 208 (AM. LAW. INST. 1981).

the board of directors has a fiduciary duty to disclose all material information fully and fairly even when there is no initial duty to disclose the information.[32] The fiduciary duty is a statutory duty under Delaware General Corporate Law, and logically disclosing supplemental information that is material is only a fulfillment of such duty and will not constitute legally sufficient consideration.[33]

The rationale is simple: If the legal duty is already owed to the promisee, then the promisor did not give up any legal right by performing such duty. Therefore, the performance was not bargained for. Such an exchange raises a suspicion as to whether it is a genuine exchange. As the comments of the Restatement point out, "[a] claim that the performance of a legal duty furnished consideration for a promise often raises a suspicion that the transaction was gratuitous or mistaken or unconscionable."[34]

Material supplemental disclosures as consideration is a bargain for forbearance to commit a tort, breach of fiduciary duty. Such forbearance is not consideration and the promise may be unenforceable as against public policy.[35] That is, the promise of a broad release of managerial liabilities out of the sale process would be unenforceable when it was supported by merely material disclosures, which is not legally sound consideration.

As we discussed, Rule 23 imposes on the Court the fiduciary duty to examine the fairness of the class action settlement.[36] Fairness is not preserved when material disclosures are given in exchange for a release because the plaintiff class is legally entitled to such disclosures. Fairness is also not preserved when valuable, but non-material disclosures, that the defendant did not have pre-existing legal duty to provide, were given in exchange for weak claims that had no value.

32. Eisenberg v. Chicago Milwaukee Corp., 537 A.2d 1051, 1057 (Del. Ch. 1987). Moreover, duties of fiduciaries are within the scope of Restatement § 73. *See* RESTATEMENT (SECOND) OF CONTRACTS § 73 cmt. b.

33. DEL. CODE ANN. tit. 8, § 365 (1991).

34. RESTATEMENT (SECOND) OF CONTRACTS § 73 cmt. a.

35. *Id.* § 73 cmt. b.

36. DEL. CH. CT. R. 23.

On the other hand, consideration need not be adequate.[37] Any performance which is bargained for is consideration.[38] This rule does not require that "consideration have an economic value equivalent to that of the promise."[39] It does not matter whether supplemental disclosures are meaningful, only of marginal and therapeutic value, or are simply helpful, any value conveyed through disclosures would be legally sufficient to constitute consideration. However, this does not mean fairness will not be achieved without having an adequacy requirement in the doctrine of consideration. As we will discuss in Part III, market competition will ensure fairness of the bargain and all that the Court has to do is to enforce the bargain.

B. Materiality Requirement as an Incentive to Withhold Information for the Sake of Settlements

On the policy front, requiring materiality in supplemental disclosure is not sound either. Normally, enforcement of a half-completed bargain is beneficial to the society. It allows freedom of individual action and exercise of judgment that increases productivity and efficient allocation of resources in the economy.[40]

Supposedly, a court shall enforce the broad release when the material disclosures were given in exchange for that release. However, since disclosing material information was only performance of a pre-existing legal duty, such a bargain shall not be enforced as a matter of public policy. Enforcing a pre-existing legal duty gives rise to the strong possibility that "the promise was obtained by an express or implied threat to withhold performance of a legal duty, the promise does not have the presumptive social utility normally found in a bargain."[41] Thus, since all major transactions attract shareholder litigation and half of these cases are settled by disclosure-only settlements, the board of directors would

37. *See* RESTATEMENT (SECOND) OF CONTRACTS § 79.
38. *Id.*
39. *Id.* § 72 cmt. d.
40. *Id.* § 72 cmt. b.
41. *Id.* § 73 cmt. a.

benefit from hiding material information in the first place in anticipation of shareholder claims. Enforcing the materiality requirement would only encourage the board to withhold disclosures that would be deemed material so that they can disclose such information to settle the highly-anticipated shareholder claims that would otherwise not be settled without a monetary compensation.

C. To Encourage or to Deter? What is the Public Policy?

Normally, freedom of contract is respected in all Western jurisdictions.[42] Freedom of contract has long been the leading public policy in Delaware and courts are supposed to enforce the plain terms of a contract freely entered by parties.[43] Still, each system "must reserve the right to declare a contract void if it is illegally or morally offensive . . . or 'contrary to public policy.'"[44]

Since there are no concerns towards the legality of such settlements, the only normative objection over a freely-entered settlement would be the public policy ground. As such, is there a public policy reason to deny all the disclosure-only settlements?

In approving disclosure-only settlements, the Chancery Court has two conflicting public policy goals in mind. The first is to lower the "deal tax." This means the court would have the

42. *See* KONRAD ZWEIGERT & HEIN KÖTZ, INTRODUCTION TO COMPARATIVE LAW 380 (Tony Weir trans., 3d rev. ed., 1998).

43. *See, e.g.*, Gildor v. Optical Solutions, Inc., No. 1416-N, 2006 WL 4782348, at *7 n.17 (Del. Ch. Jun. 5, 2006) ("It is imperative that contracting parties know that a court will enforce a contract's clear terms and will not judicially alter their bargain, so courts do not trump the freedom of contract lightly."); Douzinas v. Am. Bureau of Shipping, Inc., 888 A.2d 1146, 1152 (Del. Ch. 2006) ("[T]his court's duty is to respect the contract freely entered into by all the members . . . ."); Aspen Advisors LLC v. United Artists Theatre Co., 843 A.2d 697, 712 (Del. Ch. 2004) (ruling that enforcing the "plain terms" of a contract furthers Delaware law's goal of promoting reliable and efficient corporate and commercial laws); *see also* Marino v. Grupo Mundial Tenedora, S.A., 810 F. Supp. 2d 601, 607 (S.D.N.Y. 2011) ("The policy of the Delaware Act is 'to give maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.'") (citation omitted).

44. *See* ZWEIGERT & KÖTZ, *supra* note 42, at 380.

incentive to make a plaintiff's non-meritorious claims go away as cheaply as possible by approving disclosure settlements and mooting the claims. The second is to reject such settlements when it is not convincing that the plaintiff class received adequate representation and reasonableness or equivalence between "give" and "get" is preserved. The Court is conscientious about preventing corporate defendants from being released from future claims without having them vigorously vetted by the plaintiff's counsel.

The first policy concern led to the routine approval of disclosure settlements before *Rural Metro Corp.*, while the second concern led the Court to the materiality requirement set forth in *Trulia*.[45] Both efforts were made to fulfill the Rule 23 duty to ensure the reasonableness and substantive fairness of the two sides of the settlement.[46]

Major mergers and acquisitions (M&A) deals attract litigation, and most of them are weak claims that could not have succeeded in litigation. The benefit of disclosure-only settlements is that when the plaintiff class receives additional information through the help of the plaintiff's attorneys and recognizes that their initial claims were weak or groundless, the board of directors are released from liabilities relating to the transaction once and for all. It also increases the transparency of deal making.[47]

In light of this, the public policy would be to encourage quick settlement, especially non-monetary settlement, and the Chancery Court shall deem such settlements as beneficial. Therefore, when the defendants offer to settle the case by giving out supplemental information and a relatively small but substantial attorney fee for the plaintiff's lawyers, the court would assume that negotiations have been conducted at arm's length and in good faith.[48] Therefore, the public policy of the

45. *See In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 898 (Del. Ch. 2016); *In re* Rural Metro Corp. Stockholders Litig., 88 A.3d 54 (Del. Ch. 2014).

46. *See* DEL. CH. CT. R. 23.

47. As a result, companies are willing to provide disclosures "that would have never been in a proxy statement 20 years ago" and such disclosures have, in Strine's words "gotten increasingly more informative." Sumpter, *supra* note 18, at 687.

48. *See In re* Advanced Battery Techs., Inc. Sec. Litig., 298 F.R.D. 171,

court would be to promote deal efficiency by approving such settlements regardless of the materiality of the supplemental information.

On the other hand, the Chancery Court has to face the challenge of evaluating such settlements through a non-adversarial process.[49] The Delaware Chancery Court has a legitimate concern that routine approval of all disclosure-based settlements would result in the loss of valuable claims through the broad release.

The defendants would have the incentive to pay a relatively small fee to obtain a broad release[50] as deal insurance. Such an incentive is compatible with the plaintiff's counsel's incentive to obtain a quick attorney fee award by agreeing to the disclosure-only settlement. Such broad release, which often includes all possible claims related to the events,[51] along with "claims that could not have been litigated in the settled action, such as federal securities claims,"[52] is being seen as disproportionate to the benefit of the disclosures obtained.

Chancellor Bouchard blamed the Court of Chancery's willingness to give blind approval of such settlements as the cause of the explosion of deal litigation.[53] Would blind denial unless disclosure is material work the magic then?

Denial of all disclosure-only settlements would make the shareholder claims more expensive to settle, and would not necessarily preserve fairness.[54] Plaintiffs might flee Delaware,

179-80 (S.D.N.Y. 2014).

49. *In re Trulia*, 129 A.3d at 887.

50. Peter J. Walsh Jr. & Aaron R. Sims, *Delaware Insider: Trulia and the Demise of "Disclosure Only" Settlements in Delaware*, BUS. L. TODAY, Feb. 2016, at 1.

51. *See* Brinckerhoff v. Texas E. Prods. Pipeline Co., 986 A.2d 370, 385 (Del. Ch. 2010).

52. *Id.*

53. *See In re Trulia*, 129 A.3d at 894 ("It is beyond doubt in my view that the dynamics described above, in particular the Court's willingness in the past to approve disclosure settlements of marginal value and to routinely grant broad releases to defendants and six-figure fees to plaintiffs' counsel in the process, have caused deal litigation to explode in the United States beyond the realm of reason.").

54. Mathematically, equivalence cannot be achieved by requiring one side of the equation to have value without knowing whether the other side has any value. Fairness is therefore not preserved when valuable disclosures that would otherwise not have been legally required to be disclosed is given

or the claims might be re-litigated after the denial, or defendants would have to provide a small monetary settlement ($1 increase per share) as we have seen in *Cox Radio*.[55] In the later scenario, stockholders might still be undercompensated.

The only legitimate public policy remains that the Chancery Court shall ensure the fairness of the settlement. Approval of settlement agreement has depended and will continue to depend on whether the court has been convinced that the two sides of the contract are equivalent. Mathematically, equivalence cannot be achieved by requiring one side of the equation to have value without knowing whether the other side has any value.

III. Market Mechanisms and Judicial Assessment

A. Enforcing the Bargain: Achieving Fairness Through Market

As it has been discussed, fairness remains the only criteria in approving disclosure-only settlement. The core argument of this article is that fairness of disclosure-only settlement is achieved by enforcing the bargain as it is. In contract law, normative doctrines and theories do not concern about the fairness of the terms so long as they were freely negotiated in the market place. Fairness does not seem to matter in contract law but fairness is otherwise preserved through the use of the doctrine of unconscionability. The idea is that when the market is competitive, market information would freely flow and everyone would have access to the market price. As a result, when negotiation was at arm's length, the settlement would normally be reached at market price as no one would be willing to give more or receive less when they have access to market price. If it was found out later that the settlement was induced by misrepresentation or omission of material facts, the settlement could be rescinded based on the doctrine of fraud or

in exchange of meritless claims.

55. *See In re* Cox Radio, Inc. S'holders Litig., Civil Action No. 4461-VCP, 2010 WL 1806616 (Del. Ch. May 6, 2010), at *1.

misrepresentation.[56] If the two sides of the settlement were overall imbalanced, the performance of the settlement can be denied. If settlement terms are deemed unconscionable, the settlement can be set aside. A combination of procedural and substantive unconscionability can result in rescission of the agreement even after a settlement is reached between two parties and approved by the court.[57] In addition to that, gross disparity alone will be enough to result in a denial of specific performance.[58]

1. Fairness Matters in Contract Law

Formally, as Stephen Smith describes, fairness does not play in a role in contract law theory.[59] He went further to argue that substantive fairness has to be excluded from a ground under the heading of unconscionability.[60] The majority view is that just price does not have a doctrinal place in contract law theory, and fairness is considered irrelevant in contract law.[61] Once a defender of substantive fairness,[62] Stephen Smith observed that support for substantive fairness is not part of discourse of contract law, nor is it defended by many contract law scholars.[63] It has been said that the idea of "fair price" is meaningless in a modern economy and inconsistent with the idea of freedom of contract.[64] However, even Smith had to admit that the lack of fairness would create problems: it will result in more unjust redistribution;[65] it will reduce contracting;[66] it will harm people's abilities to plan an

56. *See* RESTATEMENT (SECOND) OF CONTRACTS § 164 (AM. Law. Inst. 1981).

57. *See id.* § 71.

58. *Id.*

59. Stephen A. Smith, *In Defence of Substantive Fairness*, 112 LAW Q. REV. 138, 138-39 (1996) [hereinafter *Substantive Fairness*].

60. *Id.*

61. *See, e.g.*, Peter Benson, *The Unity of Contract Law*, *in* THE THEORY OF CONTRACT LAW 118, 191 (Peter Benson ed., 2001); Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L. J. 698 (1981).

62. *See generally Substantive Fairness*, *supra* note 59.

63. STEPHEN A. SMITH, CONTRACT THEORY 357 (2004).

64. *Id.* at 354.

65. *Substantive Fairness*, *supra* note 59, at 146-48.

66. *Id.* at 148-49.

autonomous life.[67]

According to Smith, substantively unfair bargains will make the already unjust distribution even more unjust because losers in unfair bargains are usually the less well-off of the two contracting parties.[68] Also, non-competitive pricing in a competitive market will reduce contracting.[69] On the other hand, an imposition of normal prices will benefit even those who are unsure of normal prices.[70] Contracting at abnormal prices also harms people's ability to lead an autonomous life as our ability to plan the life is built upon the preservation of our purchasing power and abnormal prices would upset plans and one's ability to control and direct their lives.[71]

As Zweigert and Kötz observed: commutative justice has always been seen to require a certain equivalence between performance and counter-performance.[72] The gross disparity between the performance and counter-performance will open a contract up for rescission in virtually all major jurisdictions.[73]

Normally, contract law does not require equality in exchange, but gross disparity between the two sides of the contract would allow courts to avoid the contract terms as unconscionable. As Corbin describes, "adequacy of

67. *Id.* at 151-56.

68. *Id.* at 147-48.

69. *Id.* at 148-49.

70. *Id.* at 150.

71. *Substantive Fairness*, *supra* note 59, at 150-52.

72. ZWEIGERT & KÖTZ, *supra* note 42, at 328.

73. Nominal consideration is not supported by either American or English law. *See Restatement of Contracts (Second)–A Rejection of Nominal Consideration?*, 1 VAL. U.L. REV. 102 (1966); P.S. ATIYAH, AN INTRODUCTION TO THE LAW OF CONTRACT 126-29 (1995). American courts often apply unconscionability to correct unfair contracts. French law traditionally requires a counter-performance to reflect consideration of the real interest and be genuine and reasonable in order to maintain the cause of the contract. *See* Judith Rochfeld, *A Future for la cause? Observations of a French Jurist*, *in* REFORMING THE FRENCH LAW OF OBLIGATIONS, 73, 81 (John Carwright, Stefan Vogenauer, & Simon Whittaker eds. 2009); After the abolition of cause in 2016 in French civil law reforms, the new article 1143 established a new doctrine of violence économique that serves the same function. In German law, gross disparity (grobes Missverhältnis) can also render a contract void for violation of good morals (gute Sitten). *See* BGB § 138 and Bundesgerichtshof, 9 November 1961, BB, 1962, 156 (the court held that an interest rate of 45% should be held invalid as contrary to good morals).

consideration is not required to be adequate in the sense of equality in value."[74] Corbin also observed that judges, by acting also as chancellors, will avoid enforcement of an unconscionable bargain when the consideration is grossly inadequate.[75] He supplied two reasons: one reason is that the gross inadequacy may be evidence of fraud, mistake, or undue influence;[76] the other reason is that the relevant factors accompanying the inadequacy would fit into the concepts of fraud, duress, misrepresentation and undue influence.[77]

The Second Restatement of Contracts, in its comment, insists that usually overall imbalance involves factors other than mere overall imbalance to qualify the contract as unconscionable.[78] However, it also admits that "gross disparity in the values exchanged . . . may be sufficient ground, without more, for denying specific performance."[79] The Restatement gives courts broad discretion to avoid contract terms that would have unconscionable results.[80]

2. Gross Disparity in Exchange as Unconscionable

Scholars might not agree on whether the value of the objects exchanged through contracts is subjective or objective, or whether there is a just price. However, it is the consensus that so long as the market functions, the Court shall enforce the bargain as they are. Fairness would be achieved by enforcing the bargains. When the market malfunctions, exploitation will likely occur when parties no longer have access to the market price. When this happens,

74. ARTHUR CORBIN, CORBIN ON CONTRACTS 188 (1952).

75. *Id.* at 188.

76. *Id.* at 185.

77. *Id.* at 188.

78. RESTATEMENT (SECOND) OF CONTRACTS § 208 cmt. c (AM. LAW. INST. 1981).

79. *Id. See also Marks v. Gates,* 154 F. 481, 483 (9th Cir.1907) (inadequacy of consideration sufficient ground for withholding specific performance *if* it is so gross as to render the contract unconscionable); *Frank's Maintenance & Eng'g, Inc. v. C.A. Roberts Co.,* 86 Ill. App. 3d 980, 42 Ill. Dec. 25, 31–32, 408 N.E.2d 403, 409–10 (1980) ("Unconscionability can be *either* procedural or substantive or a combination of both.").

80. *Id.* § 208.

unconscionability denies a severely unequal bargain.

The Bargain Principle

Melvin Eisenberg, a doctrinal scholar without any philosophical or ideological subscriptions, explains why the bargain principle of contract law—a theory taken literally from the black letter law—is a sound theory that serves both ends of contract law, efficiency and fairness, without a normative regard for fairness.[81]

The bargain principle can be summarized as simply as "'courts do not inquire into the adequacy of consideration' or 'mere inadequacy of consideration will not void a contract.'"[82] Eisenberg converts it to a formulation that states that "damages for unexcused breach of a bargain promise should invariably be measured by the value the promised performance would have had to the plaintiff, rather than, and regardless of, the cost or value of the performance for which the defendant's promise was exchanged."[83] In other words, "a bargain promise should be enforced to its full extent."[84] Normally, in a perfect market,[85] fairness of the terms can never be reviewed by the court because the price reached through a bargained promise would be economically efficient and fair. Arguments for efficient price could be found in that the value is subjective, credit transactions would only be encouraged if the expectation that bargain promise would be kept is preserved, contract price

81. *See* Melvin Eisenberg, *The Bargain Principle and Its Limits*, 95 HARV. L. REV. 741 (1982).

82. *See id.* at 745. *See also* RESTATEMENT (SECOND) OF CONTRACTS § 79 (AM. LAW INST. 1981).

83. Eisenberg, *supra* note 81, at 745.

84. *Id.*

85. Eisenberg, *supra* note 81, at 746 (citing EDWIN MANSFIELD, MICROECONOMICS: THEORY AND APPLICATIONS 196-97 (3d ed. 1979) (A perfectly competitive market is defined as "a homogeneous commodity (which may consist of either goods or services); a marketplace at which perfect cost-free information concerning price is readily available (hereinafter referred to as a homogeneous marketplace); productive resources that are sufficiently mobile that pricing decisions readily influence their allocation; and participants whose market share is so small that none can affect the commodity's price, so that each takes the market price as given by outside forces.")).

is the most efficient price that best allocates the factors necessary for the commodity's production.[86] Such a price would also be the fair price, as, in a perfectly competitive market, contract price normally equals the benefits conferred, everybody would use the market price when it is available, and any lower-than fair price would be eliminated by market completion.[87]

However, review of objective fairness of contracts would be appropriate when perfectly competitive markets are not available.[88] As Eisenberg observed, the principle of unconscionability permits enforcement of a promise to be limited on the basis of unfair price alone.[89] Unconscionability, as described in the Restatement (Second) of Contracts, only addresses gross disparity.[90]

If Eisenberg is right, fairness is protected by contract law and would be achieved through settlement agreement so long as it resulted from a free bargain between the plaintiff class and the defendant corporation and the market was competitive. If Eisenberg is right, the plaintiff class and the plaintiff's counsel who have meritless claims would settle for valueless supplemental disclosures, and the plaintiff class who have greater chances of proving defendant's breach of fiduciary duty would not settle unless they receive a monetary settlement that equals the value of their claims, multiplying the likelihood of the success in trial minus the litigation cost.[91] In this view, courts shall not review the fairness of the settlement terms, but rather the bargaining process, such as adequacy of representation or bargaining in good faith. The Chancery Court can justifiably refuse to approve disclosure-only

86. Eisenberg, *supra* note 81, at 745-46.

87. *Id.* at 747.

88. *Id.* at 748-54.

89. *Id.* at 753.

90. *See* RESTATEMENT (SECOND) OF CONTRACTS § 208 (AM. LAW INST. 1981).

91. For those who do not think that the claims would be adequately investigated, the Chancery Court has been looking into the efforts of plaintiff counsel to determine appropriate attorney fee awards and would not approve settlements or fee awards if they did not think the case was vigorously vetted. *See, e.g.*, *In re* Transatlantic Holdings Inc. S'holders Litig., C.A. No. 6574–CS, 2013 WL 1191738 (Del. Ch. Mar. 8, 2013).

settlements when they are not convinced that sufficient vetting had taken place.

Fairness in Exchange

Among contract theorists, James Gordley, of Aristotelian tradition, and Peter Benson, of Kantian tradition, are the two leading advocates in recognizing the importance of fairness of price in contract law. Still, they both agree that only gross disparity in consideration shall be remedied by law. But they differ as to whether equality in exchange shall be the standard rule, or if it is only the baseline. Gordley argues that all deviations from just price are entitled to relief to preserve the purchasing power of the parties and the pre-existing distribution of wealth.[92] While Benson thinks that equivalence in exchange preserves the wills of the parties, he agrees that only gross disparity calls for correction.[93]

The two disagree on whether there is a just price for each contract and whether a just price can be reached or only approached. Still, both would agree that a gross deviation from the market price would call for remedy in contract law, but for different reasons. To Gordley, only gross disparity is worth pursuing for practical and evidentiary reasons. To Benson, gross disparity is evidence for vice of consent and calls for explanation.

When Value is Objective and there is a Just Price

Gordley, writing from Aristotelian tradition, thinks that just price is the market price under competitive conditions.[94] Just price "varies from day to day and from region to region."[95] Such a price reflects need, scarcity, and cost.[96] According to Aristotle, every contract of exchange is an act of "voluntary

92. *See* James Gordley, *Equality in Exchange*, 69 CAL. L. REV. 1587 (1981).

93. *See* BENSON, *supra* note 61, at 191.

94. *See* JAMES GORDLEY, FOUNDATIONS OF PRIVATE LAW: PROPERTY, TORT, CONTRACT, UNJUST ENRICHMENT 361 (2006).

95. *Id.*

96. *Id.*

commutative justice."[97] Therefore, a party shall not be made poorer or richer over contracting, but may become poorer or richer in the future.[98] There is no reason to charge a higher price or buy at a lower price if one is really making an exchange and has access to the market price. In making an exchange, no reasonable person intends to enrich the other party at their own expenses. However, one can become richer by buying low and selling high. One can become poorer by doing the opposite. Since the market price changes constantly, all one needs to do is to sell the same object he bought at a different location where the market price is higher, or on a different day when the market price is higher. Thus, the change of wealth happens through a series of contract transactions rather than one. In each one of these transactions, the pre-existing wealth and allocation of resources between the parties are to be preserved.

However, though just price is approachable and equality in exchange can be realized, not every disparity will be remedied. From the Roman rule of *laesio enormis* to the French doctrine of lesion,[99] for practical reasons, only gross disparity can be remedied. Such reasons might be that: courts are not in the best position to determine what the just price was when the contract was entered; price that seemed unfair after contracting might be fair upon conclusion – a fair bet at price fluctuation is fair; and it might not be economical to remedy every unfair price.[100]

To Gordley, the object of contract has an objective value that equals the fair market price, parties are willing to contract to exchange only because they themselves place a higher subjective value on the things they exchanged. According to

97. *Id.* at 292.

98. *Id.* at 363.

99. In Roman law, a contract could be rescinded when a thing was sold for less than half of the just price. A buyer can choose to either pay the difference between the just price and the price paid or rescind the transaction. *See* James Gordley, *Contract in Pre-Commercial Societies and in Western History*, *in* INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW 2-41 (J.C.B. Mohr, ed. 1997). French law gives relief to the unfair contract when the sale of land is for less than five-twelfths of the market value. CODE CIVIL [C. CIV.] [CIVIL CODE] art. 1674 (Fr.).

100. Gordley, *supra* note 92, at 1652-54.

Gordley's account, the price reached in a competitive market is the just price, and so long as parties negotiated at arm's length, courts shall enforce the terms unless the price was severely wrong. The end result is that a range of normal considerations would be acceptable and only extremely unfair settlements would be subject to relief.

When Value is Subjective and there is No Just Price

Benson sees contract as a transfer of ownership and the contemporary common law contract theory as a coherent unity.[101] Consideration requires two sides of the contract to be qualitatively different, and unconscionability completes the theory by requiring two sides to be identical in value.[102]

In Benson's view, contract law does not require equality in exchange, but requires equivalence in exchange, which will preserve equality in value though value is entirely subjective. By Benson's account, parties are presumed to have the intention to transact for equal value,[103] at least not the grossly lacking of equivalence.[104] In his view, no one is legally obliged to transact for equal value.[105] A party can waive the receipt of equal value through assumption of risk or by a donative intent.[106] In these two circumstances, gross inequality cannot be remedied if the inequality has objectively been willed by the party.[107]

However, a contract must honor each party's capacity to receive equal value. In the absence of donative intent and assumption of risk, gross lack of equivalence in an exchange is voidable.[108] Unconscionability supplements contractual liberty allowed by consideration with contractual fairness.[109]

101. *See* BENSON, *supra* note 61, at 118.
102. *See id.* at 193-95.
103. *See id.* at 187.
104. *See id.* at 118.
105. *See id.* at 191.
106. *See id.*, at 191.
107. *See* BENSON, *supra* note 61, at 191.
108. *See id.*
109. *See id.* at 184.

Different from Gordley's account, Benson thinks all the normal prices are competitive prices and values are subjective to the parties. Benson argues that "[a] competitive market price is an ideal notion which obtains at long-term equilibrium. It is only approached, and never fully realized, by actually existing market systems, even on the supposition that these are competitive."[110] As a result, there will be a range of competitive prices and they are all enforceable. Unconscionability only deals with a gross lack of equivalence. Contracts can be avoided when the price falls out of the baseline and parties' intention to transact at equal value can no longer be construed in light of the gross lack of equivalence. Benson's account of contractual fairness is what I call subjective fairness. However, even this subjective account has objective criterion, which is the gross lack of equivalence. By Benson's account, in *Trulia,* the plaintiff class is presumed to intend to transact for equal value in reaching the settlement. Consideration only requires the two sides to be distinctively different. Once they are, they can possibly be construed as equivalent unless there was gross lack of equivalence as measured by market prices. Such gross lack of equivalence is seen as evidence for violation of parties' intention. So, we can infer that happens when an overbroad release was obtained in exchange for disclosure of therapeutic value, in Benson's theory, gross lack of equivalence will warrant the avoidance of the settlement, even if the two sides are distinctively different.

B. The Plaintiff Firm Market

The incentive divergence between the plaintiff's counsel and the plaintiff class had led to the non-adversarial nature of the settlement agreement negotiation according to the court.[111] This incentive divergence further led to the systemic problem and market failure that eventually led to the over-compensation of the plaintiff's counsel and under-compensation of the plaintiff class. The main complaint is that the corporate

110. *See id.* at 190.

111. *See, e.g.*, *In re* Trulia Inc., Stockholder Litig., 129 A.3d 884, 893 (Del. Ch. 2016).

defendant will willingly pay the plaintiff's attorneys for broad releases. Many plaintiff firms make it a business model to obtain such an award as early as possible by reaching the disclosure settlement as cheaply and quickly as possible.[112] Several articles have been written to propose cures for the problem.[113] Such proposals include the influential one that requires materiality in approving disclosure-only settlement,[114] adjusting attorney's fee award according to the benefits conferred to the plaintiff class,[115] and shifting the attorney's fee to the plaintiff class.[116] However, the current practice does embody functional market mechanisms that will make the incentives of the plaintiff firms and the plaintiff class compatible.

When there is a meritorious case, the market will give plaintiff firms higher incentives to commit more resources in proving their theory and achieving a more beneficial settlement. After all, incentives between the plaintiff's counsel and the plaintiff class can be realigned when filing meritorious claims and achieving significant benefits for the shareholders can result in seven-figure attorney's fees, as it so happened in *Rural Metro Corp.*,[117] and filing weak claims, obtaining low value disclosures that moot claims that would lead to a five-figure award as in *Sauer-Danfoss*.[118]

The Court does not have the capacity to go provide the appropriate due diligence on the merits of the claims, but that should not concern most litigants, commentators, or practitioners. Since virtually all major mergers and acquisitions transactions attract litigation, the Court can often tell that there is little chance for the plaintiff class to obtain any monetary settlement in the first place. Approving a class action settlement that exchanges non-meritorious claims for a

112. *See* Friedlander, *supra* note 14.

113. *See, e.g.*, Friedlander, *supra* note 14; Griffith, *supra* note 18; Lebovitch & Kwawegen, *supra* note 18; Sumpter, *supra* note 18.

114. *See* Lebovitch & Kwawegen, *supra* note 18.

115. *See* Sumpter, *supra* note 18.

116. *See Correcting Corporate Benefit*, *supra* note 18.

117. *See* Friedlander, *supra* note 14.

118. *See In re* Sauer-Danfoss Inc. S'holder Litig., 65 A.3d 1116 (Del. Ch. 2011) (the court lowered the $750,000 award requested by the plaintiff's attorney for attorney's fees to $75,000 based on the merits of the work done).

broad release meets the fairness standard in Rule 23 of Delaware Court of Chancery Rules. On the other hand, the materiality requirement, regardless of the merits of the claims and availability of material information, will incentivize extortion and harassment toward the deep pockets. Also, the law firms that have built a business model for only delivering non-monetary settlements with the sole purpose of obtaining a six-figure attorney fee will not be sustainable in the market place. Such shops who rely on soliciting small investors and being selected by the Court as lead counsel in class action litigation will not likely succeed in landing representations when they have developed a reputation for only being able to deliver non-monetary settlements.

Based on a recent empirical study on the effectiveness of plaintiff law firms in mergers and acquisitions litigation and shareholder claims, the presence of identified top law firms is "significantly and positively associated with a higher probability of lawsuit success."[119] These top law firms are the entrepreneurial firms that vet the claims properly and devote substantial human and financial resources necessary to uncover a theory of breach of fiduciary duty. With such transparent market information, the firms that have developed the reputation of suing on every deal with "hastily drafted complaints"[120] will not likely be selected by the Chancery Court who select firms based on reputation and merits. Once selected, their proposed settlement would undergo more critical and severe scrutiny by the court before the approval of the settlement.

Consequently, shareholders with meritorious claims would be after the first-tier firms, and first-tier firms would have the

119. *See generally* C.N.V. Krishanan, Steven D. Solomon, & Randall S. Thomas, *Who Are the Top Law Firms? Assessing the Value of Plaintiffs' Law Firms in Merger Litigation*, 18 AM. L. ECON. R. 88 (2016).

120. Many complaints were filed upon the announcement of a transaction without committing the time and resources necessary to vet the claims. An extreme example can be found in *In re Cox Communications*. A proposal to acquire all of the public shares of Cox was announced at 4:06 am on August 2, 2004. By 8:36 am of that same day, the first of "a flurry of hastily drafted complaints" was filed with the Court. *See* Sumpter, *supra* note 18, at 680 (quoting *In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 608 (Del. Ch. 2005)).

luxury to choose from quality claims. The second-tier firms would have to settle for weak claims and it will make it even harder for them to prove their theories effectively and convincingly. Moreover, the plaintiffs would also be more likely to pursue and succeed in malpractice claims against these second-tier firms who might have cost the shareholders valuable claims. Since the plaintiff firm's markets favor merits, it would be much harder for the weaker firms with weaker claims to survive in the marketplace in the long run.

Moreover, the Court has the discretionary power to deny approval of the settlement when it is clear that there is gross disparity between the two sides of the settlement, which is a more effective tool to ensure fairness than requiring one side of the exchange to have value without knowing whether the other side has value. As it has been suggested by the Court, there are two things that the Court can do to prevent the imbalance between give and get. The Court sets the attorney's fee award corresponding to the benefit conveyed to the plaintiff class. The idea is that when the fee award is low enough to become non-profitable and all the counsel could deliver is a disclosure that has marginal and therapeutic value to the class, it would discourage plaintiff firms from taking on cases that are frivolous or invest more in proving the theory. The second tool is to refuse the proposed settlement when the release is too broad and conveys significant value compared to the marginal value of the information the plaintiff class received.

The materiality requirement proposal accepted by the court aims to disincentivize the plaintiff firms from suing on every case and force them to screen out frivolous claims.[121] However, a heightened standard for approval could make it more difficult for non-meritorious claims to go away, and go away cheaply.

As we have discussed, the first tier of top firms has the resources to investigate and screen out meritless claims, while the second-tier firms do not have the financial or human resources to do the same. Logically, they will either flee Delaware and sue in other jurisdictions or turn away most cases and deny plaintiffs access to litigation. Moreover, not

121. *See* Lebovitch & Kwawegen, *supra* note 18.

approving meager disclosures would be a denial of "deal insurance" or a punishment to the defendant, and denial of settlement leaves matters unresolved even if the court thought the claims were so weak that the plaintiff should abandon the case with prejudice.[122] The reality is that the defendants will provide modest monetary settlements in addition to the disclosures, as we have seen in *In re Cox Radio Inc. Shareholders Litigation*.[123] Even though the monetary settlement of $1 increase per share only provided modest benefit,[124] the Court will not second guess the monetary consideration and have to approve the settlement with broad release.[125] As a result, this practice might still result in under-compensation of the stockholders, which makes it more expensive to dispose of weak claims.

Imposition of materiality assumes there was no good faith in bargaining because of the divergent incentive of the plaintiff's counsel, all the shareholder claims are meritorious, and there was breach of fiduciary duty by failing to provide adequate material information in the preliminary proxy statement by the board.[126] Apparently, these premises are not always satisfied and the court is not in a good position to measure the value of the benefits that supplemental information conveys to the putative class, unless there is obvious gross disparity. The imposed materiality requirement assumes gross disparity exists in all disclosure-only settlements, which is likely not the case. On the other hand,

122. *See* Transcript of Settlement Hearing, *In re* Medicis Pharm. Corp. S'holders Litig., 2014 WL 1614336 (Del. Ch. Feb. 26, 2014) (No. 7857-CS) ("I understand, particularly from the defendants' side, the reality that what I've done probably, you know, in some ways has a punishing effect, because I don't know what else is out there that this leaves unresolved."); *In re* Transatlantic Holdings Inc. S'holders Litig., C.A. No. 6574-CS, 2013 WL1191738 (Del. Ch. Mar. 8, 2013) ("If the plaintiffs believe their claims are as weak as their brief presents, then they're obviously welcome to dismiss their claims with prejudice as to themselves and to move on if they don't wish to prosecute.").

123. *See In re* Cox Radio, Inc. S'holders Litig., C.A. No. 4461-VCP, 2010 WL 1806616, at *1 (Del. Ch. May 6, 2010).

124. *Id.*

125. *Id.* at *23.

126. *See id. See also* Gordon v. Verizon Commc'ns, Inc., 46 N.Y.S.3d 567 (App. Div. 2017).

enforcement of such a requirement creates an ethical dilemma that disclosing all material information would not entitle the company to the benefit of a disclosure-only settlement while withholding material information, a breach of fiduciary duty, makes it easy to settle shareholder claims.

C. Judicial Assessment of Merits and Attorney Fees

For the market mechanisms to function, the conflicted incentives of the plaintiff's counsel have to be compatible with those of the plaintiff class. It is essential that the level of attorney's fees corresponds to the merits of the disclosures obtained through the work of attorneys. In applying its discretion and judicial assessment,[127] the Chancery Court has adopted meticulous standards in measuring both the benefits of the disclosures and the level of attorney fees that should be awarded. *Sugarland* factors provide the guidance for the Chancery Court to determine an appropriate award. Such factors include:

> (i) the amount of time and effort applied to the case by counsel for the plaintiffs; (ii) the relative complexities of the litigation; (iii) the standing and ability of petitioning counsel; (iv) the contingent nature of the litigation; (v) the stage at which the litigation ended; (vi) whether the plaintiff can rightly receive all the credit for the benefit conferred or only a portion thereof; and (vii) the size of the benefit conferred.[128]

127. "[T]he amount of an attorneys' fee award is within the discretion of the court." *In re* Plains Res. Inc. S'holders Litig., No. Civ. A. 071-N, 2005 WL 332811, at *3 (Del. Ch. Feb. 4, 2005).

128. *Id.*, at *3 (listing the factors laid out in Sugarland Indus., Inc. v. Thomas, 420 A.2d 142, 149 (Del. 1980)).

1. Three-Scale Fee Awards

The *Sugarland* factors do not provide an effective tool for the Chancery Court to quantify an appropriate award given the fact that disclosure is "an intangible, non-quantifiable benefit."[129] Nevertheless, the Court has developed a three-scale system in *Sauer-Danfoss* that measures the benefits conveyed by the disclosures and places each case on a scale based on the quality of the disclosures and looks to "fee awards granted for similar disclosures."[130] This fee evaluating system works to realign the incentives between the plaintiffs and the plaintiffs' counsel without a materiality requirement.

Traditionally, most awards are in the range of $400,000 to $500,000. Chancellor Laster uses this range as the baseline award for "one or two meaningful disclosures."[131] Meaningful disclosures can be "previously withheld projections or undisclosed conflicts faced by fiduciaries or their advisors."[132] The award can be downgraded to the lower scale for disclosures of "questionable quality."[133] And higher awards are available for "particularly significant or exceptional disclosures."[134]

At the default level, Chancellor Laster found cases with awards ranging from $300,000 to $525,000. In this range, as Philip Sumpter observed, a few conditions have to be met: "(1) plaintiffs obtain a single meaningful disclosure, or (2) plaintiffs obtain lesser disclosures, but do 'real work' in litigating the case."[135]

To qualify for the default level of award, all the plaintiff's counsel must do is to obtain "one meaningful quanta of information."[136] A company's financial projection and banker's analysis are regarded as meaningful.[137] However, such

129. *In re* Sauer-Danfoss Inc. S'holder Litig., 65 A.3d 1116, 1136 (Del. Ch. 2011).

130. *Id.*

131. *Id.*

132. *Id.*

133. *Id.*

134. *Id.* at 1137.

135. Sumpter, *supra* note 18, at 708.

136. *Id.*

137. *Id.* at 708-10 (discussing *In re* Zenith, where the Court awarded $400,000 and "described the disclosure of management projections that were

disclosures are no longer sufficient to pass the *Trulia* court's material standard.[138]

Counsel's expended effort is more important to the Court than the time spent because it shows proof of adequate representation of a plaintiff's interest.[139] The effort might be measured by the number of depositions undertaken,[140] whether those depositions were offensive[141] or only confirmatory,[142] whether the case was settled before or after the injunction hearing,[143] whether full briefing and argument on application for preliminary injunction was prepared,[144] and whether a preliminary injunction was granted,[145] among other factors.

The award would be downgraded to the lower-than-$300,000-range when the disclosures only convey meager benefits[146] and the claims themselves are so weak that it

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used by the company's banker in connection with its fairness opinion as a meaningful, or 'major' disclosure," and Turberg v. Arcsight, where "the Court awarded $500,000 in attorneys' fees because the plaintiffs obtained previously-undisclosed banker's analysis."); *see In re* Zenith Elec. Corp., 329 F.3d 338 (3d Cir. 2003); Turberg v. Arcsight, Inc., C.A. No. 5821-VCL, 2011 WL 4445653 (Del. Ch. Sept. 20, 2011).

138. *See In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884 (Del. 2016) (holding synergy figures regarding financial advisor's value-creation analysis and information regarding individual company multiples used in financial advisor's selected transaction analysis were not material and thus did not provide adequate consideration for settlement.).

139. *See Sauer-Danfoss,* 65 A.3d at 1139 ("When an entrepreneurial plaintiffs' firm engages in adversarial discovery, obtains documents from third parties, pursues motions to compel, and litigates merits-oriented issues"). *See also* Lance P. McMillian, *The Nuisance Settlement "Problem": The Elusive Truth and a Clarifying Proposal*, 31 AM. J. TRIAL ADVOC. 221, 258 (2007).

140. *See generally In re* Lear Corp. S'holder Litig., 926 A.2d 94 (Del. Ch. 2008).

141. *Id.*

142. *See, e.g.*, Augenbaum v. Forman, No. C.A. 1569-N, 2006 WL 1716916 (Del. Ch. June 21, 2006).

143. *See, e.g.*, Globis Capital Partners, LP v. SafeNet, Inc., C.A. No. 2772-VCS, 2007 Del. Ch. LEXIS 213, at *8 (Del. Ch. Dec. 20, 2007) (settled after injunction hearing and a $1,200,000 fee was awarded). *See also Augenbaum*, 2006 WL 1716916, at *2 (the case was settled without an injunction hearing, as a result, the fee was only $225,000).

144. *See generally In re Lear Corp.*, 926 A.2d. at 94.

145. *Id.*

146. Sumpter, *supra* note 18 at 715.

should not have been brought in the first place.[147] It can also arise from the fact that the counsel "claimed excessive hours,"[148] the majority of which "derived no benefits."[149] Also, settling too early without achieving a solid benefit is another cause for a downgrade.[150] Lastly, an award over $500,000 requires significant and exceptional disclosures. This happens when the plaintiff's counsel took a risk[151] and hit a "home run."[152]

In such cases, the plaintiff's counsel might have taken ten offensive depositions, two defensive depositions, and secured a preliminary injunction.[153] They received such disclosures as information about CEO's conflict of interest and CEO's role in negotiation and the sale process,[154] or they had prepared a full brief, delivered an argument at injunction hearing, and settled only after an injunction hearing.[155] They also received extensive detailed descriptions of banker's fairness opinions and underlying analyses, two complete bankers' books, and more than 100 pages of disclosure.[156] In these two cases, the fees were set, respectively, at $800,000 and $1,200,000.[157]

As we have seen, meticulous and articulate standards in awarding attorney's fees have been established. Minimal benefits will qualify for minimal fees and meaningful disclosures will justify a hefty fee. Such guidelines shall be sufficient to measure the work of the plaintiff's counsel and make sure their incentives and interests align with the

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147. *Id.* at 719.

148. *Id.* at 720.

149. *Id.*

150. *Id.* at 721.

151. *In re* Sauer-Danfoss Inc. S'holder Litig., 65 A.3d 1116, 1140 (Del. Ch. 2011).

152. *See* Transcript of Settlement Hearing at 34, Globis Capital Partners, LP v. Safenet, Inc., 2007 Del. Ch. LEXIS 237 (Del. Ch. Dec. 20, 2007) (C.A. No. 2772-VCS).

153. *See, e.g.*, *In re* Lear Corp. S'holder Litig., 926 A.2d 94 (Del. Ch. 2008).

154. *Id.*

155. *See generally, e.g.*, Globis Capital Partners, LP v. SafeNet, Inc., C.A. No. 2772-VCS, 2007 Del. Ch. LEXIS 237, at *8 (Dec. 20, 2007).

156. *Id.*

157. *See In re Lear Corp.*, 926 A.2d at 94; *Globis Capital*, 2007 Del. Ch. LEXIS 237 at *1.

plaintiff class.

Application of such principles can be seen in cases in both pre- and post-*Trulia* periods. Fairness and balance between give and get matter, but materiality does not appear in both pre and post-*Trulia* periods. When the Court is not convinced by the counsel's effort that the claims have been vigorously investigated, neither settlement nor fee award would be approved. Wherever a settlement was approved and fee was awarded, the fee award is entirely merit-based and fits in one of the three scales discussed above.

In a 2013 case, then-Chancellor Strine declined to approve a disclosure settlement in *In re Transatlantic Holdings Inc. Shareholders Litigation*[158] even when the traditional thing to do would be to certify a class, approve the disclosure settlement, and award an attorney fee.[159] Strine admitted that it was rare to place a duty on the court to "make sure that classes are effectively represented . . . ."[160] The court is required "to act even in the absence of any kind of opposition to a settlement."[161] Though Strine emphasized that the additional information was not meaningful, not to mention material, this was not the true reason he acted untraditionally. It is the imbalance between the possibility of loss of a valuable claim and the certainty that information that is of little utility that warranted the rejection of the disclosure settlement. As Strine stated, "I don't have any confidence, unfortunately, that there was a real plaintiff behind this monitoring counsel."[162] Strine suspects that a more diligent plaintiff might be able to come forward with a damages action in the future. The likelihood of this incident and, more importantly, the value of this future option are more desirable to the Court than the virtually valueless supplemental information.[163] In serious doubt of the equivalence or equality in the settlement, Strine denied the settlement in the absence of any opposition and

158. *In re* Transatlantic Holdings Inc. S'holders Litig., No. 6574-CS, 2013 WL 1191738, at *1 (Del. Ch. Mar. 8, 2013).

159. *Id.*

160. *Id.*

161. *Id.*

162. *Id.* at *2.

163. *Id.*

decided to evaluate the merits of the case through an adversarial process. The *sua sponte* rejection without an objection was to ensure that the Court did not approve a class action settlement that was clearly unfair.

In *Riverbed*,[164] a case of similar facts decided in 2015, the court approved the settlement despite the fact that the disclosures cannot be found to be of any value except for small, therapeutic value to the class. Vice Chancellor Glasscock confirmed that this was the situation where, in Chancellor Allen's expression, "the plaintiffs have achieved for the Class a peppercorn."[165] The court was the least bothered by the fact that the benefit conferred by such settlement was insubstantial. I think that what really concerned the court was whether there was a disparity between what the plaintiffs give up and what they receive. The *Riverbed* court sided with Chancellor Allen in that a peppercorn is sufficient to support a settlement so long as it is equal to the merits of the claims given up.[166] In this case, the court was convinced that what was given up by the plaintiff was "basically nil" because, by the plaintiff's counsel's own admission, they did not have a viable claim under federal securities law.[167] Again, value, benefits, and materiality of the disclosure do not matter to the Delaware Court of Chancery. The parity between the two sides of the settlement does. It might appear that this decision was a clear deviation from *Transatlantic Holdings* and *Trulia*, I, however, see the consistencies. Here, even though the court was convinced that the disclosure was valueless, so were the plaintiff's claims. The court relied on the testimony of plaintiff's counsel about the viability of the claims in determining that the give from the class was "basically nil."[168] The parity between the two sides of the settlement warranted the approval. Still, given the merits of the disclosures, the Court lowered the requested $500,000 fee to a fee that is within

164. *In re* Riverbed Tech., Inc. Stockholders Litig., No. 10484-VCG, 2015 WL 5458041, at *1 (Del. Ch. Sept. 17, 2015).

165. *Id.* at *5.

166. *Id.* ("[A] positive result of small therapeutic value to the Class which can support . . . a settlement, but only where what is given up is of minimal value.").

167. *Id.*

168. *Id.*

the default range, $200,000.[169] Again, fairness matters, materiality of disclosures does not.

Interestingly, in a recent post-*Trulia* case in Delaware, Vice Chancellor Glasscock, the *Riverbed* judge, reaffirmed the materiality test in *Trulia* but awarded a fee for supplemental disclosures that mooted four disclosure claims and ruled that materiality was not required.[170] He argued that materiality does not apply to the award of attorney's fees when there was no settlement and a modest benefit of the supplemental disclosure would support the award of attorney's fees.[171] The plaintiffs sought $275,000 in attorney fees, the court awarded only $50,000.[172]

2. Scope of the Release Proportionate to the Scope of the Disclosures

The Chancery Court consistently refuses to approve releases when the scope of the release is too broad compared to the benefits conveyed by the disclosure.[173] This practice works to minimize global release and the loss of valuable claims. Again, the success of such practice does not rely on having a materiality requirement.

D. *Gordon v. Verizon*: The Best Interest of the Putative Class is to Enforce the Bargain

New York courts did not follow Delaware in imposing a materiality requirement. On the other hand, they enforce the bargain when they are convinced that there was a presence of bargaining in good faith.[174] In this recent post-Trulia case,

169. *Id.* at *8.

170. *In re* Xoom Corp. Stockholder Litig., No. 11263-VCG, 2016 WL 4146425, at *1 (Del. Ch. Aug. 4, 2016).

171. *Id.*

172. *Id.*

173. *See, e.g.*, *In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884 (Del. Ch. 2016); *In re* Medics Pharm. Corp. S'holders Litig., No. 7857-CS, 2014 WL 1614336, at *1 (Del. Ch. Feb. 26, 2014); *In re* Transatlantic Holdings Inc. S'holders Litig., No. 6574-CS, 2013 WL 1191738, at *1 (Del. Ch. Mar. 8, 2013).

174. *See* Gordon v. Verizon Commc'ns, Inc., 46 N.Y.S.3d 557 (App. Div.

Gordon v. Verizon Communications, *Inc.*,[175] the court expressly deviates from the tone set by *Trulia*. The New York Appellate Court deliberately went for a different direction that favors the non-monetary disclosure settlement when the merits of the case warranted the disclosure settlement. The review of settlement begins by examining "the likelihood of success, the extent of support from the parties, the judgment of counsel, the presence of bargaining in good faith, and the nature of the issues of law and fact."[176] The New York Court also set a different test for approving non-monetary settlement: whether such settlement would be in the best interest of the members of the putative class of shareholders and the corporation.[177]

The court agreed with plaintiff's decision to withdraw their claims for monetary damages "recognizing that they would be difficult to prove at trial."[178] The court's interest in assessing the claims through adversarial process is conditioned upon the availability of helpful additional disclosures. Here, the court would approve the existing disclosure agreement because they doubted the adversarial process would help plaintiff obtain "any more helpful disclosures."[179] In addition, the New York court understands that the best interest of the class is not necessarily served by requiring either the monetary settlement or the materiality of additional disclosure. According to the *Gordon* court, the present proposed settlement, albeit nonmonetary, does provide benefits to the plaintiff class with its inclusion of a fairness opinion requirement in the event that Verizon engages in a transaction with a book value in excess of $14.4 billion, and corporate governance reforms.[180] These benefits warranted not only the approval of the settlement, but also an award of attorney's fees to the plaintiff's counsel.[181]

2017).

175. *Id.*

176. *Id.* at 566.

177. *Id.* at 568.

178. *Id.* at 567.

179. *Id.* (the court reasoned that "[i]t would be speculative, at best, to assume that plaintiff could have obtained any more helpful disclosures from Verizon by proceeding to trial.").

180. Gordon v. Verizon Commc'ns, Inc., 46 N.Y.S.3d 557, 569 (App. Div. 2017).

181. *Id.* (citing Seinfeld v. Robinson, 676 N.Y.S.2d 579 (App. Div. 1998)).

The court expressly disavowed the Delaware requirement that "additional information provided to shareholders in a disclosure must contradict what has been previously disclosed in order for the disclosure to be material is not supported by New York law, however."[182]

IV. Challenges to the Finality of Settlement: *Ex-Post* Remedies to Overbroad Release

As I have argued earlier, the materiality requirement does not ensure fairness and the doctrine of consideration dictates that supplemental disclosure need not be adequate to be a legally sufficient consideration.[183] The combination of market competition and judicial assessment works better to serve the aim of achieving fairness in such class action settlements. As to the overbroad release, the *ex-ante* scrutiny by the Court is crucial but will never be able to prevent release of all meritorious claims. Still, there is an *ex-post* remedy provided by contract law if overall imbalance or gross disparity was resulted from the settlement. Finality of settlement can be challenged, enforcement of a release of liability can be rescinded when it was induced by fraudulent misrepresentation, and as being unconscionable when such a release was overbroad compared to the benefit conveyed by supplemental disclosure.

A. Fraud

A release can also be rescinded if it was induced by fraud. In *Matsuura v. Alston & Bird,* the Ninth Circuit held that releases signed in connection with settlement did not bar action alleging fraudulent inducement of those releases.[184] The court announced that parties who have been fraudulently induced to enter into a contract have a choice of remedies: they may rescind the contract or they may affirm the contract and

182. *Id.* at 571.
183. *See* RESTATEMENT (SECOND) OF CONTRACTS § 71 (AM. LAW INST. 1981).
184. *See generally* 166 F.3d 1006 (9th Cir. 1999).

sue for fraud.[185] The court was of the opinion that "[e]nforcing such a settlement would undermine the policy of encouraging voluntary settlement of disputes: if litigants cannot assume the disclosures and representations of the opposing party are made in good faith, they will be reluctant to settle."[186]

Following the teaching of *Matsuura*, the settlement could be rescinded by the plaintiff class if there were any misrepresentations made to induce a disclosure settlement that secures broad release by giving out valueless additional disclosure.

B. Overbroad as Unconscionable

Case law supports rescission based solely on overall imbalance. In divorce settlements, an unfair settlement clause would be deemed unconscionable. For example, in a New York case, a settlement clause escalating lifetime (even if she remarried) maintenance payments to the wife by four percent every year was deemed unconscionable and set aside.[187] The court reasoned that it "represents a sum far in excess of the value of plaintiff's marital distribution."[188] In cases like this, settlements can be set aside based simply on an unfair price.

In analogy, when disclosure was given in exchange for an overbroad release compared to the benefits conveyed, when reasonableness between give and get is missing and gross disparity can be proved, the plaintiff class or the defendant corporation would be able to rescind the settlement as unconscionable.

In addition, even when one argues that procedural unconscionability also has to be met before unconscionability can be applied due to the huge disparity in sophistication and resource between the stockholder class and the board of directors, procedural unconscionability would not be difficult to establish through the obvious unequal bargaining power between the two.

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185. *Id.* at 1008.
186. *Id.* at 1012.
187. Santini v. Robinson, 891 N.Y.S.2d 100 (App. Div. 2009).
188. *Id.* at 104.

V. Conclusion

The standard in approving class-action settlements has always been fairness of the settlement. Due to the agency problem and the conflicted interests between the plaintiff class and the plaintiff's counsel in the context of disclosure-only settlements, the Delaware Court of Chancery established the heightened materiality standard in approving such settlements. Supposedly, such a solution shall curb the conflict of interest and ensure fairness in disclosure-only settlements. It is also supposed to prevent corporations from receiving court-approved overbroad releases through non-material disclosures.

However, a settlement is a contract. As I have established, contract law preserves fairness by enforcing the bargain as it is. The materiality requirement, on the other hand, will contradict the very notion that enforcement of pre-existing legal duty is no consideration. Also, it will not serve the public policy of ensuring fairness in disclosure-only settlements. It also creates the ethical dilemma that would encourage corporations to withhold material information. As I have proved, market mechanisms function to eventually weed out plaintiff firms that bring weak claims and have no interest in adequately representing a plaintiff class. Chancellors have used their discretionary power to reject settlements and fee awards when it is clear that there was no adequate representation. Judicial assessment of the Court in determining the fee award realigns the incentives and interest between the plaintiff class and the plaintiff's counsel by quantifying attorney's fees according to a meticulous three-scale system.

Moreover, finality of settlement can be challenged and overbroad release can still be rescinded by applying two contract law doctrines: fraudulent misrepresentation and unconscionability.

Lastly, I predict the materiality standard will not sit well with the approval of disclosure-only settlements. In enforcing a contract, all that a court ought to do is to enforce the bargain and make sure the bargaining process was in good faith and conducted fairly. Market competition will ensure the fairness of the price, as the price would naturally be the fair market

price. When market is not competitive, exploitation will take place. When there is a lie, fraudulent inducement would be sufficient to rescind a contract. When there is no lie, unconscionability works to restore the fairness. Disclosure settlements can be valuable to the stockholder class and shall continue its function in shareholder litigation. The future of approving disclosure-only settlements lies in the combination of judicial enforcement of the bargain and meticulous judicial assessment of attorney's fees.