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ROUNDTABLE July 2021

SHAREHOLDER DISPUTES

While coronavirus (COVID-19) temporarily halted the steady rise in shareholder disputes seen in recent years, shareholders still found time to file a range of claims, including allegations of a lack of diversity among boards of directors and senior management, as well as new categories of event-driven, pandemic-related litigation. However, as the situation slowly improves, many expect to see an uptick in the volume of both shareholder activism and litigation in 2021 and beyond, as parties adjust to the post-COVID-19 landscape. ■

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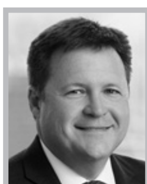

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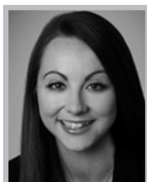

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FW: Reflecting on the last 12-18 months or so, are you seeing an increase in the number of shareholder disputes? What are some of the common causes of such disputes?

Sylvia: In 2020, the overall number of filings in the US still significantly outpaced the historical average. Due to an increase in M&A activity, primarily driven by de-SPAC (special purpose acquisition company) transactions, suits challenging the adequacy of deal disclosures have increased during the past six months. Whereas these suits once were filed exclusively in the Delaware Court of Chancery, the majority of suits now are filed either in federal district court, alleging violations of Section 14 of the Securities Exchange Act of 1934, or in New York state court, alleging breach of the fiduciary duty of disclosure. These suits typically are resolved by the target company agreeing to make supplemental disclosures and the payment of a legal fee to plaintiff's counsel. I also have observed an uptick in the traditional Section 10(b) class action securities fraud suits fuelled by recent stock market volatility.

Hines: Last year shareholders filed fewer securities class action and shareholder derivative complaints in the US than in 2019, at least partly because of the coronavirus (COVID-19) pandemic. We do not expect this moderate decrease in filings to continue, particularly as the pandemic improves. The causes of shareholder litigation vary, but certainly the pandemic brought about a new category of event-driven litigation, as shareholders filed complaints against companies negatively impacted by COVID-19 or that made statements about products or treatments to address the pandemic. In addition, shareholders began filing derivative lawsuits seeking to hold directors and officers (D&Os) accountable for the alleged lack of diversity among boards of directors and senior management and have targeted statements in corporate filings about commitments to diversity as false or misleading.

Lund: Over the last few years, there has been a steady rise in shareholder disputes in the UK. However, during 2020 – amid the COVID-19 pandemic – there appears to have been a temporary hiatus. This pause seems to be a result of, and to coincide with, a wider conciliatory approach to counterparties across the disputes market more generally, with parties heeding Cabinet Office guidance calling on corporates to steer clear of litigation throughout the pandemic, and, where necessary, turn to negotiation and mediation instead. It also reflects a reported depression in shareholder activism in 2020. That said, there is an expected uptick in the volume of both shareholder activism and litigation in 2021 as parties readjust to the post COVID-19 landscape. The volume of litigation in particular is expected to surpass even 'normal' pre-pandemic heights.

Schwartz: Despite the constant headlines, there has been a small decline in disputes over the last year. For example, according to Cornerstone Research's annual Securities Class Action Filings report, plaintiffs filed 334 new securities class actions in US federal and state courts in 2020, a 22 percent drop from 427 in 2019. Similarly, M&A filings against US companies dropped to their lowest level since 2016. It is possible that the COVID-19 pandemic, including the closing of the courts, was a contributing factor to this decline. Of course, 2020 also saw several COVID-19-related lawsuits, including claims that companies downplayed the risk of COVID-19, misrepresented the effectiveness of products to test or treat COVID-19, or failed to warn investors about pandemic-related risks to supply chain management or distribution channels.

McDonald: In the last year or so, in the US, we have seen more shareholder lawsuits concerning environmental, social and corporate governance (ESG) claims, such as complaints alleging that public company boards had not done enough to diversify their ranks or their management teams. Although these cases have so far been unsuccessful, they signal a trend we expect will continue. There has also been an explosion of shareholders seeking books and records whenever a public company faces public accusations of wrongdoing, and that has led to an increasing number of 'Caremark' claims being filed against directors alleging that they breached their duties of oversight.

FW: Have any recent, high-profile shareholder disputes caught your attention? What unique challenges and legal considerations do these cases highlight?

Hines: One interesting area is the intersection between the 2018 Supreme Court decision in *Cyan* and the March 2020 Delaware Supreme Court decision in *Sciabacucchi*. In *Cyan*, the Supreme Court held that state and federal courts have concurrent jurisdiction over claims brought under the Securities Act of 1933, and therefore Securities Act claims filed in state court are not removable to federal court. That decision led to a proliferation of securities class actions filed in state court. In response, companies began adopting federal-forum selection provisions, requiring shareholders to bring Securities Act claims in federal court. In *Sciabacucchi,* the Delaware Supreme Court unanimously held that such federal-forum provisions were valid and enforceable under Delaware law. The second half of 2020 saw a noticeable decline of Securities Act cases filed in state court, perhaps partly as result of *Sciabacucchi*. It will be interesting to see if that trend continues in 2021, and whether other states will enforce similar federal-forum provisions.

Lund: In recent years, there has been a number of significant shareholder class action claims before English courts. Most notably, these include the RBS rights issue litigation and the Lloyds/HBOS litigation. Before it settled in 2017, the RBS dispute arose from allegations that statements about RBS's financial health in its 2008 rights issue prospectus were misleading. The number and differing nature of claimants – alongside large institutional investors, thousands of private investors

were involved – meant that lawyers had to manage distinct groups of claimants with divergent objectives during the course of the matter and in settlement negotiations. The settlement procedure itself was complicated, with different groups of claimants settling at different times. The Lloyds/HBOS litigation represented the first shareholder class action to reach trial before English courts. In a 2019 judgment, the High Court rejected the shareholders' claims, which alleged that the directors had done the following. First, negligently recommended to Lloyds shareholders that they should vote in favour of the acquisition of HBOS. Second, failed to provide shareholders with sufficient information to make an informed decision on how to exercise that vote. And third, made negligent misstatements about the merits of the acquisition. This case demonstrates the complexities of the procedure applicable to claims by groups of shareholders.

Schwartz: In the second half of 2020, a series of shareholder lawsuits were filed against The Gap, Oracle, Qualcomm, Facebook and NortonLifeLock in California federal courts, alleging that each company made false or misleading statements in its proxy statements about its commitment to diversity. These types of complaints, which are fairly new, allege that despite making statements about a commitment to diversity in hiring, the companies' boards lack diverse membership. In April, Facebook won a motion to dismiss these allegations. There, the district court held that the plaintiffs had failed to make a shareholder demand, and that the alleged misstatements amounted to aspirational 'puffery'. While these cases may be 'paper tigers', they underscore that certain investors may try to use the courts to force companies to adopt certain ESG policies and agendas. The ESG issue could grow in importance as the Biden administration has stated that it intends to make increasing ESG disclosures part of its agenda.

McDonald: One area of shareholder disputes to watch is lawsuits challenging SPACs, which are formed as public companies with no operations for the specific purpose of merging with a privately held target, when they complete their merger with a private target, which is often called a 'de-SPAC merger'. SPACs have exploded in popularity in the last year, and one complaint recently filed in the Delaware Court of Chancery by a SPAC shareholder against the board of directors and sponsor of the SPAC makes sweeping allegations that the SPAC business model is rife with conflicts of interest. Many other would-be shareholder plaintiffs will be watching the outcome of this case closely.

Sylvia: *Amo v. Multiplan, et al.*, filed in March 2021 in the Delaware Court of Chancery, presents an interesting challenge to the SPAC model. Characterising the securities market's "latest and greatest" innovation as "SPAC 1.0", the plaintiff alleges that the SPAC model is "conflict-laden" and "practically invites fiduciary misconduct". Depending on how the court rules on the merits of the plaintiff's claims, this case could have transformative consequences for how SPACs are structured as well as the requirements for shareholder approval of de-SPAC merger transactions. Coupled with heightened Securities and Exchange Commission (SEC) scrutiny of SPAC transactions, fiduciary challenges voiced in *Multiplan* potentially could alter the way SPACs are sponsored as well as the sponsor's role in selecting and influencing a de-SPAC merger transaction.

FW: In your opinion, how important is it for companies to develop a quick and decisive strategy for resolving shareholder disputes? Do you believe that companies pay enough attention to this issue before disputes of this nature arise?

Lund: It is imperative that companies develop a quick and decisive strategy for resolving shareholder disputes. A company itself should seek legal advice at the earliest possible stage to ensure that its rights are adequately protected, and that it is fully aware of how its articles of association and any shareholders' or joint venture agreements should operate. Depending on the nature of the dispute, the stakes may also be high for individual directors who may need to obtain independent legal representation, which will, of course, increase costs and subsequently give rise to its own challenges as the dispute progresses. Even prior to a dispute arising, companies should gauge the mood of shareholders and seek to invest in and nurture these relationships. Companies should also look out for warning signs of a potential dispute and proactively manage

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>
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contentious issues which may give rise to disagreements. If shareholders are, or are about to become, disgruntled, companies should consult litigators and other crisis management advisers to assist in navigating the way forward.

Schwartz: The old adage that an ounce of prevention can be worth a pound of cure applies. Companies can plan by implementing robust compliance controls, strong corporate governance provisions, and making sure they have a sufficient number of independent directors. Moreover, all publicly disclosed documents should be closely reviewed. Companies would also be well-advised to retain litigation counsel to evaluate the risk of important business decisions and to deal with nascent problems. Indeed, companies often get themselves in trouble not because of bad business developments, but because of their disclosure and handling of those developments. Finally, companies should consider whether their bylaws should contain forum selection clauses requiring any shareholder disputes to be brought in a single forum that, preferably, is not plaintiff friendly.

Sylvia: In situations where a company needs to raise capital, or the likelihood of prevailing on a motion to dismiss is remote, exploring early settlement via negotiation or mediation often is an attractive strategy to resolve shareholder disputes. For M&A disclosure suits, early settlement premised on supplemental disclosures is the default strategy. Given the risk that a disclosure suit could delay or derail a transaction, paying a nominal settlement fee is an easy choice – hence why these suits are colloquially referred to as 'deal tax' suits. Insofar as disclosure suits are ubiquitous in M&A transactions, well-counselled boards know litigation is inevitable and plan accordingly. While companies rarely can anticipate negative setbacks that may engender a Section 10(b) suit, I believe that the majority of companies do appreciate that the plaintiffs' bar is waiting in the wings to pounce on any opportunity to claim that market underperformance is the product of 'fraud'. A careful consideration of appropriate, tailored risk factor disclosures is the best prophylactic to defend against such claims.

"COMPANIES OFTEN GET THEMSELVES IN TROUBLE NOT BECAUSE OF BAD BUSINESS DEVELOPMENTS, BUT BECAUSE OF THEIR DISCLOSURE AND HANDLING OF THOSE DEVELOPMENTS."

MATTHEW A. SCHWARTZ
Sullivan & Cromwell LLP

McDonald: A winning strategy in shareholder litigation often begins before any lawsuit is filed. That is why it is critical for boards to be well advised when engaging in important transactions or making important decisions. Litigators are often called in to provide pre-litigation counselling for this reason. Among other things, boards of Delaware companies should be aware that increasingly, shareholders are using Delaware's 'books and records' statute to obtain not just the board's minutes and other formal materials, but also informal communications like emails and text messages in some circumstances, before any complaint is filed.

Hines: It is critical to take steps to manage the risks associated with a potential claim before a dispute materialises, including regularly reviewing disclosure, governance and record-keeping protocols. Following the materialisation of a dispute, it is advisable to conduct a preliminary factual investigation to assess the merits of the dispute. Too often parties ignore this preliminary factual work at their peril, as the results will inform several key strategic decisions, including the scope of likely discovery, an assessment of strengths and weaknesses of claims and defences, and whether early settlement discussions are appropriate under the circumstances. Early involvement of expert witnesses is also beneficial to gain an understanding of potential exposure, which might be used to inform a settlement strategy.

FW: What particular challenges and legal considerations do shareholder disputes typically generate? What steps might be taken to overcome them?

McDonald: Shareholder litigation alleging breaches of fiduciary duties often raises complex issues and challenges requiring experienced counsel who have expertise in such litigation, which is typically but not always filed in Delaware. Often, the dispute focuses on whether the directors or officers of the company, or controlling shareholder, breached their fiduciary duties. There are several doctrines that have been developed by the courts that they use to determine whether a fiduciary duty claim can proceed to discovery and ultimately be sustained after trial, depending on the context.

Hines: One major challenge in shareholder disputes concerns the prospect of event-driven litigation resulting in multiple proceedings. For example, the filing of a securities class action often

results in a different shareholder filing a derivative action claiming that the board breached its fiduciary duties by failing to prevent the conduct that forms the basis of the initial class action complaint. In addition, the underlying event could also result in governmental investigations. When facing multiple proceedings, it is paramount to formulate a holistic approach to the various matters, where responses in each proceeding are coordinated and, to the extent possible, reinforce the themes of the case. At a minimum, a company must ensure that it does not take positions in litigation that could potentially undermine positions in more important government investigations.

Sylvia: The fundamental consideration is cost, both in terms of out-of-pocket expense and loss of productivity. Once a plaintiff's complaint survives a motion to dismiss challenge, the burdens of discovery rest entirely on the defendants insofar as a representative plaintiff rarely possesses relevant information beyond evidence related to the purchase of the defendant company's stock. In the age of e-discovery, the costs to comply with discovery requests can exceed seven figures – not including the intangible costs attendant to a management team distracted by responding to discovery as opposed to running the business. While litigation is inherently expensive, companies can take steps to mitigate the costs of e-discovery by ensuring that directors and C-suite officers exclusively utilise corporate servers, as opposed to personal emails and text messages, to conduct company business and maintain an up-to-date repository of corporate books and records, such as board minutes, resolutions and director board packages.

Schwartz: The most challenging part of shareholder disputes is their breadth. Shareholders can bring a suit on any number of theories, from fraud to conflicts of interest to M&A claims. As a result, companies need to be ready for anything. Despite the variety of theories, however, most shareholder claims stem from a material misrepresentation or omission in publicly available company documents. As a result, the best offence is a good defence – companies should be thorough in reviewing their corporate disclosures for accuracy, but also consistent between documents. Other suits stem from conflicts of interest, or an allegation that the board was biased or misled during a transaction. Therefore, it is important to maintain a sufficient number of independent directors who can comprise a special independent committee as needed.

> EARLY INVOLVEMENT OF EXPERT WITNESSES IS ALSO BENEFICIAL TO GAIN AN UNDERSTANDING OF POTENTIAL EXPOSURE, WHICH MIGHT BE USED TO INFORM A SETTLEMENT STRATEGY.
>
> MICHAEL S. HINES
> Skadden, Arps, Slate, Meagher & Flom LLP

Lund: Shareholder disputes can be incredibly costly – financially, reputationally and in terms of time and business disruption, including by way of management distraction. These consequences are often underestimated at the outset of a dispute but can become key challenges for all stakeholders as a dispute progresses. To avoid wasted time and costs, parties should take early legal advice and, with the benefit of that advice, seek to negotiate a solution. Legal considerations will include an analysis of relevant rights, obligations and potential remedies, which may be found in relevant corporate documents, as well as derived from the statutory regime. In addition to pure litigation advice on the merits of the dispute, if allegations are levelled against individual directors, then employment issues may arise, as may the need to conduct an internal investigation into the alleged conduct.

FW: What advice can you offer to shareholders when it comes to drafting and understanding key corporate documents, such as articles of association, in terms of mitigating disputes or assisting in their resolution?

Hines: Forum selection clauses included in a corporation's governing documents have received increased attention over the past year. First, in March 2020, the Delaware Supreme Court issued a ruling in *Sciabacucchi* upholding the validity and enforceability of provisions contained in a Delaware corporation's certificate of incorporation that required shareholders of that corporation to file suit alleging violations of the Securities Act of 1933 in federal court, rather than state court. Separately, in April 2021, a California federal court dismissed a shareholder derivative case alleging that a company's board of directors failed to create meaningful diversity on the board and within the company's leadership. That dismissal was based on the forum selection clause contained in the company's bylaws designating the Delaware Court of Chancery as the exclusive forum for derivative claims. As these two cases

underscore, forum selection clauses provide companies with a tool to exercise control over the venue of certain types of shareholder claims, thereby avoiding duplicative litigation and steering cases to forums more accustomed to hearing those disputes.

Sylvia: For Delaware corporations, including exclusive Delaware forum provisions in the corporate charter ensures that corporate disputes will be resolved by a Delaware court – usually the Court of Chancery – applying settled principles of Delaware law. Recently, companies have adopted exclusive federal forum provisions in corporate charters in an effort to ensure that section 11 claims under the Securities Act of 1933, which can be brought in federal or state court, are litigated in a federal forum. Last year, the Delaware Supreme Court, in *Sciabaucucchi*, upheld the propriety of exclusive federal forum provisions for Securities Act claims, but it is still an open issue whether other state courts will respect these exclusivity provisions.

Schwartz: Adding a few key clauses in founding documents can help founding shareholders mitigate costs and litigation risks. Specifically, founding shareholders would do well to add so-called exculpation clauses to key documents to limit future director liability and make it more difficult for shareholders to win on a fiduciary duty claim. Additionally, founding shareholders should be thoughtful about the state of incorporation. Although Delaware has traditionally been the primary state of incorporation for companies, Nevada and New York have become more competitive states of incorporation, with Nevada courts in particular issuing corporate-friendly decisions. Similarly, adding a forum selection clause requiring that shareholder litigation against the company be brought in a single, preferably corporate-friendly, forum can mitigate the risk that future actions on the same issues are brought by different plaintiffs' lawyers in multiple jurisdictions at the same time.

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Lund: Given English courts' approach to contractual interpretation, key corporate documents will be their starting point when it comes to establishing parties' rights, obligations and potential remedies. It follows that immense care should be taken when drafting these documents and shareholders should take advice to ensure they properly understand their rights, their obligations and the obligations owed to them by their fellow shareholders and the company. This is particularly important in light of a recent High Court decision – *Euro Accessories Ltd* – which, while reaffirming the usual principles of contractual interpretation, also noted that when interpreting a company's articles of association, the court will only have regard to those facts that readers would reasonably be expected to know and, in particular, the court will not take into account all of the factual background. It is therefore beneficial to anticipate, as far as possible, the potential for disputes among shareholders and provide for this in articles of association or shareholders' or joint venture agreements. Doing so may ultimately save a great deal of time, money and reputational harm.

McDonald: In the US, many companies now have forum-selection provisions in their charters or bylaws, which often require that shareholder disputes be brought in a single jurisdiction, typically Delaware. These provisions have generally been upheld by courts inside and outside Delaware to avoid wasteful and costly multi-forum shareholder litigation, and to provide predictability in shareholder litigation. Recently, the Delaware Supreme Court also upheld forum-selection provisions adopted by companies in their charters requiring that certain federal securities cases be litigated in federal court.

FW: What advice would you give to parties embroiled in a shareholder dispute in terms of the options for mitigating the costs – in both a financial and reputational context?

McDonald: In shareholder litigation, the goal of directors or officers that have been sued is often to get out of the case on a motion to dismiss. Once litigation proceeds past a motion to dismiss, it can become quite costly and distracting. For example, discovery may involve the collection of emails and other documents, and depositions. With this in mind, the courts in Delaware and elsewhere have developed doctrines designed to allow fiduciaries who have followed the right process to get shareholder claims against them dismissed.

Schwartz: Pre-litigation negotiations outside of court, whether supervised

through mediation or conducted through more informal channels, can avoid the need for costly, drawn-out litigation and result in a more amicable resolution. The involvement of the company's insurance carriers at the onset of a matter is very important to resolving disputes.

Lund: Parties should be advised not to let their emotions take over. While that might be easier said than done, protracted disputes driven by emotion will only serve to further sour relationships between a company and its shareholders, and between shareholders themselves. Such disputes will, no doubt, also give rise to adverse publicity and increased media interest, which could be particularly damaging if it portrays the board and management as treating shareholders badly and failing to properly run the company. Aside from the extensive legal fees associated with long-running disputes, costs to management must also be considered. Disputes can evolve into a real drain on management time, disrupting day to day operations, distracting management from championing business objectives and ultimately leading to a deterioration in value and profitability. Parties should also be encouraged to engage in mediation at an early stage – ideally before emotions start to run high – even if mediation is not expressly provided for in corporate documents.

Sylvia: Early case assessment is key. Although many shareholder suits are opportunistic responses to unexpected negative business results or an announced M&A transaction, some claims result from inadequate corporate controls or conduct that could be perceived as fraudulent or reckless. Where there are concerns that management has not discharged its duties appropriately, a corporate board should consider initiating, and disclosing, an internal investigation to determine whether management has acted inappropriately and to make management changes where warranted. If the board concludes that management has engaged in intentional or reckless misconduct, the company should move quickly to resolve any outstanding claims rather than waste time and money in protracted litigation.

Hines: Mitigating financial and reputational costs requires robust early case assessment. For example, a preliminary factual investigation to assess the merits of a dispute may inform key strategic decisions about both litigation and settlement strategies, and enable parties to develop pathways, such as litigation, potential settlement, or both, to minimise both financial and reputational costs. In addition, organisation is paramount in mitigating litigation costs. Should the case proceed to discovery, the parties and their counsel greatly benefit from early identification of the sources of discoverable information, how that information is maintained, and a plan for collecting and reviewing that information. The parties will also benefit from working cooperatively to negotiate custodians, search terms and other document production protocols concerning the search and production of electronically stored information. Such agreements will minimise disputes as the case progresses and are likely to result in material cost savings.

FW: Looking ahead, what are your expectations for shareholder disputes in the months ahead? What issues and challenges are likely to remain prevalent in this area?

Schwartz: In the first few months of the Biden administration, we have seen federal regulators become more aggressive in their enforcement priorities. As a general rule, when regulators get more aggressive, problems for corporations increase, leading to more shareholder disputes. In addition, the coming months could see a further increase in SPAC-related litigation. Between September 2020 and March 2021, at least 35 SPACs were hit with one or more shareholder lawsuits in New York state courts alone. These lawsuits in New York state courts suggest that the securities plaintiffs bar is actively pursuing these claims. Most of these suits came after the SEC issued SPAC guidance in December 2020, but these suits can come from a variety of different angles – from dissatisfied SPAC shareholders when the target company underperforms to suits alleging inadequate public disclosures by SPAC directors.

Lund: Shareholder class action cases in the UK are on the rise. These have been driven by the impact of the 2008 financial crisis, the availability of the prospectus liability regime under the Financial Services and Markets Act 2000, increased use and

> **IN THE US, WE EXPECT TO SEE MORE SHAREHOLDER LAWSUITS CONCERNING ESG CLAIMS AND 'CAREMARK' CLAIMS ALLEGING THAT PUBLIC COMPANY BOARDS FAILED TO EXERCISE ADEQUATE OVERSIGHT WHEN SOMETHING GOES WRONG.**
>
> MARK E. MCDONALD
> Cleary Gottlieb Steen & Hamilton LLP

awareness of group litigation procedures and the increasing volume and wider availability of claimant firms and litigation funding. In addition, the high-profile nature of these cases has increased awareness of shareholder rights and will likely encourage further claims in the future. Together with the current economic climate and the uncertainty created by the culmination of Brexit and the COVID-19 pandemic, it is likely that these factors will unite to result in the continued and substantial prevalence of group shareholder claims.

Sylvia: I do not expect that M&A disclosure suits will abate any time soon. Although the vast majority of the challenged 'omissions' in proxy disclosures are immaterial, the costs to litigate these claims exceed the cost to make supplemental disclosure and pay a fee to a plaintiff's attorney. Consequently, there is no reason for the plaintiffs' bar to cease filing such suits. Given the SEC's focus on SPAC transactions, and the relatively poor stock market performance of some post de-SPAC companies, I expect that the plaintiffs' bar will continue to file suits challenging disclosures made in connection with de-SPAC mergers and also challenging the role of SPAC sponsors. I also expect that recent market volatility will contribute to the number of garden variety Section 10(b) fraud class action suits filed.

Hines: In the months ahead, we expect the filing of securities class action and shareholder derivative complaints to return to the average seen in the previous few years, particularly as the pandemic improves. In addition to continued litigation arising from COVID-19, one area of potential interest concerns litigation arising from transactions involving SPACs. SPAC transactions, which are vehicles used to take private companies public, were popular in 2020 and the first quarter of 2021. According to one research firm, over half of all initial public offerings (IPOs) in 2020 involved SPACs, with over $75.3bn raised across 248 SPAC IPOs. Considering SPAC popularity and press reports concerning governmental inquiries related to SPAC transactions, shareholder litigation is likely to follow.

McDonald: In the US, we expect to see more shareholder lawsuits concerning ESG claims and 'Caremark' claims alleging that public company boards failed to exercise adequate oversight when something goes wrong. These cases will be fuelled, in part, by increasing use of books and records demands by shareholder plaintiffs, who then use the records received to craft more and more detailed complaints that may be better suited to withstand motions to dismiss. And we also expect to see a number of lawsuits challenging de-SPAC mergers. ■

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