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Lead Plaintiffs' Shareholdings Draw Chancery Review

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In orders issued in two recent high-profile shareholder actions, the Delaware Chancery Court provided new guidance regarding lead plaintiffs' shareholdings in representative proceedings. Addressing organizational matters in separate actions arising from proposed corporate transactions involving Dell Inc. and NYSE Euronext, Chancellor Leo E. Strine Jr. ordered restrictions on lead plaintiffs' trading in the relevant shares during the litigation's pendency. First, lead plaintiffs (except those with outside investment managers) cannot trade any of the securities of the corporations at issue without their counsel's prior approval, as in *In re Dell Shareholder Litigation*, C.A. No. 8329-CS (Del. Ch. Mar. 18, 2013), and *In re NYSE Euronext Shareholders Litigation*, C.A. No. 8136-CS (Del. Ch. Mar. 13, 2013). Second, lead plaintiffs must commit to retaining at least 75 percent of their holdings in the relevant shares throughout the litigation's pendency; see *Dell* and *NYSE Euronext*.

In ordering that lead plaintiffs consult with counsel prior to trading in both *Dell* and *NYSE Euronext*, Strine sought to stem the potential for lead plaintiffs to inappropriately trade on the basis of material, nonpublic information learned during the course of litigation, in violation of the securities laws and their duties as class fiduciaries. (See *In re Dell Shareholder Litigation*, C.A. No. 8329-CS (Del. Ch. Mar. 13, 2013), and *In re NYSE Euronext Shareholder Litigation*, C.A. No. 8136-CS (Del. Ch. March 8, 2013).) The court's rulings were not directed to any specific allegations of improper trading by any of the parties to the *Dell* or *NYSE* Euronext cases. Rather, the rulings were designed to put checks in place before inappropriate trading could occur. As Strine — noting the prevalence of confidential information in deal litigation and the need for candid discussions between counsel and clients — warned in the March 8 ruling in *NYSE* Euronext concerning this prohibition: "I suppose if you wish to be a pickle, then jump in that brine; but if you perhaps don't wish to be, you might want to stay out of it."

The Chancery Court has not hesitated to impose sanctions for inappropriate trading when warranted. For instance, in *Steinhardt v. Howard-Anderson*, C.A. No. 5878-VCL, 2012 Del. Ch. LEXIS 1, at *20-27 (Del. Ch. Jan. 6, 2012), Vice Chancellor J. Travis Laster sanctioned a prominent investor and designated lead plaintiff for trading abuses. The court noted that a stockholder of a Delaware corporation voluntarily assumes the role of class fiduciary when filing suit as a putative class-representative plaintiff and owes a duty of loyalty to the putative class. Trading on the basis of nonpublic information obtained through discovery thus undermines the representative-litigation process. Delaware courts have exercised remedial discretion broadly in sanctioning such unacceptable behavior, including by (1) dismissing plaintiffs from cases with prejudice, (2) barring plaintiffs from participating in recovery from litigation, (3) requiring self-reporting of the trading activity to the Securities and Exchange Commission, (4) ordering the plaintiffs to disclose such improper trading in future applications to serve as lead plaintiffs, or (5) requiring disgorgement of trading profits. (See *Berger v. Icahn Enterprises* L.P., C.A. No. 3522-VCS (Del. Ch. Nov. 16, 2009) (Order), *In re Netsmart Technologies Shareholders Litigation*, C.A. No. 2563-VCS (Del. Ch. July 16, 2007) (Order), and "Guidelines to Help Lawyers Practicing in the Court of Chancery," Section 8(c) at 13-14, http://bit.ly/wv5Au7.)

The orders by Strine in *Dell* and *NYSE Euronext* are designed to inhibit improper trades before they occur. However, these orders provide no guidelines to counsel regarding what circumstances would justify trading in affected securities by a lead plaintiff. And indeed, given the criticism of such trades in Steinhardt and the precedents cited therein, the safest course for lead plaintiffs (and their counsel) would be to assume that trading should be permitted, if ever, only in the rarest of circumstances.

In mandating that lead plaintiffs must commit to retaining at least 75 percent of their equity position during the litigation's tenure, Strine in *Dell* and *NYSE Euronext* addressed potential inadequate economic incentives for putative lead plaintiffs to pursue real litigation achievement on behalf of a class, as well as the very real concern that a lead plaintiff's selling down of its position runs exactly counter to the legal claims asserted by the plaintiff in litigation challenging a corporate transaction. Strine decried the common "litigation fig leaf" strategy, whereby a potential lead plaintiff commits to hold only a bare minimum number of shares throughout the litigation, while permitting itself to sell the remainder of its position. In Strine's words in *NYSE Euronext*, this strategy "doesn't cut it" and in fact reveals a lead plaintiff's inadequacy and atypicality.

Some level of required shareholding for representative plaintiffs is of course consistent with longstanding Delaware precedent. In the derivative-action context, Delaware courts have routinely read Section 327 of the Delaware General Corporation Law and Court of Chancery Rule 23.1 to require that plaintiff stockholders, to maintain their standing, must have held ownership both contemporaneously with the wrongdoing and continuously throughout the litigation, as in *Parfi Holding AB v. Mirror Image Internet*, 954 A.2d 911, 935-42 (Del. Ch. 2008); *Feldman v. Cutaia*, 956 A.2d 644, 654-63 (Del. Ch. 2007), aff'd, 951 A.2d 727 (Del. 2008); and *Dubroff v. Wren Holdings LLC*, C.A. No. 3940-VCN, 2009 Del. Ch. LEXIS 89 (Del. Ch. May 22, 2009). Further, lead plaintiffs' share ownership at the point of settlement has been deemed critical. Delaware courts have scrutinized the adequacy of lead plaintiffs who owned relatively few shares at the time of settlement in deciding whether to permit or deny discretionary opt-out rights to nonlead plaintiffs, as in *In re Celera Shareholder Litigation*, 59 A.3d 418, 436-37 (Del. 2012), and *In re Prodigy Communications Shareholders Litigation*, C.A. No. 19113, 2002 Del. Ch. LEXIS 95, at *11-13 (Del. Ch. July 26, 2002).

Particularly in light of the court's stated concerns with any transactions in the relevant corporation's securities while a lead plaintiff possesses material, nonpublic information, Delaware plaintiffs should be careful to avoid interpreting Strine's recent orders in *Dell* and *NYSE Euronext* as a "license" to sell down up to 25 percent of any equity position. And the chancellor's orders provide no rationale for his selection of this threshold, as opposed to any other selling limitation. While certain individual circumstances may justify limited trading by a representative plaintiff, including the presence of appropriate ethical and informational screens between traders and litigation decision-makers, and trading prompted by circumstances unrelated to the litigation, such as margin calls and liquidity needs, the *Dell* and *NYSE Euronext* orders confirm that all trades by lead plaintiffs will continue to receive close scrutiny in the Chancery Court.

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