No. 15-3799

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

IN RE: WALGREEN CO. STOCKHOLDER LITIGATION

On Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division, No. 1:14-cv-9786,
Judge Joan B. Gottschall

Reply Brief of Appellant John Berlau

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Introduction

Appellees portray the dispute on appeal here as a question of releases: the release here was relatively narrow compared to some other abusive shareholder settlements, and so, they assert, they win. *E.g.*, DB10-11; PB16-26.[1] But Berlau's appeal does not complain that the defendants snookered the class with an overbroad release; his complaint is that plaintiffs selfishly abused the class-action system to negotiate a windfall for themselves without providing any benefit for the class. This is impermissible under Rules 23(a)(4) and (e) under the best of circumstances, but it is especially pernicious here when the putative class is shareholders of the defendant who are thus made worse off simply by the litigation being brought. If the externality of the social cost of litigation that cannot benefit the class is reason to deny certification under Rule 23(a)(4), *In re Aqua Dots Products Liability Litigation*, 654 F.3d 748 (7th Cir. 2011), then surely a class action where that social cost is actually borne by the shareholder class must also fall.

Moreover, *Trulia*'s command that settling parties must limit the scope of a disclosure-only settlement release was one of *two* requirements it imposed on such settlements. The other, which Walgreens expressly acknowledges and then ignores, is that supplemental disclosures must "address a plainly material misrepresentation or omission." *In re Trulia, Inc. Stockholder Litigation*, 129 A.3d 884, 898 (Del. Ch. 2016) (cited

[1] "OB," "PB," and "DB" refer to the opening, plaintiffs', and defendants' briefs in this appeal respectively. "Axyz" and "SAxyz" refers to page xyz of Berlau's Appendix and Supplemental Appendix respectively.

at DB10 (omitting "plainly" from characterization)). And that's precisely the issue on appeal: should the Court adopt a rule like *Trulia*? Yes: *Trulia* is a natural application of cases like *Crowley*, *Aqua Dots*, and *Pearson*.

So the dispute is whether the supplemental disclosures "address a plainly material misrepresentation or omission." Misapplying *Basic Inc. v. Levinson,* 485 U.S. 224 (1988), plaintiffs assert that "materiality" is "fact-specific" (PB31), and Walgreens similarly asks for deference to the district court's finding (DB1). But "where the alleged misstatements are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance, a court may find the misstatements immaterial as a matter of law." *Appert v. Morgan Stanley Dean Witter, Inc.*, 673 F.3d 609, 617 (7th Cir. 2012) (internal quotation and citation omitted). Either anything goes, and every proxy statement is subject to a jury trial, or there are disclosures that are inherently so trivial as to be immaterial. What the Supplemental Disclosures in this case added to the total mix of information was immaterial as a matter of law (or, at least, it was clearly erroneous to find otherwise), and the shareholders further demonstrated this when they overwhelmingly approved the merger by a 42:1 yes-to-no ratio.

Plaintiffs spend a surprising amount of space claiming their suit isn't a strike suit. PB11-26. But what makes a strike suit a strike suit is, as Walgreens complains (DB6-8), the risk of expensive litigation, the threat of an injunction blocking the merger, and the settlement to more cheaply pay off class counsel. Still, nothing turns on whether this Court's taxonomy uses the non-legal term "strike suit" to classify this case. The problem remains that the "only goal of this suit appears to be fees for the plaintiffs'

lawyers." *Robert F. Booth Trust v. Crowley*, 687 F.3d 314, 319 (7th Cir. 2012). Either district courts have the discretion to reward such abuses and incentivize similar pointless suits, or, as this Court consistently holds, they do not.

Argument

I. The Walgreens brief gets the law and the public policy wrong.

Walgreens does not contend that it omitted material facts from the Proxy; it does not contend that Hays brought a meritorious complaint that would legitimately survive a motion to dismiss, or even that this is not an abusive strike suit; it does not contend that Hays satisfies Rule 23(a)(4); it does not deny that the district court committed an error of law in holding the Supplemental Disclosures material.

Walgreens simply argues that the district court has the discretion to approve this sort of settlement of a strike suit when the release is narrow, and that because an individual strike-suit settlement is good in the short run *ex post* when a defendant can pay class counsel less than the cost of litigating to victory, they are legal and good for shareholders in the long run *ex ante*. We disagree.

So does *Trulia*, which nobody argues was incorrectly decided. Under *Trulia*, a disclosure-only settlement will "be met with continued disfavor" unless

> [(*a*)] the supplemental disclosures address a plainly material misrepresentation or omission, ***and*** [(*b*)] the subject matter of the proposed release is narrowly circumscribed …

129 A.3d at 898 (emphasis added). Fair enough, the second half of this test is met here. But appellees incorrectly argue that *Trulia* is *only* about that second half, ignoring the

conjunction and the "plainly material" requirement. This settlement flunks the first part of the conjunction of the *Trulia* test, and the district court erred as a matter of law, not just in failing to apply *Trulia* and, as discussed in Section II, in finding any materiality in the Supplemental Disclosures, but in failing to apply *Aqua Dots* and *Crowley*.

A. Walgreens floats a public-policy parade of horribles if corporations are not allowed to pay extortion to class counsel to settle meritless cases. They are wrong.

Walgreens argues that if defendants are not allowed to use illusory settlements to pay class counsel to get rid of abusive strike suits, defendants would be subject to expensive litigation and be worse off. DB7-8. This is an empirical claim that ignores the dynamic effect of court-created incentives. If class counsel can't collect lucrative paychecks for settlements with illusory relief, then it won't be the case that over 97.5% of mergers (OB2-3) continue to face strike suits. Jill Fisch *et al.*, *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557, 608 (2014) ("Fisch"). If plaintiffs' attorneys can't receive a guaranteed payday for bringing a meritless case, they will instead focus on more meritorious cases rather than subjecting their weakest claims to scrutiny. *Id.* That's a benefit of Berlau's proposed rule of decision, not a cost. And, unlike Walgreens' *ipse dixit*, this hypothesis of how plaintiffs will respond to appropriately-structured incentives is supported by the aftermath of previous CCAF victories against similarly abusive rent-seeking.

In *In re Dry Max Pampers Litigation*, 724 F.3d 713 (6th Cir. 2013), and *Richardson v. L'Oreal, Inc.*, 991 F. Supp. 2d 181 (D.D.C. 2013), courts rejected $0 settlements of absurd consumer-fraud cases that paid only class counsel. Both times experienced class counsel

walked away from the litigation rather than engage in the game of discovery chicken feared by Walgreens.

Crowley's 2012 rejection of a settlement of a shareholder-derivative suit over alleged breaches of fiduciary duty relating to the Clayton Act has not produced lengthy litigation and discovery challenging interlocking directorates in the four years since. Instead, that entire class of rent-seeking litigation has, as best Berlau can tell, vanished from federal and state dockets.

And, precisely on point, *Kazman v. Frontier Oil Co.*, 398 S.W.3d 377, 388 (Tex. App. 2013), held that an idiosyncratic quirk in Texas class-action procedure precluded state courts from awarding attorney cash fees for disclosure-only settlements ***no matter how material the disclosures are***. In other words, the Texas legislature and state courts adopted an anti-disclosure-settlement rule more Draconian than the reasonable *Trulia* "plainly material" standard Berlau has proposed here. There is no evidence that plaintiffs' attorneys have responded by continuing to bring meritless Texas class actions and subjecting defendants to expensive discovery out of spite, or even that Texas corporate defendants have responded by ignoring their fiduciary disclosure duties. Rather, when courts say that attorneys don't get paid for bringing class actions that fail to help the class, attorneys listen, and don't bring (or at least bring fewer) abusive suits in the first place.

"Tailoring the fee award more closely to case quality would provide more appropriate incentives than paying counsel a nominal fee in every case, no matter how weak." Fisch at 608. Isn't that the way it's supposed to work? *Cf. Murray v. GMAC Corp.*,

434 F.3d 948, 952 (7th Cir. 2006) ("if the chance of success really is only 1%, shouldn't the suit be dismissed as frivolous and no one receive a penny?").

One can sympathize with Walgreens' dilemma of having to minimize its costs by settling a meritless strike suit that shouldn't have been brought in the first place. (Note that if *In re Southwest Airlines Voucher Litigation* hadn't rejected a *per se* rule against the red flag of clear-sailing clauses, 799 F.3d 701, 712-13 (7th Cir. 2015), Walgreens would have had the leverage to settle and then fight the abusive fee request by pointing out the absurdity of the Supplemental Disclosures, which might by itself have had the desired *ex ante* effect of deterring an abusive suit. Without that *per se* rule, plaintiffs' attorneys can demand clear-sailing as a condition of settling as they did here and hope for lack of scrutiny.) But Walgreens and other corporations will be much less likely to have this problem in the future if settlements or fee requests like those here are rejected. Fisch at 608. And even without a rule specific to M&A litigation, this Circuit holds that class counsel cannot negotiate selfish settlements under Rule 23(e) or (a)(4). OB22-23. Following *Trulia* would simply apply that existing precedent.

B. Questions of law are reviewed *de novo*.

Appellees argue at length for an abuse-of-discretion standard. DB4-5; PB10-11. Plaintiffs do so by relying on language in *Armstrong v. Board of School Directors*, 616 F.2d 305 (7th Cir. 1980), that *Pearson v. NBTY, Inc.*, explicitly disapproved. *Compare* 772 F.3d 778, 787 (7th Cir. 2014) *with* PB10. But appellees don't dispute that an error of law is an abuse of discretion, or that Berlau alleges an error of law. OB21; OB36-37. Moreover, Walgreens complains that Berlau's appeal is asking for a specific rule of law that federal

appellate courts have not yet expressly adopted. DB6-7. That is a question of law that this Court decides *de novo*. OB21.

(And while no federal appellate court has expressly adopted Berlau's position with respect to this specific type of settlement and suit, no federal appellate court has expressly rejected it, either. *Felzen v. Andreas*, 134 F.3d 873 (7th Cir. 1998), sure hinted that this Court was concerned about abusive shareholder litigation. Walgreens' proposed rule of decision would make federal courts a haven for forum-shopping self-interested attorneys seeking refuge from Delaware's thoughtful post-*Trulia* approach.)

C. Walgreens claims this settlement produces benefits to the shareholder class. They are wrong.

Walgreens argues that the settlement benefited the class because shareholders received two things: "additional information regarding the merger and the avoidance of unnecessary litigation." DB6.

First, if any additional information regarding the merger, no matter how trivial, is a shareholder "benefit," then that's *carte blanche* for attorneys to profit at the expense of shareholders with meritless strike suits. Any proxy statement could have additional exposition. There's certainly district-court precedent suggesting such a rule, and we see the rent-seeking consequence today (OB2-3; *Trulia*, 129 A.3d at 892-93 & n.21), but this Court has repeatedly declined to accept the fiction that attorneys are benefiting their putative class clients with illusory injunctions. *E.g., Crowley*, 687 F.3d 314; *Pearson v. NBTY, Inc.*, 772 F.3d 778, 784-85 (7th Cir. 2014). *Trulia* takes the same stance, and

requires the disclosures to be more than simply "additional information" (DB6), but rather, "plainly material." 129 A.3d at 898.[2]

Even if this Court were to reject *Trulia* and consider immaterial "additional information" the sort of "benefit" meriting settlement approval, there would still be the problem of fairness created by the fee windfall. *Cf. Pearson*, 772 F.3d at 782 (class counsel should not be primary beneficiary of settlement); *Pampers*, 724 F.3d 713, 718 (same). Corporations faithfully representing shareholders would never *ex ante* choose to pay editors or even lawyers hundreds of thousands of dollars for the flyspeck changes made in the supplemental disclosure, even aside from the social costs of the litigation. A disclosure has to be meaningful—plainly material, even—before it merits the sort of all-too-commonplace fee award made here. Nominal disclosures should receive at most nominal compensation.

Second, the way to achieve the benefit of "the avoidance of unnecessary litigation" is to penalize class counsel for bringing such litigation, not to reward attorneys for the bootstrapping of imposing costs on shareholders in the first place. This is essentially the position of *Crowley*: class counsel can't take credit for the benefit of

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[2] Plaintiffs argue that the district court found that "four of the six Supplemental Disclosures conferred a benefit" and that Berlau mischaracterized the court's "decision as a determination on materiality." PB30. Not true. The district court applied the Supreme Court's definition of materiality, questioning whether the disclosures would be "material to someone trying to decide on whether to vote in favor of this merger," A329, or "what ***would matter*** to a reasonable investor," A12 (emphasis added). *See TSC Indus., Inc. v. Northway, Inc.,* 426 U.S. 438, 449 (1976). But if plaintiffs' characterization is right, it just shows that the district court committed reversible error by applying the wrong legal standard.

avoiding litigation risk by putting the defendant "through the litigation wringer (this suit) *with certainty*." 687 F.3d at 319 (emphasis in original); *accord Zucker v. Westinghouse Elec. Corp.*, 265 F.3d 171, 176-77 (3d Cir. 2001).

Whether shareholders received a benefit from the settlement thus turns on whether the disclosures were "plainly material." *Trulia*, 129 A.3d at 898.

II. No, the Supplemental Disclosures aren't material, much less "plainly material."

A. The shareholder vote should prove as a matter of law that the Supplemental Disclosures were not material.

Unlike the typical posture of a lawsuit over disclosure, we don't have to speculate whether a reasonable shareholder would find an omission material: we have the empirical proof that the shareholders yawned at the Supplemental Disclosures when they overwhelmingly approved the merger, and the district court erred in failing to take this fact into account. OB39-40.

Plaintiffs assert that this was a merger approved by an "underwhelming" 73% because of the 237 million shares that did not vote or abstain. PB54-55. An editing error in the opening brief to be concise and avoid the passive voice changed "97% of votes cast" to the less precise "97% of shareholders" here and there (*e.g.*, OB13, using both formulations interchangeably). In any event, the apples-to-apples measurement in the academic literature that "best captures shareholder sentiment" for mergers is percentage of votes cast. Fisch at 580. That this 97% vote is in the third quartile of all merger votes (PB55) is hardly damning: the vast majority of mergers receive

overwhelming affirmative support. *Id.* The 42:1 yes-to-no ratio here (A625) is "overwhelming" by any definition of "overwhelming."

"[T]he value of nonpecuniary relief in merger settlements [should] be measured by its effect on shareholder voting." Fisch at 560. When a supplemental disclosure has no material effect on shareholders' votes, its only consequence is to create the illusion of relief to rationalize attorneys' fees. Courts should see through that illusion. *Cf. Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 396 (1970), (non-pecuniary benefit "must be something more than technical in its consequence").

B. Even without the context of overwhelming shareholder approval, the disclosures were not material.

As *Trulia* states,

> In using the term "plainly material," I mean that it should not be a close call that the supplemental information is material as that term is defined under Delaware law.

129 A.3d at 898. Walgreens doesn't even attempt to defend the materiality of the Supplemental Disclosures. DB1-12. Plaintiffs' attempt is unavailing.

1. The Supplemental Disclosure's contingent estimate of post-merger stock ownership percentages for SP Investors and KKR Investors was immaterial because it was readily computed from information contained in the Proxy and because it is not the "accurate" "final allocation" plaintiffs now claim.

The Supplemental Disclosures' estimating SP's and KKR's ownership increase added nothing material. To the extent shareholders wanted to make the same estimate used by the Supplemental Disclosure, the Supplemental Disclosure's inputs were readily available in the Proxy. Plaintiffs exaggerate that such a computation required

"extensive methodology that requires shareholders to use deductive reasoning." PB36. Computing the investors' ownership percentages is simply adding their current shares plus their new shares and dividing by the total outstanding. OB8. Contrary to plaintiffs' assertions (PB36) whether that computation is presented in table format (A99) or in a mathematical formula (OB8), computing a percentage is just arithmetic.[3]

In response to Berlau's cited precedents that a disclosure is immaterial if shareholders could have made the same calculations from existing disclosures, *see* OB28, plaintiffs argue that those cases are inapplicable because they did not arise in the settlement context and therefore "a different materiality standard applied." PB38. As discussed in Section I above, Berlau disagrees that a different materiality standard should apply, except to the extent that under *Trulia*, a meaningful disclosure must not only be material, but "plainly material." 129 A.3d at 898.

Plaintiffs argue that computing the percentages would require an investor to "read between the lines," citing *O'Malley v. Boris*, 742 A.2d 845, 851 (Del. 1999). PB37.

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[3] Plaintiffs argue that Berlau did not provide citations to the Proxy for KKR's holdings. PB37. The Proxy discusses that data in the same places as Berlau's citations about SP's ownership. OB8. Information for the pre-merger shares is at, among other places, A417-A418 (0.7% of 945,496,180 outstanding) and information for KKR's shares earned from the merger is at A420 (144,333,468 shares to Sellers) and A462 (KKR estimated to receive 30.1% of shares to Sellers). This data is repeated multiple times throughout the Proxy. *E.g.*, A360, A371-72, A376, A383-85, A405, A409, A463, A561, A564, A580. One can find all numbers relevant to calculating the Supplemental Disclosure's estimate and Berlau's reconstruction of it at A462-63 and A564, so Berlau's arbitrary choice of cites actually made the calculation seem more complicated than it was.

But *O'Malley* involved a brokerage firm's disclosure to its clients which "strongly implied" the broker's interest but left open "two reasonable possibilities as to how [the broker] acquired its interest." *Id*. at 851. Here, by contrast, arithmetic is not subject to multiple, possible interpretations.

To compute the percentages, plaintiffs complain that shareholders must "scour" the 231-page Proxy because the information needed was in different locations. PB38. But their argument relies upon two cases involving situations where a 20th-century investor must do an analysis with numbers in paper documents *outside* the proxy. For example, *In re TWA, Inc. Shareholders Litigation,* C.A. No. 9844, 1988 Del. Ch. LEXIS 139, at *29 (Del. Ch. Oct. 21, 1988), the plaintiffs' parenthetical omits that *TWA* was referring to SEC filings *other* than the proxy. *TWA* supports Berlau because it held that it would have been "acceptable" if the omitted "number could be derived" from information contained in the proxy. *Id*. at *29-*30.[4]

Similarly, the problem in *National Home Products Inc. v. Gray*, 416 F. Supp. 1293, 1315-16 (D. Del. 1976), was not that the information was separated or involved arithmetic, but that a reasonable investor would not be able to connect the dots from the proxy statement alone. A $936,000 tobacco inventory loss allegedly attributable to a director candidate fighting for corporate control was broken into three parts in three

[4] Moreover, *TWA* ultimately concluded that the omitted information was not material because it did not "meaningfully alter[] the total mix of information." *Id*. at *30. Same here. What reasonable shareholder thinks "I'll vote for the merger if SP's post-merger share is 'significantly increased above 7.7%,' but oppose it if it's estimated at approximately 11.3% subject to certain unknown future events that may change that amount"?

places: (i) the fact that there was a lawsuit against him; (ii) the fact that the suit was based on the inventory loss; and (iii) the fact of the amount of the inventory loss, which was omitted from the proxy statement and "buried" in a forty-page financial statement "without specifying page numbers on which the amount of the loss could be found." *Id*. at 1314-16. The court found the omission material because a reasonable investor "in studying the total 80 pages of the proxy statement and financial statement would fail to ***correlate***" the information, making it affirmatively "misleading" because of the risk of a conflict of interest if the defendant became a director and shut down the suit against him. *Id*. at 1316 (emphasis added).

Indeed, as plaintiffs admit, the Proxy specifically disclosed in multiple places that SP's and KKR's ownership would "significantly increase" and that they "may have the power to influence our affairs and the outcome of matters required to be submitted to shareholders for approval," and then detailed risks of conflicts of interest in multiple cross-referenced places. A403-04; A401; A462-63. And the Proxy detailed restrictions on the maximum amount of shares SP (167 million) and KKR (10%) could own. A595. Because the Proxy already disclosed the risk of the large-shareholder voting power, and permitted a computation of the same estimate the Supplemental Disclosure made, nothing in the Proxy was "misleading" like *National Home Products*'s proxy's attempt to bury a central conflict of interest in a hotly-contested battle for corporate control. 416 F. Supp. at 1315-16.

Moreover, this Court should note an important distinguishing factor of the cases plaintiffs cite: the paper filings of forty years ago were inherently more inconvenient to search than the electronic filings of today. It is considerably less problematic for a

reasonable shareholder to use "control-F" on a web-page or PDF to find the number of shares outstanding compared to having to read a dense document (made more dense by the threat of shareholder suits) line by line looking for a footnote about the quantification of an inventory loss. A reasonable shareholder could locate the information needed to estimate the percentages with a quick electronic search—meaning a Walgreens shareholder today has an easier time making a computation than a shareholder using a legal paper filing under *TWA*.

Finally, independently, and perhaps most importantly, plaintiffs now claim that the real problem was that the Proxy "did not disclose 'how the 144 million shares would be finally allocated among'" SP and KKR (PB35 (quoting OB7)). But the Supplemental Disclosures simply fail to fix that unfixable problem. The same contingencies that caused the Proxy to make the warning plaintiffs complain of remained after the Supplemental Disclosures: the "final allocation" still had "not yet been determined." A403-04. As the Supplemental Disclosures acknowledged (A72; OB7), the 11.3% figure was contingent both on Walgreens' future decision whether to finance the cash component of the acquisition by issuing new shares (A403) and on future share price that, if changed, could affect both the number of shares issued to SP and third parties and the percentage held by SP. *E.g.*, A580. So the Supplemental Disclosure was ***not*** the "accurate[] … post-[merger] ownership figures" (PB38) that plaintiffs trumpet, but more precisely characterized as an estimate of 11.3% under some assumptions, but perhaps more or less depending on circumstances yet to be decided that could change the numerator and/or the denominator. To learn the "accurate" figure after the Supplemental Disclosure, a shareholder must not only perform additional

calculations, but precisely predict the future. The "every additional share" plaintiffs assert is so "importan[t]" (PB39-40) and "the degree to which Pessina and KKR's control over the company would increase" (PB35) are simply not revealed in the Supplemental Disclosure. All the Supplemental Disclosure provided was the same estimate that a shareholder could already make from the Proxy's "approximat[ion]" of the share of the Step 2 Acquisition consideration. A462-63; OB8. Plaintiffs cannot take credit for a "material" disclosure that they never made. *Cf. also Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 516 (7th Cir. 1989) ("firms need not disclose tentative internal estimates").

The Supplemental Disclosure added nothing material to the Proxy.

2. Supplemental disclosure of Pessina's recusal from the Board's "decision" was not materially different than the Proxy's disclosure of Pessina's recusal from the Board's "vote."

Recognizing that the Proxy already disclosed that Pessina and Murphy did not vote on the Step 2 Acquisition, plaintiffs grasp at straws trying to distinguish between the Proxy's previously-disclosed recusal from the Board's "vote" and the Supplemental Disclosures' addition of recusal from the Board's "decision." PB42. The Supplemental Disclosure adds the following language (bolded and underlined):

> At the conclusion of the meeting, the Walgreens Board (excluding Messrs. Pessina and Murphy, **<u>who as a result of their interest in the transaction, recused themselves from the Board's decision to exercise the Call Option</u>**) unanimously approved the [amendment and the recommendation for merger].

A71.

Plaintiffs argue that the word "decision" differs from "vote" because it denotes the "discussion and deliberation that concludes with a vote." PB42. Why that would be material is unexplained, but it's wrong: "decision" can mean either "the conclusion reached *after* consideration" or "the process of deciding something." The ambiguity alone is enough to defeat plaintiffs' argument: plaintiffs cannot take credit for drafting a Supplemental Disclosure that conveyed "deliberations, discussion, and vote" when it instead said "decision." (Plaintiffs also assert materiality because the directors "had to" recuse. PB41. Not true under Illinois law. 805 ILCS 5/8.60.)

Indeed, the Proxy and Supplemental Disclosures contradict plaintiffs' broader interpretation. The approval of the Step 2 Acquisition did not happen overnight. Pessina and Murphy began serving on the Board in 2012. A421. In late 2013, Walgreens management began exploring whether to exercise the Step 2 Acquisition and the Board had several meetings regarding it in 2014. A423-A428. Neither the Proxy nor the Supplemental Disclosures disclose whether Messrs. Pessina and Murphy recused from those discussions. *Id*. The Proxy detailed the Board's August 5, 2014 meeting during which "[m]embers of the management team also provided the Board with a further overview of the transaction process to date, as well as the ***reports and recommendations discussed at prior meetings of the Board regarding the decision to exercise the Call Option*** … ." A427-A428 (emphasis added).

Even if Pessina and Murphy *actually* recused from those previous deliberations and discussions, the Proxy did not disclose this. A427-A428. Therefore, including the additional language in the Supplemental Disclosure that Pessina and Murphy recused from the decision at "***the conclusion of the [August 5] meeting,***" A71 (emphasis added),

does not inform the shareholders that Pessina and Murphy recused from the Board's multiple discussions and deliberations regarding exercise of the Call Option, even if that were material.

Berlau argued that many of the Supplemental Disclosures were immaterial because they would not have a negative impact on a shareholder's vote. OB31; OB36; OB38; OB39. Berlau explained that supplemental disclosure is only material if it "contradicts, not reinforces, management's recommendation." OB26-27 (citing authorities). Plaintiffs dispute this, arguing that the Supplemental Disclosure need not negatively impact the shareholder's vote based on *In re Schering-Plough/Merck Merger Litigation* and *In re Golden State Bancorp Shareholders Litigation*. PB42. Those cases do not stand for that proposition. No objector in either case made Berlau's argument, and the courts did not specifically address the issue or Berlau's precedents. And both are entirely distinguishable.

In *Schering-Plough/Merck*, some of the supplemental disclosures undercut management's recommendation, such as a pending arbitration over whether a change-of-control clause terminating a $2 billion/year distribution agreement would be triggered by the merger: purchaser Merck had disclosed that arbitration in its annual report acknowledging that an adverse decision would have a material adverse effect on its business, but the proxy statement omitted any mention of the dispute. 2010 U.S. Dist. LEXIS 29121, at *8 & n.3, *50 (D.N.J. Mar. 25, 2010). *Schering-Plough/Merck* held that that additional disclosure was material and a benefit conferred upon the class by plaintiffs. *Id.* at *50. But it's tautological that a risk a March 1 annual report describes as material is plainly material when omitted from a May 20 proxy statement. Berlau does not contend

otherwise. But nothing in this case comes anywhere close to a disclosure of litigation threatening to cancel a multi-billion-dollar contract.

Golden State doesn't help plaintiffs; the court held only that the "modest" disclosure was "arguably material," and ultimately approved the settlement because it provided "some benefit" to the stockholders, and then decreased the fee request by 60%. 2000 Del. Ch. LEXIS 8, at *9-*10, *15 (Del. Ch. Jan. 7, 2000). But even this tepid support for plaintiffs is no longer good law, given Delaware courts' recent decisions requiring "plainly material" supplemental disclosures. *Trulia,* 129 A.3d at 898. Plaintiffs quote *Golden State* that the disclosures made shareholders "feel more secure and informed" in deciding their vote. PB42. But Walgreens does not need class counsel's unsolicited help in selling the merger to the shareholders, *see* Fisch at 575, particularly at a cost of $370,000 plus defense fees. OB26-27. The additional information does not contradict the Board's recommendation and thus, is immaterial.

3. "Substantive discussions" between JANA and Walgreens were an obvious consequence of the negotiations of the Nomination and Support Agreement.

Regarding Mr. Rosenstein's Nomination and Support Agreement, plaintiffs argue that the additional language that during the preliminary negotiations "Mr. Rosenstein expressed his view regarding Walgreens and its strategic direction and prospects," A70, was important because nowhere else in the Proxy does it disclose that Walgreens and JANA engaged in "substantive discussions" during which JANA "could have influenced Walgreens management and/or post-merger direction." PB44.

That language adds nothing. The Proxy detailed the terms of the Nomination and Support Agreement. A419. No reasonable investor would have assumed that

Walgreens did not engage in "substantive discussions" during its negotiation. And *of course* a representative of JANA sitting on the Board of Directors will have "influence" on the post-merger direction: a director has a fiduciary duty not to be a potted plant. Indeed, any influence by Mr. Rosenstein on the "post-merger direction" was expected given that the Proxy disclosed that he was *appointed* to the Board. A419. That's not an opaque implication that a shareholder must reason through to determine that there might be influence; rather, it's a physical manifestation ***of*** JANA influence, enough "influence" to get a Board seat.

Moreover, plaintiffs do not respond to Berlau's argument that supplemental disclosure of these discussions did not reveal JANA's influence on the *merger decision* because the preliminary discussions occurred *after* the Board's decision to exercise the Call Option. OB32. Plaintiffs argue that "[a]s a factual matter" JANA met with Walgreens in April 2014. PB45 (citing to Complaint). But the Proxy and Supplemental Disclosures do not discuss an April 2014 meeting. A427-A428; A70. Regardless of whether JANA *actually* met with Walgreens in April 2014, and whether such a meeting would be material, the Supplemental Disclosures did not reveal such a meeting to the shareholders. The Proxy and Supplemental Disclosures disclosed only that JANA entered the picture after the August 5 Board decision and thus the Supplemental Disclosures did not apprise shareholders of what Plaintiffs now argue was material.

Plaintiffs argue that, notwithstanding the rule that companies need not disclose all preliminary negotiations (OB32-33), the JANA preliminary discussions potentially influenced Walgreens' strategic direction and thus were "independently significant." PB44. This is questionable as a standalone assertion, but as described above and at

OB32, the Supplemental Disclosures did not reveal any new information about JANA influence on the merger decision. Plaintiffs cannot take credit for the materiality of a disclosure they never made, much less one they have no evidence in the record to support. Thus, what the Supplemental Disclosures did disclose about the preliminary negotiations regarding the Nomination and Support Agreement are immaterial as a matter of law, and the district court erred in holding otherwise.

4. Supplemental disclosure of the defamation lawsuit revealed nothing material of Miquelon's resignation or the merger.

Plaintiffs argue that CFO Miquelon "suddenly resigned" the day before the Board approved the Call Option, and that the Proxy failed to disclose that he resigned at a "pivotal moment" and failed to disclose his lawsuit against the Company that might reveal it was a "noisy resignation." PB45-PB46. Plaintiffs argue that the defamation lawsuit was not material because of its "financial impact" but because "of the ***additional context it provided for Miquelon's resignation*** on the eve of the Company's entry into the Transaction." PB47 (emphasis added). But Berlau conceded precisely the possibility that a suit could be material without meeting the SEC 10% threshold and explained that, even if plaintiffs' speculation were true, the Supplemental Disclosure failed to satisfy such a hypothetical exception because it merely states that Miquelon resigned and that two months later, he filed a defamation lawsuit. OB34-35; A71.

But plaintiffs' characterization, unsupported by their record cites, is false: no additional context was provided. Miquelon never claimed that his resignation was

related to the merger; according to his complaint, his decision to step down was "personal, based on [Miquelon's] desire to pursue opportunities outside of Walgreens after an outstanding six-year tenure." SA3. Indeed, the basis for Miquelon's lawsuit—alleged defamatory statements made in investor meetings on August 5 to August 8—happened *after* Miquelon's resignation on August 4. SA3-SA5.

Nor was it sudden. Plaintiffs acknowledge that several months before the Proxy was filed, Walgreens filed with the SEC a Form 8-K disclosing Miquelon's resignation. PB46. That SEC filing also attached Miquelon's lengthy Transition and Separation Agreement, which was not likely negotiated and drafted that same day. *See* Walgreen Co. Form 8-K dated Aug. 4, 2014, *available at* https://www.sec.gov/Archives/edgar/data/104207/000119312514293743/d768416dex102.htm. The SEC filing also included an Offer Letter of Agreement dated July 29, 2014 with the replacement CFO, also not likely negotiated and drafted that day. *See* https://www.sec.gov/Archives/edgar/data/104207/000119312514293743/d768416dex101.htm. These documents directly refute plaintiffs' claim that the resignation was "abrupt." PB48.

Quoting *United Paperworkers Int'l Union v. Int'l Paper Co*., plaintiffs argue that additional disclosure was required because even though the resignation was revealed in an 8-K "[t]he mere fact that a company has filed with a regulatory agency documents ***containing factual information material to a proposal*** as to which proxies are sought plainly does not mean that the company has made adequate disclosure under Rule 14a-9." 985 F.2d 1190, 1199 (2d Cir. 1993) (emphasis added). But plaintiffs provide

no evidence on how the resignation and alleged defamation is material to the *merger proposal*.

Plaintiffs argue that shareholders would not dismiss the lawsuit as immaterial because "[i]nvestors would assume the worst, because, they would reason that if the firm had anything good to say for itself it would do so." PB48. If true, then the "worst" that shareholders would assume would be that Walgreens actually defamed Miquelon by unfairly accusing him of lax controls (OB35-36), and not some *non sequitur* that the lawsuit was a noisy protest against the merger. Again, plaintiffs cannot take credit for the materiality of a disclosure they did not make, especially when the factual basis for the materiality is not only absent from, but contradicted by the record.

5. Repeating the risk factors *verbatim* provides no new information and is thus immaterial.

Plaintiffs concede that Berlau is "technically correct" that the four bullets the Supplemental Disclosures added to risks considered by the Board consist of verbatim language already included in the Risk Factors Section of the Proxy. PB51. And plaintiffs concede that the Proxy described that the Board had considered "the risks of the type and nature" described under the Risk Factors Section. PB51. But plaintiffs argue that telling the shareholders that the Board considered the risks "of the type and nature" in the Risk Factors Section is not the same as saying that it was the "precise risks" considered by the Board. PB51. This makes no sense. Because the additional disclosures are *verbatim* it makes no difference if they are labeled as a "precise risk" considered or a risk "of the type and nature" considered, because it delivers the same message to the

shareholders: the Board considered it. This type of "nit-picking" is rejected by courts. *JMB Realty Corp. v. Associated Madison Cos.,* 1980 U.S. Dist. LEXIS 14477, at *19 (N.D. Ill. Oct. 8, 1980) (finding omitted language to be "superfluous").

Plaintiffs argue that if the Board had considered the "precise" risks in the Risk Factors Section that it would have said that. PB51. Or, the more logical reason the Proxy used the term "type and nature" instead of "precise" was to describe the Board's review of risk factors as expansive, and not limited. Further, plaintiffs' argument that repetition of these risks would have a negative impact on a shareholder's vote (PB52) proves too much. By that argument any proxy statement that lists risk factors twice is committing a material omission by failing to list them a third time, and then a fourth time.

6. Disclosure of the reasons for selecting Pessina as acting CEO were immaterial.

Plaintiffs complain that the 8-K disclosing Pessina's selection as acting CEO didn't provide the reasons for selection, and that, because of that shareholders needed to know whether "KKR had strong-armed his appointment," or "JANA had demanded his appointment," and thus the Supplemental Disclosure should get credit for "eliminat[ing] that uncertainty." PB52. That argument fails. Nothing in the Supplemental Disclosures confirms or denies KKR or JANA's influence. Rather, they simply provide an anodyne non-exclusive list of obvious factors that is consistent both with a hands-off and hands-on approach by KKR or JANA. A73. Plaintiffs cannot seriously claim that any reasonable shareholder is enlightened by learning that a Board selected an acting CEO based in part on "experience" and "a number of factors." No

uncertainty is eliminated. Perhaps one of that "number of factors" was that KKR strong-armed his appointment; perhaps not. But nothing in the Supplemental Disclosures tells us that. They add nothing material and, again, plaintiffs cannot take credit for the materiality of a disclosure that was not made.

***

Plaintiffs' arguments, largely relying upon the putative materiality of hypothetical disclosures never made under the settlement, effectively underscore the Supplemental Disclosures' triviality. The district court either committed an error of law or made a clearly erroneous finding when holding the Supplemental Disclosures material; they certainly aren't "plainly material." The class got no meaningful benefit from the Supplemental Disclosures.

III. Yes, this is a strike suit, but even if "strike suit" were defined as narrowly as plaintiffs wish, it doesn't save their settlement.

Plaintiffs attempt to dress up their merger strike suit as something more noble, quoting selectively from *Acevedo* and *Trulia* and *Gordon v. Verizon* to suggest that strike suits must involve broad releases or extensive fiduciary-duty claims. PB16-24. But the crux of a merger strike suit is present here, because plaintiffs sought to enjoin the merger vote. SA2.

> [P]laintiffs' leverage is the threat of an injunction to prevent a transaction from closing. Faced with that threat, defendants are incentivized to settle quickly in order to mitigate the considerable expense of litigation and the distraction it entails, to achieve closing certainty, and to obtain broad releases as a form of "deal insurance."

Trulia, 129 A.3d at 892; *see also* DB7 (complaining about cost of discovery if settlement not quick). Of the three reasons to settle quickly, plaintiffs mention only the last. Thus, a chart like plaintiffs' (PB24) that doesn't omit the columns relevant to this appeal would look like:

Case	Threatened Injunction to Delay or Block Merger?	Quickly Settled for Disclosure and Fees?
Aeroflex	**YES**	**YES**
Allied	**YES**	**YES**
Aruba	**YES**	**YES**
Riverbed	**YES**	**YES**
Trulia	**YES**	**YES**
In re Walgreen	**YES**	**YES**

Contrary to plaintiffs' characterization, the criticism of abusive merger suits in recent years regularly includes proxy strike suits such as this one. *E.g.,* Fisch at 592-600 (discussing lawsuits over disclosure); *id.* at 600-02 (advocating eliminating state-law claims over disclosure to reduce strike suits over insufficient disclosure); Natalia Steele, *Mergers & Acquisitions Strike Suits: What's a Bank To Do?*, SAFE TALK 1 (Sept. 2014) (strike suits are "lawsuits aimed at gaining a quick private settlement that would be less than the defendant's legal costs"); Robert L. Hickok, *et al.*, *Confronting the New Shareholder Strike Suit*, THE LEGAL INTELLIGENCER (Dec. 6, 2012); Tom Hals and Jonathan Stempel, *Analysis: Merger lawsuits increase—as do the legal fees*, Reuters (Feb. 11, 2011) ("Often a lawsuit seeks added disclosures … rather than monetary damages") (quoting, *inter alia*, Berlau's counsel).

But most relevantly, this case is governed by *Aqua Dots* and *Crowley*, and their requirement that putative class counsel bring a suit that actually provides benefit to the

class rather than use the class-action mechanism to leverage a settlement to benefit themselves. Nothing turns on whether the lawsuit here is classified as a "strike suit" or if we instead arbitrarily call it a "half-fizzbin." To paraphrase Shakespeare, rent-seeking by any other name is just as noxious.

IV. If the settlement approval is to be affirmed, attorneys' fees should be penalized.

If the Court adopts a rule permitting the settlement to be approved, *Pearson* still requires that the fees to a settlement be proportionate to the class benefit. The district court erred as a matter of law in failing to apply *Trulia*'s rule: a "supplemental disclosure of nominal value would warrant only a nominal fee award," rather than the windfall of a 1.3-multiple of lodestar[5] here. 129 A.3d at 899 n.46. That pre-*Trulia* district courts typically rewarded abusive settlements with even higher fees (PB56) does not mean those decisions are persuasive or even relevant. As Fisch demonstrates, there is no historical relationship between the value of supplemental disclosures and the amount of attorneys' fees. Fisch at 589.

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[5] As plaintiffs point out (PB57), Berlau hasn't appealed the lodestar, a factual finding reviewed for abuse of discretion. But an objection to 528 hours and $293,000 lodestar for an unlitigated case that settled in two weeks was hardly meritless. A108-09.

Conclusion

For the several independent reasons identified above, this Court should vacate and reverse the class certification and settlement approval or, in the alternative, affirm settlement approval, but remand for a fee award limited to $1.

Dated: April 25, 2016

Respectfully submitted,

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Theodore H. Frank

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/s/ *Theodore H. Frank*

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