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An introduction to claims and damages in M&A litigation

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We've asked lawyers from our offices in Spain, France, Germany, the Netherlands, and the U.S. to give us an overview of what to expect in M&A litigation.

What are the main claims shareholders can bring in M&A deals?

Christine Gateau, France: In any M&A transaction shareholders can bring breach of contract claims for damages against directors and officers who concluded the deal. For mergers and carve-outs, shareholders can bring summary proceedings to postpone the board meeting at which draft terms should be adopted or the annual general meeting at which an M&A deal should be approved.

Olaf Gärtner, Germany: Shareholder M&A litigation isn't well developed in Germany. However, theoretically speaking, there are three potential approaches: lack of disclosure, tortious acts, and where rules that protect shareholders have been broken. These are the three main types of cases that shareholders in public companies can be seen to bring.

Manon Cordewener, Netherlands: We see various types of claims. Inquiry proceedings are only allowed against a company, not its directors or officers. Unlawful act claims can be brought against companies, directors, and officers. And claims to ask the court to declare the board's decision to engage in an M&A deal invalid.

Jon Aurrecoechea, Spain: The four main claims here are for damages based on breach of contract; a social liability action, that is, a claim against the liable directors to compensate the company for damages; an individual liability action, in which individual shareholders (and creditors) can claim against the liable directors; and claims against the company or directors about inaccurate information in materials in a tender or initial public offering.

Bill Regan, U.S.: Claims brought by shareholders in connection with public company M&A transactions are for alleged breaches of the duty of care, the duty of loyalty, and the duty of disclosure. The most common claims by far are by the seller's shareholders against the seller's board of directors. Typically, the claims are that the seller's directors failed to obtain the best price, acted in their own financial interests, and failed to provide sufficient disclosure when seeking shareholder approval.

Does whether the company is public or private influence the claims shareholders can bring? And what's the most common claim clients talk to you about?

Pauline Faron, France: Public companies must abide by the rules that govern the stock market. They must be transparent and give their shareholders pertinent information, especially in takeover bids. The main claims relate to decisions of the French market regulator, the Autorité des marchés financiers, when clearing a corporate transaction. That said, claims here are more often between buyers and sellers of private companies.

Olaf Gärtner, Germany: Some claims apply only to listed stock companies — claims to do with the board's obligation to disclose information in line with the German Securities Trading Act, for example, or around compensation claims after a squeeze-out. However, most of the claims we see are post-M&A, where the buyer goes against the seller, which differs from shareholder litigation in M&A transactions. The former may happen because information wasn't properly disclosed, or representation warranties were breached, and so on.

Jon Aurrecoechea, Spain: The various claims apply to both publicly traded and privately held companies. That is except in claims regarding inaccurate information in materials in a tender or initial public offering. These, of course, can only be brought against companies that are subject to the capital markets regulations.

Carlijn van Rest, Netherlands: Likewise in the Netherlands, both public and private companies are subject to inquiry proceedings and claims for damages.

Ryan Philp, U.S.: Claims in private M&A deals are — similar to in Germany — typically brought by the buyer or seller, and they tend to involve earn-out disputes, indemnification issues that stem from representations and warranties, and fraud claims based on alleged misstatements or omissions that induced one party into the deal. In contrast, in public company transactions, where claims in the U.S. are brought as class actions or derivatively for the company, they're often based on the duties owed by the directors to the company or on U.S. federal securities laws.

Do the claims differ depending on whether it's the shareholder of a public company or the company itself that loses out?

Christine Gateau, France: For the most part, yes. When the company loses out, it's the legal representative who needs to start the action to get compensated. If they don't or are themselves involved in the damage, the shareholders can bring a derivative action.

Carla Wiedeck, Germany: In some cases shareholders can take legal action for the company. Apart from this, the legal situation is similar to that in France.

Jon Aurrecoechea, Spain: If the company loses out, a social liability claim is needed. If shareholders lose out, it's an individual liability claim. In a claim for breach of contract, whoever loses out, the shareholder or the company, can bring the claim. And in tenders and initial public

offerings, in which losses affect shareholders, shareholders bring the claim.

Bas Keizers, Netherlands: Dutch law doesn't allow derivative claims. That said, under certain circumstances, shareholders can claim directly from a third party if the third party did not act in line with a specific standard of due care to be observed toward the shareholders. The shareholder must prove it suffered a personal loss.

Bill Regan, U.S.: U.S. law distinguishes between direct claims that belong to the shareholders and derivative claims that belong to the company. Courts will carefully analyze the nature of the alleged injury to determine whether a claim is direct or derivative. Shareholders can bring derivative claims to recover damages to the company if certain legal thresholds are satisfied.

Can individual shareholders bring claims for other shareholders?

Ryan Philp, U.S.: A shareholder can bring a class action for themselves and other affected shareholders. Common questions of law or fact must apply to all class members. Other criteria must be met, too.

Pauline Faron, France: Class actions don't apply to shareholder claims in France. But if a number of shareholders lose out personally from the same conduct of a director or officer, the shareholders can give proxy to bring claims on their behalf to one or more other shareholders.

Olaf Gärtner, Germany: We have a so-called model litigation law, which lets shareholders claim for damages based on false, misleading, or missing information, if the same issues come up in more than 10 cases. A practical solution we have also seen over the years is that a number of shareholders sell their claims to one entity that brings the lawsuit.

Carlijn van Rest, Netherlands: In principle, a shareholder may claim only on its own behalf. Or the shareholders could jointly start legal proceedings or a collective action to seek a declaratory judgment against a third party because it acted wrongfully. In such a collective action, though, no damages can be claimed (yet). Individual shareholders could nevertheless rely on this declaratory judgment to file follow-on suits for damages.

Jon Aurrecoechea, Spain: Shareholders can file a claim against the directors for the benefit of both the company and, indirectly, the remaining shareholders.

And likewise, what if the company loses out? Can a shareholder bring derivative litigation?

Manon Cordewener, Netherlands: So-called derivative action doesn't exist under Dutch law as it's considered to be unacceptable for both the company and the shareholder to claim the same kind of damages. So, in the Netherlands there is no such thing as a "derivative suit" as applied in the U.S. or the "action sociale" as applied in Germany and France.

Olaf Gärtner, Germany: In Germany, shareholders can in limited cases bring derivative claims. For example, shareholders of a stock company that fulfill certain thresholds can bring a claim on behalf of the company against board members if the company has lost out because of gross

breaches of the law or articles, though not if the assertion of such claims is against the company's best interests.

Jon Aurrecoechea, Spain: Shareholders with minimum capital stakes can file claims for the company against the directors, when (through a shareholders' meeting) the company has refused to take action. Or if there's been a breach of the duty of loyalty, shareholders can file a claim against the directors without the company's refusal.

Bill Regan, U.S.: A shareholder must meet certain requirements to show that it is appropriate to vest the shareholder with authority to bring claims that belong to the company. The shareholder must either make a demand on the board that is wrongfully refused or show in the complaint that such a demand would have been futile due to conflicts of interest on the board.

Who has the burden of proof in M&A litigation — shareholders or the board and officers — and does it shift?

Pauline Faron, France: In general, the burden of proof lies with the claimant; it doesn't shift. And to claim, the shareholder has to prove fault, loss, and the link between the two.

Carla Wiedeck, Germany: As a claimant, the shareholder bears the burden for facts that are favorable to them. In a case brought by the company against the board, the board has to prove it acted without fault, and the company has to show evidence of the damaging act, the damage caused, and the loss.

Manon Cordewener, Netherlands: Of course, there are exceptions. There's a so-called reversal rule that may lessen the burden of proof in liability cases in the Netherlands, though it doesn't shift the burden.

Jon Aurrecoechea, Spain: Generally speaking, the burden of proof lies with plaintiffs. However, in actions or omissions of directors that are contrary to the law or the company's by-laws, the burden of proof for the lack of guilty behavior lies with the directors.

Bill Regan, U.S.: Courts apply the business judgment rule, which means the shareholder has the burden to allege facts that provide a basis to question the board's judgment. If the plaintiff overcomes the rule, the burden shifts to the defendants, who must show "entire fairness."

Steps to mitigate the risk of a claim

Buying or selling any company involves risk and uncertainty. And sometimes even the most strategic and well-planned M&A transaction does not deliver the planned benefits. This is one reason M&A deals are frequently litigated — 73% in 2017, according to a Cornerstone Research report.

There are ways to mitigate the risk of litigation. As a director or officer, you must comply with some form of the duty of care, as well as the duty of loyalty. You'll find most jurisdictions demand this. Both your board and your management must show that their decision-making is

fully informed and that they act with the care of a reasonably prudent person. They must also act in good faith and in the best interests of the company, not their own or those of another director or officer.

After the board approves an M&A deal, a shareholder vote may be needed before the deal can close. Where the vote is made on a fully informed basis, most jurisdictions bar subsequent claims that challenge the deal or the directors' conduct on the deal. Still, claims do arise. Some of your best defenses are as we describe above, on top of which you need careful attention to governance.

In the U.S., public company litigation is evolving. Certain courts have amended the law to give greater deference to arm's-length deals approved by a shareholder vote. Although the number of claims filed since these changes has decreased, shareholder litigation remains a real risk.

As you can imagine, we've only scratched the surface in this write-up. Getting the Deal Through: M&A Litigation 2018 goes much deeper. It covers 13 jurisdictions — Brazil to the U.S. It explores a wider range of the risks of M&A deals. And it brings home just how much getting your deal through matters.

We've recorded two podcasts as well. In these you'll hear about some common themes in global M&A litigation. You can listen to these at hoganlovells.com/malitigation.

Contacts

William (Bill) M. Regan

Partner

Ryan M. Philp

Partner

Dr. Olaf Gärtner, Dipl.-Kfm.

Partner

Manon Cordewener

Office Managing Partner

Christine Gateau

Partner

Dr. Carla Wiedeck

Counsel

Jon
Aurrekoetxe
a

Partner

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