Delaware Court of Chancery Disapproves Class Action Settlement Based on Concerns Over Timing of Presentation and Investigation of Claims

In *SS&C Technologies, Inc. S'holders Litig.*, C.A. No. 1525-N (Del. Ch. Nov. 29, 2006), the Delaware Court of Chancery disapproved a class action settlement for two independent reasons. *First*, the Court concluded that the "parties were dilatory in presenting [the settlement] for approval." *Second*, the Court stated that it could not "conclude from the record presented that the potential claims belonging to the class were adequately or diligently investigated or pursued." This Opinion provides important guidance to practitioners who negotiate and present class action settlements in Delaware Courts.

The transaction at issue in *SS&C* was a management-led buyout of SS&C Technologies by Carlyle Investment Management L.L.C. The company's Chairman & CEO, William Stone, converted some of his SS&C shares and options into a 31% equity position in the surviving entity, and received approximately $72.6 million for his remaining SS&C shares. Stone also entered into an employment agreement with the surviving entity.

Carlyle's initial proposal arose out of an informal process initiated by Stone with the help of an investment banking firm retained by him in his official capacity. During this process, Stone explored strategic alternatives, including the acquisition of SS&C in a transaction where he would have a significant role in the surviving entity. After discussions and preliminary negotiations, Stone informed the SS&C board of his activities. Ultimately, Carlyle submitted a written proposal to Stone to acquire SS&C for $37 per share. That proposal contemplated that Stone would contribute a significant number of his SS&C shares to the acquisition entity in exchange for equity, and that Stone would agree to vote his shares in favor of the deal.

Stone presented Carlyle's proposal to the Board, and the Board formed a special committee of disinterested directors and gave that committee broad powers to explore all alternatives and to consider, accept, or reject any acquisition proposals. The committee then retained legal and financial advisors and solicited competing offers. After receiving no other offers, and after further negotiations with Carlyle, the committee and board approved a merger with Carlyle at $37.25 per share.

After the announcement of the deal on July 28, 2005, two putative class action lawsuits were filed in the Court of Chancery challenging the transaction on the grounds that SS&C's directors had failed to seek the highest price reasonably available under *Revlon*, and that SS&C's proxy statement contained certain disclosures that were materially misleading or incomplete. In late September 2005, counsel for the parties agreed in principle to a settlement based solely on supplemental disclosures. The parties did not advise the Court of these developments or ask leave to present the settlement until after completion of the transaction. Confirmatory discovery occurred in early 2006, the stipulation of settlement was finalized in July 2006, and the settlement hearing was held in September 2006.

In rejecting the proposed settlement, Vice Chancellor Lamb began his analysis by reviewing the Court's role in settlements of representative litigation. Relying on the venerable case of *Chickering v. Giles*, 270 A.2d 373 (Del. Ch. 1970), the Court noted that "the court's function is to consider contested issues, not those which have been made moot by the parties or by events." Although the Court in *Chickering* noted that "in a given case the parties may be faced with an emergency or facts which compel action before the Court can give notice or hold a hearing on a settlement petition," the Court in *Chickering* declined to review a settlement that

had been fully accomplished (including the payment of attorneys' fees to the plaintiffs' lawyer) before notice of settlement was even mailed. 270 A.2d at 375. In *SS&C*, the proxy supplement that formed the basis for the settlement was mailed and the transaction closed, without notice to the Court, and the only part of the settlement that had not already been fully performed at the time of the settlement hearing was the payment of plaintiffs' counsel fees. Thus, the Court declined to approve the settlement "as having been untimely presented."

The Court also declined to approve the settlement because it was "unable to conclude, from the record presented, either that the plaintiffs' counsel adequately represented the interests of the class or that the settlement terms [were] fair and reasonable." On this issue, Vice Chancellor Lamb concluded that the facts raised a "series of questions about both Stone's conduct and that of the board of directors." Vice Chancellor Lamb expressed particular concern over the way the transaction was initiated by Stone "through the use of corporate resources but without prior authorization from the board of directors." In addition, the Court raised questions about whether the board was in a position to consider objectively whether or not a sale of the company should take place given Stone's inclination towards a deal with Carlyle, whether Stone's tentative agreement with Carlyle made it more difficult for the special committee to attract competing bids, and whether Stone's negotiation of a price range with Carlyle unfairly impeded the special committee from securing the best terms reasonably available.

The Court found that none of the issues it raised were "adequately addressed by the plaintiffs' counsel in connection with the proposed settlement." In that regard, the Court noted that at the settlement hearing, "due perhaps to the passage of time, the plaintiffs' counsel exhibited a striking lack of understanding about basic terms of the transaction, including the terms of senior management's participation in the deal." The Court concluded with the following admonishment of plaintiffs' counsel: "When a representative counsel is unable to correctly identify basic terms of the transaction or the basic set of legal issues thereby raised, the court can have no confidence that the interests of the class were adequately represented. This is even more true where the terms of the proposed settlement are entirely non-economic, as here, where the supplemental disclosures supply all of the consideration for the proposed settlement."

This Opinion highlights the need for practitioners in the class action arena to present all proposed settlements to the Court *before* the challenged transaction closes if possible and, if not possible, the parties must promptly advise the Court that some exigent circumstance makes it difficult or impossible to seek formal approval before the performance of any part of the settlement. This Opinion also reminds plaintiffs' counsel that, in seeking approval of settlements in class actions, they must perform a diligent investigation of claims and explain in detail why the settlement is in the best interests of the class.

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