New York Appellate Court Sets New Standard for Approving Nonmonetary and 'Disclosure-Only' Settlements

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It has become a common phenomenon for the announcement of a significant merger transaction to be quickly followed by shareholder class action or derivative litigation challenging the terms of the transaction and the accuracy and completeness of disclosures made to shareholders. These actions are often settled, subject to court approval, with the defendants agreeing to issue additional disclosures and further agreeing not to contest an application by the plaintiff for an award of attorney's fees. Recent decisions from the Delaware courts have questioned the value of such "disclosure-only" settlements and refused to approve them, particularly where the supplemental disclosures are not clearly material to shareholders.[1] On February 2, 2017, the Appellate Division of the New York Supreme Court, First Judicial Department, issued a decision in *Gordon v. Verizon Communications, Inc.*[2] that addressed the standard to be applied by New York courts in approving disclosure-only settlements. While declining to adopt the Delaware approach, the court fashioned an "enhanced scrutiny" test requiring such settlements to be beneficial to both the corporation and its shareholders.

The Decision Below: 'Failure to Materially Enhance Shareholders' Knowledge'

In *Gordon*, the shareholder plaintiff brought a putative class action on behalf of holders of common stock of Verizon Communications Inc. (Verizon) in connection with Verizon's acquisition of Vodafone Group PLC's 45 percent interest in Verizon Wireless for approximately $130 billion. The plaintiff alleged that Verizon's directors breached their fiduciary duty "resulting from defendants' failure to disclose material information" in a preliminary proxy statement filed with the Securities and Exchange Commission. The parties reached an agreement in principle to settle the lawsuit, with defendants "agreeing to disseminate to Verizon's shareholders certain additional disclosures and agreeing that for a period of three years thereafter, in the event that Verizon were to engage in a transaction involving the sale to a third-party purchaser or spin-off of assets of Verizon Wireless having a book value in excess of $14.4 billion, Verizon would obtain a fairness opinion from an independent financial advisor." Verizon subsequently filed a definitive proxy statement including these supplemental disclosures, and over 99 percent of Verizon's shareholders voted to approve the acquisition. The parties then entered into a stipulation of settlement, which was subject to court approval, whereby the defendants agreed not to oppose any fee and expense application of plaintiff's counsel that did not exceed $2 million.[3]

At the settlement fairness hearing, the motion court refused to approve the settlement and denied any award of attorney's fees to the plaintiff's counsel. The court concluded that Verizon's supplemental disclosures "individually and collectively fail[ed] to materially enhance the shareholders' knowledge about the merger" and that "[t]hey provide[d] no legally cognizable benefit to the shareholder class, and cannot support a determination that the Settlement is fair, adequate, reasonable and in the best interests of the class members."[4] The court also concluded that the corporate governance aspect of the proposed settlement "could curtail Verizon's directors' flexibility in managing minimal asset dispositions."[5]

[1] *See, e.g., In re Trulia, Inc. Stockholder Litigation*, 129 A.3d 884 (Del. Ch. 2016).

[2] 2017 NY Slip Op 00742 (Feb. 2, 2017).

[3] *Id.*

[4] *Id.* at 5.

[5] *Id.*

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The First Department Reverses: An 'Enhanced Standard' of Review in New York

On appeal, the First Department reversed and held that approval of the proposed settlement was warranted. The court observed that "disclosure only" and nonmonetary settlements had historically been approved by courts during the 1980s and '90s because they were viewed "as a useful tool in remedying corporate misfeasance." The court recognized, however, that some commentators "have opined that recent decisions ... may signal the extinction of 'disclosure-only' settlements."[6] The court nevertheless held that "[i]n its capacity as gatekeeper, a court conducting a settlement review in a putative shareholders' class action has a responsibility to preserve the viability of those nonmonetary settlements that prove to be beneficial to both shareholders and corporations."[7]

As a threshold matter, although Verizon is a Delaware corporation, the court held that New York law governed its review of the settlement based on the New York choice-of-law provision in the parties' settlement agreement and the court's conclusion that "the chosen jurisdiction bears a reasonable relationship to the parties or the transaction in question" because "Verizon's principal office is located in New York."[8] The court then considered the factors for approving class action settlements first articulated by the First Department in *In re Colt Industries Shareholders Litigation*[9] — namely, (i) the likelihood of success, (ii) the extent of support from the parties, (iii) the judgment of counsel, (iv) the presence of bargaining in good faith, and (v) the nature of the issues of law and fact.[10] In addition to these factors, the court devised two additional factors in order to "provide further guidance to courts reviewing such proposed settlements in the future."[11] First, the corporate governance reforms and nonmonetary relief "should be in the best interests of all of the members of the putative class of shareholders," and second, the settlement "should be in the best interest of the corporation."[12] The First Department concluded that its refined list of factors "assures an appropriately balanced standard of review."[13] In so doing, the court distinguished an earlier decision relying on Delaware law that was "focused primarily upon the materiality of the disclosures, rather than application of the *Colt* standard."[14]

[6] *Id.* at 6-7 (citing *In re Trulia, Inc. Stockholder Litigation*, 129 A.3d 884, 887 (Del. Ch. 2016); *City Trading Fund v. Nye*, 46 Misc. 3d 1206(A) (Sup. Ct. N.Y. Cnty. 2015)).

[7] *Id.* at 9.

[8] *Id.* at 8.

[9] 155 A.D.2d 154 (1st Dep't 1990), *mod. on other grounds*, 77 N.Y.2d 185 (1991).

[10] *Gordon*, 2017 NY Slip Op 00742 at 9.

[11] *Id.* at 10.

[12] *Id.* at 10-11.

[13] *Id.* at 14.

[14] *Id.*

Applying this "enhanced standard," the court held that the proposed settlement's corporate government reforms, including mandating an independent valuation for certain asset sales, provided a benefit to Verizon shareholders.[15] The court also concluded that the proposed settlement was in the corporations' best interest because it would "resolve the issues in this case in a manner that would reflect Verizon's direct input into the nature and breadth of the additional disclosures to be made and the corporate governance reform to be included," as well as allow Verizon to "avoid[] having to incur the additional legal fees and expenses of a trial."[16] As a result, the court held that the settlement should have been approved and remanded the case to the motion court for a determination of attorney's fees.

In a separate concurring opinion, Justice Moskowitz argued that the majority went further than necessary in setting forth the new and "enhanced" seven-part test.[17] In so doing, the concurrence noted that no party took issue with the existing *Colt* factors, and thus neither party had had the opportunity to address the new standard of review set forth by the court. Rather, the concurrence opined that the settlement could and should have been approved "under the rubric of the existing five-factor *Colt* test."[18]

Conclusion

The First Department's "enhanced" standard of review of nonmonetary settlements, with its emphasis on the benefits not only to shareholders but also to the settling corporation, could be viewed by plaintiffs' attorneys as creating a more favorable forum for seeking approval of nonmonetary settlements and related attorney's fees. Although it is too early to tell how courts will apply the *Gordon* test, because it appears to set a less onerous standard for approval of settlements (compared to the Delaware rulings), the decision may attract more merger litigation to the New York state courts, particularly given the *Gordon* court's apparent willingness to apply New York law in an action involving a Delaware corporation.

[15] *Id.* at 12.

[16] *Id.* at 13.

[17] *Id.* at 18-20.

[18] *Id.* at 20.