New York Appellate Court Describes New Standard for Disclosure-Only Settlements in New York

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A New York appellate court approved a settlement in the litigation brought over Verizon Communications, Inc.'s purchase of its former partner Vodafone Group PLC's stake in their joint venture Verizon Wireless. The appellate court overturned the decision of the lower court, which had rejected the proposed settlement, and revised the standard for approving nonmonetary settlements in shareholder class actions.

A New York appellate court approved a settlement in the litigation brought over the purchase by Verizon Communications, Inc. of its former joint venture partner Vodafone Group PLC's stake in their joint venture Verizon Wireless (*Gordon v. Verizon Commc'ns, Inc.*, 2017 N.Y. Slip Op. 00742, 2017 WL 442871 (N.Y.A.D. 1 Dept. Feb. 2, 2017)). The ruling overturns the decision of the Supreme Court (the lower court), which had held that the parties' proposed settlement—which provided for supplemental disclosures and a condition regarding future sales of the acquired business—was not in the best interests of the class members. In reaching its decision, the Appellate Division, First Department revisited the test under New York law for approving nonmonetary settlements in derivative actions, adding two new factors that courts must evaluate. Though broadening the test for judicial review of settlements beyond its initial iteration, the appellate court has arguably produced a standard that is more easily satisfied than the Delaware *Trulia* test. The appellate court remanded the matter to the lower court for a hearing to determine the appropriate amount of attorneys' fees to be awarded to plaintiff's counsel.

BACKGROUND

The litigation arose from the deal between Verizon Communications, Inc. and Vodafone Group PLC, former joint venture partners in Cellco Partnership d/b/a Verizon Wireless, for Verizon to acquire Vodafone's 45% interest in the venture for a purchase price of $130 billion. For a summary of the stock purchase agreement, see What's Market, Verizon Communications Inc./Vodafone Americas Finance 1 Inc. Purchase Agreement Summary. The parties signed the purchase agreement on September 2, 2013. Three days later, plaintiff shareholder Gordon filed suit claiming that the board of Verizon had breached its fiduciary duty by agreeing to an excessive price to pay Vodafone. The plaintiff amended her complaint after Verizon filed its proxy statement to add claims of inadequate disclosures.

PROPOSED SETTLEMENT

On December 6, 2013, counsel for the parties reached an agreement in principle to settle the action. In return for a global release of all claims, the defendant directors agreed:

- To add the following supplemental disclosures:
  - a disclosure that the valuation of Omnitel, a telecommunications company in which Verizon had an interest and which it sold to Vodafone in a separate purchase agreement, was made by independent advisors, not Verizon management;
  - additional detail explaining why the financial advisor excluded AT&T from its comparable-companies analysis;
  - further detail as to the financial advisor's use of operating and financial metrics in its comparable-transactions analysis; and
  - a tabular presentation of premiums paid in precedent minority-interest sale transactions.
- That for a period of three years after the closing, if Verizon were to engage in a transaction involving the sale to a third party or a spin-off of assets of Verizon Wireless worth more than $14.4 billion, Verizon would obtain a fairness opinion from an independent financial advisor regarding that transaction.

HEARING ON SETTLEMENT

On December 2, 2014, the lower court held a hearing to determine whether to approve the settlement. Two objecting shareholders offered argument and testimony at the hearing. The court also heard from Professor Sean Griffith, an academic who has made it a practice to buy shares in Delaware corporations going through mergers in order to obtain standing as a shareholder and testify against proposed disclosure-only settlements. In those

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instances, Professor Griffith has argued that disclosure-only settlements offer little value for shareholders in return for large attorney fees and should be rejected (for example, see Legal Update, Delaware Court of Chancery Signals Stricter Approach to Approving Settlements in M&A Deals (w-000-4790)). In the case at hand, Professor Griffith testified as an expert and offered his opinion that the fairness-opinion condition agreed to by Verizon was immaterial because fairness opinions are already routine in small asset sales.

LOWER COURT REJECTS SETTLEMENT

Following the hearing, the lower court issued an order rejecting the settlement and any award of attorney's fees to plaintiff counsel (*Gordon v. Verizon Commc'ns, Inc.*, 2014 N.Y. Slip. Op. 33367(U), 2014 WL 7250212 (N.Y.Sup., NY County, Dec. 19, 2014)). The court held that the four supplemental disclosures would not "materially enhance the shareholders' knowledge about the merger" and therefore could not support a conclusion that the settlement was "fair, adequate, reasonable and in the best interests of the class members." The court also discounted the benefit of the fairness-opinion condition on the grounds that it would restrain the Verizon board's flexibility in managing minimal asset sales.

APPEAL

On February 3, 2015, the plaintiff filed a motion to renew and/or reargue her motion for final approval of the settlement. In support of her motion, the plaintiff produced an affidavit of her own expert, Professor Stephen Lubben. The affidavit refuted Professor Griffith's opinion, contending that the fairness-opinion requirement provided a substantial benefit to the shareholders. Professor Lubben also dismissed as speculative Professor's Griffith's view that the Verizon board would obtain a fairness opinion as a matter of routine.

OUTCOME

The Appellate Division, First Department reversed the order of the Supreme Court and remanded the matter for a hearing to determine the appropriate amount of attorneys' fees to be awarded to plaintiff's counsel. In reaching its decision, the appellate court discussed the recent efforts by Delaware and New York courts to curtail the "merger tax" phenomenon, in which shareholder plaintiffs would bring rote challenges against almost all public mergers, only to settle them and grant a global release of all claims in exchange for inconsequential supplemental disclosures and payment of the plaintiff's attorney fees. In light of the increasing attention to disclosure-only settlements and the ways in which they cause waste and abuse to corporations and their shareholders, the court articulated a new test for approving such settlements under New York law. Under this expanded test, the court still found that the settlement between the Verizon board and the plaintiff shareholder generated sufficient benefit for the corporation and its shareholders to have been approved by the lower court.

A concurring opinion of the appellate court held that the current version of the test did not need to be expanded for the court to conclude that the proposed settlement satisfied New York law.

COMPETING PRECEDENT

After identifying the rise of a "cottage industry" of class action lawyers trading disclosure-only settlements for a release and attorney fees, the court reviewed two competing lines of precedent in Delaware and New York for the appropriate judicial response to the phenomenon. In one line of cases, led by the Delaware Chancery Court's 2016 *Trulia* decision, the courts have rejected settlements that do not yield "genuine benefits for stockholders," insisting instead that the supplemental disclosures address a "plainly material" misstatement or omission in the proxy statement and that the release be narrowly tailored (*In re Trulia, Inc. S'holder Litig.*, 129 A.3d 884 (Del. Ch. 2016)). As discussed in *Trulia*, the increased scrutiny of disclosure-only settlements had already begun in New York, with several settlements rejected by the same New York Supreme Court that issued the initial order in *Gordon v. Verizon Communications*:

- In *City of Trading Fund v. Nye*, the New York court commented that "[w]ithout the court serving as a gatekeeper, plaintiffs who file such ligation will continue to unjustifiably extract money from shareholders, who get no benefit from the litigation but nonetheless end up paying two sets of attorneys, both plaintiffs' and defendants'." (9 N.Y.S. 3d 592 (Table), 2015 WL 93894 (N.Y.Sup., NY County, Jan. 7, 2015).)
- In *Allied Healthcare*, the court lamented that "a culture has developed that results in cases of relatively worthless settlements... that discontinue the action (with releases) resulting in the corporate defendants not opposing an agreed upon legal fee to class counsel." The court commented that "[t]he willingness to rubber-stamp class action settlements reflects poorly on the profession and on those courts that, from time to time, have approved these settlements." (*Matter of Allied Healthcare S'holder Litig.*, 26 N.Y.S. 3d 212 (Table), 2015 WL 6499467 (N.Y.Sup., NY County, Oct. 23, 2015).)

However, as the appellate court explained, these decisions have not necessary signaled the death-knell of disclosure-only settlements. The lower court's decision in *Nye* was reversed on appeal, with the appellate court finding that the supplemental disclosures were "arguably beneficial" to the shareholders (*City of Trading Fund v. Nye*, 144 A.D.3d 595 (N.Y.A.D. 1 Dept 2016)). In addition, the Delaware Chancery Court in *Xoom* found that the supplemental disclosures offered by the defendants justified an award of attorney's fees (*In re Xoom Corp. S'holder Litig.*, 2016 WL 4146425 (Del. Ch. Aug. 4, 2016)). Left unstated by the appellate court was that the decision in *Xoom* addressed a mootness-fee application, which, the Chancery Court explained, supports a lower standard than the "plainly material" standard required for approval of a settlement, because the dismissal is only with respect to the individual plaintiffs, rather than the stockholder class. The appellate court also cited two papers that have called for "a more balanced approach in evaluating nonmonetary class action settlements."

FIVE-FACTOR TEST FOR REVIEW OF SETTLEMENTS

With that introduction to the issue of disclosure-only settlements, the court applied the five-factor test described in *Colt Industries* for reviewing class action settlements in New York (*In re Colt Indus. S'holder Litig.*, 155 A.D.2d 154 (N.Y.A.D. 1 Dept 1990)). The five factors are:

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- The plaintiff's likelihood of success on merits, weighed against the form of relief offered in the settlement.
- The extent of support from the parties for the proposed settlement.
- The judgment of counsel.
- The presence of bargaining in good faith.
- The nature of the issues of law and fact.

The appellate court held that these factors weighed in favor of accepting the proposed settlement. The plaintiff withdrew her claims for monetary damages once she recognized they would be hard to prove at trial, making it unlikely that she would have obtained more helpful disclosures from Verizon had she proceeded to trial. Only three objections to the settlement were filed out of 2.25 million Verizon stockholders, all three by attorney stockholders. Fewer than 250 stockholders opted out of the settlement. No party objected to the terms of the settlement itself, only to the award of attorney fees. The parties were represented by capable and experienced counsel, with no evidence that the negotiations were not held at arm's length and in good faith. And since the claims for monetary relief were abandoned, the only remaining issue left was the plaintiff's disclosure claim, which was best resolved by a negotiated settlement where the parties could identify the areas most in need of additional disclosure.

TWO NEW FACTORS IN SHAREHOLDER CLASS ACTIONS

After determining that the traditional *Colt Industries* test weighed in favor of approving the settlement, the court added that this does not end the inquiry. In light of the need to "curtail excesses" by not only management (for which the *Colt Industries* test is suited) but "overzealous litigating shareholders and their counsel" as well, the court revisited the test "to effect an appropriately balanced approach to judicial review of proposed nonmonetary class action settlements and provide further guidance to courts reviewing such proposed settlements in the future."

On that basis, the court added two new factors:

- The supplemental disclosures, corporate-governance reforms and any other forms of nonmonetary relief should be in the best interests of all the members of the putative class of shareholders.
- The proposed settlement should be in the best interest of the corporation and not be merely a vehicle for generating attorney fees.

The court reviewed the proposed settlement against these two factors and found that it satisfied the broadened test. In so doing, the court somewhat summarily ruled that the additional disclosures, though arguably thin, provided some additional benefit to the shareholders. More significant for the court was the inclusion of the fairness-opinion requirement. The court cited to its opinion in *Seinfeld v. Robinson* for the principle that even if a corporate-governance reform is speculative (such as in this case, in that the fairness-opinion requirement would only be activated in the event of a future sale that triggers the condition), it can still be valuable to the shareholders as a way to safeguard the valuation of corporate assets (246 A.D.2d 291 (N.Y.A.D. 1 Dept 1998)). The court added that the seventh factor—benefit to the corporation—was satisfied because Verizon had had direct input into the nature of the supplemental disclosures and the fairness-opinion requirement and would avoid incurring more fees in a trial.

Having articulated its broadened standard, the court maintained that the test resembles the *Trulia* standard. The court compared the "likelihood of success on the merits" and "nature of the issues of law and fact" factors to *Trulia*'s "claim, possible defenses, and obstacles" factors, and "the reasonableness of the 'give' and 'get'" factor in *Trulia* to the "best interests of the settlement class as a whole" factor now added to the standard in New York. In the court's view, the addition of the latter factor to the standard, together with the "best interests of the corporation" factor, assures an appropriately balanced standard of review.

The court also highlighted its difference of opinion with the lower court regarding the value of the supplemental disclosures. The appellate court characterized the lower court's ruling as requiring that a supplemental disclosure contradict what had previously been disclosed in order to be considered material. The appellate court emphasized that this approach is not supported by New York law.

PRACTICAL IMPLICATIONS

The Appellate Division, First Department has articulated what amounts to a seven-factor test for judicial review of nonmonetary, or disclosure-only, settlements:

- The plaintiff's likelihood of success on merits, weighed against the form of relief offered in the settlement.
- The extent of support from the parties for the proposed settlement.
- The judgment of counsel.
- The presence of bargaining in good faith.
- The nature of the issues of law and fact.
- The supplemental disclosures, corporate-governance reforms and any other forms of nonmonetary relief should be in the best interests of all the members of the putative class of shareholders.
- The proposed settlement should be in the best interest of the corporation and not be merely a vehicle for generating attorney fees.

Although the court offered its opinion that its test is not fundamentally different from Delaware's, the test as applied in *Gordon v. Verizon Communications* is seemingly not as strict. The *Trulia* court emphasized that supplemental disclosures must be "plainly material" in order to support a global release and payment of the plaintiff's attorney fees. The New York court, however, appealed to the standard described in the Chancery Court's *Xoom* decision. In *Xoom*, though, the Chancery Court evaluated a mootness-fee application, not a settlement. In that context, the Chancery Court held that disclosures that provide "some benefit" to the stockholders are enough to justify a typically lower mootness fee.

Throughout the appellate court's decision, disclosures that provide any benefit for the shareholders—even as thin as having previously disclosed information presented in tabular format—are deemed enough under New York law to support the settlement. The task of identifying which disclosures were most significant to the court is made somewhat harder by the fairness-opinion requirement, a

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corporate-governance reform that goes beyond disclosures alone and which was key for the court. However, the decision can still be read as implying that the disclosures alone would have won the court's approval for the settlement.

More decisions from New York courts may be necessary before it can be determined conclusively that the New York standard is more forgiving than Delaware's. To the extent that practitioners conclude that it is, a vital consideration for parties and their counsel is whether this a significant-enough reason to select New York as the governing law and forum for disputes in the acquisition agreement.

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