

First Department Opens the Door a Bit Wider to “Disclosure-Only” Settlement Agreements in Class Action Cases

by Jonathan M. Herman

Introduction

On February 2, 2017, the New York Supreme Court, Appellate Division, First Department, approved a “disclosure-only” settlement agreement in *Gordon v. Verizon Communications, Inc.*, 2017 N.Y. App. Div. LEXIS 740 (1st Dep’t Feb. 2, 2017). The Court explained, in the opinion written by Justice Marcy L. Kahn, that it has a responsibility to preserve the viability of nonmonetary settlements as long as they are beneficial to both shareholders and corporations and “promote fairness to all parties.” *Id.* at *15.

Nonmonetary class action settlement began in the 1980s when, in the context of mergers and acquisitions, plaintiffs filed complaints alleging corporate misconduct and called for corporate governance reforms. Eventually, the use of nonmonetary settlements became disfavored, as courts came to view such settlements in shareholder class actions “as a cottage industry for the plaintiffs’ class action bar ... causing waste and abuse to the corporation and its shareholders.” *Id.* at *11. Thus, decisions in both New York and Delaware reflected an increasingly negative view of “disclosure-only” and other forms of nonmonetary settlements.

The *Gordon* decision is significant because it signals that New York courts may now view such settlements more favorably. Accordingly, corporations and plaintiffs’ counsel should consider whether New York is now a more favorable jurisdiction for mergers and acquisitions litigation than Delaware.

Verizon Litigation

On September 2, 2013, Verizon publically announced that it had entered into a \$130 billion stock purchase agreement with Vodafone Group, PLC, whereby Verizon acquired Vodafone subsidiaries. The deal effectively changed Verizon Wireless from a joint

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venture between Verizon and Vodafone into a wholly-owned subsidiary of Verizon.

On September 5, 2013, plaintiff Natalie Gordon filed a putative class action on behalf of all holders of outstanding Verizon common stock, alleging that Verizon's board of directors breached its fiduciary duty by causing Verizon to pay an excessive price for Verizon Wireless stock. Roughly a month later, Verizon filed with the SEC a preliminary proxy statement setting forth the background and terms of the transaction. Plaintiff then amended the complaint to bring additional claims from Verizon's alleged failure to disclose material information concerning the transaction.

Within weeks, the parties engaged in settlement discussions and, by December 6, 2013, agreed in principle to settle the action. Defendants agreed to provide Verizon's shareholders with additional disclosures and further agreed that, for a period of three years thereafter, Verizon would obtain a fairness opinion from an independent financial advisor in the event Verizon were to sell Verizon Wireless or spin-off its assets in excess of \$14.4 billion.

On October 6, 2014, the motion court – Justice Melvin Schweitzer of the New York County Supreme Court – certified the action as a class action and preliminarily approved the settlement. However, following a fairness hearing at which two objectors testified in opposition to the settlement, Justice Schweitzer issued an order reversing his preliminary order and declining to approve the settlement agreement. *Gordon v. Verizon Communications, Inc.*, 2014 N.Y. Misc. LEXIS 5642 (Sup. Ct., NY County, Dec. 19, 2014). The motion court was persuaded by the objectors to scrutinize the settlement agreement more closely to determine “whether it truly is fair, adequate, reasonable, and in the best interest of class members.” *Id.* at *4. Justice Schweitzer concluded that the information Verizon agreed to disclose to shareholders did not “materially enhance shareholders’ knowledge about the merger” and did not establish that settlement to be fair and in the best interests of the class members. *Id.* at *16-17.

The Appellate Decision

On appeal, Justice Kahn analyzed the parties’ proposed settlement in light of the factors set forth previously by the First Department in *In re Colt Indus. S’holder Litig.*, 553 N.Y.S.2d 138 (App. Div. 1990). In *Colt*, the Court identified the following factors a court should examine in determining the merits of a proposed class action settlement: (1) the likelihood of success; (2) the extent of support from the parties; (3) the judgment of counsel; (4) the presence of bargaining in good faith; and (5) the nature of the issues of law and fact. *Id.* at 141. Justice Kahn found that each of these five factors weighed in favor of the proposed settlement.

However, the *Gordon* decision states that, in addition to the five *Colt* factors, courts should examine two additional factors: (6) whether the forms of nonmonetary relief are in “the best interests of all of the members of the putative class of shareholders” and (7) “whether the proposed settlement is in the best interest of the corporation, recognizing that the lack of a monetary or quantifiable benefit to the corporation does not necessarily preclude such a finding.” 2017 N.Y. App. Div. LEXIS 740, at *19, 24.

With respect to the new sixth factor, the Court explained that “[a]pplication of the sixth factor of our enhanced standard, whether the proposed settlement is in the best interests of the putative settlement class as a whole, requires a review of whether the key aspects of the proposed settlement would benefit the Verizon shareholders.” *Id.* at *20. The Court found that the most beneficial aspect of the proposed settlement was its inclusion of a fairness opinion requirement in the event that Verizon engages in a transaction involving the sale or spin-off of assets of Verizon Wireless having a book value in excess of \$14.4 billion.

With respect to the new seventh factor, the Court found that the proposed settlement 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 part of the proposed settlement.” *Id.* at *24. “And, by agreeing to the settlement, Verizon avoided having to incur the additional legal fees and expenses of a trial.” *Id.*

Thus, the Court concluded that, in light of the five original *Colt* factors and the two new factors, the proposed settlement should be approved.

The Concurring Opinion

In a brief concurring opinion, Justice Moskowitz opined that the majority “goes much further than is necessary to determine this appeal,” as “no party to this appeal took issue with the existing *Colt* test.” *Id.* at *34. Accordingly, Justice Moskowitz “part[ed] ways with the majority on its conclusion that [the Court] should analyze the proposed class settlement under a new seven-factor test.” *Id.* at *36. Justice Moskowitz believes that the Court should have simply approved the proposed class settlement under the original five-factor *Colt* test, “as the proposed settlement under that test is fair, adequate, and in the class members’ best interest.” *Id.*

Takeaway Points

The *Gordon* decision is noteworthy for the following reasons.

First, by adding a new sixth factor to the *Colt* test, courts in the First Department will now place a greater emphasis on fairness to the putative class of shareholders in determining whether to approve settlement agreements. Under this factor, additional disclosures and the requirement of a fairness opinion from an independent financial advisor would both weigh in favor of approving a proposed settlement.

Second, by adding a new seventh factor to the *Colt* test, courts in the First Department will now place a greater emphasis on the best interests of the corporation in determining whether to approve settlement agreements. Under this factor, the avoidance of further legal fees weighs in favor of approving a proposed settlement.

Finally, the *Gordon* decision signals that New York is perhaps becoming a friendlier jurisdiction for proposed “disclosure-only” and other types of nonmonetary settlement agreements. This contrasts with recent decisions in Delaware, such as *Matter of Trulia, Inc. Stockholder Litig.*, 129 A.3d 884, 887 (Del. Ch. 2016), where the Court held that a proposed disclosure-only settlement was “not fair or reasonable because none of the supplemental disclosures were material or even helpful to Trulia’s stockholders” and noted that scholars expressed concerns “that these settlements rarely yield genuine benefits for stockholders.” See also *In re Xoom Corp. Stockholder Litig.*, 2016 WL 4146425 (Del. Ch. 2016). As such, corporations, as well as plaintiffs’ counsel, should consider whether New York is a more favorable forum than Delaware for M&A litigation.

Of course, reasonable minds can differ whether a nonmonetary settlement legitimately benefits a corporation and its stockholders. Analysis of the terms of such proposed settlements will likely yield different results in the hands of different judges.

Perhaps the true test of whether the *Gordon* decision will open the door widely in New York to such settlements will be revealed on remand in Justice Schweitzer’s courtroom as he evaluates the application of plaintiffs’ counsel for an award of attorneys’ fees. While the original terms of the negotiated settlement in *Gordon* called for attorneys’ fees “not exceeding \$2 million,” 2017 N.Y. App. Div. LEXIS 740, at *6, close scrutiny of the value of the services provided by counsel in a case where a nonmonetary settlement was achieved within a couple of months of the filing of the amended complaint will likely be required, and a low award may dampen the enthusiasm of class counsel to commence future litigation of this sort. Compare *Xoom*, where the Delaware Chancery Court reduced the requested fee from \$275,000 to \$50,000.