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Commercial division update – Judicial approval of disclosure – only class action settlements

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In his Commercial Division Update column, Thomas J. Hall discusses recent Commercial Division decisions applying a new standard for judicial approval of non-monetary class action settlements in New York.

New York CPLR Rule 908 requires court approval for class action settlements: "A class action shall not be dismissed, discontinued, or compromised without the approval of the court." The role of the court is to judge independently whether the settlement is fair, reasonable and in the best interest of the class members. During the 1980s and 1990s, New York courts routinely approved non-monetary class action settlements. More recently, concerns have arisen that courts serve as no more than a "rubber stamp" for collusive settlements of meritless class actions where the real benefit is the payment of attorney fees to class counsel, prompting reconsideration of the judiciary's role in approving such settlements.

In 2017, the First Department adopted a new standard for such approvals of whether the class members will receive "some benefit" from a disclosure-only settlement with no monetary payment other than to class counsel for attorney fees. In contrast, the Delaware courts now use a higher standard of whether the supplemental disclosures will "materially enhance" the class members' knowledge. This column discusses recent Commercial Division decisions applying this new standard in New York.

Disclosure-only class settlements

Non-monetary or "disclosure-only" class action settlements can be a valuable tool in combating corporate misconduct and enhancing the rights of class members. Historically, courts typically viewed supplemental disclosures as sufficiently material because they offered additional information that would, for example, assist shareholders voting on a transaction. For example, in *Rosenfeld v. Bear Stearns*, 237 A.D.2d 199 (1st Dept. 1997), the First Department upheld the trial court's approval of a settlement even though it did not include monetary compensation, where defendant agreed to disclose to their class plaintiff customers the compensation defendants received on their margin accounts.

In recent years, critics have argued that such settlements frequently serve no purpose other than to pad the pockets of the plaintiffs' bar who use the threat of delaying a transaction through litigation to pressure corporations into quick settlements of meritless claims. Because of such tactics, such settlements have earned nicknames like "peppercorn and fee settlements," "strike suits" and "merger taxes." Recognizing

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the potential pitfalls associated with disclosure-only settlements, in recent years the Delaware courts have imposed greater scrutiny of such settlements that offer little to no benefit to class members. In *In re Trulia*, 129 A.3d 884 (Del. Ch. 2016), the Delaware Chancery Court rejected a proposed settlement because "none of the supplemental disclosures were *material* or even helpful to Trulia's stockholders," meaning that reasonable shareholders would not have considered the disclosures when exercising their rights. The supplemental disclosures there provided only "extraneous details" to an already substantial disclosure of the methods used and assumptions made by the financial advisor to the transaction. Highlighting its exasperation, the court went further, advising:

> practitioners should expect that disclosure settlements are likely to be met with continued disfavor in the future unless the supplemental disclosures address a plainly material misrepresentation or omission, and the subject matter of the proposed release is narrowly circumscribed to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sale process, if the record shows that such claims have been investigated sufficiently.

Appellate precedent

The prevailing law in New York for over two decades was *In re Colt Indus. S'holder Litig.*, 155 A.D.2d 154, 160 (1st Dept. 1990), which outlined five factors that a court should consider in reviewing proposed class action settlements: (1) the likelihood of success on the merits of the case; (2) the extent of support of class members; (3) the judgement of counsel; (4) the good-faith of the bargaining; and (5) the nature of the legal and factual issues.

In 2017, the First Department added to these *Colt* factors. In *Gordon v. Verizon Communications*, 148 A.D.3d 146 (1st Dept. 2017), the court reversed the trial court's disapproval of a disclosure-only settlement because the proposed supplemental disclosures "individually and collectively fail[ed] to *materially enhance* the shareholders' knowledge about the merger" and "provide[d] no legally cognizable benefit to the shareholder class, and [could] not support a determination that the Settlement [was] fair, adequate, reasonable and in the best interests of the class members." In rejecting the settlement, the trial court had recognized that 97 percent of corporate mergers or acquisitions "attract at least one shareholder lawsuit, and many attract several suits." The trial court stated that approval of the settlement would be to "enable[] unwarranted divestiture of shareholder rights by virtue of plaintiff's release, as well as a misuse of corporate assets were plaintiff's legal fees to be awarded." *Gordon v. Verizon Commc'ns*, No. 653084/13, 2014 WL 7250212 (N.Y. Co. Dec. 19, 2014).

On appeal, the First Department reversed, finding that, even though it lacked monetary compensation, the settlement's proposed supplemental disclosures offered "some benefit" to the putative class." A court conducting a settlement review in a putative shareholders' class action has a responsibility to preserve the viability of those non-monetary settlements that prove to be beneficial to both shareholders and corporations, while protecting against the problems with such settlements recognized since *Colt*, in order to promote fairness to all parties." While the court determined that each *Colt* factor weighed in favor of the proposed settlement, this did not end the inquiry. Recognizing "the need to curtail excesses not only on the part of corporate management, but also on the part of overzealous litigating shareholders and their counsel," the court adopted two additional factors. First, the proposed settlement should be "in the best interests of all of the members of the putative class of shareholders," which requires a finding that the supplemental disclosures will provide "some benefit" to the class members. Second, "the proposed settlement should be in the best interest of the defendant corporation." Considering these additional factors, the court determined that the supplemental disclosures indeed provided some benefit to the shareholders and were in the best interest of the corporation.

Commercial division

Since *Gordon*, three Commercial Division decisions by Justice Shirley Werner Kornreich of the New York County Commercial Division have applied this "some benefit" standard.

In *Roth v. Phoenix*, 56 Misc. 3d 191 (N.Y. Co. March 24, 2017), the court approved a non-monetary class action settlement that afforded the class "all of the disclosure they could have expected to obtain" through continued litigation. The court agreed with plaintiffs that the original disclosures failed adequately to inform the corporation's bondholders about how the transaction "would impact the value and market for the bonds" and their right to receive additional financial information. Thus, in applying *Gordon*'s sixth factor, whether the settlement was in the best interest of the putative settlement class, the court held that the supplemental disclosures brought "*real benefit*" to the plaintiff class by ensuring financial transparency post-merger. While

acknowledging that "disclosure-only settlements resolving pre-merger lawsuits are the subject of much controversy and often properly viewed with a fair degree of skepticism," because the supplemental disclosures here brought real benefit the court found "this case lack[ed] the pernicious indicia of a frivolous 'strike suit' seeking a 'merger tax.'" Going even further, the court noted that "*Gordon*'s 'some benefit' test [could] not be viewed as anything other than an outright rejection of *Trulia*'s 'plainly material' standard and in this case, the remedial disclosures would pass muster under *Trulia* (meaning that *Gordon*'s lower standard is easily satisfied)."

Saska v. Metropolitan Museum of Art, 57 Misc. 3d 218 (N.Y. Co. June 15, 2017), a consumer class action, was brought by class of patrons of the Metropolitan Museum of Art who alleged the museum's admission policy was deceptive in that its signage failed to inform the public clearly that the listed admission prices were merely suggestive, not mandatory. To settle that suit, the museum agreed to change the admission signs, which the court approved along with an award of attorney fees because the proposed settlement "provid[ed] a real benefit to the public." In approving the settlement, Justice Kornriech found that she did "not believe a reasonable person could compare the two signs side-by-side and conclude that the new sign [was] not a significant improvement over the old sign. "As to attorney's fees, the court noted that "the value of the disclosure-only settlement should dictate the amount of the award, here, the value is considerable," thus the $350,000 award was reasonable.

In the most recent case, Kornriech clarified the interpretation of *Gordon*'s "some benefit" standard when confronted with, what the court viewed as, a true strike suit seeking a merger tax. In *City Trading Fund v. Nye*, 2018 WL 792283 (N.Y. Co. Feb. 8, 2018), the court refused to approve a non-monetary class action settlement because the proposed supplemental disclosures were "utterly useless to shareholders." The court held that "some benefit" means that the supplemental disclosures must be "helpful to the shareholders," in that they "aid[ed] a reasonable shareholder in deciding whether to vote for the merger." The court found that disclosures can fall within a spectrum, from the disclosure of the CEO's favorite baseball team, which has no benefit, to disclosure of management projections made in the ordinary course of business that reveals that the company's value materially deviates from the sale price of the transaction at issue, which plainly qualifies as material. Here, in contrast, one primary additional disclosure was projections of third-party financial analysts that were publicly available, which the court found immaterial to shareholders. The court addressed the three other supplemental disclosures, finding they would not matter to a reasonable shareholder: (1) "tell me more" disclosures, here disclosure that management had conversations about forecasts; (2) disclosure of the common stock in the company held by the banks rendering advice on the merger and fees paid to them; and (3) disclosures outlining exactly which executive officers may receive additional compensation post-merger.

Conclusion

Exactly which kinds of supplemental disclosures will fall outside this spectrum of usefulness will be decided on a case-by-case basis. The *City Trading* court readily acknowledged "there is no denying the difficulty of assessing the value of supplemental disclosures." What is clear, however, is that New York courts will utilize *Gordon*, even though not as rigorous as the Delaware standard, as a sword against the practice of bringing groundless class actions in the hope of a quick settlement requiring meaningless supplemental disclosures and awarding a significant attorney fee.

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