February 22, 2018

New York Trial Court Does Its Best To Shore Up Standard for Approving Disclosure-Only Class Action Settlements

by Annica Bianco

Takeaway: Strike suits against corporate mergers are often resolved in worthless "disclosure-only" settlements. Derided as a "peppercorn and a fee," a disclosure-only settlement provides no monetary relief to the stockholders. Instead, it results in the payment of a significant fee to the plaintiff's attorney, coupled with "supplemental disclosures" about the transaction to address alleged deficiencies in the proxy. The new disclosures – touted in the settlement as beneficial to shareholders – are typically worthless. Led by the Delaware Court of Chancery, most notably in *In re Trulia, Inc. Stockholder Lit.*, 129 A.3d 884 (Del. Ch. 2016) (Bouchard, C.) ("*Trulia*"), a number of courts have heightened the showing required for approval of such settlements, resulting in a decline in meritless merger litigation. However, New York's First Department has not followed suit, endorsing in a recent decision (*Gordon*) a more lenient settlement approval standard, a decision criticized by a leading commentator (John C. Coffee, Jr.) as constituting a "legal rubber stamp." *See Gordon v. Verizon Commc'ns, Inc.*, 148 A.D.3d 146, 46 N.Y.S.3d 557 (1st Dept. 2017). But a recent New York trial court decision, *City Trading*, shows that even in jurisdictions such as New York that have not expressly adopted Delaware's *Trulia* standard, trial judges are still on the lookout and will not approve disclosure-only settlements perceived as worthless to the shareholders of a corporation. *City Trading Fund v. Nye*, No. 651668/2014, 2018 WL 792283 (N.Y. Sup. Ct. Feb. 8, 2018).

In *City Trading*, the trial judge (Judge Shirley Werner Kornreich of the New York County Supreme Court) evaluated a proposed disclosure-only settlement arising out of a stockholder suit that sought to enjoin a merger on the basis of inadequate disclosures. The trial court was required to apply New York's governing *Gordon* standard. Her opinion strongly suggests, however, that she did so under protest.

The *Gordon* decision, which was issued after *Trulia* and acknowledged the "increasingly negative view" of disclosure-only settlements, declined to follow *Trulia*'s lead. *Gordon*, 148 A.D.3d at 154-155. To the contrary, the *Gordon* court observed that it was premature to conclude that *Trulia* and like decisions signaled the extinction of disclosure-only settlements. *Id*.

The *Gordon* court went on to review the then-current New York standard for approving non-monetary settlements, adding two additional factors to address "the need to curtail excesses" in M&A litigation. *Id*. at 158. These two additional factors required that a settlement be in "the best interests of all of the members of the putative class" and also "in the best interest of the corporation." *Id*. The *Gordon* court concluded that, as supplemented, the New York standard was "comparable" to *Trulia* and "assure[d] an appropriately balanced standard of review." *Id*. at 162. But there was quick disagreement with the *Gordon* court's conclusion that the two standards were comparable. *Gordon* was widely viewed as a more lenient standard and a meaningful departure from *Trulia*. *See City Trading*, 2018 WL 792283, at *1 n.4 (discussing John Coffee's article criticizing *Gordon*, entitled, *The Race to the Bottom: Is the Last Stop New York?*).

In *City Trading*, the trial court in which *Gordon* originated, albeit before a different judge, and which initially denied approval of *Gordon's* disclosure-only settlement before being reversed by the First Department in *Gordon*, had a chance to respond. And respond it did.

City Trading discusses the *Trulia* and *Gordon* standards at length. The decision regales the former as "a thorough and compelling decision" that "eloquently explained" the dynamic of so-called strike suits. *Id*. at *5, n.8. In contrast, the court dedicates a nearly page-long footnote to criticism of *Gordon*. *Id*. at *1, n.4. And although the court issued its decision under the cloak of *Gordon*, it employed language plucked directly from *Trulia* to do so. The court summarized *Trulia*'s "plainly material" standard as requiring that the value of the proposed disclosures "should not be a close call." *Id*. at *5. It then used this same language to characterize the case before it: "This case is not a close call." *Id*. at *10. The court distinguished *City Trading* from two post-*Gordon* decisions in which New York courts granted final approval of disclosure-only settlements, noting that neither of those "was a strike suit seeking the extraction of a merger tax." *Id*. at *14. It went on to dismiss the supplemental disclosures proposed in that case as "utterly worthless" before dutifully, if briefly, applying the facts to the *Gordon* factors. *Id*. at *17. With no room left for suspense, the court rejected the proposed disclosure-only settlement. *Id*.

In addition to its thorough and approving summary of *Trulia*, *City Trading* is also noteworthy because the court effectively shored up the New York standard, a task it was uniquely situated to undertake, given the case's procedural history. *Id*. at *2. The parties in *City Trading* had already appeared once before the appellate court following the trial court's denial of preliminary approval of a disclosure-only settlement. *Id*. In that first appeal, which preceded *Gordon*, the appellate court reversed the trial court's denial as premature on a motion for preliminary approval (the "Preliminary Decision"). *Id*. It found that the proposed disclosures were "arguably beneficial" and directed the trial court to hold a fairness hearing to determine whether final approval of the settlement should be granted. *Id*.

The *City Trading* court spent several pages assessing the intended meaning of the *Gordon* standard, which requires that proposed disclosures provide "some benefit to the shareholders." *Id*. at *7-8. It specifically considered and rejected the conclusion that *Gordon* only required that proposed disclosures be "arguably beneficial," language the appellate court had used in its Preliminary Decision in *City Trading*. *Id*. A finding that proposed disclosures were only "arguably beneficial" would not pass muster under *Gordon*. *Id*. Instead, the *City Trading* court concluded that a showing of "some benefit" required that "the court must be able to plausibly conclude that the supplemental disclosures would, in fact, aid a reasonable shareholder in deciding whether to vote for the merger." *Id*.

Through its analysis, *City Trading* arguably elevated the standard set out in *Gordon*. Moving forward, New York courts will have to contend with the distinction between disclosures that are "arguably beneficial," which would fail the *Gordon* test under *City Trading*'s analysis, and those which would plausibly in fact provide information that assists a stockholder in assessing and approving a merger. The court's tough analysis also reveals the limits of *Gordon*'s plaintiff-friendly leniency. The decision serves as a reminder to prospective litigants that despite disparate standards for approving disclosure-only settlements, those standards are subject to an inherently flexible materiality analysis that will likely be made against the backdrop of *Trulia*. And, parties should no longer presume that they will be able to settle such claims for a "peppercorn and a fee." *Id*. at *1 (quoting *Solomon v. Path Commc'ns Corp.*, 1995 WL 250374, at *4 (Del. Ch. 1995)).