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In Gordon v. Verizon, *New York Appellate Division Shows Greater Receptivity to Non-Monetary Settlements than Delaware Courts Have Shown Since* Trulia

In *Gordon v. Verizon Communications* (Feb. 2, 2017), the New York Appellate Division (First Department) reversed the New York Supreme Court's rejection of a non-monetary settlement to a class action challenging an M&A transaction. The lower court's rejection of the settlement had been based on the approach established by the Delaware Court of Chancery in its seminal 2016 *Trulia* decision—which the New York Appellate Division declined to adopt in *Gordon*. The proposed settlement included (i) supplemental disclosures—which the appellate court found provided "some benefit" to the shareholders, and (ii) a "corporate governance reform," in the form of a required fairness opinion for certain potential future sales of assets—which the appellate court characterized as "the most beneficial aspect of the proposed settlement" and found "provided a benefit" to the shareholders.

Key Points

- In *Gordon*, the New York Appellate Division showed greater receptivity toward non-monetary settlements (possibly including "disclosure-only" settlements) than the Delaware courts have since *Trulia*.
- Based on *Gordon*, the plaintiffs' bar may seek to file M&A lawsuits in New York, when possible, rather than in Delaware.
- Based on *Gordon*, the plaintiffs' bar may press to include in non-monetary settlements, in addition to supplemental disclosures, one or more corporate governance reforms, deal term amendments, or other non-monetary benefits (so-called "therapeutic benefits")—as was customary in the past before disclosure-*only* settlements proliferated.
- As a result of *Gordon*, other jurisdictions possibly may be more likely to not follow *Trulia* or to apply the *Trulia* standards less stringently.
- Delaware corporations that do not yet have a Delaware-only forum selection bylaw may consider adopting one to ensure that the strict standards of *Trulia* will apply (thereby discouraging the plaintiffs' bar from bringing non-meritorious M&A suits). We note that a Delaware corporation headquartered in New York that has such a bylaw may decide to waive it and permit suit to be brought in New York if the company believes that would be a more favorable forum for the litigation or a potential settlement.

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Background

Verizon Communications, Inc. ("Verizon") acquired Vodafone plc's 45% interest in Verizon Wireless—which they had been operating as a joint venture—for $130 billion (effectively converting the joint venture to a wholly-owned subsidiary of Verizon). Verizon's issuance of shares to effect the acquisition was approved by "some 99.8% of the Verizon shareholders" (in the words of the court). The plaintiff-shareholders alleged that the Verizon board had breached its fiduciary duties to the Verizon shareholders by causing Verizon to pay an excessive price and by failing to disclose material information in the proxy statement. The parties' proposed settlement provided for (a) supplemental disclosures by Verizon relating to the valuation of Verizon Wireless, and (b) a "corporate governance reform" consisting of a requirement that, for the following three years, Verizon would obtain an independent fairness opinion if it sold (or independent financial advice if it spun off) more than 5% of Verizon's assets. The settlement also included a so-called "intergalactic" release by the Verizon shareholders of all claims against the defendants.

The New York Supreme Court rejected the settlement. Expressly following the approach taken by Delaware in *Trulia* (described below), the lower court found that the supplemental disclosures and the fairness opinion requirement did not support the release of claims. The Appellate Division reversed, declining to adopt the *Trulia* approach. Instead, the Appellate Division expanded the test for evaluating non-monetary settlements set forth in its 1990 *Colt* decision. Applying this test, the Appellate Division approved the settlement, finding that the combination of the supplemental disclosures and the fairness opinion requirement provided "sufficient benefit" to the shareholders. The case was remanded to the Supreme Court for determination of the attorneys' fee award.

Discussion

It appears that, as compared to Delaware courts, the New York Appellate Division is more receptive to approving non-monetary settlements (possibly including "disclosure-only" settlements). In *Gordon*, the New York Appellate Division found that the supplemental disclosures provided for in the settlement were "of some benefit to the shareholders." The court characterized the fairness opinion requirement as "the most beneficial aspect of the proposed settlement" and suggested that it, alone, was of "sufficient benefit to support the settlement." (The court did not indicate whether the supplemental disclosures alone would have been sufficient to support the settlement.) The court took no issue with the scope of the release included in the proposed settlement, which was equivalent to what the Delaware courts have described (and criticized) as "intergalactic."

By contrast, in *Trulia*, the Delaware Court of Chancery focused on ensuring that the supplemental disclosures to be received by the plaintiff class (their "get") justified the release they were to provide to the defendants (their "give"). *Trulia* established that: (i) the court would not view a supplemental disclosure as providing a benefit to the class members unless the disclosure was "plainly material"—*i.e.*, it was "not a close call" that it would "materially" affect the "total mix of information" that shareholders would regard as relevant; and (ii) a release would have to be narrowly crafted—*i.e.*, "could cover the disclosure claims made, as well as only those sale process and price claims that the record show[ed] were sufficiently investigated in discovery and prosecuted."

Based on the *Trulia* standard, we do not believe that a Delaware court would have approved the *Gordon* settlement. The New York Appellate Division's focus in *Gordon* on whether the supplemental disclosures and the fairness opinion requirement were of "sufficient benefit" to support the settlement differs from the

Trulia focus on the "materiality" of supplemental disclosures and the breadth of a release. Further, footnote 15 in the *Trulia* opinion indicates that, the Delaware court would not view a minor corporate governance, deal amendment, or other "therapeutic" benefit to the shareholders as sufficient to support a settlement. Moreover, under *Trulia*, even if supplemental disclosures or other benefits were material, the release could not be "intergalactic" in scope..

As a result of *Gordon*, the plaintiffs' bar may seek to file more M&A lawsuits in New York rather than Delaware. Following *Trulia*, there has been a significant decline in M&A litigation filings, particularly in Delaware. The *Gordon* decision likely will encourage the plaintiffs' bar to focus on whether an M&A litigation can be filed in New York. However, such lawsuits likely will be filed in New York only where the target company is incorporated in New York or, in the absence of a forum-selection bylaw, headquartered in New York. We note that a Delaware (or other) corporation would have the flexibility to waive a forum selection bylaw to permit suit to be brought in New York when it believes it would be in the corporation's best interests to do so.

The New York standard under *Colt*, as enhanced by *Gordon*. To evaluate the proposed non-monetary settlement in *Gordon*, the Appellate Division applied the test set forth in its 1990 *Colt*. The *Colt* test, as summarized in *Gordon*, requires consideration of the following five factors: "[T]he likelihood of success [on the merits], the extent of support from the parties, the judgment of counsel, the presence of bargaining in good faith, and the nature of the issues in law and fact." In *Gordon*, with little to no discussion, the court summarily concluded that each of the five *Colt* factors "weigh[ed] in favor of the proposed settlement." Then, acknowledging the "need to curtail excesses … of overzealous litigating shareholders and their counsel," the court added two new factors to the *Colt* test "in order to effect an appropriately balanced approach." These two new factors are: (i) "whether the proposed settlement is in the best interests of the putative settlement class as a whole, [which] requires a review of whether the key aspects of the proposed settlement would benefit the Verizon shareholders"; and (ii) "whether the proposed settlement is in the best interests of the corporation."

The court's conclusion in *Gordon* that the settlement served the "best interests of the class."

- **Supplemental disclosures.** In considering the first additional factor under the enhanced *Colt* test, the court found that each of the four supplemental disclosures included in the proposed settlement was "of some benefit" to the class. The supplemental disclosures were:
  - *Disclosure of the names of the three investment advisors that valued Verizon Wireless' interest in another company*—which, according to the court, "eliminate[ed] any speculation by shareholders as to the source of the valuation analysis, *i.e.*, whether the valuation analysis was performed by investment advisors or was the result of a self-serving valuation by Verizon management";
  - *Disclosure of "factors considered by a financial advisor in including or excluding companies in [the comparable companies analysis]"*—which "allowed the Verizon shareholders to assess" the exclusion of AT&T from that analysis;
  - *Disclosure of "further detail as to the financial advisor's use of operating and financial metrics in its comparable transactions analysis"*; and

- *Formatting into a "tabular presentation" the already-made disclosures of premiums paid in precedent minority buy-in transactions*—which "distilled a series of complex transactions into a more accessible format."

- **Corporate governance reform.** According to the court, the future fairness opinion requirement "provided a benefit to Verizon shareholders in mandating an independent valuation, without restricting the flexibility of directors in making a pricing determination." The court noted that the fairness opinion requirement would apply only contingently on certain sales occurring in the future and acknowledged that a fairness opinion might well typically be provided without any corporate governance requirement to do so. Nonetheless, the court concluded, "having such a corporate governance reform in place to safeguard the valuation of corporate assets in the event of such as sale constitutes a sufficient benefit to the putative class of shareholders as a whole to warrant approval [of the settlement]."

The court's conclusion in *Gordon* that the settlement served the "best interests of the corporation." The court stated: "[T]he 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. And, by agreeing to the settlement, Verizon avoided having to incur the additional legal fees and expenses of a trial." We note that it appears that this reasoning could be applied to most if not all proposed settlements.

***To what extent* will New York be more receptive to non-monetary (including "disclosure-only") settlements than Delaware?**

While *Gordon* demonstrates greater receptivity by the New York Appellate Division toward the approval of disclosure-based settlements than has been the cae in Delaware under *Trulia*, the extent of that receptivity awaits further judicial development in New York. Commentators have differing views on the likely practical effect of *Gordon.*

Some commentators interpret *Gordon* as reflecting that New York has staked out its own ground in articulating the standards for approving settlements, but they expect that, as a practical matter, the result in any given case is likely to be the same in New York as it would be in Delaware. They emphasize:

- **The trend toward the *Trulia* approach**. Other jurisdictions (including most recently the Seventh Circuit, in *Walgreens*) have adopted the *Trulia* approach.

- **Arguably substantively similar tests.** The *Colt* test, as enhanced by the two new factors added by *Gordon*, arguably is substantively similar to the *Trulia* test—requiring a weighing of the settlement's benefits to the class. Although (as the court suggests in *Gordon*) the Delaware law focuses more on "the materiality of the disclosures," and New York's focus appears to be on a weighing of all of the *Colt*-prescribed factors, the two approaches are not necessarily inconsistent. Indeed, after quoting from *Trulia*, the court suggested that the New York and Delaware approaches involve "comparable standards." The court stated:

  > As cases such as *Colt* demonstrate, New York courts, like their Delaware counterparts, independently examine class action settlements before approving them, using comparable standards. The *Colt* factors of "likelihood of success on the merits" and "the nature of the issues of law and fact" are comparable to the "claim, possible defense, and obstacles" factors in *Trulia*, and "the reasonableness of the 'give' and 'get' or what class

members receive in exchange for ending the litigation" is covered by the factor of "best interests of the settlement class as a whole" factor we now add to the standard. The addition of that factor to the standard, together with the "best interests of the corporation" factor, assures an appropriately balanced standard of review.

- **Acknowledgment of "merger tax" problem.** The court acknowledged in *Gordon* that disclosure-only settlements have "proved problematic," "[offer] minimal benefits either to the shareholders or to their corporations," and effectively impose a "merger tax" on transactions. The court also acknowledged that both Delaware and New York have "call[ed] for drastic curtailment of [M&A] class action lawsuits, finding them to amount to meritless lawsuits filed in order to raise a threat of enjoining or delaying closure of the transaction, and thereby incentivizing settlement."

Other commentators interpret *Gordon* as signaling that a pre-*Trulia* type of disclosure-only settlement (*i.e*., non-material disclosure in exchange for an "intergalactic" release of claims), which will not any longer be approved in Delaware, may now be approved in New York. We note:

- **The court declined to adopt *Trulia* and characterized the extinction of disclosure-only settlements as possibly "premature."** The court went out of its way to reject *Trulia*. Moreover, the court stated that the opinion of "some commentators" that "recent decisions, including *Trulia*, [and, in New York,] *Allied Healthcare* and the motion court's decision in *City Trading Fund* may signal that the extinction of 'disclosure-only' settlements" possibly was "premature." The court noted that, in *City Trading Fund*, the Appellate Division reversed the motion court's rejection of the disclosure-only settlement "finding that the motion court's determination was premature where the additional disclosures to be made pursuant to the proposed settlement in that case were 'arguably beneficial' to the shareholders."

- **The court discussed at length the "usefulness" of non-monetary settlements.** The court titled the first part of its legal analysis in the opinion as "The Role of Nonmonetary Settlements of Shareholder Class Action Litigation in Promoting Sound Corporate Governance in Mergers and Acquisitions." In that lengthy section, the court reviewed why non-monetary settlements were routinely approved in the past, emphasizing that they were viewed by the courts "as a useful tool in remedying corporate misfeasance."

- **The New York and Delaware standards appear to be different in substance and tone.** The *Trulia* standard focuses on a balancing of the shareholders' "give" (the breadth of the release) versus their "get" (the benefit from the disclosures and any other non-monetary benefits). By contrast, *Gordon*'s enhanced *Colt* standard focuses on a balancing of the best interests of the shareholders who are members of the class in the litigation and the best interests of the *corporation*—that is, the "get" and "give" of the class members (*qua* class members) versus the "get" and "give" of the corporation. The consideration of the corporation's interests appears to represent a significant difference, in substance and tone, from *Trulia*. More importantly, irrespective of the language of the *Colt* test as compared to the *Trulia* test, in *applying* the respective tests, the Appellate Division appears to be less restrictive than the Delaware courts in the circumstances under which a settlement will be approved.

Practice Points

- **Delaware corporations that have not already adopted Delaware-only forum selection bylaws should consider doing so.** Verizon, a Delaware corporation, did not have a forum

selection bylaw requiring that M&A suits be brought in Delaware. A Delaware-only forum selection bylaw would ensure the application of *Trulia* to a proposed non-monetary settlement, thus discouraging less meritorious suits challenging M&A transactions. At the same time, given the result in *Gordon*, a Delaware corporation that has a Delaware forum selection bylaw may consider waiving it to permit suit to be brought in New York when it may be in the best interests of the corporation to do so.

- **Parties may consider including in proposed settlements, in addition to supplemental disclosure, other non-monetary benefits.** Based on the Appellate Division's approval of the *Gordon* settlement, and its view that the requirement for an independent fairness opinion in the event of certain future Verizon asset sales was "the most beneficial" aspect of the proposed settlement, parties presenting settlements in New York should consider including in proposed settlements other non-monetary benefits in addition to supplemental disclosures. These types of benefits, in the past, have included changes in the transaction terms, such as reducing matching rights or termination fees, lengthening a go-shop period or requiring additional fairness opinions with respect to the transaction. When, as in *Gordon*, the transaction involves acquisition of less than all of the target company, the use of the acquiror's stock as part of the consideration to the target shareholders, and/or a vote by the acquiror's shareholders, the additional non-monetary benefits can include corporate governance reforms (such as the fairness opinion requirement in *Gordon*). We note that, in the past, when it was common to structure settlements with these types of additional benefits, certain Delaware opinions criticized the additional forms of settlement consideration as delivering minimal benefits to shareholders.

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