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New York Court Declines to Approve Disclosure-Only Settlement, Even Under More Lenient *Gordon* Standard

The New York Supreme Court, New York County recently declined to approve what the court described as a "peppercorn and a fee" disclosure-only settlement in a public company M&A litigation, noting that while until recently most courts would routinely approve such settlements, "that is no longer the case." Applying New York's *Gordon* standard for approving such settlements—which only requires "some benefit for the shareholders" and is less exacting than standards applied in many other jurisdictions, most notably Delaware's "plainly material" standard under *In re Trulia*—the court's decision in *City Trading Fund* v. *Nye* demonstrates that even under the New York approach, disclosure-only settlements will not be approved simply as a matter of course, as the court will still analyze the benefits of the added disclosures under the circumstances. The opinion also advocates for the adoption in New York of Delaware's stricter *Trulia* standard, perhaps indicating a position among some New York jurists that appellate courts should revisit the issue. In any event, the decision adds to a nationwide trend of courts acting to discourage the plaintiffs' bar from bringing frivolous claims in public company M&A situations.

Background

City Trading Fund involved the acquisition of Texas Industries, Inc. by Martin Marietta Materials, Inc. Plaintiff, a shareholder of Martin Marietta, sought preliminarily to enjoin the merger, alleging that the board of Martin Marietta breached its fiduciary duties to the company's shareholders by making material misstatements and omissions in the definitive proxy relating to the proposed merger. The parties entered a disclosure-only settlement, subject to approval by the court, that required the company to make certain supplemental disclosures, and proposed a payment of $500,000 in attorneys' fees to plaintiff's counsel, but provided no monetary relief to the shareholders, all in exchange for a release of company disclosure violations. The New York Supreme Court (trial court) denied the plaintiff's motion for preliminary approval of the settlement, and, on appeal, the Appellate Division of the New York Supreme Court for the First Department remanded the case, holding that the lower court's ruling was premature and should have awaited a fairness hearing during which opposition from shareholders could be expressed. Indeed, on remand, other shareholders with holdings much greater than plaintiff's ten shares expressed their objections to the settlement because of its lack of relative shareholder benefit, with the plaintiff being the only shareholder to expressly support it.

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Court's Holding

On remand, the court applied New York law to the dispute, given that approval of class action settlement agreements is a matter of procedural law and therefore governed by New York law rather than the law of the jurisdiction of incorporation of the defendant corporation (North Carolina). Therefore, the court was required to apply the standard to approve disclosure-only settlements set forth by the First Department in *Gordon* v. *Verizon Communications, Inc.*, which requires consideration of the following factors: (i) the likelihood of success, (ii) the extent of support from the parties, (iii) the judgment of counsel, (iv) the presence of bargaining in good faith, (v) the nature of the issues of law and fact, (vi) whether the proposed settlement is in the best interests of the putative settlement class as a whole, and (vii) whether the proposed settlement is in the best interest of the corporation. According to the *Gordon* court, the sixth factor (regarding the best interests of the class) is satisfied when the supplemental disclosures provide "some benefit to the shareholders"—a standard less exacting than Delaware's *Trulia*'s standard, which requires that supplemental disclosures address a "plainly material" misrepresentation or omission for a court to approve a settlement. Even applying the *Gordon* test, however, the *City Trading Fund* court denied approval of the settlement, concluding that all of the supplemental disclosures were "utterly useless to the shareholders."

Takeaways

There are several notable aspects of the court's opinion in *City Trading Fund*:

- *New York courts will not necessarily approve disclosure-only settlements simply as a matter of course and will still analyze the benefits of the added disclosures under the circumstances.* Following *Gordon*, some speculated that the standard set forth in that case could have allowed for disclosure-only settlements in New York without any real judicial oversight. The court in *City Trading Fund* signals the opposite, defining *Gordon*'s "some benefit" standard to require that the supplemental disclosures "aid a reasonable shareholder in deciding whether to vote for the merger." Here, the court found the supplemental disclosures (which included, among others, (i) what the court labeled as "tell me more" disclosures, (ii) already publicly available research analyst projections and (iii) the financial advisors' exact holdings and fees (beyond the initial disclosure of "customary" fees)) to be "utterly worthless – because they would not matter to any reasonable shareholder and provide no benefit to the class."

- *Projections will only be considered material for purposes of disclosure-only settlements if they are management projections.* The supplemental disclosures at issue in *City Trading Fund* included publicly available third-party analyst projections. The court, relying on Delaware authority, found these disclosures to be "of trivial value given all of the other information disclosed to the shareholders." Indeed, the court admonished plaintiff's counsel for confounding third-party

projections and management projections in its argument that Delaware courts deem projections to be material, when instead, as the court pointed out, Delaware courts only find the latter to be material.

- *The* City Trading Fund *court praised Delaware's adoption of the* Trulia *standard and encouraged New York courts to reconsider adoption of this stricter standard.* In its opinion, the *City Trading Fund* court wrote that *Trulia* was a "thorough and compelling decision" that "was the culmination of the Chancery Court's negative experience with . . . strike-suits, which not only impugn the integrity of the court system, but also adversely affect the ability of stockholders with genuine claims to hold corporate directors accountable for actual, serious breaches of fiduciary duty . . . ." Moreover, the court advocated for New York's adoption of *Trulia*, noting that at least two federal courts had adopted the standard, and that historically, New York had modeled its class action rules on federal standards due to the federal courts' "extensive experience with complex class actions." Similarly, in encouraging the adoption of *Trulia*, the court noted that "Delaware courts are uniquely suited to understand which types of merger challenges have merit, and, specifically, what types of disclosures matter to shareholders." The court also cautioned against the adoption of a less exacting standard in New York, noting that it could lead the State's courts to "[d]evelop[] a reputation for attracting and countenancing worthless strike suits . . . ." Whether the court's opinion will prove to be persuasive to New York appellate courts remains to be seen.

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