

New York Supreme Court: Rejects Proposed \$300 Million Settlement in Derivative Lawsuit on Fairness Grounds (Securities Law Alert)

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On December 10, 2021, the New York Supreme Court denied a proposed \$300 million settlement in a closely watched shareholder derivative lawsuit alleging that the controlling shareholder defendants^[1] defrauded the minority shareholders of a NYSE-listed Chinese company incorporated in the Cayman Islands. *In re Renren Derivative Litig.*, 2021 WL 5873150 (N.Y. Sup. Ct. 2021) (Borrok, J.). Citing fairness concerns, the court held that the proposed settlement “cannot be approved as a settlement to a derivative action structured with direct payments to certain minority shareholders but excluding relevant injured minority shareholders.” Specifically, the court took issue with plaintiffs’ counsel’s argument that only his clients should be paid and not all of the minority shareholders who were harmed, pointing out that plaintiffs were certain of the minority shareholders that are entitled to payment.

The parties entered into the stipulation of settlement in October 2021. It was notable due to both its record-breaking size and for creating a rare direct cash payment to the minority shareholders totaling *at least* \$300 million. The proposed settlement was subject to a “true up” process that could have increased the ultimate payment amount depending on the final determination of the number of shares and American Depositary Shares held by non-defendants.

In rejecting the proposed settlement, the court explained that having undertaken to make a claim on behalf of all minority shareholders, plaintiffs may not limit the rewards reaped by this action to themselves. The court observed that this would be “antithetical” to the concept of the derivative action. Citing *Benedict v. Whitman Breed Abbott & Morgan*, 910 N.Y.S.2d 474 (N.Y. App. Div. 2010), the court concluded that “the settlement as structured is not fair and reasonable to the effected shareholders and when taken as a whole is ‘so unfair on its face to preclude judicial approval[.]’”

By way of background, the defendant company became a major social media company in China after a prominent U.S. social media company was banned there. This development led to interest from Western investors and the company’s U.S. IPO, which raised over \$777 million. The lawsuit arose when plaintiffs claimed that defendants misrepresented, in soliciting its IPO, how the company planned to use the IPO proceeds and by seeking personal financial benefits. Plaintiffs alleged that the company had invested its 2011 NYSE IPO proceeds towards a number of ventures and became a *de facto* venture capital fund. Plaintiffs further alleged that defendants defrauded the company and its minority shareholders out of over \$500 million in company investment assets by spinning off the company’s assets into a private company in exchange

for an undervalued cash dividend. Plaintiffs asserted derivative claims under Cayman law and New York law in connection with the spin-off.

In May 2020, the New York Supreme Court denied defendants’ motions to dismiss and held that plaintiffs had standing to bring derivative claims under Cayman law under the “fraud on the minority” exception established in the seminal English case, *Foss v. Harbottle* (2 Hare 461 [1843]).^[2] *In re Renren Derivative Litig.*, 127 N.Y.S.3d 702 (N.Y. Sup. Ct. 2020). The court also held that it had personal jurisdiction over defendants based on their significant New York activities. In March 2021, the Appellate Division unanimously affirmed that there was proper personal jurisdiction and standing to pursue Cayman law derivative claims in New York against the company and its directors. *In re Renren*, 140 N.Y.S.3d 701 (N.Y. App. Div. 1st Dept. 2021). The parties reached the proposed settlement, now rejected, following the Appellate Division’s decision.

^[1] The company’s CEO/board Chair, certain directors, controlling shareholders and the financial advisor for a special committee of the board. The complaint alleged that together defendants controlled a majority of the company’s stock.

^[2] Shareholders do not have standing to pursue derivative litigation under Cayman law unless they can meet one of the four exceptions first articulated in *Foss*. To proceed, a shareholder must show that the conduct: (1) infringed on the shareholder’s personal rights; (2) would require a special majority to ratify; (3) qualifies as a fraud on the minority; or (4) consists of an *ultra vires* act.

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