LEXSEE 1992 U.S. DIST. LEXIS 12702

IN RE RJR NABISCO, INC. SECURITIES LITIGATION; MARY F. BROWN, RICHARD L. WHARTON, JACK KOGOK, BARBARA HANDEL, VALERIE FRIEDMAN, MARTIN FOSTER, AMELIA FOUNTAIN, AND C. MICHAEL CARTER, Plaintiffs,-against-RJR NABISCO, INC., F. ROSS JOHNSON, ANDREW G.C. SAGE, II, ROBERT J. CARBONELL, JOHN L. CLENDENIN, EDWARD A. HORRIGAN, JR., CHARLES E. HUGEL, JOHN G. MEDLIN, JR., and JAMES O. WELCH, JR., Defendants.

M.D.L. Docket No. 818 (MBM), 88 Civ. 7905 (MBM)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

1992 U.S. Dist. LEXIS 12702; Fed. Sec. L. Rep. (CCH) P96,984

August 24, 1992, Decided
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JUDGES: Mukasey

OPINIONBY: MICHAEL B. MUKASEY

OPINION:

OPINION AND ORDER

MICHAEL B. MUKASEY, U.S.D.J.

This consolidated class action is before the Court for a determination of whether a settlement in the amount of $72.5 million pursuant to a stipulation dated January 28, 1992 is fair, reasonable and adequate to the classes affected thereby, and, if so, to set the fees of class counsel. No member of any of the affected classes has objected to the proposed settlement. For the reasons set forth in Section II below, the proposed settlement is approved as fair, reasonable and adequate.

The only objections to the proposed fee from those immediately affected by it are those of a former opt-out plaintiff, Golden Eagle, Inc., which waited until after an initial settlement had been reached to pursue its own course in the litigation and, after doing so briefly, sought and received permission to opt back into the Open Market Class, one of the three settling classes. Those objections simply endorse objections contained in a letter to the Court dated June 19, 1992 from defendant RJR Nabisco's in-house counsel. For the reasons set forth in Section [*3] III below, class counsel will receive a fee of

$17,713,784.50, plus expenses of $411,215.50, or a total of $18,125,000, which is 25% of the settlement fund.

I.

This action was triggered by RJR's announcement on October 20, 1988 that members of its management would seek to acquire the company in a leveraged buyout ("LBO") merger transaction at $75 per share. That announcement set off a bidding contest which culminated in RJR's acquisition for about $109 per share by an entity organized by Kohlberg, Kravis, Roberts & Company ("KKR"). Total consideration exceeded $25 billion.

Approximately seven months earlier, on March 30, 1988, RJR had offered to purchase about 10% of its outstanding shares for between $52 and $58 per share, the exact price to be determined by a Dutch auction. The Offer to Purchase issued in connection with that tender offer recited that except as disclosed in that document, "the Company has no plans or proposals which relate to or would result in . . . an extraordinary corporate transaction, such as a merger, reorganization or liquidation, involving the Company or any of its subsidiaries . . . [or] (f) any other material change in the Company's corporate [*4] structure or business." The tender was completed on May 5, for more than 21,200,000 shares, at $53.50 per share.

Thereafter, on July 21, 1988, RJR made the Special Vesting Offer proposing to cash out certain non-qualified stock options and stock appreciation equivalents. Holders of such options were invited to surrender them during August 1988 in return for a payment of the difference between the grant or exercise price and a premium price of $53.50 per option, with the further inducement that unvested options would vest immediately. However, the Special Vesting Offer provided that in order to participate a holder had to surrender all options. RJR purchased options to more than 1,367,000 shares pursuant to this offer.

The consolidated class action complaint alleges that between the beginning of the self-tender offer on March 30, 1988, and the announcement of the proposed management LBO on October 20, 1988, defendants failed to disclose certain material information in connection with the self-tender offer, the Special Vesting Offer and sales by foyer RJR shareholders on the open market. Plaintiffs allege that at least six items of information were omitted that a reasonable stock [*5] or option holder would have considered significant in deciding whether to tender stock or sell options to the company, or sell stock on the open market. Specifically, plaintiffs allege that the "no plans or proposals" language in the Offer to Purchase issued in connection with the March 30 self-tender was misleading for failure to disclose, (1) alleged plans for a management-led LBO at $75 or more, or an alternative plan for a corporate restructuring of RJR developed in 1987 and 1988 by investment banker Frank Benevento under the code name Project Sadim ("Midas" spelled backwards) and said to have been seriously considered by defendant F. Ross Johnson, RJR's chief executive officer; (2) the alleged expression of interest by Henry Kravis of KKR, in September 1987, in helping Johnson to lead an LBO of RJR at $80 per share; and (3) an alleged unsolicited proposal by C.D. Spangler, RJR's largest shareholder, and Citibank, N.A., in February 1988, for a management-led LBO at $68 per share.

Further, plaintiffs allege that the Special Vesting Offer did not disclose, (1) that RJR had adopted "golden parachute" contracts for Johnson and other senior executives and had given Johnson stock [*6] for distribution to other executives; (2) that management had met in July 1988 with Shearson Lehman Hutton to develop plans for an LBO, an effort Shearson continued thereafter; and (3) that Johnson and others had decided during the pendency of the Special Vesting Offer to pursue seriously an LBO.

In addition, plaintiffs claim that letters dated August 10, 1988 from RJR to stockholders and participants in RJR's employee benefit plans were materially misleading. These letters described a shareholders' rights plan, known popularly as a "poison pill," which plaintiffs claim was proposed to counteract any takeover that would undo defendants' LBO plans but which RJR asserted "was not adopted in response to any specific effort to acquire control of the Company and we are not aware of any such effort . . . ."

Plaintiffs have argued that these alleged misstatements and omissions violated Sections 10(b) and 13(e) of the Securities Exchange Act of 1934, *15 U.S.C. §§ 78j*(b) and 78m(e), and Rules 10b-5 and 13e-4 promulgated thereunder.

After the filing of a Consolidated Amended Class Action Complaint on January 31, 1991, the Court on March 18, 1991 granted plaintiffs' unopposed motion to certify [*7] three classes, all of which exclude, to the extent necessary, officers and directors of RJR:

1. former stockholders of RJR who tendered common stock to the company between March 30, 1988 and April 26, 1988 and whose stock was acquired by RJR for $53.50 per share pursuant to the self-tender offer (the "Tender Class");

2. current and former employees of RJR who exercised non-qualified stock options or stock appreciation equivalents between August 1, 1988 and August 31, 1988 pur-

suant to the Special Vesting Offer, and received from RJR the difference in cash between the grant price of each stock option or stock appreciation equivalent (the "Options Class"); and

3. former stockholders of RJR who sold RJR common stock on the open market between March 30, 1988 and October 20, 1988 (the "Open Market Class").

There followed more than two years of discovery which plaintiffs' lead counsel describes as "aggressive and methodical." (Lowey Aff. p.5) This included review of more than 25,000 pages of documents, and 30 depositions. Based on what I saw in the few and focused discovery disputes that came before the court, and in the summary judgment motions discussed below, counsel's description [*8] of discovery seems apt.

In April 1991, defendants moved for summary judgment. Their papers, thorough without being prolix, argued that the claims of all three classes must fail because the alleged omissions and misstatements could not have been material and because plaintiffs have not adduced any evidence of fraudulent intent. In essence, defendants argue that the evidence shows defendants and others at RJR considered a wide variety of options to raise the market price of the company's stock and improve its fortunes, that the LBO option was only one of many hypothetical options, that that option and its terms were not set until shortly before they were announced, and that no decisions worthy of announcement were made before the last date when defendants owed any class of plaintiffs a duty to disclose. In addition, defendants argue that there is no implied right of action under § 13(e) of the Exchange Act, that the Special Vesting Offer was not a self tender giving rise to rights for the Options Class, that RJR owed no duty of disclosure to the Open Market Class after August 31, 1988, that plaintiffs' state law claims for negligent misrepresentation and breach of fiduciary duty [*9] fail for lack of materiality, and that there is no evidence the independent director defendants knew of senior management's plans for an LBO. Plaintiffs responded point for point, and defendants replied. These submissions were sub judice beginning in July 1991. The Court was notified in November 1991 that settlement negotiations might moot such motions.

In their summary judgment motion, defendants point to a wide variety of proposals, some incompatible with an LBO, that were being considered by RJR management to enhance the company's fortunes. They note that corporations routinely formulate and consider all sorts of plans, and that proposals such as Project Sadim, Project GM — a proposal to create separate classes of stock for RJR's tobacco and food businesses — and others, are the warp and woof of daily corporate existence. They argue that to single out one such proposal with the benefit of hindsight as embodying the master plan for later action, while disregarding other and incompatible proposals that were taken no less seriously at the time they were generated, is both naive and unfair.

Plaintiffs point to circumstances they suggest show that plans to pursue strategies [*10] other than an LBO were mere diversions. They argue that KKR's conduct shows Johnson's September 1987 discussions with Kravis were indeed serious and worthy of disclosure, and that the summary rejection of the Spangler/Citibank proposal is evidence that defendants were protecting their own impending LBO. Plaintiffs reject defendants' contention that the March 30 self-tender and the later Special Vesting Offer were simply attempts to raise the market price of RJR stock, and argue that defendants were simply trying to diminish the number of shares they would have to buy, and thus the cost to them, when they tendered for control of the company. Defendants argue in response that this sinister theory makes no economic sense, that the market set the price they would have to pay to control RJR regardless of the number of shares outstanding. Plaintiffs point to golden parachute and other enhancements, as well as authority granted to Johnson to distribute stock to senior executives, as evidence particularly as to members of the Tender and Options classes that plaintiffs were not told all that a reasonable investor would have considered important in responding to the offers.

Regarding the [*11] outside directors, plaintiffs rely particularly on the company's summary rejection of the Spangler/Citibank proposal as evidence that they at least were negligent in the discharge of their duties.

II.

The proposed settlement would allocate the proceeds among the three classes and subgroups within them in relation to both the perceived strength of each class' claims and an estimate of the maximum damage each allegedly suffered. Members of the Tender Class would receive an allocation of $26 million, to be divided in varying amounts between those who tendered shares owned before March 30, 1988 and those who tendered shares acquired thereafter. Members of the Options Class would divide $13.5 million. Members of the Open Market Class would receive $33 million, to be divided among those who owned shares before March 30, 1988 and sold them between March 30 and August 10, 1988, those who owned shares before March 30, 1988 and sold them between August 11 and October 20, 1988, and those who acquired shares on or after March 30, 1988 and sold them between March 30 and October 20, 1988.

Although no member of the affected classes has objected to the proposed settlement, I am not free simply [*12] to apply the proverbial rubber stamp of approval:

In passing on settlements of class actions under *F.R.Civ.P. 23* the judge should not regard himself as an umpire in typical adversary litigation. He sits also as a guardian for class members who have not received a notice or who lack the intellectual or financial resources to press objections.

Weinberger v. Kendrick, 698 F.2d 61, 69 at n.10 (2d Cir. 1982) (citations omitted), cert. denied, *464 U.S. 818 (1983).* Nonetheless, the same case teaches that the law favors settlements, of class actions no less than of other cases, Id. at 73, and a trial judge need not conduct an inquiry so detailed as to amount to a trial in order to decide whether a proposed settlement makes a trial unnecessary. *City of Detroit v. Grinnell Corp., 495 F.2d 448, 462 (2d Cir. 1974).* Moreover, I should give deference, when considering the fairness of the proposed settlement, to the judgment of experienced class counsel, *In re Warner Communications Securities Litigation, 798 F.2d 35, 37 (2d Cir. 1986),* a deference evoked comfortably here because the [*13] benefits of such experience have been readily apparent in the submissions and court appearances that have marked the course of this litigation.

The Court in Grinnell listed with approval nine factors considered by the district court in that case before it approved the settlement:

(1) the complexity, expense and likely duration of the litigation, (2) the reaction of the class to the settlement, (3) the stage of the proceedings and the amount of discovery completed, (4) the risks of establishing liability, (5) the risks of establishing damages, (6) the risks of maintaining the class action through the trial, (7) the ability of the defendants to withstand a greater judgment, (8) the range of reasonableness of the settlement fund in light of the best possible recovery, [and] (9) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation.

Grinnell, 495 F.2d at 463 (citations omitted). Of those factors, the last appears to be the end product of the other eight, and thus should not count as a separate factor.

Factors 1, 2, 3, 6 and 7 are straightforward. Taking this litigation full course is [*14] likely to be a complex, expensive and time consuming proposition. The class members have raised no objection to the settlement. Discovery has been thorough and the issues distilled in a summary judgment motion. The classes seem likely to last through a trial, and RJR could sustain a larger judgment. The last factor weighs, de minimis, against this settlement, and against any settlement that does not take defendants to the brink of bankruptcy.

The risks of establishing liability and damages are considerable. Without adumbrating in any way the likely outcome of the summary judgment motions sub judice, as is immediately apparent from the summary of arguments set forth above, those motions present complex legal questions, some of first impression, and offer an array of possible outcomes, from outright dismissal of the case to dismissal of certain claims by some or all of the classes. Even as to claims that survive that motion, plaintiffs would have to prove all the elements of such claims at trial and, because of the nature of the underlying transactions, do so largely through hostile witnesses, and then even if they prevail survive appeal. Damages would have to be proved [*15] based on the difference between what plaintiffs received for their shares or rights, and what they would have received had the statements at issue by defendants been truthful and complete. What plaintiffs would have received necessarily would be the subject of dispute between experts, a dispute whose outcome is impossible for me to predict.

In these circumstances, and absent any indication that there is anything unfair about either the proposed settlement or the allocation of settlement proceeds, I can only conclude that the settlement negotiated at arms length by skillful counsel is fair, reasonable and adequate, and I do so conclude.

III.

That brings us to the matter of fees. Plaintiffs' counsel have requested fees and reimbursement of expenses that would aggregate 25% of the settlement amount, with about .7% or $388,692.70 constituting reimbursable expenses, and the remainder, about 24.3% or $17.7 million, constituting fees. By letter dated June 19, 1992, RJR executive vice president and general counsel L. R. Ricciardi objects. He argues that the large plaintiff classes defined by plaintiffs' counsel raised the specter of damages exceeding $2 billion, and that this specter [*16] virtually assured a settlement in some sizeable amount. He notes that the requested fees total six times the value of the time spent by plaintiffs' counsel, what is referred to as the lodestar amount, which amount he says equals the total fees of all defense counsel. In addition, he states that plaintiffs' counsel estimated during settlement negotiations that the fee request would lie in the range of $10–12 million, a range which plaintiffs' counsel now exceed by about 50%. In sum, he says plaintiffs' counsel are asking for too much. Finally, RJR's counsel disclaims any selfish interest here because the settlement amount is the same regardless of how much is allocated to fees. By letter dated June 23, 1992, counsel for Golden Eagle

Industries, Inc. endorses Ricciardi's views on behalf of his client.

Ricciardi's claim of disinterestedness is less weighty than it might otherwise be when one considers that the only class member to object is Golden Eagle, an entity headed by C.D. Spangler, RJR's major shareholder. As set forth above, that plaintiff opted out of the class and then quickly opted back in. See p.1, supra. Obviously, Spangler and entities he controls would [*17] find a perceptible difference in their recovery if attorneys' fees are significantly reduced, and just as obviously an UK executive would have every reason to help a major stockholder.

Before reaching the merits of this dispute, it is important to deal also with the reference in Ricciardi's letter to a fee estimate by plaintiffs' counsel during settlement negotiations. This suggests a conflict of interest — that during settlement negotiations plaintiff's counsel tried to strike a deal with the defense as to fees that compromised his clients' interest — but plaintiffs' counsel has dispelled that suggestion in a supplemental affidavit dated June 24, 1992. In that affidavit he discloses that in a conversation apparently at the conclusion of settlement negotiations, defense counsel pressed him to estimate the amount of fees plaintiffs' counsel would request so that UK could estimate the cash flow cost of the settlement if payment were to be made in installments. As plaintiffs' counsel describes the conversation, without rebuttal from any source, he accommodated defense counsel with an informal and non-binding estimate of "'around 15%.'" (Lowey Aff. p.4) I am convinced that there [*18] was no impropriety, and that plaintiffs' counsel did not put the interests of lawyers in competition with those of clients during settlement negotiations. *Malchman v. Davis, 761 F.2d 893, 907 (2d Cir. 1985),* cert. denied, *475 U.S. 1143 (1986).* There does not appear to have been any sustained attempt to negotiate what is called a "clear sailing" provision whereby defense counsel waive the right to object to plaintiffs' fee request, and the statement in plaintiffs' initial brief that, "the subject of attorneys' fees was not discussed during settlement negotiations," was substantially if not literally correct.

Turning to the merits, as set forth below, the award of a percentage fee in common fund cases such as this is consistent with the better and increasingly prevailing view in such cases, the requested percentage lies well within the limits awarded in similar cases, plaintiffs' counsel have not taken a free ride on the efforts of a government agency and the settlement was skillfully negotiated.

I had occasion recently to weigh the relative merits of percentage and lodestar fee awards in common fee cases. In re Gulf Oil/Cities Service [*19] Tender Offer Litigation, 87 Civ. 8982 (MBM) (S.D.N.Y. May 21, 1992). No party has raised any argument that would lead me to change the conclusions I reached there, and therefore I repeat them:

Where counsel have helped create a fund to be shared by numerous plaintiffs, courts have tended increasingly to award fees based on a percentage of the fund rather than on the lodestar calculation of time multiplied by an hourly rate. See, e.g., *Blum v. Stenson, 465 U.S 886, 900 n.16 (1984)* (stating that in common fund cases "a reasonable fee is based on a percentage of the fund bestowed on the class . . . ."); Court *Awarded Attorney Fees, 108 F.R.D. 232, 254-59 (1985)* (report of Third Circuit task force recommending use of percentage calculations in common fund cases); *In re Agent Orange Product Liability Litigation, 611 F. Supp. 1296, 1306 (E.D.N.Y. 1985),* aff'd in part, rev'd in part, *818 F.2d 226 (2d Cir. 1987)* (criticizing lodestar approach as one that "tends to encourage excess discovery, delays and late settlements, while it discourages rapid, efficient and cheaper resolution of litigation").

[*20]

Id. at 19.

Although RJR and Golden Eagle certainly are correct that plaintiffs' counsel have asked for what is, in absolute terms, a lot of money, as Judge Weinstein observed, "The prospect of handsome compensation is held out as an inducement to encourage lawyers to bring such suits." *Dolgow v. Anderson, 43 F.R.D. 472, 494 (E.D.N.Y. 1968).* What should govern such awards is not the essentially whimsical view of a judge, or even a panel of judges, as to how much is enough in a particular case, but what the market pays in similar cases:

The judicial task might be simplified if the judge and the lawyers bent their efforts on finding out what the market in fact pays not for the individual hours but for the ensemble of services rendered in a case of this character. This was a contingent fee suit that yielded a recovery for the "clients" (the class members) of $45 million. The class counsel are entitled to the fee they would have received had they handled a similar suit on a contingent fee basis, with a similar outcome, for a paying client. Suppose a large investor had sued Continental for securities fraud, and won $45 million. What would its lawyers [*21] have gotten pursuant to their contingent fee contract?

In the *Matter of Continental Illinois Securities Litigation, 962 F.2d 566, 572 (7th Cir. 1992)* (Posner, J.). RJR and Golden Eagle have pointed to no case in which a 25% fee has been rejected as excessive in a litigation of this kind, nor have they cited any data reflecting that contingent fee contracts in similar cases have yielded counsel a smaller

share of the fund. Indeed, they have cited no cases at all on this point.

By contrast, it appears that numerous cases in this district and elsewhere support an award in this range. Some were cited in In re Gulf Oil/Cities Service Tender Offer Litigation, supra, slip op. at 20. Others are cited at page 54 of plaintiffs' memorandum. Indeed, in *In re Activision Securities Litigation, 723 F. Supp. 1373, 1378–79 (N.D. Cal. 1989),* the court suggested that 30% should be presumptive and that courts should vary upward or downward from that figure depending on extraordinary circumstances.

Nor is it persuasive to argue as Ricciardi does that plaintiffs' counsel defined a massive class, raising the possibility of a recovery in the billions [*22] of dollars, and that this virtually assured a huge settlement; in other words, that this case is being settled for nuisance value. Defendants could have opposed plaintiffs' proffered class definitions, could have awaited the outcome of the fully briefed summary judgment motions, and if they lost at that preliminary stage could have fought on and taken the case to trial, and perhaps prevailed. Which is to say, they could have abated the nuisance. Instead, they and plaintiffs chose to settle; that choice means that UK as one of the defendants and Golden Eagle as a willing member of the class, forego not only further combat, but also the claim that they did not really make a choice.

The facts in aid of plaintiffs' case were developed by plaintiffs' counsel, not by a government agency. They then used what they had developed to negotiate a settlement with skill and in such a way as to minimize the burden on the court. The fee they have requested is reasonable for such a case.

For the above reasons, the settlement is approved as fair, reasonable and adequate, and plaintiffs' counsel will receive a fee of $17,713,784.50 plus expenses of $411,215.50, or a total of $18,125,000.

SO [*23] ORDERED:

Dated: New York, New York
August 24, 1992

Michael B. Mukasey,
U.S. District Judge