URT DECISIONS

L.P. v. THE CORNERSTONE GROUP, INC.—See memorandum on file.

IA PART 25

Justice DeGrasse

PROPERTY CLERK, NEW YORK CITY POLICE DEPARTMENT v. DINALDI—Settle judgment. See memorandum on file.

ALLSTATE INSURANCE CO. v. DELL—Settle order. See memorandum on file.

IA PART 28

Justice Dontzin

THE BEAR STEARNS COMPANIES, INC., v. JARDINE STRATEGIC HOLDINGS LIMITED — The Court has before it the following motions in this consolidated class action:[1]

a. a motion by the defendant Jardine Strategic Holdings Limited ("Jardine") for an order pursuant to CPLR §3212 granting summary judgment;

b. a motion by plaintiffs, Mortimer Schulman, Seymour Lazar, Nessim Husni and Richard Schwarzchild ("Schulman Plaintiffs")[2] for an order pursuant to CPLR 902 to modify this Court's prior order of October 27, 1989, based on its September 12, 1989 decision, to provide that class members who did not respond to the class action notice be assigned the subclass represented by the Settlement subclass (Schulman Plaintiffs);

c. a cross-motion on behalf of the plaintiff Fred Kayne for an order imposing costs and sanctions against Jardine pursuant to 22 NYCRR Section 130.1-1.

Bear Stearns and Fred Kayne opposed the Jardine and the Schulman Plaintiffs motions. The Schulman Plaintiffs support the Jardine motion.

Bear Stearns and Co., Inc., ("Bear Stearns"), through its principal subsidiary Bear Stearns Co., Inc., is a publicly held major stock brokerage and securities firm involved in trading, brokerage, underwriting and banking service activities, etc. Bear Stearns and Co., ("The Partnership") is comprised in large part of officers and directors of Bear Stearns. Prior to 1985, before Bear Stearns went public, its business was conducted through the Partnership. At the times relevant here, the partners of the Partnership owned approximately 45 percent of Sears Stearns outstanding common stock (38,077,876 shares). For purposes of this decision, the Bear Stearns entities, except where otherwise indicated, will be referred to as Bear Stearns.

Jardine is a multi-national corporation, incorporated under the laws of Bermuda. It maintains its principal office in Hong Kong and is listed on the Hong Kong stock exchange. Generally, it is in the business of owning minority shares in a broad range of corporate interests throughout the world.

The other essential facts concerning the circumstances leading to the underlying lawsuit for breach of contract, other than those discussed here, are set forth in this Court's written decisions dated June 17, 1988 and September 12, 1989, and need not be repeated.

Jardine, by moving for summary judgment at this time, is in essence exercising its leave to renew a prior motion for summary judgment, after the completion of discovery, which was granted by this Court in its June 17, 1988 decision (aff'd 143 AD2d 1073). Thus, at the outset, the Kayne cross-motion is denied. Moreover, the Jardine motion cannot fairly be characterized as "frivolous."

The Jardine Motion[3]

This motion, as did the others that preceded it, arises out of Jardine's termination of a certain Tender Order and Transaction Agreement under which Jardine agreed to purchase 20 percent of Bear Stearns outstanding common stock and cumulative preferred stock for a total sum of approximately $400,000,000. Jardine terminated the Tender Offer on October 23, 1987, some four days following the very dramatic stock market crash of October 19th of that year. Jardine maintains, as it has throughout, that its right to terminate the offer as a matter of law is contained in Section 14 of the Tender Offer (also Exhibit B to the Transaction Agreement), and that a simple reading of what Jardine characterizes as the plain language of that provision, when applied to the impact on the business and operations of Bear Stearns following the October 19 "crash," leads to the irresistable conclusion that Jardine had an absolute right to terminate the Tender Offer.

Section 14 entitled "Conditions of the Offer" provides as follows:

Notwithstanding any other provisions of the Offer, the purchaser . . . may terminate or amend the Offer if at any time on or after September 30, 1987 and prior to the time of payment of any such Shares any of the following events shall occur and remain in effect:

(a) any change shall have occurred or been threatened, other than as comtemplated in the Transaction Agreement in the business, properties, assets, liabilities, condition (financial or otherwise), operations or results of operations of the Company or any of its subsidiaries taken as a whole, or the Purchaser shall have become aware after September 30, 1987, of any fact with respect to the Company that, in the reasonable judgment of the Purchaser has material adverse significance with respect to the value of the Shares to the Purchaser."

Jardine claims that Section 14 of the Tender Offer protected it against material adverse changes occurring or threatened in the business or operations of Bear Stearns, during the period of the Tender Offer (September 30 through November 3, 1987, unless otherwise extended). It is conceded that during that period, Bear Stearns bore the risk of any material adverse change that occurred or was threatened in the operations or business of Bear Stearns or any of its subsidiaries taken as a whole.

It is also generally agreed that for purposes of this motion, the relevant financial information and financial comparisons concerning Bear Stearns business or result of operations would be those for the time period up to and including the quarter ending October 30, 1987. This time period would seem to provide a fair and rational basis for determining whether Jardine's termination of the Tender Offer here was justified. However, it should be noted in passing, that the figures and comparisons for the period following the October 30, 1987 quarter, including those to date, presented by both sides, generally agree only to the extent that such submissions refer to Bear Stearns. Not surprisingly, this data has apparently been selectively analyzed and submitted to further each side's cause.

During, and indeed subsequent to the oral argument in these proceedings, the parties have confronted the Court with the question of whether its decision of June 19, 1988, holding that the terms of Section 14 relating to material adverse changes are not clear and unambiguous is the law of the case. Bear Stearns argues that this holding is the law of the case because the decision was affirmed by the Appellate Division (143 AD2d 1073). Jardine argues that since the Appellate Division affirmance was without opinion, the holding is not the law of the case, and therefore, that issue may be revisited here. Moreover, Jardine argues that the Court did not deal with the "threat of material adverse change" in its June 17, 1988 decision. The Court sua sponte has decided to review the "ambiguity" issue without deciding the law of the case issue.

Turning a moment to the issue of "risk." Jardine misreads, or perhaps the Court did not make clear in the June 17, 1988 decision, its comments concerning risk. The Court was not referring to who bore the risk during the Tender Offer period, but rather to Jardine's understanding of the cyclical nature, volatility and riskiness of the business in which it was making a substantial investment. At the time the Court wrote the June 17 decision, it did not have before it all of the details that are now available to demonstrate that "Jardine understood and knew the volatility and riskiness of the security business . . ." (Id. p. 11). It is now clear from the following few among several examples that it did:

a. Declarations by Jardine's Chairman, Simon Keswick, and Brian Powers, (Managing Director and Jardine's principal negotiator and architect of the Transaction Agreement and Tender Offer), that in accordance with Jardine's business practices it was making a long term strategic investment in Bear Stearns;

b. During the period of due diligence and in the review of Bear Stearns business and operations, Jardine was assisted by the investment banking firm of John D. Wolfensohn, Inc., ("Wolfensohn") and the accounting firm of Arthur Anderson & Co. ("Arthur Anderson"), and was advised that it was making the investment at the top of an unprecedented "Bull Market." Jardine was also advised that in the very near future they should expect a down turn, which would effect Bear Stearns' performance and this could occur notwithstanding Bear Stearns significant profitability since "going public" in 1985.

c. Similiar advice was given to Jardine by its other advisers, Coopers and Lybrand, as well as McKinsey & Company;

d. It was Chairman Keswick's belief, when recommending acceptance of the Jardine and Bear Stearns deal to his Board of Directors, that they were paying a premium price for a business with a "proven ability to perform well even during a down turn in the business cycle."

It was this background and these circumstances that led this Court to state in its June 17 decision: "[o]ne can fairly assume that Jardine was fully apprised of the risks inherent in the business in which it sought to make a substantial investment" (Id. P. 11). Therefore, it is important to emphasize that this Court must consider Jardine's motion within this framework of reference.

Jardine argues, as it did in its earlier motion, that what is "material" as a matter of law is simply defined as that which is "significant," "substantial," or "of consequence," and that these terms are clear as is the term "adverse." As was pointed out in the June 17, 1988 decision, the difficulty with this argument is that that which may be "material" in one situation (i.e., investments by individual shareholders under questionable disclosure situations), is not applicable in others such as that found here (i.e., a tender offer) (see Basic Inc. v. Levinson, 485 U.S. 224 (1988). An SEC definition or average stockholder's definition of materiality is not necessarily applicable here.

The question of ambiguity is not determined by extrinsic evidence, but as a matter of law from the face of the document itself, as well as the integral factual elements that may be implicitly involved. This concept of leaving the initial determination in the hands of the trial Judge is supported by policy, practicability and experience. Sutton v. East River Savings Bank, 55 NY2d 551, 554 [1982]; Schmidt v. Magnetic Head Corporation, 97 AD2d 151, 156, 164 (2nd Dept. 1983).

This Court is contrained to conclude, as it did in its earlier decision, that the material adverse change clause is ambiguous, and that extrinsic evidence is necessary in over to determine the intentions of the parties, as to the meaning, as well as their understanding of this critical language. See, S & S Media, Inc. v. S Media, Inc., 84 AD2d 356, 360 (1st Dept. 1982); Manley v. Pandick Press, Inc.; 72 AD2d 452, 456 (1st Dept. 1980); Walk-in Medical Centers v. Breuer Capital Corp., 651 F. Supp. 1009, 1016-17 (S.D.N.Y. 1986) aff'd 818 F.2d 260, 263 (2nd 4 Cir. 1987).[4]

Given the sharply conflicting affidavits and deposition testimony as to what the understanding of the negotiators and their attorneys [5] was concerning the meaning and application of the material adverse change clause, it seems clear that the parties should have an opportunity to present extrinsic evidence in support of their respective positions. See, In re Gulf Oil/Cities Service Tender Offer Litigation, 725 F. Supp. 712, 739 [S.D.N.Y. 1989].

This conclusion becomes all the more compelling, when one considers the following examples of the differences between the parties on this issue:

a. Based on the conflicting affidavits and portions of deposition transcripts that have been submitted to the Court, there is a very sharp dispute as to what took place when the principals and their lawyers, who were negotiating the agreements, met on the evening of September 28, 1987 (two days before the Transaction Agreement and Tender Offer was signed) concerning the interpretation and clarification of the material adverse change clause, or threat thereof, and under what circumstances Jardine would have a right to terminate the Tender Offer.

b. There is a serious credibility issue between William J. Montorous, (Chief Financial Officer and Director of various Bear Stearns entities and a principal negotiator for Bear Stearns) and Mr. Powers who has been described before, as to whether it was the intent of the parties, that given the cyclical nature of the industry and of Bear Stearns business, that a "break even quarter," or a modestly profitable one, would not constitute a material adverse change, so as-to trigger Jardine's right of termination.

c. There also is a sharp credibility issue between Mr. Powers and Mr. Michael C. Murr, one of Bear Stearns representatives (and one of the original architects of the Bears Stearns-Jardine deal), as to whether a bargain was struck that the termination provision did not protect against the cyclical movement of the market generally, or the price of Bear Stearns specifically — the so called "up a thousand down a thousand, your risk our risk deal."

Jardine argues that both the Transaction Agreement and Tender Offer are fully innovated and, therefore, no oral modification is permitted. It should be made clear that the Court is permitting the introduction of extrinsic evidence only to explain and clarify the ambiguity as to the intentions of the parties concerning the material adverse change clause, and not to modify the agreement.

Jardine argues that given the events and changes in Bear Stearns operations immediately following the "crash" (as demonstrated by the results of extensive discovery over the past two years), it has met the heavy burden of proving that no factual issues exist as to whether a material adverse change occurred or was threatened, and that summary judgment should be granted here. These include the followng:

a. Bear Stearns suffered an immediate approximate loss of $100,000,000 on the day of 'the "crash" in its arbitrage and clearance departments.

b. Bear Stearns suffered an $18.3 Million loss for the month of October, 1987, not as a result of "operations" but by adjustments of various accrued bonus reserves and certain "unusual" changes in accounting methods. This constituted the worst month in Bear Stearns history as a public company because it was their first pretax loss.

c. Bear Stearns reported a quarterly pretax loss of $4.8 Million for the quarter ending October 30, 1987.[6] This was significant in comparison to the $79.8 Million average pretax quarterly income earned since it went public in 1985.[7]

d. That since 1987, Bear Stearns suffered a substantial reduction in return of equity and a loss in its compound growth rate.

e. Bear Stearns reduced its reputed anticipated pre-tax income for fiscal "88" from $420 Mil1on to approximately $200 Million.

f. Bear Stearns stock fell from $19 to $13 per share immediately following the crash.

All of the foregoing is significant in light of public positions taken by Alan Greenberg, Chairman of Bear Stearns and its principal officer, as well as other high level executives of Bear Stearns, that the only significant statistics and meaningful criteria for measuring Bear Stearns success are: return on equity; pretax income (because of the uncertain effects of tax rate changes); pre-tax profit margins; and compound growth rates.

Moreover, Jardine points to statements made by these same Bear Stearns executives that the swing in the stock market caused by the October 19th crash went far beyond any of the anticipated parameters, and that the parameters of swings in the market are now unpredictable.

Finally, Mr. Powers claims that on October 21, 1987, in his first conference with Mr. Greenberg following the "crash," Mr. Greenberg told him that the "crash" caused a material adverse change in the operations of Bear Stearns. Mr. Greenberg denies this and says that he was talking about a change for the better, given the comparative condition of Bear Stearns after the "crash" to other stock brokerage companies, and the advantages that the situation afforded to Bear Stearns for the future. This obviously raises another serious credibility issue that the fact finders must resolve.

Bear Stearns paints a very different picture of the events following the October 19th crash:

a. It concedes that it did suffer a $100,000,000 loss between its arbitrage and clearance departments, which it claims were well managed, given the frenzy at the time. However, it points out that the Bear Stearns other operations, (i.e. retail, mergers and acquisitions and fixed income) by comparison did better than in the prior fiscal year.

b. For the quarter ending October 30, 1987, Bear Stearns reported a net after tax income of $414,000 — "a break even quarter" — the significance of which has been discussed above.

c. That the adjustment for the month of October, 1987 from bonus reserves and accounting practices was not "suspect" or "unusual" but in accordance with generally accepted practices in existence prior to the "crash,"

d. That the decline in earnings for the quarter ending October 30, 1987 had no negative impact on Bear Stearns capital, (which remained over One Billion Dollars) and that Bear Stearns and its subsidiaries suffered no impairment of the lines of credit with banks during the week of October 19, 1987 or thereafter.

e. That Bear Stearns future prospects following the "crash" were enhanced because it was in a better competitive position given the comparative weakness of its competitors.

f. That Jardine's consultant Arthur Anderson, in an interoffice communication (authored by a Louis P. Salvatore) indicated that they were not aware of any material negative effect on Bear Stearns operations as a result of the stock market "crash."

To summarize, Bear Stearns argues and has presented facts and figures in support of its contention that the impact of events following the "crash" did not adversely materially effect or threaten to effect Bear Stearns short or long term operations.

It is clear that in the present posture of the case, as reflected by the state of the record, the central issue of whether there was a material adverse change in the operations of Bear Stearns taken as a whole0r whether one was threatened as a result of the "crash," cannot be resolved as a matter of law. This issue is permeated with material disputed facts which must be resolved at trial.[8] Summary judgment must be denied if any party shows facts sufficient to require a trial of any issue of fact. CPLR 3212(b); Kane Mfg. Corp. v. Partridge, 144 AD2d 340 (2nd Dept. 1988) (Where the intent of the parties must be determined by disputed evidence or inference outside the written words of the instrument, a triable issue of fact is present precluding summary judgment). See also, Mallad Constr. Corp. v. Couzity Fed. Sav. & Loan Assn., 32 NY2d 285 [1973]. If a genuine issue of fact is found to exist, summary judgment must be denied. Rowan v. Brady, 98 AD2d 638 (1st Dept. 1983).

Reasonable Judgment Clause

Jardine maintains that no genuine issue exists concerning the application of the "reasonable judgment" clause to the October "crash" and that the impact of the "crash" on Bear Stearns was materially adversely significant with respect to the value of Bear Stearns shares to Jardine. Finally, Jardine contends that the minutes of the Jardine Board of Directors meeting on September 23, 1987, clearly demonstrate that Jardine's judgment in terminating was based on the events following the "crash," their impact upon Bear Stearns and the radical changes that followed in the securities business market place.

Bear Stearns challenges these assertions. It claims that the record reflects that Mr. Powers decided to terminate the Tender Offer before the meeting of the Jardine Board on October 23, 1987 and that he did so before all of the facts and figures had been provided to him by Mr. Greenberg and other Bear Stearns executives. Bear Stearns claims that Mr. Powers began to prepare the press release announcing the termination immediately following the first meeting with Mr. Greenberg.

According to Bear Stearns, the primary and only reason for the termination was Jardine's concern o what would happen to its stock on the Hong Kong exchange when it opened. That exchange was closed for a week following the October 19, 1987 crash in New York. To support this contention, Bear Stearns points to an alleged conversation between Mr. Powers and Mr. Michael Murr in which Mr. Powers allegedly stated that they had to terminate the Tender Offer because Jardine's stock was getting "killed in the gray market" in London (off-market trading) and that they had to "bust the deal" in order to protect the Jardine stock when the Hong Kong exchange opened.

As to the Jardine Board's minutes, Bear Stearns raises questions concerning the content which it claims indicates that the Boards' primary concerns were other than those claimed by Jardine. Moreover, Bear Stearns claims that the minutes were prepared by Jardine's attorney, which was not their usual practice, and this makes the minutes suspect, if not unreliable. These are but a few of the factual issues raised by Bear Stearns to challenge Jardine's contention that no genuine issue exists in connection with Jardine's exercising the reasonable judgment clause to terminate the Offer.

There are differences between the parties as to whether an objective standard or a subjective standard should be applied in determining Jardine's actions here, compare Fursmidt v. Hotel Abby Holding Corp., 10 AD2d 447, 449 (1st Dept. 1960); Loengard v. Metal & Thermit Corp., 204 F. Supp. 74, 77 (S.D.N.Y. 1962); Walk-in Medical Centers v. Breuer Capital Corp., supra; In re Gulf Oil, supra. However, even by applying the objective standard urged by Jardine, the question still comes down to whether a reasonable person would believe that the events following the "crash" were of "material adverse significance with respect to the value of [Bear Stearns] shares to [Jardine]." (See Loengard v. Metal & Thermit Corp., supra; Royster Co. v. Union Carbide Corp., 737 F.2d 941, 945 (11 Cir. 1984), (which applied New York Law).

The discovery held since this Court's June 17, 1988 decision has not resolved the "reasonable judgment clause" issue, anymore than it has the "material adverse change" or "threat thereof" issues. Indeed, discovery has demonstrated that these are all triable factual issues that preclude summary judgment.

Schulman Plaintiffs (Settlement Class) Motion

The Schulman Plaintiffs seek to amend this Court's Order (based upon this Court's decision of September 12, 1989),[9] to include in the Schulman Settlement subclass, the 20,000,000 shares, which in accordance with the Order and Notice, were assigned to the Kayne subclass, because the stockholders holding those shares did not respond by exercising any of the options.

This Court again recognizes that decisions granting class action status are not immutable and are subject to change depending upon subsequent events that may develop Friar v. Vanguard Holding Corporation, 78 AD2d 83, 95 (2nd Dept. 1980). It

is in this spirit that the various points raised by counsel for the Schulman Plaintiffs are considered.

As to the legal issues, most of the arguments raised in this proceeding were considered in the September 12, 1989 decision and need not be revisited.

The Schulman Plaintiffs argued that the Notice sent to the stockholders which included this Court's two decisions, one of which appointed Kayne's lawyer Mr. Borstein, as best qualified to represent the Kayne subclass (comprised of stockholders other than those of Bear Stearns or Jardine) prejudiced the Schulman Settlement subclass because that decision might be viewed as an endorsement of the Kayne subclass. The simple answer to this is that the final form of the Notice came about as a result of a series of conferences in which all attorneys participated and were heard. The Notice in its final form was a compromise. The same answer holds for the argument that the Notice was too confusing and too long. Moreover, the Schulman Plaintiffs filed a Notice of Appeal after the Order was entered, which apparently they did not perfect. (Jardine perfected its appeal and lost).

The Schulman Plaintiffs argue that many of the shares were held in street names and that the street holders did not have sufficient time to transmit the Notice to the stockholders in order to afford them an opportunity to respond in time, notwithstanding that the time to respond was extended for a period of two weeks. This does pose a problem of fairness and proper concern, but it is not resolved by assigning all 20,000,000 shares to the Settlement subclass. To do so, one would have to assume, absent any basis to do so, that all of these stockholders would have opted for the Settlement subclass, if they received the Notice in time.

The Court also is concerned that some of the stockholders who elected to go into the Kayne or Bear Stearns subclasses, also endorsed the option form to indicate that they wanted to be part of the Settlement subclass. At the time of oral argument, the exact number of such shares was not available but seemed to be ascertainable in the future. It should be noted that both of these problems have been substantiated by the affidavit of a Mr. Bernhammer of the Trust Company of New Jersey, which was selected to administer the Notice proceedings.

To attempt to remedy this situation, counsel for the Schulman Plaintiffs is requested to communicate with Mr. Bernhammer of the Trust Company of New Jersey to ascertain the following:

1. Whether any late responses were received from any stockholders whose stock was held in a street name, and who apparently received their Notices too late to respond in time.

2. The names of stock holders whose stock was held in street names who did not receive the Notices from the street holders.

3. The number of returns in which the stockholder selected either the Kayne or Bear Stearns subclass and then on the form also opted to be a part of the Settlement subclass.

When this information is received, the Court will attempt to fashion an Order to enable any stockholder who has not had an opportunity to select an option and who may want to select the Settlement subclass, to be able to do so.

To summarize, the motion for summary judgment is denied in all respects. The Kayne cross-motion is denied. The Schulman Plaintiffs (Settlement subclass) motion is granted to the extent indicated above and otherwise denied.

This constitutes the Decision and Order of the Court.

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(1) Pursuant to this Court's decision dated September 12, 1989, aff'd on opinion of this Court — AD2d — (NYLJ May 10, 1990 Pg. 25, Col 5.), 3 sub classes were created: The Kayne Class, The Settlement Class (Schulman Plaintiffs) and the Bear Stearns Class.

(2) For purposes here, Fred Kayne who originally was part of the Schulman action will be considered as a separate party plaintiff (See this Court's decision dated September 12, 1989.)

(3) Some of the submissions and arguments made in support of the motion for summary judgment were advanced by counsel for the Schulman Plaintiffs, but for purposes of economy will be discussed here as Jardine's position. Similarly, submissions and arguments made by Kayne's counsel in opposition will be discussed as Bear Stearn's position.

(4) Interestingly, while Jardine has maintained throughout that the language involved is clear and unambiguous, Jardine has presented extrinsic evidence in order to support its position. See Missett v. Missett, 125 AD2d 275 (1st Dept. 1986).

(5) Jardine argues that very skilled lawyers from very prestigious firms negotiated and drafted these agreements, including Section 14. Therefore, it must follow that the language clearly and unambiguously evinces the intent of the parties. Be that as it may, that is hardly dispositive of this issue.

(6) Bear Stearns claims it had a $414,000 after-tax profit for that quarter, as will be discussed hereafter.

(7) The pretax operating income for the first three quarters of 1987 was as follows: January 30, 1987 — $117.2 Million; April 30, 1987 — $88.4 Million; and July 31, 1987 — $72.6 Million. The after-tax net income for those three quarters, respectively was: $59.6 Million; $44.7 Million; and $47.9 Million.

(8) In reaching this conclusion the Court has taken into consideration the recently submitted affidavits and transcripts of conversations between Messrs. Alvin Einbinder (who apparently was then Chief Operating Officer and member of the Executive Committee of Bear Stearns), Richard Harrington and William Gangi (Senior Managing Directors of Bear Stearns in charge of the clearance department). Apparently some of these gentlemen participated in Bear Stearns-Powers meetings immediately following the "crash." In their taped conversations they discussed what their reactions would be if they were on Jardine's side. They speculated as to whether Jardine might ask to renegotiate the $23 per share offer indicating that they probably would, if the situation was reversed. Suffice it to say, that this is but another situation which the fact finders may take into consideration in deciding the ultimate issue here.

(9) Since oral argument and the submissions in this proceeding, the Appellate Division unanimously *affirmed* "for the reasons stated in [this Court's] memorandum decision" (supra).