

Memorandum

Recent \$300 Million Settlement by U.S.-Listed Chinese Company Renren Highlights Increased Risk of U.S. Derivative Litigation Concerning Foreign Private Issuers

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Renren, Inc. (“Renren”), a NYSE-listed Chinese company incorporated in the Cayman Islands, recently settled a shareholder derivative litigation in New York state court for at least \$300 million. According to the complaint, Renren, which initially positioned itself as the “Facebook of China,” invested its 2011 NYSE IPO proceeds towards a number of ventures and became a *de facto* venture capital fund. The minority shareholder plaintiffs alleged that Renren’s CEO, Joseph Chen, along with certain other directors, controlling shareholders and the financial advisory company Duff & Phelps, defrauded Renren and its minority stockholders out of over \$500 million in company investment assets by spinning off Renren’s assets into a private company in exchange for an undervalued cash dividend. The Renren plaintiffs asserted derivative claims under Cayman Islands law and New York law in connection with the spin-off.

This record-breaking settlement involving a U.S.-listed Chinese company comes several months after the Appellate Division of the New York Supreme Court affirmed a lower court’s finding that there was proper jurisdiction and standing to pursue Cayman law derivative claims in New York against Renren and its directors. *See In re Renren, Inc.*, 192 A.D.3d 539, 140 N.Y.S.3d 701 (2021). Historically, derivative claims relating to non-U.S. companies incorporated offshore have faced significant legal hurdles in U.S. courts; these companies primarily faced exposure through federal securities litigation and SEC regulatory action. The Renren lawsuit and settlement illustrates that New York courts are increasingly willing to entertain derivative actions against non-U.S. companies, closely aligning the legal threats against the boards of such companies with that of U.S.-based and -incorporated issuers which often face secondary corporate law challenges whenever federal securities litigation is initiated.

Derivative Actions Relating to Non-U.S. Corporations

A derivative action is a lawsuit brought by a shareholder that seeks recovery on behalf of and for the benefit of the corporation itself. Derivative claims are commonly asserted against U.S.-incorporated entities when shareholders believe that corporate directors or officers have breached their fiduciary duties to the detriment of the company. Derivative claims can be brought in a variety of circumstances, including following industrial accidents, product failure or cybersecurity breaches that impact a company’s reputation or business prospects. They are also

commonly filed as follow-on cases to federal securities lawsuits, seeking to recoup the costs of defense and settlement of such cases from the directors and officers personally.

Derivative suits relating to non-U.S. corporations have historically faced legal hurdles. Several foreign jurisdictions—including the Cayman Islands—have “leave of court” rules that require a plaintiff to apply for leave of the local court before a derivative claim may be pursued. *See, e.g., ARC Capital, LLC v. Kalra*, No. 652931/2012, 2013 WL 3072008 (N.Y. Sup. Ct. Jun. 18, 2013) (dismissing derivative claims where the plaintiff has failed to seek leave of the Cayman Islands Grand Court as required by that court’s Rule 12A). Beginning in 2017, however, New York courts began to hold that foreign “leave of court” rules are procedural, not substantive, and do not restrict New York courts’ ability to hear derivative claims relating to foreign corporations. *See Davis v. Scottish Re Grp. Ltd.*, 30 N.Y.3d 247, 251, 88 N.E.3d 892, (2017) (holding that Rule 12A “is a procedural rule that does not apply in New York courts”); *Mason-Mahon v. Flint*, 166 A.D.3d 754, 756-57, 87 N.Y.S.3d 556 (2018) (holding that the U.K. Companies Act, a leave-of-court rule similar to Rule 12A, was a procedural rule and not binding on New York courts); *City of Aventura Police Officers’ Ret. Fund v. Arison*, 70 Misc. 3d 234, 248, 1345 N.Y.S.3d 662 (N.Y. Sup. Ct. 2020) (following *Mason-Mahon* and finding the judicial-permission requirement under the U.K. Companies Act procedural in nature).¹

Standing has also been a historical challenge for derivative claims under Cayman law. Shareholders cannot pursue derivative litigation under Cayman law unless one of four narrow exceptions first articulated in *Foss v. Harbottle* (2 Hare 461[1843]) is satisfied. 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.

Plaintiff shareholders have tried to advance the third exception (“fraud on the minority”) before U.S. courts, with limited success. *See, e.g., Shenwick v. HM Ruby Fund, L.P.*, 106 A.D.3d 638, 639, 966 N.Y.S.2d 69 (2013) (finding the *Foss* fraud on the minority exception inapplicable because the defendants did not obtain a personal benefit at the company’s expense, and dismissing the case for lack of standing); *Davis v. Scottish Re Grp. Ltd.*, 160 A.D.3d 114, 73 N.Y.S.3d 533 (2018) (dismissed on remand for lack of standing). In *Davis*, the Appellate Division held on remand that in order to invoke the “fraud on the minority” exception, a plaintiff must plead sufficient facts to show that (a) the alleged wrongdoers controlled a majority of the stock with voting rights; and (b) those wrongdoers diverted corporate assets for their personal benefit.

¹ Simpson Thacher represented the defendants in the *Arison* case. Despite the court’s ruling on the “leave of court” issue, Simpson Thacher was able to secure a dismissal for lack of standing because the U.K. Companies Act only permits a registered member of the company—which the plaintiff was not—to assert derivative claims. The court found the membership requirement substantive rather than procedural because, among other things, the statute itself “shapes the substantive rights of stakeholders to sue derivatively.” *Arison*, 134 N.Y.S.3d at 678.

In re Renren, Inc.

In *Renren*, the New York Supreme Court held that the plaintiffs had standing to bring derivative claims under the *Foss* “fraud on the minority” exception. *In re Renren, Inc.*, 67 Misc. 3d 1219(A), 127 N.Y.S.3d 702 (N.Y. Sup. Ct. 2020). The complaint alleged that the defendants together controlled a majority of Renren’s stock. The complaint also alleged in sufficient detail that the defendants had defrauded U.S. investors by misrepresenting, in soliciting its IPO, how Renren planned to use the IPO proceeds and by seeking personal financial benefits at the expense of the company and the minority stockholders. The court also held that it had personal jurisdiction over the defendants based on their “significant New York activities,” including Renren’s IPO on the NYSE, the use by Renren of New York bankers and attorneys for its IPO, the approval from the New York State Department of Financial Services for the spin-off transaction giving rise to the derivative suit, and the consent by Renren in multiple agreements to be governed by New York law. In March 2021, the Appellate Division unanimously affirmed the lower court’s decision.

On October 7, 2021, the parties entered into a settlement stipulation for a rare direct cash payment to the minority shareholders totaling *at least* \$300 million. The stipulation states that “the portion of the Net Settlement Amount payable to Renren Shareholders who are record shareholders of Renren Class A ordinary shares as of the Record Date shall be paid directly by the Administrator or through third-party payment entities, as directed by the Administrator, from the Settlement Account.” The settlement is subject to a “true up” process that could increase the ultimate payment amount depending on the final determination of the number of shares and American Depositary Shares held by non-defendants.

Key Takeaways

- New York courts are becoming increasingly friendly to derivative claims asserted by shareholders of foreign corporations.
- New York courts no longer require shareholders to comply with the judicial-permission requirements of foreign jurisdictions such as the Cayman Islands.
- Shareholders of Cayman companies have had success in establishing standing in New York courts by showing that the defendants’ conduct constitutes a fraud on the minority.
- Although a number of case-specific facts were critical to the *Renren* court’s determination on jurisdiction and standing, the lawsuit—and the significant settlement—could potentially attract more suits of a similar nature in New York or elsewhere in the United States.

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