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9 UNITED STATES DISTRICT COURT
10 NORTHERN DISTRICT OF CALIFORNIA

11 IN RE ZORAN CORPORATION
12 DERIVATIVE LITIGATION,

Case No. CV 06-05503 WHA

**MEMORANDUM OF NOMINAL
DEFENDANT ZORAN CORPORATION
IN SUPPORT OF PRELIMINARY
APPROVAL OF DERIVATIVE
SETTLEMENT**

13
14 This Document Relates To:

15 ALL ACTIONS

16 Date: TBA
17 Time: TBA
18 Ctrm: 9, 19th Floor
The Honorable William Alsup

1 **I. INTRODUCTION**

2 Consistent with the guidance in the Court’s April 7, 2008 order (the “April 7 Order”), the
 3 parties—Plaintiff Gerald del Rosario (“Plaintiff”); Defendants Raymond A. Burgess, Uzia Galil, Levy
 4 Gerzberg, Camillo Martino, James D. Meindl, James B. Owens, Jr., Karl Schneider and Arthur B.
 5 Stabenow (the “Individual Defendants”); and Nominal Defendant Zoran (collectively with the
 6 Individual Defendants, “Defendants”)—have negotiated and agreed to the terms of a new proposed
 7 settlement (the “New Settlement”).¹ The New Settlement provides substantial benefit to Zoran and
 8 addresses directly the concerns expressed previously by the Court:

- 9
- 10 • The Court expressed concern about the level of consideration to be paid to Zoran under
 11 the prior proposed settlement and the fact that the consideration would be entirely non-
 12 cash. The New Settlement calls for payment of approximately \$3.4 million in cash to
 13 Zoran by certain of the Individual Defendants and their insurers.
 - 14 • The Court expressed concern regarding the valuation and timing of options cancellation
 15 and repricing by the Individual Defendants. The New Settlement calls for valuation of
 16 cancelled options based on Black-Scholes calculations with assumptions set forth
 17 clearly in the Stipulation of Settlement, and in a manner that ensures that the Individual
 18 Defendants cannot retrospectively select a favorable date.
 - 19 • The Court expressed concern regarding the scope of the releases in the prior proposed
 20 settlement, and that release language has been amended in the New Settlement.
 - 21 • Moreover, based on the results of the SEC inquiry, the conclusions of the Company’s
 22 independent investigation and the discovery to date, Zoran believes this is a very
 23 favorable result for the Company. Also, given the recovery set forth above, Zoran has a
 24 strong interest in avoiding further protracted and costly litigation. Discovery and trial
 25 preparation have impacted a number of non-defendant Company employees and third
 26 parties and, obviously, this matter continues to divert Zoran senior management from
 27 the business of the Company.
 - 28 • Finally, the Individual Defendants’ applicable insurance coverage has diminishing
 limits, such that additional defense costs stand to compromise the availability of the
 portion of the New Settlement to be funded by the Individual Defendants’ carriers. For
 all of these reasons, Zoran respectfully urges the Court to grant preliminary approval to
 the New Settlement.

27 ¹ The Stipulation of Settlement for the New Settlement is attached as Exhibit A to the
 28 Declaration of Steven S. Kaufhold filed herewith (“Kaufhold Decl.”).

1 **II. DISCUSSION**

2 Under Federal Rule of Civil Procedure 23.1(c), a derivative action “may be settled, voluntarily
3 dismissed, or compromised only with the court’s approval.” Like a class action settlement, a derivative
4 settlement should be approved if it is “fundamentally fair, adequate and reasonable.” *Principe v.*
5 *Ukropina (In re Pac. Enters. Sec. Litig.)*, 47 F.3d 373, 377 (9th Cir. 1995) (internal quotations omitted).
6 There is “a strong judicial policy that favors settlements” in derivative and class actions. *Id.* (internal
7 quotations omitted); *see also S.F. NAACP v. S.F. Unified Sch. Dist.*, 59 F. Supp. 2d 1021, 1029 (N.D.
8 Cal. 1999). Consequently, courts in this District have long established that “[t]he issue is not whether
9 the settlement could be better, but whether it is fair, reasonable and adequate and free from collusion.”
10 *S.F. NAACP*, 59 F. Supp. 2d at 1028-29; *see also Boyd v. Bechtel Corp.*, 485 F. Supp. 610, 617 (N.D.
11 Cal. 1979) (“the court is not to make a final determination of liability or damages, or to hold a trial or
12 rehearsal of the trial[, n]or is it to determine whether a better settlement might have been negotiated”).
13 As discussed at length below, the New Settlement more than meets this standard.

14 **A. The New Settlement Provides Tangible Financial Benefit To Zoran In Ways That**
15 **Specifically Address The Court’s Previously Stated Concerns**

16 As expressed in the April 7 Order, the Court’s primary concern with the parties’ first proposed
17 settlement appeared to be that the settlement did not confer upon the Company the \$1.65 million in
18 consideration that it promised. *See, e.g.*, April 7 Order at 9. The New Settlement directly addresses
19 this concern by providing for \$3,395,000 in cash to be paid to Zoran by its CEO Dr. Gerzberg, its CFO
20 Mr. Schneider and the insurance carrier on behalf of the Individual Defendants. Stipulation of
21 Settlement ¶ 2.4(a). Thus, the New Settlement more than doubles the consideration promised by the
22 previous proposed settlement, and there is no risk that this consideration is illusory. As the Court
23 noted, of the numerous estimated damage figures submitted by Plaintiff’s expert, the largest such
24 figure is roughly \$16 million. April 7 Order at 7. The Company doubts that Plaintiff will recover *any*
25 amount of damages if this action proceeds to trial, and believes that his maximum recovery would fall
26 far short of \$16 million even if liability existed. Nonetheless, it is worth noting that the approximately
27 \$3.4 million cash payment in the New Settlement is over one-fifth of Plaintiff’s asserted *maximum*
28 damage figure. Both the Ninth Circuit and courts in this District have approved settlements in which

1 defendants have paid a far smaller proportion of the potential recovery amount. *See, e.g., In re Pac.*
2 *Enters.*, 47 F.3d at 377 (approving derivative settlement of \$12 million despite a potential recovery of
3 over \$1 billion); *Dunleavy v. Nadler (In re Mego Fin. Corp. Sec. Litig.)*, 213 F.3d 454, 459 (9th Cir.
4 2000) (“the Settlement amount of almost \$2 million was roughly one-sixth of the potential recovery”);
5 *In re Omnivision Techs., Inc.*, No. C-04-2297 SC, 2008 WL 123936 at *5 (N.D. Cal. Jan. 9, 2008)
6 (approving settlement amount “in excess of 6% of the potential”); *In re Cylink Sec. Litig.*, 274 F. Supp.
7 2d 1109, 1114 (N.D. Cal. 2003) (“The \$6.2 million settlement constitutes 13.8 percent of potential
8 losses”). Indeed, a court in this District has previously noted that median settlement figures for
9 securities class actions range anywhere from under 3% to just under 7% of potential recovery, far less
10 than the 20% offered in this case. *In re Omnivision*, 2008 WL 123936 at *5 (under 3%); *In re Cylink*,
11 274 F. Supp. 2d at 1114 (less than 7%).

12 While the approximately \$3.4 million cash payment would be sufficient value in and of itself to
13 make the New Settlement fair, reasonable and adequate, the benefit tendered to the Company in the
14 New Settlement goes even beyond that payment in that under its terms, (1) Dr. Gerzberg voluntarily
15 agrees to cancel options worth a total of \$482,310; and (2) Dr. Gerzberg and Messrs. Schneider and
16 Stabenow voluntarily agree to reprice certain of their options to prevent their realizing any gain on
17 options that were remeasured in Zoran’s restatement of financials. Stipulation of Settlement ¶¶ 2.4(b)-
18 (c). In its April 7 Order, the Court expressed concern that tendering cancelled options as consideration
19 could be problematic because the valuation of such options could be manipulated by retrospectively
20 choosing a favorable price. *See* April 7 Order at 10-12. The New Settlement, however, addresses and
21 obviates this concern by committing Dr. Gerzberg to cancel a fixed *dollar amount’s* worth of options,
22 rather than a fixed number of options. Stipulation of Settlement ¶ 2.4(c). The New Settlement protects
23 against this dollar amount being based on a “cherry-picked” retrospective date by establishing that, for
24 example, if the closing price of the Company’s stock is lower on the trading day immediately
25 preceding the date on which the Court preliminarily approves the New Settlement (a date *prospectively*
26 chosen by the Court) than it is on May 13, 2008 (the last trading date immediately preceding the date
27 on which the Individual Defendants presented the Stipulation of Settlement to Plaintiff’s counsel), Dr.
28 Gerzberg will nonetheless cancel enough options at this lower valuation to constitute a total value of

1 \$482,310. *Id.* Accordingly, there should be no dispute that the cancellation of Dr. Gerzberg's options
2 will amount to \$482,310 in value for the Company.²

3 With respect to the repricing of options, the options to be repriced under the New Settlement
4 have not yet been repriced, unlike in the first proposed settlement, where the options had already been
5 repriced before the settlement had been reached. Stipulation of Settlement ¶ 2.4(b). This is responsive
6 to the Court's concern as to whether the repricing can constitute consideration. *See* April 7 Order at
7 12-14 (recognizing that repricing "would be a possible benefit to the Company," but concluding that
8 the repricing of options specifically agreed upon could not count as consideration because options were
9 already repriced before the parties sought approval of the first proposed settlement).

10 The New Settlement is also responsive to the concerns stated in the April 7 Order as to the
11 scope of the release, as the release encompasses those claims "that have been asserted or could have
12 been asserted" based on the allegations "in the Derivative Litigation or closely related thereto, up to
13 and through the date of the filing of the Consolidated Complaint in the Derivative Litigation on March
14 14, 2007, including all matters alleged in, or which could have been alleged in, any of the complaints
15 filed in the Derivative Litigation;" and those claims "that were made or could have been made against
16 the Released Persons arising out of, relating to, or in connection with the prosecution, defense,
17 Settlement or resolution of the Derivative Litigation." Stipulation of Settlement ¶¶ 1.14, 3.1. This
18 release directly addresses the Court's earlier-stated view that the release (1) not cover claims
19 postdating the Consolidated Complaint, and (2) release only those claims "made in the consolidated
20 complaint and those closely related thereto." April 7 Order at 15.

21 In conclusion, the terms of the New Settlement respond to the concerns articulated by the Court
22 in its April 7 Order, conferring upon the Company almost \$4 million in total consideration. Zoran
23 respectfully submits that this consideration, in conjunction with the significant corporate governance
24
25
26

27 ² Plaintiff's counsel and his expert have reviewed and found acceptable the methodology used
28 in the Individual Defendants' Black-Scholes calculations for valuing the cancelled options. Kaufhold
Decl. ¶ 5.

1 reforms promised to the Company's shareholders³, more than establishes the New Settlement as fair,
2 reasonable and adequate to all parties.

3 **B. Further Discovery Has Confirmed That Plaintiffs' Prospects For Prevailing On**
4 **The Merits Are Low, Making The New Settlement Particularly Fair And Adequate**

5 In approving settlements, both the Ninth Circuit and courts in this District have taken into
6 account the difficulties that plaintiffs would face in prevailing on the merits of their cases. *See in re*
7 *Mego*, 213 F.3d at 459 (approving settlement "in light of the uncertainties of trial and difficulties in
8 proving scienter"); *Linney v. Cellular Alaska P'ship*, 151 F.3d 1234, 1240 (9th Cir. 1998) (evaluating
9 settlement in light of "considerable statute of limitations problems"); *In re Omnivision*, 2008 WL
10 123936 at *4 (approving settlement where plaintiffs "faced a number of problems in actually proving
11 their case on the merits" and "the amount [p]laintiffs might recover if they prevailed at trial is
12 uncertain"). As the Ninth Circuit has also observed, "derivative lawsuits are rarely successful." *In re*
13 *Pac. Enters.*, 47 F.3d at 378. All of the evidence so far indicates that the plaintiff in this case, like
14 those in other derivative cases, is unlikely to prevail.

15 The third parties that have investigated Zoran's stock option policies and practices have
16 roundly concluded that the Company and the Individual Defendants engaged in no wrongdoing. First,
17 the SEC conducted an inquiry into Zoran's stock option practices, including receipt of voluminous
18 documents relating to all of the Company's significant officer/director and refresh grants; following
19 that review, the SEC terminated its investigation without recommending any enforcement action
20 against any current or former Zoran employee, officer or director (including the Individual
21 Defendants). Kaufhold Decl. ¶ 6. As a court in this District noted in *In re Omnivision*, the fact that
22 "the Securities and Exchange Commission has already investigated" Zoran's stock practices "and
23 decided not to take further action . . . suggest[s] some weaknesses on the merits." 2008 WL 123936 at
24 *4.

27 ³ The Court has expressed the opinion that such reforms do not suffice "in lieu of" substantial
28 monetary consideration. April 7 Order at 16. In the New Settlement, the corporate governance
reforms are to be provided *in addition to* substantial monetary consideration.

1 Likewise, an independent committee of the Zoran board of directors separately conducted an
2 exhaustive investigation of Zoran's stock option policies and practices with the assistance of
3 experienced independent counsel and found no fraud. Kaufhold Decl. ¶¶ 7, 9. The independent
4 investigation covered stock option grants made up through 2006 and included interviews of at least 23
5 current and former employees, officers and directors; and five of the Company's attorneys and
6 accountants from DLA Piper and PricewaterhouseCoopers with knowledge regarding the Company's
7 stock option policies and practices. *Id.* at ¶¶ 7-8. Finally, the committee and its counsel identified over
8 a million potentially relevant records and identified as responsive and reviewed 228,000 Company
9 records. *Id.* The Company and its counsel believe that the investigation was thorough and
10 comprehensive. *Id.* at ¶ 9. The investigation reached no conclusion by the committee of any fraud or
11 intentional wrongdoing by any of the Individual Defendants (or any other Zoran personnel). *Id.*

12 Subsequently, during the course of this litigation, the parties have exchanged over a million
13 pages of documents and have completed seven significant depositions: namely, those of Dr. Gerzberg,
14 Mr. Schneider, Mr. Galil (Zoran's Chairman of the Board of Directors), Messrs. Stabenow and Burgess
15 (both Zoran Directors), Zoran Human Resources Vice President Connie Frederickson-Bray, and Dr.
16 Gerzberg's and Mr. Schneider's Executive Assistant Diana Young. *Id.* at ¶ 10. None of the deposition
17 testimony to date, including testimony from the depositions after the April 7 Order, has supported a
18 finding of fraud or intentional misconduct by any of the Individual Defendants. *Id.* In short, Plaintiff's
19 low chances of proving liability make this settlement even more fair, reasonable and adequate from the
20 Company's perspective.

21 **C. The New Settlement Will Benefit Zoran By Avoiding The Time And Expense Of**
22 **Further Complex Litigation**

23 It is also appropriate for the Court to consider the complexity and expense of continued
24 litigation in evaluating the fairness and adequacy of the proposed settlement. *See Granada Invs., Inc.*
25 *v. DWG Corp.*, 962 F.2d 1203, 1205 (6th Cir. 1992). At this point of the litigation, the New Settlement
26 can still resolve this action on terms that will financially benefit the Company. If this complex
27 derivative action were to continue, however, Zoran would incur substantial fees and costs due to the
28 indemnity rights of the Individual Defendants. Kaufhold Decl. ¶ 11. For example, the parties

1 anticipate taking at least eight additional party and nonparty depositions. *Id.* at ¶ 12. The cost to Zoran
2 and the other parties of such additional depositions, expert discovery, preparation of summary
3 judgment motions and trial preparation will be considerable. *Id.* Incurring this cost is also totally
4 unnecessary; although some discovery has not yet been completed, “formal discovery is not a
5 necessary ticket to the bargaining table where,” as here, “the parties have sufficient information to
6 make an informed decision about settlement.” *Linney*, 151 F.3d at 1234 (internal quotations omitted);
7 *accord In re Mego*, 213 F.3d at 459; *In re Omnivision*, 2008 WL 123936 at *5.

8 The timing of this settlement is especially critical because the defendants’ applicable insurance
9 coverage is in the form of diminishing-limits policies, such that defense fees and costs reduce the
10 amount of insurance available for potential resolution of this litigation. Kaufhold Decl. ¶ 13. Thus,
11 continuation of the litigation may quickly exhaust any funds available to settle the case. *Id.* If the
12 opportunity for settling passes, litigation proceeds and (as Zoran anticipates) the Individual Defendants
13 prevail at trial, Zoran will incur millions of dollars in attorney’s fees and costs both in defending itself
14 and pursuant to its indemnity obligations. *Id.* at ¶ 14. There is simply no reason for Zoran to take this
15 risk in light of the certain recovery available through the proposed settlement.

16 **D. The Entire Settlement Process Has Been Conducted At Arms Length, Free From**
17 **Collusion**

18 The settlement process in this action began with a mediation process overseen by the
19 Honorable United States District Judge Charles Legge (Ret.). Kaufhold Decl. ¶ 1. Judge Legge met
20 with parties personally and continued the mediation process via teleconferences with the parties. *Id.* at
21 ¶¶ 1-2. Plaintiff attended the mediation personally, as did Zoran independent director Philip Young.
22 *Id.* at ¶ 1; Declaration of Philip Young (“Young Decl.”) ¶ 2. Mr. Young, a non-management director, is
23 not a defendant in this action. Young Decl. ¶ 1. Mr. Young was an active participant in each part of the
24 mediation on behalf of Zoran. *Id.* at ¶ 2.

25 After the April 7 Order, the parties engaged in further arms-length negotiation, guided by the
26 Court’s concerns. Kaufhold Decl. ¶ 4. Mr. Young collaborated with Company counsel regarding the
27 New Settlement, and ultimately reviewed and authorized its execution. Young Decl. ¶¶ 2-4. Mr.
28 Young believes that the New Settlement is in the best interests of the Company and its shareholders.

1 *Id.* at ¶ 4. In conclusion, the New Settlement is not only substantively fair and adequate, but is also the
2 result of an unimpeachable process. Accordingly, it warrants approval.

3 **III. CONCLUSION**

4 For all of these reasons, Nominal Defendant Zoran respectfully requests that the Court grant
5 preliminary approval for the New Settlement.

6 Dated: May 30, 2008

AKIN GUMP STRAUSS HAUER & FELD LLP

7
8 By _____/s/_____

9 Steven S. Kaufhold
10 Attorneys for Nominal Defendant Zoran Corp..