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Bulletin

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Halliburton: Supreme Court Issues Landmark Ruling Reaffirming the Applicability of Fraud-on-the-Market Doctrine

Naumon A. Amjed, Esquire & Andrew Dodemaide, Esquire

On June 23, 2014, the Supreme Court of the United States issued its opinion in *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. ___ (2014) ("*Halliburton*") refusing to overrule or otherwise significantly modify its holding in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988) ("*Basic*"), which established one of the essential features of federal securities class action litigation: the presumption of reliance under the "fraud-on-the-market" doctrine. A reversal of *Basic* would have drastically limited investors' ability to pursue class action litigation under Section 10(b) of the Securities Exchange Act of 1934 — the federal anti-fraud statute.

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Bylaw Madness: Boards Writing Their Own Rules for Litigation

Lee Rudy, Esquire[1]

Bylaws restricting stockholders' ability to sue are the latest — and deadliest — tool ever utilized by corporate boards. The new bylaws being passed by corporate directors purport to write the rules for litigation filed against the board members themselves. These bylaws rely on two recent Delaware court decisions (*Boilermakers*[2] and *ATP*[3]) that find board-adopted bylaws presumptively valid, even when they regulate matters outside the boardroom and were never explicitly consented to by stockholders. Proponents of these bylaws say they deter frivolous and duplicative litigation, and thus save companies money. But these bylaws do far more than deter frivolous litigation; if upheld by courts, they will make it economically irrational for serious investors to pursue even the most meritorious claims.

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1 The author thanks Michael Hanrahan of the firm Prickett Jones & Elliott, P.A., and specifically recommends Mr. Hanrahan's article "The Parade of Horribles Has Begun," (PLI 2014) for a fuller exposition of many of the legal issues discussed herein.

2 *Boilermakers Local 154 Retirement Fund, et. al. v. Chevron Corp., et. al.*, 73 A.3d 934 (Del. Ch. 2013).

3 *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014).

Delaware Chancery Court Denies Motion to Dismiss and Applies Entire Fairness Standard to Transaction with Controlling Stockholder

Matthew A. Goldstein, Esquire

On April 15, 2014, Kessler Topaz successfully defeated a motion to dismiss in an action brought by a stockholder of Erickson Air-Crane, Inc. ("Erickson" or the "Company") that alleged the Company's majority stockholder caused the Company to overpay for the assets of financially troubled Evergreen Helicopters, Inc. ("Evergreen") and its insolvent parent Evergreen International Aviation, Inc. ("EIA") to the detriment of Erickson and its minority stockholders. Erickson's majority stockholder, ZM Funds, held a majority of the $125 million in second lien debt owed by EIA and Evergreen. As part of the transaction, Erickson was in effect paying off debt owed by EIA and Evergreen to ZM Funds and others at face value in order to protect ZM Funds' subordinated debt position in EIA/Evergreen. In declining to dismiss the claims, Vice Chancellor J. Travis Laster held that entire fairness review applies in a case where a controlling stockholder stands on both sides of a transaction. Under this standard, the controlling stockholder has the burden of proving that the transaction was fair to the company's minority stockholders in both its financial terms and the process employed in arriving at the transaction.

In March 2013, Erickson, EIA and Evergreen entered into a Stock Purchase Agreement ("SPA") pursuant to which Erickson purchased the capital stock of Evergreen for $185 million in cash, a $17.5 million Erickson unsecured promissory note and approximately 4 million shares of Erickson preferred stock valued at $47.5 million by attributing a value of $11.85 per share. Concurrently with the SPA, Erickson and EIA entered into a Second Lien Stock Purchase Agreement with ZM Funds and other holders of $125 million of second lien debt owed by EIA and Evergreen, pursuant to which 3,375,527 shares of the preferred stock

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KTMC Still Slugging at Billionaire Harold Hamm Despite Legislative "Home-Towning"

Leah Heifetz, Esquire and Lee Rudy, Esquire

Kessler Topaz Meltzer & Check, LLP will continue to pursue contentious shareholder litigation in Oklahoma state court, despite the defendants' legislative efforts to undo the Firm's previous victories in court. The litigation challenges a transaction between Continental Resources, Inc. and Harold Hamm, the company's billionaire founder and majority shareholder, whereby Continental bought petroleum assets from Mr. Hamm for $340 million. Plaintiffs Laborers District Council Construction Industry Pension Fund and Winston O. Watkins allege that Hamm caused the company to overpay for these assets.

The assets purchased by Continental in the disputed deal were originally part of Continental's interest in the Bakken shale formation in Montana and North Dakota. Hamm and another Continental officer, Jeffrey Hume, purchased these assets in 2002, by entering into a "participation agreement" under which they paid Continental for a share of the expenditures chargeable to the assets. However, the development of the Wheatland assets cost much more than they generated in revenues, and Hamm and Hume decided to sell them back to Continental. They first expressed an interest in the sale in November 2010, but Continental's board of directors officially sat on the proposal for a year (while engaging in informal negotiations that allowed Hamm and Hume to lay the groundwork for an extremely favorable transaction). The delay allowed board member Mark Monroe, Continental's former COO, to serve as chairman of the committee of "indepen-

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New York Attorney General Shines a Light on Dark Pools

Andrew N. Dodemaide, Esquire

Dark pools are trading venues where securities trades are executed anonymously outside national exchanges. Dark pools have grown in popularity in recent years, particularly among institutional investors, as a way to trade large blocks of shares without alerting the market or revealing trading strategies. There are at least 40 dark pools operating within the United States, and some of the largest dark pools are operated by notable Wall Street banks, including Barclays, Morgan Stanley, Goldman Sachs, and J.P. Morgan. Despite the increased popularity of dark pools, recent events have confirmed that dark pool participants must be careful to protect themselves against aggressive trading practices that have become increasingly common in these venues.

Recently, regulators have subjected several major dark pools (and their operators) to fines and lawsuits. For example, on July 1, 2014 the Financial Industry Regulatory Authority ("FINRA") fined Goldman Sachs $800,000 and ordered it to return $1.67 million to harmed customers because it executed customer trades in its SIGMA-X dark pool at prices inferior to the best bids on the market at the time. Another dark pool, Liquidnet Inc., recently paid a $2 million penalty to the Securities and Exchange Commission ("SEC") for allegedly improperly sharing information about its customers with outside parties in order to expand its business operations. Finally, on June 25, 2014 the New York State Attorney General, Eric Schneiderman, filed a lawsuit against Barclays PLC and its United States affiliate Barclays Capital, Inc. (collectively, "Barclays") alleging that Barclays operated its dark pool, Barclays LX, through "fraud and deceit" by hiding the level of predatory trading conducted in the dark pool by high-frequency trading ("HFT") firms who use complex computer algorithms and fast electronic connections to impose an artificial fee on legitimate trades. Although HFT strategies vary, HFT firms generally extract these "fees" by front-running purchasers of stock and selling the stock to those purchasers at slightly higher prices. This generates pennies or fractions of a penny in profit for the HFT firm per trade, but is repeated at a high frequency.

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Recent Developments in Australian Class Actions

Emily N. Christiansen, Esquire

Australia considering adoption of a common fund for open-class class actions

New changes may be coming to the operation of class actions in Australia. Australia's class action regime is technically an opt-out system but in practice the system more frequently operates as an opt-in system. An opt-out system is that in which all individuals and institutions will be bound by the outcome of a pending case unless they take action to remove themselves from the action and it is perhaps the best known type of system because it is utilized in both the United States and Canada. Conversely, an opt-in system is that in which interested claimants need to take action and register at the beginning of a case in order to participate in any judgment or settlement.

The reason for the discrepancy between the principle and the practice of Australia's class actions is the fact that Australian attorneys are prohibited from representing clients on a contingency fee basis and so most class actions require third party funding in order to proceed. In order to allow third party funders to collect a portion of the settlement or judgment in exchange for their bearing the risk of the litigation and covering all of the attorney fees and other costs associated with the litigation, classes are usually defined in such a way that limits participants to those individuals or institutions that have signed a litigation funding agreement by a particular deadline. Without a funding agreement in place, third party funders would not be able to recoup their investment and would likely be uninterested in funding litigation. The result is that the representative plaintiff would be responsible for bearing all the risk and paying all costs and fees.

The discrepancy between the principle and the practice of Australia's class action system may be about to change. Australian courts are currently considering a petition that, if approved, would allow for the creation of a common fund and would allow litigation funders to directly claim a part of any settlement or judgment. The petition was filed on behalf of Canada's International Litigation Funding Partners in conjunction with the recently announced securities fraud litigation being pursued by Australian

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Proposed Topics for Discussion:

- What key governance practices and policies should plans prioritize?
- Due diligence considerations and "Do's and Don'ts" of directly investing in foreign markets
- What due diligence should pension plans conduct when monitoring their investment managers' activities?
- Increased SEC scrutiny of private equity firms and ensuing potential for litigation
- Increasing constraints: US Chamber of Commerce petition to limit shareholder proposals, outcomes of Halliburton and IndyMac Supreme Court Decisions on investors' ability to file suits
- What do fiduciaries need to know and prioritize when it comes to continued domestic regulation?
- Prominent securities litigation cases of the past 12 months influencing fiduciary decision-making
- Maximizing available resources to manage and mitigate potential risks (ie: technical, fraud, enterprise management)

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Halliburton: Supreme Court Issues Landmark Ruling Reaffirming the Applicability of Fraud-on-the-Market Doctrine

(continued from page 1)

In *Basic*, the Supreme Court created a rebuttable presumption that investors rely on all material information (including a company's statements and misstatements) when purchasing shares of stock traded in an efficient market. This rebuttable presumption, which is known as the "fraud-on-the-market" doctrine, is premised on the theory that stock traded on an efficient market incorporates all material information into its price. The fraud-on-the-market doctrine is a necessary feature of securities class actions under Section 10(b). The doctrine allows plaintiffs to establish the requisite reliance element of a securities fraud claim without showing that they personally reviewed the alleged misrepresentations when making investment decisions. The presumption of reliance therefore eliminates individualized questions of reliance that would prevent class certification.

In the underlying action in *Halliburton*, Halliburton Co. opposed class certification by attempting to rebut the fraud-on-the-market presumption of reliance through evidence that the alleged misstatements at issue in that case had no impact on the price of the company's stock. The district court, however, declined to consider this evidence, and found that the requirements for class certification under the Federal Rules of Civil Procedure — including the requirement that common issues predominate over individualized questions — had been satisfied. The Fifth Circuit affirmed the district court's decision, finding that it was premature at the class certification stage to consider evidence offered to show that the price of the company's stock was not affected by the alleged misstatements. Halliburton appealed that decision to the Supreme Court.

Halliburton's petition to the Supreme Court presented the Court with the question of whether it should "overrule or substantially modify the holding of *Basic*, to the extent that it recognizes a presumption of classwide reliance derived from the fraud-on-the-market theory." Halliburton urged the Supreme Court to overturn or substantially revise *Basic* because, as Halliburton asserted, the theory on which the fraud-on-the-market presumption rests (the efficient market hypothesis) had been "roundly rejected" by economists and had proven difficult for courts to apply. Halliburton argued in the alternative that defendants should be permitted to demonstrate at the class certification stage that the alleged misrepresentations did not have an impact on the price of the company's stock, and thus, were not incorporated in such a way that investors could be presumed to have relied upon the misleading information (thereby defeating class certification).

Plaintiffs' response argued that *Basic* is a seminal decision that has been reaffirmed by [the Supreme] Court and repeatedly endorsed by Congress," and that the economic theory that underpins *Basic* remains sound. Not surprisingly, the United States Chamber of Commerce and other corporate-defense-oriented entities submitted *amicus curiae* (or "friend of the court") briefs in support of Halliburton's argument that the Court should overturn *Basic*. Several institutional investors conversely submitted *amicus* briefs arguing that *Basic* should not be overturned.

The Supreme Court issued its ruling in *Halliburton* on June 23, 2014, holding that the *Basic* presumption of reliance should remain intact.[1] Central to the Court's holding was the determination that Halliburton had failed to provide any "special justification" for overruling *Basic*'s "long-settled" precedent. The Court observed that the debate among economists over the efficient market hypothesis was already ongoing at the time *Basic* was decided, but that "[e]ven the foremost critics of the efficient-capital-markets hypothesis acknowledge that public information generally affects stock prices." Moreover, the Court explained that the *Basic* presumption of reliance was based on the "fairly modest" premise that "market professionals generally consider most publicly announced material statements." Thus, although the Court recognized the criticism that the efficient market hypothesis had garnered since *Basic*, there had been no "fundamental shift in economic theory that could justify overruling a precedent on the ground that it misunderstood, or has since been overtaken by, economic realities."

Nevertheless, the Court revised certification procedures in *Halliburton*, holding that defendants should be permitted at the class certification stage to rebut the presumption of reliance using evidence that the misrepresentation at issue did not affect the stock price. While this result provides defendants with an opportunity to undermine investors'

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[1] While all nine Justices concurred in the judgment of the Court reversing class certification, Justices Thomas, Scalia, and Alito issued a separate concurring opinion arguing that *Basic* was wrongly decided and should be overruled.

KTMC Still Slugging at Billionaire Harold Hamm Despite Legislative "Home-Towning"

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dent" directors who would "negotiate" with Hamm and Hume, because he would then be three years' removed from his management position at the Company and thus purportedly "independent" under NYSE rules. As chairman of the committee, Monroe negotiated the transaction on behalf of Continental on his own directly with Hume, agreeing to a price of $340 million to be paid in Continental common stock, even though Continental's own financial advisor valued the assets between $167 and $255 million. This was an unfair price reached through an unfair process that benefited Hamm and Hume at the expense of Continental's minority shareholders. Accordingly, plaintiffs brought class action and derivative claims alleging that Continental's directors breached their fiduciary duties to the minority shareholders and to the company.

Defendants moved to dismiss the litigation, contending that Plaintiffs needed to have made a pre-suit "demand" on the board before bringing derivative claims on behalf of Continental. KTMC convinced the state court that because Hamm, as Continental's majority shareholder, stood on both sides of the deal, the Court had to review the transaction under Oklahoma's strict "intrinsic fairness" standard, which places the burden of proving the deal's fairness on the controller. Defendants' motion to dismiss was thus denied. Nearly a year later, after the Delaware Chancery Court issued its defendant-friendly MFW decision,[1] Defendants renewed their motions to dismiss, which were again denied. Defendants then begrudgingly began producing nonpublic discovery materials.

Apparently unhappy with their efforts to get the litigation dismissed in court, defendants, along with several other large Oklahoma companies, turned their sights on the Oklahoma legislature. Acting with these other companies and their paid lobbyists, defendants proposed a modification to Oklahoma's civil procedure rules to require that a "non-prevailing party" in a derivative action pay the "prevailing" party's attorneys' fees. The legislature passed this amendment, and it was signed into law by Governor Mary Fallon on May 23, 2014.

While the words "prevailing party" appear to apply equally to both shareholder-plaintiffs and corporate defendants, the statute was hardly neutral. Oklahoma law already entitled successful derivative plaintiffs to recover their attorneys' fees, so the amendments' real purpose and effect is to give corporate defendants the right to recover attorneys' fees from shareholders. Since corporate defendants are indemnified by their companies and covered by directors' and officers' insurance, this law puts shareholder-plaintiffs, who are actually suing only on behalf of the company and not in their own names, in the position of being the only parties in a derivative case with exposure to personal liability. While the Delaware Supreme Court recently ruled that non-stock corporations may adopt such fee shifting provisions in their bylaws,[2] these amendments legislatively apply a "loser pays" rule to all Oklahoma corporations, drastically affecting the rights of shareholders of corporations in the state. The Continental defendants' purpose in passing the amendments, of course, was to pressure the plaintiffs into withdrawing their derivative claims challenging the Wheatland action, and to insulate themselves from shareholder derivative litigation in the future by effectively eliminating all future derivative litigation in Oklahoma.

KTMC promptly sought judicial review of the new statute by filing a separate "declaratory judgment" action. This new action sought a ruling that the new Oklahoma statute was unconstitutional, and that it should not be retroactively applied to Plaintiffs' ongoing litigation. Specifically, Plaintiffs asked the court to hold that in a derivative action, a shareholder "prevails" when it defeats a motion to dismiss, and thus stands in the shoes of the company. A shareholder-plaintiff in a derivative action only seeks to benefit the company (not itself) by pursuing such an action. It thus makes little sense, and advances no legitimate public policy, for such a shareholder to bear the risk of paying millions in defendants' fees if the company, which it seeks to benefit, loses at trial. Defendants moved to dismiss the declaratory judgment action, arguing that because Plaintiffs might never be liable for defendants' fees, that the action was unripe. On August 22, 2014, the Oklahoma state judge assigned to the declaratory judgment action agreed, and dismissed the lawsuit.

Unfortunately, Plaintiffs now face the choice of continuing with what we believe to be meritorious derivative litigation, but risking the possibility of paying millions in fees if we are deemed not to have "prevailed," or walking away from these claims. For this reason, fee-shifting in representative litigation will dissuade any rational shareholder from participating in such an action, and KTMC cannot in good faith recommend that any shareholder assume such a risk of liability. Luckily, in drafting the Continental complaint, KTMC included a class claim along with our main derivative claims. The new Oklahoma statute does not shift fees in class actions, so KTMC is likely going to move forward with this single class claim, while abandoning meritorious derivative claims that stood to benefit the company and all of its minority shareholders. We eagerly await the next chapter in this hard-fought litigation.

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[1] *In re MFW S'holders Litig.*, 67 A.3d 496 (Del. Ch. 2013).

[2] *ATP Tour v. Deutscher Tennis Bund,* 91 A.3d 554 (Del. 2014).

Recent Developments in Australian Class Actions *(continued from page 3)*

law firm Maurice Blackburn against Allco Finance Group. If the petition is successful, the result would be both that Canada's International Litigation Funding Partners would be allowed to recover up to 35% of any settlement or judgment and that a precedent would be set for future class actions to proceed as open-class class actions. There would no longer be a requirement for claimants to register in advance and sign a third party funding agreement in order to potentially recover from any loss. Instead, claimants would automatically be included as part of any class unless they removed themselves, or opted-out, by a stated deadline. A common fund would be created out of any settlement or judgment and the litigation funder could claim a portion of the proceeds before the proceeds are distributed amongst the claimants.

Many commentators believe that allowing for a common fund would be a positive development for both claimants and defendants alike. A common fund would improve access to justice, increase class size, and leave defendants with greater certainty that they were resolving all particular claims that could arise against them from a particular factual incident. A hearing was held in Australia on August 22, 2014, but no decision in the matter has yet been issued.

Australia Imposes Limits on For-Profit Class Actions

Another major development to the Australian class action system concerns the Australian Federal Court's imposition of new restrictions on certain litigation funders and for-profit class actions. Australia is now vying with Canada to be the second most active securities litigation market. With the increase in securities litigation, there has been an increase in third party litigation funders entering the market and Australia is now faced with growing concerns over potential abuse and potential conflicts of interest.

Perhaps the most egregious example of abuse of the class action process concerns lawsuits filed by Melbourne City Investments Pty Ltd ("MCI"). Between October and December of 2013, MCI, acting as the representative party, filed lawsuits through its lawyer, Mr. Elliott, against Leighton Holdings Ltd, Treasury Wine Estates Ltd, and Worley Parsons Ltd.[1] In addition to serving as the attorney for MCI, Mr. Elliott was the sole director and shareholder of MCI and he purchased a small number of shares in Leighton Holdings, Treasury Wines, and Worley Parsons on the same day that MCI was incorporated.

Treasury Wines and Leighton both filed motions against MCI seeking to have the litigation stayed or to have Mr. Elliott removed as counsel for the class. Both Treasury and Leighton contended that the legal actions were brought against the companies for the sole purpose of generating legal fees for Mr. Elliott and not to benefit a class of shareholders. The Court agreed, finding that it was probable that the proceeding was brought for the sole purpose of generating legal fees for Mr. Elliott and it ordered that Mr. Elliott could not serve as counsel for the class. In reaching its conclusion, the Court noted that, "the [hypothetical fair-minded independent observer] would consider Mr. Elliott is compromised in his role as a solicitor] such that there would be a real risk that he could not give detached, independent and impartial advice taking into account not only the interests of MCI (and its potential exposure to an adverse costs order), but also the interests of group members." Despite holding that Mr. Elliott could not continue as class counsel, the court declined to stay or dismiss the proceedings against either Leighton Holdings or Treasury Wines because there was otherwise nothing irregular about the proceedings.

Worley Parsons actually sought to have the case MCI filed against it dismissed, not on the basis of a conflict, but on the basis that MCI lacked standing. Worley Parsons argued that MCI lacked standing because MCI's purchase of shares in Worley Parsons pre-dated any of the alleged fraudulent and misleading activity that led to its filing the lawsuit and seeking to represent a class of shareholders. The Court ultimately agreed that MCI was not a member of the group of shareholders that it sought to represent and it dismissed the case. These cases against MCI demonstrate Australia's commitment to preventing disreputable litigation funders and attorneys from filing class actions that are not for the benefit of the shareholders.

Kessler Topaz will continue to monitor these events in Australia along with all developments associated with class action and securities fraud litigation in non-U.S. jurisdictions.

[1] Note: Kessler Topaz notified its affected clients about pending actions against these three companies. The pending litigation that Kessler Topaz alerted clients to were cases that were filed by other firms and not the cases filed by MCI.

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The 10th Annual Rights & Responsibilities of Institutional Investors will again be held in Amsterdam and co-sponsored by Institutional Investor and Kessler Topaz Meltzer & Check LLP. Many of the most pressing issues for investors and shareholders covered in this agenda will consider the ways that these investment, legal and compliance officers from European public pension, insurance fund and mutual fund companies are paving a path forward—together— to meet larger, long term ESG and governance goals.

Through panels, workshops and case studies, participants will engage with industry peers and thought leaders on the question of collaborative action and collective engagement, including such topics as

- Where are there opportunities for cross-national collaboration to influence regulatory processes?
- Assessing European Commission regulatory proposals and near-term impact for engaged investors
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- Examining board diversity and the growing influence of investment committees
- How prominent securities litigation cases of the past 12 months have influenced fiduciary decision-making
- Formalizing policies to stimulate investing in renewable energies
- To what extent can and should fiduciary duty play a role in ESG?

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New York Attorney General Shines a Light on Dark Pools *(continued from page 3)*

Using evidence from whistleblower testimony, internal emails, and Barclays' marketing materials, the Attorney General's complaint (the "Complaint") alleges that Barclays sought to make its dark pool the largest by trading volume "through a series of false statements." According to the Complaint, Barclays touted its dark pool to investors as a safe haven against predatory HFT firms, while allowing predatory HFT firms access to its dark pool and its clients' trades. As set forth in more detail below, the Complaint alleges that Barclays' marketing materials misrepresented: (1) the extent of HFT and the amount of aggressive HFT activity in its dark pool; (2) the lack of protection actually offered by its "Liquidity Profiling" service against HFT tactics; (3) the manner in which it routed its client orders to favor Barclay's trading venues; and (4) the fact that Barclays catered its dark pool to HFT firms.

1. Type and Extent of HFT Activity

In its marketing materials, Barclays often included graphic charts analyzing the "liquidity landscape" of its dark pool. These charts, which represented each firm trading in the dark pool as a circle on a scale roughly corresponding to the aggressiveness of that firm's trading, purportedly showed that the dark pool was a safe trading venue with few HFT firms and very little aggressive trading. In fact, internal emails revealed that Barclays had intentionally "de-emphasized the number of [high frequency traders]" in the charts by obscuring certain HFT firms behind other HFT firms on the scale. Emails also revealed that Barclays completely removed one aggressive HFT firm from a chart, thereby skewing the representation of risk to investors.

2. Barclays' "Liquidity Profiling" Service

Barclays created its "Liquidity Profiling" service purportedly to insulate investors from predatory trading by quickly responding with corrective actions when it detected adverse behavior. It claimed that its Liquidity Profiling service has the ability to analyze "each interaction in the dark pool" so that Barclays could "restrict HFTs interacting with our clients." According to the Complaint, however, the Liquidity Profiling service "offers little or no benefit to Barclays' clients." In fact, the Attorney General's investigation revealed that Barclays: (1) never prohibited a single HFT firm from participating in its dark pool no matter how toxic or predatory its activity was deemed to be; (2) did not regularly update the ratings of traders monitored by the Liquidity Profiling service, meaning traders were often categorized in ways that did not reflect their aggressive trading activity in Barclays' dark pool; (3) applied "overrides" to a number of traders in the dark pool, assigning safe Liquidity Profiling ratings to certain traders that should have been rated as toxic; and (4) did not apply its Liquidity Profiling service to a significant portion of the trading activity in its dark pool.

3. Barclays' Routing Practice

Barclays' marketing materials claimed that it routed client orders in a manner that did not favor any particular trading venue. The Attorney General's investigation found, however, that almost all client orders were routed to Barclays' dark pool first, regardless of the probability that a given trade would execute there, would execute at a favorable price, or would cause information leakage.[1] Barclays admitted as much in emails to a select group of HFT firms in March 2014, telling them that approximately 90% of all orders "are first directed into the dark pool."

4. Barclays Catered to HFT Firms

According to the Attorney General's Complaint, while Barclays represented to clients that it was working to keep them safe from predatory HFT tactics, the bank supplied HFT firms with advantages over traditional investors in its dark pool. Specifically, it allowed HFT firms to connect directly to its servers, it processed orders slowly enough to allow HFT firms an opportunity for latency arbitrage,[2] and it charged high-frequency traders little or nothing to trade. One former senior-level Director stated that, "Barclays was doing deals left and right with high frequency firms to invite them into the pool to be trading partners for the buy side. So the pool is mainly made up of high frequency firms."

In relation to the above allegations, the Attorney General asserts in his Complaint that Barclays committed securities fraud in violation of New York's Martin Act (General Business Law §§ 352 *et seq.*) and persistent fraud and illegality in violation of New York Executive Law § 63(12).

Although dark pools serve as a useful venue for many investors seeking to make legitimate trades, certain dark pools are also frequented by HFT firms who make executing trades more expensive for other investors. As such, investors who wish to execute trades in a dark pool may wish to avoid certain venues so as to protect themselves against these aggressive trading practices.

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[1] Information leakage occurs when an investor's trade order is revealed to other investors, brokers, or HFT firms, thereby defeating the purpose of trading in the dark pool.

[2] Latency arbitrage refers to an HFT firm's ability to take advantage of the fact that certain traders receive market information more quickly than others. Latency arbitrage is an essentially zero-risk trading method.

Bylaw Madness: Boards Writing Their Own Rules for Litigation *(continued from page 1)*

Historically, bylaws have only regulated internal corporate processes, such as director elections. While bylaws were sometimes susceptible to abuse by corporate directors seeking to ward off dissidents or thwart proxy proposals, they were never explicitly used to set the rules for shareholder litigation. That has all changed in the wake of *Boilermakers* and *ATP*. *Boilermakers* upheld the validity of a "forum selection" bylaw, which mandated that shareholder litigation concerning the fiduciary duties of directors of a Delaware corporation be filed in Delaware. While perhaps non-controversial in effect, the *Boilermakers* court's reasoning, which required the shareholder opposing the bylaw to demonstrate that it could never operate lawfully under any scenario, set an impossible standard that shareholders will never be able to meet. *Boilermakers* also extended the permissible use of board-adopted bylaws: by allowing corporate directors to write litigation rules governing *where* they could be sued, *Boilermakers* paved the way for other, more aggressive bylaws governing *how* they could be sued.

ATP followed this spring, surprisingly holding that a board-adopted "fee shifting" bylaw at a non-stock corporation was valid. The Delaware Supreme Court's reasoning would appear to extend to all manner of bylaws, even at public corporations. *ATP* is now being touted by public corporations when they adopt new bylaws setting rules for how and where they can be sued. The clear purpose of these new bylaws is to seek to insulate directors and officers from the legal scrutiny imposed by shareholder actions. New bylaws are being adopted every week, limited only by the aggressiveness and creativity of the corporate bar. In just two months during the summer of 2014, at least eleven public companies adopted bylaws shifting attorneys' fees in shareholder litigation,[4] and another half dozen have been adopted as of this writing. Several of these bylaws were adopted just after disclosure of negative events that the directors would assume might spawn shareholder litigation.[5] One was adopted in the middle of ongoing shareholder litigation, with company counsel explicitly trumpeting the company's adoption of the bylaw as a "sword" to pressure plaintiffs to drop their lawsuit.[6]

The new bylaws being adopted are also not limited to forum selection and fee shifting. One company included a "surety" bylaw allowing the company to require shareholders to post a bond for the company's litigation expenses.[7] Another company, while adopting a fee shifting bylaw that requires a non-prevailing shareholder to pay the company's fees, simultaneously absolved the company from ever owing fees to a successful shareholder plaintiff, even if the litigation led to "the creation of any common fund, or . . . a corporate benefit."[8] More and more aggressive provisions are likely to be included in these anti-litigation bylaws, especially since many of the bylaws have "severability" provisions, which state that even if one provision is struck down, the remaining terms still survive.[9]

Clearly, the slope is getting slippery. If the slide continues, corporate directors will be set free to draft and enforce the rules of representative litigation that is supposed to police directors' own conduct. Advocates for these new bylaws, and for the hurdles they place before shareholder litigants, say they curb meritless litigation that distracts corporate actors from faithfully serving the shareholders.[10] But these bylaws cast such a wide net that they will also foreclose even the most well-meaning stockholders from ever pursuing even the most meritorious claims.

Proponents call these bylaws "fee shifting" or "loser pays" bylaws, but this description ignores the text of the bylaws,[11]

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4 Viper Energy Partners, LP ("Viper") (May 29, 2014); LGL Group (June 11, 2014) ("LGL"); Townsquare Media, LLC ("Townsquare") (June 24, 2014); Echo Therapeutics, Inc. ("Echo") (June 25, 2014); Biolase, Inc. ("Biolase") (June 30, 2014); Westlake Chemical Partners LP ("Westlake") (June 30, 2014); Hemispherx BioPharma, Inc. ("Hemispherx") (July 10, 2014); Antero Resources Midstream LLC ("Antero") (July 11, 2014); Lannett Company, Inc. ("Lannett") (July 17, 2014); American Spectrum Realty, Inc. ("American Spectrum") (July 25, 2014); and Portfolio Recovery Associates, Inc. ("Portfolio Recovery") (July 28, 2014).

5 *See, e.g.*, Echo (adopted following proxy contest by 20% shareholder); Biolase (adopted in connection with dispute with former CEO/Chairman); Lannett (adopted one day after disclosing receipt of interrogatories and subpoena from Connecticut AG related to price fixing investigation); American Spectrum (adopted amidst allegations that CEO engaged in self-dealing and fraud); LGL (adopted following earnings miss, resignation of CEO, termination of Controller); Portfolio Recovery (adopted following negative blog posts and just prior to earnings miss).

6 Liz Hoffman, "Shareholder Suit Involving Loser-Pays Provision Heats Up in Delaware," *The Wall Street Journal* (July 22, 2014) (concerning Hemispherx BioPharma's adoption of a fee shifting bylaw in the middle of litigation).

7 Hemispherx.

8 LGL Group.

9 *See, e.g.*, Viper, LGL, Biolase, Westlake.

10 Avrohom J. Kess & Yafit Cohn, "'Loser Pays' Rules Make a Comeback," *The Wall Street Journal* (Aug. 27, 2014).

11 *Id.*

which are one-sided, only applying to shareholders.[12] Corporations and their directors are not obligated to pay the shareholders' legal fees if they "lose." Moreover, under these bylaws, shareholders are equally liable for the company's legal fees even if they "win," since most of the post-*ATP* bylaws state that the shareholder is liable for fees unless he or she "substantially achieves, in substance and amount, the full remedy sought." In *Southern Peru*,[13] for example, described as one of the largest trial victories ever for shareholders,[14] shareholders sought nearly $2 billion in damages from the company's majority shareholder and independent directors, but recovered ("only") $1.3 billion before interest, and the court dismissed the independent directors from the case. Under most of the fee-shifting bylaws adopted this summer, plaintiff's counsel in *Southern Peru* would have owed defendants for their millions of dollars in fees despite winning one of the largest judgments in corporate law history. Facing such bylaws, even stockholders with substantial shareholdings will find it economically irrational to risk owing millions of dollars in fees in the hopes of recovering their portion of any judgment, no matter how large.

Proponents say that fee shifting bylaws will introduce an element of risk that will cause plaintiffs' lawyers to carefully consider whether to file suit.[15] In making this argument, these commentators demonstrate how totally unfamiliar they are with the real risks that already face plaintiffs' lawyers whose payment is totally contingent on their success. Even without the threat of picking up defendants' fees, for example, the trial lawyers in *Southern Peru* invested approximately $3.5 million in time, plus more than $1.1 million in expenses, which the lawyers were prepared to lose at trial. While commentators freely Monday-morning quarterbacked defendants' decision to take the case to trial after the defendants lost,[16] during the trial it was hardly clear that the plaintiff would prevail. In colloquy with plaintiffs' counsel during the trial, the court described the independent directors as "smart dudes," and told the plaintiff's lawyers directly that he doubted their case had merit.[17]

This article summarizes the *Boilermakers* and *ATP* decisions, as well as the torrent of even more virulent anti-litigation bylaws that are currently being adopted at other companies in the wake of these decisions. While efforts in the Delaware courts and legislature to curb the spread of these bylaws are uncertain and thus far unsuccessful, the best chance to kill off this rapidly growing threat is through direct investor engagement and opposition with the corporations in which we invest.

Background: Delaware Statutory Authority for Board-Enacted Bylaws

A board's authority to pass bylaws derives from the stockholders, who must explicitly consent to delegate this authority to the board.[18] Historically, through a shareholder vote, stockholders delegate to directors the ability to pass bylaws designed to regulate the "internal" conduct of the corporation. For example, bylaws have typically governed when board meetings are held, how officers are elected, and how often committees will meet. *Boilermakers* expanded this traditional use of bylaws by approving an "exclusive forum" bylaw, and *ATP* expanded it even further by allowing a non-stock corporation to shift fees through a bylaw. The questionable reasoning of these decisions is that if bylaws can appropriately regulate internal corporate matters, then bylaws can also appropriately regulate litigation challenging such internal corporate matters. Both decisions also rely on the questionable premise that a bylaw is a "flexible contract" between the shareholders, directors, and company,[19] despite that one party to the contract has the power to unilaterally amend the contract and enforce it against the others.[20]

(continued on page 12)

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[12] Larry Hammermesh, "Consent in Corporate Law," *Widener Law School Legal Studies Research Paper Series no. 14-31*, available at http://ssrn.com/abstract=2488209 ("A real 'loser pays' rule evenhandedly allocates the cost of litigation to the losing party, whether the plaintiff or the defendant.").

[13] *In re Southern Peru Copper Corp. S'holder Deriv. Litig.*, 52 A.3d 761 (Del. Ch. 2011), *aff'd*, 51 A.2d 1213 (Del. 2012). KTMC and their Delaware co-counsel served as lead counsel for plaintiffs in the *Southern Peru* litigation.

[14] Alison Frankel, "$1.3 billion Grupo ruling is Strine v. Goldman, ex-Wachtell partner," *Reuters* (October 17, 2011).

[15] *See* Kess & Cohn, *supra* (fee shifting would "forc[e] plaintiffs attorneys to be more careful about choosing to file a claim").

[16] *See, e.g.*, Steven Davidoff Solomon, "Grupo Mexico Hit With $1.26 Billion Judgment," *The New York Times* (October 17, 2011) ("this huge judgment ultimately appears to be a failure of lawyering by the defendant's lawyers. . . . I suspect the matter could have been settled early on for a few million dollars.").

[17] The trial court referenced its earlier skepticism when awarding attorneys' fees, stating, "[Plaintiff's counsel] advanced a theory of the case that a judge of this court, me, was reluctant to embrace. I denied their motion for summary judgment. . . . I asked a lot of questions at trial because I was still skeptical of the theory."

[18] *8 Del. C. § 109(b)*.

[19] *Boilermakers*, 73 A.3d at 939-40.

[20] Hammermesh, *supra*.

Bylaw Madness: Boards Writing Their Own Rules for Litigation *(continued from page 11)*

Boilermakers

In *Boilermakers*, investors challenged two "exclusive forum selection" bylaws passed by the boards of Chevron Corporation and FedEx Corporation.[21] These bylaws prohibited stockholders of these companies from bringing certain types of litigation in any court other than the Delaware Court of Chancery. Chevron and FedEx justified the exclusive forum selection bylaws by pointing to academic studies finding a substantial increase in "multi-forum" litigation, where multiple stockholders file duplicative suits, mostly challenging M&A transactions, in multiple courts. Chevron and FedEx said the bylaw would prevent this supposed potential drain on corporate resources.[22]

Chevron and FedEx also argued that exclusive forum selection bylaws properly allowed the Delaware courts to opine on important issues of Delaware corporate law.[23] But in defending the bylaws, defendants ended up arguing that shareholders had the right to file suit outside of Delaware, and if defendants wanted to enforce the bylaw they would make a motion in front of that foreign court, which must then apply Delaware law to decide whether to enforce the bylaw and dismiss the case. Defendants, meanwhile, would get a free option to decide whether or not they prefer the foreign court or the Delaware Court of Chancery. For example, defendants might not enforce an exclusive forum bylaw against a stockholder who filed suit outside of Delaware if the defendants felt they had a sympathetic judge.[24] Or they might choose to litigate outside of Delaware if by doing so they could choose a weaker adversary than a stockholder who had complied with the bylaw and filed suit in Delaware. Thus, the end result of *Boilermakers*' approval of exclusive forum bylaws is that shareholders are still free to file outside of Delaware, defendants have a unilateral right to decide whether those cases can proceed, and non-Delaware courts will be the exclusive arbiters of whether Delaware law compels application of the bylaw.

Instead of letting plaintiffs take discovery and challenge the Chevron and FedEx boards' process in adopting these bylaws, the *Boilermakers* court allowed defendants to move for "judgment on the pleadings," which generally requires the moving party (defendants) to demonstrate that under no set of facts would plaintiffs be able to prevail. Prior Delaware cases determining the validity of bylaws had struck down bylaws unless they were was valid in "any possible circumstance."[25] Specifically, in *CA*, the Delaware Supreme Court held that a stockholder-proposed bylaw was invalid because: "Under at least one such hypothetical, the board of directors would breach their fiduciary duties if they complied with the Bylaw."[26] Plaintiffs in *Boilermakers* assumed that this rule would apply equally to bylaws proposed by a corporation. Thus in opposing Defendants' motion for judgment on the pleadings, Plaintiffs provided several scenarios under which enforcement of the Chevron and FedEx bylaws would have been inequitable.

Whereas the *CA* court, in rejecting a stockholder-proposed bylaw, had only required the board to come up with "hypothetical" scenarios under which the bylaw would be improperly enforced, the *Boilermakers* court flipped that standard on its head. *Boilermakers* relied heavily upon the "presumption that bylaws are valid."[27] The court held that plaintiffs (not the board) had "the stringent task of showing that the bylaws cannot operate validly in any conceivable circumstance" and "are invalid in all circumstances."[28] The court dismissively referred to plaintiffs' examples of how the bylaw might operate inequitably as a "parade of horribles,"[29] and dismissed plaintiffs' attempt to "conjur[e] up imagined future situations where the bylaws might operate unreasonably."[30]

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[21] KTMC and its co-counsel in Delaware served as lead counsel in *Boilermakers*.

[22] *Boilermakers*, 73 A.3d at 943-44.

[23] Interestingly, however, in *City of Providence v. First Citizens Bancshares*, 2014 Del. Ch. LEXIS 168 (Del. Ch. Sept. 8, 2014), the court recently upheld a bylaw of a Delaware corporation that designated North Carolina as the exclusive forum for litigation.

[24] For example, directors of Galena Biopharma, Inc., who currently face derivative litigation in Oregon and Delaware, first moved to dismiss the Oregon litigation in favor of the Delaware suits under their forum selection bylaw. But when the Oregon court requested supplemental briefing on this topic (and defendants perhaps believed that they would lose), the defendants reversed course, and moved to stay the Delaware litigation in favor of the Oregon securities suits.

[25] *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 238 (Del. 2008).

[26] *Id.*

[27] *Id.* at 940.

[28] *Id.* at 940, 941.

[29] *Id.* at 958.

[30] *Id.* at 940. For example, plaintiffs pointed out that the FedEx bylaw would make it impossible to sue most corporate officers, because the Delaware Court of Chancery would not have personal jurisdiction over them. The court found that the bylaw was still valid because the plaintiff could still sue directors and senior officers, which was sufficient in the "bulk of typical internal affairs cases." *Id.* at 960.

Boilermakers thus green-lighted corporate boards' aggressive anti-litigation bylaws, since these bylaws would be reviewed so liberally that shareholders would likely never be able to invalidate them. Specifically, while under *CA*, bylaws proposed or adopted by stockholders are invalid if there is any possible circumstance where they would be inconsistent with the law,[31] under *Boilermakers*, board-adopted bylaws are valid unless they would always be inconsistent with law.[32]

ATP

ATP, the Association of Tennis Professionals, is a non-stock corporation whose members are tennis players and tournament operators, each with representatives on the board, and all of whom depend on the ATP for their livelihood. ATP adopted a "fee-shifting" bylaw, which requires a non-prevailing party to reimburse the prevailing party for its legal fees.[33]

The ATP Bylaw applies to any member or prior member or anyone acting on their behalf who (i) initiates or asserts any claim or counterclaim against the corporation or any member or (ii) even offers substantial assistance or has a financial interest in such a claim.[34] The bylaw's criteria for fee-shifting is that the claimant "does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought."[35] The potential liability is for "all fees, costs and expenses of every kind."[36]

In upholding the "facial validity" of the *ATP* Bylaw, the Delaware Supreme Court gave extremely broad deference to board-adopted bylaws. Like in *Boilermakers*, *ATP* interpreted the requirement that a bylaw not "conflict with law" to mean that the bylaw is valid unless it conflicts with law in all circumstances. *ATP* held that "[a] bylaw that allocates risk among parties in intra-corporate litigation" satisfies the requirement that bylaws regulate the internal affairs of the corporation.[37] Whereas *Boilermakers* explained that forum selection bylaws merely "regulate *where* stockholders may file suit, not *whether* the stockholder may file suit or the kind of remedy that the stockholder may obtain,"[38] the *ATP* court approved a fee-shifting bylaw even though it would clearly foreclose litigation. In fact, *ATP* also held that the corporation's "intent to deter litigation" was not "invariably an improper purpose."[39]

Advocates for fee shifting claim that these bylaws will effectively weed out frivolous cases by discouraging them from ever being brought.[40] But even some well-known corporate law firms concede that fee-shifting bylaws will likely deter meritorious cases as well.[41]

Even if a shareholder is willing to file a case and risk paying millions in fees if she loses, that shareholder will face enormous pressure to settle the case quickly, since defendants' fees generally climb exponentially the closer a case gets to trial. Ironically, however, these bylaws might actually make it impossible to settle, since court rules prohibit representative plaintiffs from "receiv[ing] . . . any form of compensation, directly or indirectly, for prosecuting or serving as a representative party. . . ."[42] A settlement term absolving a shareholder of liability under a fee-shifting bylaw would create a conflict of interest that would likely disqualify the plaintiff from serving as a class representative.[43]

After ATP, Creative Boards Flex Their Muscles with Even More Aggressive Bylaws

Following the *ATP* decision, fee-shifting bylaws are now being touted as "The Next Bylaw" for use in the directors' "Delaware Defensive Arsenal" against stockholders,[44] mak-

(continued on page 14)

[31] *CA*, 953 A.2d at 238.

[32] *Boilermakers*, 73 A.3d at 940-41.

[33] Although unclear from the text of the *ATP* decision, the parties represented to the Court in their briefs and at oral argument that the bylaw was reciprocal, applying to both ATP and its members alike. The bylaws being adopted by public companies after *ATP*, by contrast, are unilateral.

[34] *Id.*

[35] *ATP*, 91 A.3d at 556.

[36] *Id.*

[37] *Id.* (quoting 8 *Del. C.* § 109(b)).

[38] *Boilermakers*, 73 A.3d at 951-52 (emphasis in original).

[39] *ATP*, 91 A.3d at 560.

[40] *See, e.g.*, Kess & Cohn, *supra*.

[41] Skadden, Arps, Slate, Meagher & Flom LLP, "Fee-Shifting Bylaws: The Delaware Supreme Court Decision in *ATP Tour*, Its Aftermath and the Potential Delaware Legislative Response The Decision" (May 22, 2014) ("[T]here is the risk that adoption of fee-shifting bylaws could significantly deter, or eliminate, even meritorious claims.").

[42] *See* Del. Ch. Ct. R. 23, 23.1.

[43] *N.J. Carpenters Pension Fund v. infoGROUP, Inc.*, 2013 Del. Ch. LEXIS 43, *16 n. 42 (Del. Ch. 2013) ("The Courts generally accord the greatest weight to the presence or absence of conflicts of interest or economic antagonism when evaluating a lead plaintiff's adequacy.").

[44] Schiff Hardin LLP, "Fee-Shifting: The Next Bylaw in the Delaware Defensive Arsenal?" (May 15, 2014).

Bylaw Madness: Boards Writing Their Own Rules for Litigation *(continued from page 13)*

ing clear that these bylaws are weapons of war to be used against the stockholder enemy.[45]

The defense community understands that *Boilermakers* and *ATP* grant boards of directors "significant legal latitude to specify the rules of the game for intra-corporate litigation."[46] Delaware stock corporations are now rapidly adopting one-way fee-shifting bylaws that essentially copy the ATP Bylaw or raise the stakes on stockholder litigation even further.[47] As of this writing, for example, corporations have adopted bylaws that not only shift fees to shareholders, but bylaws that (i) preclude stockholders from recovery of their litigation costs even if the litigation is successful and produces a common fund or common benefit; [48] (ii) require shareholders to post a bond to cover defendants' fees while litigation continues;[49] (iii) apply retroactively to ongoing litigation in both state and federal court.[50] The rationale for upholding forum selection bylaws has also been used to justify bylaws making arbitration the exclusive forum for stockholder claims.[51]

By allowing corporate directors to use bylaws to change the rules governing stockholder suits, the Delaware courts have given one side to corporate litigation the power to create its own tactical advantages over the other side. While *courts* have historically determined the procedures for litigation concerning disputes between shareholders and their corporate fiduciaries, under these recent decisions, now *directors* have been empowered to write their own litigation rules.

Even if certain portions of these bylaw packages might ultimately be invalidated in court, however, defendants clearly see little downside in adopting them. Under *Boilermakers*, a laundry list of bylaws proscribing the rules for stockholder litigation will be upheld unless the bylaws would conflict with law in all circumstances. Under this rationale, defendants figure, why not take a shot? At worst, these ever-more aggressive bylaws will at least scare off a certain proportion of stockholder claims, and at best, they will be upheld as within the corporation's valid business judgment.

What Can Be Done?

Investors cannot stand by and watch as corporate boards continue to adopt bylaws that restrict stockholders' rights to challenge their conduct. After *Boilermakers* and *ATP*, corporations appear to believe that their directors have virtually unfettered authority to draft bylaws changing the rules of litigation and insulating their conduct from judicial review. Investors' only options to address this rapidly-evolving crisis are (1) the Delaware courts, (2) the Delaware legislature, (3) the SEC and/or U.S. Congress, and (4) concerted investor action. Of these options, the last has the greatest likelihood of success.

Delaware Courts

As described above, the Delaware courts have already stated that they will grant tremendous judicial deference to corporate bylaws. The standards of *Boilermakers* and *ATP* are impossible to meet. The only chance for success in the Delaware courts is if the Delaware Supreme Court decides, in light of the uproar created by its *ATP* decision, to limit *ATP* to non-stock corporations. Even if it does so, however, the judicial principle of *Boilermakers*, that corporate boards can write litigation rules, will likely survive, and creative boards will continue to adopt additional bylaws restricting stockholders' rights.

That said, at least one shareholder challenge to a board-adopted fee-shifting bylaw is under consideration by the Delaware Court of Chancery. In June 2014, the board of Hemispherx adopted a fee-shifting bylaw that also (i) required shareholders to post a bond, and (ii) applied retroactively to plaintiffs' pending litigation challenging certain bonuses paid to Hemispherx officers. Plaintiffs sought a ruling that the bylaw is invalid, noting among other things that the *ATP* decision did not allow retroactive application of a fee-shifting bylaw to ongoing derivative litigation. This motion to invalidate the Hemispherx bylaw is currently being briefed and will likely be argued in the fall of 2014.[52]

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[45] Liz Hoffman, "Shareholder Suit Involving Loser-Pays Provision Heats Up in Delaware," *The Wall Street Journal* (July 22, 2014) (Hemispherx's counsel proclaiming it can use fee shifting bylaw "as a sword" to defend against litigation it deems meritless).

[46] Wilson, Sonsini, Goodrich & Rosati, "Delaware Supreme Court Endorses 'Fee-Shifting' Bylaw in Certified Questions of Law," (May 12, 2014).

[47] *E.g.*, June 25, 2014 8-K filed by Echo Therapeutics, Inc., Ex. 3.2 Amended and Restated Bylaws Section 5.13.

[48] LGL.

[49] Hemispherx.

[50] Hemispherx.

[51] *Katz v. Commonwealth REIT*, Case No. 24-C. 13-001299 (Md. Cir. Ct. Feb. 19, 2014); *Delaware County Emps. Ret. Fund v. Portnoy*, 2014 WL 1271528 (D. Mass. Mar. 26, 2014).

[52] KTMC and its Delaware co-counsel are lead counsel for plaintiffs in the *Hemispherx* litigation, captioned *Kastis v. Carter*, C.A. No. 8657-CB (Del. Ch.).

Delaware Legislature

While the defense community has gone to great pains to describe *ATP*'s opponents as the "plaintiffs' bar,"[53] in fact the vast majority of the Delaware corporate bar (including defense lawyers) understand that *ATP* poses a grave threat not only to stockholder access to justice, but to the entire corporate form. Defense lawyers observed that corporations are intended to be limited-liability investments for stockholders, where the extent of their liability is the value of their shares.[54] *ATP* upended this bedrock corporate principle by imposing liability on stockholders through board-adopted bylaws. Within weeks of ATP, legislation was drafted by the Delaware Corporation Law Council, which is primarily composed of transactional lawyers and litigators who represent corporations, to limit the applicability of *ATP* to non-stock corporations. The proposed legislation was approved by the Executive Committee of the Delaware State Bar Association and introduced into the Delaware State Senate.

After a lobbying effort that included former Chief Justice Myron T. Steele and former Chancellor William B. Chandler III, each now working for corporate defense firms, the Delaware Legislature declined to proceed with the legislation. Instead, the Legislature passed a resolution calling upon the Delaware corporate bar to study the situation further and perhaps propose the legislation in January 2015. A full-court lobbying effort by numerous corporate interests is now underway to stymie this legislative fix when the Delaware legislature reconvenes.

SEC/Congress

Some observers wonder whether the Chamber and its allies have so overplayed their hand with the newest raft of bylaws that the SEC and/or Congress will take action to protect American investors. The SEC's opposition to mandatory stockholder arbitration suggests the SEC might take some interest in this fight. However, as anyone who reads a newspaper knows, these days the U.S. Congress is where good ideas go to die.

Stockholder Action

While numerous law firms are advising corporate clients to put in exclusive forum bylaws and seriously consider fee-shifting bylaws, that advice usually comes with the caution that corporate boards should consider the potential reaction of institutional stockholders, stockholder representation organizations and stockholder advisory firms.[55] Corporate boards and their advisors will be attempting to gauge what types of litigation bylaws, if any, stockholders will let them get away with. There has been some opposition to exclusive forum bylaws from activist stockholders, trade union groups and the Council of Institutional Investors. For example, ISS recently recommended that shareholders withhold votes for the independent directors of Biolase after the company adopted a fee shifting bylaw. ISS wrote:

> It may be the case that a responsible board should seek to limit a company's exposure to meritless lawsuits which drain shareholder resources. A responsible board, however, would also seek to mitigate the offsetting risk that any such action will then chill potentially meritorious lawsuits. Any successful bylaw adopted by a responsible board to address this topic would require not only careful crafting but ratification by a majority of a company's shareholders. . . .
>
> Letting the court rather than this particular bylaw may not be the most cost-efficient process for sorting out the truth in any litigation — but it is a much more robust way to balance all the interests of the company's shareholders, which is the more significant and enduring governance objective.

While both legislation and litigation seeking to curb the spread of litigation-related bylaws play out over the next several months, investor reaction to this new trend must be fierce and concerted. Boards who adopt bylaws that limit investors' ability to challenge board misconduct should be told that they will be thrown out and publicly shamed.

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[53] *See* Kess & Cohn, *supra* ("plaintiffs attorneys hijacked the moral high ground").

[54] *See* Hammermesh, *supra* ("Indeed, [fee shifting bylaws] seemed especially alien to me in a system of limited liability, in which shareholders of corporations understand that they cannot be made liable for monetary losses to any extent beyond the amount of their investment in the corporation.").

[55] *See, e.g.,* "Fee Shifting Bylaws: The Current State of Play," *Skadden Arps* (June 20, 2014) ("[T]here is a significant risk that adoption of fee-shifting bylaws by boards of directors of those companies could generate a meaningful adverse reaction from, among others, governance advocates, proxy advisory firms and some stockholders.").

Delaware Chancery Court Denies Motion to Dismiss and Applies Entire Fairness Standard to Transaction with Controlling Stockholder *(continued from page 2)*

valued at $11.85 per share would be delivered to the second lien debt holders, including ZM Funds, on a dollar-for-dollar basis in exchange for $40 million of second lien debt, valued at face value. Accordingly, ZM Funds received a total of 1,689,155 shares of preferred stock, worth approximately $32.9 million on the date received, at a discounted price of $11.85 per share in exchange for $20 million face value of second lien debt of EIA/Evergreen.

On August 8, 2013, Kessler Topaz commenced litigation against Erickson, its board of directors and ZM Funds. On December 4, 2013, Kessler Topaz filed an amended complaint seeking: (i) to recover for Erickson's minority stockholders the dilution and expropriation of value of their Erickson shares that resulted from the elements of the transaction that benefited the holders of first and second lien debt, including ZM Funds; (ii) to force disgorgement and restitution of the improper profits that ZM Funds realized as a result of the transaction; and (iii) equitable remedies, including cancellation of the shares held by ZM Funds.

After briefing by both parties, on April 15, 2014, Vice Chancellor Laster held oral argument on defendants' motion to dismiss and denied the motion on three separate grounds. First, Vice Chancellor Laster agreed with plaintiff that defendants provided extensive information outside the pleadings that converted the motion to dismiss into a motion for summary judgment. He denied the motion so plaintiff can have the opportunity to take discovery. Second, Vice Chancellor Laster agreed with plaintiff that the complaint adequately states both direct claims (dilution suffered by Erickson's minority stockholders) and derivative claims (over-issuance of Erickson shares to ZM Funds) as recognized by the Delaware Supreme Court in *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006) and *Gatz v. Ponsoldt*, 925 A.2d 1265 (Del. 2007). Finally, in analyzing demand futility for the derivative claims, Vice Chancellor Laster held that in a case where a controlling stockholder, such as ZM Funds, stands on both sides of a transaction, demand futility is analyzed under the more exacting standard of entire fairness as opposed to the more deferential business judgment standard. Relying on *Kahn v. Tremont Corp.*, 694 A.2d 422 (Del. 1997), Vice Chancellor Laster stated "[b]ecause the transaction involves a controller [ZM Funds], entire fairness is the standard . . . Demand is futile under the second prong of [*Aronson v. Lewis*, 473 A.2d 805 (Del. 1984)]."

This outcome represents a substantial accomplishment for Kessler Topaz and will protect minority stockholders of public corporations from a domineering controlling stockholder. Kessler Topaz is continuing to litigate its claims to recover for the Company and its minority stockholders the damages caused as a result of the transaction.

Halliburton: Supreme Court Issues Landmark Ruling Reaffirming the Applicability of Fraud-on-the-Market Doctrine *(continued from page 5)*

efforts to obtain relief on a classwide basis, it is unlikely that *Halliburton* will have a substantial effect on securities class action litigation. Additionally, much of the evidence likely relevant to decide the existence of a price impact will already be before the court. Recognizing this, Justice Ginsberg noted in her concurring opinion that the Court's judgment "should impose no heavy toll on securities-fraud plaintiffs with tenable claims." In fact, allowing defendants the opportunity to present evidence of the absence of a price impact is already occurring within the Second Circuit, which is home to more securities class action litigation than any other jurisdiction in the nation.[2]

The Supreme Court's ruling in *Halliburton* largely maintains the *status quo* of securities class action litigation. By reaffirming *Basic* while providing only a minor concession to defendants, the *Halliburton* opinion is by and large a victory for investors.

[2] See *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474 (2d Cir. 2008) (allowing defendants to offer evidence rebutting the presumption of reliance at the class certification stage).

Calendar of Upcoming Events

Georgia Association of Public Pension Trustees (GAPPT) Annual Conference

September 23 – 25, 2014

Calloway Gardens — Pine Mountain, GA

The Georgia Association of Pension Plan Trustees (GAPPT) Annual Conference provides their members with a forum for the discussion of benefit plan issues, a network for the sharing of benefit plan issues, solutions, and resources, and to provide support and information for education, training, advancement and accreditation for public plan trustees and personnel. The agenda for this meeting is still under development.

Council of Institutional Investors Fall Conference

September 29 – October 1, 2014

Millennium Biltmore — Los Angeles, CA

Florida Public Pensions Trustees Association (FPPTA) Fall Trustees School

October 5 – 8, 2014

Hyatt Coconut Point — Bonita Springs, FL

International Foundation of Employee Benefit Programs (IFEBP) U.S. Annual Conference

October 12 – 15, 2014

Boston Convention and Exhibition Center — Boston, MA

External factors continue to draw attention to benefit plans. Do you have the information you need to sustain your plans and make the best decisions possible? The Annual Employee Benefits Conference provides a well-rounded program offering ideas for dealing with difficult situations, innovative approaches for seemingly impossible dilemmas and a strong grounding for meeting your fiduciary obligations. You'll explore tested ideas and gather the supporting facts you need to implement them. You'll connect with industry leaders and peers who are facing the same issues you are.

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Calendar of Upcoming Events

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NCPERS Public Safety Employees Pension & Benefits Conference

October 26 – 29, 2014

Westin New Orleans Canal Place — New Orleans, LA

The Public Safety Employees Pension & Benefits Conference is dedicated to providing quality education that is specifically tailored for the unique needs and demands of public safety pensions. Since 1985, the Conference has educated hundreds of public safety pension trustees, administrators and staff; union officials; and local elected officials by featuring presentations from recognized leaders in both the worlds of finance and politics, providing news on the latest developments, and offering attendees the opportunity to network with fellow trustees.

State Association of County Retirement Systems (SACRS) Fall Conference

November 11 – 14, 2014

Monterey Hyatt — Monterey, CA

SACRS is an association of 20 California county retirement systems, enacted under the County Employees Retirement Law of 1937. SACRS now meets as an organization twice a year, including the Spring Conference, with all 20 counties participating through attendance by Trustees, Administrators, Treasurers and staff. Education and legislation are the principal focus of these meetings, particularly education in the investment and fiduciary responsibility area.

U.S. Markets New England Institutional Investor

November 19, 2014

Sheraton Boston — Boston, MA

The 2nd Annual New England Institutional Investor Forum is an educational conference designed to address the needs of New England's pension, foundation, and endowment community. The program's agenda will cover investments, fiduciary responsibilities, legal and legislative issues, healthcare benefits, actuarial assumptions, asset/liability management and best practices in fund Management. The forum is specially designed to bring together 100 plus attendees representing Maine, Vermont, New Hampshire, Massachusetts, Rhode Island and Connecticut.

U.S. Markets Pennsylvania Institutional Investor Forum

December 3, 2014

Philadelphia, PA

The Pennsylvania Institutional Investors Forum is a closed door educational conference designed to address the needs of the Pennsylvania Public Pensions and Institutional Investor Community. The program's agenda will cover investments, fiduciary responsibilities, legal and legislative issues, healthcare benefits, actuarial assumptions, asset/liability management and best practices in plan management. The forum is specially designed to bring together 100 plus attendees.

Florida Public Pensions Trustees Association (FPPTA) Winter Trustees School

February 1 – 4, 2015

Rosen Centre — Orlando, FL

Evolving Fiduciary Obligation of Pension Plans (EFOPP)

February 10, 2015

Tempe Mission Palms — Tempe, AZ

The day-long seminar, hosted in Tempe, Arizona, will bring together leading investment, legal, and compliance officers from U.S. public pension funds and Taft-Hartley funds from across the country. Through panels, workshops and case studies, participants will engage with industry peers and thought leaders on the pressing issues facing the pension industry, including a myriad of investment matters, funding and political pressures, as well as questions relating to shifting corporate governance structures and the fiduciary duties and rights of active shareholders.

National Association of Public Pension Attorneys (NAPPA) Winter Seminar

February 11 – 13, 2015

Tempe Mission Palms — Tempe, AZ

Rights and Responsibilities of Institutional Investors (RRII)

March 19, 2015

Amsterdam, The Netherlands

The day-long meeting, hosted in Amsterdam, will bring together leading investment, legal, and compliance officers from European public pension, insurance fund and mutual fund companies. Through panels, workshops and case studies, participants will engage with industry peers and thought leaders on the question of shifting corporate governance structures and as such, their fiduciary duties and rights as active shareholders.

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