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The Bulletin is a quarterly newsletter by Kessler Topaz Meltzer & Check to help institutional investors stay

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HIGHLIGHTS

KESSLERTOPAZ MELTZERCHECK LLP

SECURITIES FRAUD PLAINTIFFS' FRIEND OR FOE?: ASSESSING THE POTENTIAL IMPACT OF SUPREME COURT JUSTICE NEIL M. GORSUCH'S APPOINTMENT ON THE FUTURE LANDSCAPE OF PRIVATE SECURITIES FRAUD LITIGATION

Meredith L. Lambert, Esquire

On April 10, 2017, Neil McGill Gorsuch, a 49-year-old former appellate court judge for the United States Court of Appeals for the Tenth Circuit, was sworn in as an Associate Justice of the United States Supreme Court, filling the fourteen-month-vacancy left by the passing of the late Supreme Court Justice Antonin Scalia. President Donald Trump announced Judge Gorsuch's nomination on January 31. Following twenty hours of questioning at his confirmation hearings before the Senate Judiciary Committee of the United States Senate last month, the Senate ultimately voted in favor of Judge Gorsuch's confirmation on April 7, 2017. While Judge Gorsuch has issued only one

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KESSLER TOPAZ ACHIEVES $32 MILLION SETTLEMENT CHALLENGING CONFLICTED NON-PUBLIC REIT MERGER

Grant D. Goodhart, III, Esquire

In the summer of 2016, Kessler Topaz commenced litigation against the directors and executive officers of Apple REIT Ten, Inc. ("Apple Ten" or the "Company") and the executive officers of Apple Hospitality REIT, Inc. ("Apple Hospitality") in connection with a proposed merger of the two companies in which Apple Ten would be merged into Apple Hospitality. Both Apple Ten and Apple Hospitality were Virginia-based real estate investment trusts ("REITs") founded by Glade Knight who was Chairman of both companies

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KESSLER TOPAZ'S LITIGATION AGAINST FACEBOOK, INC. AND MARK ZUCKERBERG CHALLENGING RECLASSIFICATION SCHEME: AN UPDATE

Matthew A. Goldstein, Esquire

Below, we provide an update on Kessler Topaz's ongoing litigation against the directors of Facebook, Inc. which was discussed at length in the KTMC Summer 2016 Bulletin.[1] As previously discussed, the litigation relates to Facebook's intention to issue a new class of non-voting Class C stock (the "Reclassification"), and to give each Facebook stockholder two shares of Class C stock for each share of Class A or B stock they currently hold (the "Dividend"). Because Facebook's founder and majority stockholder Mark Zuckerberg controls Facebook through his ownership of Facebook's 10-vote-per-share Class B stock, the Reclassification and Dividend will allow him to sell or transfer the bulk of his Facebook economic ownership of Class A and C shares to further his philanthropic aims while continuing to control the company through his Class B shares. On behalf of an institutional stockholder of Facebook, Kessler Topaz alleges that Facebook is giving Zuckerberg an undeserved benefit for little in return and seeks to enjoin the Dividend, or, if the Dividend is consummated, to recover for the minority public Class A stockholders damages in connection with the issuance of the Dividend.

In August and October 2016, while the parties were in the midst of document discovery and depositions, Kessler Topaz filed motions to compel the production of various documents withheld on the basis of attorney-client privilege. At the time Kessler Topaz filed the motions, defendants had recently produced documents showing the special committee (comprised of three Facebook directors designated to negotiate the terms of the Reclassification) was severely compromised by the conduct of its members and of the committee's and Facebook's legal and financial advisors. From a special committee member giving Zuckerberg direct insight into the committee process, and even coaching him in real-time during negotiations with the committee, to legal and financial advisors making sure the committee never saw proposals to protect the interests of the public Class A stockholders, the disloyalty was stunning. In the motions, Kessler Topaz challenged, among other things, documents withheld on the basis of attorney-client privilege that appeared to involve business advice rather than legal advice, and therefore did not qualify as privileged communications.

On November 9, 2016, the Court heard oral argument on the motions, and on November 16, 2016, the Court issued an order that resulted in the Court giving Plaintiffs access to many of the documents they sought. Specifically, the Court ordered the parties to submit certain categories of documents for the Court to review *in camera* (in private) so it could make a determination whether to compel the financial advisors to produce these documents to Plaintiffs. In so holding, the Court noted that the special committee's process involved direct manipulation of analyses performed by the special committee's financial advisors and "facially dubious back-channel communications" between Zuckerberg and a special committee member. Upon its *in camera* review of hundreds of documents, the Court ordered the financial advisors to produce nearly all of the documents to Plaintiffs. The Court stated that the *in camera* review of a subset of purportedly privileged documents revealed that Zuckerberg and the special committee had engaged in "an overly broad and obfuscatory invocation of the attorney-client privilege" and noted that although the special committee and Zuckerberg had deliberately routed ordinary business communications through attorneys, that was insufficient to convert those business communications into legal advice. The documents have now been produced and Kessler Topaz is in the process of reviewing them.

The Court's orders on the discovery motions are a significant victory for Plaintiffs and demonstrate Kessler Topaz's vigorous prosecution of the litigation to protect the interests of Facebook's public Class A stockholders. Discovery in the case is ongoing, and the trial of the case is scheduled for October 9-13, 2017. ■

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[1] The case is *In re Facebook, Inc. Class C Reclassification Litig.*, Consol. C.A. No. 12286-VCL (Del. Ch.).

KESSLER TOPAZ WINS APPEAL IN "REVERSE PAYMENT" ANTITRUST CASE

Quinn Kerrigan, Esquire and Terence S. Ziegler, Esquire

Kessler Topaz won an important reversal from the United States Court of Appeals for the First Circuit in an antitrust class action case relating to the contraceptive drug Loestrin 24 Fe. The First Circuit reversed a district court decision which initially dismissed the case based on a narrow reading of Supreme Court precedent concerning "reverse payment" settlements. Such settlements are a creature of pharmaceutical patent litigation where, somewhat unusually, the plaintiff-patentee pays the defendant-infringer to settle an infringement action. The Supreme Court has found that these agreements can sometimes unreasonably diminish competition in violation of the antitrust laws. *FTC v. Actavis,* 133 S. Ct. 2223 (2013) ("*Actavis*").

The firm, along with its co-counsel, represents direct purchasers of Loestrin 24 who allege that brand manufacturer Warner Chilcott and generic manufacturer Watson Pharmaceuticals, Inc. entered into an unlawful reverse-payment settlement of patent litigation concerning the drug. Pursuant to the settlement, Watson agreed to delay marketing its generic version of Loestrin 24 for nearly four and half years in exchange for significant non-cash consideration, including several lucrative agreements and licenses with Warner Chilcott. Direct purchasers allege that the settlement allowed Warner Chilcott to avoid generic competition and retain exclusivity in the relevant antitrust market for much longer than it otherwise would have in a competitive market. As a result, direct purchasers paid significantly more for Loestrin 24 and its generic equivalents than they should have. We allege that the settlement agreement violates the federal Sherman Antitrust Act and seek damages based on the overcharges that direct purchasers were forced to pay.

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ADR TRANSACTIONS IN SECURITIES LITIGATION AFTER MORRISON

Matthew L. Mustokoff, Esquire and Joshua A. Materese, Esquire

Seven years ago, the U.S. Supreme Court eliminated the extraterritorial reach of the federal securities laws in *Morrison v. Nat'l Australia Bank Ltd.,* 561 U.S. 247, 130 S. Ct. 2869 (2010). In an attempt to lay down a "bright line" rule, the Court held that Section 10(b) of the Securities Exchange Act of 1934, the primary antifraud provision under the federal securities laws, applies only to (1) "transactions in securities listed on domestic [i.e., U.S.] exchanges," or (2) "domestic transactions in other securities." *Id.* at 249. Through the adoption of this two-pronged "transactional" test, the *Morrison* Court sought to provide a clear standard for the lower courts so as to avoid the fact-specific — and often conflicting and/or arbitrary — application of the Exchange Act to cases with a transnational element.

In setting forth this new standard, the Supreme Court erased decades of an Exchange Act jurisprudence that was more policy-driven and less focused on fixed boundaries of statutory reach. Indeed, the prevailing test prior to *Morrison*, enunciated by the U.S. Court of Appeals for the Second Circuit, focused on whether the particular case involved "either some effect on American securities markets or investors" or "significant conduct in the United States" — the so-called "conducts and effects" test. *Id.* at 257. Paradoxically, while defense lawyers hailed *Morrison*'s "transactional" test as an upwelling of clarity that would yield more judicial consistency, in practice, the *Morrison* ruling has proven to be anything but a bright line, as the lower courts have wrestled with its application and, in particular, what qualifies as a "domestic transaction."

The ambiguity clouding the parameters of *Morrison* has touched cases involving securities of all kinds, including American Depositary Receipts ("ADRs") — also known as "American Depositary Shares" ("ADSs"). An ADR is a U.S. dollar-denominated form of equity ownership in a non-U.S. company whose value is derived

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Institutional Investor
FORUMS

KESSLER TOPAZ
MELTZER CHECK LLP

2ND ANNUAL

Canadian Fiduciary Roundtable

JUNE 6, 2017 | FAIRMONT ROYAL YORK | TORONTO

For 12 years in Europe and for 8 in the US, Institutional Investor has co-hosted events focusing on active engagement by institutions in the companies they invest in. Given Canadian institutions' unique position and needs, we have created a full-day roundtable focusing on shareholder rights, active engagement, legal recourse, and governance issues to take place June 6 in Toronto. The 2nd Annual Canadian Fiduciary Roundtable will gather 25 senior legal and investment representatives of pension funds and asset management firms to discuss such issues as:

- the changing role of the legal and compliance functions within investing institutions
- how general counsels' (and their staffs') responsibilities contribute to both strategy and investments
- which engagement practices are actually producing results; how can institutions make the most of opportunities to affect governance change when necessary
- quantifying the benefits of being an actively engaged investor.

Whether it is determining the true definition, scope, and role of a fiduciary or taking a look at the level of transparency in private markets investments, fiduciaries are placing growing emphasis on due diligence procedures and establishing governance guidelines so as to meet and overcome tomorrow's challenges in an efficient, pragmatic manner.

On June 6 we will offer a thorough overview of the landscape within which Canadian institutions are operating to fulfill their obligations as fiduciaries and active shareholders, and in turn, how they may better leverage strategies and objectives within this environment. Emphasizing real-world examples of how shareholders are engaging with the companies they invest in, this half-day event will review the most crucial legal decisions, regulatory actions, and developments investors should be aware of, and offer insights on the approaches successful plans have implemented to create the structures that meet investment return targets strategically and for the long term.

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SNAP INC. COMPLETES $3.4 BILLION IPO BY ISSUING NON-VOTING STOCK

Matthew A. Goldstein, Esquire

On March 2, 2017, Snap Inc., the parent company of messaging app Snapchat, completed its IPO, raising $3.4 billion and giving the company a market value of $24 billion. Snap sold 200 million shares at $17 each, above the initial estimated range of $14 to $16, and the stock was oversubscribed by ten times. The overwhelming demand for the Snap IPO is remarkable for many reasons, including that the shares sold in the IPO came with no voting rights. In fact, Snap is the first company to complete an IPO on a U.S. stock exchange offering only non-voting stock.

Snap now has a three-class share structure. Class A stock, the class available for purchase in the IPO, does not include any voting rights, but allows stockholders who own Class A shares to attend the company's annual meeting and ask questions. However, because the Class A stock is the only class of stock registered under the Securities Exchange Act of 1934 and is non-voting, Snap is not required to file annual proxy statements or information statements prior to annual meetings unless a vote of the Class A stock is required by applicable law. Class B stock is reserved for executives and early investors and is entitled to one vote per share. Class C stock is held exclusively by Snap's co-founders, CEO Evan Spiegel and CTO Bobby Murphy, and is entitled to ten votes per share. Holders of Class B and C stock will vote together as a single class on all matters submitted to a stockholder vote. Due to their ownership of all Class C shares, Spiegel and Murphy hold a combined 88.5% of Snap's total voting power and will have the power to control the outcome of all matters submitted to stockholders for approval, including the election, removal and replacement of directors and any merger, consolidation, or sale of substantially all of Snap's assets. As the Class A stock issued in the IPO has no voting rights, the IPO did not dilute Spiegel and Murphy's voting control over Snap.

Snap's issuance of only non-voting stock in its IPO is an extreme extension of the "founder control" principle exhibited in the last decade of Silicon

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DEAL ON EUROPEAN SHAREHOLDER RIGHTS DIRECTIVE

Bram Hendricks, *Client Relations Manager, Europe*

The legislative process related to a revised Shareholder Rights Directive ('Directive') in Europe is coming to an end. In December 2016, the European policy bodies involved in the negotiation process reached a compromise. The proposed Directive has the objective to overcome certain corporate governance short comings in European listed companies, and to encourage more long-term oriented and active engagement by shareholders. It should contribute to the long term sustainability of companies based in the European Union ('EU') and to enhance the growth, job creation and competitiveness of the European economy. Based on the proposal that has been negotiated, shareholders of EU listed companies will gain additional rights to hold boards of directors accountable. At the same time, shareholders will have more disclosure obligations.

Background

In 2012, the European Commission published an action plan for more engaged shareholders and sustainable companies. The financial crisis had revealed that significant weaknesses in corporate governance of financial institutions played a role in the crisis. Although corporate governance in listed companies outside the financial sector did not give rise to the same concern, certain weaknesses had also been observed here. In particular, there is a perceived lack of shareholder interest in holding management accountable for their decisions and actions, compounded by the fact that many shareholders appear to hold their shares for only a short period of time. As a result, in April 2014, the European Commission presented a proposal for the revision of the Shareholder Rights Directive. The proposal aimed to tackle corporate governance shortcomings relating to listed companies and their boards, shareholders (institutional investors and asset managers), intermediaries and proxy advisors.

Shareholder Rights Directive: What's in it?

Almost three years after the European Commission's proposal for a revised Shareholder Rights Directive was launched, the EU institutions involved have now reached a compromise. While

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SECURITIES FRAUD PLAINTIFFS' FRIEND OR FOE?: ASSESSING THE POTENTIAL IMPACT OF SUPREME COURT JUSTICE NEIL M. GORSUCH'S APPOINTMENT ON THE FUTURE LANDSCAPE OF PRIVATE SECURITIES FRAUD LITIGATION

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Tenth Circuit decision that addresses claims under the Private Securities Litigation Reform Act of 1995 ("PSLRA"), his judicial philosophy and legal writings while in private practice offer additional insight into how his appointment might impact the future landscape of private securities litigation.

Judge Gorsuch was nominated to the Tenth Circuit Court of Appeals by President George W. Bush and confirmed by voice vote in the U.S. Senate in 2006. Judge Gorsuch earned his undergraduate degree from Columbia University, law degree from Harvard Law School, and Doctor of Philosophy in Law from University College, Oxford. In his early legal career, Judge Gorsuch clerked for Judge David B. Sentelle on the U.S. Court of Appeals for the D.C. Circuit from 1991 to 1992, and then for U.S. Supreme Court Justices Byron White and Anthony Kennedy, from 1993 to 1994. For the next ten years, Judge Gorsuch worked in private practice with the law firm of Kellogg, Huber, Hansen, Todd, Evans & Figel. Thereafter, Judge Gorsuch served as a Deputy Associate Attorney General at the U.S. Department of Justice until his appointment to the Tenth Circuit.

Much like his predecessor Justice Scalia, Judge Gorsuch is considered a conservative jurist and an outspoken proponent of textualism, or the theory that laws should be interpreted narrowly in accordance with their ordinary meaning. In this regard, Judge Gorsuch's sole opinion in a PSLRA case — *MHC Mutual Conversion Fund LP v. Sandler O'Neill & Partners LP*, 761 F.3d 1109 (10th Cir. 2014) — reflects his commitment to a careful textual analysis. There, Judge Gorsuch addressed the issue of when Section 11 of the Securities Act of 1933 imposes liability on issuers for statements of opinion.[1] In a thorough analysis of the statutory text and common law principles, Judge Gorsuch offered three possible readings of Section 11 with respect to opinion liability: (1) opinions about future events can never be actionable; (2) liability may be imposed where plaintiffs show that the speaker subjectively disbelieved the opinion and that the opinion was objectively false; and (3) liability may be imposed when a fiduciary or someone who holds himself out to be an expert offers an opinion that lacks an objectively reasonable basis.[2] Critically, Judge Gorsuch questioned whether this broader third reading was consistent with Supreme Court precedent and Section 11's statutory text and history and appeared inclined to adopt the second reading as the appropriate standard.[3] In any event, however, Judge Gorsuch found that it was not necessary to resolve this issue because even if the broader "objectively reasonable basis" test were available, the plaintiffs' allegations that the defendant had misled them by saying in 2009 that it believed the market for mortgage-backed securities would soon rebound still failed to satisfy that standard.[4] When the Supreme Court addressed this same issue a year later in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, it held in accordance with Judge Gorsuch's inclination that affirmative statements of opinion are actionable only if they are objectively false and the speaker did not actually hold the stated belief.[5] Moreover, in his concurrence in *Omnicare,* Justice Clarence Thomas cited Judge Gorsuch's reluctance to commit to the objectively reasonable basis test in admonishing the Court to exercise the same caution.[6]

Judge Gorsuch's inclination toward limiting the scope of liability in private securities fraud cases is also reflected in his writings while in private practice. For example, in 2005, Judge Gorsuch co-authored a working paper for the Washington Legal Foundation titled "Settlements in Securities Fraud Class Actions: Improving Investor Protection."[7] In that paper, Judge Gorsuch identified certain structural problems related to securities fraud class actions, observing

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1 *See MHC Mutual Conversion Fund LP v. Sandler O'Neill & Partners LP*, 761 F.3d 1109, 1111 (10th Cir. 2014).

2 *See id.* at 1112-15.

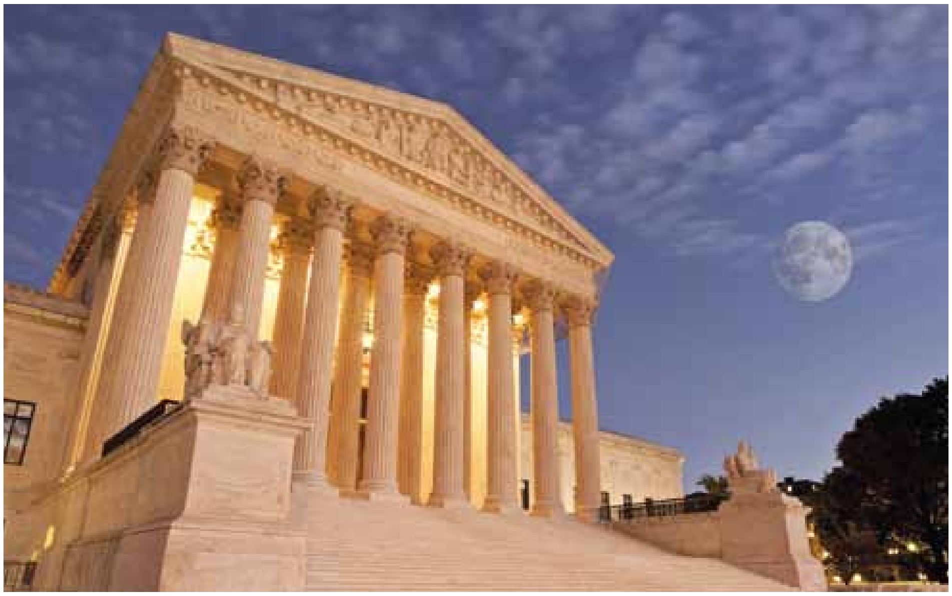
3 *See id.* at 1115-17.

4 *See id.* at 1117.

5 *See id.*, 135 S. Ct. 1318, 1327 (2015).

6 *See id.* at 1337.

7 Neil M. Gorsuch and Paul B. Matey, *Settlements in Securities Fraud Class Actions: Improving Investor Protection*, Washington Legal Foundation, Critical Legal Issues, Working Paper Series No. 128, April 2005, available at http://www.wlf.org/upload/0405WPGorsuch.pdf.



that "economic incentives unique to securities litigation encourage class action lawyers to bring meritless claims and prompt corporate defendants to pay dearly to settle such claims. These same incentives operate to encourage significant attorneys' fee awards even in cases where class members receive little meaningful compensation."[8] To address these issues, Judge Gorsuch proposed a number of reforms, including, among others: (1) enforcing the PSLRA's loss causation requirement; (2) mandating separate settlement funds for plaintiffs' attorneys' fees to incentivize defendants to scrutinize fee requests; (3) reviving the lodestar method for calculating awards for attorneys' fees to provide a safeguard against attorney over-billing; (4) employing a bidding process to determine class counsel; (5) encouraging oversight by state and federal agencies of class action settlements; (6) prohibiting parallel private class actions in cases where the SEC has already acted to compensate victims of securities fraud; and (7) applying the PSLRA's "professional plaintiff" bar, which prohibits a party from serving as a lead plaintiff in more than five securities class actions brought during a three-year period, to institutional investors.[9]

Consistent with his proposed reform calling for enforcement of the PSLRA's loss causation requirement, Judge Gorsuch also wrote an amicus brief on behalf of the United States Chamber of Commerce in *Dura Pharmaceutiscals Inc. v. Broudo,* 544 U.S. 336 (2005). Citing a number of the same concerns raised in the Washington Legal Foundation working paper, Judge Gorsuch noted in particular that "[b]y diverting resources away from productive economic uses, meritless securities actions threaten to slow the spread of new investments, reduce the efficiency of capital markets, and limit the competitiveness of the American economy."[10] Thus, Judge Gorsuch urged the Court to adopt a pleading standard for loss causation that requires plaintiffs to plead that the defendant's conduct was a proximate cause of the plaintiff's loss as a "key safeguard against such suits."[11] Similarly, in 2005, after the Supreme Court heard oral argument in *Dura*, Judge Gorsuch co-authored an article titled "No Loss, No Gain; The Supreme Court should make clear that securities fraud claims can't dodge the element of causation."[12] Combining his textualist approach to statutory interpretation with his policy views on private securities class actions, Judge Gorsuch wrote: "The Supreme Court . . . has a unique opportunity to apply the undisputable principles of common law and the clear intent of the legislature to articulate a uniform standard for pleading securities fraud claims that will protect true investor loss due to fraud without damaging our national economy."[13]

Although at first blush, Judge Gorsuch's policy preferences appear to favor corporate defendants over their shareholders, in at least one respect, Judge Gorsuch has advocated on behalf of investors asserting private causes of action under the federal securities laws. Specifically, Judge Gorsuch has routinely encouraged the meaningful participation of shareholders in the review of proposed securities class action settlements. For example, in an amicus brief written on behalf of the Council of Institutional Investors in *Devlin v. Scardelletti*, 2002 WL 113883 (2002), Judge Gorsuch argued that class members should be permitted to object to proposed class-wide settlements in district court proceedings without intervening as parties.[14] In support of this contention, Judge Gorsuch noted that in enacting the PSLRA, Congress recognized that institutional investors were "especially well-positioned to represent the interests of absent class members in many class action disputes, and to prevent the collusion that frequently occurs between defendants and plaintiffs' attorneys in

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8 *Id.* at 2.

9 *See id.* at 15-31.

10 Brief for Chamber of Commerce of the United States as Amicus Curiae Supporting Petitioners, *Dura Pharm. Inc. v. Broudo*, 544 U.S. 336 (2005) (No. 03-932).

11 *Id.* at 3.

12 Neil M. Gorsuch and Paul B. Matey, *No Loss, No Gain; The Supreme Court should make clear that securities fraud claims can't dodge the element of causation*, THE NATIONAL LAW JOURNAL, January 31, 2005.

13 *Id.*

14 *See* Brief of Amicus Curiae Council of Institutional Investors in Support of Petitioner, *Devlin v. Scardelletti*, 2002 WL 113883, at *2 (2002).

SECURITIES FRAUD PLAINTIFFS' FRIEND OR FOE?: ASSESSING THE POTENTIAL IMPACT OF SUPREME COURT JUSTICE NEIL M. GORSUCH'S APPOINTMENT ON THE FUTURE LANDSCAPE OF PRIVATE SECURITIES FRAUD LITIGATION

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settling such cases."[15] Accordingly, he expressed his concern that requiring formal intervention "would erect a substantial and unnecessary barrier to participation by objecting institutional shareholders in the review of proposed settlements in class action disputes where their participation is most needed."[16] Likewise, in the Washington Legal Foundation working paper, Judge Gorsuch echoed these concerns regarding the weak incentive for plaintiffs' attorneys and defendants in private securities fraud class actions to reach settlement terms that are favorable to class members, as well as the lack of a meaningful opportunity for absent class members to review proposed settlement terms before deciding to opt-out of such actions.[17]

Given these views, it remains unclear how Judge Gorsuch may rule in two separate securities fraud cases set to be decided by the Supreme Court later this year. In the first case, *California Public Employees' Retirement System v. ANZ Securities Inc*, the Supreme Court will address the issue of whether the filing of a class action tolls the three-year statute of repose for claims of putative class members under Section 13 of the Securities Act.[18] To the extent Judge Gorsuch is inclined to limit private rights of action under the federal securities laws, then he will likely hold that Section 13's statute of repose cannot be tolled. By contrast, to the extent Judge Gorsuch recognizes the value in affording absent class members the opportunity to request exclusion from class actions at a time when they can make a more informed decision regarding whether to protect their interests individually, then he may find that tolling applies. In the second case, *Leidos, Inc. v. Indiana Public Retirement System*, the Supreme Court will consider whether Item 303 of SEC Regulation S-K, which requires companies to disclose, among other things, "any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way," creates a duty to disclose that gives rise to liability under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.[19] Again, given his proclivity toward narrowing the scope of liability under the PSLRA, then Judge Gorsuch will likely conclude that a defendant's failure to disclose information required to be disclosed under Item 303 is not actionable under Section 10(b). Alternatively, however, Judge Gorsuch may reason that allowing an Item 303 violation to serve as a basis for a Section 10(b) claim neither expands the scope of liability under Section 10(b) nor conflicts with Supreme Court precedent insofar as he determines that Section 10(b) claims predicated on Item 303 violations can only be sustained in very limited circumstances where plaintiffs allege both that: (1) the defendant failed to comply with Item 303, which imposes an actual knowledge requirement; and (2) the allegedly omitted information satisfies the test for materiality established in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

In sum, while Judge Gorsuch's jurisprudence and policy views suggest certain skepticism toward private securities fraud cases, that should not discourage shareholder plaintiffs seeking to redress their losses through private causes of action under the federal securities laws. As an initial matter, it is unlikely that Judge Gorsuch will allow such policy views to drive his decision-making. Rather, it appears that Judge Gorsuch will apply a careful, text-based legal analysis and will closely adhere to legal precedent. However, even if Judge Gorsuch were influenced by his policy views, many of these views are principally aimed at improving the efficiency of private securities fraud class actions to ensure that investors are adequately protected and compensated for their losses. As such, his potential rulings on key issues affecting private securities fraud plaintiffs will not necessarily be antagonistic to their interests. ■

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[15] *Id.* at *1.

[16] *Id.* at *2.

[17] *See* Gorsuch and Matey, *Settlements in Securities Fraud Class Actions*, *supra* n. 7, at 6, 13-14.

[18] *See California Pub. Employees' Ret. Sys. v. ANZ Sec., Inc.*, 137 S. Ct. 811, 196 L. Ed. 2d 596 (2017).

[19] *See Leidos, Inc. v. Indiana Pub. Ret. Sys.,* No. 16-581, --- S.Ct. ----, 2017 WL 1114966, at *1 (U.S. Mar. 27, 2017).

SNAP INC. COMPLETES $3.4 BILLION IPO BY ISSUING NON-VOTING STOCK

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Valley IPOs. For example, when Google (now Alphabet) and Facebook went public, each company had a dual-class stock structure whereby the Class A shares issued in the IPO were entitled to one vote per share and the Class B shares, held exclusively by the founders and other early investors, were entitled to ten votes per share. The founders maintained voting control, but new investors at least had a voice and the prospect of the founders' control being diluted over time. Since their IPOs, though, Alphabet and Facebook have completed reclassifications whereby each company issued non-voting Class C stock as a dividend to the holders of Class A and Class B stock with the explicit purpose of avoiding further dilution of the founders' voting control. Although the now tri-class stock structures of Alphabet and Facebook still give disproportionate voting power to the founders due to their ownership of substantially all of the Class B stock, these companies, unlike Snap, still issue annual proxy statements, and stockholders can still vote at annual meetings on corporate actions, including "say-on-pay" provisions under the Dodd-Frank Act.

As Snap made clear in its IPO filings, "holders of Class A common stock will not have any ability to influence stockholder decisions." By eliminating voting rights entirely, Snap has prevented stockholders from nominating, electing or replacing directors, submitting stockholder proposals, and approving or blocking a takeover. Moreover, Snap is preventing activist investors from pressuring for change if Snap is underperforming. In essence, Snap is eliminating any system of checks and balances on corporate actions and is operating somewhat like a private company. Only time will tell whether Snap's limiting its public investors to non-voting stock will be a bridge too far for investors, regulators, and other stakeholders with an interest in effective corporate governance. ■

KESSLER TOPAZ ACHIEVES $32 MILLION SETTLEMENT CHALLENGING CONFLICTED NON-PUBLIC REIT MERGER

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and had appointed the same group of executive officers to run each REIT, many of whom had a long history of serving as executive officers for several other Knight-founded REITs.

At the time of the proposed merger, Apple Ten was publicly held but not traded on a national stock exchange (a "non-public REIT") while Apple Hospitality became a publicly traded company in 2015 shortly after a roll up of three other Knight-founded non-public REITS, Apple REITs Seven, Eight and Nine.

After the merger was announced in April 2016, Kessler Topaz began investigating the proposed transaction. The proposed merger was purportedly the "liquidation event" that Apple Ten shareholders had been promised when they initially invested in Apple Ten. However, the merger consideration being offered to Apple Ten shareholders was valued at only $10.85 on the day the merger was announced, well below the $11 per share price many Apple Ten investors had paid for the stock at the time of their initial investment.

Meanwhile, Mr. Knight stood to personally receive approximately $65 million upon the closing of the merger through his convertible preferred "founder's shares" which he had purchased for $0.10 each when Apple Ten was formed in 2010. Mr. Knight had also gifted approximately 25% of his founder's shares to the members of his management team, including his son Justin Knight.

Kessler Topaz's investigation revealed that the merger of Apple Ten and Apple Hospitality was rife with conflicts. Glade Knight was Chairman of both Apple Ten and Apple Hospitality's Board of Directors and Justin Knight was President of Apple Ten, and director, President, and CEO of Apple Hospitality. Further, the executive officers of Apple Ten and Apple Hospitality were identical, and the "Special Committee" of Apple Ten directors, who were appointed to negotiate the merger on behalf of Apple Ten, were long-time business associates and friends of Glade Knight.

When Apple Ten filed its preliminary proxy statement with the SEC in June 2016, Kessler Topaz commenced arduous, expedited litigation towards a trial just five months later.

Kessler Topaz filed a complaint on behalf of an individual who had purchased Apple Ten shares during the Company's public offering. The complaint was filed in the United States District Court for the Eastern District of Virginia. Simultaneously, Kessler Topaz filed a motion for expedited discovery and, three weeks later, a motion to preliminarily enjoin the merger.

The complaint alleged two claims: (1) breach of fiduciary duty of loyalty and good faith against the members of the Apple Ten Board for approving the unfair merger, and knowingly issuing materially false, incomplete, and misleading statements in the proxy statement; and (2) aiding and abetting those breaches of fiduciary duty against Apple Hospitality and the executive officers of both Apple Ten and Apple Hospitality.

In sum, the complaint alleged that Glade Knight orchestrated an artificial, non-competitive negotiation process conducted on one side by a Special Committee stacked with Glade Knight's long-time friends, and on the other side by Apple Ten/Apple Hospitality management who stood on both sides of the merger, including Glade Knight's son Justin Knight, who substantially led the merger negotiations on the Apple Hospitality side. The complaint asserted that the Special Committee predetermined from the outset to approve Apple Hospitality's acquisition of Apple Ten on terms favorable to Glade Knight and to the detriment of Apple Ten's shareholders.

During the two weeks of expedited discovery, Kessler Topaz reviewed and analyzed tens of thousands of documents and deposed several of the defendants, including Glade Knight, Justin Knight and Kent Colton (the chairman of the Special Committee), as well as a representative of Citigroup, the Special Committee's financial advisor in connection with merger.

The Court held a hearing on Plaintiff's motion for a preliminary injunction on August 26, 2016. Plaintiff sought to postpone the shareholder vote and to force Defendants to issue corrective disclosures about the process leading to the merger and how Defendants concluded that the $10.85 per share price was fair.

The Court declined to enjoin the merger, but set the case for a jury trial to begin on November 14, 2016 — giving the parties less than three months to complete fact discovery, expert discovery, and prepare the case for a jury trial. The Eastern District of Virginia is colloquially referred to as the "rocket docket" due to the quick schedule that cases often follow in that district. The schedule set by the Court in this action, however, was much more truncated even by "rocket docket" standards.

From the outset, Kessler Topaz faced significant legal hurdles. Because Apple Ten was incorporated in Virginia, Virginia law applied to the conduct at issue. Virginia law is considered friendly to corporate directors, typically reviewing their conduct under the deferential "business judgment rule."

For example, unlike Delaware law, under Virginia law, the directors do not owe "*Revlon* duties", i.e., the Apple Ten Board had no duty to obtain the highest price for Apple Ten's shareholders in the context of a merger. Virginia law *presumes* that directors "act on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the corporation."[1] And as long as directors rely on the advice of independent advisors, as the Special Committee did here, they are shielded from liability.

During September and October 2016, Kessler Topaz conducted extensive fact and expert discovery and developed a strong case to support their claims that the negotiation process was flawed and the merger consideration was undervalued. For example, as to the merger negotiation process, Kessler Topaz would have presented evidence at trial that the Apple Ten directors had breached their fiduciary duties by employing a sham Special Committee process, composed of Glade Knight's allies, who were carrying out Glade Knight's plan hatched several years prior to sell Apple Ten to Apple Hospitality.

Indeed, evidence demonstrated that the Special Committee had disregarded its financial advisor's advice and decided not to market Apple Ten publicly to third parties to determine Apple Ten's true market price. This process, known as a "market check," would have informed the Special Committee of Apple Ten's value in the market and facilitated a competitive bidding process to yield a higher price for Apple Ten shareholders.

Rather, the Special Committee decided on a non-competitive, single-bidder process which only worked to favor the interests of Glade Knight and Apple Hospitality. The Special Committee justified this decision by opting to pursue a post-signing "go-shop" in which Citigroup marketed Apple Ten publicly after a deal was already signed with Apple Hospitality.

Kessler Topaz's expert witness, Harvard business and law professor Guhan Subramanian, was prepared to testify at trial that due to informational asymmetries, managerial financial incentives, and timing considerations, the use of a "go-shop" in the context of this merger (which was analogous to a management-led buyout) was unlikely to yield a fair value for the Apple Ten shareholders. Indeed, Professor Subramanian opined that such "go-shops" rarely end with a topping bidder stepping forward because of the inherent disadvantages of outbidding a preferred buyer like Apple Hospitality. This is especially the case with situations, such as this one, where the buyer and seller are so intimately related.

As to the merger consideration, Kessler Topaz's financial expert witness, Mr. Chad Coffman, was prepared to testify at trial that Citigroup's financial analyses as to the fairness of the merger consideration had major flaws and that, once corrected, resulted in a 17.7% higher value for Apple Ten than the merger consideration negotiated by the Special Committee.

With less than two weeks to trial and after two separate settlement conferences with an experienced Magistrate Judge in the Eastern District of Virginia, the parties agreed to resolve the action for a $32 million payment to be made to Apple Ten's former shareholders.

We believe this settlement, which was approved by the Court on March, 15, 2017, was an excellent result for Apple Ten shareholders in light of the significant risks in the case. The settlement was reached less than two weeks before the Firm was set to try the case to a jury, demonstrating Kessler Topaz's belief that true trial-readiness is the best way to achieve the best results for shareholders. ■

[1] *Poth v. Russey*, 281 F. Supp. 2d 814, 826 (E.D.Va. 2003).

ADR TRANSACTIONS IN SECURITIES LITIGATION AFTER MORRISON

(continued from page 3)

from the common or preferred stock of foreign issuers traded on non-U.S. exchanges. ADRs can be listed and trade on a U.S. exchange (typically, the New York Stock Exchange) or they can trade "over-the-counter," or "OTC." In *Morrison*, the security at issue was defendant National Australia Bank's common stock traded on the Australian Stock Exchange and other non-U.S. exchanges. However, the Court specifically noted that National Australia Bank also issued ADRs listed on the New York Stock Exchange. *See id*. at 247. While the *Morrison* Court did not analyze or decide any issues pertaining to the ADRs, its express differentiation between the defendant's common stock and ADRs could be read to suggest that the Court did not intend for ADRs to be excluded from the scope of Section 10(b). This interpretation notwithstanding, the application of *Morrison* to ADRs is an area that is just beginning to develop.

Defining "Domestic Transaction"

Two years after *Morrison*, the Second Circuit set forth its test for establishing a domestic transaction under *Morrison*'s second prong, holding that a transaction is domestic if title passes or liability becomes "irrevocable" within the United States. *See Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 68 (2d Cir. 2012). Perhaps not surprisingly, courts within and outside the Second Circuit applying the "irrevocable liability" test have taken divergent views regarding where the locus of irrevocable liability resides. For example, some courts have held that irrevocable liability occurs at the point where the plaintiff or plaintiff's broker authorizes the trade,[1] while others have held that it is at the point where the trade is "settled" or "cleared" (commonly through the Depositary Trust Company in New York City).[2] As a result of these conflicting decisions, the "irrevocable liability" approach to *Morrison* has cleared up some, but far from all, of the uncertainty surrounding *Morrison*'s second prong.

Further adding to the confusion left in *Morrison*'s wake, the Second Circuit followed up its adoption of the "irrevocable liability" test in *Absolute Activist* by adding another wrinkle to the *Morrison* analysis. In *Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE*, the Second Circuit held that, in certain circumstances, a transaction may be "so predominately foreign" in nature as to render Section 10(b) inapplicable altogether even where a plaintiff satisfies *Morrison*'s second prong by showing that the transaction occurred in the U.S. 763 F.3d 198, 216 (2d Cir. 2014) (explaining that a "domestic transaction is necessary *but not necessarily sufficient* to make Section 10(b) applicable [under *Morrison*]") (emphasis added). The Second Circuit reached this conclusion after determining that the transaction at issue — a private swap contract executed in the U.S. but the value of which was derived from the price of Volkswagen stock traded in Germany — was a "predominantly foreign" transaction that did not fall within the reach of the U.S. statutory regime. Although *Parkcentral* involved a distinctive derivatives transaction that is readily distinguishable from the more routine types of securities transactions commonly at issue in Section 10(b) cases, the decision nonetheless complicates the *Morrison* analysis in transnational cases.

ADRs Under *Morrison*

Taken together, these decisions have left courts and practitioners to grapple with *Morrison*, more specifically, when does Section 10(b) apply to transactions in foreign-based securities and what criteria should be considered. Of particular note, courts have struggled with how to treat ADRs — under *Morrison*.

ADRs themselves typically trade within the U.S and, as a general matter, can be either "sponsored," meaning the foreign issuer participates with the depositary bank that issues the ADRs for the issuer's foreign shares, or "unsponsored," meaning the depositary bank issues the ADRs without the issuer's involvement

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[1] *See In re Sanofi-Aventis Sec. Litig.*, 293 F.R.D. 449, 458 (S.D.N.Y. 2013) (irrevocable liability occurs upon "the act of agreeing on the number of shares to exchange, and the price the buyer is to pay").

[2] *See Absolute Activist Master Value Fund, Ltd. v. Ficeto*, No. 09-cv-8862, 2013 WL 1286170, at *18 (S.D.N.Y. Mar 28, 2013).

and, perhaps, even without its consent. While many ADRs are "listed" on U.S. exchanges, and have therefore been held to satisfy *Morrison*'s first prong (i.e., "transactions in securities listed on domestic exchanges"),[3] other ADRs are "unlisted" and trade only in the over-the-counter markets. Consequently, these unlisted ADRs must qualify as "domestic transactions" under *Morrison*'s second prong to come within Section 10(b)'s ambit.

The *Volkswagen* Decision

In a recent decision, Judge Charles Breyer of the Northern District of California addressed the question of *Morrison*'s application to claims based on transactions in sponsored, over-the-counter ADRs, providing much needed guidance in this area of securities law. *See In re Volkswagen "Clean Diesel" Marketing, Sales Practices & Product Liability Litigation*, 2017 WL 66281 (N.D. Cal. Jan. 4, 2017) ("*Volkswagen*").

Volkswagen is a securities class action brought against Volkswagen Aktiengesellschaf, Volkswagen Group of America, Volkswagen of America, and Audi of America, Inc. (collectively, "Volkswagen") and a number of Volkswagen executives for alleged violations of Section 10(b) and Rule 10b-5 promulgated thereunder. The shareholder class alleged that, despite their knowledge that certain Volkswagen-issued vehicles did not comply with U.S. and European emissions regulations, Volkswagen and its executives misled investors by falsely assuring them that the vehicles in question met all such regulations. Plaintiffs alleged that Volkswagen's misrepresentations surrounding emissions compliance artificially inflated the price of Volkswagen's securities around the world, including its ADRs traded in the U.S. Volkswagen maintains two sponsored ADR programs, representing the preferred and ordinary shares, both of which are sponsored by Volkswagen and trade on the over-the-counter market.

Court Rejects Application of *Parkcentral* to ADRs Sponsored by Foreign Issuer

The Volkswagen defendants moved to dismiss the plaintiffs' ADR-based claims on extraterritoriality grounds, arguing that non-listed, over-the-counter ADRs fell outside the reach of Section 10(b) under *Morrison*. As an initial matter, the court acknowledged that the OTC market on which the Volkswagen ADRs traded was not a "domestic exchange" as defined by *Morrison* and its progeny, and thus *Morrison*'s first prong was not satisfied. *Id.* at *4.

With respect to the second prong, the defendants, relying on the Second Circuit's decision in *Parkcentral*, argued that even if the plaintiffs could establish that the transaction took place within the U.S., Section 10(b) should not apply to their claims because their ADR transactions were "predominately foreign." *Id.* Specifically, the defendants argued that OTC ADRs were akin to the private swap agreements in *Parkcentral* and, thus, the plaintiffs' claims should be similarly barred because the value of the Volkswagen ADRs depended on an underlying foreign-issued security, and all relevant actions giving rise to plaintiffs' claims pointed to Germany. *Id.* at *5.

Judge Breyer disagreed and rejected the application of *Parkcentral*'s narrow, fact-specific holding to the case at hand. *Id.* at *5. The court explained that the *Parkcentral* plaintiffs had purchased swap agreements in private transactions in the U.S. to bet that the stock of one company, Volkswagen, would decline in value after another company, Porsche, announced it had no intention of acquiring control of Volkswagen, when, in reality, it did. *Id.* (citing *Parkcentral*, 763 F.3d at 207). While the underlying transactions took place in the U.S., the German corporate defendant had not sponsored the swap agreements, had no connection or control over the underlying security, and all relevant events had taken place in Germany. *Id.* Under these circumstances, Judge Breyer explained, the *Parkcentral* Court held that "the imposition of liability under § 10(b) on these *foreign defendants with no alleged involvement in plaintiffs' transactions*, on the basis of the defendants' largely foreign conduct, for losses incurred by the plaintiffs in securities-based swap agreements based on the price movements of foreign securities, would constitute an impermissibly extraterritorial extension of the statute." *Id.*

With that factual context in mind, Judge Breyer reasoned that, unlike the *Parkcentral* private swap agreements, the OTC ADRs at issue in *Volkswagen* were sponsored by the defendant, Volkswagen, which meant that Volkswagen was directly involved in the domestic offering of those ADRs in the U.S. *Id.* In other words, by sponsoring the ADRs, Volkswagen "took affirmative steps to make its securities available to investors here in the United States." *Id.* at *6. The court also noted that Volkswagen had, in connection with its sponsorship, "enter[ed] into a Deposit Agreement governed by New York law with a depositary bank, and submit[ed] a Form F-6 Registration Statement to the SEC to make the ADRs available in the United States." *Id.* Given these actions, Judge Breyer found that the plaintiffs satisfied *Morrison* because the ADRs

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[3] *See, e.g., U.S. v. Martoma*, 2013 WL 6632676, at *3 (S.D.N.Y. Dec. 17, 2013) (collecting cases).

DEAL ON EUROPEAN SHAREHOLDER RIGHTS DIRECTIVE

(continued from page 5)

the compromise text still needs to be formally approved by the European Council in April or May 2017, the outline is clear.

The rules establish rights and requirements for shareholders and companies, as well as other actors in the investing chain, including proxy advisors. The Directive provides, among other things, additional protection for shareholders with regard to related party transactions. It also provides shareholders with a vote on the remuneration policy for executive directors. The Directive also includes a provision for vote confirmation in case of electronic proxy voting. At the same time, European institutional investors will become subject to additional disclosure requirements.

Related party transactions

The Directive provides additional safeguards to shareholders of EU listed companies with regard to related party transactions. Transactions with related parties may cause prejudice to companies and their shareholders, as they may give the related party the opportunity to appropriate value belonging to the company (to the detriment of other shareholders). The Directive provides that material related party transactions are subject to a vote by the shareholders or the board of directors in order to protect the interests of the company. Companies should also publicly announce material transactions and provide sufficient information to share with other shareholders and creditors so they have the opportunity to assess the fairness of the transaction. Precise identification of the related party is necessary to better assess the risks implied by the transaction, and to challenge this transaction, including through legal action. The Directive does not provide a definition of material related party transactions, and therefore leaves it up to the Member States to define which transactions are subject to the provisions.

Vote on executive remuneration

In order to ensure that shareholders have an effective say on the remuneration policy, they should be granted the right to hold a binding or advisory vote on the remuneration policy. The remuneration policy should contribute to the business strategy, long-term interests and sustainability of the company, and should not be linked entirely or mainly to short-term performance objectives. The Directive states that a directors' performance, in light of the bonus scheme, should not only be assessed on the basis of financial performance. It should also take into account non-financial performance criteria, including where appropriate, environmental, social and governance factors. In order to ensure that the implementation of the remuneration policy is in line with the policy, shareholders should also be granted the right to vote on the company's remuneration report. In case a majority of the shareholders vote against a company's remuneration report in a given year, the company should explain in its next remuneration report how the vote of the shareholders has been taken into account.

Additional disclosure requirements

European based institutional investors and asset managers will become subject to additional disclosure requirements. Under the new rules, they will be required — on a comply or explain basis — to develop and disclose a policy on how they intend to engage with investee companies. The policy on shareholder engagement should describe, among other things, how institutional investors and asset managers integrate shareholder engagement in their investment strategy. Institutional investors and asset managers are also expected to disclose information about the implementation of their engagement policy. This should also include information about how they have exercised their voting rights. Additionally, institutional investors should annually disclose to the public how the main elements of their equity investment strategy are consistent with the profile and duration of their liabilities.

The Directive also touches on the relationship between asset managers and institutional investors. Asset managers should give proper information to institutional investors in order to allow the latter to assess whether the manager acts in its best long-term interests. According to the Directive, this information includes corporate governance matters as well as other medium-to-long-term portfolio risks. Asset managers should also disclose to institutional investor clients, information about portfolio turnover, portfolio turnover costs and their policy on securities lending. At the same time, institutional investors should disclose to the public, certain key elements of their arrangements with asset managers. An example, the asset manager is incentivized to align its investment strategy and decisions with the profile and duration of the liabilities of the institutional investors.

Shareholder identification

In the Directive, a provision is introduced that listed companies should have the right to identify their shareholders in order to be able to directly communicate with them. Intermediaries should have an obligation to communicate to the company, at their request, the information regarding shareholder identity. This also applies to intermediaries outside of the EU, which provide services with respect to shares of companies that have their registered office in an EU Member State, and whose shares are admitted to trading on a regulated market in the European Union. That information should at least include the name and contact details of the shareholder, the number of shares held by that shareholder, and at the request of the company, also include information about the date of acquisition. Companies and intermediaries should be allowed to store personal data until they have learned that a person or institution has ceased to be a shareholder.

Vote confirmation

As part of their stewardship responsibilities, many institutional investors make use of their voting rights at shareholder meetings of investee companies worldwide. Because most shareholders do not attend shareholder meetings in person, voting of shares to elect directors and approve or reject major corporate transactions, occurs principally via solicited proxies. Electronic proxy voting is the principal means by which most shareholders exercise their voting rights. But many investors have asked the question whether the existing proxy voting system is up to the task. It is widely recognized that the voting chain is long, complex, and that obstacles need to be overcome. Investors do not, for example, receive a confirmation that the vote has been exercised in line with their instructions.

The Directive recognizes that it is important for shareholders to know whether their votes have been correctly taken into account. Therefore, the provision is introduced that a confirmation of receipt of votes should be provided in case of electronic voting. The Directive does not provide any specifics about the vote confirmation, such as the format or content. Also, shareholders who cast a vote in a general meeting should have the ability to verify after the general meeting, whether the vote has been validly recorded and counted.

As mentioned previously, the European Council still needs to formally adopt the Directive in April or May 2017. After the Directive is officially published, EU Member States will have two years to transpose it into national legislation. Kessler Topaz Meltzer & Check LLP is able to provide its clients with more guidance and advice about the provisions in the Shareholder Rights Directive. ■

KESSLER TOPAZ WINS APPEAL IN "REVERSE PAYMENT" ANTITRUST CASE

(continued from page 3)

At issue before the First Circuit was whether the non-cash payment received by Watson triggers antitrust scrutiny under *Actavis*. The appellate court rejected the lower court's finding that under *Actavis* only a pure cash payment would prompt such scrutiny and found that other non-cash forms of payment will suffice.

Regulatory Framework

A brief review of the regulatory systemoverning access to prescription drugs is helpful to contextualize the First Circuit's decision. At bottom, the system is designed to balance the desire to reward innovation with the need to provide access to affordable drugs. The Drug Price Competition and Patent Term Restoration Act of 1984, commonly known as Hatch-Waxman, promotes the availability of less expensive generic products by simplifying the regulatory hurdles that generic manufacturers face in bringing their products to market. Under Hatch-Waxman, generic manufacturers are allowed to bypass the more burdensome New Drug Application ("NDA") process that brand companies must follow and file an Abbreviated New Drug Application ("ANDA"), which relies on the safety and effectiveness findings contained in the brand manufacturer's original NDA. Generic manufacturers must further show that the proposed generic product contains the same active ingredient(s), dosage form, route of administration, and strength as the brand product and that it is biologically equivalent, i.e. it is absorbed at the same rate and to the same extent as the brand product.

FDA approval of an ANDA, however, is dependent in part on the scope and duration of the patents covering the brand-name drug. Hatch-Waxman establishes procedures for resolving patent disputes between brand and generic manufacturers. Specifically, when seeking FDA approval of an ANDA, a generic manufacturer must certify that it will not infringe the brand manufacturer's patent. It can satisfy this requirement in numerous ways, including by certifying that the patent at issue is invalid or will not be infringed by the generic manufacturer's proposed product. This is what's known as a "paragraph IV certification."

To encourage generic manufacturers to seek approval of their products and challenge weak patents, Hatch-Waxman granted the first generic manufacturer to make a paragraph IV certification a 180-day exclusivity period to market the generic version of the drug upon receiving final approval from the FDA. During the 180-day period of exclusivity, the FDA may not grant final approval to any other generic manufacturer's ANDA for the same brand drug. However, the paragraph IV certification essentially counts as patent infringement and often provokes litigation.

Defendants' Reverse Payment Settlement

It is under this regulatory backdrop that Warner Chilcott and Watson's scheme with respect to Loestrin 24 played out. The defendants started as adversaries. Four months after branded Loestrin 24 received FDA approval in 2006, Watson notified Warner Chilcott that it filed an ANDA seeking to market generic Loestrin 24. Watson's letter included a paragraph IV certification that its generic product would not infringe U.S. Patent No. 5,552,394 (the " '394 patent"), the patent covering Loestrin 24. As the first generic manufacturer to file an ANDA with a paragraph IV certification, Watson was entitled to the 180-day exclusivity period. Upon receiving notice from Watson, Warner Chilcott sued for patent infringement in July 2006.

Warner Chilcott and Watson proceeded to litigate the patent case, with Watson attacking the '394 patent on grounds that it was invalid and unenforceable and that its proposed generic product would not infringe the '394 patent. Watson's arguments were based on, among other things, defects it identified in the '394 patent and certain misrepresentations and omissions that were made to the U.S. Patent and Trademark Office when the '394 patent was prosecuted. Faced with the prospect of losing the patent case and imminent generic competition, Warner Chilcott decided to settle in January 2009.

Pursuant to the settlement agreement, Watson agreed to delay the marketing of its generic Loestrin 24 product until January 2014, which would turn out to be approximately four years and four months after Watson obtained final FDA approval of its ANDA, in September 2009. In exchange for agreeing to delay its competing generic product for nearly four and a half years, Watson received several lucrative agreements and licenses. Though ostensibly non-cash consideration, these agreements and licenses were extremely valuable to Watson. This included a "no-AG" agreement, pursuant to which Warner Chilcott agreed not to launch a competing generic product during Watson's 180-day exclusivity period. This meant that when Watson's generic product finally came to market in January 2014 it would be the only generic product on the market for 180 days, allowing it to obtain all generic sales during that time period and charge a higher price for its generic product in the absence of competition.

In addition to the no-AG agreement, Warner Chilcott also agreed to designate Watson as a co-promoter of Femring, Warner Chilcott's hormone therapy product, which entitled Watson to a percentage of that product's net sales and fees. Further, Watson was granted an exclusive license to market a chewable oral contraceptive that became known as Generess Fe.

Actavis and the Current Litigation

All told, direct purchasers allege Warner Chilcott agreed to pay Watson tens of millions of dollars in agreements and licenses in order to delay competition in the relevant antitrust market. There was no procompetitive justification for this large reverse payment other than to keep Watson's generic product off the market and for Warner Chilcott to maintain its monopoly profits until January 2014. At its core, the reverse payment settlement was directed to delaying true generic competition in the relevant antitrust market and, ultimately, preventing purchasers from paying dramatically lower prices.

In *Actavis*, the Supreme Court found that "a reverse payment, where large and unjustified, can bring with it the risk of significant anticompetitive effects." *Actavis*, 133 S. Ct. at 2237. The likelihood of a reverse payment bringing about such effects "depends upon its size, its scale in relation to the payor's anticipated future litigation costs, its independence from other services for which it might represent payment, and the lack of any other convincing justification." *Id.* The Court left to the lower courts the structuring of reverse payment antitrust litigation consistent with the *Actavis* opinion. *Actavis*, 133 S. Ct. at 2238.

On the heels of *Actavis*, we filed our consolidated amended complaint on December 6, 2013 in the District Court for the District of Rhode Island. We alleged that Warner Chilcott and Watson engaged in an unlawful scheme with respect to Loestrin 24, in violation of Section 1 of the Sherman Act. We asserted, among other things, detailed allegations concerning Hatch-Waxman, Loestrin 24 and the '394 patent, the likely invalidity and unenforceability of the '394 patent, and the reverse payment settlement. With respect to the settlement we provided the detail necessary to conclude that the reverse payment from Warner Chilcott to Watson had a conservative value of tens of millions of dollars.

Despite our robust pleadings, the district court granted defendants' motion to dismiss our complaint, basing its ruling on a narrow reading of *Actavis*. Specifically, the district court found that under *Actavis* a large and unjustified payment only triggers antitrust liability when it is made in cash and that because we had "not pled facts suggesting that a cash payment was made, [the complaint] must be dismissed." *In re Loestrin 24 Fe Antitrust Litigation*, 45 F.Supp.3d 180, 193 (D.R.I. 2014). Despite its ultimate conclusion, the district court acknowledged that direct purchasers had adequately pled the existence of a Sherman Act violation. *Id.* Further, the district court noted that "it is of relatively little import" whether a payment for delay is made in cash or not and that "ultimately, *Actavis* can only serve as the solution to anticompetitive pay for delay arrangements insofar as it encompasses both cash and . . . increasingly prevalent non-cash payments." *Loestrin*, 45 F.Supp.3d at 193-194.

After we appealed the district court's decision, the First Circuit reversed the lower court, rejecting its limiting "cash only" analysis of *Actavis*. In doing so, the First Circuit was clear that *Actavis* "acknowledges that antitrust scrutiny attaches not only to pure cash reverse payments, but to other forms of reverse payment that induce the generic to abandon a patent challenge, which unreasonably eliminates competition at the expense of consumers." *In re Loestrin 24 Fe Antitrust Litigation*, 814 F.3d 538, 550 (1st Cir. 2016). The court noted that this approach is "consistent with antitrust law, which has consistently prioritized substance over form." *Id.* The case was remanded to the district court for further proceedings.

With its victory at the appellate level, Kessler Topaz has now returned to the district court and continues to vigorously litigate this matter consistent with the findings of the First Circuit and our ongoing investigation. ■

ADR TRANSACTIONS IN SECURITIES LITIGATION AFTER MORRISON

(continued from page 13)

in question "were and are offered to domestic investors on an OTC market located in the United States — and [p]laintiffs in fact purchased the ADRs in the United States." *Id*.

The defendants further argued, unsuccessfully, that because the ADRs in question were the "lowest level" of ADRs, or Level 1 — which means that Volkswagen had neither sought to raise capital in the U.S. nor filed periodic reports with the U.S. Securities and Exchange Commission ("SEC") (i.e., had not availed itself of the U.S. market) — the ADR transactions were, again, "predominately foreign." *Id*. at *5-6. As a general matter, ADRs fall within one of three levels, with Level 2 and Level 3 status requiring heightened SEC reporting, but providing the registrant with more access to the U.S. capital market.

Judge Breyer rejected this argument, explaining that "although Volkswagen is not subject to the SEC reporting requirements for Level 2 and 3 ADRs, it nevertheless must, and does, comply with SEC Rule 12g3-2(b), which requires a foreign issuer of certain domestic securities, such as ADRs, to provide on its website English-translated versions of market disclosure documents provided in its home country such that U.S. investors have relevant investment information." *Id*. Again, the court emphasized Volkswagen's sponsorship and active role in the marketing of the ADRs. *Id*. Based on these facts, Judge Breyer rejected the argument that "no relevant conduct occurred in the United States," explaining that the defendants' "relevant actions, which are clearly tied to the United States, take this case beyond the unique circumstances of [*Parkcentral*]." *Id*. As a result, the court held that the shareholder class had established a "domestic transaction" under *Morrison*'s second prong. This holding an be harmonized with the California district court's holding in *Stoyas v. Toshiba Corp*., where the court held that *unsponsored* ADRs that were both sold and purchased in the U.S. do not satisfy *Morrison*'s second prong absent evidence that the "[d]efendant was involved in those transactions in any way." 191 F. Supp. 3d 1080, 1094 (C.D. Cal. 2016).

Conclusion

The *Volkswagen* decision holds that Section 10(b) extends to claims based on transactions in over-the-counter ADRs, placing a particular focus on whether the offering of the ADR was sponsored by the foreign issuer-defendant. Sponsorship, according to the *Volkswagen* court, is evidence of the foreign issuer's direct involvement in, and affirmative steps toward, the offering of its ADRs in the U.S., which, Judge Breyer held, brought the plaintiffs' claims outside the holding of *Parkcentral*. While the *Volkswagen* court's guidance with respect to ADR-based claims is constructive, notably, both Judge Breyer's Volkswagen decision and the Second Circuit's *Parkcentral* decision appear to go beyond *Morrison*'s mandate of a bright-line "transactional" test — i.e., is the security either listed on a U.S. exchange or did the transaction occur within the U.S. — opting instead to focus on the qualitative facts at hand and draw distinctions based on the foreign issuer's actual contact with the U.S. market. Thus, whether *Volkswagen* has clarified or enhanced the confusion created by *Morrison* remains an open question. ■

WHAT'S TO COME

State Association of County Retirement Systems (SACRS) — Spring Conference
May 16 – 19 ■ Napa Valley Marriott Hotel & Spa — Napa, CA

National Conference on Public Employee Retirement Systems (NCPERS) — Annual Conference & Exhibition
May 21 – 24 ■ The Diplomat Hotel — Hollywood, FL

Pennsylvania Association of Public Employee Retirement Systems (PAPERS) — 13th Spring Forum
May 24 – 25 ■ Hilton Hotel — Harrisburg, PA

Canadian Fiduciary Roundtable
June 6 ■ Fairmont Royal York — Toronto, Ontario, Canada

County Treasurer's Association of Pennsylvania — Annual Convention
June 13 – 15 ■ Kalahari Resort and Convention Center — Pocono Manor, PA

Florida Public Pensions Trustees Association (FPPTA) — 33rd Annual Conference
June 25 – 28 ■ Omni Orlando Resort at ChampionsGate — Orlando, FL

National Association of Public Pension Attorneys (NAPPA) — Legal Education Conference
June 27 – 30 ■ Portola Hotel — Monterey, CA

Missouri Association of Public Employee Retirement Systems (MAPERS) — Annual Conference
July 12 – 14 ■ Tan-Tar-A Resort — Osage Beach, MO

Pennsylvania State Association of County Controllers (PSACC) — Annual Conference
July 23 – 27 ■ Cork Factory Hotel — Lancaster, PA

County Commissioners Association of Pennsylvania (CCAP) — Annual Conference and Trade Show
August 6 – 9 ■ Bayfront Convention Center – Erie, PA

Georgia Association of Public Pension Trustees (GAPPT) — Annual Conference
September 11 – 14 ■ The King and Prince Beach and Golf Resort — St. Simon's Island, GA

Council of Institutional Investors (CII) — 2017 Fall Conference
September 13 – 15 ■ Hilton San Diego Bayfront — San Diego, CA

National Conference on Public Employee Retirement Systems (NCPERS) — Public Safety Employees' Pension & Benefits Conference
October 1 – 3 ■ Hyatt Regency San Antonio — San Antonio, TX

Florida Public Pensions Trustees Association (FPPTA)— Fall Trustee School
October 8 – 11 ■ Tampa Marriott Waterside Hotel & Marina — Tampa, FL

International Foundation of Employee Benefit Programs (IFEBP) — 63rd Annual Employee Benefits Conference
October 22 – 25 ■ Mandalay Bay Resort and Casino — Las Vegas, NV

State Association of County Retirement Systems (SACRS) — Fall Conference
November 13 – 17 ■ Hyatt Regency San Francisco Airport — Burlingame, CA

County Commissioners of Pennsylvania (CCAP) — Fall Conference
November 19 – 21 ■ Hershey Hotel — Hershey, PA

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