Fall 2016

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

FULLY INFORMED

HIGHLIGHTS

Kessler Topaz Is Appointed Co-Lead Counsel in Litigation Challenging *Tesla Motors, Inc.'s Acquisition of SolarCity Corporation*

U.S. Court of Appeals Adopts Delaware Standard on Disclosure-Only Settlements of Merger Litigation

Australia Makes a Move Toward Allowing Common Fund Recoveries For Litigation Funders in Class Actions, but Key Issues Remain Unclear

Payment Card: The Second Circuit's Swipe at a Record Antitrust Settlement Should Have Limited Implications for Securities Class Actions

KTMC Associate, Samantha E. Holbrook, Serves as Coach for Temple Law'sPrestigious Trial Team

Second Circuit Eases Loss Causation Burden for Defrauded Investors in Watershed Ruling

KTMC GUEST COLUMN

Jordan Rand, Partner, Dilworth Paxson LLP

"When, Not If: What Fiduciaries Need to Know About Cyber Insurance"

EVENTS — What's to Come

KESSLER TOPAZ IS APPOINTED CO-LEAD COUNSEL IN LITIGATION CHALLENGING *TESLA MOTORS, INC.'S ACQUISITION OF SOLARCITY CORPORATION*

Kristen Ross, Esquire

On October 10, 2016, the Delaware Court of Chancery appointed Kessler Topaz as co-lead counsel in an action brought on behalf of Tesla Motors, Inc. ("Tesla") and a class of its stockholders challenging Tesla's acquisition of SolarCity Corporation ("SolarCity") in an all-stock transaction valued at over $2 billion. The acquisition is rife with conflicts and Kessler Topaz believes that Tesla is substantially overpaying for SolarCity. The action, captioned *In re Tesla Motors, Inc. Stockholder Litigation*, C.A. No. 12711-VCS, alleges that Tesla's Board of Directors breached its fiduciary duties owed to Tesla and its stockholders by approving the acquisition and that the acquisition unjustly enriched certain of its directors, including well-known billionaire Elon Musk.

(continued on page 6)

U.S. COURT OF APPEALS ADOPTS DELAWARE STANDARD ON DISCLOSURE-ONLY SETTLEMENTS OF MERGER LITIGATION

Michael C. Wagner, Esquire

In Kessler Topaz's Winter 2016 Bulletin, we described what now appears to be a settled trend in decisions from the Delaware Court of Chancery regarding settlements of merger litigation that principally provide additional disclosures to stockholders. These settlements had historically offered stockholders supplemental factual disclosures in exchange for broad "intergalactic" releases that insulated the defendants from any other claims regarding the transaction. The Court of Chancery, we noted, had reversed its routine approval of these "disclosure-only" settlements, and the attorneys' fees generally paid with an approved settlement, deciding to reject

(continued on page 9)

AUSTRALIA MAKES A MOVE TOWARD ALLOWING COMMON FUND RECOVERIES FOR LITIGATION FUNDERS IN CLASS ACTIONS, BUT KEY ISSUES REMAIN UNCLEAR

Geoffrey C. Jarvis, Esquire

On October 26, 2016, the Full Court of the Federal Court of Australia (the "Full Court"),[1] in *Money Max Int Pty Ltd (Trustee) v QBE Insurance Group Limited* [2016] FCAFC 148, granted an application to allow for litigation funders providing funding for class actions to obtain a funders' fee from all members of the class. The Court concluded, for the first time after several failed attempts, to allow for what are known as "common fund" orders. This decision has the potential for a significant impact on — and perhaps expansion of — litigation funding in Australia, but there still remain a number of open issues that will determine if that potential is realized.[2]

The Nature of Class Actions and Funding in Australia

In Australia, class actions can be brought on a "closed" or an "open" basis. In a closed class action, the class is comprised of only those investors who have signed a retention letter with class counsel and funding agreements with the litigation funder ("funded group members"). In an open class action, on the other hand, there are some funded group members, but there are also group members who have not entered into funding agreements with the funder ("unfunded group members"). Unfunded group members can essentially free ride on the funded group members and obtain many of the benefits of the litigation without bearing any of the costs.

The free rider issue previously had been addressed by Australian courts through what are known as funding equalization orders as part of the settlement of the class action. The effect of such orders is to redistribute an amount equivalent to the commissions that would have been payable by unfunded group members (had they entered into funding agreements) between all group members.[3] Thus, members of the class who have not signed a funding agreement are charged a fee as if they had signed up and the aggregate amounts collected are redistributed among all members of the class — both those who signed funding agreements and those who did not. The total commission that is owed to the funder does not change — it receives only the fees to which it was entitled from the funded group members — but the burden of paying that aggregate amount is borne by all members of the class.

The Potential Benefits of a Common Fund Order

A common fund approach, like the funding equalization approach, is a means to address the free rider problem. In theory, however, a common fund approach — particularly if ordered early in a case — has several potential advantages. Where a common fund is ordered, the same funding terms would be applied to all group members from potentially the outset of the case. This would provide the funder with the certainty that it would be able to call upon the entire class who benefits from the action to fund its premium. It would also provide all class members with knowledge that they would be subject to paying the funder and allow those who object to opt-out or at least object to the settlement if they consider it insufficient given the funding fee. It also potentially would allow class actions to be brought more quickly since there would be no need for a delay while the solicitors and funders "book-build", *i.e.*, sign-up class members to fund agreements. The book-building process sometimes can take several years.

(continued on page 16)

[1] The Federal Court of Australia is an Australian superior court that has jurisdiction to deal with most civil disputes governed by Australian federal law. Cases are heard at first instance by a single judge. The Federal Court includes an appeal division referred to as the Full Court where hearings are held before three judges. The only avenue of appeal from the Full Court is to the High Court of Australia.

[2] Litigation funding is critical in Australian class actions because lawyers are not permitted to act on a contingency basis. Thus, third party funding is required where litigants are unable or unwilling to pay the costs of the litigation.

[3] *P Dawson Nominees Pty Limited v Brookfield Multiplex Limited (No 4)* [2010] FCA 1029

PAYMENT CARD: THE SECOND CIRCUIT'S SWIPE AT A RECORD ANTITRUST SETTLEMENT SHOULD HAVE LIMITED IMPLICATIONS FOR SECURITIES CLASS ACTIONS

Nathan A. Hasiuk, Esquire and Johnston de F. Whitman, Jr., Esquire

Obtaining class certification in an action under the United States federal securities laws requires, among other things, demonstrating that questions of law or fact common to class members predominate over any individualized issues. *See* Federal Rule of Civil Procedure 23(b)(3). Defendants in such actions most frequently challenge class certification on the basis of predominance, arguing that market inefficiency or an alleged absence of price impact defeats a classwide presumption of reliance under *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), requiring class members to demonstrate reliance individually. Defendants also frequently challenge the adequacy of the proposed class representative under Federal Rule of Civil Procedure 23(a)(4) by contending that the representative possesses interests that are antagonistic to, or otherwise in conflict with, the interests of other class members.

Defendants in securities class actions may now also attempt to rely upon a recent Second Circuit opinion, *In re Payment Card Interchange Fee and Merch. Disc. Antitrust Litig.*, 827 F.3d 223 (2d Cir. 2016) in challenging the adequacy of a proposed class representative. As discussed herein, however, reliance on *Payment Card* in the securities fraud context will likely be misplaced, given both the distinct facts of that litigation and prior Second Circuit decisions declining to find fundamental conflicts between subclasses in securities fraud cases. While federal courts have not yet rendered decisions addressing the impact of *Payment Card*, the decision likely does not pose a significant additional challenge to obtaining class certification in a securities fraud class action.

Payment Card was commenced in 2006 against Visa and MasterCard on behalf of approximately 12 million current merchants and an unbounded number of future merchants, and resulted in a settlement of $7.25 billion plus certain injunctive relief — the largest antitrust settlement in history. Plaintiffs were merchants who accepted or would in the future accept Visa and MasterCard-branded credit cards, and were thereby bound by the card-issuer's network rules, which plaintiffs challenged as anti-competitive. *Id.* at 228. The parties agreed to a settlement after intense litigation, which included the production of more than 80 million pages of documents, 400 depositions, 32 days of expert testimony from 17 experts, and extensive negotiations involving both mediators and the court. *Id.* at 229.

In 2014, the United States District Court for the Eastern District of New York approved the settlement and certified two settlement-only subclasses based on the different types of relief afforded to current and future merchants in the proposed settlement. Namely: (i) a $7.25 billion monetary settlement was to be divided among merchants in operation at the time of settlement and certified as a subclass under Rule 23(b)(3); and (ii) a second subclass of future merchants certified under Rule 23(b)(2) were to receive purely injunctive relief consisting of modifications to the network rules imposed

(continued on page 10)

KTMC ASSOCIATE, SAMANTHA E. HOLBROOK, SERVES AS COACH FOR TEMPLE LAW'S PRESTIGIOUS TRIAL TEAM

Temple University Beasley School of Law is home to a nationally-ranked, award-winning Trial Team, recognized across the region for the strength of its advocates. Since the creation of the program by the late Professor Edward D. Ohlbaum in 1992, Temple Law teams have competed in approximately eight invitational, regional and national tournaments a year, earning Temple Law one of the best records in the country in major law school tournaments. The prestige of the trial team program at Temple Law is borne out by its competition record: to date, Temple teams have won five national and twenty-one national invitational championships. In the National Trial Competition, Temple Law has won the regional twenty-eight of the last thirty years, and "made the cut" to the national quarterfinal round seventeen times since 1995, finishing first in 1999, 1998 and 1995; and second in 2007, 1993 and 1992. Temple Law was also the first school to win the Top Gun National Mock Trial Competition when it was created in 2010, and the only school to win it twice. Temple Law also has deep connections to Kessler Topaz Meltzer & Check with numerous, partners, associates, and staff which are Temple alums. In addition, the Firm sponsors the Temple University Beasley School of Law Diversity Scholarship providing a full year's tuition to a qualified diversity student.

(continued on page 13)

Institutional Investor
FORUMS

8TH ANNUAL

Evolving Fiduciary Obligations of Institutional Investors

FEBRUARY 21, 2017 | TEMPE MISSION PALMS | TEMPE, AZ

Keynote Speaker

Al Gore
Former Vice President of the United States, Chairman,
The Climate Reality Project

Globalization–And the Role of Active Engagement in It–At a Crossroads

For 8 years now, in conjunction with co-host Kessler Topaz Meltzer & Check LLP, and with the essential input of an Advisory Board of your peers, we will offer a thorough overview of the landscape within which legal advisors 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 one-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.

Topics for Discussion:

- ❖ Putting Principles into Action: The General Counsels' Panel
- ❖ The Volkswagen Litigation: A Truly Global Shareholder Action
- ❖ Post-Morrison: What Is the Best Means for Smaller or Less Experienced Plans to Take Action Outside the US?
- ❖ Redefining "Fiduciary" for Everyone? The Consequences of the DOL's Fiduciary Rule for Plan Sponsors and Their Managers and Advisors
- ❖ Identifying and Rectifying Conflicts of Interest in Agreements with Managers and Consultants
- ❖ Creating an Investment Organization to Succeed: Governance, Structure, and Politics: The Canadian Example

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SECOND CIRCUIT EASES LOSS CAUSATION BURDEN FOR DEFRAUDED INVESTORS IN WATERSHED RULING

Margaret Onasch, Esquire and Josh Materese, Esquire

On September 27, 2016, the United States Court of Appeals for the Second Circuit issued a landmark ruling that provides new guidance for plaintiffs asserting claims under the federal securities laws. In *In re Vivendi, S.A. Securities Litigation*, the Second Circuit recognized for the first time the viability of the so-called "maintenance theory" of inflation in fraud-on-the-market securities class actions. 838 F.3d 223 (2d Cir. 2016) (*Vivendi III*). The maintenance theory allows a plaintiff to assert securities fraud claims based on false and misleading statements that did not cause an increase in a company's stock price and instead served to "maintain" the preexisting price inflation until a subsequent corrective disclosure, thus expanding the universe of potentially actionable statements. With this decision, the Second Circuit joined the Courts of Appeals for the Eleventh and Seventh Circuits in holding that plaintiffs do not need to prove a specific increase in stock price as a result of a particular misrepresentation by a defendant in order to assert a claim under Section 10(b).[1] In this same decision, the Second Circuit reinforced the validity of the "materialization of risk" theory of loss causation, which it first accepted in *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 173 (2d Cir. 2005).[2]

Procedural Background. *Vivendi* was a securities class action brought against Vivendi Universal, S.A. and two of the company's senior officers for alleged violations of the anti-fraud provisions of the U.S. securities laws, including Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 of the rules promulgated thereunder. *In re Vivendi Universal, S.A. Securities Litigation*, 765 F. Supp. 2d 512, 520-21 (S.D.N.Y. 2011) ("*Vivendi II*"). The plaintiffs alleged that Vivendi and certain of its officers falsely

(continued on page 14)

[1] These circuits recognized the viability of this theory in *FindWhat Inv'r Grp. v. FindWhat.com*, 658 F.3d 1282 (11th Cir. 2011) and *Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. 2010), respectively. While some commentators have asserted that in *IBEW Local 98 Pension Fund v. Best Buy Co.*, 818 F.3d 775 (8th Cir. 2016), the Eighth Circuit implicitly questioned the viability of the maintenance theory at the class certification stage, under the unique factual circumstances presented in that case, no circuit court has expressly rejected the theory.

[2] In *Lentell*, the Second Circuit explained that "to establish loss causation, a plaintiff must allege that . . . the misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security" and dubbed the event or events that released this previously concealed information the "materialization of risk." 396 F.3d at 173.

"WHEN, NOT IF: WHAT FIDUCIARIES NEED TO KNOW ABOUT CYBER INSURANCE"

Jordan Rand, Partner, *Dilworth Paxson LLP*

Find me a centralized repository of personal, financial and health information, and I will find you millions of attempts per day to access, steal or corrupt it. Even absent a malicious actor, there is an increasing likelihood that private data will be inadvertently made public. This is our world.

Somewhat like higher education institutions, public pension funds and other institutional investors are at the center of the bulls-eye, as they may maintain all three types of information. In my home town, Philadelphia, we saw it in 2011. A Philadelphia Public School Pension Fund employee mistakenly posted an unencrypted file on a public website, compromising the personal information of over 2,000 members. It was unclear how much of that data was actually accessed or misused.

In 2014, the Arizona State Retirement System suffered a considerably larger data breach, again without the kind of hacking attack that most associate with data breaches. The ASRS had sent two unencrypted computer discs to a dental benefits company. The discs contained personal information for over 44,000 members, but the discs never arrived. The ASRS spent almost $300,000 to ensure that the information on the discs was not obtained and misused by a third party. Again, it did not appear that any of the information was misused.

(continued on page 7)

Jordan is an insurance coverage litigator and recognized authority in the field of cyberinsurance coverage law. He is a partner in the commercial litigation department in Dilworth Paxson LLP's Philadelphia office. To stay abreast of the latest developments in cyberinsurance coverage law, subscribe to Jordan's blog: www.databreachninja.com

KESSLER TOPAZ IS APPOINTED CO-LEAD COUNSEL IN LITIGATION CHALLENGING *TESLA MOTORS, INC.'S ACQUISITION OF SOLARCITY CORPORATION*

(continued from page 1)

Background

On June 21, 2016, Tesla, which designs, manufactures and sells electric vehicles and energy storage products, announced in a blog post that it had made an offer to acquire solar energy system installer SolarCity. Elon Musk is the Chairman of the Board and largest stockholder of both companies, and also serves as Tesla's CEO. SolarCity was founded by Musk's cousins, Peter and Lyndon Rive, after Musk reportedly suggested they get into the solar industry. Elon Musk has long propped up the struggling, debt-ridden and cash-burning SolarCity, from taking out personal loans to purchase SolarCity stock to causing his private company Space Exploration Technologies Corporation, commonly known as SpaceX, to buy large blocks of SolarCity's "solar bonds." Upon the announcement of Tesla's offer to acquire SolarCity, Tesla's stock price dropped by 10% and it was promptly downgraded by several analysts.

On August 1, 2016, Tesla and SolarCity announced that they had executed a merger agreement pursuant to which Tesla would acquire SolarCity in an all-stock transaction that at the time valued SolarCity at approximately $2.6 billion, or between $25.37 and $25.83 per share (the "Acquisition"). The Acquisition is essentially a bailout of SolarCity, which otherwise could face bankruptcy in the near future. The Acquisition received approval from stockholders of both Tesla and SolarCity on November 17, 2016 and closed shortly thereafter. Although the companies have long touted that the required approval consisted of not only a majority of the total shares of each company, but also a majority of shares not affiliated with Elon Musk, these assurances were hollow, as the body of Tesla stockholders that participated in the purportedly "non-affiliated" votes still included many conflicted stockholders who owned shares in both companies and therefore stood to benefit from the bailout of SolarCity. Not surprisingly, Elon Musk acted like the Acquisition had already taken place well before the November 17th votes.

The Litigation

On September 12, 2016, Kessler Topaz commenced a class and derivative action in the Delaware Court of Chancery on behalf of several Tesla stockholders challenging the Acquisition, which plaintiffs allege is unfair to Tesla and its minority stockholders. Prior to commencing the litigation, Kessler Topaz undertook a thorough investigation of the facts and circumstances surrounding the Acquisition, including a review of certain non-public documents obtained from Tesla pursuant to 8 *Del. C.* § 220. The action alleges, among other things, that the members of Tesla's board of directors, including Elon Musk as its controlling stockholder, breached their fiduciary duties owed to the Company and its minority stockholders in approving the Acquisition, and that the Acquisition unjustly enriched the Tesla directors who owned SolarCity stock.

On October 10, 2016, the Court appointed Kessler Topaz as co-lead counsel in the action, noting that Kessler Topaz and its co-counsel "have an extraordinary track record in representative litigation in this Court, and I underscore 'extraordinary.'" Kessler Topaz seeks to recover for Tesla and its minority stockholders the damages suffered as a result of the Acquisition. The parties are currently negotiating a schedule for the defendants' response to the operative complaint. ■

"WHEN, NOT IF: WHAT FIDUCIARIES NEED TO KNOW ABOUT CYBER INSURANCE"

(continued from page 5)

That, however, was not the case this June, when hackers infiltrated at least 91 City of Chicago municipal employee retirement accounts and drew fraudulent loans in excess of $2.6 million. That same month, hackers stole the personal data of over a million Japanese citizens from the country's pension system.

When, not if.

It has become increasingly accepted that a director, whether of a public or private enterprise, has a duty to ensure that his or her enterprise has protections and policies in place for cybersecurity. There is also an apparent trend to formalize these requirements by regulation in particularly vulnerable industries, as is happening in New York in the financial and insurance industries.

It is equally settled that the best laid plans of mice and men will in this context most definitely go awry. Enterprise risk management must therefore include both front-end security and back-end risk transfer mechanisms, such as stand-alone cyberinsurance.

Cyberinsurance generally offers first party coverages that enable an insured to pay the considerable costs associated with identifying the source of a breach, mitigating the breach and complying with legal notice, credit monitoring and other potential post-breach obligations. These policies also offer coverage for cyberextortion, the ransomeware events that have made so many headlines in the healthcare industry, in addition to public relations coverage to address negative post-breach press. Most carriers also have available digital asset coverage, to cover the cost to restore corrupted or lost data, and business interruption insurance to address losses caused by network down time or other security related incidents. While not all of these first party coverages are appropriate for every entity, many believe that some combination of them is as or more important than the third party liability type coverages that more closely resemble commercial general liability coverage.

Cyber policies do provide these third party coverages, such as coverage for liability and defense in the event of a lawsuit by data subjects — the folks whose information was compromised. These policies also offer regulatory coverage, as government agencies have increasingly taken an aggressive role in investigating breaches and assessing substantial penalties against breached entities.

These basic coverage elements are fairly well understood at this stage in what is becoming an increasingly mature market. Not quite 20 years old, the cyberinsurance market generated almost $3 billion in premiums last year. Many project that that number will reach $5 billion or more by 2020. Few doubt that this market will eventually run parallel to the traditional property insurance market that generates $100 billion in annual premiums.

Given the maturation of the market and the influx of new carriers into it, it has become increasingly important to have a deeper understanding of cyber coverage beyond the fact that it is a necessity. Forms and language vary widely from carrier to carrier, and there is a wide range of products purporting to address cyber risk.

Not all products are created equal. A key misconception is that endorsements to other policies, such as professional liability policies, provide sufficient protection. While these endorsements can often be inexpensively added to traditional coverages, you get what you pay for. On October 25, 2016, one of the few courts to address cyber coverage to date specifically ruled that endorsements to property and casualty policies provided only first party, and not third party defense or indemnity coverage, after a grocery store chain was hacked and sued by various credit unions. *Camp's Grocery, Inc. v. State Farm Fire & Casualty Co.*, 2016 WL 6217161 (N.D. Ala.). Endorsements to other lines must be closely scrutinized, with a working assumption that they offer only limited or partial coverage for cyber risk.

Another area that is sometimes misunderstood is the relative value of data, with many assuming that financial information is the most valuable. Credit card numbers and bank account numbers, however, can be changed. The value window of that data is therefore small. Health information, on the other hand, may never change and is the most valuable data. For entities maintaining this information, cyberinsurance underwriters will want to see this data segregated from other less valuable data, with greater controls in place to limit access to it. Premiums will depend in large part on these protections and the number of records maintained by the insured.

To make a final, but critical point, insureds must carefully review exclusions that relate specifically to cybersecurity measures. Entities should be extremely wary of any exclusion requiring "reasonable" security or that speaks to specific security controls. Good policies will not include these types of exclusions because underwriters understand that what is reasonable or required today will change tomorrow, if not later today. And speaking as a lawyer, the last thing I would want for a client post-breach is a dispute with an insurer about whether security controls were reasonable.

The cyberinsurance procurement process is unique. Policies must be read. Language can be and is often negotiated. Form policies have greatly improved, but many of the provisions in them are new, have not been tested in court or have never been applied in the rapidly evolving digital landscape. Take advantage of this moment in time to work with carriers and brokers to tailor policies to your entity's needs so that when, not if, a breach occurs, your policy is ready to respond. ■

Institutional Investor FORUMS

12TH ANNUAL

The Rights & Responsibilities of Institutional Investors

MARCH 9-10, 2017 | NH GRAND HOTEL KRASNAPOLSKY | AMSTERDAM

Keynote Speaker

Condoleezza Rice

United States Secretary of State
(2005 – 2009)

Globalization and Its Consequences for Responsible Shareholders

The 12th Annual Rights & Responsibilities of Institutional Investors forum will again be held in Amsterdam and co-hosted by Institutional Investor and Kessler Topaz Meltzer & Check LLP. The pressing issues covered in this agenda will consider the ways that investment, legal and compliance officers from public pension plans, insurance funds, mutual fund companies, sovereign wealth funds, and selected asset management firms globally are paving a path forward—together—to meet larger, long term ESG and governance goals.

The 2017 program will focus on the opportunities—as well as the hurdles—presented by the evolving phenomenon of globalization. Will the new year see responsible investors acting more in concert to reach defined, achievable goals? Or will the growing stresses in the global investable landscape prove to be a step backward for the institutions focusing on governance, stewardship, and active engagement with the firms they invest in?

Topics for Discussion:

- ❖ Global CIO/CEO Panel
- ❖ General Counsels' Panel
- ❖ What Are the Consequences of the Prudent Person Rule for Active Shareholders?
- ❖ Setting the Standard for Auditor Accountability
- ❖ Trends and Developments for the Proxy Season 2017
- ❖ 2017: What Are Your Engagement Priorities?

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U.S. COURT OF APPEALS ADOPTS DELAWARE STANDARD ON DISCLOSURE-ONLY SETTLEMENTS OF MERGER LITIGATION

(continued from page 1)

disclosure settlements unless they provided "plainly material" information to stockholders. In essence, it now has to be obvious to the Court that the additional disclosures provided in a proposed settlement would have been important to stockholders in deciding whether to vote in favor, or against, a proposed merger transaction.

On August 10, 2016, in *In re Walgreen Co. Stockholder Litigation*,[1] the U.S. Court of Appeals for the Seventh Circuit, based in Chicago, adopted Delaware's "plainly material" standard for assessing disclosure settlements. The Court of Appeals overruled a decision by a District Court judge to approve a disclosure-only settlement of class action litigation arising from the $15 billion merger between Walgreen Co., the operator of Walgreens pharmacies, and Switzerland-based Alliance Boots. Judge Richard Posner, widely considered one of the top legal minds of his generation, wrote the Court of Appeals' decision.

In the settlement of the case, which occurred 18 days after the lawsuit was filed and less than a week before the stockholder vote, Walgreens agreed to provide six additional disclosures in supplemental proxy materials sent to its stockholders in exchange for a class-wide release of all disclosure claims.[2] Walgreens also agreed to pay the plaintiff's attorneys $370,000 in fees for conferring the benefit of additional disclosures. One stockholder class member objected to the settlement. The District Court, in approving the settlement and overruling the stockholder objection, had misgivings about and questioned the value of the additional disclosures, but ultimately concluded that the "supplemental disclosures may have mattered to a reasonable investor" in deciding how to vote on the deal.[3] Accordingly, the District Court approved the settlement and the award of attorney's fees. The stockholder objector appealed.

In the Court of Appeals' opinion reversing the District Court, Judge Posner criticized the lower court for making insufficient findings regarding settlement's actual value to Walgreens' stockholders: "'May Have' is not good enough. Possibility is not actuality or even probability. The question the judge had to answer was not whether the disclosures may have mattered, but whether they would be likely to matter to a reasonable investor."[4] Judge Posner analyzed each of the six supplemental disclosures and found all immaterial.[5] He reasoned that "[d] isclosures are meaningful only if they can be expected to affect the votes of a nontrivial fraction of the shareholders, implying that shareholders found the disclosures informative. . . . The supplemental disclosures in this case did not do that; they contained no new information that a reasonable investor would have found significant."[6]

Because of the Court of Chancery's deep experience, and the District Court's relative unfamiliarity, with merger litigation, the Court of Appeals advised the District Court to "heed"[7] the Court of Chancery's decision in *In re Trulia, Inc. Stockholder Litigation*,[8] one of the cases we discussed in the Winter 2016 Bulletin. Judge Posner adopted the "plainly material" standard that the Court of Chancery first announced in that case, and found that none of the disclosures in the Walgreens settlement met that standard.[9] The Court of Appeals, further, harshly criticized the stockholder's counsel who negotiated and proposed the settlement, finding that their pursuit of the settlement demonstrated that counsel "can't be trusted to represent the interests of the class."[10] In sending the case back to the District Court, Judge Posner suggested that the case should either be dismissed or new counsel should be appointed to represent the stockholder class.[11]

The Court of Appeals' decision in *Walgreen*, like the Court of Chancery's recent rulings regarding disclosure-only settlements, is a positive development for stockholders. All federal courts in Illinois, Indiana and Wisconsin have to follow the Court of Appeals decision in *Walgreen*, and Judge Posner's decision is likely to be persuasive elsewhere. Judge Posner recognized Delaware's preeminence in addressing merger litigation, giving additional reasons for courts outside of Delaware to follow the Court of Chancery. As other articles in the Kessler Topaz Bulletin have shown over the years, the Court of Chancery does not hesitate to award stockholders a real remedy when they are wronged by corporate fiduciaries. Stockholders would do well if other courts enforced stockholder rights as the Court of Chancery does. ■

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1 --- F.3d ----, No. 15-3799, slip op. (7th Cir. August 10, 2016).

2 *Id.*, slip op. at 3.

3 *Id.*, slip op. at 8-9.

4 *Id.*, slip op. at 8.

5 *Id.*, slip op. at 3-6.

6 *Id.*, slip op. at 7.

7 *Id.*, slip op. at 9.

8 129 A.2d 884 (Del. Ch. 2016).

9 *In re Walgreen Co.*, sip op. at 11

10 *Id.*, slip op. at 12.

11 *Id.*

PAYMENT CARD: THE SECOND CIRCUIT'S SWIPE AT A RECORD ANTITRUST SETTLEMENT SHOULD HAVE LIMITED IMPLICATIONS FOR SECURITIES CLASS ACTIONS

(continued from page 3)

by Visa and MasterCard. *Id.* at 229-30.[1] The district court, however, only appointed class representatives from the (b)(3) subclass and only one class counsel. While only members of the Rule 23(b)(3) monetary settlement subclass had the opportunity to opt out of the settlement, the settlement released all present and future claims arising out of the conduct alleged in the complaint, including the claims of members of the Rule 23(b)(2) subclass that could not opt out of the settlement. *Id.* Significantly, the release of claims against the defendants had no end date, but the injunctive relief for members of the Rule 23(b)(2) subclass would terminate in 2021. Numerous objectors appealed the settlement.

On appeal, the Second Circuit unwound nearly 10 years of litigation effort, vacating class certification and rejecting the settlement, finding that the (b)(2) subclass was inadequately represented by the class representatives, and therefore the settlement violated due process. The class representatives and their counsel represented both the Rule 23(b)(3) subclass receiving monetary relief and the (b)(2) subclass receiving only injunctive relief. Under those circumstances, the Second Circuit concluded that the class representatives and their counsel were in a conflicted position that could have led them to negotiate the settlement by increasing the monetary recovery for the (b)(3) subclass in exchange for agreeing to reduce the injunctive relief for the (b)(2) subclass. *Id.* at 234.

Although the result seems shocking at first glance, the Second Circuit's *Payment Card* decision is consistent with Second Circuit and Supreme Court precedent. In this regard, the court reiterated that due process, or fairness to class members, requires "that the named plaintiff at all times adequately represent the interests of the absent class members." *Id.* at 231. "That principle is secured by Rule 23(a)(4) . . . . which requires that the representative parties . . . fairly and adequately protect the interests of the class." *Id.* at 231, quoting Fed. R. Civ. P. 23(a)(4). The "adequacy" requirement is two-fold, focusing "'on conflicts of interest between named parties and the class they seek to represent,' as well as the 'competency and conflicts of class counsel.'" *Id.*, quoting *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 625, 626 n. 20 (1997).

Here, the Second Circuit noted that even where a fundamental conflict exists, a class can still be certified provided that there is a "structural assurance of fair and adequate representation," such as dividing the class into subclasses with separate representation. *Id.* (quoting *Amchem*, 521 U.S. at 627). The court further observed that "it is obvious after *Amchem* that a class divided between holders of present and future claims . . . requires division into homogenous subclasses under Rule 23(c)(4)(B), with separate representation to eliminate conflicting interests of counsel." *Id.* at 232, quoting *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 856 (1999). Even if the class is subdivided such that a single class representative holds claims in all subclasses, the *Payment Card* court noted that its prior decisions required that each subclass must be given separate representation where the interests of the subclasses are antagonistic to each other "on a matter of critical importance," such as how the money would be distributed. *Id.* at 233, discussing *In re Literary Works in Elec. Databases Copyright Litig.*, 654 F.3d 242, 254 (2d Cir. 2011).

The *Payment Card* court applied these well-established principles to the settlement-only classes before it and rejected the settlement. In so doing, the court observed that the "most consequential relief afforded the (b)(2) class," namely the ability to surcharge Visa and MasterCard-branded credit cards at the point of sale, was of questionable value given that many states prohibited such surcharging, and that a provision of the settlement prohibited surcharging by merchants who also accepted American Express. 827 F.3d at 229-30. Thus, only a small subset of the (b)(2) class could avail themselves of the injunctive relief available to that subclass. As such, the (b)(2) class members

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[1] Rule 23(b)(2) provides an alternative basis for class certification where plaintiffs seek injunctive relief that is appropriate on a classwide basis. A showing of predominance is not required for (b)(2) classes or subclasses.

were subject to a broad release of all claims arising out of the conduct alleged in the complaint, *id*. at 230, but many would receive little or no benefit from the settlement.

While an "inferior recovery [is not] determinative evidence of inadequate representation," *Literary Works*, 654 F.3d at 253, absent separate representation, a reviewing court has no way of assessing whether the inferior recovery reflects the relative weakness of the claims of the subclass or inadequate representation arising out of an intra-class conflict, *Payment Card*, 827 F.3d at 233. The Second Circuit concluded, therefore, that due process requires that a settlement-only subclass in such circumstances be provided "independent counsel pressing its most compelling case." *Literary Works*, 654 F.3d at 253. The *Payment Card* court emphasized that the involvement of impartial mediators and judges in the settlement negotiations could not cure the deficiency inherent in unitary representation when there are fundamental intra-class conflicts. 827 F.3d at 234-35. Consequently, the Second Circuit found the settlement violated the due process rights of absent members of the (b)(2) subclass, who were given only injunctive relief of questionable utility in exchange for a permanent release of their claims. *Id*. at 240.

In assessing any potential impact of *Payment Card* on securities fraud cases, it is important to bear in mind the distinctive features of the class at issue in that case: (i) a settlement-only class involving subclasses certified under different provisions of Rule 23; (ii) with different relief afforded to each subclass; (iii) non-overlapping membership; and (iv) unitary representation. *Payment Card*, 827 F.3d at 235.[2] The presence of all these features would be extraordinarily rare in a securities fraud class action. This is particularly true given that claims for monetary relief generally may not be certified under Rule 23(b)(2). *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 361 (2011).

Moreover, the *Payment Card* court noted that a settlement reached *after* a class is certified does not raise the same level of suspicion that inferior subclasses may have been undervalued to maximize the recovery of the subclass that the class representatives represent. 827 F.3d at 236. In securities class actions that are certified prior to settlement, unitary representation of subclasses should not create the problems seen in the *Payment Card* settlement, particularly because it is highly unlikely that one subclass will receive money while another subclass will receive only injunctive relief — all in exchange for releasing all claims against the defendants. Even in the context of a class seeking certification for settlement purposes only, courts have held that potential conflicts of interest between possible subclasses are not implicated where the proposed settlement makes no distinction in terms of distribution among subclasses. *See, e.g., Lyons v. Scitex Corp.*, 987 F. Supp. 271, 275 (S.D.N.Y. 1997) (distinguishing *Amchem* and finding class representative adequate where

(continued on page 18)

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[2] The *Payment Card* court stressed that it was not holding "that (b)(3) and (b)(2) classes cannot be combined in a single case, or that (b)(3) and (b)(2) classes necessarily and always require separate representation." *Id*.

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 are now launching a full-day roundtable focusing on shareholder rights and attendant issues to take place June 6 in Toronto. The Canadian Fiduciary Roundtable will gather 25 senior representatives of pension funds and selected endowments and asset management firms to discuss such issues as setting priorities in your ESG/SRI investing, making the most of opportunities to affect governance change when necessary, and quantifying the benefits of being an actively engaged investor.

Whether it is determining the true definition 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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KTMC ASSOCIATE, SAMANTHA E. HOLBROOK, SERVES AS COACH FOR TEMPLE LAW'S PRESTIGIOUS TRIAL TEAM

(continued from page 3)

Samantha E. Holbrook, an associate of the firm, has served as a coach for Temple Law's Trial Team since 2012. During her time as a student at Temple Law, Ms. Holbrook was a member of the team herself, having competed in the National Institute for Trial Advocacy's Tournament of Champions Competition in the fall of 2010, and gone on to make it to the semi-finals in the Regional Tournament for the National Trial Competition, which Temple Law hosts each year in Philadelphia, in the spring of 2011. Her success as an advocate on Temple Law's Trial Team led Ms. Holbrook to be awarded the Philadelphia Trial Lawyers Association James J. Manderino Award for Trial Advocacy in June, 2011. As an alumna of Temple's Trial Team, Ms. Holbrook was eager to give back to the program, gladly accepting the position as an adjunct professor coaching the Trial Team in 2012.

Over the years in this role, Ms. Holbrook has coached seven teams, competing in trial competitions across the country. Beginning in the fall of 2012, Ms. Holbrook coached a team competing in the National Civil Rights Competition in Los Angeles, California. She then went on to coach teams competing in the John Marshall School of Law Trial Competition in Houston, Texas, in the spring of 2013, and The National Civil Rights Competition in Queens, New York, in the fall of 2013. In the spring of 2014, Ms. Holbrook, along with her co-coach, Brian Burack of the Chester County District Attorney's office, coached a team to a first place victory in the Capitol City Challenge Tournament hosted by American University's Washington College of Law in March, 2014. In the Capitol City Challenge Tournament's six year history, Temple has won the championship three times and finished second once. In 2014's championship run, the team defeated 20 other teams, including Fordham University in the final round. One of Temple Law's advocates was awarded "Best Advocate" in the final round of the Capitol City Tournament. Thereafter, Ms. Holbrook accompanied teams to the Buffalo Niagara Mock Trial Competition in Buffalo, New York, in the fall of 2014, and the American Association for Justice Student Advocacy Trial Competition in Brooklyn, New York, in the spring of 2015, where the team brought home semi-final honors under the leadership of Ms. Holbrook and her co-coach, Philadelphia Court of Common Pleas Judge, Mia Roberts Perez. Most recently, this fall Ms. Holbrook coached a team competing in the Puerto Rico Trial Advocacy Competition in Puerto Rico.

Each tournament releases a comprehensive trial problem approximately six to eight weeks prior to the scheduled competition. Competing teams are required to analyze the case file, make use of the evidence included, and craft prosecution and defense case theories to present at competition. The students are broken down into team of four, with two individuals comprising each a plaintiff and defense team, each student serving as an attorney, and oftentimes, also as a witness for their teammates. During every trial, each team member must deliver one speech (either an opening or a closing) and conduct one direct and one cross examination. Generally, each team tries a minimum of three trials during the preliminary rounds of the tournament before advancement to the medal rounds (quarters, semi-finals and finals). In each trial, students are judged by a bench of at least three trial lawyers and/or judges from the respective tournament sites, scored on opening and closing speeches, direct and cross examinations, presentation of evidence and objections, and overall style and demeanor.

The success of Temple Law's Trial Team program can be attributed in large part to a rigorous practice schedule, dedicated faculty members, and, of course, talented students. Typically, teams meet three times a week to practice for several hours at a time, including one day over the weekend, to refine case presentations and polish their litigation skills prior to competition. The time commitment can be demanding, but the payoff equally as rewarding. "My membership on Temple's Trial Team was one of the most fulfilling experiences of my law school career," says Ms. Holbrook. "When Temple invited me back to participate in the program as an adjunct professor, I didn't think twice about accepting the offer. Giving back to the program as a coach has been so rewarding, and I cannot think of a better way to honor the memory of my own late Trial Team coach, Professor Edward Ohlbaum ("Eddie"), than by carrying forth his legacy of training strong Temple advocates. I am honored to have the opportunity to do just that."

Sara E. Jacobson, Director of Trial Advocacy Programs and Associate Professor at Temple Beasley School of Law comments, "Sam Holbrook is one of our most dedicated and talented coaches. She was an amazing asset to the team when she was in law school and continues to build Temple's legacy of Trial Team excellence by building the next generation of trial team competitors. As a coach she is smart, she is fair, and she works to bring the best out of the students she coaches. We are very, very lucky to have her on our coaching staff. When the Appellate Advocacy/Moot Court program decided to expand and was looking for coaches, my first thought was of Sam. She is, put simply, as strong as a coach as she is in a courtroom."

At KTMC, Ms. Holbrook concentrates her practice in the areas of consumer protection, ERISA, and fiduciary litigation. ■

SECOND CIRCUIT EASES LOSS CAUSATION BURDEN FOR DEFRAUDED INVESTORS IN WATERSHED RULING

(continued from page 5)

represented Vivendi's liquidity position in 2001 and 2002, which artificially inflated the price of the company's American Depositary Receipts, causing investors to suffer losses when the truth about the company's liquidity condition was revealed through a series of events in 2002. *In re Vivendi Universal, S.A. Securities Litigation*, 605 F. Supp. 2d 570, 573 (S.D.N.Y. 2009) ("*Vivendi I*"). Following a three-month trial, the jury returned a verdict for the plaintiffs, finding that Vivendi had violated Section 10(b) and Rule 10b-5. *Vivendi II* at 520-21.

After the jury verdict, the defendant company, Vivendi, renewed its motion for judgment as a matter of law with respect to a number of issues, including the plaintiffs' reliance on the maintenance theory and materialization of the risk theory. As discussed herein, Judge Richard Howell, of the Southern District of New York, denied Vivendi's motion. *Vivendi II* at 555-63. Following Judge Holwell's decision, Vivendi appealed to the Second Circuit challenging, among other things, the plaintiffs' reliance on the maintenance theory of inflation by claiming that the testimony of Dr. Blaine Nye, the plaintiffs' expert on damages and loss causation, was unreliable and inadmissible. *Vivendi III.* Vivendi also challenged the sufficiency of the evidence introduced by the plaintiffs to support loss causation, and specifically, whether the loss that the plaintiffs sought to establish resulted from a materialization of the risk concealed by Vivendi's misstatements. *Id.*

Maintenance Theory of Inflation. With regard to loss causation, Vivendi argued to the district court that the jury's acceptance of the maintenance theory of inflation was improper. *Vivendi II* at 561-63. Under this theory, as noted above, a misrepresentation or omission may be actionable where it does not introduce inflation into a company's stock price and instead maintains existing inflation.

The plaintiffs in *Vivendi* sought to recover for the losses they suffered when the truth about the company's liquidity condition was revealed in 2002, notwithstanding that many of the statements the plaintiffs alleged were materially false and misleading did not cause a corresponding increase in Vivendi's stock price — i.e., these statements had no "price impact" at the time of issuance. However, Vivendi contended that it was insufficient to show merely that the stock price declined on days when corrective information was revealed and instead asserted that the plaintiffs were required to demonstrate that inflation was introduced into the stock price when the false statements were made.

Thus, in challenging the jury's loss causation finding, Vivendi claimed, in part, that the plaintiffs failed to prove that any of the alleged misstatements caused inflation because the inflation identified by the plaintiffs' expert, Dr. Nye, "did not correspond to the fifty-seven misstatements, such that 43 of the fifty-seven statements the jury found to violate Section 10(b) actually occurred on days when inflation remained constant or decreased." *Vivendi II* at 561. Vivendi further contended that the jury could not properly find liability for statements made on days during which the inflation of the stock price either decreased or remained constant. *Id.*

The maintenance theory of inflation is the commonsense retort to Vivendi's argument — false information may be impounded into a company's stock price by maintaining the price at an artificially inflated level as opposed to introducing new inflation, especially where such false information serves to preserve a status quo when the status quo has, in fact, changed. Recognizing this, Judge Holwell rejected Vivendi's contentions and explicitly adopted the maintenance theory, stating, "courts have suggested that a misstatement may cause inflation simply by *maintaining* existing market expectations, even if it does not actually cause the inflation in the stock price to increase on the day the statement is made." *Id.* Judge Holwell further stated that "a statement can cause inflation by causing the stock price to be artificially maintained at a level that does not reflect its true value." *Id.* at 562. As the court explained:

> The maintenance theory of inflation simply reflects the reality that inflation in a company's stock price is difficult to quantify with mathematical precision in any case, and that in a case where a company repeatedly makes statements that omit information about its liquidity risk, it is reasonable to conclude that each misstatement played a role in causing the inflation in the stock price (whether by adding to the inflation or

> helping to maintain it), even if it is not possibly to quantify the exact impact that each statement had on the inflation.

Id. Therefore, Judge Holwell denied Vivendi's motion for judgment as a matter of law with respect to the plaintiffs' reliance on the maintenance theory of inflation.

On appeal, Vivendi changed tack slightly, arguing that the district court abused its discretion in admitting Dr. Nye's testimony and asserting that Dr. Nye's testimony was unreliable, due, in part, to his reliance on the maintenance theory. *Vivendi III* at 253-60. In addressing Vivendi's contentions, the Second Circuit first provided an overview of Dr. Nye's methodology and then turned to Vivendi's claim that the fact that forty-two of the false and misleading statements alleged by the plaintiffs "did not directly correlate with specific increases in inflation made [Dr.] Nye's testimony unreliable." *Id*. at 253-56.

Vivendi asserted that "the securities laws require an alleged misstatement to have a 'price impact,' and that no such price impact exists with respect to these forty-two statements." *Id*. at 256. Vivendi's contention was based on its argument that "statements that introduce new inflation actually affect a company's stock price, while statements that merely maintain inflation have no impact . . . because the pre-existing inflation would have persisted had the defendant who made those inflation-maintaining statements simply remained silent . . . ." *Vivendi III* at 257. Vivendi also criticized Dr. Nye for "fabricat[ing] an erroneous inflation 'maintenance' theory" — a theory that Vivendi claimed violated the securities laws. *Id*. at 256. As the Second Circuit explained, Vivendi's argument "rests on two premises: that the maintained inflation would have remained if Vivendi had simply remained silent; and that Vivendi had the option of remaining silent even though it in fact chose to speak." *Id*. at 257.

Like the district court, the Second Circuit was not persuaded by Vivendi's challenge to the maintenance theory. Citing to the Eleventh Circuit's *FindWhat* opinion, the Second Circuit noted: "It is far more coherent to conclude that [an affirmative material] misstatement does not simply maintain the inflation the inflation but indeed prevents the preexisiting inflation in a stock price from dissipating." *Id*. at 258 (citing *FindWhat*, 658 F.3d at 1317). The Second Circuit further noted that by assuming that the question of whether the inflation would have remained in the stock price had the company remained silent was relevant, Vivendi "misunderstands the nature of the obligations a company takes upon itself at the moment it *chooses*, even without obligation, to speak." *Vivendi III* at 258. In other words, "once a company chooses to speak, the proper question for purposes of our inquiry into price impact is not what might have happened had a company remained silent, but what would have happened if it had spoken *truthfully." Id*.

As the Second Circuit summarized: "Vivendi's argument thus rests on erroneous principles that, once dispelled, make clear that it is hardly illogical or inconsistent with precedent to find that a statement may cause inflation not simply by *adding* it to a stock, but by maintaining it." *Vivendi III* at 258. The Second Circuit then noted that it "agree[d] with the Seventh and Eleventh Circuits that securities-fraud defendants cannot avoid liability for an alleged misstatement merely because the misstatement is not associated with an uptick in inflation." *Id*. at 259.

Applying these principles to the facts of the case, the court stated, "there is little need to speculate what would have happened to the inflation in Vivendi's stock price had it released to the public not a rosy picture of its liquidity state, but the misgivings its executives were sharing behind the scenes." *Id*. at 258. Circling back to the relevance of Dr. Nye's testimony, the court concluded that Dr. Nye's testimony was relevant to both loss causation and damages, stating: "*A fortiori* [Dr.] Nye's testimony did not have to show an association [with an increase in stock price] for each alleged misstatement in order to rest on a reliable foundation and be relevant to the task at hand." *Id*. at 260.

Materialization of the Risk Theory. At the district court level, Vivendi also challenged the plaintiffs' "materialization of risk" theory of loss causation. Under this theory, a plaintiff may claim damages caused by the occurrence of subsequent adverse events, rather than a one-for-one correction of a prior misstatement or omission, if these events were a foreseeable materialization of the risk concealed by the defendant's fraud.

In contesting the jury verdict, Vivendi argued that the plaintiffs failed to show a connection between the alleged fraud and the events that they claimed were materializations of Vivendi's undisclosed liquidity risk. *Vivendi II* at 555. Specifically, Vivendi asserted that for these materialization events to fall within the zone of risk concealed by the defendants' fraud, "a reasonable investor who believed the fraud must have perceived each of the events in question as 'remote or highly unlikely.'" *Id*. at 556. Vivendi also contended that the alleged materialization "events did not reveal anything undisclosed about the 'specific misrepresentations' alleged by plaintiff, and therefore cannot be said to fall within the zone of risk concealed by the fraud." *Id*.

Judge Holwell rejected both of these contentions. First, the court concluded that based on the testimony from fact and expert witnesses introduced by the plaintiffs, "the jury was entitled to conclude that each event identified by Dr. Nye fell within the zone of risk concealed by Vivendi's fraud in the sense that an investor who believed the fraud would have thought it 'highly unlikely' that these events would unfold at the time they did and under the

(continued on page 17)

AUSTRALIA MAKES A MOVE TOWARD ALLOWING COMMON FUND RECOVERIES FOR LITIGATION FUNDERS IN CLASS ACTIONS, BUT KEY ISSUES REMAIN UNCLEAR

(continued from page 2)

The *Money Max* Proceeding

The *Money Max* case is a shareholder class action brought by Money Max, against QBE Insurance Group Ltd (QBE), pursuant to the Federal Court of Australia Act 1976. QBE is alleged to have made misleading statements and failed in its disclosure obligations with respect to its North American business during the period August 20, 2013 through December 6, 2013. The action is funded by a litigation funder, International Litigation Funding Partners Pte Ltd ("ILFP"). Money Max has sought an "open class" comprising all persons who acquired an interest in QBE shares during the Class Period. There were approximately 1300 members of the class who had signed funding agreements with ILFP, which collectively held between 25 and 50 percent of all QBE shares that were impacted by the fraud. *Money Max* at ¶¶25-29. Pursuant to each Funding Agreement, ILFP was to receive a funding fee of either 32.5% or 35% (depending upon how many QBE shares they acquired in the class period).

The *Money Max* "Common Fund" Decision

Money Max had sought an order by the Court requiring all members of the open class, whether or not they had signed a funding agreement, to pay a commission of 30 percent of their recovery to the funder. As an alternative, it proposed a somewhat ambiguous second order that would require that

> no amount payable by the Applicant and Group Members pursuant to [the common fund order] is to exceed an amount that would otherwise be payable by the Applicant and Group Members in the event that [the common fund order] had not been made

Money Max at ¶34.2.

The Full Court granted Money Max's proposal and allowed a common fund for the first time, hold that:

> A common fund approach may be said to enhance access to justice by encouraging "open class" representative proceedings as a practical alternative to the "closed class" representative proceedings which are prevalent in funded shareholder class actions. Open class proceedings are more consistent with the opt out representative procedure envisaged by the legislature . . . . Further, by encouraging open class proceedings, a common fund approach may reduce the prospect of overlapping or competing class actions and reduce the multiplicity of actions that sometimes occurs with class actions.

The Full Court, however, declined to establish a funding percentage at the outset as sought by Money Max and instead concluded that it would not occur until much later in the proceeding. It relied in part on experience in U.S. class action for its finding that not establishing the rate at the outset might discourage funders. It also specifically noted "our view that it is highly likely that the funding commission will be approved at a rate lower than 32.5% or 35% [the two rates in the funding agreements for the case]." *Money Max* at ¶11. Finally, the Full Court adopted the "alternative" proposed by Money Max and concluded that class members would not be worse off under the common fund order than if the order had not been made. *Money Max* at ¶11. It also allowed class members to opt-out of the class action if they did not wish to be subject to a common fund.

Implications of *Money Max* for Funders and Class Actions in Australia

Money Max undeniably is an important precedent, requiring for the first time all of the members of a class who benefit from the action to bear the costs associated with obtaining that recovery through the imposition of a common fund. The decision, however, imposed two important contrary considerations that may (or may not) impact the significance of the decision going forward.

First, by not allowing the commission level for the funders to be set until near the end of the proceeding, funders may be deterred from relying on the common fund approach altogether and continuing with the book-building procedures and the use of closed class actions as heretofore has been the norm. On the other hand, it is relatively undisputed that, even though in U.S. class actions fee determinations for lawyers are not made until the end of such cases, that uncertainty has not caused a reduction in such actions (as noted by the Full Court). This may well prove to be the case in Australia as well. Thus, it is possible (and perhaps even likely) that as courts in Australia issue common fund orders, and funders understand what their likely levels of recovery will be, the lack of an

upfront recovery rate will not be a significant deterrent to bringing such actions.

On the other hand, the additional requirement imposed by the Full Court that class members would not be worse off under the common fund order than if the order had not been made, may have such a deterrent effect — depending upon how it is interpreted going forward. At least one defense firm has opined that under this provision, a funder will not be able to obtain more compensation that it is entitled to under its funding agreements and thus "the total commission payable to the funder has not increased, and in fact may decrease, as the funding commission is capped at the amount payable had the order not be made."[4] This firm has concluded that "the funder may still need to attempt to reach individual agreements with all group members as that is the only way to increase its funding fee. . . ."[5]

If this interpretation turns out to be accurate, the ability of applicants to obtain funding of 100% open class actions, without resort to book-building and the signing up of class members to funding agreements, likely would be impossible since the "alternative" compensation that would act as the cap on the aggregate funding proceeds would be no funding agreements and thus "0" compensation to the funder. In fact, under this interpretation, it is not even clear that a common fund order would provide any benefits different from the funding equalization orders that have been relatively commonplace.

This interpretation of the decision, however, while consistent with the language employed by the Full Court, would seem to fly in the fact of the Full Court's determination that it was making a significant change in the funding environment in Australia. So there is the reasonable likelihood that courts that interpret the Money Max decision will not limit funders' aggregate returns merely to those that they would obtain under existing funding agreements. As is often the case with such landmark decisions — "only time will tell." ■

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[4] "A Common Fund Order, Or Is It?, Clifford Chance Briefing Note, October 2016, www.cliffordchance.com/briefings/2016/10/a_common_fund_orderorisit.html.

[5] *Id.*

SECOND CIRCUIT EASES LOSS CAUSATION BURDEN FOR DEFRAUDED INVESTORS IN WATERSHED RULING

(continued from page 15)

circumstances they did." *Id.* at 557. Second, Judge Holwell found that "it was perfectly reasonable for the jury . . . to conclude that the events on the nine days identified by Dr. Nye, including several ratings downgrades, revealed new information about Vivendi's liquidity condition that had been concealed by Vivendi's fraud." *Id.* at 560. Thus, Judge Holwell denied Vivendi's challenge to the plaintiffs' theory of loss causation and declined to overturn the jury's verdict.

On appeal, Vivendi similarly asserted that the concealed risk (i.e., the risk of a liquidity crisis) must have materialized through a more significant problem (i.e., an actual liquidity crisis) in order for the plaintiffs to show that Vivendi's fraud caused their losses. *Vivendi III* at 261. Because there was no objective liquidity crisis event, such as a bankruptcy, default or insolvency, Vivendi argued that the plaintiffs could not prove loss causation. *Id.*

The Second Circuit, however, was again unpersuaded by Vivendi's contention. Citing to *Lentell*, the court reiterated that "to establish loss causation, plaintiffs must show that a misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security." *Vivendi III* at 261. Thus, the Second Circuit stated: "Whether the truth comes out by way of a corrective disclosure describing the precise fraud inherent in the alleged misstatements, or through events constructively disclosing the fraud does not alter the basic loss causation calculus." *Id.* at 262.

Turning to the facts of the case, the court explained that while "no specific corrective disclosure ever exposed the precise extent of Vivendi's alleged fraud, Plaintiffs' theory of loss causation nevertheless rested on the revelation of the truth" in that "Vivendi's alleged misstatements concealed its liquidity risk, and a series of events in the first half of 2002 made the truth about that liquidity crisis come to light." *Id.* After reviewing the loss causation events identified by Dr. Nye, the court again cited to *Lentell*, concluding that there was "ample evidence to support the jury's finding of a sufficiently direct relationship between the loss that Plaintiffs suffered on these nine days and the information misstated or concealed by Vivendi." *Vivendi III* at 262-63. The court determined, therefore, that the evidence presented at trial was "sufficient for the jury to conclude that the nine events identified by [Dr.] Nye revealed the truth about Vivendi's liquidity risk, and that concealment of 'the subject' of Vivendi's alleged misstatements — its liquidity risk — was therefore 'the cause of the actual loss suffered' by Plaintiffs." *Id.* at 263.

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The Second Circuit's decision in *Vivendi* is particularly notable because it provides important guidance for plaintiffs in pleading and proving damages and loss causation, including with respect to the type of statements upon which claims may be brought. By recognizing for the first time the viability of the "maintenance theory" of inflation and reinforcing its acceptance of the "materialization of risk" theory, the Second Circuit has ensured that plaintiffs can continue to prosecute securities fraud cases in the Second Circuit, even where the defendants' alleged misstatements do not introduce inflation into a company's stock price. ■

PAYMENT CARD: THE SECOND CIRCUIT'S SWIPE AT A RECORD ANTITRUST SETTLEMENT SHOULD HAVE LIMITED IMPLICATIONS FOR SECURITIES CLASS ACTIONS

(continued from page 11)

settlement-only class included purchasers both before and after partial corrective disclosure and class representative purchased only after partial disclosure).

It bears noting that although certification of subclasses is well-established in securities cases, *see, e.g. In re Cendant Corp. Litig.,* 264 F.3d 201, 244 n. 25 (3d Cir. 2001) (encouraging district courts to consider subclassing in cases of potential intra-class conflict); *In re Countrywide Fin. Corp. Sec. Litig.*, 273 F.R.D. 586, 621 (C.D. Cal. 2009) (*sua sponte* certifying multiple subclasses for different debt offerings), courts in the Second Circuit have been reluctant to require subclasses based on purported intra-class conflicts. *See, e.g., In re Vivendi Universal, S.A. Sec. Litig.*, 242 F.R.D. 76, 118 (S.D.N.Y. 2007) (holding small difference in damages between holders of ADSs and ordinary shares based on different returns did not warrant creation of subclasses at class certification stage); *In re NYSE Specialists Sec. Litig.*, 260 F.R.D. 55, 74 (S.D.N.Y. 2009) (declining to certify buyer/seller subclasses at class certification because "[i]f, in the future, it becomes clear that intra-class conflicts related to damages require the creation of sub-classes, then the [c]ourt will address the issue at that time," *id.*); *In re Deutsche Telekom Ag Sec. Litig.*, 229 F. Supp. 2d 277, 283 (S.D.N.Y. 2002) (holding that "the variation in legal standards between plaintiffs' Securities Act and Exchange Act claims does not mandate the creation of subclasses"). Courts have been even more disinclined to recognize subclasses at earlier stages of litigation. *See, e.g., Constance Sczesny Tr. v. KPMG LLP*, 223 F.R.D. 319, 325 (S.D.N.Y.2004) (denying as premature appointment of lead plaintiff for proposed sub-class of option purchasers at lead plaintiff selection stage); *In re Forcefield Energy Inc. Sec. Litig.*, 2015 WL 4476345, at *6 (S.D.N.Y. July 22, 2015) (distinguishing *Literary Works* and holding that it would be premature to address concern about purported conflict between equity-holders and note-holders at lead plaintiff stage).

Nevertheless, one can envision an opportunistic defendant citing *Payment Card* for the proposition that a proposed class representative can never adequately represent the interests of multiple subclasses. Indeed, one court outside the Second Circuit appeared to adopt this interpretation of the *Payment Card* decision. *See In re Pac. Sunwear of Cal., Inc.*, 2016 WL 4250681, at *12 (Bankr. D. Del. Aug. 8, 2016) ("[T]he Second Circuit [in *Payment Card*], citing United States Supreme Court decisions as well as its own, specifically rejects the argument that class representatives who hold claims in more than one subgroup can adequately represent any one of those subgroups."). Even where defendants do not challenge the adequacy of class representatives, others, including unsuccessful aspirants for lead plaintiff, absent class members seeking to intervene, or objectors following a settlement, may rely on *Payment Card* in hopes of undermining the adequacy of the class representative or class counsel by arguing that the existence of subclasses or even potential subclasses creates inherent intra-class conflict. Such a sweeping interpretation of *Payment Card* plainly ignores the careful analysis of the Second Circuit and the general inapplicability of its reasoning to securities fraud cases. Therefore, going forward, it will be important for class representatives and class counsel to bear in mind the specific facts and circumstances that gave rise to the *Payment Card* decision so as to limit it to its facts. ■

WHAT'S TO COME

National Conference on Public Employee Retirement Systems (NCPERS)
January 29 – 31, 2017 ■ Capital Hilton — Washington, D.C.

Florida Public Pensions Trustees Association (FPPTA) — Trustee School
January 29 – February 1, 2017 ■ Rosen Centre — Orlando, FL

Evolving Fiduciary Obligations of Institutional Investors (EFOII)
February 21, 2017 ■ Tempe Mission Palms — Tempe, AZ

Sovereign Wealth Fund Institute (SWFI) — Institutional Investor Forum
February 21 – 22, 2017 ■ The Westin Kierland Resort & Spa — Scottsdale, AZ

National Association of Public Pension Attorneys (NAPPA) — Winter Seminar
February 22 – 24, 2017
Tempe Mission Palms — Tempe, AZ

Council of Institutional Investors (CII) — 2017 Spring Conference
February 27 – March 1, 2017 ■ Mandarin Oriental Hotel — Washington, D.C.

Rights and Responsibilities of Institutional Investors (RRII)
March 9 –10, 2017 ■ NH Grand Hotel Krasnapolsky — Amsterdam, The Netherlands

Georgia Association of Public Pension Trustees (GAPPT) — Trustee School
March 20 – 22, 2017 ■ Macon Marriott City Center — Macon, GA

Florida Public Pensions Trustees Association (FPPTA) — Wall Street Program
March 28 – April 1, 2017 ■ New York Marriott East Side — New York, NY

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