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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

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM V. ANZ SECURITIES, INC.: CLARIFYING INVESTORS' OPT-OUT RIGHTS

Ryan T. Degnan, Esquire and Meredith L. Lambert, Esquire

On June 26, 2017, the Supreme Court of the United States issued a landmark decision in *California Public Employees' Retirement System (CalPERS) v. ANZ Securities, Inc.*, which now requires investors to determine, often at the outset of class litigation, whether to pursue direct (or "opt-out") claims in securities fraud actions or run the risk of having individual claims deemed untimely.[1] In a 5-4 opinion delivered by Justice Kennedy, the Court affirmed the Second Circuit's ruling that the filing of a class action complaint does not toll (or otherwise suspend) the three-year statute of repose period set forth in Section 13 of the Securities Act of

(continued on page 6)

[1] *Cal. Pub. Emps. Ret. Sys. v. ANZ Secs., Inc.*, __ U.S. __, 137 S.Ct. 2042 (2017) ("*CalPERS*").

CALIFORNIA FEDERAL COURT ISSUES BREAKTHROUGH RULING IN MULTIBILLION DOLLAR INSIDER TRADING ACTION

Joshua A. Materese, Esquire

On March 15, 2017, the District Court for the Central District of California issued a momentous ruling in the *Basile v. Valeant Pharm. Int'l, Inc.*, 2017 U.S. Dist. LEXIS 37400 (C.D. Cal. Mar. 15, 2017) ("*Allergan*"), certifying a class of investors pursuing claims for violations of the federal insider trading laws, including Section 14(e) of the Securities Exchange Act of 1934 ("34 Act") and Rule 14e-3 promulgated thereunder. These securities regulations were adopted as part of the "Williams Act" amendments to the 1934 Act and are designed to curtail insider

(continued on page 16)

DELAWARE APPRAISAL LITIGATION: RECENT DECISIONS SUGGEST THAT ONLY CASES WHERE THERE IS A RELATED-PARTY ACQUIRER MAKE SENSE

Geoffrey C. Jarvis, Esquire

Delaware appraisal litigation occurs where shareholders are deprived of their ownership interest in a corporation for cash consideration (or a mixture of cash and stock) as the result of a corporate merger and/or sale of control of the corporation.[1] In an appraisal case, a court will determine the "fair value" of the shares in the acquired company formerly held by a shareholder seeking appraisal. The party seeking appraisal will then be awarded the price determined by the court rather than the deal price.[2] Historically, appraisal litigation was seen as focused entirely on the value of the company in which the shareholder was losing his or her ownership interest. It was commonly suggested that such litigation involved no claim of "wrong-doing" by anyone and was strictly a valuation exercise.

Over the last four years, however, the view that appraisal litigation was premised strictly on valuation — with little or no emphasis on the underlying structure of the transaction or how it occurred — has radically changed. Beginning with a decision in *Huff Fund Inv. P'ship v. CKx, Inc.*, 2013 WL 5878807 (Del. Ch. Nov. 1, 2013), the Delaware Court of Chancery increasingly has focused on the "deal process" in reaching their appraisal decisions. In at least 7 cases where the court has concluded that there was an adequate process — and particularly a process that involves the to-be-acquired company being marketed to a broad selection of potential acquirers — it has found that the deal price represents the fair value of the company.[3] Where the court awards deal price, the entity bringing the appraisal case essentially gets the same value it would have obtained (with the possibility of some interest) had it not chosen to litigate at all. Such deal price decisions essentially are the equivalent of a defense verdict.

Particularly instructive is the very recent decision in *In re PetSmart, Inc.* 2017 WL 2303599 (Del. Ch. May 26, 2017). PetSmart was acquired in 2015, by a private equity acquiror, BC Partners, Inc. The acquisition was the result of an extended process in which a number of potential buyers were contacted and at least five entities made bids for the company. Three parties made final bids and, after some negotiation, a bid by BC Partners was accepted.

Despite the seemingly robust sales process, a number of sophisticated hedge funds decided to initiate appraisal proceedings. They alleged, based upon the information disclosed in an SEC filing about projected cash flows of PetSmart and issues with the valuations performed by PetSmart's investment bank, that the company was undervalued and the fair value exceeded the deal price. In fact, the appraisal petitioners' views were sufficiently widely held and PetSmart became the largest appraisal case (in value of the shares as to which appraisal was brought) in the history of Delaware appraisal litigation, with more than $800 million in shares (valued at the deal price) submitted for appraisal.

The Delaware Court rejected the hedge funds' concerns about the deal price and found that "the process leading to the Merger was

(continued on page 8)

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[1] To bring an appraisal case, a shareholder has to follow a number of specific steps that, if not properly carried out, will result in dismissal of the litigation.

[2] Only in extremely rare case will the fair value be lower than the deal price, but it is possible.

[3] *In re PetSmart, Inc.* 2017 WL 2303599 (Del. Ch. May 26, 2017); *Merion Capital L.P. v. Lender Processing Services, Inc.*, 2016 WL 7324170 (Del. Ch. Dec. 16, 2016); *Merion Capital LP v. BMC Software, Inc.*, 2015 WL 6164771 (Del. Ch. Oct. 21, 2015); *LongPath Capital, LLC v. Ramtron Int'l Corp.*, 2015 WL 4540443 (Del. Ch. June 30, 2015); *Merlin P'rs LP v. AutoInfo, Inc.*, 2015 WL 2069417 (Del. Ch. Apr. 30, 2015); *In re Appraisal of Ancestry.com, Inc.*, 2015 WL 399726 (Del. Ch. Jan. 30, 2015); *Huff Fund Inv. P'ship v. CKx, Inc.*

SECOND CIRCUIT ANNOUNCES RULE FOR EVALUATING MATERIALITY OF INTERIM FINANCIAL RESULTS, REJECTS FIRST CIRCUIT'S "EXTREME DEPARTURE" TEST

Richard Russo, Esquire and Jonathan Neumann, Esquire

The federal securities laws require companies to disclose their operating results and other financial information to investors on a quarterly and annual basis. Typically, companies must provide quarterly financial disclosures to investors within 45 days after the end of each fiscal quarter, and must also provide annual financial disclosures to investors within 90 days of the end of each fiscal year. *See* General Instructions to Forms 10-Q and 10-K. However, under certain circumstances, a company may be required to disclose financial information to its investors outside of these traditional reporting periods — and its failure to do so can give rise to liability under the federal securities laws. Recently, in *Stadnick v. Vivint Solar, Inc.*, 861 F.3d 31, 33 (2d Cir. 2017), the Second Circuit provided guidance as to when a company's failure to make such interim financial disclosures can constitute a violation of the federal securities laws and, in particular, Section 11 of the Securities Act of 1933 ("Securities Act").

The duty to make interim financial disclosures most often arises in the context of a new stock offering, such as an initial public offering ("IPO"). A stock offering or an IPO must be accompanied by certain offering documents, including a registration statement. A registration statement typically incorporates certain documents by reference, including the issuer's most recent financial results and operating performance. Securities and Exchange Commission ("SEC") Regulation S-X permits such incorporation so long as the most recent financial results are less than 135 days old. (However, where the issuer's last published financial results are *more* than 135 days old as of the date of the offering, Regulation S-X requires the registration statement to include updated financial data.) Courts, including the *Vivint* court, have therefore generally conceded that a company has no affirmative duty under Regulation S-X to disclose interim financial information if its most recent published financial statements are less than 135 days old.

Nevertheless, Regulation S-X is not the only way in which a duty to disclose interim financial data can be triggered. Section 11 of the Securities Act imposes liability on an issuer of a registration statement in three circumstances: if (1) the statement "contained an untrue statement of a material fact," (2) the statement "omitted to state a material fact required to be stated therein," or (3) *the omitted information was "necessary to make the statements therein not misleading*."

(continued on page 12)

RETHINKING TRADITIONAL NOTIONS OF FAIR PLAY AND SUBSTANTIAL JUSTICE

Tyler S. Graden, Esquire

Over the last several terms, the Supreme Court has decided a series of cases reshaping the answer to a basic question asked in every lawsuit: Where can a defendant be sued? This last term, the Supreme Court issued two decisions, *Bristol-Myers Squibb Co. v. Superior Court of California, San Francisco Cty.,* 137 S. Ct. 1773 (2017) and *BNSF Ry. Co. v. Tyrrell,* 137 S. Ct. 1549 (2017), confirming that the decades-long test examining "traditional notions of fair play and substantial justice" is no longer the rule, and instead favoring a bright line test that favors a defendant's state of incorporation and principal place of business.

The Fourteenth Amendment's Due Process Requirement

The Fourteenth Amendment's Due Process Clause requires that a state court must have personal jurisdiction over a defendant if its decision could deprive that defendant of life, liberty or property.

Since its seminal decision in *International Shoe Co. v. Washington,* 326 U.S. 310 (1945), the Supreme Court has recognized two types of personal jurisdiction: (1) "general" jurisdiction, which the Court in *International Shoe* found was established where a defendant has such "continuous and systematic" contacts with the state where the

(continued on page 14)

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Shareholder Engagement in an Era of Uncertainty: Proactive or Reactive?

Improving engagement with the companies they invest in has become an increasingly accepted strategy among an ever-broader and more diverse group of institutional active shareholders, with many entities making large strides towards improvement on several key issues. But the global macro environment today is in an unprecedented state of volatility. Uncertainty is possibly the one common denominator, given what investors are confronting on the macroeconomic, geopolitical, regulatory and legal landscapes in most major markets.

And sustained uncertainty, to misquote Frank Herbert, is the mind killer. Will 2018 see a further deepening of expansion and forward momentum within the realm of shareholder rights in Europe, Canada, and possibly even the US while progress is made within the increasingly important markets in Japan and Asia? Or will active shareholders retrench and use this time to re-evaluate their priorities and their engagement strategies?

The 13th Annual Rights & Responsibilities of Institutional Investors will again be held in Amsterdam and co-sponsored by Institutional Investor and Kessler Topaz Meltzer & Check LLP. The pressing issues for investors and shareholders covered in this agenda will consider the ways that legal, investment, and compliance officers from European and selectively, global public pension, insurance funds and mutual fund companies, are paving a path forward to meet their responsibilities and to leverage their rights as active investors.

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KESSLER TOPAZ SECURES $86.5 MILLION SETTLEMENT CHALLENGING MANAGEMENT-LED BUYOUT OF EXAMWORKS GROUP, INC.

Paul Hastings LLP, Legal Counsel for ExamWorks Group, Inc., Contributes $46.5 Million Towards Settlement

J. Daniel Albert, Esquire & Stacey A. Greenspan, Esquire

Kessler Topaz, serving as co-lead counsel on behalf of City of Daytona Beach Police and Fire Pension Fund ("City of Daytona" or "Plaintiff"), recently obtained an $86.5 million settlement for a class of former public stockholders of ExamWorks Group, Inc. ("ExamWorks" or the "Company") resulting from litigation relating to the acquisition of ExamWorks by private equity firm Leonard Green & Partners, L.P. ("Leonard Green"). Kessler Topaz secured the settlement just two weeks before trial was scheduled to begin. The law firm Paul Hastings LLP ("Paul Hastings") was named as a defendant in the litigation and contributed $46.5 million in resolution of Plaintiff's claims, making the settlement unique in M&A litigation where a target company's counsel is rarely named as a defendant and even more rarely makes a monetary contribution to a settlement.

The litigation arose from ExamWorks' announcement on April 27, 2016 that it would be acquired by Leonard Green for $35.05 per share in cash. This represented only a 4% premium for ExamWorks, which was the leader in the independent medical examination market. ExamWorks further announced that certain of its directors and officers, including ExamWorks co-founders Richard Perlman and James Price, would rollover up to $45 million of their ExamWorks' equity into the post-merger entity (the "Rollover Investors"). Considering the low premium and apparent insider conflict, Kessler Topaz began investigating the merger.

Kessler Topaz's investigation revealed that the merger was rife with conflicts. As an initial matter, the Board was conflicted — a majority of its members worked together for over a decade on the boards of other publicly-held companies that Messrs. Perlman and Price ran and sold. The Board's legal advisor, Paul Hastings, was also conflicted. The lead attorney on Paul Hastings' deal team was Messrs. Perlman's and Price's attorney for approximately fifteen years, which included having advised Messrs. Perlman's and Price's other publicly traded companies. Moreover, Paul Hastings improperly advised all of the ExamWorks' parties in connection with the merger despite their oftentimes divergent interests, including the Board, the special committee of the Board created, in part, to insulate the sales process from the Rollover Investors' conflicting interests (the "Special Committee") and the Rollover Investors themselves. Paul Hastings even advised the Special Committee to allow the Rollover Investors to attend and participate in Special Committee meetings.

Kessler Topaz's investigation similarly revealed that the definitive proxy statement ExamWorks filed with the Securities and Exchange Commission to solicit votes in favor of the merger (the "Proxy") was materially misleading and incomplete. Among other things, the Proxy failed to adequately disclose the conflicts of the Board and Paul Hastings.

Recognizing that these conflicts undermined the reasonableness of the Board's sales process and ability to maximize value for ExamWorks' stockholders, Kessler Topaz filed suit in the Delaware Court of Chancery against ExamWorks, the Board, the Rollover Investors and Leonard Green on behalf of City of Daytona as a representative for the class of ExamWorks stockholders. Twelve days after filing the complaint, Kessler Topaz successfully sought expedited discovery in support of its motion to preliminarily enjoin the stockholder vote on the merger. Kessler Topaz thereafter agreed to defendants' request to have an expedited trial in lieu of preliminary injunction proceedings because defendants claimed they could not complete discovery before the Company held the stockholder vote on the merger.

After conducting initial expedited discovery of over sixty-five thousand pages of documents, Kessler Topaz made the somewhat unorthodox decision to name the Board's legal and financial advisors as aiders and abettors of the Board members' alleged breaches of fiduciary duty. Specifically, Kessler Topaz filed an amended complaint on behalf of City of Daytona alleging that Paul Hastings' conflicted counsel contributed to the Board's agreement to sell ExamWorks for an unfair price. The amended complaint alleged that Paul Hastings conspired with Messrs. Perlman and Price to steer the Company's sale to Leonard Green at the price that Leonard Green was willing to pay, including having

(continued on page 11)

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM V. ANZ SECURITIES, INC.: CLARIFYING INVESTORS' OPT-OUT RIGHTS

(continued from page 1)

1933 (the "Securities Act").[2] *CalPERS* formally eliminated the "*American Pipe*" tolling doctrine's application to statutes of repose, which previously allowed absent class members to rely on the filing of a class action complaint to suspend the running of the statute of repose on their individual claims until a ruling on class certification. Accordingly, *CalPERS* held that the plaintiff's individual action asserting claims under Section 11 of the Securities Act was time-barred because the complaint had been filed more than three years after the date of the relevant securities offering despite the fact that a class action had been filed before the repose deadline.[3] While the Court's ruling eliminates any ambiguity over the timeliness of investor's opt-out claims, it also makes clear that investors will no longer have the option of assessing developments in a class action before deciding whether to opt out and prosecute securities fraud claims individually. As noted by Justice Ginsberg in her dissenting opinion, delaying a decision to pursue direct claims is no longer an option in securities actions, as the inapplicability of *American Pipe* tolling to repose periods will have the effect of encouraging "[a]ny class member with a material stake . . . to file a protective claim, in a separate complaint or in a motion to intervene, before the three-year period expires."[4]

Factual and Procedural Background

In *CalPERS*, the California Public Employees' Retirement System (the "Plaintiff"), was previously a passive class member in a securities class action that asserted claims under Section 11 in connection with certain securities offerings by Lehman Brothers Holdings Inc. in 2007 and 2008. In February 2011 — more than three years after the relevant securities transactions occurred — Plaintiff elected to opt out of the class action and filed a separate complaint against the underwriters of the relevant securities offerings (the "Defendants"). Defendants moved to dismiss Plaintiff's action as untimely under the three-year limitations period set forth in Section 13 of the Securities Act and Plaintiff countered that its action was not untimely because the three-year statute of repose period had been tolled during the pendency of the class action. In support of this contention, Plaintiff principally relied on *American Pipe & Constr. Co. v. Utah*, 414 U.S. 538 (1974), in which the Supreme Court held that the filing of a class action complaint tolls the applicable statute of limitations until a ruling on class certification. The district court rejected Plaintiff's argument and held that the Securities Act's three-year statute of repose period, as opposed to the Securities Act's one-year statute of limitations period, is not subject to tolling.[5]

On appeal, the Court of Appeals for the Second Circuit affirmed the district court's decision while acknowledging the disagreement among several circuit courts as to whether *American Pipe* tolling applies to the Securities Act's statute of repose.[6] Plaintiff appealed and the Supreme Court of the United States granted *certiorari* on the question of whether the Securities Act's statute of repose period is tolled when a class action was timely filed within the three-year statute of repose period.[7]

Majority Opinion

In deciding this question, the Supreme Court first turned to "the nature and purpose" of the three-year time limitation of Section 13 of the Securities Act to determine whether it constituted a statute of limitations or a statute of repose.[8] Distinguishing the two, the Court explained that statutes of limitations are designed to encourage plaintiffs "to pursue diligent prosecution of known claims" and, consistent with this purpose, typically begin to run "when the injury occurred or was discovered."[9] By contrast, statutes of repose, which are enacted to protect defendants from liability after a specified period of time, begin to run at the time of the last culpable act or omission.[10] With this important distinction in mind, the Court examined the text of Section 13, which provides that "[i]n no event" shall an action be brought more than three years after the relevant securities offering.[11] Based on this

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2 *Id.* at 2055.

3 *Id.*

4 *Id.* at 2058.

5 *See id.* at 2048.

6 *See id.*

7 *See id.*

8 *See id.*

9 *Id.* at 2049.

10 *Id.*

11 *Id.* (quoting 15 U.S.C. § 77m).

language, as well as the statute's structure, which also includes a one-year statute of limitations period, and its legislative history, the Court concluded that Section 13's three-year time limitation is a statute of repose "designed to protect defendants' financial security in fast-changing markets by reducing the open period for potential liability."[12]

Having determined that Section 13's three-year time limitation is a statute of repose, the Court next addressed whether the tolling rule discussed in *American Pipe* is legal or equitable in nature. Ultimately, the Court concluded that "the source of the tolling rule applied in *American Pipe* is the judicial power to promote equity, rather than to interpret and enforce statutory provisions."[13] Given that the Supreme Court has repeatedly recognized that statutes of repose are not subject to equitable tolling, this finding was dispositive.[14]

Turning to Plaintiff's four counterarguments, the Court dismissed each in short order. First, the Court rejected Plaintiff's contention that *CalPERS* was "indistinguishable from *American Pipe*" and reiterated that *American Pipe* involved a statute of limitations, which may be tolled by equitable considerations, whereas *CalPERS* involved a statute of repose, which generally may not.[15]

Second, the Court disposed of Plaintiff's argument that the filing of the class action within three years fulfilled the purpose of the statutory time limit by putting respondents "on notice" of the claims against them and the potential new plaintiffs who might assert those claims. Contrary to this reasoning, the Court observed that allowing such claims to proceed would create a host of uncertainties for defendants that statutes of repose were designed to prevent by protecting them from future liability after a certain time.[16]

Third, the Court was unpersuaded by Plaintiff's claim that the dismissal of its individual suit as untimely would eviscerate its ability to opt out and file a new claim. While acknowledging that the ability to opt out of a class action "should not be disregarded," the Court concluded that "[i]t does not follow, however, from any privilege to opt out that an ensuing suit can be filed without regard to mandatory time limits set by the statute."[17]

Fourth, the Court rejected Plaintiff's argument that refusing to apply *American Pipe* tolling to the Securities Act's statute of repose could cause "non-named class members [to] inundate district courts with protective filings" — noting that even if that were true, the Court could not simply "rewrite the statute of repose or its plain import."[18] Moreover, the Court considered it likely that Plaintiff's concerns were "overstated" given that Plaintiff had "not offered evidence of any recent influx of protective filings in the Second Circuit" despite the fact that tolling of statutes of repose has not been permitted in that circuit since 2013.[19]

Separately, the Court addressed Plaintiff's alternative argument that tolling was not even necessary because the filing of the class-action complaint effectively "brought" Plaintiff's "action" within the three-year state of repose period and the filing of an individual complaint was ultimately irrelevant. In rejecting this argument, the Court concluded that it relied on the incorrect premise that "an 'action' is 'brought' when substantive claims are presented to any court, rather than when a particular complaint is filed in a particular court."[20] The Court also found the argument implausible and observed that "[t]aken to its logical limit, an individual action would be timely even if it were filed decades after the original securities offering — provided a class action lawsuit had been filed at some point within the initial 3-year period" — thereby negating the temporary purpose of tolling under *American Pipe*.[21]

For these reasons, the Supreme Court concluded that the Securities Act's three-year statute of repose period could not be tolled under *American Pipe* and, as a result, Plaintiff's complaint was properly dismissed as being untimely.

Dissenting Opinion

In writing for the Dissent, Justice Ginsburg, joined by three other justices, agreed with Plaintiff's alternative argument that the filing of the class action complaint provided notice to Defendants of their potential liability to all putative class members, including opt-out plaintiffs, within the repose period.[22] Accordingly, the Dissent concluded that Plaintiff's decision to opt out of the class action did not implicate the concerns underlying the Securities Act's statute of repose.[23]

In reaching this conclusion, the Dissent cautioned that the Majority's ruling would " gum up the works of class action litigation" by encouraging defendants to "slow walk discovery and other precertification proceedings so the clock will run on potential opt outs" and encouraging "[a]ny class member with a material stake . . . to file a protective claim, in a separate complaint or in a motion to intervene, before the three-year period expires."[24] Furthermore, the Dissent noted that one of the "harshest consequences" of the Majority's decision would fall on the "least sophisticated" class members "who fail to file a protective claim within the repose period" and face a high risk of becoming "saddled with inadequate

(continued on page 8)

[12] *Id.* at 2049-50.

[13] *Id.* at 2051.

[14] *Id.* (citing *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 363 (1991)).

[15] *Id.* at 2052-53.

[16] *Id.* at 2053.

[17] *Id.*

[18] *Id.* at 2053-54.

[19] *Id.* at 2054.

[20] *Id.* at 2054.

[21] *Id.*

[22] *Id.* at 2056-57.

[23] *See id.* at 2057.

[24] *Id.* at 2058.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM V. ANZ SECURITIES, INC.: CLARIFYING INVESTORS' OPT-OUT RIGHTS

(continued from page 7)

representation or an inadequate judgment."[25] To this end, the Dissent admonished "courts and class counsel to take on a more active role in protecting class members' opt-out rights" by "notify[ing] class members about the consequences of failing to file a timely protective claim" before the repose period expires.[26]

Impact of *CalPERS*

The Supreme Court's decision in *CalPERS* fundamentally alters the rules of securities class action litigation by holding that statutes of repose are not subject to *American Pipe* tolling. While this ruling affords securities class action defendants greater certainty over their potential liability to future opt-out plaintiffs after a specified period of time, it also makes clear that investors with material losses can no longer take a "wait-and-see" approach when deciding whether to pursue individual claims. Given that important developments in securities class actions — such as rulings on class certification and summary judgment, or the announcement of a settlement — frequently are not resolved until several years into the prosecution of the litigation, investors must be more proactive in assessing the merits of the claims and the benefits of filing an individual opt-out action. Accordingly, investors should actively monitor ongoing securities cases in which they have sustained significant losses and stay apprised of the relevant statutes of repose in such cases. In addition, counsel and their clients should work together to make informed, early determinations about the merits of their clients' claims and the size of their clients' potential recovery. By taking such steps, investors will be better positioned to quickly decide whether filing an individual action would be strategically advantageous to remaining a passive class member. ■

[25] *Id*. at 2057.

[26] *Id*. at 2058.

DELAWARE APPRAISAL LITIGATION: RECENT DECISIONS SUGGEST THAT ONLY CASES WHERE THERE IS A RELATED-PARTY ACQUIRER MAKE SENSE

(continued from page 2)

reasonably designed and properly implemented to attain the fair value of the Company."[4] The Court further concluded that the PetSmart projections, upon which the hedge funds had relied in proposing a much higher fair value for PetSmart were unreliable:

> [t]he management projections upon which Petitioners rely as the bedrock for their [valuation] analysis are, at best, fanciful and I find no basis in the evidence to conclude that a [valuation] analysis based on other projections of expected cash flows would yield a result more reliable than the Merger consideration.[5]

Given that it is always possible for a court to criticize projections, the doubts expressed by the Court regarding the PetSmart projections can be viewed more as an affirmation of the deal process rather than as a general issue with the use of the projections and valuation techniques in appraisal litigation.

In the aftermath of *PetSmart*, there is substantial reason to believe that in the absence of legitimate concerns about a sales process, an appraisal proceeding resulting from the sale of a company to a third party buyer, will run the risk of an ultimate determination that the sales price is adequate. In fact, our research of all reported Delaware appraisal decisions since 2010 (*see* Table 1, on next page), demonstrates that (with the exception of a single settlement involving Safeway), every acquisition involving a third party buyer has received a lower premium (percentage by which the appraisal award exceeds the deal price) from the Delaware Courts than every transaction involving a related/interested purchaser. Further, the average premium for cases involving an interested buyer is 83% since 2010,

[4] *PetSmart*, 2017 WL 2303599 at *2.

[5] *Id*.

while the average premium for cases involving a third party buyer is only 4.1%.

The conclusion that should be taken from our research, and the decisions discussed above, is that when considering bringing an appraisal action, an investor should look first at the relationship between the acquiror and the acquired entity (and/or the acquired entity's management). Where there is an interested buyer, even what appears to be the best possible process can still result in a substantial appraisal award, so review of the specific process is less significant in that case.[6] In the case where there is a third-party buyer, the investor should then look to see if there are meaningful issues with the process that resulted in the consummation of the deal. While this is not to say that all third party deals will fail as appraisal cases,[7] and all interested-party deals will be successful, an initial focus on the identity of the purchaser and its relationship with the corporation being sold, with a subsequent focus on the sales process, is now the essential beginning point of any investor considering bringing appraisal litigation in Delaware. ■

Table 1
Decided Cases (Or With A Publicly Disclosed Settlement) From 2010 To 2016

Case	Premium	Additional Return From Interest	Transaction Type
ISN Software (2016)	239%	20%	Interested
Sunbelt Beverage (2010)	149%	219%	Interested
Orchard Enterprises (2012)	128%	36%	Interested
Laidler v. Hesco (2014)	87%	25%	Interested
Owen v. Cannon (2015)	60%	13%	Interested
Dell (2016)	28%	19%	Interested
Cox Radio (2013)	20%	27%	Interested
Golden Telecom (2010)	20%	15%	Interested
Dole (2015)	20%	N/A	Interested
Average Premium – Interested Transactions	**83%**	**46.75%***	
Safeway (settlement 2015)	26%	N/A	3rd Party
Amer. Comm. Airlines (2013)	16%	14%	3rd Party
3M Cogent (2013)	9%	14%	3rd Party
DFC Global (2016)	8%	14%	3rd Party
Lender Processing Services (2016)	0%	11.5%**	3rd Party
Ancestry.com (2015)	0%	13%	3rd Party
Ramtron (2015)	0%	0.2%	3rd Party
Autoinfo (2015)	0%	12.4%	3rd Party
BMC Software (2015)	0%	N/A	3rd Party
CKx (2013)	0%	23%	3rd Party
JustCare (2012)	(-14)%	12%	3rd Party
Average For 3rd Party Transactions	**4.1%**	**12.67%**	
Average For All Transactions	**39.6%**	**28.7%*****	

* 19.4% excluding Sunbelt Beverage
** Minimum award — not yet paid
*** 15.8% excluding Sunbelt Beverage

6 *See In re Appraisal of Dell Inc.*, 2016 WL 3186538 (Del. Ch. May 31, 2016). In *Dell*, the company was acquired by a group led by its founder Michael Dell. Even though the company and the board sought to run a clean process, which resulted in a finding that the process utilized would easily withstand scrutiny under a fiduciary duty claim (*id.* at *29), the Court, given the identity of the buyer, and other factors, decided not to rely on deal price and instead undertook a valuation of the company that resulted in the award of a 28% premium.

7 *See, e.g., In Re Appraisal of DFC Global Group*, 2016 WL 3753123 (Del. Ch. July 8, 2016). In *DFC*, an extended sales process and a sale to a third party buyer with no management involvement still resulted in an award of an 8% premium because of issues with the timing of the sale and other considerations.

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The general counsel's role has both changed and expanded in recent years. In the progressive and increasingly regulated environment that we live in today, many funds are reevaluating their use of outside counsel, their legal departments' objectives and priorities, and their fund-wide engagement strategies.

With the essential input of an Advisory Board representing the audience who will attend this event, the Institutional Governance and Legal Symposium will offer a thorough overview of the legal landscape affecting institutional shareholders, including legal executives and investment officers from asset management firms, sovereign wealth funds, and selected public pension plans. Emphasizing real-world examples of how shareholders are engaging with the companies they invest in, the Symposium will review the most crucial legal decisions, regulatory actions, and developments in M&A, private equity, etc., and offer insights on the approaches successful plans have implemented to meet their legal, compliance, and investment objectives.

The Institutional Governance and Legal Symposium is being developed in order to provide a forum in which true peers can gather under Chatham House rules to exchange expertise and share experiences on their common issues.

To learn more about the Symposium and whether you might be qualified to attend, please contact Institutional Investor.

Institutional Investor

KESSLERTOPAZ MELTZERCHECK LLP

KESSLER TOPAZ SECURES $86.5 MILLION SETTLEMENT CHALLENGING MANAGEMENT-LED BUYOUT OF EXAMWORKS GROUP, INC.

(continued from page 5)

advised the Company to engage two financial advisors, Goldman Sachs & Co. ("Goldman") and Evercore Group, L.L.C. ("Evercore"), with obvious conflicts that also favored the Company's sale to Leonard Green at $35.05. Leonard Green was an important Goldman client, and Evercore had a Senior Managing Director on the Board who stood to gain personally from the merger as a Rollover Investor. The amended complaint alleged that Goldman and Evercore joined in the conspiracy to sell ExamWorks to Leonard Green at $35.05.

The amended complaint also alleged that Paul Hastings advised the Board to issue materially misleading and incomplete disclosures. The amended complaint specifically alleged that Paul Hastings drafted the Proxy and meeting minutes about the merger, and because Paul Hastings attended Board and Special Committee meetings about the merger, knew what happened and what was discussed. Yet "facts" in the Proxy conflicted with "facts" in the meeting minutes, and "facts" in the Proxy and meeting minutes conflicted with facts in contemporaneous communications and deposition testimony. In other words, Kessler Topaz developed facts through initial expedited discovery that provided ammunition to overcome a potential argument by defendants that the stockholder vote on the merger was uncoerced and fully informed, and thereby, under the Delaware Supreme Court's ruling in *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015), would have foreclosed City of Daytona's ability to recover post-closing damages.

Kessler Topaz then dove headlong into full discovery, which had to be completed in short order to comply with the expedited trial schedule. Discovery included reviewing over one million pages of documents and deposing nine fact witnesses and four experts.

Paul Hastings' conflicts played a unique role throughout the litigation and the discovery process. For example, after ExamWorks and the Board raised as a defense against liability that they reasonably relied on Paul Hastings' legal advice, Kessler Topaz successfully argued that defendants had waived privilege to all merger-related communications with Paul Hastings. Consequently, Kessler Topaz reviewed thousands of pages of communications between Paul Hastings, on the one hand, and ExamWorks, the Board, the Rollover Investors, Leonard Green, Goldman and/or Evercore on the other. Kessler Topaz also reviewed hundreds of pages of merger-related communications among the lawyers on Paul Hastings' deal team. These communications proved severely damaging to defendants and provided significant leverage to secure the tremendous monetary settlement for ExamWorks stockholders.

Despite defendants' infighting and finger-pointing, they continued to fight tooth and nail in the litigation. Accordingly, Kessler Topaz employed a divide and conquer strategy, and only three and a half weeks away from trial, Kessler Topaz reached a partial settlement of the litigation with ExamWorks, the Board, the Rollover Investors, Goldman, Evercore and Leonard Green to resolve the claims asserted against those parties for $40 million. The partial settlement included ExamWorks' assignment to Kessler Topaz of all claims ExamWorks had against Paul Hastings in connection with the merger. Using this partial settlement as leverage, Kessler Topaz was able to pressure Paul Hastings into settling. Thus, just two weeks before trial, Paul Hastings agreed to settle the claims against it for $46.5 million.

The $86.5 million settlement is among the largest class action settlements in M&A litigation in the Court of Chancery in the last decade and the largest settlement in Chancery Court since Kessler Topaz settled *In re Dole Food Co., Inc. S'holder Litig.*, C.A. No. 8703-VCL, Order and Final Judgment (Del. Ch. Feb. 10, 2016) for $148.2 million in 2015.[1] A hearing for the Court to approve each partial settlement is scheduled to take place on September 12, 2017. ■

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[1] *See generally* Cornerstone Research reports available at https://www.cornerstone.com/Publications (Review of M&A Litigation for 2015 and 1H 2016, 2014, 2013 and 2012).

SECOND CIRCUIT ANNOUNCES RULE FOR EVALUATING MATERIALITY OF INTERIM FINANCIAL RESULTS, REJECTS FIRST CIRCUIT'S "EXTREME DEPARTURE" TEST

(continued from page 3)

15 U.S.C. § 77k(a). Thus, even where interim financial results are not required to be disclosed under Regulation S-X, and as such generally cannot give rise to liability under prong (2) above, courts have held that a duty to disclose interim financial results arises under Section 11 if the omitted information was "necessary to make the statements therein not misleading." *Id.* As discussed further below, the First and Second Circuits have developed two different standards to evaluate liability under this third prong.

A. The First Circuit's "Extreme Departure" Standard

In *Shaw v. Digital Equipment Corp.*, the First Circuit held that an issuer of new stock would be required to disclose "nonpublic information indicating that the quarter in progress at the time of the public offering will be an *extreme departure* from the range of results which could be anticipated based on currently available information." 82 F.3d 1194, 1210 (1st Cir. 1996) (emphasis added).

The defendant in *Shaw* prepared its registration statement on SEC Form S-3, which required disclosure of "any and all material changes." *Id.* at 1205. The successful offering of preferred shares in *Shaw* closed four days before the end of the third quarter. *Id.* at 1200. Two weeks after the third quarter's close, the company announced an operating loss of $183 million for the quarter, which was far greater than analysts had expected. *Id.* The price of the common and preferred stock dropped approximately 20% below the IPO offering price. *Id.*

The *Shaw* plaintiffs alleged that, as of the date of the IPO, the defendants knew that the company's third quarter performance would be substantially worse than that of previous quarters and yet failed to disclose it. *Id.* at 1206. Accepting the factual allegations as true, the First Circuit concluded that the defendant possessed, at the time of the IPO, interim information that created a "substantial likelihood" that Digital's performance during the quarter in question would represent an "extreme departure" from its previous performance. *Id.* at 1211. The operating loss was therefore material to the offering and disclosure was required. *Id.*

Prior to *Vivint*, certain district courts in the Second Circuit had used *Shaw's* "extreme departure" test to evaluate whether omissions of interim financial results were material. *See, e.g., Stadnick v. Vivint Solar, Inc.*, 2015 WL 8492757, at *12 (S.D.N.Y. Dec. 10, 2015); *In re Lone Pine Res., Inc.*, 2014 WL 1259653, at *5 (S.D.N.Y. Mar. 27, 2014); *In re Focus Media Holding Ltd. Litig.*, 701 F. Supp. 2d 534, 542 (S.D.N.Y. 2010); *In re Turkcell Iletisim Hizmetler, A.S. Sec. Litig.*, 202 F. Supp. 2d 8, 12 (S.D.N.Y. 2001); *In re N2K Inc. Sec. Litig.*, 82 F. Supp. 2d 204, 208 (S.D.N.Y. 2000), *aff'd sub nom. In re N2K Inc. Sec. Litig.*, 202 F.3d 81 (2d Cir. 2000).[1] These cases had created some confusion among litigants and district courts as to the appropriate standard in the Second Circuit to evaluate the materiality of a registration statement's omissions.

B. The Second Circuit Re-Endorses the "Total Mix" Standard

In *Vivint*, the Second Circuit held that a company has a duty to disclose interim financial results if a reasonable investor would view the omission of such information as "significantly alter[ing] the 'total mix' of information made available." 861 F.3d at 37 (citing *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438 (1976); *DeMaria v. Andersen*, 318 F.3d 170 (2d Cir. 2003)).

Vivint is a company that installs and then leases solar energy systems to homeowners. Vivint has a unique business model in which losses and income are variably allocated between two investor groups: shareholders and non-controlling interests ("NCI"), made up of outside investors. Importantly, shareholders' losses increase when NCI's losses decrease and vice versa.

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[1] The Second Circuit has likewise relied on *Shaw* in a number of decisions, albeit not for its "extreme departure" standard. *See Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 102 & 102 n.5 (2d Cir. 2015) (citing *Shaw* in finding that statutes and regulations can give rise to disclosure obligations); *Iowa Pub. Emps.' Ret. Sys. v. MF Glob., Ltd.*, 620 F.3d 137, 141 (2d Cir. 2010) (citing *Shaw* for the proposition that courts must consider statements and omissions in context); *In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d 347, 360 n.8 (2d Cir. 2010) (citing *Shaw* to demonstrate differences between Sections 11 and 12 of the Securities Act of 1933); *Rombach v. Chang*, 355 F.3d 164, 170 n.5 (2d Cir. 2004) (citing *Shaw* for the notion that the Rule 9(b) pleading standard applies to allegations sounding in fraud).

On October 1, 2014, Vivint held an IPO in which it sold 20.6 million shares at a price of $16 per share. Six weeks after the IPO, Vivint released its third quarter results, which disclosed that the net income for shareholders had decreased by $40.8 million between the second and third quarters. The company further disclosed at this time that the shift was attributable to a reallocation of income from shareholders to NCIs due to the timing of an installation of solar systems. Following the release of the company's third quarter results, Vivint's share price dropped to $11.70.

A putative class of investors in the IPO later filed suit against Vivint, arguing that the registration statement omitted material information in the form of the company's third quarter 2014 results. Because Vivint's third quarter results were less than 135 days old at the time of the IPO, the company argued that it had no affirmative obligation to disclose such results under SEC Regulation S-X. Relying on the First Circuit's decision in *Shaw*, the plaintiff investors argued that Vivint's third quarter results nevertheless represented an "extreme departure" from previously reported financial performance.

The district court granted the defendants' motion to dismiss, ruling that Vivint's third quarter results did not represent an "extreme departure" from its previous performance. *Vivint*, 2015 WL 8492757, at *12. Citing directly to *Shaw*, the district court reasoned that, "[a]lthough plaintiff focuses on the earning per share figure, it does not tell the whole story, and evaluating the broader financial data indicates that the volatility in net income available to stockholders and earnings per share derived not from a disastrous and unexpected shift in the Company's business but instead largely from the accounting methods that were fully disclosed in the Registration Statement." *Id.*

On appeal, the Second Circuit affirmed the district court's dismissal, but expressly declined to adopt *Shaw*'s "extreme departure" standard. The court explained that the standard in the Second Circuit for assessing whether there is a duty to disclose interim financial results under the Securities Act is set out in the Second Circuit's *DeMaria* decision, which held that such a duty can arise when "there is a substantial likelihood the disclosure of the omitted [information] would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." *Vivint*, 861 F.3d at 37. The Second Circuit re-endorsed the *DeMaria* standard because it "rests upon the classic [i.e., Supreme Court] materiality standard in the omission context." *Id.* at 37-38. The Second Circuit also criticized *Shaw*'s "extreme departure" test because it (i) "leaves too many open questions," such as the degree of change necessary to trigger the standard and which metrics should be considered, and (ii) can be "analytically counterproductive" because it can fail to consider appropriately or sufficiently the context of the omitted information. *Id.*

Applying the *DeMaria* standard, the Second Circuit determined that the plaintiffs' focus on income available to shareholders and earnings-per-share only was "too myopic, both temporally and with regard to the number of relevant metrics." *Id.* at 38. In particular, the Second Circuit determined that the alleged "omissions" must be assessed in light of the "total mix" of information available, including: (i) "the performance of all five metrics disclosed by Vivint [] from the first quarter of 2013 through the second of 2014," and (ii) "the disclosures [in the registration statement] regarding Vivint's unique business plan and the HLBV accounting method." *Id.* When viewed in this light, the third quarter shareholder earnings were "consistent with a pattern of fluctuation that began with the first quarter of 2013." *Id.* In other words, the Second Circuit explained, "there was never a trend of the shareholders' income increasing or decreasing. A reasonable investor, therefore, would not have harbored any solid expectations based on prior performance as to Vivint's third quarter 2014 performance as measured by the two metrics identified by Stadnick." *Id.* at 39. Thus, under these circumstances, increased shareholder losses alone did not suggest any financial distress to alter the mix of information.

C. Future implications

Going forward, it remains to be seen whether the two different tests articulated by the First and Second Circuits will produce different results. Interestingly, both plaintiffs and defendants have claimed a victory in *Vivint*. On the one hand, defense attorneys have suggested that *Vivint* precludes plaintiffs from focusing on any single metric in isolation. On the other hand, plaintiffs have claimed that the familiar "total mix" standard is more permissive than *Shaw's* "extreme departure" requirement. Thus, the distinction may ultimately prove to be only semantic. After all, the result in *Vivint* was the same under both standards.

Still, it is important to point out that *Vivint's* "total mix" standard prescribes a *materiality* analysis to determine whether a defendant has a duty to disclose interim financial results. The Second Circuit has consistently held that materiality is a highly fact-intensive issue that should be resolved by the fact finder. *See, e.g., Freidus v. Barclays Bank PLC*, 734 F.3d 132, 140 (2d Cir. 2013) ("The materiality of statements and omissions under §§ 11 and 12(a)(2) is a fact-specific, context-specific inquiry."); *Litwin v. Blackstone Grp., L.P.*, 634 F.3d 706, 717 (2d Cir. 2011) ("A complaint may not properly be dismissed . . . on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance."). In practice, this should mean that claims alleging the omission of interim financial information should be dismissed less often and, in most instances, should be left to the trier of fact to resolve. This, of course, is a welcome development for plaintiffs. ■

RETHINKING TRADITIONAL NOTIONS OF FAIR PLAY AND SUBSTANTIAL JUSTICE

(continued from page 3)

lawsuit is filed so as not to offend "traditional notions of fair play and substantial justice," and (2) "specific" jurisdiction where the specific controversy underling the lawsuit occurred in that state.

A court with general jurisdiction may hear any claim against that defendant; whereas, a court with specific jurisdiction may only decide issues related to the claims that provide the court with jurisdiction.

International Shoe Revisited

In 2014, the Supreme Court decided *Daimler AG v. Bauman*, 134 S. Ct. 746 (2014). On its face, *Daimler* appeared to simply concern foreign plaintiffs suing a foreign defendant based on foreign conduct. However, as decided, *Daimler* had much farther reaching implications.

In *Daimler*, twenty-two Argentinian residents filed suit in the Norther District of California against DaimlerChrysler Aktiengesellschaft ("Daimler AG"), a German public stock company, alleging that Daimler AG's Argentinian subsidiary collaborated with state security forces during Argentina's 1976-1983 "Dirty War" to kidnap, detain, torture and kill workers in Argentina. The Argentinian residents sought damages from Daimler AG under United States federal law, Argentinian law, and California law.

The Argentinian plaintiffs argued that the Northern District of California could exercise general jurisdiction over Daimler AG because Daimler AG's U.S. subsidiary distributed vehicles in California. The Ninth Circuit ultimately held that California courts could exercise general jurisdiction over Daimler AG based on principles of agency and considerations of "reasonableness."

In a unanimous ruling, the Supreme Court reversed, holding that California courts lacked jurisdiction to hear the plaintiffs' claims. However, the majority's opinion, written by Justice Ginsberg and joined by all Justices except Justice Sotomayor, went further and changed the contours of *International Shoe*'s decades old jurisdictional jurisprudence.

As Justice Sotomayor pointed out, the Court could have found that, "no matter how extensive Daimler's contacts with California, the State's exercise of jurisdiction would be unreasonable given that the case involves foreign plaintiffs suing a foreign defendant based on foreign conduct, and given that a more appropriate forum is available."

Instead, borrowing from an earlier decision in *Goodyear Dunlop Tires Operations, S.A. v. Brown*, 131 S. Ct. 2846 (2011), the majority found that, rather than simply requiring that contacts with the forum state be "continuous and systematic" so as to not offend "traditional notions of fair play and substantial justice," the contacts must instead be "so 'continuous and systematic' as to render [it] essentially at home in the forum State" when viewed in comparison to the company's nationwide and worldwide activities. *Daimler,* 134 S. Ct. at 749 (quoting *Goodyear,* 131 S. Ct. at 2851).

This was a landmark shift, as no matter how great a defendant's contacts with a single state, post-*Daimler* those contacts are to be considered in relation to all other contacts in all other jurisdictions. As Justice Sotomayor observed in her concurrence, the "obvious" result of the Court's analysis "will be to shift the risk of loss from multinational corporations to the individuals harmed by their actions."

Daimler Applied: Limiting Plaintiffs' Options

This past term, the Supreme Court decided two cases — *BNSF Ry. Co. v. Tyrrell,* 137 S. Ct. 1549 (2017) and *Bristol-Myers Squibb Co. v. Superior Court of California, San Francisco Cty.,* 137 S. Ct. 1773 (2017) — which arguably extended *Daimler*'s reach.

The first case, *BNSF Ry. Co.,* involved personal injury claims filed in Montana state court under the Federal Employers' Liability Act ("FELA"). The plaintiffs, however, did not reside in Montana, nor did their injuries occur in Montana. Rather, the plaintiffs claimed that FELA's statutory provisions explicitly allowed them to file suit in any state court.

The Supreme Court unanimously rejected the plaintiffs' interpretation of FELA. However, Justice Ginsberg's opinion, again joined by all eight Justices except Justice Sotomayor (Justice Gorsuch did not participate), went further. Instead of simply sending the case back to Montana state court to consider whether sufficient contacts with the state existed to support general jurisdiction, the majority held that Montana lacked general jurisdiction under *Daimler* because, except for in extraordinary circumstances, a defendant is only "at home" in its state of incorporation and principal place of business.

A few weeks after issuing *BNSF Ry. Co.*, the Supreme Court decided *Bristol-Myers Squib* in an 8-1 decision, with Justice Sotomayor dissenting. In *Bristol-Myers Squibb*, a group of 86 California residents and 592 residents from 33 other states filed a complaint in California state court alleging that they were injured after taking Bristol-Myers Squibb's ("BMS") drug Plavix.

BMS successfully argued in California state court that, under *Daimler*, the non-California plaintiffs could not invoke general jurisdiction. However, because the California and non-California plaintiffs brought nearly identical claims, and because there was no question that specific jurisdiction existed with respect to the California plaintiffs' claims, the California Supreme Court employed a "sliding scale approach" and found that specific jurisdiction existed over all plaintiffs' claims.

Notably, no matter what the Court decided, BMS would have to defend nearly identical claims brought by the California plaintiffs in California court. If anything, the burden on BMS to litigate all 677 plaintiffs' claims in California — rather than in 34 states across the country — was less. However, BMS mounted a jurisdictional challenge, the obvious result was to make it more difficult, expensive and time consuming for the plaintiffs to litigate their claims.

With Justice Alito now writing the majority opinion, the Supreme Court sided with BMS. The Court explained that, in determining whether personal jurisdiction is present, "the 'primary concern' is the 'burden on defendants'" but that "[e]ven if the defendant would suffer minimal or no inconvenience from being forced to ligate before the tribunals of another state; even if the forum State has a strong interest in applying its law to the controversy; even if the forum State is the most convenient location for litigation, the Due Process Clause, acting as an instrument of interstate federalism, may sometimes act to divest the State of its power to render a valid judgment." *Bristol-Myers Squibb*, 137 S. Ct. at 1781 (quoting *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 294 (1980)).

While *Bristol-Myers Squib* involved specific jurisdiction, the Due Process Clause controls for both specific and general jurisdiction. As such, the Court's focus on the Due Process Clause "as an instrument of interstate federalism," marks a further shift away from the bedrock principles of "fair play and substantial justice" that have guided the Court's inquiry since *International Shoe.* While the Court explicitly left open the question whether the Constitution imposes the same restrictions on the exercise of personal jurisdiction by a federal court, the Supreme Court has certainly provided a new framework to address this question. ■

CALIFORNIA FEDERAL COURT ISSUES BREAKTHROUGH RULING IN MULTIBILLION DOLLAR INSIDER TRADING ACTION

(continued from page 1)

trading on material nonpublic information relating to a tender offer.[1]

The *Allergan* decision marks one of the first Rule 14e-3 class actions to ever be certified in private litigation. Of particular importance to investors, provides new guidance for Section 14(e) and Rule 14e-3 plaintiffs concerning the required showing of class-wide reliance at the class certification stage. In its decision, the District Court confirmed that such reliance is presumed under the Supreme Court's long-standing precedent in *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153 (1972) ("*Affiliated Ute*") and, importantly, that defendants cannot rebut the presumption by arguing a supposed lack of "price impact" when the relevant tender offer was formally commenced. The decision also reaffirmed the continued vitality of the Ninth Circuit's seminal class certification precedent, *Blackie v. Barrack*, 524 F.2d 891 (9th Cir. 1975), despite Defendants' assertions that *Blackie* may have been partially overruled by subsequent Supreme Court decisions.

Background

Allergan is a securities class action brought against Pershing Square Capital Management, L.P. and Valeant Pharmaceuticals International, Inc., as well as the companies' respective Chief Executive Officers, William Ackman and Michael Pearson, among others. Plaintiffs allege that Defendants violated Sections 14(e) and Rule 14e-3, as well as Section 20A (which also concerns insider trading), by engaging in an illegal insider trading and front-running scheme that deprived a class of Allergan, Inc. shareholders of billions of dollars.

The scheme began in early 2014, when Ackman and Pearson agreed that in exchange for insider information regarding Valeant's then-undisclosed plans to launch a hostile takeover and tender offer for Allergan, Ackman and his hedge fund, Pershing, would secretly accumulate billions of dollars in Allergan common stock from unsuspecting investors. *Allergan*, 2017 U.S. Dist. LEXIS 37400, *4-6. As alleged, Ackman and Pershing knew those shares would skyrocket in value once Valeant publically revealed its takeover plans. *Id.* Once, through stealth and undetectable trading techniques, Pershing reached a nearly 10% stake in Allergan (known as a "toehold"), the scheme called for Valeant to then disclose to the market its unsolicited bid to acquire Allergan, and for Pershing to vote its shares in support of that bid. *Id.* Defendants' secret agreements also provided that if a competing bidder or "white knight" ultimately topped Valeant's bid and acquired Allergan, Pershing would kick back 15% of its insider trading proceeds to Valeant. *Id.* at *5-6. As Defendants anticipated, when Valeant finally announced its hostile bid and Pershing disclosed it's nearly 10% stake in Allergan, the price of Allergan common stock skyrocketed nearly $20 per share, generating more than $1 billion in instant profits for Pershing in a single trading day. *Id.* at *7. A short time later, in June 2014, Valeant officially launched a tender offer for Allergan. *Id.* In November 2014, another bidder for Allergan emerged, agreeing to acquire Allergan for $219 per share — over $100 per share more than the lowest price Pershing had paid for its Allergan shares acquired from unsuspecting shareholders during Pershing's covert buying program. *Id.* As a direct result of Pershing's insider trading, it walked away with billions of dollars in profit, kicking back approximately $400 million to Valeant. *Id.*

Rule 14e-3 was adopted to prevent this precise practice, known as "warehousing," where an offering person like Valeant (i.e., the prospective acquirer offering to purchase the tendered shares) intentionally leaks information to a friendly investor (Pershing) to buy shares in advance of a hostile bid, giving the favored investor windfall profits at the

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[1] A tender offer is a public offer by a prospective acquirer to all shareholders of a publicly traded company (i.e., the target) to tender their shares for sale at a specified price during a specified period of time. It is a tool commonly used to facilitate a hostile takeover.

expense of uninformed sellers of the target's shares. Accordingly, Plaintiffs immediately brought suit in December 2014. After overcoming Defendants' numerous attempts to dismiss their complaint, Plaintiffs moved to certify a class of shareholders who sold Allergan common stock contemporaneously with Pershing's purchases of Allergan stock during the period of February 25, 2014 through April 21, 2014.

Notable Legal Implications

Unlike many Section 10(b) cases, where the alleged wrongdoing typically arises from defendants issuing false and misleading statements, the alleged misconduct in Section 14(e) and Rule 14e-3 cases involves a failure to disclose material nonpublic information obtained from an acquirer regarding a planned merger transaction and related tender offer. While courts have rarely been given the occasion to address Section 14(e) or Rule 14e-3 plaintiffs' reliance at the class certification stage, numerous courts in the Ninth Circuit and elsewhere have held that "reliance is not an 'essential element' of a claim under [S]ection 14(e)," casting doubt on whether a Section 14(e) (or Rule 14e-3) plaintiff must actually prove reliance at class certification. *Church v. Consol. Freightways, Inc.*, 1991 U.S. Dist. LEXIS 15419, at *24-25 (N.D. Cal. June 14, 1991) (quoting *Plaine v. McCabe*, 797 F.2d 713, 721 & n.15 (9th Cir. 1986)).[2] In opposing certification, Defendants challenged, among other things, Plaintiffs' ability to demonstrate class-wide reliance, raising a question of first impression for the District Court.

In a victory for class action plaintiffs, the District Court confirmed that because claims under Section 14(e) and Rule 14e-3 involve a duty to disclose or abstain as opposed to affirmatively false statements, class-wide reliance is presumed under the Supreme Court's decision in *Affiliated Ute*. *Allergan*, 2017 U.S. Dist. LEXIS 37400, at *39-40. In *Affiliated Ute*, the Supreme Court held that in cases like those brought under Section 14(e) and Rule 14e-3 "involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery." 406 U.S. at 153. The District Court further explained that in failure to disclose cases, "it is necessary only that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision." Order at 22 (internal citations and quotations omitted). *Allergan*, 2017 U.S. Dist. LEXIS 37400, at *40. Because proof of materiality is not required at the Rule 23 stage[3], the District Court held that Plaintiffs are entitled to a presumption of reliance. *Id.*

The District Court next addressed Defendants' contentions that: (i) a presumption of reliance under *Affiliated Ute* is rebuttable, as is the case with the fraud-on-the-market presumption, and (ii) that Defendants had successfully rebutted the presumption by arguing that evidence shows that the alleged material nonpublic information regarding Valeant's takeover plans and tender offer had no effect on Allergan's stock price when Valeant officially launched the tender offer. *Id.* at *40-41. Acknowledging that the Supreme Court has not yet addressed whether an *Affiliated Ute* presumption is rebuttable at class certification, the District Court presumed that Defendants could attempt to rebut the presumption, but held that they had failed to do so. *Id.* at *40-42. More specifically, it explained while "Defendants' arguments center on the fact that when Valeant explicitly mentioned a tender offer, and later made a tender offer, the stock price was unaffected . . . . the material information may be 'relating' to a tender offer and need not be literally the fact of a tender offer." *Id* (citing 17 C.F.R. § 240.14e-3(a)). Applying this correct legal framework, the District Court pointed to evidence that after the April 2014 announcement of Valeant's hostile takeover bid (which was accompanied by SEC filings referencing how a potential Valeant tender offer would be structured), the stock price did, in fact, increase substantially. *Id.* at *41-42. Thus, Defendants failed to rebut the presumption of reliance under *Affiliated Ute*.

Notably, the District Court also rejected Defendants' attempt to cast doubt on *Blackie,* another longstanding securities class action precedent. *Id.* at *44. In *Blackie*, the Ninth Circuit rejected defendants' challenges to class certification based on alleged concerns regarding "intra-class conflicts" and plaintiffs' ability to calculate damages class-wide, holding "the amount of price inflation during the period can

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[2] Where reliance is a necessary element of their claims, if no presumption applies, then every plaintiff must prove direct reliance, thus preventing class certification. As a result, Plaintiffs in securities fraud class actions typically seek to invoke a presumption of reliance through the "fraud-on-the-market" doctrine — the presumption that "a public, material misrepresentation will distort the price of stock traded in an efficient market, and that anyone who purchases the stock at the market price may be considered to have done so in reliance on the misrepresentation." *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2417 (2014).

[3] *Amgen Inc. v. Connecticut Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1196 (2013) ("failure of proof on the *common* question of materiality ends the litigation and thus will never cause individual questions of reliance or anything else to overwhelm [common] questions").

CALIFORNIA FEDERAL COURT ISSUES BREAKTHROUGH RULING IN MULTIBILLION DOLLAR INSIDER TRADING ACTION

(continued from page 17)

be charted and the process of computing individual damages will be virtually a mechanical task." 524 F.2d at 905. In *Allergan*, Defendants boldly claimed *Blackie* was called into question and overruled in part by recent Supreme Court decisions, including *Comcast Corp. v. Behrend*, 133 S. Ct. 1426 (2013). *Allergan*, 2017 U.S. Dist. LEXIS 37400, at *44-45. The District Court correctly disagreed, declining Defendants' invitation to impose a heightened requirement to prematurely demonstrate a more taxing damages methodology at this stage. *Id.* at *45.

In a last ditch effort to undo this new precedent, Defendants petitioned the Ninth Circuit Court of Appeals for interlocutory review of the Court's opinion under Fed. R. Civ. P. ("Rule") 23(f). In that petition, which was penned by former U.S. Solicitor General, Paul D. Clement, Defendants asserted that the District Court's ruling was "manifestly erroneous" and raised "unsettled" issues of law. Among other challenges, Defendants asked the Ninth Circuit to reject the District Court's Rule 23 findings regarding reliance and to revisit the continued viability of its prior decision in *Blackie*. In another victory for Plaintiffs, after three rounds of briefing, the Ninth Circuit rejected Defendants' petition, effectively re-affirming the District Court's holding.

* * *

The District Court's well-reasoned decision, along with the Ninth Circuit's wholesale rejection of Defendants' Rule 23(f) petition, signals that for the foreseeable future, Section 14(e) and Rule 14e-3 class members will enjoy a broad presumption of reliance under *Affiliated Ute* and that the Ninth Circuit's *Blackie* decision remains the law of the land in the Ninth Circuit, thus eliminating key impediments to class certification for investors harmed by insider trading. ■

* *Kessler Topaz serves as Co-Lead counsel for the Allergan Plaintiffs and Class*

WHAT'S TO COME

SEPTEMBER 2017

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

OCTOBER 2017

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

NOVEMBER 2017

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

Pennsylvania Association of Public Employee Retirement Systems (PAPERS) — 11th Annual Fall Workshop

November 14 – 15
DoubleTree by Hilton Hotel & Suites ■ Pittsburgh, PA

JANUARY 2018

National Conference on Public Employee Retirement Systems (NCPERS) — Legislative Conference

January 28 – 30
Capital Hilton ■ Washington, DC

Florida Public Pensions Trustees Association (FPPTA) — Winter Trustee School

January 28 – 31
Hyatt Regency ■ Orlando, FL

FEBRUARY 2018

National Association of Public Pension Attorneys (NAPPA) — Winter Seminar

February 21 – 23
Tempe Mission Palms ■ Tempe, AZ

MARCH 2018

Rights and Responsibilities of Institutional Investors (RRII)

March 8 – 9
NH Grand Hotel Krasnapolsky
Amsterdam, Netherlands

Georgia Association of Public Pension Trustees (GAPPT) — Trustee School

March 19 – 21
Macon Marriott City Center ■ Macon, GA

Florida Public Pensions Trustees Association (FPPTA) — Wall Street Program

March 27 – 31
The Intercontinental New York Barclay Hotel
New York, NY

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