Summer 2016

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

FULLY INFORMED

HIGHLIGHTS

KESSLER TOPAZ MELTZER CHECK LLP

FOR WHOM THE STATUTE TOLLS: AN UPDATE

Margaret E. Onasch, Esquire and Johnston de F. Whitman, Jr., Esquire

Below, we provide an update on the discussion of the appeal pending before the United States Court of Appeals for the Third Circuit in *North Sound Capital LLC v. Merck & Co., Inc.*, No. 16-8012, which was discussed at length in the KTMC Winter 2016 Bulletin, as well as a recent decision by the United States Court of Appeals for the Sixth Circuit that addressed some of the same issues that the Third Circuit will decide in *North Sound Capital*.

The *North Sound Capital* appeal is now docketed as Case No. 16-1364, and merits briefing has been was completed on June 23, 2016. As previously discussed, the central issue in the *North Sound Capital* appeal is whether the tolling doctrine established by the United States Supreme

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KESSLER TOPAZ CAUSES STEMCELLS, INC. AND COGENT COMMUNICATIONS HOLDINGS, INC. TO *REPEAL ILLEGAL BYLAWS INTENDED TO DETER STOCKHOLDER LITIGATION*

Kristen L. Ross, Esquire

In May 2014, corporate boards across the country began adopting bylaws designed to prevent stockholders from exercising their rights to bring class and derivative litigation challenging corporate wrongs. These restrictive provisions included "fee-shifting" bylaws, which required plaintiffs to pay the defendants' legal fees in stockholder litigation that was less than 100% successful, and "no-pay" bylaws, which required plaintiffs to bear their own legal fees even if they created a common fund or benefit for their fellow stockholders or the corporation. Corporate boards adopted these types of bylaws to insulate themselves from liability for breach of fiduciary duty and other violations of law by deterring stockholders from commencing litigation against them.

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WHEN DOES PRICE MATTER? BEST BUY AND THE PRESUMPTION OF RELIANCE

Ryan T. Degnan, Esquire

On April 12, 2016, the United States Court of Appeals for the Eighth Circuit issued a significant decision that may have important ramifications for plaintiffs asserting class action claims under the federal securities laws. In *IBEW Local 98 Pension Fund v. Best Buy Co., Inc., et al.*, 818 F.3d 775 (8th Cir. 2016), the Eighth Circuit became the first appellate court to find that defendants had successfully defeated class certification by rebutting the "presumption of reliance" under the framework set forth by the Supreme Court of the United States in *Halliburton Co. v. Erica P. John Fund Inc.*, 134 S. Ct. 2398 (2014).

The Fraud-On-The-Market Presumption of Reliance

Under Section 10(b) of the Securities Exchange Act of 1934, plaintiffs pursuing claims for securities fraud are required to prove, among other things, that they relied upon an alleged misrepresentation in connection with the purchase or sale of a security. However, in the context of a securities fraud class action, requiring each member of the purported class to demonstrate individualized reliance poses two problems. First, it would subject plaintiffs to an extraordinarily difficult evidentiary burden in that they would have to show a "speculative state of facts," namely, how each class member would have acted but for the misrepresentation. *Basic v. Levinson*, 485 U.S. 224, 245 (1988). Second, requiring proof of each class member's reliance would run afoul of Federal Rule of Civil Procedure 23(b)(3) — which requires that issues "common to class members predominate over any questions affecting only individual members" in order to certify an action as a class action. *Id.* at 230. As such, claims requiring proof of individual reliance for each investor are typically not certified as class actions.

Addressing these issues, the Supreme Court held in *Basic* that securities fraud plaintiffs are entitled to a presumption of class-wide reliance — which would allow maintenance of a case as a class action — based on the "fraud-on-the-market" theory — which holds that efficient securities markets incorporate all publicly available information (including misstatements) into a stock's price, and thus, investors implicitly purchase or sell securities in reliance on the integrity of the market price (and all of the company's representations). *Id.* at 247. However, the fraud-on-the-market presumption may be rebutted with "evidence that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price." *Id.* at 248.

In *Halliburton*, the Supreme Court affirmed the continued validity of the fraud-on-the-market presumption of reliance but stated that defendants may be able to rebut the presumption at the class certification stage — rather than at the later summary judgment stage or at trial — by presenting evidence that, among other things, an alleged misstatement had no impact on the price of the stock. *Halliburton*, 134 S. Ct. at 2405. Prior to *Halliburton* is significant given that several federal circuits held that defendants were not permitted to use evidence of a lack of "price impact" at the class certification stage to rebut the fraud-on-the-market presumption.

Best Buy and the Post-*Halliburton* Landscape

In February 2011, a group of individuals filed a class action complaint against Best Buy Co., Inc. ("Best Buy") in the United States District Court for the District of Minnesota, asserting that Best Buy's earnings guidance released in connection with its second quarter 2011 earnings announcements was false and misleading. Plaintiffs' claims against Best Buy arose out of two statements made on September 14, 2010. The first statement was an 8:00 a.m. press release announcing that Best Buy was increasing its full-year 2011 earnings per share ("EPS") guidance by ten cents to a range between \$3.55 and \$3.70. The second statement was made during a 10:00 a.m. conference call when Best Buy's Chief Financial Officer stated that the company's earnings were "essentially in line with our original expectations for the year" and that Best Buy was "on track to deliver and exceed [its] annual EPS guidance." Best Buy's common stock, which closed the prior day at \$34.65,

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THE SUPREME COURT OPENS THE DOOR TO STATISTICAL EVIDENCE IN CLASS ACTIONS

Melissa L. Troutner, Esquire

On March 22, 2016, the Supreme Court of the United States issued an eagerly-anticipated decision concerning the use of statistical evidence to prove liability in class and collective actions. In *Tyson Foods, Inc. v. Bouaphakeo*, the Court affirmed a jury verdict that relied on a statistical analysis to establish class-wide liability for employees seeking damages for unpaid overtime. 136 S. Ct. 1036 (2016). In doing so, the Supreme Court held that the use of representative statistical sampling evidence ***"will depend on the purpose for which the sample is being introduced and on the underlying cause of action."*** *Id.* at 1049 (emphasis added). The ramifications of *Tyson Foods* will play out in the lower courts as plaintiffs attempt to seize on the Court's acceptance of statistical analysis to establish class-wide liability.

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DELAWARE COURT OF CHANCERY PROVIDES SLIGHT VINDICATION FOR SHAREHOLDERS IN DELL APPRAISAL

Grant Goodhart, Esquire

On May 31, 2016, Vice Chancellor J. Travis Laster ruled that Dell shareholders were underpaid by almost $4.00 per share in Dell's management-led buyout in 2013. According to Vice Chancellor Laster, the buyout price of $13.88 per share did not reflect the true "intrinsic value" of Dell, which the Vice Chancellor held was in fact $17.62 per share,[1] representing a roughly $6 billion total underpayment by founder Mr. Dell and his partners.

The opinion represents a victory for shareholders seeking appraisal and breaks a recent trend of appraisal actions that had held the deal price to be fair. The result provides a boon to dissenting shareholders who feel they are being cashed out of their companies for unfair value.

Delaware law provides appraisal rights for shareholders who dissent from a merger on the grounds that the offering price is inadequate. The appraisal statue provides for judicial determination of the intrinsic worth, or fair value, of the company's shares.[2] This obligation to determine fair value falls squarely on the court, with each party carrying the burden to prove their respective valuation position.[3]

In Dell's case, the buyout was led by a group composed of Mr. Dell and Silver Lake Partners (the "Buyout Group").[4] The Buyout Group originally proposed a deal price of $13.65 in cash, which Dell's special committee of directors accepted and recommended to the full board and shareholders.[5] However, prior to the shareholder meeting, investors such as Carl Icahn and T. Rowe Price publicly opposed the merger at the recommended price. Due to that public pressure, and Icahn filing his own preliminary proxy statement threatening to nominate an alternate slate of directors, Dell postponed the vote. Ultimately, the Buyout Group raised the offer price by $0.10 per share plus a special one-time cash dividend of $0.13 per share.[6] This brought the deal price to effectively $13.88 per share. Stockholders approved the deal on September 12, 2013. A relatively low 70% of shares present at the meeting voted in favor of the deal.[7]

While Icahn chose not to seek appraisal (backing off his public threat to do so) other shareholders did. In the consolidated appraisal action, shareholders argued that the intrinsic value of Dell was actually closer to $28.00 per share, while Dell's expert argued that the offer price was generous, and the true fair value was $12.68 per share.[8] In his opinion, Vice Chancellor Laster settled on a valuation in between the two, at $17.62 per share.

Vice Chancellor Laster noted that there was "widespread and compelling evidence of a valuation gap" presented at trial between the market's perception of Dell's worth and the company's

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1 In *re Appraisal of Dell Inc.*, No. CV 9322-VCL, 2016 WL 3186538 (Del. Ch. May 31, 2016).

2 *See generally* 8 Del. C. § 262.

3 *In re Appraisal of Dell Inc.*, No. CV 9322-VCL, 2016 WL 3186538 (Del. Ch. May 31, 2016).

4 *Id.*

5 *Id.*

6 *Id.*

7 *Id.*

8 *Id.*

8TH ANNUAL

Evolving Fiduciary Obligations of Institutional Investors

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

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.

Keynote Speaker

Al Gore

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

Al Gore was referred to by *Time* magazine as "a businessman who is out to change the world." An environmental, business, and tech visionary recognized as one of the world's leading activists, Vice President Al Gore offers a unique perspective on national and international issues, including the threats of climate change and the future of tech.

Consistently an active leader in technology, Al Gore is uniquely in touch with the opportunities and challenges in charting a new digital society. Vice President Gore's status as a leader in global politics, technology and business influences his positions as member of the Board of Directors of Apple and a Senior Partner at Kleiner Perkins Caufield & Byers, Silicon Valley's preeminent venture firm. In addition, he is Chairman of Generation Investment Management, an asset-management company incorporating sustainability values into the financial-services world.

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SECRET MERGER SCHEME EXPOSED AND ELIMINATED THROUGH REIT LITIGATION

Stacey Greenspan, Esquire and Lee Rudy, Esquire

In the spring of 2016, Kessler Topaz commenced litigation that exposed a secret merger plan to "roll up" a series of related companies into their parent. The firm exposed this plan through its own internal investigation, which included blockbuster testimony from a former corporate director who corroborated defendants' illicit plan. In the face of lawsuits challenging two of the planned roll up transactions, both companies immediately abandoned their scheme. And two other sister companies, likely fearing additional lawsuits, pulled their deceptive stockholder proposals as well. Indeed, this litigation proved so potent that it achieved 100% success within a matter of days.

The companies at issue are each Real Estate Investment Trusts ("REITs") that are publicly held but not traded on a national stock exchange (a "non-traded REIT"). Each is indirectly controlled by AR Global Investments, LLC ("AR Global"). Each REIT's governing charter sets forth certain protections for stockholders in the event that the REIT enters into a "roll up" transaction, i.e., a merger with the parent AR Global. These protections include a right to an independent appraisal of the value of the REIT, and to be paid that fair value in cash.

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KESSLER TOPAZ LEADING LITIGATION AGAINST FACEBOOK, INC. AND MARK ZUCKERBERG CHALLENGING ENTRENCHMENT SCHEME

Matthew A. Goldstein, Esquire

Controlling stockholders owe fiduciary duties to minority stockholders. Among other things, controllers cannot cause the corporation to effect a transaction that would benefit the controller at the expense of the minority.[1] Kessler Topaz is currently leading stockholder litigation against the directors of Facebook, Inc., relating to a proposed transaction that will entrench Facebook's founder and controlling stockholder Mark Zuckerberg in power for decades to come, at the same time allowing Zuckerberg to sell or transfer the vast majority of his Facebook stock.

Specifically, Facebook has announced its intention to issue a new class of non-voting Class C stock (the "Reclassification"), and to give each Facebook stockholder two shares of Class C stock for each share of A or B stock that they currently hold (the "Dividend"). Because Zuckerberg controls Facebook through his majority ownership of Facebook's 10-vote Class B stock, the Reclassification and Dividend will allow Zuckerberg to sell or transfer the bulk of his Facebook economic ownership (A and C shares) while continuing to control the company through his B shares.

Zuckerberg currently holds 60% of Facebook's voting power, while holding only about 15% of Facebook's equity. After the Reclassification and Dividend, even if Zuckerberg sells or transfers all of his Class C shares, he will still control the company, but will only own 5% of its equity.

Numerous lawsuits were filed challenging the Reclassification. Following competing submissions and a contested hearing, the Court appointed Kessler Topaz and its institutional client as co-lead plaintiff and co-lead counsel, respectively. Kessler Topaz lawyers filed a consolidated class action complaint on June 6, 2016 seeking to enjoin consummation of the Reclassification or, in the event the Reclassification is consummated, money damages as a result of defendants' breaches of fiduciary duties.[2] Defendants have agreed not to effect the Reclassification and Dividend until after the court rules on plaintiffs' application for a permanent injunction to stop the transaction. Trial is tentatively scheduled for April of 2017.

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[1] *Frank v. Elgamal*, C.A. No. 6120-VCN, 2012 WL 1096090, at *8 (Del. Ch. Mar. 30, 2012); *Gentile v. Rossette*, 906 A.2d 91, 103 (Del. 2006).

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

FOR WHOM THE STATUTE TOLLS: AN UPDATE

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. . . the Sixth Circuit joined the Second Circuit in holding that the Exchange Act and Securities Act of 1933 (the "Securities Act") statutes of repose cannot be tolled by the American Pipe tolling doctrine.

Court in *American Pipe & Constr. Co. v. Utah,* 414 U.S. 538 (1974) can be applied to toll the five-year statute of repose set forth in the Securities Exchange Act of 1934 (the "Exchange Act"). A number of *amici curiae*, including a group of United States and European institutional investors, and the National Association of Shareholder and Consumer Attorneys submitted briefs in which they argued that *American Pipe* tolling principles should apply to statutes of repose. The Securities Industry and Financial Markets Association also submitted an *amicus curiae* brief, in which it argued that tolling principles should not apply to statutes of repose. As a date for oral argument has not yet been set, we cannot predict when the Third Circuit will issue its decision.

While the Third Circuit has yet to determine whether *American Pipe* tolling principles apply to the Exchange Act's statute of repose, with its May 19, 2016 decision in *Stein v. Regions Morgan Keegan Select High Income Fund, Inc.*, 821 F.3d 780 (6th Cir. 2016), the Sixth Circuit joined the Second Circuit in holding that the Exchange Act and Securities Act of 1933 (the "Securities Act") statutes of repose cannot be tolled by the *American Pipe* tolling doctrine. As we reported in the 2016 Winter Bulletin, in *Police & Fire Ret. Sys. of the City of Detroit v. IndyMac MBS, Inc.*, 721 F.3d 95, 109 (2d Cir. 2013), the United States Court of Appeals for the Second Circuit concluded that *American Pipe* tolling did not apply to the statute of repose set forth in Securities Act. By siding with the Second Circuit, the Sixth Circuit tipped the weight of United States Circuit Court authority to the view that plaintiffs asserting direct claims for securities violations under the Exchange Act and the Securities Act must commence litigation within the applicable statutes of repose to preserve their individual claims, regardless of whether there is a pending class action asserting the same claims that such plaintiff would allege on an individual basis. The United States Court of Appeals for the Tenth Circuit continues to be the only circuit court to have held that *American Pipe* applies to *both* statutes of limitations and statues of repose. *Joseph v. Wiles*, 223 F.3d 1155, 1167 (10th Cir. 2000). The Sixth Circuit's *Regions Morgan Keegan* decision increases the likelihood that the United States Supreme Court will be asked to consider the applicability of the *American Pipe* tolling doctrine to statutes of repose.

The *Regions Morgan Keegan* appeal originated from individual actions filed in 2013 by two groups of plaintiffs in the United States District Court for the Western District of Tennessee, asserting claims under Sections 11, 12(a)(2) and 15 of the Securities Act, Sections 10(b) and 20(a) of the Exchange Act and Securities and Exchange Commission Rule 10b-5. The plaintiffs alleged that they suffered significant losses resulting from their purchases of Morgan Keegan funds. According to the plaintiffs, these funds were overvalued and concentrated in risky securities, all of which the plaintiffs claimed was unlawfully concealed by the defendants.

Prior to the plaintiffs' lawsuits, two separate putative class actions also asserting claims based on purchases of the Morgan Keegan funds were filed in the same court in 2007. These two class actions were settled in 2013 and 2015, respectively, with classes certified for settlement purposes in both cases. Upon the defendants' motions to dismiss the individual actions, the district court initially found that the plaintiffs' claims were not untimely under the applicable statues of limitations and repose. However, the district court then reversed its decision upon reconsideration. The appeal to the Sixth Circuit ensued, with the plaintiffs asserting that the *American Pipe* doctrine tolled the Securities Act and Exchange Act statutes of limitation and repose applicable to their claims.

In addressing the applicability of *American Pipe* tolling to the Exchange Act and Securities Act statutes of repose, the Sixth Circuit noted the Circuit split between the Tenth Circuit and Second Circuit and reviewed the reasoning underlying each court's conclusion. In holding that *American Pipe* tolled statutes of repose pending a class certification decision, the Tenth Circuit stated: "[A]pplication of the *American Pipe* tolling doctrine to cases such as this one does not involve 'tolling' at all. Rather, [the plaintiff] has effectively been a party to an action against these defendants since a class covering him was requested but never denied." *Wiles*, 223 F.3d at 1168. Therefore, the Tenth Circuit concluded that "*American Pipe* tolling applies to the statute of repose governing [the plaintiff's] action." *Id.*

The Second Circuit, by contrast, found that regardless of whether *American Pipe* tolling was classified as equitable or statutory (a distinction discussed in greater detail in the Winter 2016 Bulletin), it could not apply to statutes of repose. *IndyMac*, 721 F.3d 95. In reaching this conclusion, the Second Circuit relied heavily on the Supreme Court's decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 363 (1991), in which the Court held that the three-year limitation period in Section 13 of the Securities Act was a "period of repose *inconsistent* with tolling" and to which tolling principles did not apply. The Second Circuit interpreted *Lampf*'s holding to have foreclosed equitable tolling of the Securities Act statute of repose. *IndyMac*, 721 F.3d at 109. Therefore, the Second Circuit determined that the only way this statute of repose could be tolled under *American Pipe* was if the doctrine was a form of legal or class action tolling derived from Federal Rule of Civil Procedure 23. *Id.* The Rules Enabling Act, 28 U.S.C. § 2072, provides that "rules of practice and procedure" promulgated by the Supreme Court, including the Federal Rules of Civil Procedure, "shall not abridge, enlarge or modify any substantive right." The Second Circuit concluded that tolling a statute of repose through an application of the *American Pipe* doctrine "would impermissibly affect the right of defendants to be free of liability after three years," thus violating the Rules Enabling Act. *IndyMac*, 721 F.3d at 109.

The Sixth Circuit found that as compared to the Tenth Circuit's decision in *Wiles,* the Second Circuit's *IndyMac* decision articulated "the more cogent and persuasive rule." Among other things, the Sixth Circuit noted that the *IndyMac* decision is more consistent with the Supreme Court's decision in *CTS Corp. v. Waldburger*, 134 S.Ct. 2175 (2014), wherein the Court noted that a statute of repose "will not be tolled for any reason." 134 S.Ct. at 2183. The Sixth Circuit also explained that statutes of repose "vest a substantive right in defendants to be free from liability" and further stated that the court could not "endorse the Tenth Circuit's view that '[d]efendants' potential liability should not be extinguished simply because the district court left the class certification issue unresolved.'" *Regions Morgan Keegan*, 821 F.3d at 794 (quoting *Wiles*, 223 F.3d at 1168). Therefore, the Sixth Circuit "join[ed] the Second Circuit in holding that, regardless of whether *American Pipe* tolling is derived from courts' equity powers or from Rule 23, it does not apply to statutes of repose." *Id.* at 794-95. In light of this holding, and because the repose period applicable to the plaintiffs' claims began to run more than five years before they filed their actions in federal court, the Sixth Circuit found that the plaintiffs' Exchange Act and Securities Act claims were time-barred by the statutes of repose.

The Sixth Circuit's decision regarding the applicability of *American Pipe* tolling to statutes of repose is not entirely surprising in light of the court's precedent. Notably, while not directly relevant to the issue of statute of repose tolling, the Sixth Circuit previously "declined to extend *American Pipe* tolling to plaintiffs who file individual actions *before* the district court rules on class certification" in *Wyser-Pratte Mgmt. Co. v. Telxon Corp.*, 413 F.3d 553 (6th Cir. 2005). In addressing the argument that the *Regions Morgan Keegan* plaintiffs' claims were barred under the applicable statutes of limitations, the Sixth Circuit quoted its earlier decision, which further provided: "a plaintiff who chooses to file an independent action without waiting for a determination of the class certification issue may not rely on the *American Pipe* tolling doctrine. . . . [t]he purposes of *American Pipe* tolling are not furthered when plaintiffs file independent actions before decision on the issue of class certification, but are when plaintiffs delay until the certification issue has been decided." *Wyser-Pratte* 413 F.3d at 568, 569. While recognizing that the *Wyser-Pratte* decision expressed the minority view, the Sixth Circuit in *Regions Morgan Keegan* rejected the plaintiffs' argument that *Wyser-Pratte* was wrongly decided and not binding. Thus, this so-called "forfeiture" rule, by which plaintiffs forfeit the benefit of *American Pipe* tolling if they file suit prior to the adjudication of a motion for class certification in a parallel class action, remains good law in the Sixth Circuit.

Following the Sixth Circuit's decision in *Regions Morgan Keegan*, the Tenth Circuit is now outnumbered two-to-one by the circuit courts holding that *American Pipe* tolling cannot be applied to the Exchange Act and Securities Act statutes of repose. It remains to be seen whether the Third Circuit will join the Tenth Circuit and even the score or side with the Second and Sixth Circuits and widen the divide. In any event, a petition for writ of *certiorari* to the Supreme Court is likely to result in either or both of *Regions Morgan Keegan* and *North Sound Capital*. Thus, it appears to be only a matter of time before the United States Supreme Court decides these issues and eliminates the existing uncertainty.

In light of these recent decisions, investors with potentially large losses in a security that is at issue in a pending securities class action should regularly monitor such class actions pending in courts within the Second and Sixth Circuit to determine whether to file an individual action before the applicable statute of repose expires. Because a pending securities class action within the foregoing circuits (and, potentially the Third Circuit) will not provide any statute of repose tolling benefit, investors who fail to file individual actions prior to the running of the applicable statutes of repose risk having their claims extinguished if class certification is denied in the pending class action, and will otherwise lose their right to seek an individual recovery. ■

Institutional Investor FORUMS

12TH ANNUAL

The Rights & Responsibilities of Institutional Investors

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

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?

Proposed Topics for Discussion:

- ❖ Globalization and Its Consequences for Responsible Shareholders
- ❖ Brexit/Future of Europe Panel
- ❖ The Importance of Tackling Climate Change
- ❖ Volkswagen Case Study
- ❖ What Are the Consequences of the Prudent Person Rule?
- ❖ Geopolitical Perspective

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KESSLER TOPAZ LEADING LITIGATION AGAINST FACEBOOK, INC. AND MARK ZUCKERBERG CHALLENGING ENTRENCHMENT SCHEME

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Facebook's Capital Structure Pre-Reclassification

When Facebook went public in May 2012, the company's capital structure gave disproportionate voting power to Zuckerberg through his ownership of super-voting Class B shares. Since that time, Facebook has had a dual-class stock structure consisting of Class A stock, which is entitled to one vote per share, and Class B stock, which is entitled to ten votes per share. As the Class B stock is sold or transferred, it automatically converts into Class A stock, losing nine votes per share. Thus, as other Class B holders have sold over time, Zuckerberg's control position has strengthened.

At the moment, Zuckerberg beneficially owns 60% of the total voting power of all outstanding shares of Facebook Class A and Class B stock, despite only owning 15% of Facebook's outstanding equity. With only about 15% of the remaining Class B shares outside of Zuckerberg's control, he can no longer count on the conversion of substantial numbers of ten-vote Class B shares held by others into one vote Class A shares to bump up his voting percentage. Zuckerberg has nearly fully exploited the potential of the existing dual-class structure to allow him to maintain voting control through a reduced equity stake.

Facing this reality, Zuckerberg approached the board of directors in August 2015 with his concern that if he were to monetize a significant number of his shares, he would likely lose control over the company. Zuckerberg proposed that Facebook's stock be reclassified, and the board of directors immediately responded by establishing a special committee to review Zuckerberg's proposal.

Zuckerberg Pledges to Donate His Wealth

On December 1, 2015, Zuckerberg announced the formation of the Chan Zuckerberg Initiative LLC ("CZI"), a charitable organization founded by him and his wife. Zuckerberg's announcement, revealed in a letter to his newborn daughter, stated that he and his wife intend to donate 99% of their Facebook shares – currently valued at approximately $45 billion — during their lifetime to advance CZI's mission. The announcement also affirmed that Zuckerberg plans to remain Facebook's CEO for many years to come.

Zuckerberg's announcement also made clear that he fully expected the special committee to approve the Reclassification. While Zuckerberg was theoretically awaiting the special committee's decision about the Reclassification, Zuckerberg's public announcement that he intended both to give away his Facebook stock and continue to stay in control of Facebook makes clear that he believed the special committee's decision was a foregone conclusion.

The Reclassification

Zuckerberg was correct. The special committee unanimously recommended that the board of directors approve the Reclassification, and it was publicly announced on April 27, 2016. The Reclassification contemplates amending Facebook's Certificate of Incorporation to provide for: (i) the creation of 15 billion shares of non-voting Class C stock; (ii) an increase in the number of authorized Class A shares from 5 billion to 20 billion; (iii) the equal treatment of Class A shares, Class B shares, and Class C shares (i.e., same amount and form of consideration) in connection with certain transactions and upon liquidation, dissolution, or winding up of the company; and (iv) "Sunset Provisions" which will require that Zuckerberg's shares of Class B stock will automatically convert into Class A stock within specified periods of time following Zuckerberg's death, disability or resignation.

The special committee and board of directors also approved the Dividend, which contemplates issuing two Class C shares for each outstanding Class A and Class B share. After the Reclassification and Dividend, the Class B stock will represent only about 6.4% of Facebook's outstanding economic interest, but it will control 70% of the company's voting power. Because Zuckerberg owns the majority of the Class B stock, the Dividend will allow him to donate or otherwise monetize all of his Class C stock, bringing his equity interest in the company down to only 5%, while retaining his 60.1% voting power.

On behalf of an institutional client of Facebook, Kessler Topaz alleges that Facebook's public stockholders are giving Zuckerberg an undeserved benefit for little in return. Zuckerberg has agreed to enter into a "Founder Agreement" whereby he will: (1) not sell or transfer Class B shares to result in his owning less than a majority unless he converts all Class B shares into A shares; (2) not vote for or sell into any change of control transaction unless the Class A, B and C stock will receive the same amount and form of consideration; and (3) meet with the board of director from time to time to discuss succession planning. Kessler Topaz argues that these governance provisions are both of little value and also totally illusory, since Zuckerberg can unilaterally walk away from any of them. Stated another way, the "give" does not match the "get."

(continued on page 17)

DELAWARE COURT OF CHANCERY PROVIDES SLIGHT VINDICATION FOR SHAREHOLDERS IN DELL APPRAISAL

(continued from page 3)

"operative reality."[9] As the Vice Chancellor noted, Dell was a company in transition, evolving from a predominantly PC sales focused business to one seeking to specialize more in software sales and cloud-based and other services to enterprise customers. This evolution, however, had the effect of diminishing short-term results as the long-term remained the focus of Dell's management. As the market lagged behind in its understanding that Dell was no longer merely a PC sales business, the market price fell and Mr. Dell and management believed that Dell was being undervalued.[10]

Mr. Dell and his advisors believed that the "valuation gap" existed because the market and Dell's shareholders were overly focused on the short-term rather than their long term vision for the company. Vice Chancellor Laster held that proposing the buyout while the stock was undervalued in the market had the effect of "anchoring" price negotiations to an artificially low level, divorced from the company's fundamentals.[11] As is often the case in merger negotiations, the market price per share generally provides a reference point for price haggling.[12] Thus, the investor shortsightedness coupled with Mr. Dell's opportunistic buyout timing during that myopia, "anchored" the price to a level below the fair value.[13]

The Vice Chancellor was quick to emphasize that in this situation, unlike some others, there was "no evidence that Mr. Dell or his management team sought to create the valuation disconnect so that they could take advantage of it. To the contrary, they tried to convince the market that that Company was worth more." According to Vice Chancellor Laster, the process here was clean, and "easily would sail through if reviewed under enhanced scrutiny."[14] Thus, there was no breach of fiduciary duty by Mr. Dell or the Board.[15] "But," as the Vice Chancellor explained, "that is not the same as proving that the deal price provides the best evidence of the Company's fair value."[16]

Important in the Vice Chancellor's decision is the principle going forward that deal price provides merely one "data point" for the intrinsic value of the company in an appraisal proceeding.[17] Especially in management-led buyouts, a variety of factors may undermine the persuasiveness of the deal price as evidence of fair value.[18] The decision also breaks a recent chain of Chancery appraisal opinions — including Vice Chancellor Sam Glasscock III's rulings in appraisals for Ancestry.com, BMC Software Inc., and CKx Inc. — holding the deal price to be the fair value.[19] Vice Chancellor Laster's recognition that deal price does not always represent fair value should be encouraging to disaffected stockholders who wish to challenge deals they see as unfair in an appraisal proceeding. This is especially the case in management-led buyout transactions, as opportunistic timing is an ever-present risk.[20]

One unfortunate footnote to the Dell appraisal opinion is that not all shareholders who opposed the deal will share in the fruits of Vice Chancellor Laster's holding, specifically T. Rowe Price. An important lesson to learn from T. Rowe Price's situation is that Delaware's appraisal statute is strictly enforced. In order to

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[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] *Id.*

[13] *Id.*

[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] *Id.*

[18] *Id.*

[19] *See, e.g., In re Appraisal of Ancestry.com Inc.*, 2015 WL 399726 (Del. Ch. Jan. 30, 2015); *Merion Capital LP v. BMC Software Inc.*, 2015 WL 6164771 (Del. Ch. Oct. 21, 2015); *Huff Fund Inv. P'ship v. CKx Inc.*, 2013 WL 5878807 (Del. Ch. Nov. 1, 2013); *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).

[20] *In re Appraisal of Dell Inc.*, No. CV 9322-VCL, 2016 WL 3186538 (Del. Ch. May 31, 2016). ("the Delaware Supreme Court [has] acknowledged that an appraisal proceeding can and should address the problem of opportunistic timing[.]").

be eligible for appraisal under Delaware law, the dissenting shareholder must (1) continuously hold their shares through the effective date of the merger, and (2) not vote in favor of the merger.[21] Unfortunately for T. Rowe Price, it inadvertently failed to comply with the second requirement. Notwithstanding T. Rowe Price's adamant and vocal opposition to the proposed buyout, through a series of intermediaries it accidentally voted in favor of the deal.

Like most shareholders, T. Rowe Price held its shares of Dell through brokers, one of whom was State Street Bank & Trust Co. ("State Street"). Both T. Rowe Price and State Street outsourced their voting practices. As Vice Chancellor Laster described:

> State Street outsourced to Broadridge Financial Solutions, Inc. the task of collecting and implementing voting instructions from its many account holders, including [ ] T. Rowe [Price]. To carry out that task, State Street gave Broadridge a power of attorney which authorized Broadridge to execute proxies on State Street's behalf. At that point, voting authority for [ ] T. Rowe [Price] shares rested with Broadridge.
>
> To fulfill its contractual obligations to State Street, Broadridge communicated with State Street's account holders and obtained voting instructions by mail, by telephone, or over the internet. With T. Rowe [Price], the process involved an additional party: Institutional Shareholder Services Inc. ("ISS"). To facilitate the submission of voting instructions in connection with numerous meetings of stockholders each year, T. Rowe [Price] [ ] retained ISS to notify T. Rowe [Price] about upcoming votes, provide voting recommendations, collect T. Rowe[ ] [Price's] voting instructions, and convey them to Broadridge. To make the voting process more efficient, T. Rowe [Price] [had] a computerized system that automatically generate[d] default voting instructions and provide[d] them to ISS. *The default voting instruction for a management-supported merger is to vote in favor.*[22]

The problem was that because the Dell squeeze-out was so controversial — in no small part thanks to T. Rowe Price's opposition — the shareholder meeting was pushed back three times to both negotiate the price increase and get enough votes.[23]

Before the first scheduled meeting of Dell's shareholders, T. Rowe Price informed ISS that some of its funds wanted to vote against the merger. ISS recorded the votes against the merger into its voting system. The first three times the meeting was postponed ISS kept the old voting instructions from T. Rowe Price, and T. Rowe Price checked into the ISS voting system to ensure the instructions were correct.[24] However, prior to the fourth scheduled meeting, the ISS voting system generated a new meeting record for the re-scheduled meeting, which inadvertently replaced the prior meeting's records.[25] This had the effect of deleting the voting instructions that had been entered in the ISS voting system. The T. Rowe Price voting selections automatically pre-populated with the default voting instructions called for by T. Rowe Price's voting policies.[26] As a result, the voting system populated the new meeting record with instructions to vote "FOR" the Merger.[27]

No one from T. Rowe Price's proxy team logged into the ISS system this time to check the status of the voting instructions. Thus, the default instructions were conveyed automatically to ISS.[28] This time, the meeting was not postponed and the vote was sufficient to approve the buyout.

While T. Rowe Price blamed the discrepancy on a computer glitch, and argued that the court should take its well-publicized opposition to the deal into consideration, Vice Chancellor Laster ruled that an investor assumes such a risk if it uses intermediaries in its voting practices.[29] Remember, the Delaware appraisal statute has very strictly enforced rules, which in this case were particularly unforgiving.

Ultimately, the Dell decision reaffirms shareholders' rights to pursue an appraisal remedy when they feel they are not being adequately compensated in a merger transaction. This valuable tool is an important investor check on opportunistic merger transactions, especially in the case of a controlling shareholder squeeze-out. Investors interested in exercising their appraisal rights must remember the strict statutory requirements for doing so, the most important of which are (1) continuously holding onto the shares through the effective date of the merger, and (2) not voting in favor of the transaction. ■

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21 *See* 8 Del. C. § 262(a).

22 *In re Appraisal of Dell Inc.*, No. CV 9322-VCL, 2016 WL 2854414 (Del. Ch. May 11, 2016) (emphasis added).

23 *Id.*

24 *Id.*

25 *Id.*

26 *Id.*

27 *Id.*

28 *Id.*

29 *Id.*

THE SUPREME COURT OPENS THE DOOR TO STATISTICAL EVIDENCE IN CLASS ACTIONS

(continued from page 3)

Background of the Case

In *Tyson Foods*, employees ("Plaintiffs") in a meat processing plant operated by Tyson Foods, Inc. ("Tyson" or "Defendant") brought a wage and hour collective action under the Fair Labor Standards Act of 1938 ("FLSA") and a damages class action under Iowa state law, and sought compensation for unpaid overtime incurred when putting on and taking off protective gear, *i.e.*, "donning and doffing." *See id.* at 1042. Tyson compensated some, but not all, employees for donning and doffing time and did not keep records documenting the amount of time each employee spent on these activities despite the fact that wearing protective gear was required. In order to recover damages for unpaid wages, class members were required to prove that the time they spent donning and doffing, plus the time at their workstations, totaled more than 40 hours per week. *See id.* Because Tyson did not keep official records of donning and doffing time for the over 3000 putative class members, Plaintiffs' expert studied videotapes of such activities at the facility and averaged the time taken by workers to put on and remove their protective gear. *See id.* at 1043. Plaintiffs used this statistical average to establish Defendant's liability for uncompensated overtime. *See id.* at 1044. The district court certified an FLSA collective action class and an Iowa state law class, and the jury awarded Plaintiffs $2.9 million in compensation damages. Tyson objected to certification of the classes under Federal Rule of Civil Procedure 23(b)(3) — which requires that common questions predominate over individualized issues in order to certify a class action — contending that variations in individual employees' donning and doffing time made reliance on Plaintiffs' statistical sample improper and created individualized issues that predominated over common questions. The Eighth Circuit affirmed the judgment and damages award. *See id.*; *see also Bouaphakeo v. Tyson Foods, Inc.*, 765 F.3d 791, 800 (8th Cir. 2014).

Ultimately, the Supreme Court affirmed the Eighth Circuit's holding and held that the district court did not err in certifying and maintaining the class based on statistical sampling. *See Tyson Foods*, 136 S. Ct. at 1044-45. The Supreme Court found that statistical sampling may be used where there are no alternative means to establish liability and class members are similarly situated such that a representative sample is reliable evidence. *Id.* at 1047-48. The Court found that the experiences of a subset of Tyson employees were probative as to the experiences of all class members because each employee worked in the same facility, performed similar work, and was paid under the same company policy. *See id.* at 1048.

In approving the use of statistical sampling, the Court emphasized that whether a representative sample can be used in the class action context hinges on whether the evidence would be sufficient in establishing liability in individual actions brought by each class member. *See id.* at 1048-49. Thus, the Supreme Court found its holding in accord with *Wal-Mart Stores, Inc. v. Dukes*, 564 U. S. 338 (2011), and noted that *Wal-Mart* "does not stand for the broad proposition that a representative sample is an impermissible means of establishing classwide liability." *Tyson Foods*, 136 S. Ct. at 1048. Rather, the underlying question in both cases was "whether the sample at issue could have been used to establish liability in an individual action." *Id.*

The Supreme Court further observed that the "permissibility [of statistical evidence] turns not on the form a proceeding takes — be it a class or individual action — but on the degree to which the evidence is reliable in proving or disproving the elements of the relevant cause of action." *Id.* at 1046. The Court also refuted Defendant's argument that reliance on representative evidence deprived it of the ability to litigate individual defenses and held that Defendant's primary defense, which was to show that the sampling study was unrepresentative or inaccurate, was common to the claims made by all class members. *Id.* at 1047. Accordingly, Plaintiffs' use of statistical evidence as common proof to establish liability complied with Federal Rule of Civil Procedure 23(b)(3) because class members were similarly situated such that the common question of whether employees should be compensated for time spent donning and doffing predominated over any individual issues.

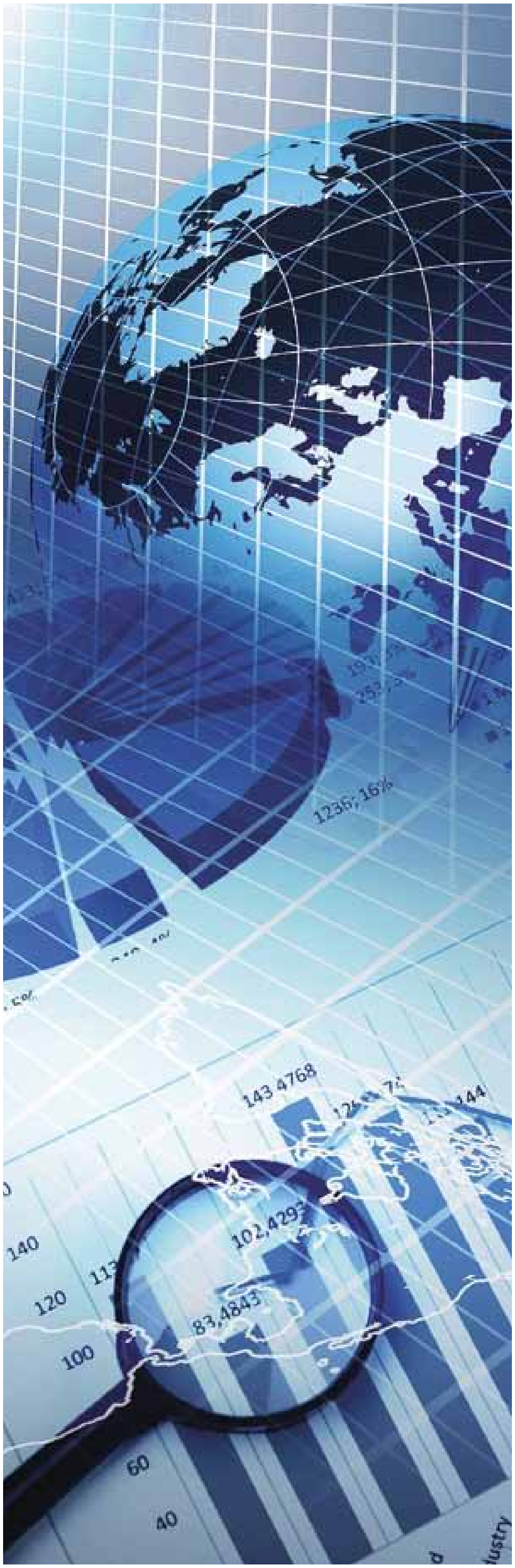
Post-*Tyson Foods* Use of Statistical Evidence to Prove Liability in Class Actions

Historically, courts have been more willing to permit plaintiffs to use statistical evidence to allocate damages than to establish liability in class action litigation. *See, e.g*, *Sullivan v. Kelly Servs., Inc.*, 268 F.R.D. 356, 365 (N.D. Cal. 2010) (noting that statistical evidence is commonly accepted by courts for calculating damages in large class actions); *Wal-Mart*, 564 U.S. at 355-56 (rejecting the use of statistical evidence in determining class-wide liability for a proposed class of 1.5 million employees alleging sex discrimination). In *Tyson Foods*, for the first time, the Supreme Court condoned using statistical sampling to establish liability as well as damages in collective and class actions. 136 S. Ct. at 1046-47 ("If the sample could have sustained a reasonable jury finding as to hours worked in each employee's individual action, that sample is a permissible means of establishing the employees' hours in a class action."). The *Tyson Foods* court did not limit its analysis of the use of statistical sampling to wage and hour claims but instead emphasized that ***"the fairness and utility of statistical methods in contexts other than those presented here will depend on the facts and circumstances particular to those cases."*** 136 S. Ct. at 1049 (emphasis added); *see also id.* at 1046 ("In a case where representative evidence is relevant in proving a plaintiff's individual claim, that ***evidence cannot be deemed improper merely because the claim is brought on behalf of a class***.") (emphasis added).

To date, the implications of *Tyson Foods* have not been extensively considered by the lower courts. Citing *Tyson Foods*, one court allowed the use of statistical evidence to prove liability in a wage and hour case where an evidentiary gap was caused by the defendant. In *Villalpando v. Exel Direct Inc.*, delivery drivers brought state law wage and hour claims against their employer alleging that they had been misclassified as independent contractors and undercompensated. No. 12-cv-04137-JCS, 2016 U.S. Dist. LEXIS 53773, at *3 (N.D. Cal. Apr. 21, 2016). Unlike Tyson, which did not keep any record of donning and doffing time, the employer in *Villalpando* produced four million paper documents including delivery drivers' manifests and timesheets that were disorganized, illegible, and potentially incomplete. *Id.* at *28-29. Given the magnitude and inadequacy of the documents produced, the delivery drivers relied on two expert reports to prove their claims — one using exemplar calculations of the delivery drivers' operation costs per mile and another calculating damages based on data derived from representative documents and testimony. *Id.* at *6-13. Following *Tyson Foods*, the court held that the delivery drivers could prove class-wide liability based on reasonable inferences drawn from the expert reports as to the time they worked and the amount of employee expenses they were owed. *Id.* at *32, *42-43, *71-75.

In another case, third-party payor plaintiffs ("TPPs") attempted to apply the *Tyson Foods* holding to a Racketeer Influenced and Corrupt Organizations Act ("RICO") and consumer fraud class action against a drug manufacturer. *See In re Celexa & Lexapro Marketing & Sales Practices Litigation*, No. 13-13113-NMG, 2016 U.S. Dist. LEXIS 72056, at *29-30 (D. Mass. June 2, 2016). The TPPs proffered an expert regression analysis to establish the causal relationship between the drug manufacturer's fraudulent promotions of its anti-depressant drugs and off-label prescriptions paid for by the TPPs. *See id.* at *30. The court found that the TPPs failed to meet the threshold requirement of *Tyson Foods* — *i.e.*, the TPPs failed to show that each class member could have relied on the aggregate statistical evidence to prove but-for causation in an individual action and, therefore, could use the statistical analysis to prove causation on a class-wide basis. *See id.* at *30, *39.

Overall, the *Tyson Foods* holding is a positive development for plaintiffs and may support the use of statistical analysis in establishing liability in class action litigation. The full impact of *Tyson Foods* will continue to be shaped as plaintiffs endeavor to capitalize on the Supreme Court's acceptance of representative evidence to establish class-wide liability. ■



KESSLER TOPAZ CAUSES STEMCELLS, INC. AND COGENT COMMUNICATIONS HOLDINGS, INC. TO *REPEAL ILLEGAL BYLAWS INTENDED TO DETER STOCKHOLDER LITIGATION*

(continued from page 1)

Fee-shifting and no-pay bylaws are invalid, inequitable, and contrary to well-established law. Indeed, in June 2015 the Delaware legislature banned fee-shifting bylaws entirely for Delaware corporations. Nevertheless, only a handful of companies have rescinded their fee-shifting bylaws, and many also have adopted or attempted to adopt no-pay bylaws. To date, no court has upheld the validity of fee-shifting or no-pay bylaws. When challenged by Kessler Topaz and its clients, two companies with such bylaws, StemCells, Inc. ("StemCells") and Cogent Communications Holdings, Inc. ("Cogent"), were unwilling to stand behind their bylaws and opted instead to rescind them.

Background

The wave of fee-shifting bylaws began after the Delaware Supreme Court issued its decision in *ATP Tour, Inc. v. Deutscher Tennis Bund ("ATP")*, 91 A.3d 554 (Del. 2014). In *ATP*, the Court considered four abstract certified questions concerning the "facial validity" of a hypothetical bylaw adopted by the board of a non-stock membership corporation. The Court held that "fee-shifting provisions in a non-stock corporation's bylaws can be valid and enforceable under Delaware law" and that some form of a fee-shifting bylaw could be enforced against existing members of a non-stock corporation if the bylaw was "otherwise valid and enforceable."[1]

Following *ATP*, a number of publicly traded corporations adopted bylaws providing for fee-shifting, among other things, in order to deter stockholder litigation by making it financially and procedurally impracticable for stockholders to institute and maintain claims. Specifically, to date, at least 60 companies, including StemCells and Cogent, adopted or attempted to adopt fee-shifting bylaws, and many more announced that fee-shifting provisions in their governing documents would be adopted upon the closing of initial public offerings. Many of these companies adopted fee-shifting bylaws in conjunction with the release of information that was likely to prompt stockholder litigation, such as a merger transaction, an earnings miss, a dispute with an officer or director, or a governmental or internal investigation. The potentially crippling financial liability imposed by these bylaws, typically "for all fees, costs and expenses of any kind and description," which could only be avoided if the stockholder-plaintiff achieved nearly 100% success on the merits, served as a deterrent to challenge any misconduct by a corporation's directors and officers, no matter how blatant and harmful to the corporation or its stockholders.

The mass adoption of these fee-shifting provisions in 2014 and 2015 drew harsh criticism from stockholder rights advocates and corporate governance experts. In response to the *ATP* decision and the broad scale adoption of fee-shifting provisions, the Delaware legislature

[1] *Id*. at 555, 560.

overwhelmingly passed, and the governor later signed into law, a bill amending the Delaware General Corporation Law ("DGCL") to, among other things, ban fee-shifting provisions from the certificate or bylaws of Delaware stock corporations. The new anti-fee-shifting provisions of the DGCL became effective on August 1, 2015.

Less common than fee-shifting, but also adopted in the aftermath of *ATP* by at least 11 companies, are no-pay provisions. These provisions are contrary to longstanding law recognizing that when a stockholder recovers a common fund for the benefit of persons other than himself, or confers a benefit on the corporation or its stockholders through litigation, the stockholder is entitled to a reasonable attorneys' fee from the fund or corporation, respectively.[2]

StemCells

On June 11, 2015 — the very day the Delaware Senate passed the anti-fee-shifting bill — the board of directors of StemCells, a Delaware corporation, voted to amend the Company's bylaws to adopt a fee-shifting provision. Despite its essentially being dead on arrival, the fee-shifting provision was never rescinded. Instead, on October 23, 2015, the StemCells board doubled-down and further amended its bylaws to maintain the fee-shifting provision and to provide that in the event the fee-shifting provision was found to be invalid or otherwise unenforceable (which the board knew was the case), then a no-pay provision would apply. The no-pay provision stated that, regardless of the outcome of an "intra-partes" action or claim against the company or its directors and/or officers, no stockholder was entitled to recover attorneys' fees and costs, except in very limited circumstances.

On April 27, 2016, Kessler Topaz commenced an action in the Delaware Court of Chancery on behalf of a StemCells stockholder challenging the company's fee-shifting and no-pay bylaws.[3] Less than a week after the complaint was filed, StemCells announced that its board of directors had removed these provisions from the company's bylaws, which was tantamount to a concession that the bylaws were invalid.

Cogent

On November 3, 2014, the board of directors of Cogent adopted three bylaws intended to restrict stockholder litigation: (1) a relatively common (and undoubtedly legal) "exclusive forum" bylaw that required shareholders to bring all litigation in the Delaware Court of Chancery; (2) a fee-shifting bylaw; and (3) a no-pay bylaw.

In addition to the reasons why fee-shifting and no-pay provisions are catergorically invalid, all three of Cogent's litigation-deterring bylaws were also invalid for other reasons. First, a board can only adopt bylaws if the company's certificate of incorporation (as approved by the shareholders) specifically authorizes it to do so, and Cogent's certificate of incorporation did not contain such a provision. Accordingly, the Cogent board did not have the authority to adopt the exclusive forum, fee-shifting, or no-pay bylaws without specific stockholder approval. Second, the Cogent bylaws were adopted just before the company announced negative earnings. The board thus appeared to have adopted these bylaws to insulate themselves from liability from any litigation that might have been brought about by these negative announcements. If, as it appeared, the bylaws were adopted in bad faith, then they would be invalid.[4]

Cogent subsequently asked its stockholders to cast a "non-binding" vote in favor of the bylaws at its annual meeting scheduled for April 16, 2015. The vote was improper because the Company failed to disclose the purpose of the bylaws or that the board was not legally authorized to adopt bylaws at all. Cogent thus appeared to be seeking ratification by its shareholders of an *ultra vires* act without disclosing complete and truthful information regarding the bylaws and the board's powers.

On March 27, 2015, Kessler Topaz filed a complaint in the Delaware Court of Chancery on behalf of a Cogent stockholder and moved for expedited proceedings and a preliminary injunction seeking to enjoin the April 15, 2015 annual meeting. On March 30, 2015, Cogent filed with the Securities and Exchange Commission a proxy supplement notifying its stockholders that the company was rescinding the bylaws and removing the ratification proposal from the agenda for the upcoming meeting. Kessler Topaz ultimately settled the case based on the defendants' agreement to file an additional proxy supplement disclosing that the board had acted in violation of the DGCL and had no power to adopt, amend or repeal Cogent's bylaws.

As exemplified by the StemCells and Cogent cases, Kessler Topaz diligently monitors corporate governance trends, particularly those that have negative effects on stockholders' rights, and does not hesitate to commence litigation when appropriate to protect and defend the rights of stockholders and their ability to hold corporate directors and officers accountable for their actions. ■

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[2] *Americas Mining Corp. v. Theriault*, 51 A.3d 1213, 1252-53 (Del. 2012) (explaining common fund doctrine) (quoting *Boeing Co. v. Van Gemert*, 444 U.S. 472, 478 (1980)); *Dover Historical Soc'y, Inc. v. City of Dover Planning Comm'n*, 902 A.2d 1084, 1089 (Del. 2006) (explaining corporate benefit doctrine).

[3] *Guardino v. StemCells, Inc., et al.*, C.A. No. 12266-CB (Del. Ch.).

[4] *Schnell v. Chris-Craft Indus. Inc.*, 285 A.2d 437, 438-39 (Del. 1971).

WHEN DOES PRICE MATTER? BEST BUY AND THE PRESUMPTION OF RELIANCE

(continued from page 2)

opened trading at 9:30 a.m. on September 14, 2010 at $37.25, and eventually closed trading that day at $36.73. Three months later, on December 14, 2010, Best Buy announced that its fiscal third quarter 2011 sales fell short of expectations, and significantly reduced its fiscal year 2011 EPS guidance to a range between $3.20 and $3.40. In response to this announcement Best Buy's common stock fell nearly 15%, from a close of $41.70 per share on December 13, 2010, to close at $35.52 per share on December 14, 2010.

On August 5, 2013, the district court granted in part, and denied in part, Best Buy's motion to dismiss the claims. *IBEW Local 98 Pension Fund v. Best Buy Co., Inc., et al.*, 958 F. Supp. 2d 1065 (D. Minn. 2013). As an initial matter, the district court found that the claims related to the 8:00 a.m. press release were not actionable on the ground that the alleged misstatements were protected by the Private Securities Litigation Reform Act of 1995's (the "PSLRA") safe harbor for forward-looking statements. *Id.* at 1074 (citing 15 U.S.C. § 78u-5). Specifically, the court found that the statements were protected by the safe harbor because plaintiffs failed to establish that the guidance was knowingly false when made. *Id.* at 1075. However, the district court sustained plaintiffs' claims in connection with the subsequent conference call, finding that the Chief Financial Officer's statements regarding Best Buy's performance being "on track" and "essentially in line with our original expectations" were representations of present condition and were not entitled to protection under the PSLRA's safe harbor. *Id.* at 1076.

In their subsequent motion for class certification, plaintiffs relied on *Basic*'s fraud-on-the-market presumption to establish the reliance element on a class wide basis. In opposing class certification, Best Buy attempted to rebut the presumption of reliance and argued through expert testimony that because Best Buy's stock price increased between 8:00 a.m. and 10:00 a.m. on September 14, 2010 — after the press release — but did not increase after the 10:00 a.m. conference call, the conference call statements (the only actionable statements) had no discernible impact on the stock price. *IBEW Local 98 Pension Fund v. Best Buy Co., Inc., et al.*, No. 11-429 (DWF/FLN), 2014 U.S. Dist. LEXIS 108409, at *15 (D. Minn. August 6, 2014). Thus, Best Buy argued that the plaintiffs could not utilize the fraud-on-the-market presumption of reliance because they could not demonstrate price impact. While plaintiffs agreed that the conference call statements did not immediately increase Best Buy's stock price, plaintiffs argued through expert testimony that the conference call statements "maintained" the inflation introduced into the stock price by the earlier (but inactionable) press release. *Id.* at *15. The district court ultimately agreed with the plaintiffs and certified the class, holding that even though the conference call statements did not lead to an immediate rise in Best Buy's stock price, the statements could have further inflated the price, prolonged the inflation of the price, or slowed the rate of the price's decline. *Id.* at *18. The district court further held that "price impact can be shown by a decrease in price following a revelation of the fraud," and thus, Best Buy was required to prove that its stock price did not decrease on December 14, 2010, in order to rebut the presumption. *Id.* at *19-20.

. . . plaintiffs agreed that the conference call statements did not immediately increase Best Buy's stock price, plaintiffs argued through expert testimony that the conference call statements "maintained" the inflation introduced into the stock price by the earlier (but inactionable) press release.

On April 12, 2016, the Eighth Circuit reversed the district court's class certification order. *IBEW Local 98 Pension Fund v. Best Buy Co., Inc., et al.*, 818 F.3d 775 (8th Cir. 2016). The Eighth Circuit concluded that Best Buy presented compelling evidence that successfully rebutted the *Basic* presumption of reliance. In particular, the Eighth Circuit noted that plaintiffs and Best Buy were in agreement that, while the 8:00 a.m. press release caused an immediate impact on Best Buy's stock price, the 10:00 a.m. conference call caused no additional price increase. *Id.* at 782. The Eighth Circuit held that the "overwhelming evidence" of no "front-end" price impact "severed any link between the alleged conference calls misrepresentations and the stock price at which plaintiffs purchased" and, therefore, was sufficient to rebut the *Basic* presumption. *Id.* In reaching its decision, the Eighth Circuit rejected plaintiffs' arguments that: (1) the conference call statements caused a gradual stock price increase between September and December 2010; and (2) the decline in Best Buy's stock price after the alleged corrective disclosure on December 14, 2010, was evidence that the conference call statements "maintain[ed] an inflated stock price." *Id.* at 782-83. As to the first argument, the Eighth Circuit found that such a gradual increase was contrary to the premise upon which the *Basic* presumption is founded (*i.e.*, that an efficient market will "rapidly reflect" all publicly available information). *Id.* at 783. As to plaintiffs' second "price maintenance" argument, the Eighth Circuit noted simply that plaintiffs and their expert "provided no evidence that refuted defendants' overwhelming evidence of no price impact." *Id.*

On June 1, 2016, the Eighth Circuit declined to reconsider its April reversal of class certification. *IBEW Local 98 Pension Fund v. Best Buy Co., Inc., et al.*, 2016 U.S. App. LEXIS 10003 (8th Cir. June 1, 2016).

While *Best Buy*, given its unique facts, may not be applicable to every class certification contest, the Eighth Circuit's holding is instructive for several reasons. First, *Best Buy* is the first circuit court decision since *Halliburton* to find that a defendant has successfully rebutted the presumption of reliance at the class certification stage. Second, the Eighth Circuit's decision rejecting plaintiffs' price maintenance theory suggests that, under some factual circumstances, a defendant may be able to rebut the presumption by showing that the misstatements did not directly increase the price of the company's stock price, and that a defendant need not also demonstrate that a subsequent stock price decline was unrelated to the correction of alleged misstatements.

Critically, however, *Best Buy* did not expressly reject the intrinsic viability of a "price maintenance" theory and the Eighth Circuit's decision instead suggests only that a price maintenance theory, without ample supporting evidence, may be insufficient to overcome compelling front end evidence put forth by the defendant. Accordingly, plaintiffs seeking to utilize the price maintenance theory may be best-served by affirmatively demonstrating — through detailed expert testimony — how the defendant's stock would have reacted but-for defendant's concealment of the truth. Indeed, the price maintenance theory remains a viable means to show price impact as evidenced by the recent decision in *Strougo v. Barclays PLC*, in which the Honorable Shira A. Scheindlin of the Southern District of New York found that "plaintiffs have asserted a tenable theory of price maintenance." 312 F.R.D. 307, 326 (S.D.N.Y. 2016) (explaining that "When an omission or misrepresentation prevents a non-inflated price from falling, that omission or misrepresentation introduces inflation into the stock."). As such, *Best Buy* will likely be a focal point for both plaintiffs and defendants as issues of reliance continue to be a battleground at the class certification stage in securities fraud litigation. ■

KESSLER TOPAZ LEADING LITIGATION AGAINST FACEBOOK, INC. AND MARK ZUCKERBERG CHALLENGING ENTRENCHMENT SCHEME

(continued from page 9)

Harm to the Facebook's Minority Stockholders

Historical analysis of non-voting stock makes it likely that the Class C stock will trade at a 2%-6% discount to the Class A stock, and thereby reduce the value of stock held by the current Class A stockholders other than Zuckerberg. Because Zuckerberg holds only 0.17% of the Class A stock and the overwhelming majority of his stockholdings are in Class B stock, he will not suffer the same economic harm as Facebook's public stockholders, on whose behalf the litigation is brought.

Even if the Class C stock trades at a modest 2% discount to the Class A stock, the collective loss to the Class A shares not held by Zuckerberg would be approximately $3.7 billion, compared to a loss to Zuckerberg of a mere $6.5 million — a very small price Zuckerberg will pay to be able to monetize an estimated $45 billion worth of stock while maintaining absolute voting control of Facebook.

Moreover, the Reclassification will extend Zuckerberg's control of Facebook indefinitely. Absent the Reclassification, if Zuckerberg were to sell or transfer the majority of his Facebook stock, the minority stockholders would gain control of the company. After the Reclassification, however, Facebook's minority stockholders will be denied control even though Zuckerberg disposes of most of the remainder of his already decreased equity interest in the company. This expanded form of control comes at the expense of the minority holders of Class A Stock, who will: (i) receive no real consideration from Zuckerberg; (ii) have two-thirds of their equity interest in Facebook forcibly converted from voting Class A shares to non-voting Class C shares; and (iii) be deprived of any possibility of future influence over the company's affairs.

The Reclassification and the adoption of the amendments to the Certificate of Incorporation were presented to Facebook's stockholders at Facebook's annual meeting on June 20, 2016. The results of the vote were a foregone conclusion, since Zuckerberg controlled the vote. Nonetheless, 82% of votes cast by non-insiders were against the Reclassification. This is clear evidence that the stockholders do not like what Zuckerberg and Facebook's board of directors have foisted upon them.

Kessler Topaz's Efforts to Protect Minority Stockholders

Through the action involving Facebook, Kessler Topaz seeks to enjoin Facebook from effecting the Class C stock dividend or, if the dividend is consummated, to recover for the minority public Class A stockholders damages in connection with the issuance, specifically, the damages suffered as a result of the reduction in value of the Class A shares. A trial is currently scheduled for April 24-28, 2017. ■

SECRET MERGER SCHEME EXPOSED AND ELIMINATED THROUGH REIT LITIGATION

(continued from page 5)

On April 29, 2016, the Boards of Directors of four AR Global-controlled, non-traded REITs[1] announced that they were asking their stockholders to vote to amend their corporate charter to eliminate the roll-up protections. The Boards told stockholders that the proposed amendments were designed to give the companies more "optionality" in terms of their strategic transactions and potentially to increase the likelihood of greater "liquidity" for stockholders.

But the truth, as Kessler Topaz uncovered, was that the Boards of these companies were secretly plotting to roll each of the REITs into another AR Global-controlled entity. If stockholders voted to eliminate the roll-up protections, they would be ineligible to receive appraisal benefits, and would have little recourse to fight such a transaction.

On May 26, 2016, Kessler Topaz commenced litigation in the U.S. District Court for the Southern District of New York on behalf of a shareholder of one of these REITs.[2] The litigation challenged the false and misleading disclosures in the REIT's proxy materials that were disseminated to stockholders to request that they approve the charter amendments. Specifically, plaintiff alleged that defendants were misleading stockholders to approve charter amendments that would eliminate their rights to roll-up protections without telling them that defendants were in fact planning a roll-up.

Along with his complaint, plaintiff filed a motion for preliminary injunction, which sought to stop the stockholder vote on the charter amendments pending supplemental disclosures relating to the planned roll-up transaction. In support of this application, plaintiff attached a declaration from a former director of one of the REITs, who had resigned from the board over a dispute relating to conflicts of interest surrounding the planned roll-up.

Within days of the filing of this lawsuit, defendants capitulated. Defendants offered to withdraw the charter amendments from consideration at the stockholder meeting, and plaintiff agreed to settle the litigation. As a result of the litigation and settlement, stockholders' rights in the event of an eventual roll-up are preserved.

Kessler Topaz filed one additional lawsuit against another of the sister REITs controlled by AR Global, also challenging the false and misleading disclosures in the company's proxy materials relating to the proposed charter amendments.[3] Again, within days, defendants capitulated, withdrawing the offending charter amendments from consideration at the stockholder meeting.

Likely fearing additional lawsuits, within days of Kessler Topaz's second lawsuit, the other two REITs unilaterally withdrew their proposed charter amendments from stockholder consideration.

As a result of this litigation, stockholders of these four REITs will enjoy strong stockholder protections in the planned roll-up transactions should they move forward. Kessler Topaz's litigation effectively realized the entire relief it sought for all of the REITs while only filing suit on behalf of two. These cases illustrate the firm's commitment to, and effectiveness in, patrolling the board room so that non-transparent Boards of Directors do not take advantage of their stockholders. ■

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[1] The four REITS were American Realty Capital – Retail Centers of America, Inc. ("RCA"), Realty Finance Trust, Inc. ("RFT"), American Realty Capital Healthcare Trust III, Inc. ("HT III") and American Realty Capital Global Trust II, Inc. ("Global II").

[2] The case is *Simpson v. Michelson, et al.*, No. 1:16-cv-03970-ALC (S.D.N.Y.).

[3] *Rurode v. Realty Finance Trust, Inc. et al.*, No. 1:16-cv-04553-UA (S.D.N.Y.).

EVENTS

WHAT'S TO COME

Pennsylvania State Association of County Controllers (PSACC) Annual Conference
July 24 – 28, 2016
Hilton Garden Inn Southpointe — Canonsburg, PA

County Commissioners Association of Pennsylvania (CCAP) Annual Conference and Trade Show
August 07 – 10, 2016
Split Rock Lodge — Lake Harmony, PA

National Association of State Treasurers (NAST) Annual Conference
September 10 – 14, 2016
Fairmont Olympic Hotel — Seattle, WA

Georgia Association of Public Pension Trustees (GAPPT) Annual Conference
September 19 – 22, 2016
Legacy Lodge — Lake Lanier Islands, GA

Florida Public Pensions Trustees Association (FPPTA) Trustees School
September 25 – October 28, 2016
Hyatt Regency Coconut Point — Bonita Springs, FL

Council of Institutional Investors (CII) Fall Conference
September 28 – 29, 2016
Palmer House Hilton — Chicago, IL

National Conference of Public Employee Retirement Systems (NCPERS) Conference
October 23 – 26, 2016
Planet Hollywood Hotel — Las Vegas, NV

State Association of County Retirement Systems (SACRS) Fall Conference
November 08 – 11, 2016
Renaissance Esmeralda Resort & Spa — Indian Wells, CA

International Foundation of Employee Benefit Programs (IFEBP) US Annual Conference
November 13 – 16, 2016
Orange County Convention Center — Orlando, FL

PA Association of Public Employee Retirement Systems (PAPERS) Fall Workshop
November 15 – 16, 2016
The Wyndham — Philadelphia, PA

County Commissioners of Pennsylvania (CCAP) Fall Conference
November 20 – 22, 2016
Hotel Hershey — Hershey, PA

Conference of Western Attorneys General (CWAG) Winter Dinner
November 29, 2016
Ritz Carlton — Ft. Lauderdale, FL

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