KESSLER TOPAZ

Bulletin

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Kessler Topaz Obtains $1.26 Billion in Damages from Grupo Mexico in *In re Southern Peru Copper Corporation Shareholder Derivative Litigation*

Michael C. Wagner, Esquire and James H. Miller, Esquire

Following a trial litigated as co-lead counsel by Kessler Topaz in June 2011, the Delaware Court of Chancery has awarded damages of $1.26 billion on behalf of Southern Peru Copper Corporation ("Southern").[1] This is the largest award of damages in a shareholder derivative case ever ordered by the Court of Chancery.

As the Court ruled in its 105 page post-trial opinion issued on October 14, 2011, Southern incurred these damages as a result of a 2004 self-interested transaction between Southern and its controlling stockholder, Mexican mining giant Grupo Mexico (the "Transaction"). We alleged, and the Court found, that Southern's board of directors caved to the will of its controlling stockholder when it massively overpaid in Southern common stock to acquire Grupo Mexico's Mexican mining assets held through Grupo Mexico's subsidiary, Minera Mexico. The Court's ruling will help ensure that majority-controlled public corporations are not manipulated for their controller's benefit.

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[1] The action is entitled *In re Southern Peru Copper Corporation Shareholder Derivative Litigation*, Consol. C.A. No. 961-CS, and the trial was held before the Honorable Leo E. Strine, Jr., Chancellor of the Delaware Court of Chancery. Southern changed its name to Southern Copper Corporation in 2005.

The Supreme Court Wraps Up a Busy Term — a Mixed Bag for Investors

Naumon A. Amjed, Esquire and Ryan T. Degnan, Esquire

The closing weeks of the Supreme Court's 2010 term were marked by two key decisions involving the federal securities laws: *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011) ("*Janus*") and *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011) ("*Halliburton*"). In *Janus*, the Court was asked to determine whether a mutual fund's investment manager could be liable under Section 10(b) for statements in the mutual fund's prospectus materials where the materials were prepared by, but not directly attributed to, the investment manager. Ultimately, Justice Clarence Thomas's majority decision dismissed claims against the investment manager, opted for a narrow definition of primary liability, and held that a person or entity must have "ultimate control" over the content and the dissemination of a misrepresentation in order to be liable under Section 10(b). In *Halliburton*, a unanimous Court rejected the Fifth Circuit's requirement that a plaintiff bringing a Section 10(b) claim must prove loss causation at the class certification stage in order to trigger the fraud-on-the-market presumption of reliance. We briefly explore both cases.

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Wachovia Bond Litigation: A Historic Post-Credit Crisis Settlement of $627 Million

Christopher Nelson, Esquire and Alessandra C. Phillips, Esquire

On August 9, 2011, the U.S. District Court for the Southern District of New York preliminarily approved a settlement of a securities class action (the "Action") against Wachovia Corporation, KPMG LLP, and others, that will result in a payment of $627 million to investors who purchased Wachovia bonds and preferred securities that were sold between July 31, 2006 and May 29, 2008. The Firm serves as co-lead counsel in the Action. The settlement represents a spectacular win by the Firm for investors. Indeed, in terms of the raw dollar amount and the percentage of damages recovered, the settlement is a virtually unprecedented result. It is one of the 14th largest settlements of all securities class actions of any sort, and the single largest settlement ever of a case solely alleging violations of the Securities Act of 1933. Additionally, KPMG's contribution of $37 million to the total amount of $627 million is at the high end of the spectrum for auditor settlements, especially in a case that does not involve any financial restatement or admission of wrongdoing.

Wachovia's Golden West: A Golden Goose Egg

Spurred on by the booming mortgage origination business fueled by the rapid increase in the value of real estate, in May of 2006, Wachovia purchased Golden West, a California-based residential mortgage lender, which at the time was the country's second largest savings and loan. Golden West's principal asset was a $120 million portfolio of adjustable rate mortgage loans, known as the "Pick A Pay" portfolio. At the time, Wachovia was a bank holding company, engaging in capital management, general banking, and investment banking. With a market capitalization of $112 billion, Wachovia was seen at the time as one of the more conservative of the large financial services providers, with a stable outlook. Before the merger with Golden West, most of the loans in Wachovia's consumer portfolio were traditional fixed rate mortgages. In contrast, Golden West's key product was a payment option adjustable rate mortgage ("Option ARM"), otherwise known as Pick-A-Pay loans.

Pick-A-Pay loans were attractive to consumers because they offered a low initial "teaser" interest rate which would eventually reset to a higher rate. The loans also allowed borrowers to make a "minimum payment" that was less than the monthly interest due on the loan, which had the effect of increasing (rather than decreasing) the borrower's outstanding loan balance,

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Frauds Rising in the East and Setting in the West

Naumon A. Amjed, Esquire and Ryan T. Degnan, Esquire

The legitimacy of many Chinese corporations listed on American and Canadian stock exchanges has been called into question over the past several months. The disclosure of Chinese corporate fraud by regulators, analysts, and shareholder lawsuits has led to the delisting of several stocks and substantial destruction of shareholder value. This article summarizes a few examples of recently exposed Chinese corporate frauds with particular emphasis on frauds resulting in private shareholder litigation. Since the cases discussed herein are at the beginning stages of litigation, investors do not yet have a clear indication as to what specific hurdles (if any) will be encountered by litigating against Chinese listings and whether claims will result in any recovery. One common thread to the Chinese frauds we have sampled is that the schemes appear to be directed exclusively to overseas investors. Often records filed with Chinese regulators are vastly different from reports filed with western authorities. Analysts able to access and interpret Chinese filings have, in some cases, uncovered schemes by simply comparing financial reports filed with Chinese regulators against reports filed in the west. One analyst provided the following rationale for the discrepancy: "For the most part, they keep their noses clean in China. If these guys were pulling the same thing in China, the punishment is a bullet to the head."[1]

Chinese Companies Access Western Capital Markets

Several Chinese companies have used reverse mergers[2] to access U.S. capital markets. According to Cornerstone Research, "[b]etween January 2007 and March 2010, only 56 Chinese companies accessed U.S. capital markets

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Frequently Maligned Class Action Lawsuits Actually Deter Financial Wrongdoing, Study Finds

Jeff McCord of The Investor Advocate

Washington, DC, September 29, 2011 — Though often criticized as frivolous and lacking economic benefit, new research by finance and accounting professors at Rutgers and Emory universities' business schools finds that class action lawsuits are a strong deterrent to misrepresenting corporate financial results and other wrongdoing. And, in many instances class actions are a stronger deterrent than SEC enforcement.

"Our research found statistically and economically significant deterrence associated with both SEC enforcement and class action lawsuits," said Simi Kedia, Ph.D, MBA, associate professor of finance at Rutgers University School of Business in an interview with The Investor Advocate. "We looked at firms in the same industry as the enforcement target and found that the average peer firm subject to SEC action and/or litigation reduces discretionary accruals (i.e., reporting as sales transactions for which payment has not been received) equivalent to 14 percent to 22 percent of the media return on assets in the aftermath of such enforcement."

The study, a working paper presented at a couple of conferences and now being circulated for comment before publication, measured the effectiveness of the two

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Jeff McCord is a former US Senate staffer, Securities Investor Protection Corp (SIPC) executive and was a free-lance journalist for Dow Jones publications (in pre-Murdoch days). He is a public affairs/public relations consultant and has worked with many financial institutions, law firms and associations including the National Association of Shareholder and Consumer Attorneys (NASCAT). Jeff publishes a blog (www.the-investor-advocate.com) to promote investor protection by reporting events, studies, and other news ignored by mainstream media. He may be reached at jmccord@crosslink.net.

"Come On In" — Court Confirms European Asset Managers' Ability to Prosecute Claims Under the Federal Securities Laws

Naumon A. Amjed, Esquire and Ryan T. Degnan, Esquire

Judge Shira Schiendlin of the Southern District of New York recently issued a landmark decision squarely affirming a European investment manager's standing to bring claims under the federal securities even though the investments at issue were made by the manager's sub-funds (or associations). *See Faris v. Longtop Financial Technologies Limited*, 2011 U.S. Dist. LEXIS 112970 (S.D.N.Y. Sept. 21, 2011) ("*Longtop*"). *Longtop* is important in two respects. First, the court recognized that European asset managers may have inherent authority under governing foreign law to pursue claims for losses suffered by their associations. Second, the court noted that confirming a manager's authority through an assignment of claims from the associations (or sub-funds) is more than sufficient to address standing problems normally faced by asset managers. *Longtop* conclusively puts to rest standing attacks against asset managers who obtain valid assignments and specifically recognizes that the unique structure of European asset managers is not an automatic bar to their ability to pursue litigation — as a lead plaintiff or directly — in the United States or their ability to receive an assignment of claims. We briefly discuss the court's ruling.

Longtop's Fraud

Longtop Financial Technologies Limited ("Longtop" or the "Company"), headquartered in Hong Kong, provides a range of software solutions and services to financial institutions located in the People's Republic of China. The Company's solutions and services include the development, licensing and support of software solutions, the provision of maintenance, support, and other services, and system integration services related to the procurement and sale of third party hardware and software. Since 2007 the Company presented investors growing revenues and cash balances with revenue increasing 160% from $65 million in FY2008 to $169 million in FY2010.

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Kessler Topaz Patent Litigators Prepare for Trial Against Garmin, Volkswagen in GPS Device Litigation

Matthew Mustokoff, Esquire

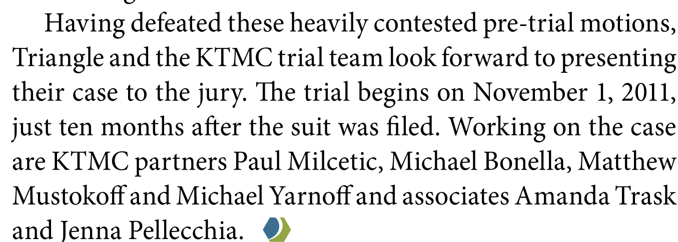
Kessler Topaz is on the eve of taking its first patent infringement case to trial. The firm represents Silicon Valley-based Triangle Software LLC and its founder, Dr. Andre Gueziec, against Garmin International, Inc., the leading manufacturer and importer of GPS navigation devices for the US market, and Volkswagen Group of America, an importer of automotive navigation systems. The case was originally brought against two additional defendants, Westwood One and TomTom, both of whom settled on favorable terms with Triangle. The case, filed in the "rocket docket" of the Eastern District of Virginia last December, is believed to be the largest patent infringement case involving real-time traffic-routing technology to be prosecuted by a private plaintiff. Triangle claims that Garmin and Volkswagen have infringed, and continue to infringe, five of Dr. Gueziec's patents which all relate to the determination of the fastest route between two points based on live traffic conditions. More specifically, two of the patents-in-suit cover technology used to generate three-dimensional traffic reports, two relate to algorithms used to identify the fastest route based on real-time traffic data and one covers the system used to calculate the average speed on particular roads based on archived, historical traffic data.

Several years ago, Triangle attempted to sell this patented technology to Garmin and several other competitors. Although Garmin declined the opportunity to buy or license Triangle's patents, it is now manufacturing and selling products which, Triangle alleges, uses the patented inventions. Thus, Triangle will assert at trial that Garmin's infringement of the Triangle patents is "willful." Under the Patent Act, a jury finding of willful infringement enables a prevailing plaintiff to seek treble damages from the trial court in post-verdict proceedings.

As is typical in the Eastern District of Virginia, the case has proceeded on a furious pace. Discovery was completed in just over four months and included depositions across the United States and in the Netherlands. During the last week of September 2011, U.S. District Judge Claude Hilton denied Garmin's and Volkswagen's motions for summary judgment. The court rejected defendants' argument that Triangle's patents are invalid in light of a textbook called "Vehicle Location and Navigation Systems" written by Zhao Lin which, defendants claim, constitutes "prior art" that anticipates all of the claims of the patents-in-suit. To invalidate a patent issued by the US Patent and Trademark Office (USPTO), a defendant faces a high legal hurdle: it must show by clear and convincing evidence that the USPTO overlooked the prior art during the patent application process and should have found the prior art to supersede the applicant's invention(s). The court found that defendants did not meet this evidentiary standard to warrant summary judgment.

The district court also denied Volkswagen's motion to exclude Triangle's infringement expert, an electrical engineer who will demonstrate how the defendants' products infringe the patents, and the defendants' joint motion to exclude Triangle's damages expert, an economist who will testify at trial as to the reasonable royalty owed to Triangle as compensable damages. Reasonable royalty damages are determined by considering the factors that would have impacted a "hypothetical negotiation" between Triangle and each defendant for the patented technology, taking into account relative bargaining power, the actual and projected profitability of the infringing products and the novelty of the inventions, among other things.

Having defeated these heavily contested pre-trial motions, Triangle and the KTMC trial team look forward to presenting their case to the jury. The trial begins on November 1, 2011, just ten months after the suit was filed. Working on the case are KTMC partners Paul Milcetic, Michael Bonella, Matthew Mustokoff and Michael Yarnoff and associates Amanda Trask and Jenna Pellecchia.



The Kessler Topaz *Bulletin* is a quarterly newsletter for our clients and all investors and consumers. In our continuing effort to educate our clients and keep them informed, the *Bulletin* strives to provide updates not only on the cases we are litigating, but also on trends in the law and other issues that are important to our readers. Our attorneys regularly contribute articles about the cases they are litigating, important legal precedents, and other issues relevant to our practice. Copies of the current issue and all previous issues of the *Bulletin* are available on our website and we welcome you to contact us to obtain a *Bulletin* by mail.

Kessler Topaz Recovers $24 Million for Shareholders in eBay and GSI Commerce Merger

Michael Wagner, Esquire and Stefanie Anderson, Esquire

Kessler Topaz recently achieved significant benefits for shareholders of GSI Commerce, Inc. ("GSI" or the "Company"). GSI, a provider of e-commerce and interactive marketing services for brands and retailers, announced in late March that it had agreed to be sold to eBay for $29.25 per share in cash. eBay agreed, as part of the transaction, that it would sell certain of GSI's highly regarded assets to a newly formed holding controlled by GSI's founder, Chairman of the board of directors (the "Board"), and Chief Executive Officer, Michael G. Rubin ("Rubin"). Representing Erie County Employees Retirement System, we filed a class action complaint in Delaware's Court of Chancery relating to the Company's proposed merger with eBay and the asset sale to Rubin.

Our complaint alleged that Rubin held secret negotiations with eBay, without informing the GSI Board, to divide GSI's assets between himself and eBay. Instead of promptly informing the Board that it had the opportunity to explore alternatives for three existing GSI business units that eBay did not want, Rubin negotiated to acquire those GSI businesses for himself. We also alleged that Rubin and the Board's "lead director," Ron Fisher, whom Rubin had told about his eBay negotiations, let the GSI Board agree to acquire a fourth business Rubin wanted, Fanatics, Inc. ("Fanatics"), without revealing that Rubin had already been negotiating with eBay to acquire Fanatics at a lower price and that Rubin knew when GSI bought Fanatics that eBay did not want the business.

Helping Rubin to acquire those GSI assets, eBay agreed to make large capital contributions to those businesses, forgive millions of dollars of intercompany debt and provide Rubin with extremely favorable financing for nearly the entire purchase price. As the director and officer of a Delaware corporation, Rubin owes a fiduciary duty to GSI and the public stockholders. Because he was selling GSI stock in the merger and buying GSI assets from eBay, Rubin was both a seller and a buyer in the transaction. Therefore, we alleged, he had a financial interest in the transaction that substantially diverged from and conflicted with the interests of GSI and its public stockholders.

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Victory for Plaintiffs As Countrywide MBS Case Sent Back to State Court

Jennifer Joost, Esquire

Since its passage, Section 22(a) of the Securities Act of 1933 (the "Securities Act") has allowed investors to assert claims for damages for material misstatements in public offering documents (i.e., registration statements and prospectus supplements) in both state and federal court.[1] In 1998, Congress passed the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") to address so-called "federal flight"—filing class actions asserting securities fraud claims under state law in state court to avoid the stricter requirements of the Private Securities Litigation Reform Act of 1995 ("PSLRA"), including higher pleading requirements, a mandatory discovery stay and limits on damages, which applied to securities fraud class brought under federal law.[2] SLUSA amended Section 22(a) to prevent investors from filing class actions asserting state law fraud and Securities Act claims concerning nationally traded securities (or, "covered securities") in state court.[3] SLUSA did not alter an investors' ability to bring a class action asserting only Securities Act claims concerning securities that are not traded on a national exchange; for those claims, an investor could still seek relief in state court.

In November 2007, David Luther filed an action on behalf of himself and others similarly situated asserting claims under the Securities Act concerning material misstatements in the offering documents related to Countrywide Corporation's ("Countrywide") issuance of mortgage-backed securities ("MBS") from 2005 through 2007 in the Superior Court of Los Angeles County (the "Superior Court"). The misstatements included a failure to disclose that, *inter alia*, Countrywide was not complying with its underwriting standards in originating the mortgages underlying the MBS at issue and was using improperly inflated loan-to-value ratios and appraisals of the residences refer-

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[1] *See* 15 U.S.C. §77v.

[2] *See* May 18, 2011 Order at 10.

[3] *See* 15 U.S.C. §77p.

Institutional Investor
FORUMS

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Evolving Fiduciary Obligations of Pension Plans

FEBRUARY 7, 2012 | THE DUPONT HOTEL | WASHINGTON, DC

Wielding New Shareholder Rights and Investment Strategies to Meet Plan Objectives

There is broad agreement that many of the investment models and ideas on which institutions have relied for decades are flawed and insufficient for ensuring that established goals can be met. Add in corporate governance and other shareholder engagement concerns, and the bar is raised for plans struggling to develop strategies and actions that are both practical and have a high probability of success.

Investing institutions find themselves at a crossroads because contrasting trends involving shareholder rights and the lack of clarity on adjusting investment programs to meet current and future commitments, compounded by the continuing unstable economic outlook. On the one hand, action is demanded but the limits on how to respond are still being tested and the outcomes remain unknown. On the other hand, institutions are obliged to take action, to make decisions that cannot wait in order to ensure they are discharging their duties in a timely manner and within acceptable fiduciary guidelines.

Now in its third year, Institutional Investor's **The Evolving Fiduciary Obligations of Pension** Plans roundtable will provide a comprehensive examination of the vital issues that plan sponsors and their legal advisors must understand in order to properly fulfill their roles as fiduciaries and as shareholders. Co-hosted by Kessler Topaz Meltzer & Check, LLP, this one-day event will offer valuable insights into the ways in which fiduciaries can be most effective in engaging with the management of portfolio companies. We will review the key legal decisions and trends investors should be aware of, and discuss the ideas shaping the strategies under consideration by leading institutions in order to obtain superior investment results.

Our audience of senior pension fund executives, their legal advisors, and other investment professionals will have an opportunity to hear from a number of their peers and outside experts as well as to share insights and experiences regarding the most critical fiduciary issues they face today. Participants will be provided with impartial perspectives on how fiduciaries can optimally meet their objectives and avoid difficulties, as well as receive timely information and guidance on various investment strategies and legal options.

❐ **Yes, I would like to attend** the Evolving Fiduciary Obligations meeting (no registration fee required)

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Note: *Please do not secure your travel arrangements until you have received written confirmation from Institutional Investor of your registration. Participation is strictly limited to qualified directors. Due to capacity restraints, all registrations will be accepted on a first come first served basis. Institutional Investor reserves the right to make any amendments to the program.*

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The Supreme Court Wraps Up a Busy Term — a Mixed Bag for Investors *(continued from page 1)*

Janus Capital Group, Inc. v. First Derivative Traders

In order to state a claim for fraud under Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), the primary anti-fraud provision under the federal securities laws, a plaintiff must allege: (1) a material misrepresentation or omission by the defendant; (2) scienter (a wrongful state of mind); (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.[1] The Supreme Court has long held that a defendant may only be liable under Section 10(b) in lawsuits brought by private litigants if he is found to be a primary violator.[2] That is, a private right of action does not extend to claims against defendants for "aiding and abetting liability."[3] In *Janus*, the Court was faced with arguments challenging the boundaries of what actions fall within the purview of "primary liability."

Plaintiffs in *Janus* alleged that Janus Capital Group Inc. ("JCG") and its wholly-owned subsidiary Janus Capital Management ("JCM"), a mutual fund investment advisor, were liable under Section 10(b) for misrepresentations contained in the prospectuses of one of their mutual fund offerings. The district court dismissed the claims against JCG and JCM after finding that the plaintiffs failed to adequately allege that JCG and JCM made any material misstatements or omissions.[4] In doing so, the district court relied upon *Central Bank* and noted that Section 10(b) does not provide for aiding and abetting liability or "secondary liability." Accordingly, the district court found that JCG and JCM could not be primary violators because the statements at issue in the case were not "directly attributable" to the defendants despite allegations of significant involvement in the drafting and preparation of the statements.[5]

On appeal, the Fourth Circuit rejected the district court's reliance on the "direct attribution" test.[6] In doing so, the Fourth Circuit noted that while direct attribution is sufficient for liability, "the attribution determination is properly made on a case-by-case basis by considering whether interested investors would attribute to the defendant a substantial role in preparing or approving the allegedly misleading statement."[7] On the facts, the appeals court held that Section 10(b) claims could be brought against JCM, but not JCG, because "the publicly disclosed responsibilities of JCM" allowed "interested investors [to] infer that JCM played a role in preparing or approving the content of the Janus fund prospectuses."[8] As such, the Fourth Circuit adopted a flexible approach that considers the facts of the case and how investors would view the parties' involvement in the dissemination of the misleading statements.

In reviewing the Fourth Circuit's interpretation of who "makes" a statement under Section 10(b), the Supreme Court relied heavily on its prior decisions in *Central Bank* and *Stoneridge*[9] to hold that "the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it."[10] The Court further clarified that "[o]ne who prepares or publishes a statement on behalf of another is not its maker [a]nd in the ordinary case, attribution within a statement or implicit from surrounding circumstances is strong evidence that a statement was made by — and only by — the party to whom it is attributed."[11] In assessing the facts before it, the Court concluded that the mutual fund itself had "ultimate control" and even though JCM acted "like a speechwriter [and] may have assisted" the mutual fund, "JCM itself did not 'make' those statements."[12] Therefore, JCM could not be liable under Section 10(b) because it did not make a misstatement.

The dissenting opinion in *Janus* expressed concerned with the majority's narrow definition of "make" and noted the inequities of a situation where "guilty management writes a prospectus (for the board) containing materially false statements and fools both board and public into believing they are true[.]"[13] Justice Breyer noted that "under the majority's rule, in such circumstances ***no one*** could be found to have 'ma[d]e' a materially false statement."[14]

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[1] *See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 157 (2008).

[2] *See Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 180 (1994).

[3] *Id.*

[4] *In re Mut. Funds Invest. Litig.*, 487 F. Supp. 2d 618, 622 (D. Md. 2007).

[5] *Id.* at 621.

[6] *In re Mut. Funds Invest. Litig.*, 566 F.3d 111, 124 (4th Cir. 2009).

[7] *Id.*

[8] *Id.* at 127.

[9] In *Stoneridge* the Supreme Court examined Exchange Act claims brought against certain vendors of cable set-top boxes who had allegedly conspired with Charter Communications to help Charter inflate its reported revenues. 552 U.S. at 153-55. The Court ultimately concluded that despite the vendors' deceptive acts, the private plaintiffs had not established that they "relied" on the vendors' actions and thus could not establish the elements of a private claim. *Id.* at 160-62.

[10] *Janus*, 131 S. Ct. at 2302.

[11] *Id.*

[12] *Id.*

[13] *Id.* at 2310.

[14] *Id.* at 2310 (emphasis original).

The Rights & Responsibilities of Institutional Investors

MARCH 22, 2012 ◈ RENAISSANCE AMSTERDAM HOTEL ◈ AMSTERDAM

Turning Words Into Action

For 7 years, *The Rights & Responsibilities of Institutional Investors* meeting has offered objective analysis of the issues facing active owners and provided insightful examination of the vital issues confronting European investors. During those years, the dialog has both deepened and broadened.

We are pleased to announce that the 2012 meeting will endeavor to address both sets of issues facing investors today: ensuring that institutions have the means to exercise their full rights as shareholders and yet also have the information and the tools they need to meet their unique investment objectives. In its simplest form this goal means that we will be offering parallel tracks of sessions over the course of this single day meeting, but more importantly it means addressing the full, broad spectrum that pension plans and their managers and advisors are confronting. For example, what are the investment practices and strategic guidelines that will help institutions achieve their investment and risk management objectives while exercising their fiduciary duties, including benefiting from responsible investment practices and active engagement.

In 2012, *The Rights & Responsibilities of Institutional Investors,* again co-sponsored by Institutional Investor and Kessler Topaz Meltzer & Check, LLP, will offer investment, compliance and legal officers from European public pension and insurance funds and mutual fund companies the information they require on how to turn principles into sound fiduciary and investment practice.

Keynote Speaker

President Mikhail Gorbachev
Nobel Peace Prize Winner

☐ **Yes,** I am interested. Please send me more information about The Rights & Responsibilities of Institutional Investors.

☐ I would like to nominate a senior executive from my organization to receive an invitation.

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Registration is COMPLIMENTARY for qualified delegates.

For further information, please contact Ann Cornish +1 (212) 224-3877 acornish@iiconferences.com

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The Supreme Court Wraps Up a Busy Term — a Mixed Bag for Investors *(continued from page 7)*

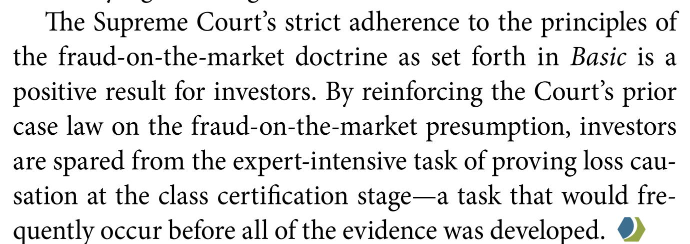
Erica P. John Fund, Inc. v. Halliburton Co.

As noted above, “loss causation” and reliance are elements of Section 10(b).[15] The Supreme Court has previously described loss causation as the “causal connection between the material misrepresentation and the loss.”[16] The reliance element of a Section 10(b) claim may be presumed under the fraud-on-the-market doctrine if the action involves securities traded in an efficient market.[17] In *Halliburton*, the Court was faced with the question as to whether the Fifth Circuit’s lone-wolf requirement that “securities fraud plaintiffs must also prove loss causation” in order to trigger the fraud-on-the-market doctrine—which is a prerequisite to obtaining class certification—was appropriate.[18]

In *Halliburton*, the lead plaintiff alleged that defendant Halliburton Co. (“Halliburton”) inflated the company’s stock price by downplaying the company’s exposure to asbestos liabilities, overstating its revenue, and overstating the benefits of a corporate merger. When the lead plaintiff moved for class certification, the district court concluded that a class could not be certified because the lead plaintiff had failed to prove loss causation.[19] The district court reasoned that because the lead plaintiff had failed to prove loss causation, the class would not be entitled to the necessary presumption of reliance generated by the fraud-on-the-market doctrine. Specifically, the court held that “[p]laintiffs who seek class status by showing collective reliance through the [fraud-on-the-market] presumption must show that the defendant made public, material misstatements, that the stocks traded in an efficient market, and that the stock price was actually affected by the purported fraud.”[20]

On appeal, the Fifth Circuit relied upon its prior decision in *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 487 F.3d 261 (5th Cir. 2007), and held that a plaintiff must “meet this court’s requirements for proving loss causation at the class certification stage.”[21] Despite its departure from every other court of appeals that has explicitly addressed the issue, the Fifth Circuit reaffirmed *Oscar* and held that loss causation must be established “at the class certification stage by a preponderance of all admissible evidence” in order to trigger the fraud-on-the-market presumption of reliance necessary for certification.[22]

In its unanimous decision rejecting the Fifth Circuit’s requirement of proving loss causation at the class certification stage, the Supreme Court first provided clarification of how the fraud-on-the-market presumption is triggered: “plaintiffs must demonstrate that the alleged misrepresentations were publicly known (else how would the market take them into account?), that the stock traded in an efficient market, and that the relevant transaction took place ‘between the time the misrepresentations were made and the time the truth was revealed.’”[23] Turning to the Fifth Circuit’s loss causation requirement, the Court bluntly stated that the Fifth Circuit’s “requirement is not justified by *Basic* or its logic.”[24] The Court further remarked: “we have never before mentioned loss causation as a precondition for invoking *Basic*’s rebuttable presumption of reliance. The term ‘loss causation’ does not even appear in our *Basic* opinion. And for good reason: Loss causation addresses a matter different from whether an investor relied on a misrepresentation, presumptively or otherwise, when buying or selling a stock.”[25]



The Supreme Court’s strict adherence to the principles of the fraud-on-the-market doctrine as set forth in *Basic* is a positive result for investors. By reinforcing the Court’s prior case law on the fraud-on-the-market presumption, investors are spared from the expert-intensive task of proving loss causation at the class certification stage—a task that would frequently occur before all of the evidence was developed.

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[15] *Stoneridge*, 552 U.S. at 157.

[16] *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U. S. 336, 342 (2005).

[17] Under the fraud-on-the-market doctrine, as set forth by the Supreme Court in *Basic Inc. v. Levinson*, “[b]ecause most publicly available information is reflected in market price, an investor’s reliance on any public material misrepresentations, therefore, may be presumed[.]” 485 U. S. 224, 247 (1988). As the Court recognized, requiring individual proof of reliance “would place an unnecessarily unrealistic evidentiary burden” on plaintiffs that traded on the open market. *Id.* at 245. Additionally, such a requirement would effectively eliminate any possibility of allowing a Section 10(b) action to proceed as a class action due to the multitude of individual issues that would appear. *Id.* at 242.

[18] *Halliburton* , 131 S. Ct. at 2183.

[19] *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 2008 U.S. Dist. LEXIS 89598, at *73 (N.D. Tex. Nov. 4, 2008).

[20] *Id.*, 2008 U.S. Dist. LEXIS 89598, at *17.

[21] *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330, 344 (5th Cir. 2010).

[22] *Id.* at 335.

[23] *Halliburton*, 131 S. Ct. at 2185.

[24] *Id.*

[25] *Id.* at 2186.

"Come On In" — Court Confirms European Asset Managers' Ability to Prosecute Claims Under the Federal Securities Laws *(continued from page 3)*

Cash balances increased over 379% between FY2007 (reporting $69 million) and FY2010 (reporting $331 million). The steady increase in Longtop's financial performance resulted in the Company's shares reaching a high of $42.86 per share on November 10, 2010. At its height, Longtop's market capitalization was approximately $2.4 billion. The Company's success, however, appears to be completely fabricated.

The truth about Longtop's actual financial health began to surface on April 26, 2011 when a research report questioned whether Longtop's extremely high margins were actually achievable and specifically questioned whether the Company was manipulating its results by parking expenses in off-balance sheet entities. The Company held a conference call on April 28, 2011 and vehemently rejected the allegations. Notwithstanding the Company's assurances, trading in Longtop's shares was halted by the NYSE on May 17, 2011 pending the release of "news" about the Company. After the market closed on May 18, 2011 — two full trading days after trading in its shares was halted — the Company announced that it would delay the release of its fourth quarter results (originally scheduled to be released on May 23, 2011). Three days later, on May 23, 2011, Deloitte Touche Tohmatsu ("DTT"), Longtop's independent auditor, resigned. DTT's resignation letter provides extraordinary details about Company's manipulation of its financial reports. According to the resignation letter:

- Longtop's COO attempted to stop DTT's audit by, among other things, calling banks purportedly holding Longtop's accounts and falsely advising them that DTT was not the Company's auditor;
- Longtop prevented DTT's employees from leaving the Company's premises and seized audit files; and
- On May 20, 2011, the Chairman of the Company called DTT's Eastern Region Managing Partner to inform him that "***there were fake revenue in the past so there were fake cash recorded on [Longtop's] books***."[1]

DTT also disavowed all clean audit opinions it previously issued for Longtop, refused to be associated with the Company's 2010 and 2011 financial communications, and stated that Longtop's actions could "constitute illegal acts for purposes of Section 10A of the Securities Exchange Act of 1934."

Selecting a Lead Plaintiff

Investors filed class action litigation against Longtop and its officers alleging violations under the federal securities laws shortly after news of its fraud surfaced. Since the lawsuits asserted claims under the federal securities laws, federal law (specifically, the Private Securities Litigation Reform Act of 1995 ("PSLRA")) dictates how leadership in the case is to be organized and provides a specific protocol for appointing a "lead plaintiff." The lead plaintiff is ultimately responsible for directing counsel and litigating all investors' claims. Under the PSLRA, investors who assert the largest financial interest in an action (usually the largest loss) and who are also adequate and typical are appointed to lead a case. The selection of a lead plaintiff is a critical decision.

In *Longtop* two primary movant groups emerged as potential lead plaintiff candidates. The first group, represented by Kessler Topaz, consisted of an American union pension fund and a European investment manager domiciled in Denmark. This group suffered the largest loss of any movant before the court from their investment in Longtop securities (hereinafter the "Presumptive Lead Plaintiff"). The second group (or the "Challenging Group") consisted of two hedge funds and two individual investors. The Challenging Group's members reside in the United States.

The Challenging Group's primary argument against the appointment of the Presumptive Lead Plaintiff focused on the European investment manager's purported lack of standing. In summary, the Challenging Group argued that the European investment manager's sub-funds (or associations), not the European investment manager, were the actual injured parties and thus were the only entities with standing under Article III of the U.S. Constitution to pursue claims in federal court. The Challenging Group also argued that even if the manager secured an assignment of claims (as it had in the *Longtop* action) such an assignment would be void under Danish law.[2]

The court rejected these arguments. In holding that the European investment manager had received a valid assignment of claims from its associations, the court looked to the language of the assignment and concluded that the language was "virtually identical" to the language of an assignment found to be valid by the Supreme Court of the United States in *Sprint Communications Co., L.P. v. APCC Services, Inc.*,

(continued on page 18)

[1] Unless otherwise noted, all emphases are added.

[2] An assignment of claims transfers an assignor's interest in a claim to an assignee. There are some exceptions to this rule but courts have generally allowed assignments where the assignee agrees to return funds collected through litigation to the assignor.

Kessler Topaz Obtains $1.26 Billion in Damages from Grupo Mexico in *In re Southern Peru Copper Corporation Shareholder Derivative Litigation*

(continued from page 1)

The Transaction

At the beginning of 2004, Grupo Mexico controlled both Southern and Minera Mexico; it owned 54% of Southern and 99% of Minera Mexico. Publicly traded and Delaware incorporated Southern was primarily a copper mining company with operations located in Peru. It was financially sound, with strong cash flow and no debt. Its shares paid regular quarterly dividends, and Southern was poised to benefit substantially from rising copper prices.

Minera Mexico was a different story. The privately held Mexican copper mining company was debt-ridden, and its cash flow was tied up in debt repayments and thus not available to fund growth. Unwilling to fund Minera Mexico's growth, Grupo Mexico conceived a plan by which Southern would acquire Minera Mexico in exchange for Southern stock. Southern's cash could then be used to fund Minera Mexico's growth, and Grupo Mexico would receive tens of millions of shares of valuable Southern common stock.

On February 3, 2004, Grupo Mexico proposed to the Southern board of directors that Southern acquire Minera Mexico. Grupo Mexico proposed that Minera Mexico's value was approximately $3.1 billion, and that Southern pay Grupo Mexico that amount in Southern shares to acquire Minera Mexico.

In response, Southern formed a "Special Committee" of purportedly independent directors to consider Grupo Mexico's proposal. After more than eight months of purported negotiation, the Special Committee essentially capitulated to Grupo Mexico's original demand. On October 21, 2004, the Special Committee approved the Transaction by which Southern agreed to acquire Minera Mexico from Grupo Mexico in exchange for 67.2 million shares of Southern common stock. These shares were worth exactly what Grupo Mexico had originally demanded: $3.1 billion.

The Litigation

Plaintiff alleged that Minera Mexico was worth at least $1 billion less than what Southern agreed to pay Grupo Mexico, and that the Transaction was thus entirely unfair to Southern and its public stockholders. As the controlling stockholder of both Southern and Minera Mexico, Grupo Mexico stood on both sides of the Transaction. Delaware law holds that, under such circumstances, Grupo Mexico owed a duty to ensure that the transaction was "entirely fair" to the company and its minority stockholders. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983). This heightened standard requires that the transaction be fair in terms of both price and process. *Id*. at 711.

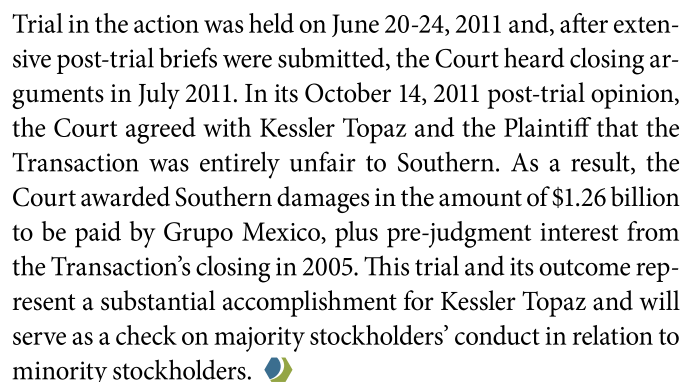
After filing its initial complaint in the Court of Chancery, Kessler Topaz engaged in nearly five years of document and deposition discovery. Numerous defendants and related third-parties—including financial advisors to Grupo Mexico and the Special Committee, and additional experts retained by the Special Committee—produced hundreds of thousands of pages of documents. Kessler Topaz attorneys then traveled throughout the United States, Mexico, and Peru to take depositions of defendants and their advisers.

After discovery concluded, the defendants asked the Court to dismiss the case. Kessler Topaz argued that the Transaction was not "entirely fair" to Southern as a result of the $1 billion overpayment and the disloyal negotiation process employed by the Special Committee. Grupo Mexico and related defendants argued that Kessler Topaz should bear the burden of demonstrating that the Transaction was not entirely fair to Southern. The Special Committee members argued they should be dismissed from the action pursuant to Delaware's statutory director indemnification provision because they did not breach their fiduciary duty of loyalty to Southern.[2]

Following a hearing on the requests for pre-trial dismissal, the Court expressed skepticism regarding the fairness of the Transaction. He called defendants' financial analysis of the Transaction "alchemy," and stated that "there are some fairly basic questions, fundamental questions, about whether the special committee, however well-intentioned, actually simulated genuine arm's-length bargaining" with Grupo Mexico. Accordingly, Chancellor Sttine denied Grupo Mexico's motion and held that Grupo Mexico must demonstrate at trial that the Transaction was entirely fair to Southern.[3]

The Trial

Trial in the action was held on June 20-24, 2011 and, after extensive post-trial briefs were submitted, the Court heard closing arguments in July 2011. In its October 14, 2011 post-trial opinion, the Court agreed with Kessler Topaz and the Plaintiff that the Transaction was entirely unfair to Southern. As a result, the Court awarded Southern damages in the amount of $1.26 billion to be paid by Grupo Mexico, plus pre-judgment interest from the Transaction's closing in 2005. This trial and its outcome represent a substantial accomplishment for Kessler Topaz and will serve as a check on majority stockholders' conduct in relation to minority stockholders.



[2] *See* 8 Del. C. § 102(b)(7) (directors of Delaware corporations are insulated for monetary damages in connection with breaches of the fiduciary duty of care, but can be held financially liable for breaches of the fiduciary duty of loyalty).

[3] Chancellor Strine did dismiss the Special Committee members from the action, finding that they did not breach their fiduciary duty of loyalty, but held that whether the Special Committee fulfilled their fiduciary duty of care would be heavily scrutinized at trial.

Frauds Rising in The East and Setting in the West *(continued from page 2)*

through an initial public offering [('IPO')], compared with an estimated 150 companies that gained access via a reverse merger."[3] The mode to accessing western capital markets, however, appears to be unrelated to the legitimacy of many Chinese enterprises. Both reverse merger companies and traditional IPOs have been implicated in fraudulent conduct. One report suggests that Chinese corporations account for 80% of the permanent trading halts issued by the NASDAQ since December 2010.[4] Revelation of fraud is often followed by shareholder litigation. According to Cornerstone Research, "[s]ince the beginning of 2010, plaintiffs have filed at least 33 securities class actions alleging violations of Section 10(b), Rule 10b-5, or Section 11 in matters involving CRMs [Chinese reverse merger companies]."[5] In the first half of 2011, investor class action lawsuits against Chinese companies accounted for 25.5 percent of all securities fraud class action filings in the United States.[6] "For the CRMs named in these complaints, the aggregate market capitalization decline during the putative class periods was greater than $8 billion, and the average market capitalization decline was $250 million. Seven out of the 33 complaints name an investment bank as codefendant, including five complaints that allege violations of Section 11."[7]

The frequency of allegations against Chinese listings has led the U.S. Securities and Exchange Commission ("SEC") to assemble a task force designed to identify and curtail further fraud from Chinese listed companies.[8] The SEC, has among other things, partnered with the Public Accounting Oversight Board and held meetings with China's Finance Ministry and the China Securities Regulatory Commission in an effort to gain access to the records of Chinese auditing firms as a means to identify additional fraudulent corporations.[9] Separately, credit ratings agencies such as Moody's Investors Service have begun to announce "red flags" affecting numerous Chinese corporations.[10]

An Early Example of Chinese Corporate Fraud

Duoyuan Printing, Inc. ("Duoyuan"), a Beijing-based designer and manufacturer of printing equipment, was among the first of the recent wave of Chinese corporations to become the target of shareholder lawsuits alleging fraud. Duoyuan held its initial public stock offering in November 2009.[11] By incorporating in Wyoming and offering its common stock to the U.S. market, Duoyuon raised more than $42 million in capital.[12]

Duoyuan's foray with American investors was short-lived. On September 13, 2010, less than a year after its initial stock offering, allegations of fraud began to surface. Specifically, in September 2010 Duouyan fired its auditors, Deloitte Touche Tohmatsu CPA Ltd. ("DTT"), after DTT requested access to original bank statements it deemed necessary to complete its audit of Duoyuan's financial results.[13] DTT's request followed the firm's determination that certain supporting documents could not be authenticated as well as identification of potential inconsistencies in Duoyuan's records. At the same time, Duoyuan announced that its CEO, its CFO, and four of its directors had also resigned. On this news, Duoyuan's shares plummeted over 50% in a single trading session. Within weeks, shareholders had filed suit against Duoyuan alleging violations under the federal securities laws.

Troubling news for Duoyuan and its shareholders continued in March 2011 when the company announced that it was the target of a SEC investigation.[14] Specifically, the SEC was investigating whether Duoyuan "filed materially false documents with the SEC . . . and had engaged in deceit in

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[3] Cornerstone Research, Investigations and Litigation Related to Chinese Reverse Merger Companies—Financial, Economic, and Accounting Questions, July 2011.

[4] *See* http://www.zerohedge.com/article/chinese-frauds-account-80-nasdaq-permanent-trading-halts, last accessed September 26, 2011.

[5] Cornerstone Research, Investigations and Litigation Related to Chinese Reverse Merger Companies—Financial, Economic, and Accounting Questions, July 2011.

[6] Cornerstone Research, Securities Class Action Filings — 2011 Mid-Year Assessment.

[7] Cornerstone Research, Investigations and Litigation Related to Chinese Reverse Merger Companies—Financial, Economic, and Accounting Questions, July 2011.

[8] Scott Eden, *SEC Warns on Reverse Merger Stocks*, The Street, June 9, 2011, available at: http://www.thestreet.com/story/11148562/1/sec-warns-on-reverse-merger-stocks.html.

[9] Dinny McMahon and Michael Rapoport, *Challenges Auditing Chinese Firms*, The Wall Street Journal, July 12, 2011.

[10] Kate O'Keeffe, *Moody's Red Flags Sink Hong Kong-Listed Chinese Stocks*, The Wall Street Journal, July 12, 2011.

[11] Duoyuan Printing, Inc. Announces Pricing of Initial Public Offering (Form 8-K), filed November 6, 2009.

[12] *Id.*

[13] Duoyuan Printing Announces Management Reorganization and Change of Auditor (Form 8-K), filed September 13, 2010.

[14] Duoyuan Printing, Inc. (Form 8-K), filed March 18, 2011.

dealings with the Company's external auditor."[15] By April 2011 Duoyuan's stock was delisted from the New York Stock Exchange — in large part because the company failed to file any financial statements with the SEC since May 2010 and had yet to acquire an auditor after DTT's termination over six months earlier.[16] Duoyuan Printing's shares are currently trading over the counter and at a fraction of its pre-disclosure share price:

Duoyuan would prove to be a precursor of things to come at other Chinese listed corporations: interference with external auditors' investigations; allegations of materially false financial statements filed with the SEC; SEC investigations; severe stock declines; and the halt of trading and eventual delisting of company stock on stock exchanges.

Analysts' Involvement in Disclosing Frauds

Analysts have played a major role in uncovering fraud in Chinese corporations listed on American and Canadian stock exchanges. One example involves China MediaExpress Holdings, Inc. ("CCME"), a Beijing-based company that purported to be the largest provider of video advertising on Chinese commercial busses — claims that now appear to be almost entirely fabricated.[17] On January 30, 2011, Citron Research ("Citron") released a report suggesting that CCME was actually a relatively unknown company in China that "[did] not exist at the scale that they are reporting to the investing public."[18] Shortly thereafter, Muddy Waters, LLC ("Muddy Waters"), a small due-diligence firm, issued a similar report asserting that CCME "is engaging in a massive 'pump and dump' scheme whereby it significantly inflates revenue and profits in order to enrich management through earn-outs and stock sales."[19] Muddy Waters estimated that CCME's actual 2009 revenues were no more than $17 million as compared to the $95.9 million that the company had reported in its SEC filings.[20] Muddy Waters also reported that the company had installed its video advertising equipment in only half of the busses it had claimed in its SEC filings and, even then, most of the busses actually played DVD movies provided by passengers rather than CCME's advertising content.[21] Muddy Waters' detailed report led to a 33% decline in the company's stock price in single-day trading.

By March 2011, CCME's auditor, DTT, had resigned after stating that it could not "rely on the representations of management" and had "lost confidence" in CCME's commitment to "reliable financial reporting."[22] Specifically, DTT was concerned about "possible undisclosed bank accounts and bank loans," and "issues concerning the validity of certain advertising agents/customers and bus operators."[23] Trading of the company's stock was suspended in March 2011. CCME was then delisted from the NASDAQ in May 2011 and is currently trading in pink sheets.[24] These developments left CCME's investors with millions in losses:

Similarly, market professionals have uncovered massive fraud at other Chinese corporations trading in western markets including, for example, Puda Coal, Inc. ("Puda

(continued on page 16)

[15] *Id.*

[16] Scott Eden, *NYSE Moves to Delist China RTO Duoyuan Printing*, The Street, March 29, 2011. Available at: http://www.thestreet.com/story/11064420/1/nyse-moves-to-delist-china-rto-duoyuan-printing.html.

[17] Citron Research, *Citron Research Reports on China Media Express (Nasdaq:CCME)*, January 30, 2011, available at: http://www.citronresearch.com/index.php/2011/01/30/citron-research-reports-on-china-media-express-nasdaqccme/.

[18] *Id.*

[19] Muddy Waters Research, *Muddy Waters Initiating Coverage on CCME — Strong Sell*, February 3, 2011, available at: http://www.muddywatersresearch.com/research/ccme/initiating-coverage-ccme/.

[20] *Id.*

[21] *Id.*

[22] Dinny McMahon, *'Backdoor' China Plays Under Fire*, The Wall Street Journal, June 9, 2011.

[23] *Id.*

[24] *Id.*

Kessler Topaz Recovers $24 Million for Shareholders in eBay and GSI Commerce Merger

(continued from page 5)

The conflicts of interest did not end with Rubin, however. To help ensure that the proposed merger and asset sale to Rubin both closed, we alleged that the entire Board and certain GSI executive officers entered into voting agreements with eBay, committing them to vote their stock in favor of the merger and against any alternative transaction (the "Support Agreements"). In exchange, we alleged, the entire GSI Board approved more than $20 million in cash and stock payments to certain of GSI's senior executives and created other financial incentives for the Board that differed from those of stockholders generally. In short, we alleged that the Board ensured that they, Rubin and his executive officer cohorts would all benefit greatly from the merger's consummation and obtain substantial benefits that would not be shared with the Company's public stockholders.

It was also clear that the GSI Board did not have the time, leverage or will to negotiate effectively on behalf of the GSI stockholders. Indeed, GSI's Board was absent from discussions with eBay until a "Special Committee" of the Board was established on March 17, 2011 — just 11 days before the merger agreement was signed — to negotiate with eBay. Within this compressed timeframe and following months of negotiations between Rubin and eBay, the Board had little negotiating ability to undo a deal that Rubin had already largely negotiated on his own.

All of these factors substantially compromised the directors' ability to negotiate effectively on behalf of GSI's stockholders.

From among five stockholders who filed complaints, the Court appointed Erie County as Lead Plaintiff. In partnership with our Delaware co-counsel, we analyzed more than 58,000 pages of documents and conducted seven depositions within a two-week period. The depositions included those of Rubin, two eBay executives, GSI's lead director Fisher, two purportedly independent GSI directors, and a representative from the investment bank that had provided GSI with financial advice.

After extensive briefing and on the eve of the hearing on our application to stop the merger and asset sale from proceeding, Erie County reached an agreement with Defendants to settle the case. Principally, Defendants agreed to pay GSI's public shareholders — i.e., those who are unaffiliated with members of GSI's Board and senior management — approximately $24 million in additional merger consideration.

The transaction closed in mid-June 2011, and the stockholders received that additional money at that time. The Court will consider whether to approve the settlement on November 15, 2011.

Victory for Plaintiffs As Countrywide MBS Case Sent Back to State Court *(continued from page 5)*

enced in the mortgages. Shortly thereafter, we filed a class action on behalf of two additional plaintiffs and others similarly situated for a broader range of MBS in state court. After combining the two actions (hereafter the "Countrywide MBS Action"), we, with the assistance of co-counsel, have been litigating these claims in state court since the fall of 2008.

After an unsuccessful attempt to remove the Countrywide MBS Action to federal court,[4] defendants moved to dismiss the Countrywide MBS Action, claiming that SLUSA amended Section 22(a) of the Securities Act to prevent Luther from filing a class action asserting claims under the Securities Act in state court. Essentially, defendants argued, even though the Countrywide MBS Action asserted claims under the Securities Act only, concerning securities that, as all parties agreed, were not traded on a national exchange, the Superior Court did not have jurisdiction over the Countrywide MBS Action.

Defendants based their argument on a misreading of Section 22(a). Section 22(a) provides the state court with jurisdiction over actions asserting Securities Act claims "except as provided in Section 16 [15 U.S.C. §77p] with respect to covered class actions."[5] Instead of referencing Section 16 as a whole, defendants argued that the reference to Section 16 was, in reality, a reference to Section 16(f)(2), a definitional section setting forth the requirements for a "covered class action." Because Section 16(f)(2) does not require a covered class action to concern a security traded on a national exchange or assert state law claims, defendants argued that Congress amended Section 22(a) to prevent investors from filing the type of claims asserted in the Countrywide MBS Action in state court. No court—state or federal—had previously opined as to whether SLUSA altered

(continued on page 18)

[4] *See Luther v. Countrywide Home Loans Servicing*, No. 2:07-CV-08165-MRP(MANx), 2008 U.S. Dist. LEXIS 26534 (C.D. Cal. Feb. 28, 2008) (remanding the *Luther* action to state court) *aff'd Luther v. Countrywide Home Loans Servicing LP*, 533 F.3d 1031 (9th Cir. 2008).

[5] 15 U.S.C. §77v.

Wachovia Bond Litigation: A Historic Post-Credit Crisis Settlement of $627 Million

(continued from page 2)

a phenomenon known as "negative amortization." If the negative amortization caused the borrower's loan-to-value ("LTV") ratio to exceed certain levels, the loan would automatically "recast" to require much higher fully-amortizing payments over the remaining term of the loan. These features meant that Pick-A-Pay loans were not only more attractive to high-risk borrowers who could only afford to make the minimum payments, but that these borrowers were far more likely to default if the interest rate on the loan reset to a higher number, or if the loan recast, resulting in higher fully-amortizing payments. Accordingly, the Pick-A-Pay loans were substantially riskier than standard mortgages and required especially conservative underwriting standards in order to prevent an increased rate of default and a corresponding increase in the bank's exposure to impaired mortgage-based assets.

In the boom housing years before 2006, when the value of residential homes increased year-over-year, the risk of default was not much of a concern to investors, as refinancing was cheap and borrowers used the inflated equity in their homes to stave off financial constraints. However, from 2006 to 2008, housing values began to decline — for example, 70 percent of Wachovia's Pick-A-Pay loans were made in Arizona, California, and Florida, where real estate prices subsequently suffered a precipitous plunge — and concerns rose about financial institutions' exposure to mortgage-based and subprime mortgage-based assets. Investors wanted accurate and complete information about Wachovia's exposure to these types of assets. Notwithstanding investors' desire for a complete financial picture, Wachovia gave them anything but that. Specifically, in documents Wachovia filed with the Securities and Exchange Commission (in connection with its sale of over $35 billion in securities) during 2006-2008, the Company repeatedly and falsely touted its underwriting standards and the quality of the Pick-A-Pay loan portfolio. Indeed, the Pick-A-Pay portfolio was not subject to conservative underwriting, but rather suffered from markedly lax underwriting guidelines. The flaws in the underwriting standards began under the leadership of Golden West management, and continued (and worsened) after Wachovia acquired the company in 2006. By early 2008, the market began to learn the truth, and in April 2008, Wachovia disclosed that *14% of its $120 billion portfolio had LTV portfolios above 100 percent* — a far cry from its previous public representations.

Making matters worse, the Pick-A-Pay portfolio was just one of Wachovia's problems during this period. In addition, Wachovia had significant exposure to subprime collateralized debt obligations ("CDOs") and residential mortgage-backed securities ("RMBS"). As with the Pick-A-Pay portfolio, Wachovia failed to report in a timely fashion any exposure until late 2007, when it announced a $438 million write down of CDOs due to "disruption" in the capital markets. Two months later, Wachovia announced it had reduced its "net" CDO exposure from $1.79 billion to $680 million after taking another $1.1 billion write down. It also disclosed for the first time that it had an RMBS exposure of $2.5 billion. In January 2008, Wachovia revealed its remaining "gross" CDO exposure was $5 billion — but even then it described the exposure in misleading terms, as "hedged with financial guarantors" without disclosing that those guarantors lacked the means to cover more than a fraction of the exposure.

Shortly thereafter, and in response to these problems, Wachovia fired its CEO (just three days after the last offerings at issue in this Action). By the end of June, 2008, Wachovia's market capitalization was only $25.89 billion — or little more than it had paid for Golden West two years before. By September 2008, the bank was on the brink of insolvency. And on October 3, 2008, Wells Fargo announced it would acquire Wachovia in an all-stock deal for $15.1 billion — a fire sale price, at best. Wells Fargo later announced it had identified pre-existing credit impaired loan balances in the Pick-A-Pay portfolio totaling $59.8 billion — or half of the value of the entire Pick-A-Pay portfolio.

Wachovia Is Sued, then Settles

As a result of these events, multiple lawsuits were filed against Wachovia, including equity shareholder actions, direct shareholder actions, and bond/note holder actions. The Firm brought the Action against Wachovia in California state court on behalf of the Southeastern Pennsylvania Transit Authority on January 21, 2009, representing purchasers of bonds and certain preferred securities issued by Wachovia. Shortly thereafter, the case was removed to federal court, and transferred to the Southern District of New York so that it could be heard by the same judge adjudicating another, similar, case against Wachovia. The Firm was then appointed co-lead counsel, and filed an amended complaint against Wachovia, and others, on May 28, 2010 ("Bond/Notes Complaint"). Specifically, the Bond/Notes Complaint brought claims under Sections 11, 12(a)(2), and 15 of the Securities Act, and named as defendants: Wachovia, numerous Wachovia executives and directors, Wells Fargo, numerous investment banks that served as underwriters in connection with offerings of Wachovia securities, and the accounting firm KPMG, which had audited Wachovia's financial statements in connection with several offerings. In response, the defendants filed a number of motions to dismiss, to which the Firm responded on behalf of investors.

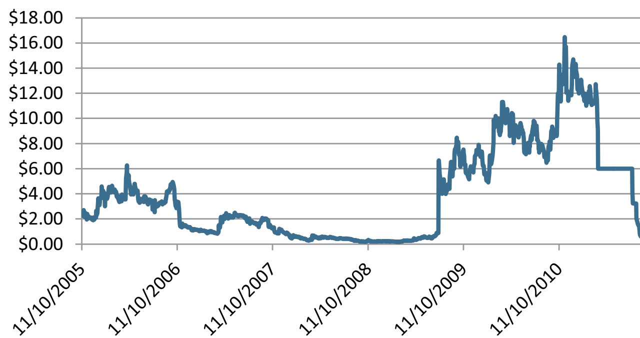
Once briefing on the motions to dismiss was completed,

(continued on page 17)

Frauds Rising in The East and Setting in the West *(continued from page 13)*

Coal"). In April 2011, allegations surfaced suggesting that Puda Coal's chairman had secretly transferred ownership of the company's key subsidiary — which controls the overwhelming majority of the company's operations and assets — in a series of undisclosed transactions in 2009 and 2010.[25] The transactions left the company seriously compromised and allowed Puda Coal's chairman to profit tremendously at the expense of the company's shareholders. As a result of the transactions, Puda Coal was allegedly saddled with a $530 million loan with a 14.5 percent annual interest rate from CITIC, a Chinese state-owned investment conglomerate.[26]

Before these details became public, Puda Coal was able to capitalize on two public stock offerings that netted the company in excess of $100 million in proceeds.[27] Not only did the company's auditors fail to verify the company's financial statements, but Puda Coal's underwriters failed to recognize that the company was a mere shadow of its reported value — allowing investors to purchase grossly inflated stock. Puda Coal would later announce an internal investigation after acknowledging that the allegations were likely true.[28] This announcement led to the suspension of trading of the company's stock and the resignation of the company's auditor.[29] Trading in Puda Coal's stock was halted on April 11, 2011. Since resuming trading in pink sheets, the stock has plummeted to barely $0.50 per share:



Similarly, allegations have surfaced against Sino-Forest Corporation ("Sino"), a forest plantation operator in China whose shares trade on the Toronto Stock Exchange. According to the company's Canadian securities filings, Sino's primary business involves the purchase, development, maintenance, and sale of standing timber land in China. On June 2, 2011, Muddy Waters issued a 39-page report alleging that Sino was engaged in widespread fraud that likely began when it became a publicly traded company in 1995. Among other allegations, Muddy Waters asserted that the company's reported purchases of nearly $3 billion in timber, the company's primary asset, were significantly overstated. Supporting its theory, Muddy Waters identified five of the six counterparties to these purported purchases and concluded that only one appears to be a legitimate entity. Even then, Muddy Waters determined that the transactions with this counterparty were likely overstated by at least $800 million. Muddy Waters was unrelenting in its attack against Sino and likened it to Bernard Madoff's historic Ponzi scheme — describing Sino as an institutional fraud that is "stratospheric in size." Muddy Waters dismissed the company's $7 billion enterprise value as a farce and valued Sino's shares under $1 per share. On this news, the company's stock price declined from a close of CDN $18.21 per share on June 1, 2011 to CDN $14.46 per share when trading was halted on June 2, 2011 — a decline of over 20%. When trading resumed on June 3, 2011, Sino's shares fell to CDN $5.23 per share at the close of trading — a further decline of almost 64%.

On June 18, 2011 *The Globe and Mail* — one of Canada's largest newspapers — published an investigatory article confirming the core allegations of the Muddy Waters report. *The Globe and Mail*'s confirmation resulted in Sino's stock falling to CDN $2.73 per share at the close of trading on Monday, June 20, 2011 and reaching a low of CDN $1.99 per share at the close of trading on June 21, 2011. On August 26, 2011, the Ontario Securities Commission ("OSC") — which is currently investigating Sino — ordered the immediate suspension of trading in Sino's securities.[30] The OSC also

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[25] Alfred Little, *Puda Coal Chairman Sells Half the Company; Pledges the Other Half to Chinese PE Investors*, Seeking Alpha, April 11, 2011, available at: http://www.seekingalpha.com/article/262779-puda-coal-chairman-sells-half-the-company-pledges-the-other-half-to-chinese-pe-investors.

[26] *Id.*

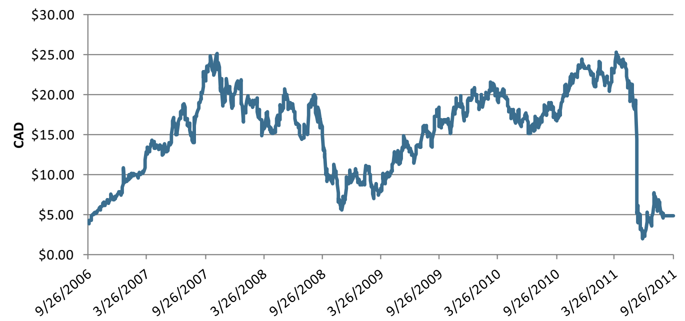
[27] *Id.*

[28] Puda Coal Commences Investigation (Form 8-K), April 11, 2011 ("Although the investigation is in its preliminary stages, evidence supports the allegation that there were transfers by Mr. Zhao in subsidiary ownership that were inconsistent with disclosure made by the Company in its public securities filings. Mr. Zhao has agreed to a voluntary leave of absence as Chairman of the Board of the Company until the investigation is complete.").

[29] *Puda Coal Says Auditor Resigns*, Reuters, July 12, 2011, available at: http://www.reuters.com/article/2011/07/12/pudacoal-idUSL3E7IC3J920110712.

[30] *See* Caroline Van Hasselt, *Canada's Top Securities Regulator Halts Sino-Forest Trading*, The Wall Street Journal, August 26, 2011.

ordered the resignation of the company's top executives including the company's CEO on allegations that Company "misled the public by misrepresenting some of its timber holdings."[31] While the mandatory dismissal orders were subsequently suspended because the OSC "'was persuaded' that the 'resignations can only be obtained after a hearing. . . .'"[32] As the following chart demonstrates, stock declines resulting from disclosure of Sino's fraud have led to significant losses for investors.



Conclusion

The foregoing examples represent just a handful of the recent allegations of fraudulent activity at Chinese corporations. The scope and duration of these schemes perpetrated as a means of taking advantage of shareholders is staggering, and yet, is still not fully understood. As analysts, regulators, and shareholders continue to investigate Chinese corporations, it is likely that additional instances of fraud will be identified. Not only is fraud of this magnitude damaging to investors who have purchased stock from these companies, but it also may have a chilling effect on investment in legitimate Chinese corporations who suffer by association with their peers.

[31] *Id.*

[32] *Id.*

Wachovia Bond Litigation: A Historic Post-Credit Crisis Settlement of $627 Million

(continued from page 15)

the Action remained quiet until earlier this year, when Judge Sullivan denied the overwhelming majority of Defendants' dismissal motions as they related to the Bond/Notes action on March 31, 2011. The Opinion fully sustained the Bond Plaintiffs' substantive claims, with the exception of some of the offerings for which there was no named plaintiff who purchased from that offering. The Opinion was particularly favorable in that Judge Sullivan rejected certain of Defendants' arguments that would have eliminated most of the damages that Class members could potentially recover. As a result, the Firm was able to ensure that they would have a fighting chance to recover the majority of the damages that defendants' conduct had caused. In addition to sustaining all counts of the Bond/Notes Complaint against Wachovia and the Individual Defendants, the Opinion also completely rejected the dismissal motion of KPMG on substantive grounds, finding that the Bond/Notes Complaint had sufficiently alleged that Wachovia's 2006 and 2007 financial statements and KPMG's audit opinions on those financial statements were materially false and misleading when issued.

After Lead Plaintiffs' case survived Defendants' motions to dismiss, the parties agreed to participate in a mediation session before Hon. Daniel Weinstein, a retired judge. After the mediation session, the parties continued to hold discussions and negotiations regarding a possible settlement. After months of negotiations and meetings, the parties were able to reach a settlement with defendants. Shortly thereafter — to ensure that the settlements were warranted and in the best interests of investors — the Firm conducted extensive confirmatory discovery. All told, the Firm travelled to Charlotte, North Carolina and New York to take fifteen interviews of key Wachovia employees and five interviews of KPMG employees, reviewed millions of pages of documents produced by defendants, and analyzed a representative sample of 10,000 of Wachovia's loan files.

Conclusion

While the Wachovia settlement is notable in terms of raw size, it is especially remarkable in that it represents a recovery of between 30-50% of the maximum possible damages that the plaintiffs could have ever expected to recover. This percentage of recovery stands far above the average recovery in the overwhelming majority of securities class actions, and even higher than the more recent subprime recoveries that have been announced to date. In sum, the settlement is a great result for Wachovia's investors. We are proud of the Firm's accomplishments in reaching a settlement of historic proportions that provided an outstanding recovery to shareholders.

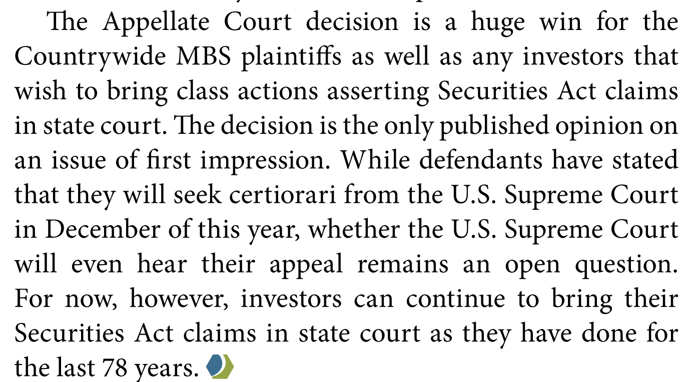
Victory for Plaintiffs As Countrywide MBS Case Sent Back to State Court *(continued from page 14)*

an investor's ability to bring a class action that did not assert state law claims and did not involve a "covered security." As to this issue of first impression, however, the Superior Court agreed with defendants and granted their motion to dismiss the Countrywide MBS Action on January 12, 2010.

We appealed the Superior Court's decision to the California Court of Appeals for the Second District (the "Appellate Court") in March 2010. In so doing, we argued that Section 22(a)'s reference to Section 16 required the court to read the entirety of Section 16 to determine if it applied. Section 16 does not affect the "rights and remedies" accorded to investors under the Securities Act "except as provided in subsection (b)." If subsection b does not apply to an action, then Section 16 cannot be used to alter the rights or remedies of investors under the Securities Act. Section 16(b) provides that a "covered class action" asserting state law claims concerning material misstatements made in connection with the purchase or sale of a "covered security" cannot be maintained in state or federal court. Thus, Section 16(b) only applies to class actions asserting state law claims concerning securities traded on national exchanges. Because the Countrywide MBS Action asserted Securities Act claims concerning MBS—a security that defendants' conceded did not trade on a national exchange and therefore was not a "covered security"—Section 16 does not prevent the Countrywide MBS Action from being heard in state court.

The Appellate Court agreed. In a unanimous opinion issued on May 18, 2011, the Appellate Court held that in order to determine whether the Countrywide MBS Action can be brought in state court, it "must look to all of section 77p [Section 16], and see what it provides" and, after doing so, determined that "[n]othing…in section 77p describes this case" and, therefore, it "is not precluded and can be maintained" in state court. [6]

After receiving the appellate court's decisive opinion, defendants unsuccessfully sought a rehearing before the appellate court. Subsequently, the California Supreme Court denied defendants' request for certiorari of this issue, transferring the case back to the Appellate Court. There, defendants moved to stay the issuance of the remittur to the Superior Court which the Appellate Court promptly denied. The Countrywide MBS Action returned to the Superior Court for further adjudication on September 27, 2011.



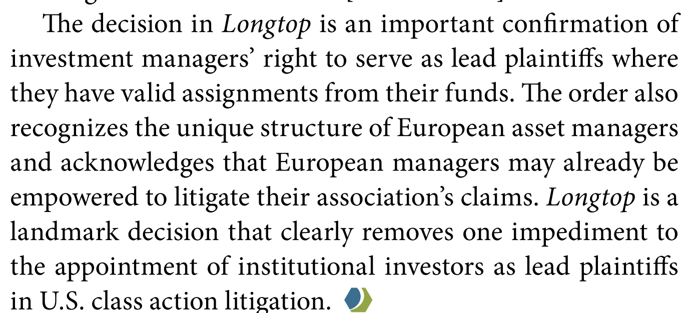
The Appellate Court decision is a huge win for the Countrywide MBS plaintiffs as well as any investors that wish to bring class actions asserting Securities Act claims in state court. The decision is the only published opinion on an issue of first impression. While defendants have stated that they will seek certiorari from the U.S. Supreme Court in December of this year, whether the U.S. Supreme Court will even hear their appeal remains an open question. For now, however, investors can continue to bring their Securities Act claims in state court as they have done for the last 78 years.

[6] May 18, 2011 Order at 7-8.

"Come On In" — Court Confirms European Asset Managers' Ability to Prosecute Claims Under the Federal Securities Laws *(continued from page 10)*

554 U.S. 269 (2008). *Longtop*, 2011 U.S. Dist. LEXIS 112970, at *18. As such, the court held that the assignment "conclusively establishes" the European investment manager's standing. *Id*.

The court then turned to and rejected the Challenging Group's assertion that Danish law does not permit investment managers to receive assignments from their investment funds. Relying upon the European investment manager's Danish law expert, the court concluded that Danish law provides investment managers with "the inherent power to prosecute [their sub-funds'] claims as a matter of right, without an assignment of claims." *Id*. at *19. The court also noted that three United States district courts have allowed the same manager to bring securities claims after it secured an assignment. Accordingly, the court held that "the [a]ssignment is valid and there is no question as to [the European investment manager's] legal authority to receive an assignment of claims from [its sub-funds]." *Id*. at *21.



The decision in *Longtop* is an important confirmation of investment managers' right to serve as lead plaintiffs where they have valid assignments from their funds. The order also recognizes the unique structure of European asset managers and acknowledges that European managers may already be empowered to litigate their association's claims. *Longtop* is a landmark decision that clearly removes one impediment to the appointment of institutional investors as lead plaintiffs in U.S. class action litigation.

Frequently Maligned Class Action Lawsuits Actually Deter Financial Wrongdoing, Study Finds

(continued from page 3)

primary methods of federal securities regulatory and law enforcement: "public" enforcement by the Securities and Exchange Commission; and, "private" enforcement through securities class action lawsuits.

Regulatory Failures Enhance Importance of Class Actions

A recent story by the *New York Times'* Gretchen Morgenson reported on why private lawsuits are particularly important at a time when federal failure to enforce the law is considered one cause of our ongoing financial-economic crisis and of public discontent with government:

"When federal authorities don't fulfill their obligation to enforce the law, they essentially give an imprimatur to the financial entities to do whatever they want and disregard the law," said Kathleen C. Engel, a professor at Suffolk University Law School in Boston. "To the extent there are places where shareholders and borrowers can pursue claims, they are really serving the function of the government. They are our private attorneys general."

"Lawsuits have long been a crucial method for shareholders to recover losses. A February letter to the Securities and Exchange Commission from the general counsel of the California Public Employees' Retirement System noted that private litigants in the 100 largest securities class action settlements had recovered $46.7 billion for defrauded shareholders."

www.nytimes.com/2011/08/08/business/aig-to-sue-bank-of-america-over-mortgage-bonds.html

"I am not surprised at all that rigorous unbiased research now proves class action law suits are a robust deterrent to financial fraud and wrongdoing," explained Salvatore J. Graziano, Esq., president of the National Association of Shareholder and Consumer Attorneys. "On behalf of defrauded institutional investor clients, securities plaintiffs' attorneys routinely conduct thorough and ground breaking investigations of corporate defendants including securing information from knowledgeable former employees in our civil prosecutions. In fact, private investor lawsuits at times also help further investigations by the SEC and other federal agencies."

Indeed, the new study found that in cases where both the SEC and class action lawsuits take action, on average private lawsuits precede SEC action by 297 days.

Not surprisingly, the strongest deterrence effect was found when both SEC proceedings and class actions are launched.

Class Actions Recover More Money and Can Be a Stronger Deterrent than SEC

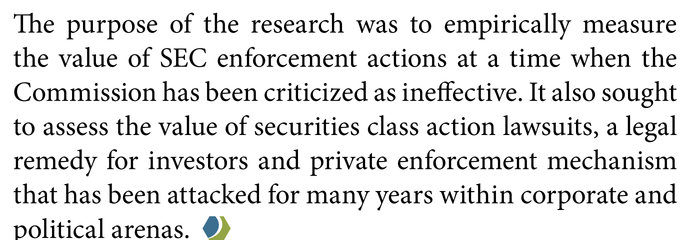
"Class action lawsuits, although often maligned as frivolous and socially wasteful, can have positive externalities by curbing aggressive reporting behavior of peer firms," the paper by Dr. Kedia and her colleagues states. Indeed, class action lawsuits recover far more money — twice as much or more — from wrongdoers than SEC actions, according to sources cited by the professors. And, in most situations, the deterrence value of class actions (in the absence of SEC enforcement) is actually stronger than that of the SEC when acting without a corresponding class action.

This first study to validate the enforcement value of class actions through empirical research was conducted by Dr. Kedia and Shivaram Rajgopal, Ph.D., Chartered Accountant and Schaefer Chaired Professor of Accounting at Emory University's Goizueta Business School, with Jared Jennings, a doctoral student at the University of Washington's school of business. Their paper, entitled "The Deterrence Effects of SEC Enforcement and Class Action Litigation," reports their analysis of 474 SEC actions alleging financial statement misrepresentation and 1,111 class action lawsuits alleging violations of Generally Accepted Accounting Procedures during 1996 through 2006. The paper was first circulated for comment in June. http://papers.ssrn.com/abstract=1868578

Among other findings, the professors reported:

- "***The SEC publicly targets a very small fraction of firms — in our sample only 0.74% of firms*** were subject to SEC enforcement. At these low levels of enforcement, a substantial fraction of misreporting is likely to go undetected. Therefore, if potential miscreants consider the probability of detection to be too low, they are unlikely to change their behavior."

- "***Securities class action litigation for alleged reporting irregularities is more likely against an average firm — in our sample 1.28% of firms*** are subject to class action litigation. The greater likelihood of class action litigation, combined with higher monetary sanctions, likely renders lawsuits as a potentially effective way to deter reporting irregularities at peer firms."



The purpose of the research was to empirically measure the value of SEC enforcement actions at a time when the Commission has been criticized as ineffective. It also sought to assess the value of securities class action lawsuits, a legal remedy for investors and private enforcement mechanism that has been attacked for many years within corporate and political arenas.

Calendar of Upcoming Events

57th U.S. Annual Employee Benefits Conference • October 30 – November 2, 2011

New Orleans Memorial Convention Center — New Orleans, LA

The Annual Employee Benefits Conference provides an ideal venue for discussing the latest cost-saving ideas, getting updates on legislative developments, finding creative approaches to new challenges and collaborating with your peers who are dealing with the same issues you face.

International Corporate Governance Network 2011 Autumn Mid-Year Conference
December 12 – 13, 2011

Mandarin Oriental — Miami, FL

ICGN Conferences bring together leading speakers and delegates from all sides of the corporate governance community including investment, business, the professions and policy-making. ICGN Conferences are held in every region of the world to ensure cross-border dialogue with international relevance on emerging issues in corporate governance.

The European Pensions Symposium • February 1 – 3, 2012

Intercontinental Paris Le Grand — Paris, France

Institutional Investor's European Pensions Symposium is one of the world's leading forums for heads of pension funds. Now in its 20th year, the two-and-a-half day event is attended by over 100 chief investment and executive officers from some of Europe's largest and most innovative pension funds. The Symposium focuses primarily on investment issues facing pension funds and the entire programme is driven by an expert advisory board representing corporate and public pension funds with varied structures, liabilities and investment strategies.

The Evolving Fiduciary Obligations of Pension Plans: Wielding New Shareholder Rights and Investment Strategies to Meet Plan Objectives
February 7, 2012

The DuPont Hotel — Washington, D.C.

Our audience of senior pension fund executives, their legal advisors, and other investment professionals will have an opportunity to hear from a number of their peers and outside experts as well as to share insights and experiences regarding the most critical fiduciary issues they face today. Participants will be provided with impartial perspectives on how fiduciaries can optimally meet their objectives and avoid difficulties, as well as receive timely information and guidance on various investment strategies and legal options.

Rights & Responsibilities of Institutional Investors: Turning Words Into Action
March 22, 2012

Renaissance Hotel — Amsterdam, Netherlands

For seven years, The Rights & Responsibilities of Institutional Investors meeting has offered objective analysis of the issues facing active owners and provided insightful examination of the vital issues confronting European investors. During those years, the dialogue has both deepened and broadened.

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