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

FULLY INFORMED

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EVENTS — What's to Come

AUSTRALIAN HIGH COURT UPHOLDS ABILITY OF NON-RESIDENT SHAREHOLDERS TO PARTICIPATE IN SHAREHOLDER CLASS ACTIONS

Emily N. Christiansen, Esquire

An October 12, 2022 landmark decision by the High Court of Australia, in *BHP Group Limited v. Impiombato,* preserved the ability for shareholders who are not resident in Australia to continue to participate in shareholder class actions against Australian companies.

BHP Billiton Ltd. ("BHP") is a mining company that is among the world's top producers of major commodities, including iron ore. It has a dual-listed structure with two parent companies (BHP Billiton Ltd. and BHP Billiton PLC) that operate

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THE SEC'S EXECUTIVE COMPENSATION CLAWBACK RULES WILL LIKELY INCREASE FINANCIAL REPORTING TRANSPARENCY AND ACCOUNTABILITY TO INVESTORS

Barbara A. Schwartz, Esquire and Karissa J. Sauder, Esquire

In October 2022, after years of debate and public comment, the United States Securities and Exchange Commission (the "SEC") voted to adopt final "clawback" rules regarding executive compensation (the "Clawback Rules"). The Clawback Rules, which were mandated by Congress in 2010, but were not implemented until now, will require publicly traded companies to claw back certain incentive-based executive compensation if their financial reports are restated.

The Clawback Rules will better align the interests of executives and shareholders by reducing the risk that executives will reap unwarranted compensation windfalls (at investors' expense) by misreporting companies' financial results. Additionally, the Clawback Rules should increase financial reporting transparency by requiring publicly traded companies to certify annually whether they have restated any financial results.

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PRICE IMPACT AND THE SPEED OF INFORMATION: RECENT DEVELOPMENTS IN SECURITIES CLASS CERTIFICATION

Matthew L. Mustokoff, Esquire and Margaret E. Mazzeo, Esquire

In outlining the contours of the "fraud-on-the-market" presumption of reliance, the Supreme Court in *Basic v. Levinson* held that the presumption is rebuttable through evidence that "severs the link" between the defendant's misrepresentation and the loss suffered by the stockholder (i.e., the stock price decline). A quarter-century later in *Halliburton II*, the Court expounded that one way for a defendant to "sever the link" is by demonstrating a lack of price impact: "[I]f a defendant could show that the alleged misrepresentation did not, for whatever reason, actually affect the market price, . . . then the presumption of reliance would not apply."[1]

The Court in *Basic* and *Halliburton II* left unanswered a critical question regarding price impact: how long does it take new, value-relevant information to impact the stock price of a security trading in an efficient market? The Court declined to lay down a bright-line rule with regard to the proper time period in which to assess price impact. As the Court made clear in *Basic*, "by accepting this rebuttable presumption, we do not . . . adopt any particular theory of how quickly and completely publicly available information is reflected in market price."[2] The Court again turned down the opportunity to address the question of timing of price impact in *Halliburton II*, reiterating that "market efficiency is a matter of degree" and that "*Basic*'s presumption of reliance . . . does not rest on a 'binary' view of market efficiency'" that requires the stock price to immediately absorb material public information — or to absorb such information within a prescribed timeframe.[3]

In the wake of *Halliburton II*, the district and circuit courts have granted plaintiff-investors a degree of latitude when it comes to the amount of time it takes for information to be disseminated, analyzed, and synthesized before it is reflected in a company's stock price. In these cases, the courts have rejected arguments by defendants — both in

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[1] *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258, 269 (2014) ("*Halliburton II*").

[2] *Basic*, 485 U.S. at 248 n.28.

[3] *Halliburton II*, at 272.

KESSLER TOPAZ ACHIEVES SIGNIFICANT VICTORY IN SECURITIES FRAUD CASE INVOLVING ZILLOW OFFERS DEBACLE

By Stacey Kaplan, Esquire

On December 7, 2022, U.S. District Judge Thomas S. Zilly of the Western District of Washington denied in large part the Defendants' motion to dismiss a securities fraud action against Zillow Group, Inc. ("Zillow" or the "Company") and its most senior executives.[1] Zillow is best known for operating the real estate website "zillow.com." The action alleges that Defendants violated Section 10(b) of the Securities Exchange Act by affirmatively misleading investors about the reckless and undisclosed bet the Company was taking with its Zillow Offers iBuyer business.

iBuyers use algorithms to estimate home values, and then make instant cash offers to purchase homes based on those estimated values. If a homeowner accepts, the iBuyer makes repairs and flips the home. Zillow entered the iBuyer business in 2018, launching Zillow Offers. By 2021, however, Zillow Offers' growth was lagging. In an attempt to jumpstart it, Plaintiff alleges that in Spring 2021, Defendants

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[1] The case is *Jaeger v. Zillow Group, Inc.*, Civil Action No. 2:21-cv-01551-TSZ (W.D. Wash.). Defendants are Zillow's Chief Executive Officer Richard N. Barton, Chief Financial Officer Allen W. Parker, and Chief Operating Officer Jeremy Wacksman. Lead Plaintiff is individual investor Jeremey Jaeger. Kessler Topaz serves as co-counsel in the action with Lead Counsel Hagens Berman Sobol Shapiro, LLP.

KTMC CLASS CERTIFICATION VICTORY IN MAZDA DEFECTIVE WATER PUMP LITIGATION DEMONSTRATES WINNING STRATEGY FOR MULTISTATE CLASS ACTIONS

Matthew Macken, Esquire, Jordan Jacobson, Esquire, and Melissa Troutner, Esquire

Historically, consumers seeking to hold companies accountable for unfair or fraudulent conduct were able to pursue claims on behalf of nationwide classes. But in the last decade, courts across the country, including most notably the Ninth Circuit in *Mazza v. American Honda Motor Company*, 666 F.3d 581 (9th Cir. 2012), have stymied this approach, finding that certification of nationwide classes under a single state's consumer protection law is improper. Given this shifting legal landscape, consumers have been required to pursue new strategies in order to obtain recoveries for individuals in multiple states.

Kessler Topaz has been at the forefront of developing these new strategies and, in October, succeeded in obtaining the successful certification of eight classes covering purchasers in seven states. The case is *Sonneveldt v. Mazda Motor of America, Inc., et al.*[1] and this victory demonstrates that, in the wake of *Mazza* and similar decisions, plaintiffs armed with the right strategy can still successfully bring multistate consumer protection class actions.

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[1] Case No. 8:19-cv-01298 (C.D. Cal.)

EXPANDING THE DGCL'S SECTION 102(B)(7) SANCTUARY FOR MISBEHAVING FIDUCIARIES: THE FUTURE OF PROSECUTING SENIOR OFFICER MISCONDUCT

Lauren Lummus, Esquire

Traditionally, by virtue of owning shares of a company's stock, a stockholder has rights to hold corporate officers and directors accountable for breaching their fiduciary duties.[1] In the Delaware General Corporation Law, the Delaware legislature has determined the limits of stockholders' rights to do so, *e.g.*, by enacting and amending legislation like 8 *Del. C.* § 102(b)(7) ("Section 102(b)(7)"), which exculpates corporate directors, and now also corporate officers, from liability for certain breaches of their fiduciary duties.

In 1986, the Delaware General Assembly enacted Section 102(b)(7) to provide qualified sanctuary to corporate directors who would face personal, monetary liability for breaching their duty of care by exculpating directors from such liability.[2] Section 102(b)(7) is not self-executing; each Delaware corporation must decide for itself whether to adopt an exculpatory provision under Section 102(b)(7),[3] though virtually all public companies do so.

On August 1, 2022, the Delaware General Assembly amended Section 102(b)(7) (the "Amendment") to expand the 102(b)(7) sanctuary to senior corporate officers.[4] While containing most of the same criteria as the existent Section 102(b)(7) sanctuary for directors, the Amendment provides more limited circumstances in which senior officers may enter its sanctuary.

First, the 102(b)(7) sanctuary is available only to particular senior officers. According to the statute, a covered 'officer' is "a person at the time of an act or omission as to which liability is asserted is deemed to have consented to service of process . . . pursuant to §3114(b) of Title 10 [of the Delaware Code Annotated]."[5] This includes a company's president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer or chief accounting officer, as well as other individuals identified as the most highly compensated officers in filings

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[1] *See generally*, David Kernshaw, The Foundations of Anglo-American Corporate Fiduciary Law (Cambridge Univ. Press, 2018).

[2] Del. Code Ann. tit. 8, § 102(b)(7) (1986).

[3] *See* Del. Code Ann. tit. 8 § 102(b) (2022).

[4] Del. Code Ann. tit. 8 § 102(b)(7) (2022).

[5] Del. Code Ann. tit. 8 § 102(b)(7) (2022).

Institutional Investor

KESSLER TOPAZ MELTZER CHECK LLP

KEYNOTE SPEAKER

Boris Johnson

Former Prime Minister of the United Kingdom

17TH ANNUAL

RIGHTS & RESPONSIBILITIES OF INSTITUTIONAL INVESTORS

MARCH 9, 2023 / AMSTERDAM*

Institutional Investor, in partnership with Kessler Topaz & Check, LLP (KTMC), will hold the 17th annual Rights & Responsibilities of Institutional Investors event. Join us as we draw together senior investment, legal, and compliance officers from European, North American, Middle Eastern, and Asian public pension, insurance funds, and mutual fund companies to discuss the most pressing issues for engaged investors and active shareholders.

Preliminary Topics

We are excited to bring you the first look of our 2023 discussion topics. Topics under consideration include:

- What Are the Implications of Geopolitical Tensions and Macroeconomic Volatility on the Work of Governance Professionals?
- Is the Private Equity Boom Turning into a Pyramid Scheme, and What Could it Mean for Asset Owners?
- Developing ESG Competencies on Boards and Beyond
- Integrating the Latest ESG Trends into Stewardship Practices
- Navigating the Path to Net-Zero
- A Review of the Asset Recovery Landscape

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*Venue to be confirmed upon registration

AUSTRALIAN HIGH COURT UPHOLDS ABILITY OF NON-RESIDENT SHAREHOLDERS TO PARTICIPATE IN SHAREHOLDER CLASS ACTIONS

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as a single economic entity with a unified board and management team. BHP Billiton Ltd. is registered as an Australian company and listed on the Australian Stock Exchange. BHP Billiton PLC ("BHP PLC") is registered in the United Kingdom and listed on the London Stock Exchange and the Johannesburg Stock Exchange. The case against BHP stems from the November 5, 2015 collapse of the Fundão dam at the Germano iron ore mine in Brazil (BHP owned 50 percent of the mine), which caused a toxic mudslide that swept away the village of Bento Rodrigues, killed 19 people, and caused permanent environmental damage to the area. On news of the mine's dam collapse, BHP's stock price declined. BHP's stock price declined further when reports surfaced indicating that BHP knew or should have known that there was a significant risk of collapse as early as October 2013 and that, despite its knowledge of the risk of the dam collapsing, BHP failed to immediately disclose the risk to investors in violation of its obligations under the Australian Corporations Act.

On May 31, 2018, the Australian law firm Phi Finney McDonald commenced proceedings against BHP in the Victorian Registry of the Federal Court of Australia (*Impiombato v. BHP Billiton Limited* (VID648/2018).[1] The claim was brought by a Representative Applicant on behalf of all shareholders, wherever domiciled, that acquired an interest in BHP and BHP Billiton PLC shares listed on the Australian, London, and Johannesburg stock exchanges between October 21, 2013 and November 9, 2015. A similar action was subsequently filed by the Australian law firm Maurice Blackburn and after the Australian court entertained a carriage motion, Phi Finney McDonald and Maurice Blackburn agreed to jointly prosecute the matter and were formally appointed as co-leads by the Australian Appeal Court on July 19, 2019.

On May 12, 2020, BHP filed and served on the plaintiffs an interlocutory application seeking orders to strike-out[2] claims brought on behalf of BHP PLC shareholders and to exclude shareholders of both BHP and BHP PLC who are not resident in Australia from participating in the class action, or in the alternative, to require these shareholders to opt-in and affirmatively submit to the jurisdiction of the Court. On November 27, 2020, the Australian Federal Court rejected BHP's strike-out claims. With respect to the claims brought on behalf of BHP PLC shareholders, the judge held that the inclusion of those claims in this case is at least an arguable interpretation of the relevant statutory provisions and that it is a matter that should be decided at trial once the parties have presented all facts and arguments. With respect to BHP's application to exclude foreign shareholders from the proceedings, the Federal Court conclude that there is nothing in the language of the Federal Court Act of Australia (which provides the basis of class actions) that limits application to only Australian class members. Similarly, the Federal Court also determined that the relevant provisions of the Australian Corporations Act also contained no language limiting the application of the law to only shareholders resident in Australia. On December 11, 2020 BHP appealed to the Full Court of the Federal Court of Australia. On June 3, 2021, the Full Federal Court upheld the decision of the Federal Court and rejected BHP's appeal. BHP sought and was granted leave to appeal to the Australian High Court.

On October 12, 2022, the Australian High Court unanimously rejected BHP's appeal and upheld the earlier decisions of both the Federal Court and the Full Federal Court. In rejecting BHP's arguments, the High Court explained:

> *BHP's construction of Pt IVA ignores the Constitution and the legislation passed by the Commonwealth Parliament vesting jurisdiction in the Federal Court, and rewrites the Federal Court of Australia Act… [w] ho makes the claim and where they live does not determine the jurisdiction of the Federal Court or the claims that may be brought in accordance with the procedures in Pt IVA… BHP's construction would undermine the purpose of Pt IVA by not allowing non-residents to be group members in representative proceedings.*

The court's rejection of BHP's arguments is important not only for those shareholders who are participating in (or eligible to participate in) the class action against BHP but also for the continued ability of non-resident shareholders to continue to pursue recoveries in Australia against Australian-listed companies who have committed disclosure violations, fraud, or abuse. ■

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[1] Kessler Topaz Meltzer & Check is directly involved in this case and is working with the Australian lawyers, representing institutional investor clients, and providing litigation funding.

[2] A strike-out application is similar to a Motion to Dismiss in the United States.

THE SEC'S EXECUTIVE COMPENSATION CLAWBACK RULES WILL LIKELY INCREASE FINANCIAL REPORTING TRANSPARENCY AND ACCOUNTABILITY TO INVESTORS

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Congress Mandates the SEC to Develop Clawback Rules

For several decades, Congress has demonstrated a clear intent to give the SEC the authority to claw back executive compensation that is awarded based on a company's false financial reporting. Indeed, Section 304 of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"), which was enacted in the wake of the "dotcom" market crash which exposed massive frauds involving Enron, WoldCom, and Tyco, among others, instructs that if a public company issues an accounting restatement due to its material noncompliance with financial reporting requirements — *resulting from misconduct* — the company's chief executive officer and chief financial officer must repay "any bonus or other incentive-based or equity-based compensation" they received during the year following the false financial statement, as well as any profits realized from their sales of the company's stock during that time.[1]

In 2010, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") in the wake of the Great Recession. Along with many other provisions intended to improve the financial regulatory system and protect consumers and investors, the Dodd-Frank Act added Section 10D to the Securities Exchange Act of 1934 (the "Exchange Act"), instructing the SEC to develop expanded clawback rules (to be adopted in turn by U.S. securities exchanges). Specifically, Section 10D of the Exchange Act provides that the rules should require companies to implement a policy providing that, if a company is required to restate its financial reports due to material noncompliance with reporting requirements, the company must claw back from *any* executive officer the incentive-based compensation awarded in excess of what would have been paid under the restated reports during the *three-year* period preceding the restatements.[2] Notably, unlike Section 304 of the Sarbanes-Oxley Act, Section 10D does *not* specify that these new clawback rules should apply only in the case of misconduct.

In July 2015, the SEC finally proposed its specific clawback rules as required by Section 10D. Under the proposed rules, companies restating their financial reports would be required to, among other things, claw back any incentive-based compensation that executive officers would not have received under the restated financial reports, such as bonuses tied to accounting metrics that are later revealed to be inaccurate.[3] The proposed rules further stated that "[r]ecovery would be required from current and former executive officers who received incentive-based compensation during the three fiscal years preceding the date on which the company is required to prepare an accounting restatement to correct a material error."[4]

While these proposed rules were not initially adopted, in October 2021 — several months after Gary Gensler was confirmed as the new SEC Chair — the SEC revived the rules and reopened the public comment period.[5]

The Final Clawback Rules

On October 26, 2022, following the conclusion of the comment period, the SEC voted 3-2 to adopt the final Clawback Rules. As adopted, the Clawback Rules are even broader — and therefore more protective of investors — than the rules previously proposed. Specifically, the Clawback Rules provide that, when a company is required to prepare an accounting restatement due to prior error, it must claw back excess incentive-based compensation awarded within the three fiscal years preceding the date the

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[1] *See* 15 U.S.C. § 7243(a).

[2] *See* 15 U.S.C. § 78j-4.

[3] *See* U.S. Securities and Exchange Commission, *SEC Proposes Rules Requiring Companies to Adopt Clawback Policies on Executive Compensation* (July 1, 2015), https://www.sec.gov/news/press-release/2015-136.

[4] *Id.*

[5] *See* U.S. Securities and Exchange Commission, *Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation* (Oct. 14, 2021), https://www.sec.gov/rules/proposed/2021/33-10998.pdf. In June 2022, the SEC reopened the public comment period on the proposed rules for a second time. *See* U.S. Securities and Exchange Commission, *Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation* (June 8, 2022), https://www.sec.gov/rules/proposed/2022/33-11071.pdf.

restatement was required — *regardless of whether the company's error was the result of fraud or other misconduct*.[6] Critically, the Clawback Rules apply *both* in cases of "Big R" restatements (that is, restatements due to errors that were material at the time) *and* in cases of "little r" restatements (restatements that correct errors that were not previously material, but would be material if left uncorrected or if the entirety of the error was adjusted for in the current period).[7]

The Clawback Rules further instruct national securities exchanges (such as the NASDAQ and New York Stock Exchange) to develop listing standards consistent with these rules, meaning that any public company that does not wish to be delisted will be forced to comply. The Clawback Rules will become effective 60 days after publication in the Federal Register, and the securities exchanges' new listing standards must become effective within one year after the Clawback Rules' publication in the Federal Register. Accordingly, listed companies will likely be required to adopt compliant clawback policies by the end of 2023 or beginning of 2024.

Possible Effects of the Clawback Rules

SEC Chairman Gensler has heralded the Clawback Rules as a means to "strengthen the transparency and quality of corporate financial statements, investor confidence in those statements, and the accountability of corporate executives to investors." [8]

Indeed, one of the most significant changes that the Clawback Rules will bring about is increased transparency, directing new focus to "little r" restatements. In recent years, companies have drifted away from reporting inaccuracies through "Big R" restatements, which require companies to file Form 8-K reports with the SEC that draw investor attention to their accounting mistakes, in favor of "little r" restatements, which do not require separate filings with the SEC.[9] Between 2005 and 2020, "little r" restatements have grown from 34.8% of all restatements to 75.7%.[10] The steep decline in more serious restatements

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[6] *See* U.S. Securities and Exchange Commission, *Listing Standards for Recovery of Erroneously Awarded Compensation* (Oct. 26, 2022), at 133-34, https://www.sec.gov/rules/final/2022/33-11126.pdf.

[7] *See id.* at 134. As noted below, "little r" restatements do not require immediate restatement, but may be restated when the company files its next financial report that would include the incorrect financial results.

[8] Chris Matthews, *SEC adopts rules mandating clawbacks of executive pay*, MarketWatch (Oct. 26, 2022), https://www.marketwatch.com/story/sec-set-to-adopt-rules-mandating-clawbacks-of-executive-pay-11666794288/.

[9] *See* Jean Eaglesham, *Shh! Companies are Fixing Accounting Errors Quietly*, The Wall Street Journal (Dec. 5, 2019), https://www.wsj.com/articles/shh-companies-are-fixing-accounting-errors-quietly-11575541981.

[10] *See* Mark Maurer, *SEC Revives Proposal to Claw Back Executive Pay*, The Wall Street Journal (Oct. 14, 2021), https://www.wsj.com/articles/sec-revives-proposal-to-claw-back-executive-pay-11634231515?mod=business_minor_pos14.

INSTITUTIONAL INVESTOR
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KEYNOTE SPEAKER

Boris Johnson

Former Prime Minister of the United Kingdom

INSTITUTIONAL GOVERNANCE AND LEGAL SYMPOSIUM

MARCH 9, 2023 / AMSTERDAM

Institutional Investor, in partnership with Kessler Topaz Meltzer & Check, LLP (KTMC) is holding our fifth annual gathering of senior legal executives at asset management firms. This meeting will provide a private, closed-door environment to discuss issues related to governance, shareholder engagement and legal and compliance.

Preliminary Topics

We are excited to bring you the first look of our 2023 discussion topics. Topics under consideration include:

- Private Equity: Potential for Conflict of Interest
- Corporate Governance Best Practice for Asset Managers
- Global Sustainable Investing: How Does a Firm Stay Compliant in Multiple Jurisdictions?
- Geopolitical Risks
- Litigation Case Study
- The Increasingly Complex Landscape of Asset Recovery

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PRICE IMPACT AND THE SPEED OF INFORMATION: RECENT DEVELOPMENTS IN SECURITIES CLASS CERTIFICATION

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the pleading (loss causation) and class certification contexts — that the analysis or commentary regarding previously released information cannot cause a price impact in an efficient market. For example, in *In re Chicago Bridge & Iron Co. N.V. Securities Litigation*, the court rejected the defendants' price impact challenge, explaining that "'[w]hile it is generally true that in an efficient market, any information released to the public is presumed to be immediately digested and incorporated into the price of a security, it is plausible that complex economic data understandable only through expert analysis may not be readily digestible by the marketplace.'"[4] The *Chicago Bridge* court recognized that the mere echoing of already-public information by an analyst cannot be corrective, but a "third-party's *analysis* of a company's already-public financial information can[] contribute new information to the marketplace."[5]

The Ninth Circuit in *In re BofI Holding, Inc. Securities Litigation* similarly observed that "some information, although nominally available to the public, can still be 'new' if the market has not previously understood its significance."[6] As the Ninth Circuit further explained, the fact that an alleged disclosure "relie[s] on nominally public information does not, on its own, preclude [it] from qualifying as [a] corrective disclosure" as "the time and effort it took to compile this information make it plausible that the [disclosure] provided new information to the market, even though all of the underlying data was publicly available."[7] The court acknowledged that in some cases, "someone" — often a securities analyst — needs to put the pieces together before the market [can] appreciate [the] import" of particular data or other information about a company's sales, businesses, or operations.[8]

In *Billhofer v. Flamel Technologies, S.A.*, the court rejected the defendants' attempt to rebut the *Basic* presumption by arguing that an analyst report discussing results from an adverse clinical drug trial was not corrective because the results had been previously available to the public.[9] The court explained that "*Basic* does not require a perfectly efficient market or require a court to draw purely academic and unfounded conclusions regarding the spread of information."[10] Thus, the court ruled: "The results of the CASPER trial were not 'publicly available' simply because they were posted in an obscure location on the internet. The CASPER trial results became publicly available when an analyst . . . issued a research report on the disappointing clinical results."[11]

Below we examine two recent district court decisions from 2022 in which the courts rejected the price impact arguments raised by the defendants and provided important analysis of the issues posed by the dissemination of complex or confusing information as well as the time it can take new information to impact a stock's market price.

Allegheny County Employees' Retirement System v. Energy Transfer LP

In *Allegheny County Employees' Retirement System v. Energy Transfer LP*, the plaintiff alleged that Energy Transfer and its senior officers made a series of false statements regarding Energy Transfer's construction of three natural gas pipelines in Pennsylvania.[12] In denying the defendants' motion to dismiss at the pleadings stage, Judge Gerald McHugh of the Eastern District of Pennsylvania sustained the plaintiff's allegations that a series of corrective disclosures resulted in a stock price decline and were sufficient to establish loss causation.[13] When the plaintiff subsequently moved for class certification, the defendants again challenged the corrective disclosures, contending that they had "severed the link" between the misrepresentation and the loss by demonstrating that the disclosures had no impact on Energy Transfer's stock price.[14] The court explained that the "key disputes" regarding price impact focused "on how long a time period following an event the Court should consider in determining if there was a price impact, taking into account the significance of intervening news or events that might either confound the market, and what is reasonably necessary to comprehend the significance of a disclosure."[15]

As a threshold matter, the defendants argued that "price impact under an efficient market presumption must take place almost instantaneously with the disclosure of new information to the market."[16] The court disagreed, stating: "The efficient price is not set by an invisible hand that instantly reflects new information in a security's price, but through the dynamic, high-volume exchange of a security over an appropriate window of time."[17] As Judge McHugh explained: "[T]he nature

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[4] 2020 WL 1329354, at *7 (S.D.N.Y. Mar. 23, 2020) (quoting *Pub. Emps. Ret. Sys. Of Miss. v. Amedisys, Inc.*, 769 F.3d 313, 323 (5th Cir. 2014) (*Wall Street Journal* article analyzing public Medicare records constituted corrective disclosure because underlying information "had little to no probative value in its native state").

[5] *Id.*

[6] 977 F.3d 781, 794 (9th Cir. 2020).

[7] *Id.* at 795.

[8] *Id.*

[9] 281 F.R.D. 150, 160 (S.D.N.Y. 2012).

[10] *Id.*

[11] *Id.*

[12] No. CV 20-200, 2022 WL 3597200 (E.D. Pa. Aug. 23, 2022).

[13] *Id.*

[14] *Id.* at *4.

[15] *Id.*

[16] *Id.* at *6.

PRICE IMPACT AND THE SPEED OF INFORMATION: RECENT DEVELOPMENTS IN SECURITIES CLASS CERTIFICATION

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and timing of the disclosures here, the lack of transparency, the attempts by Energy Transfer to cast damaging information in a positive light, and the obvious confusion in the market at certain points require a more precise and nuanced analysis of when the market would have absorbed relevant information."[18]

The first corrective disclosure alleged by the plaintiff was Energy Transfer's announcement during an earnings call on Thursday, August 9, 2018, that the company would only be able to meet the stated construction deadlines for one of its new pipelines through the temporary use of old 12-inch pipelines that were already in place, instead of the 20-inch pipelines called for in the plans.[19] Energy Transfer did not indicate how long the 12-inch pipeline would be used for or quantify the resulting reduction in throughput capacity.[20] The following day — Friday, August 10 — two analysts published reports that revised the anticipated earnings for the company based on the disclosed information.[21] By the end of the day on Monday, August 13, Energy Transfer's stock price had declined by 5.6% from its close on Wednesday, August 8 (i.e., the day before the corrective disclosure) — a statistically significant decline over this period of three trading days.[22]

In challenging this disclosure, the defendants argued that they had severed the link between the allegedly corrective information and the share price because the company's share price did not decline in a statistically significant manner on the day of the disclosure (August 9) or the following day (August 10), and the decline on the following Monday (August 13) was "too distant to support a finding of price impact under efficient market conditions."[23] In response, the plaintiffs argued that the August 9 earnings call did not provide a clear enough disclosure to impact the market; rather, "it was the analysts' interest and report of August 10 that clarified the disclosure sufficiently enough for the market to quantify its impact on price and, from there, cause the drop in price."[24] In other words, it took three trading days for the information regarding the status of the pipelines to impact the stock price.

The court found that the defendants failed to establish a lack of price impact and therefore did not rebut the presumption of reliance with respect to this corrective disclosure. As Judge McHugh explained, "when Energy Transfer discussed the use of the 12-inch pipeline on their call with investors on August 9, 2018, the disclosure was artfully crafted and required *additional clarifying information*."[25] This additional clarifying information was provided in part through the August 10, 2018 analyst reports.[26] After a "private discussion" with Energy Transfer, Wolfe Research published a report stating that the company's disclosure "was confusing," that "transparency and disclosure on this project are very low," and that there would likely be a one-year delay until the pipeline reached full capacity due to the re-purposing of the old, smaller diameter pipes.[27] Also on August 10, 2018, Wells Fargo published an analyst report that similarly noted that Energy Transfer's statements regarding the piping that would be used for the project "confuse[d] the market," and required follow-up from Wells Fargo analysts "to gain clarity."[28] Through further inquiry of Energy Transfer, the Wells Fargo report concluded that the pipeline's capacity would be

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[17] *Id.* Judge McHugh observed that the Third Circuit has "recognized a need for flexibility," citing to *In re Merck & Co. Sec. Litig.*, 432 F.3d 261, 269 (3d Cir. 2005), where the Third Circuit referred to "the period immediately following disclosure," but added "this does not mean instantaneously of course," as well as *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 635 (3d Cir. 2011), where the Third Circuit noted, "[t]hat some information took two days to affect the price does not undermine a finding of efficiency." *Id.* Judge McHugh further noted that a "recent case from this district concluded that a two-day window was relevant" citing to *Pelletier v. Endo Int'l PLC*, 338 F.R.D. 446, 486 (E.D. Pa. 2021), which held that "[w]hile most public information *should* be absorbed into an efficient market quickly, the related price impact may occur more slowly *where clarifying or contextualizing information is disclosed later.*"

[18] *Id.* at *6.

[19] *Id.* at *11.

[20] *Id.*

[21] *Id.*

[22] *Id.*

[23] *Energy Transfer LP*, 2022 WL 3597200, at *11.

[24] *Id.*

[25] *Id.* at *12 (emphasis added).

[26] *Id.* at *12-13.

[27] *Id.* at *12.

[28] *Id.* at *13.

reduced by nearly 65% compared to what the company had told investors during the class period, the projected cost of the project would be nearly double what the company had represented, and full service of the pipeline would start two years later than previously expected.[29]

Judge McHugh concluded that "[g]iven the confusion described on the earnings call, and the need for journalists and analysts to follow up, a delay in the market absorbing the news does not on its own suffice to sever the link."[30] As the court continued, "it bears emphasis that the critical information was not announced by the company itself, but through analysts' reports, a factor that courts have deemed relevant in looking to time periods beyond a day."[31] The court was unpersuaded by the defendants' claims that the analysts did not change their overall outlook with respect to Energy Transfer, noting that the "conclusions and recommendations [the analysts] draw are distinct from the facts and figures they report," further stating:

> Investors, particularly sophisticated investors, will make their own judgments based on the information made available through the investigation and quantification work of the analysts. The information reported here, independent of the analysts' conclusions, would have been objectively concerning to market participants because it quantified delays and identified an impact on profitability.[32]

The second corrective disclosure alleged by the plaintiff was related to a stop work order that was issued in the weeks following an explosion on one of the company's pipelines.[33] The plaintiff alleged that on Saturday, October 27, 2018, the *Associated Press* republished an article discussing some of the controversy

(continued on page 12)

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[29] *Id.*

[30] *Id.*

[31] *Id.*

[32] *Id.* at *14. The court further found that "the justifications advanced by Plaintiffs' expert in his deposition for applying a multi-day window are sensible given all the surrounding circumstances" and observed that "[u]nder *Amgen,* the issue of when information 'credibly entered the market' is a matter for trial.'" *Id.* (quoting *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, 568 U.S. 455 at 481-82 (2013)).

[33] *Id.*

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(continued from page 11)

surrounding one of Energy Transfer's pipelines and then, on Monday, October 29, 2018, the Pennsylvania Department of Environmental Protection issued a stop work order for a separate Energy Transfer pipeline.[34] There was a statistically significant decline in Energy Transfer's share price between market close on Friday, October 26, 2018, and Monday, October 29, 2018.[35] The defendants argued that because the article was originally published on October 21 and the stop work order was not published until October 30, neither of the pieces of allegedly corrective information could be linked to the share price decline on October 29.[36]

The court acknowledged that the article at issue was originally published by the *Pittsburgh Post-Gazette* on October 21, 2018, but explained that the "*Associated Press*'s October 27th republication of the article from the *Pittsburgh Post-Gazette* necessarily broadcast the controversy over the September explosion to a wider audience: the *Gazette* is a regional publication in Western Pennsylvania which as of October 2018 published print editions three days a week, while the *Associated Press* is a leading national wire service with broad distribution."[37] With respect to the Pennsylvania Department of Environmental Protection stop work order, the parties disputed when news of this order was publicized to the market and submitted competing evidence on this point.[38]

Ultimately, the court found that while " [n]either side's analysis of the timing issue is particularly illuminating[,]" a "close consideration of the record leads [the court] to conclude that Defendants have not rebutted the presumption of market reliance."[39] Focusing first on the stop work order, the court noted that "a wire service that follows state news was in possession of the press release on October 29th and published the contents of the release on that same date as an item of news."[40] Turning to the news articles, the court stated:

> In my view, the *Associated Press* reprint has significance in three respects. First, the fact that the story was deemed worthy of reprint would give it greater significance. Second, as noted above, it would bring the story to a wider, national audience. Finally, it would heighten awareness that the project was one to watch closely, increasing the likelihood that concerned investors would more closely monitor project news and the DEP website.[41]

Therefore, the court concluded that the defendants had not severed the link with respect to this corrective disclosure:

> On the record as it stands, the same day a stop work order was publicly issued and on the first trading day after a problematic story was widely distributed, Energy Transfer's stock decreased by a substantial amount relative to the energy index. As with the August 2018 disclosure, Defendants do not offer a competing explanation sufficient to sever the link between the disclosures and the alleged misrepresentations.[42]

The third corrective disclosure alleged by the plaintiff was a December 2018 announcement by the Chester County District Attorney of an investigation into Energy Transfer for its role in causing sinkholes in Pennsylvania.[43] Several media outlets reported this announcement on Wednesday, December 19, 2018 and Thursday, December 20, 2018 through various sources, including Twitter, AM radio, news wires, trade news publications, and daily newspapers.[44] By market close on Friday, December 21, Energy Transfer's stock had declined from its closing price on Tuesday, December 18.[45]

In challenging this disclosure, the defendants argued that the news regarding the investigation was widely disseminated as of Wednesday, December 19, and thus the decline on Friday,

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[34] *Id.*

[35] *Energy Transfer LP*, 2022 WL 3597200, at *14.

[36] *Id.* at *15-16.

[37] *Id.* at *15.

[38] *Id.*

[39] *Id.* at *16.

[40] *Id.*

[41] *Energy Transfer LP*, 2022 WL 3597200, at *17.

[42] *Id.*

[43] *Id.*

[44] *Id.*

[45] *Id.*

December 21 was "too distant in time from the December 19th corrective disclosure to be the product of an efficient market."[46] The court sided with the plaintiffs, stating:

> The factual nuances surrounding this disclosure are complex, and the issue is a close one, but on balance there is a substantial and unexplained drop on December 21st that corresponds to Energy Transfer's internal expressions of concern over traffic about the story on social media. On that basis I conclude it has failed to rebut the presumption.[47]

As the court explained, on December 19, 2018, at 11:36 am, the Chester County District Attorney announced an investigation into Energy Transfer and news outlets disseminated the story beginning that morning.[48] After market close on December 19, the *Associated Press* ran an article on the announcement.[49] Trading in Energy Transfer's stock on December 20 showed mixed results.[50] Then, just before market close on December 20, Reuters published a story about the investigation.[51] Energy Transfer's stock declined precipitously on December 21.[52] The plaintiffs' expert asserted that the decline on December 21 was statistically significant and the defendants' expert was "notably silent on the statistical significance of the price movement on December 21st, only restating her contention as to distance in time" from the initial dissemination of the allegedly corrective information.[53] Thus, the court stated, "[t]he question then becomes whether the drop on December 21st is too remote in time from the initial announcement of the investigation, and whether wide dissemination of the news on the 19th and 20th would have blunted the impact of the disclosure."[54]

In establishing the link between the announcement and the decline in Energy Transfer's stock price, the plaintiff pointed to "a flurry of social media posts being tracked internally by Energy Transfer," asserting that this "showed widespread interest in the news on December 21st."[55] Relying in part on this evidence, the court explained:

> The Reuters story went online less than thirty minutes before the close of trading on December 20th. Defendants are correct that the market reacts almost immediately to certain types of information, but immediate reaction is more likely to occur when a listed company itself releases information or the information is quantitative in nature such as earnings. The decline on December 21st occurred contemporaneously with substantial online dissemination and discussion of the Hogan investigation.[56]

The court also emphasized that the defendants "offer no plausible alternative explanation for the declines that day in comparison to the sector as a whole."[57] The court concluded, therefore, that the defendants had failed to sever the link and rebut the presumption of reliance.[58]

In re Celgene Corporation Securities Litigation

In *In re Celgene Corporation Securities Litigation*, the plaintiff alleged that Celgene and certain of its officers made materially false and misleading statements regarding the company's progress toward filing a new drug application with the Food and Drug Administration (FDA) for ozanimod, a multiple sclerosis drug.[59] Specifically, the plaintiff claimed that Celgene concealed from investors the belated discovery of a metabolite (i.e., a chemical compound formed through the metabolism of ozanimod) that required additional testing and jeopardized the company's timeline for FDA submission and approval. After the court granted the plaintiff's motion for class certification, the defendants filed a motion to modify the certified class period, arguing that the court had failed to consider all of the relevant evidence concerning price impact.[60]

The plaintiff alleged two corrective disclosures regarding the failed ozanimod new drug application and subsequent stock price declines. First, on February 28, 2018, Celgene disclosed that the FDA had refused to accept the ozanimod application for filing, but gave no reason for the FDA's decision.[61] Then, on April 29, 2018, Morgan Stanley published an analyst report concluding that the FDA required additional toxicology testing of the ozanimod metabolite — disclosed for the first time four days earlier — which could delay the refiling of its new drug application by up to three years.[62]

In its April 29 report, Morgan Stanley analyzed data from toxicology studies for ozanimod's previously-known metabolites to conclude that the required toxicology studies for the newly discovered metabolite would cause a delay of one to three years in Celgene's resubmission of the ozanimod new drug application.[63] The data had been previously released on posters

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46 *Id.*

47 *Energy Transfer LP*, 2022 WL 3597200, at *17.

48 *Id.*

49 *Id.*

50 *Id.*

51 *Id.*

52 *Id.* at *18.

53 *Energy Transfer LP*, 2022 WL 3597200, at *18.

54 *Id.*

55 *Id.*

56 *Id.* at *19.

57 *Id.*

58 *Id.*

59 No. 18-cv-4772 (D.N.J. Apr. 13, 2022) (ECF No. 198), Opinion & Order.

60 *Id.*

61 *Id.* at 3.

62 *Id.*

63 *Id.* at 8-9.

PRICE IMPACT AND THE SPEED OF INFORMATION: RECENT DEVELOPMENTS IN SECURITIES CLASS CERTIFICATION

(continued from page 13)

displayed at the 2013 and 2014 annual meetings of the American Association of Neurology, but it had not been disseminated outside of these conferences.[64] The defendants argued that the alleged corrective information disclosed through the Morgan Stanley report was limited to the length of the delay of the resubmission to the FDA, and that because other analysts had already predicted a delay of up to three years, they had severed the link between misrepresentation and loss.[65] Judge John M. Vazquez agreed that the defendants had "sever[ed] the link with respect to the length of the delay as the corrective disclosure," but he rejected the defendants' framing of the alleged corrective information as "too narrow."[66] The court noted the plaintiff's allegation that "analysts attributed [the stock price] decline [on April 30, 2018] to the revelations that resulted from Morgan Stanley's detailed *specialized analysis and digestion* of Celgene's informationally-complex AAN disclosure" which included "new information as to why the additional studies were necessary" and "the types of studies needed."[67]

Judge Vazquez rejected the defendants' argument that this information was not actually new because Morgan Stanley had simply relied on previously-available information and, therefore, its report was "nothing more than analyst commentary based on previously available facts."[68] The court explained that he "cannot conclude that the posters were publicly available before the April 29 report."[69] As the court noted: "[I]t appears that Morgan Stanley took public information (FDA guidance and Receptos S-1) and (at most) 'nominally' public information (the 2013 and 2014 AAN posters) to piece together a more detailed and new conclusion in comparison to other analysts. This amounts to a corrective disclosure."[70] The court continued: "Further, because the April 29 report synthesized information to reach a new opinion, the market reaction to the underlying information addressed in the report is not the same as the market reaction to the April 29 report itself."[71] Thus, the court concluded that "it appears, more likely than not, that the April 29 report provided the market with new, corrective information about the Metabolite discovery" and thus found that the defendants had failed to "sever the link between the alleged misrepresentations and the stock price."[72]

Conclusion

As these recent decisions demonstrate, in the wake of *Basic* and *Halliburton II*, the courts have adopted a flexible approach to evaluating both the time it takes for new, value-relevant information to impact a company's stock price and the ability of third-party analyses or commentaries regarding previously-disclosed information to serve as corrective disclosures. These cases underscore that the disclosure of information can take time to impact the price of a security — even in an efficient market — especially when that information is obscure or complex, and that information may also need to be analyzed or digested by a securities analyst before the market can understand its import and the stock price can react accordingly. ■

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[64] *Id.*

[65] *Id.* at 9.

[66] *Celgene*, Opinion & Order at 9-10.

[67] *Id.* at 9-10 (emphasis added).

[68] *Id.* at 11.

[69] *Id.*

[70] *Celgene*, Opinion & Order at 12.

[71] *Id.*

[72] *Id.* at 12-13.

EXPANDING THE DGCL'S SECTION 102(B)(7) SANCTUARY FOR MISBEHAVING FIDUCIARIES: THE FUTURE OF PROSECUTING SENIOR OFFICER MISCONDUCT

(continued from page 3)

with the U.S. Securities and Exchange Commission, and also any individual who has consented to be designated as an officer to accept service of process.[6]

Second, just like for directors, a Section 102(b)(7) provision exculpates only an officer's breach of their fiduciary duty of care; exculpation does not extend to a breach of the duty of loyalty.[7]

Third, Section 102(b)(7) does not exculpate "acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law."[8] Delaware courts have held that this provision restricts Section 102(b)(7) only to cover misconduct that constitutes simple or gross negligence, and this limitation will apply equally to directors and officers.[9]

Fourth, unlike the protections available for directors, a Section 102(b)(7) provision can exculpate officers from liability only for direct claims brought by stockholders, *i.e.*, claims that the officer breached one or more fiduciary duties owed directly to stockholders. Officers are not exculpated for derivative claims, *i.e.*, claims that the officer breached one or more fiduciary duties owed to the corporation, or other claims brought by or on behalf of the corporation.[10] This limitation is significant because it means the board of directors (or shareholders, if the board fails to act) will maintain their present ability to bring claims against senior officers for misconduct that causes harm to the corporation.

Fifth, as is the case for directors, Section 102(b)(7) applies only to exculpate officers from liability for monetary damages; the statute's plain language does not prohibit awards of equitable remedies against directors or officers.[11]

One recent lawsuit has raised important questions about whether all classes of stockholders, even those without standard voting rights, are entitled to vote on the adoption of a new or amended Section 102(b)(7) provision. In *Electrical Workers Pension Fund, Local 103, I.B.E.W., v. Fox Corporation*, stockholders of Class A Common Stock of Fox Corporation ("Fox") allege that Fox improperly adopted a Section 102(b)(7) provision applicable to officers without obtaining a vote of Class A shares.[12] Although Fox's Class A Common Stock carries no standard voting rights, the Class A stockholders argue that amending Fox's charter to adopt a Section 102(b)(7) provision applicable to officers is an action fundamentally affecting all stockholders' rights under 8 *Del. C.* § 242(b)(2), and therefore requires the affirmative votes of all classes of stockholders, including Class A. The Class A stockholders allege that by obtaining only a vote of the Class B stockholders, a significant portion of whom are executive officers who would benefit from the new provision, Fox unlawfully insulated its officers from personal liability. If a company can lawfully implement a Section 102(b)(7) provision for senior officers based only on votes from the class of stock the officers control, then stockholders could have very limited prospects for prosecuting future officer misconduct.

In general, stockholders should consider how a Section 102(b)(7) sanctuary could influence the behavior and decision-making of senior officers. At best, officers acting within the Section 102(b)(7) sanctuary will act in good faith with the promise of limited personal liability in the event their decisions turn out other than as expected. At worst, the Section 102(b)(7) sanctuary could embolden or obfuscate officer misconduct. Time will tell whether extending Section 102(b)(7) exculpation to officers benefits corporations, stockholders, and the officers themselves, or just the latter. ■

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[6] Del. Code tit. 10 § 3114 (1953).

[7] Del. Code Ann. tit. 8 § 102(b)(7)(i) (2022).

[8] Del. Code Ann. tit. 8 § 102(b)(7)(ii) (2022).

[9] *See Malpiede v. Townson*, 780 A.2d 1075, 1093, 1094-95 (Del. 2001).

[10] Section 102(b)(7)'s protection does not extend to "[a]n officer in any action by or in the right of the corporation." Del. Code Ann. tit. 8 § 102(b)(7)(v) (2022).

[11] Del. Code Ann. tit. 8 § 102(b)(7) (2022).

[12] Complaint, *Electrical Workers Pension Fund, Local 103, I.B.E.W., v. Fox Corporation*, Case No. 2022-1007 (Del. Ch. 2022).

KTMC CLASS CERTIFICATION VICTORY IN MAZDA DEFECTIVE WATER PUMP LITIGATION DEMONSTRATES WINNING STRATEGY FOR MULTISTATE CLASS ACTIONS

(continued from page 3)

Mazza v. American Honda Motor Company and Its Impact on Nationwide Class Actions

In *Mazza*, plaintiffs purchased certain Acura vehicles equipped with a Collision Mitigation Braking System (CMBS). Plaintiffs alleged that the company had not warned consumers that the system's three stages could overlap, that the system may not warn drivers in time to avoid an accident, and that the system would disengage in bad weather. Plaintiffs sought relief under the California Unfair Competition Law and the Consumer Legal Remedies Act and moved to certify a nationwide class of consumers pursuant to California's consumer protection laws. The District Court granted certification.

The Ninth Circuit disagreed. Applying California's choice of law rules, it held that there were material differences in the various consumer protection laws and each state had an interest in having its own law applied (and such interest outweighed California's interest in applying its own law to out-of-state purchasers). Having found that certification of a nationwide class pursuing claims under California's consumer protection statute was improper, the Ninth Circuit next determined whether separate classes pursuant to the consumer protection laws of the forty-four different states at issue could be certified. The panel determined material differences in the state consumer

protection laws made certification inappropriate. Because the laws of numerous different states would have to be applied, the class was not sufficiently cohesive and the Ninth Circuit vacated the class certification decision.[2]

Kessler Topaz's Success in New Strategy for Certifying Multistate Class Actions

After *Mazza*, one option available to plaintiffs is to bring claims on behalf of state-specific classes, and seek certification of those classes based on common, predominating questions that can be answered with classwide proof. This allows that a jury to make factual findings in a single trial to determine liability under each state's laws.

Using this strategy, in 2019, Kessler Topaz brought an action in the Central District of California, *Sonneveldt v. Mazda Motor of America, Inc., et al.*, asserting claims under the laws of nine states. In *Sonneveldt*, Kessler Topaz asserted fraud and deceptive trade practice claims on behalf of purchasers of 2008-2015 Mazda CX-9 and 2009-2013 Mazda6 vehicles with 3.5L or 3.7L Cyclone engines (the "Class Vehicles") across nine states who allege that their vehicles' internal water pumps contain an identical design defect in the mechanical seal that causes the water pumps to prematurely fail before the useful service life of the Class Vehicles (the "Defect").

In March 2022, Kessler Topaz moved to certify nine state classes seeking recovery under certain common law fraud and consumer protection laws, as well as a tenth class seeking recovery under California's Song-Beverly Act. In their opening brief, Plaintiffs were careful to specifically allege why class certification was appropriate pursuant to the law of each particular state. One of the ways that Mazda attempted to defeat certification was by pointing to alleged differences in the state laws — specifically, arguing that they differed in their requirements for materiality, reliance, causation, privity, and manifestation. Plaintiffs countered by highlighting the similarity of the state laws at issue — throughout their briefing, Plaintiffs diligently cited each relevant state law, emphasizing their cohesiveness and how their requirements could be satisfied with common proof.

In a 77-page opinion, the court granted certification of seven state-wide consumer protection classes, as well as an eighth class of California purchasers under Song-Beverly. Plaintiffs achieved this success by demonstrating to the court that common questions regarding the existence of the defect, Mazda's failure to disclose it, and the harm suffered by members of the Classes predominated each of the state law claims for the state-specific Classes. In addition, although Plaintiffs sought relief pursuant to different state laws, their claims could be proven with common, classwide proof, and could be adjudicated in a straightforward, efficient manner in a single trial. Resolving these core legal and factual issues in one proceeding is also more efficient than conducting redundant proceedings and unnecessarily expending judicial resources in courts across the country, with the attendant risk of yielding inconsistent rulings.

By waging this state-by-state fight for each Class, Kessler Topaz was able to successfully counter Mazda's attempt to shift the focus away from what the Plaintiffs have in common — namely, Mazda's fraudulent and deceptive conduct and the economic harm that resulted — and achieve certification, moving Plaintiffs and members of the Classes one step closer to their day in court. This success shows that a well-informed strategy and effective legal arguments are key to overcoming the legal barriers standing between consumers and justice. ■

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[2] This opposition to nationwide classes enforcing state laws has expanded beyond consumer protection statues. The Ninth Circuit reached a similar conclusion when considering a proposed nationwide class seeking relief under state antitrust laws in *Stromberg v. Qualcomm Inc.*, 14 F.4th 1059 (9th Cir. 2021).

KESSLER TOPAZ ACHIEVES SIGNIFICANT VICTORY IN SECURITIES FRAUD CASE INVOLVING ZILLOW OFFERS DEBACLE

(continued from page 2)

undertook a series of drastic and risky actions, including applying large "overlays" on top of the values generated by Zillow's pricing algorithms, which significantly increased purchase offers. Not surprisingly, many homeowners accepted Zillow's inflated offers and soon the Company was touting the "strong demand" for Zillow Offers to investors while concealing the risky overlays that had actually driven growth.

Within months, Defendants' reckless bets caught up to them. By November 2, 2021, Zillow announced that it was shuttering Zillow Offers, taking a $569 million impairment charge because it had overpaid for 18,000 homes, and axing 25% of its workforce. In response, Zillow's stock prices plummeted, causing significant investor losses. Market commentators expressed outrage, calling the announcement a "financial disaster," a "debacle" and declaring that "management should be accountable."

On May 12, 2022, Plaintiff filed the operative complaint ("Complaint") in the action on behalf of a class of investors who purchased Zillow's stocks[2] from August 5, 2021 to November 2, 2021, inclusive. Defendants moved to dismiss the Complaint in its entirety on July 11, 2022. On December 7, 2022, Judge Zilly denied Defendants' motion as to all but one statement. The case will now proceed to discovery.

The Zillow Offers Debacle

Traditionally, Zillow made money by selling advertisements to real estate agents. But by 2018, Zillow's core business had slowed and its stock prices were stagnating. That year, Zillow announced that it would enter the "iBuyer" market, thereby providing the Company with a brand new revenue source to reaccelerate growth. Over the next few years, Zillow quickly expanded Zillow Offers; by mid-2021, it accounted for 60% of Zillow's revenues.

Several factors were critical to Zillow Offers' success. *First*, its pricing models had to accurately predict home values at the time of resale. If it made offers that were too high, it risked overpaying and losing money. If it made offers that were too low, sellers would not accept and the business would not grow. *Second*, the longer Zillow took to renovate a home, the higher its holding costs. Zillow thus had to drive down costs by renovating homes for less, and flipping them quickly. *Third*, the iBuyer market was already crowded when Zillow joined, with competitors including Opendoor, Offerpad, and Redfin Now. To catch up to competitors, Zillow had to quickly scale its business by purchasing more homes.

To achieve scale, in 2021 Zillow's executives set lofty volume targets for Zillow Offers. But by the end of the first quarter of 2021, the Company was significantly behind target, causing executives to internally declare a "code red." In Spring 2021, Zillow launched a secret initiative called "Project Ketchup," a play on the words "catch up," to speed up the pace of home purchases. Through Project Ketchup, Zillow applied "overlays," (at times referred to internally as "offer calibrations") — sometimes as high as 700 basis points — on top of the values generated by the Company's algorithms to push offer prices higher. The overlays had their intended effect, quickly doubling and then quadrupling Zillow Offers' purchase volumes. But the overlays also substantially increased the risk that Zillow had overpaid for homes.

Project Ketchup also included initiatives to drive down Zillow Offers' costs. In particular, through Project Ketchup, Zillow Offers reduced the rates it paid contractors and shrunk the scope of home renovations. The negative repercussions were swift, with contractors deprioritizing or outright refusing to work on Zillow Offers' projects. This, in turn, meant that Zillow could not get homes renovated quickly, causing them to linger on its books and drive up holding costs. In fact, the Complaint alleges that by June 2021, the Company had a massive (and undisclosed) backlog of homes needing renovation.

But when Defendants announced Zillow's second quarter 2021 ("2Q21") earnings on August 5, 2021 — the first day of the Class Period — they concealed both the risky overlays and the backlog of homes. Instead, Defendants

[2] This includes Zillow's Class C capital stock, which traded under the ticker symbol "Z" during the Class Period, and Class A common stock, which traded under the symbol "ZG" during the Class Period.

told investors that Zillow Offers' increased home purchase growth was the result of "progress" the Company had purportedly made in "improving" and "strengthening" its algorithmic pricing models. Defendants also attributed the volume growth to purported "strong demand" for Zillow Offers, all the while concealing the risky overlays that had driven that demand. In addition, in announcing 2Q21 earnings, Defendants also touted Zillow Offers' improved cost structure, boasting about the "durability" of its cost improvements. At the same time, Defendants concealed the severe negative impacts those purported "improvements" were having, including the large renovations backlog that was preventing Zillow Offers from quickly and efficiently reselling homes.

Within months, however, cracks in the façade began to emerge. First, on October 4, 2021, analyst RBC Capital Markets warned that its internal analyses in Phoenix suggested that Zillow had "meaningful inventory" that it "bought at too high a price." On October 17, 2021, Bloomberg reported that Zillow would pause its homes buying. Zillow confirmed the report the next day, blaming "a backlog in renovations." On November 1, 2021, KeyBanc reported that the majority of the homes in Zillow Offers' inventory were worth less than it paid for them. These disclosures sent Zillow's stock prices plummeting.

Then, on November 2, 2021, Defendants disclosed that they were shuttering Zillow Offers and laying off 25% of the Company's workforce. They also disclosed that Zillow would take an inventory write-down as high as $569 million, admitting that it had paid too much for a staggering 18,000 homes. On this news, Zillow's stock prices lost approximately a quarter of their value. Market commentators were outraged, calling the announcement a "debacle," a "major strategic retreat and a black eye," a "financial disaster," and declaring that "[m]anagement should be accountable." As one analyst summed it up, "Zillow (and the stock) paid dearly for its, arguably, reckless approach to share gains."

The Court's Opinion

Defendants moved to dismiss the Complaint on July 11, 2022, arguing that Plaintiff failed to adequately allege three elements of its 10(b) claim: falsity, scienter, and loss causation. Defendants also argued that certain statements were immunized from liability by the Private Securities Litigation Reform Act of 1995's ("PSLRA") "safe harbor" for forward-looking statements. On December 7, 2022, Judge Zilly issued an order rejecting the vast majority of Defendants' arguments.

Falsity

In their motion to dismiss, Defendants first argued that Plaintiff had failed to adequately allege falsity. In particular, Defendants argued that: (i) Plaintiff did not adequately allege that their statements were false or misleading; (ii) Defendants adequately disclosed the requisite information to investors; and (iii) some of the statements were inactionable "puffery."[3] The Court rejected each of these arguments.

First, Judge Zilly found that "Plaintiff has plausibly pleaded that the challenged statements would have been misleading to a reasonable investor."[4] In so holding, the Court reasoned that in making their statements that the Company's growth was driven by "sharpening" its pricing models, the Complaint alleged that "Defendants concealed the broader, more complicated, human-driven process implemented by Project Ketchup, as well as the resultant 'offer calibration' practice, and instead created the misleading impression that Zillow was still advancing its automation efforts."[5] The Court also upheld the alleged misrepresentations regarding Zillow's "durable operational improvements," explaining that they were alleged to be "misleading because Zillow could not sustain its cost cuts, which had caused contractors to de-prioritize or refuse Zillow's renovation jobs."[6] Finally, Judge Zilly held that the Complaint adequately alleged that Defendants' statements regarding strong consumer demand "were misleading because the higher volume of transactions did not result from consumer demand for Zillow Offers, but rather from the significant price overlays added to Zillow's pricing models, which drove up the rate of home acquisitions."[7]

Second, the Court rejected Defendants' contention that "they gave the market enough information to determine that Defendants used pricing overlays," explaining that "Defendants had a duty not to mislead the market to believe that Zillow was progressing automation for pricing and inventory decisions . . . when, as the CAC alleges, Zillow had introduced overlays that reduced automation."[8] The Court also credited the impressions that "analysts drew from Defendants' public statements," explaining that "[t]he perceptions of analysts are an acceptable measure of what reasonable investors would have understood."[9] Finally, with respect to Defendants' argument that they "disclosed to the market the truth about reduced payments to contractors," the Court found that "the disclosures cited by Defendants do not mention that contractors were refusing, stopping, or delaying jobs as a result of the reductions or that the

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[3] *Jaeger v. Zillow Group, Inc.,* 2022 WL 17486297, at *6 (W.D. Wash. Dec. 7, 2022).

[4] *Id.*

[5] *Id.*

[6] *Id.*

[7] *Id.* at *7.

[8] *Id.*

[9] *Id.*

KESSLER TOPAZ ACHIEVES SIGNIFICANT VICTORY IN SECURITIES FRAUD CASE INVOLVING ZILLOW OFFERS DEBACLE

(continued from page 19)

lower renovation costs might not be sustainable or were likely not durable."[10]

Third, Judge Zilly rejected Defendant' argument that their statements were mere "puffery."[11] In so holding, the Court explained that Defendants had focused on certain phrases out of context, "while ignoring the rest of the verbiage, which recites the number of home purchases during the first and second quarters of 2021, and draws a connection to 'strong customer demand' and 'progress . . . in strengthening our pricing models and automation.'"[12] In other words, the statements Defendants challenged "contain statements of fact and conclusions or projections drawn from facts; they are not puffery."[13]

Scienter

Defendants also argued that Plaintiff failed to adequately allege scienter — i.e., the requisite mental state. But as Judge Zilly explained, scienter can be satisfied through allegations "that defendants actually knew of, or had access to, information contradicting the challenged statements."[14] The Court found the Complaint met this standard. In so holding, the Court relied on allegations sourced from former employees ("FEs") of Zillow, which "indicat[ed] that Zillow's senior executives knew of Project Ketchup well before the Class Period."[15] It also found the FE allegations adequate to allege that "Defendants knew about, or acted in reckless disregard concerning, the inventory backlog."[16]

In finding scienter adequately pled, the Court also relied on the core operations doctrine, through which a court "may infer 'that facts critical to a business's core operations . . . are known to a company's key officers.'"[17] It explained that Plaintiff had alleged that "Zillow Offers was a core operation because it accounted for 60% of Zillow's revenue," "would drive [the Company's] future growth," and was "the primary stock sentiment driver."[18] These allegations, Judge Zilly found, "support[ed] an inference that the faltering or failure of Zillow Offers would not go unnoticed."[19] The Court further explained that, "[g]iven the sheer scope and magnitude of Project Ketchup and the pricing and inventory changes that resulted . . . a claim that Defendants' lack of knowledge about Project Ketchup would be an absurd concept."[20]

Loss Causation

Defendants also challenged loss causation — i.e., the causal connection between the misrepresentations and omissions and the losses sustained by a plaintiff. In particular, Defendants argued that the alleged corrective disclosures were insufficient because they did not directly disclose the overlays or that renovation cost cuts had caused the backlog. The Court declined to require that amount of specificity, instead holding that "Plaintiff sufficiently alleges that the 'truth became known' as a result of the various partial disclosures"[21] and "[a] resultant stock drop accompanied each of these disclosures." The Court also rejected Defendants' argument that loss causation was defeated because, after dropping following two of the corrective disclosures, Zillow's stock prices later recovered.[22]

Safe Harbor

Finally, Defendants' argued certain of their statements were immunized from liability by the PSLRA safe harbor. Under the safe harbor, a defendant is not "liable for a false or misleading statement if it is forward-looking and either is

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[10] *Id.*

[11] *Id.*

[12] *Id.* at *8.

[13] *Id.*

[14] *Id.* (citing *S. Ferry LP, No. 2 v. Killinger*, 542 F.3d 776, 786 (9th Cir. 2008)).

[15] *Id.*

[16] *Id.* at *9.

[17] *Id.* (quoting *S. Ferry*, 542 F.3d at 783).

[18] *Id.*

[19] *Id.* (citing *In re Iso Ray, Inc. Sec. Litig.*, 189 F. Supp. 3d 1057, 1078–79 (E.D. Wash. 2016).

[20] *Id.* (citing *SEB Inv. Mgmt. AB v. Align Tech., Inc.*, 485 F. Supp. 3d 1113, 1134 (N.D. Cal. 2020)).

[21] *Id.* at *10.

[22] *Id.* (citing *Brendon v. Allegiant Travel Co.*, 412 F. Supp. 3d 1244, 1264 (D. Nev. 2019); *Nathanson v. Polycom, Inc.*, 87 F. Supp. 3d 966, 985 (N.D. Cal. 2015)).

accompanied by cautionary language or is made without actual knowledge that it is false or misleading."[23] Defendants argued that certain statements fell within the safe harbor because: "(i) the phrases 'we expect' or 'going to be,' when inserted into a sentence, transform the entire statement into a forward-looking one; (ii) the word 'durable' is an intrinsically forward-looking term because it indicates that the current trend will continue into the future; and (iii) the phrase 'back on track' is inherently forward-looking."[24]

Judge Zilly found that each of these arguments "lacks merit."[25] The Court reasoned that, "[a] future-tense phrase does not automatically immunize a statement from containing separable, present- or backward-looking aspects, and simply appending 'magic words' does not itself obviate any potential to mislead investors."[26] Ultimately, the Court held that, "[t]o fall under the PSLRA's safe harbor, the statement must be forward-looking in substance, not merely in form, with no separable present- or backward-looking aspects."[27] The Court also found Defendants' cautionary language inadequate, explaining that, "[t]o the extent Defendants rely on generic warnings relating to their statements," Plaintiff alleged that they "were insufficient because the risks at issue had already materialized."[28]

Conclusion

Judge Zilly's opinion in *Jaeger v. Zillow Group, Inc.* is an important securities fraud precedent. Significantly, in upholding Plaintiffs' falsity allegations, the Court rejected Defendants' arguments that their disclosures shielded them from liability. It also found that scienter was adequately alleged based, in part, on the core operations doctrine. In addition, the Court rejected Defendants' argument that their statements were immunized by the PSLRA safe harbor because they contained future tense phrases. Instead, the Court made clear that, to fall under the safe harbor, a statement must be forward-looking in substance, not merely in form, and must have no separable present- or backward-looking aspects. ■

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[23] *Id.* at *4 (quoting *In re Quality Sys., Inc. Sec. Litig.*, 865 F.3d 1130, 1141 (9th Cir. 2017)).

[24] *Id.* at *5.

[25] *Id.*

[26] *Id.* (citing *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 575 U.S. 175, 193 (2015)).

[27] *Id.*

[28] *Id.* at *4 n.7 (citing *In re Harman Int'l Indus., Inc. Sec. Litig.*, 791 F.3d 90, 102–03 (D.C. Cir. 2015)).

THE SEC'S EXECUTIVE COMPENSATION CLAWBACK RULES WILL LIKELY INCREASE FINANCIAL REPORTING TRANSPARENCY AND ACCOUNTABILITY TO INVESTORS

(continued from page 7)

has left observers worrying that companies are pressuring accountants and auditors to massage results in order to reduce the need for full restatements, thereby obscuring restated results from public scrutiny and allowing executives to retain performance-based compensation even in spite of company clawback policies that may already exist.[11] Accordingly, the Clawback Rules require companies to include check boxes on their annual financial reports indicating whether they have corrected errors included in previously-issued financial statements and whether those errors constitute restatements that required a recovery analysis of executive compensation.[12] This requirement, which alerts to *any* restated results (as well as immaterial corrections), is expected to draw investor attention — and calls for clawbacks — to restatements.[13]

The Clawback Rules will also have the important effect of reducing excess pay to executives and the associated costs that are borne by investors. Although executive compensation clawback policies have become widespread since the passage of the Dodd-Frank Act, with more than 90% of companies in the S&P 500 having adopted such policies, the Clawback Rules represent a significant broadening of the scope of the clawback policies that many companies currently have in place. [14]

When executives receive performance-based compensation on the basis of (intentionally or unintentionally) misstated financial data, they receive a windfall at investors' expense.[15] Allowing executives to retain pay that is not supported by the achievement of stated performance metrics weakens executives' incentives to generate value for the shareholders, regardless of whether the pay is the result of misconduct.[16] Additionally, the ability to acquire excess pay through financial reporting manipulation may lead executives to take actions that ultimately incur additional costs on the company, for example through increased taxes paid in relation to overstated earnings that may dwarf the excess pay made to executives.[17]

Rather than standing to benefit from misstated financial reporting, all executives will risk losing up to three years of excess incentive pay relating to *any* restatement — even those resulting from inadvertent error. This broad reach creates a strong incentive for executives to strengthen their oversight in order to ensure their companies are both meeting performance goals (to meet the criteria for performance-based compensation) and providing accurate financial reports (to avoid clawbacks).

Ultimately, the increased transparency afforded by the Clawback Rules is likely to give investors clearer information regarding corrections to companies' financial reporting, as well as additional insight into whether restatements of any kind have resulted in any compensation clawback. The broad reach of the Clawback Rules should further make it substantially more difficult for executives who benefitted from misstated financial results to retain unwarranted windfalls at the expense of investors. ■

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[11] *See* Chris Matthews, *SEC adopts rules mandating clawbacks of executive pay*, MarketWatch (Oct. 26, 2022), https://www.marketwatch.com/story/sec-set-to-adopt-rules-mandating-clawbacks-of-executive-pay-11666794288/.

[12] *See* U.S. Securities and Exchange Commission, *Listing Standards for Recovery of Erroneously Awarded Compensation*, at 113-14 (Oct. 26, 2022), https://www.sec.gov/rules/final/2022/33-11126.pdf.

[13] *See* Paul Kiernan, *Accounting Errors to Cost Executives Their Bonuses Under SEC Rule*, The Wall Street Journal (Oct. 26, 2022), https://www.wsj.com/articles/sec-to-vote-on-rule-to-claw-back-executive-pay-11666792822.

[14] *See* Jun Frank and Paul Hodgson, *Clawback Policies: Evolving Market Norms and SEC Rules*, ISS Insights (Sept. 13, 2022), https://insights.issgovernance.com/posts/clawback-policies-evolving-market-norms-and-sec-rules/.

[15] *See* Jesse M. Fried and Nitzan Shilon, *The Dodd-Frank Clawback and The Problem of Excess Pay*, The Corporate Board (Jan./Feb. 2012), http://www.law.harvard.edu/faculty/jfried/1201FriedShilon.pdf.

[16] *See id*.

[17] *See id*.

WHAT'S TO COME

MARCH 2023

CII Spring 2023 Conference & 38th Anniversary — Council of Institutional Investors

March 6 – 8

Washington, DC ■ Mandarin Oriental Washington

17th Annual Rights & Responsibilities of Institutional Investors (RRII)

March 9

Amsterdam

Institutional Governance and Legal Symposium (IGLS)

March 9

Amsterdam

Georgia Association of Public Pension Trustees (GAPPT) Fourteenth Annual Conference

March 20 – 23

Buford, GA ■ Legacy Lodge

APRIL 2023

Texas Association of Public Employee Retirement Systems (TEXPERS) 2023 Annual Conference

April 2 – 5

Austin, TX ■ Austin Marriott Downtown

Pennsylvania State Association of Country Controllers (PSACC) 2023 Spring Conference

April 19 – 21

State College, PA ■ Hyatt Place State College

MAY 2023

State Association of County Retirement Systems (SACRS) 2023 Spring Conference

May 10 – 13

San Diego, CA ■ Paradise Pointe Resort & Spa

JUNE 2023

Florida Public Pensions Trustees Association (FPPTA) 39th Annual Conference

June 25 – 28

Orlando, FL ■ Rosen Shingle Creek

National Association of Public Pension Attorneys (NAPPA) Legal Education Conference

June 27 – 30

San Antonio, TX
San Antonio Marriott Rivercenter

AUGUST 2023

County Commissioners Association of Pennsylvania (CCAP) Annual Conference & Trade Show

August 6 – 9

Erie, PA ■ Erie Bayfront Convention Center

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