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FULLY INFORMED

LISTENING FOR THE DEATH KNELL: SUPREME COURT TO REVIEW CLASS CERTIFICATION APPELLATE TACTICS

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Earlier this year, the Supreme Court of the United States agreed to hear a case that is likely to have important ramifications for class action plaintiffs. Specifically, the Supreme Court has agreed to resolve the question of whether a plaintiff may, as of right, appeal a denial of class certification after the plaintiff has voluntarily dismissed its claims. The resolution of this issue will affect plaintiffs' tactical options in class action litigation and will significantly impact the cost-benefit analysis of continuing to pursue litigation in the event that a trial court denies class certification but allows individual claims to proceed.

Under the Federal Rules of Civil Procedure, plaintiffs are generally permitted to appeal trial court orders as of right only when a "final decision" has been issued—that is, a decision that entirely disposes of the merits of the litigation. Ordinarily, however, a denial of class certification by a trial court is not considered a "final decision" and instead qualifies as an "interlocutory" order because the denial does not bring complete resolution to the merits of a plaintiff's individual claims.

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KESSLERTOPAZ MELTZERCHECK LLP

KTMC HEADS TO NEW YORK'S HIGHEST COURT TO PROTECT SHAREHOLDER RIGHTS

Leah Heifetz, Esquire

On March 23, 2016, Kessler Topaz will head to the New York Court of Appeals, the state's highest court, to argue *Matter of Kenneth Cole Prods., Inc. Shareholder Litigation* (Case No. 54), APL-2015-00155, which will address New York's standard of review for going-private transactions proposed by controlling shareholders. This case is before the Court of Appeals as the result of Kessler Topaz's successful motion for leave to appeal the decision of an intermediate appellate court, which the Court of Appeals only grants in extremely limited circumstances.

The standard of review utilized by courts in controlling-stockholder cases is critically important to shareholders. Going-private transactions carried out by controlling shareholders are often abusive. Controlling shareholders can take advantage of their powerful positions to squeeze out minority shareholders at an unfair price, using tactics such as setting

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DELAWARE'S EVOLVING JURISPRUDENCE ON CORRECTIVE PROXY DISCLOSURE SETTLEMENTS IN MERGERS AND ACQUISITIONS LITIGATION

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Mergers and acquisitions ("M&A") litigation has recovered billions of dollars for stockholders over the last decade, forcing faithless fiduciaries and their advisors to compensate stockholders for breaching their fiduciary duties or aiding and abetting those breaches. The Delaware courts have recognized the "meaningful economic benefits" generated by M&A litigation, which in the last year in Delaware alone has recovered in excess of $300 million.[1]

M&A litigation can also provide for meaningful and important disclosure of information to stockholders when they are making a voting decision. For example, M&A litigation can force the disclosure of information concerning alternative proposals that corporate insiders may be hiding to mislead stockholders into approving a transaction with a preferred bidder.[2] Similarly, M&A litigation has been effective in requiring corporate insiders to disclose accurate financial information so that stockholders can make informed decisions on the financial merits of a transaction.[3] From a legal standpoint, such disclosure of additional information is "material" to stockholders and, accordingly, must be publicly disclosed before a stockholder vote.[4]

Nonetheless, the field of M&A litigation has experienced criticism in recent years as the number of lawsuits has rapidly increased. Indeed, an empirical study of M&A transactions over the last decade found that stockholder litigation had more than doubled, with approximately 95% of all $100+ million public transactions in the United States being challenged in 2014.[5] And between 2012 and 2014, settlements exclusively based on the disclosure of supplemental information to stockholders comprised approximately 70% of all M&A settlements in Delaware.[6] These settlements typically resolved lawsuits with little formal discovery, but nonetheless provided broad releases of claims against the defendants and awarded attorney's fees to the plaintiffs.

Commentators have laid the blame on this increase in so-called "disclosure only" settlements on a number of parties. Corporate lobbyists have suggested that it is the plaintiffs' bar that is the problem, because plaintiffs' attorneys are incentivized to settle M&A litigation quickly for disclosures and an award of attorneys' fees. Others have criticized corporate defendants for seeking to buy broad releases of potential claims in connection with M&A transactions, rather than seeking dismissal of non-meritorious litigation. And still others have criticized the courts themselves for failing to perform their role as gatekeepers and approving settlements that provided questionable benefits to stockholders.

Corporate policy makers in Delaware ultimately agreed that frivolous M&A litigation needed to be curbed while, at the same time, preserving the Delaware courts' important role in protecting stockholders' rights.

In the extreme, this led to proposed legislation that would have permitted companies to adopt fee-shifting bylaws, essentially requiring stockholders to foot the bill for defendants' attorneys' fees if the litigation was not completely successful in every respect. Yet, litigation — even in the best of cases —

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[1] *See In re Trulia, Inc. S'holder Litig.*, 2016 Del. Ch. LEXIS 8, at *15-16 & n.17 (Del. Ch. Jan. 22, 2016) (citing example recoveries including the $148 million verdict in the litigation of the acquisition of Dole Food Company).

[2] *See, e.g.*, *In re Topps Co. S'holders Litig.*, 926 A.2d 58, 77-79 (Del. Ch. 2007).

[3] *See, e.g.*, *In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171, 202-203 (Del. Ch. 2007).

[4] Delaware defines materiality in the disclosure context to mean that there is a substantial likelihood that the information would be considered important in a reasonable stockholder's deliberation and decision making process before casting his or her vote. *See id.* at 199-200.

[5] *See In re Trulia*, 2016 Del. Ch. LEXIS 8, at *23-24 (citing Matthew D. Cain & Steven Davidoff Solomon, Takeover Litigation in 2015 at 2 (Jan. 14, 2016), *available at* http://ssrn.com/abstract=2715890).

[6] *Id.*, at *24 & n.28.

FOR WHOM THE STATUTE TOLLS

Michelle M. Newcomer, Esquire and Johnston de F. Whitman, Jr., Esquire

Putative class members seeking to opt-out of pending and future class actions brought under the Securities Act of 1933 (the "Securities Act") or the Securities Exchange Act of 1934 (the "Exchange Act"), to pursue their claims individually, may be required to act a lot sooner to preserve their claims depending upon the outcome of an interlocutory appeal recently granted by the United States Court of Appeals for the Third Circuit.

In *North Sound Capital LLC v. Merck & Co., Inc.*, 16-8012, the Third Circuit determined to resolve the following questions: (1) whether the "class action tolling" rule set forth in the seminal 1974 United States Supreme Court decision in *American Pipe & Constr. Co. v. Utah,* 414 U.S. 538 (1974) is "legal" or "equitable" in nature; and (2) whether interpreting *American Pipe* tolling to extend the five-year statute of repose under the Securities Exchange Act of 1934 would abridge a defendants' substantive rights, enlarge a plaintiffs' substantive rights, or otherwise modify a substantive right within the meaning of the Rules Enabling Act, 28 U.S.C. § 2072(b). The majority of federal district courts hold that the tolling rule adopted in *American Pipe* is legal in nature, and applies to statutes of repose. *See, e.g., North Sound Capital LLC v. Merck & Co., Inc.*, 2015 U.S. Dist. LEXIS 113369, at *23 (D.N.J. Aug. 26, 2015) (collecting cases). However, only two Circuit Courts of Appeals have addressed these questions in the context of a securities law class action, and have reached opposite conclusions. Because of the divergence in appellate authority on this important issue, it is likely that United States Supreme Court will be asked to consider the Third Circuit's determination of *North Sound Capital.*

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Accordingly, pursuant to Federal Rule of Civil Procedure 23(f), a plaintiff may request that an appellate court consider an appeal regarding the denial of class certification, but appellate courts have discretion in choosing whether to consider the appeal. Indeed, appellate courts hear only one in five interlocutory appeals of class certification denials on average, even though the denial of class certification often sounds the "death knell" of plaintiffs' claims due to the high cost of pursuing complex litigation only on behalf of the named plaintiffs. In several instances where an appellate court has refused to review the denial of class certification, plaintiffs have responded by voluntarily dismissing their claims and, in doing so, attempted to trigger a "final decision" that permits the plaintiffs the right to appeal the denial. It is the use of this drastic — but sometimes necessary — tactic which is now under review by the Supreme Court.

In 2011, a group of individuals filed a class action complaint against Microsoft Corporation ("Microsoft"), asserting that Microsoft's Xbox 360 gaming consoles were sold with a design defect that can cause the consoles to scratch game discs and render them unplayable. *See Baker, et al. v. Microsoft Corporation,* No. 11-cv-00722-RSM (W.D. Wash. filed April 28, 2011). Microsoft moved to strike the class allegations in plaintiffs' complaint, arguing that principles of comity required the court to follow a previous court's decision to deny certification to a proposed class of plaintiffs asserting substantially similar claims against Microsoft. *See In re Microsoft Xbox 360 Scratched Disc Litig.*, No. C07-1121-JCC, 2009 U.S. Dist. LEXIS 109075 (W.D. Wash. Oct. 5, 2009) (denying class certification). The district court agreed, and held that the denial of class certification in the previous *Scratched Disc Litigation* warranted striking the class allegations in the *Baker* action. *See Baker v. Microsoft Corp.*, 851 F. Supp. 2d 1274 (W.D. Wash. 2012).

After the district court struck the plaintiffs' class allegations, plaintiffs sought an interlocutory appeal of the denial of class certification pursuant Federal Rule of Civil Procedure 23(f). When the Ninth Circuit exercised its discretion and refused to hear plaintiffs' appeal, the parties stipulated to the dismissal of the plaintiffs' substantive claims with prejudice. In making that stipulation, plaintiffs asserted that upon dismissal of their action, they intended to appeal the district court's order striking the class allegations. By contrast, Microsoft asserted that plaintiffs would have "no right to appeal the Court's Order striking Plaintiffs' class allegations after entry of their requested dismissal." In the fall of 2012, the district court dismissed the action with prejudice while "reserving to all parties their arguments as to the propriety of any appeal." Plaintiffs filed an appeal shortly thereafter.

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On March 18, 2015, the Ninth Circuit reversed the district court's order striking plaintiffs' class action allegations. *See Baker v. Microsoft Corp.*, 797 F.3d 607 (9th Cir. 2015) (amended July 20, 2015). As a threshold matter, the Ninth Circuit held that it had jurisdiction over the appeal, stating that "in the absence of a settlement, a stipulation that leads to a dismissal with prejudice does not destroy the adversity in that judgment necessary to support an appeal." *Id.* at 612 (quoting *Berger v. Home Depot USA, Inc.*, 741 F.3d 1061, 1064 (9th Cir. 2014)). In regard to the district court's order, the Ninth Circuit additionally held that it was inappropriate to strike the class allegations, as the previous decision in the *Scratched Disc Litigation* was itself based on outdated precedent, and remanded the matter to the district court. *Id.* at 612-16.

On October 9, 2015, Microsoft filed a petition for a writ of certiorari before the Supreme Court of the United States, seeking review of whether a federal court of appeals has jurisdiction to review an order denying class certification after plaintiffs voluntarily dismissed their claims with prejudice. In its petition, Microsoft argued that there is an "entrenched" circuit split on the matter and noted that the Third, Fourth, Seventh, Tenth, and Eleventh Circuits have each held that a dismissal of claims with prejudice by either voluntary dismissal or dismissal for lack of prosecution does not confer appellate jurisdiction to review a denial of class certification. *See, e.g., Camesi v. Univ. of Pittsburgh Med. Ctr.*, 729 F.3d 239 (3d Cir. 2013); *Rhodes v. E.I. du Pont de Nemours & Co.*, 636 F.3d 88 (4th Cir. 2011); *Chavez v. Ill. State Police*, 251 F.3d 612 (7th Cir. 2001); *Bowe v. First of Denver Mortg. Investors*, 613 F.2d 798 (10th Cir. 1980); *Druhan v. American Mut. Life*, 166 F.3d 1324 (11th Cir. 1999).

Certain of those circuit courts have reasoned that plaintiffs should not be permitted to "manufacture finality" for appellate purposes by acceding to the dismissal of their claims. *See, e.g., Camesi,* 729 F.3d at 245 (discussing voluntary dismissal); *Bowe*, 613 F.2d at 799-800 (discussing dismissal for lack of prosecution). In particular, these courts have found guidance in the Supreme Court's opinion in *Coopers & Lybrand v. Livesay*, in which the Supreme Court held that an order denying class certification is not itself a final decision that a plaintiff may appeal as of right and would result in piecemeal litigation and a waste of judicial resources. 437 U.S. 463, 474-75 (1978). Other courts in the Fourth and Eleventh Circuits have adopted an alternative position, reasoning that appellate jurisdiction does not exist because plaintiffs, by virtue of their voluntary dismissal of their claims, have forfeited their Constitutional standing to continue pursuing those claims. *See, e.g., Rhodes*, 636 F.3d at 100; *Druhan*, 166 F.3d at 1326-27.

However, as acknowledged in Microsoft's petition, the Second and Ninth Circuits have found that plaintiffs who allow the dismissal

of their claims with prejudice maintain the right to appeal denials of class certification. *See, e.g.*, *Baker*, 797 F.3d at 612; *Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 903 F.2d 176 (2d Cir. 1990) (addressing an appeal following dismissal for lack of prosecution). For instance, in *Merrill Lynch*, the Second Circuit observed that *Livesay* is "inapplicable where . . . the putative class representative's individual claims have been dismissed," and similarly noted that any concerns over piecemeal litigation are not implicated when plaintiffs "risk forfeiting their potentially meritorious individual claims" in pursuing their appeal. 903 F.2d at 179. Separately, as described above, the Ninth Circuit reasoned in Baker that an action "retains sufficient adversity to sustain an appeal" following a voluntary dismissal with prejudice, thus supporting appellate court jurisdiction. 797 F.3d at 612.

On January 15, 2016, the Supreme Court granted Microsoft's petition for certiorari, agreeing to resolve the question of whether a federal appellate court has jurisdiction to review an order denying class certification after the named plaintiffs voluntarily dismiss their individual claims with prejudice. The parties' substantive briefs are expected in coming months, and oral argument is yet to be scheduled.

If the Court adopts the approach followed by the Third, Fourth, Seventh, Tenth, and Eleventh Circuits, plaintiffs will often be foreclosed from obtaining appellate review of a denial of class certification, and may be forced to either abandon their claims if the relative costs of further pursuit are too great, or pursue costly individual litigation in the hopes that an appeals court will ultimately reverse the class certification denial after final judgment on the merits has been entered. Conversely, if the Court recognizes the need for timely review of class certification decisions and adopts the Second and Ninth Circuit's approach, such plaintiffs will be free to immediately dismiss their claims and appeal a class certification denial as of right. The Supreme Court's decision in the case will therefore shape the strategic options available to plaintiffs if a trial court's denial of class certification renders individual claims economically unviable. ■

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up negotiations with directors they hand-picked, refusing to allow their negotiating counterparts to test the market to see whether they are really maximizing the value of the corporation, and using the corporation's resources and insider information to their negotiating advantage. In addition, even when a vote by the minority shareholders is required to approve the deal, controllers are often able to coerce the outcome of the vote. A controller can cause the corporation to issue misleading proxy materials recommending that minority shareholders vote for a transaction, forcing the shareholders to make a decision without being fully informed about the process that resulted in the proposed deal or whether the price they would receive for their shares is fair. Minority shareholders also understand that saying no to a powerful controller can invite retaliation that would affect the value of their stock.

Because of this potential for abuse, New York has historically strictly scrutinized such transactions. New York law has, for several decades, required majority shareholders to prove the "entire fairness" of all transactions between themselves and the companies they control. The intermediate court in *Kenneth Cole*, however, affirmed the dismissal of our complaint under the much more deferential "business judgment rule." This standard of review defers to corporate directors' business decisions unless a plaintiff can demonstrate that the directors acted disloyally or in bad faith. The intermediate court held that "entire fairness" scrutiny was not required because a majority of the company's minority stockholders had approved the buyout transaction when they voted to approve it.

On appeal to the state's highest court, Kessler Topaz will argue that this analysis was flawed. Numerous decisions have recognized that controlling stockholder buyouts are inherently coercive, and frequently financially unfair. Controllers have enormous power to coerce minority shareholders and mislead them with false and misleading proxy disclosures. We will argue that New York should continue its long precedent of strictly scrutinizing these conflicted transactions to ensure that they are fair to the minority in both process and price.

Background of the Case

Kenneth Cole Productions ("KCP" or the "Company") was a publicly held fashion company based and incorporated in New York. KCP's controlling shareholder was its founder, chairman, and Chief Creative Officer, Kenneth D. Cole ("Cole"). Cole held 89% of KCP's voting power, including all of KCP's super-voting Class B stock and 1.6 million shares of its Class A stock.

After several years of financial losses, in 2011, KCP implemented a new strategic plan that placed the Company on a much more positive path. For Cole, this presented the perfect moment to take his eponymous Company private. By acquiring full ownership of KCP just as the new plan was beginning to produce results, Cole would be able to pay a lower price for the minority-held shares and then enjoy the full upside of the Company's positive new trajectory.

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is almost never completely successful, and the legislation would have basically shut down all M&A litigation, meritorious or not. With the prospect of fee shifting, few rational stockholders would ever file a lawsuit because of the substantial risk and the classic "tragedy of the commons" problem of representative litigation — where one stockholder faces all the risk of fee-shifting but must share any potential benefit of the litigation with all other stockholders.

After the Delaware legislature rejected this fee-shifting legislation, and actually banned Delaware corporations from adopting fee-shifting provisions, the Chancery Court began reevaluating the merits of disclosure only settlements. Prior to 2015, the Chancery Court almost always approved disclosure only settlements, reluctant to question the settling parties' judgment that additional disclosures obtained in a settlement justified the broad release of any claims against the defendants. Beginning in the summer of 2015, however, that abruptly changed.

Last July, Vice Chancellor Travis Laster declined to approve a settlement in litigation challenging Cobham PLC's $1.5 billion acquisition of Aeroflex Holding Corp.[7] The court rejected the settlement because the stockholder's global release of claims against defendants (described by the Vice Chancellor as "intergalactic" in its scope) was too broad. Specifically, the Vice Chancellor found that the additional disclosures and minor changes to the transaction terms would support only a release of claims related to those particular issues, but that the release of all potential stockholder claims — even undiscovered "unknown claims" — was simply too lopsided in the defendants' favor to be a reasonable resolution of the lawsuit.

In September, Chancellor Andre Bouchard followed Vice Chancellor Laster's lead, declining to approve the settlement of litigation challenging the merger between real estate appraisal websites Trulia and Zillow.[8] Instead, Chancellor Bouchard said he would take additional time to consider the settlement and asked the parties to submit briefing on whether supplemental disclosures must be material to stockholders to support a disclosure settlement approval. He also asked the parties to submit written arguments on whether it is appropriate to approve a broad release of potential claims on the basis of additional disclosures in a settlement.

Also in September, Vice Chancellor Samuel Glasscock narrowly approved a disclosure settlement challenging private equity firm Thoma Bravo's $3.6 billion acquisition of Riverbed Technology.[9] In approving the settlement, over the objection of a law professor arguing that the disclosures had no value and the release of claims was too broad, the Vice Chancellor noted that the court was approving the settlement's broad release because the parties had negotiated it in good faith based on the Delaware courts' past precedent.[10] The court warned, however, that in light of the recent developments in the law, the M&A field was being put on notice that the Delaware courts would no longer be rubberstamping broad releases of potential claims in exchange for supplemental disclosures.

The trend continued in October, when Vice Chancellor Laster rejected another disclosure settlement in connection with Hewlett-Packard's $2.7 billion acquisition of Aruba Networks.[11] The Vice Chancellor conceded that the court was changing course, stating "we have to acknowledge that settling for disclosure only and giving the type of expansive release that has been given has created a real systemic problem." The Vice Chancellor suggested that if the release of claims against the defendants had been tailored to compromise only disclosure claims that the court may have approved the settlement, but as it was there was no basis in the record to support such a broad release of claims in exchange for disclosures.

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[7] *Acevedo v. Aeroflex Holding Corp., et al.*, C.A. No. 9730-VCL (Del. Ch. July 8, 2015).

[8] *In re Trulia, Inc. S'holder Litig.*, C.A. No. 10020-CB (Del. Ch. Sept. 16, 2015).

[9] *In re Riverbed Tech., Inc. S'holders Litig.*, 2015 Del. Ch. LEXIS 241 (Del. Ch. Sept. 17, 2015).

[10] *Id.* at *19-20.

[11] *In re Aruba Networks, Inc. S'holder Litig.*, Consol. C.A. No. 10765-VCL (Del. Ch. Oct. 9, 2015).

Finally, in January of this year, Chancellor Bouchard announced a new standard for disclosure settlements in his ruling rejecting the *Trulia* settlement. Disclosure settlements will now be generally disfavored unless the supplemental disclosures are "plainly material" and the proposed release is "narrowly circumscribed to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sale process." [12] It is reasonable to conclude that the entire Chancery Court has now adopted the "plainly material" standard for disclosure settlements set forth in *Trulia,* marking a shift in Delaware law.

Not all disclosure settlements will be rejected under the new paradigm, however. For example, following the *Trulia* decision, Chancellor Bouchard approved a settlement, finding that the disclosure of free cash flow projections was "plainly material." [13] Vice Chancellor John Noble also recently approved a disclosure settlement where he found that the supplemental disclosures met the plainly material standard set forth in *Trulia.*[14]

In the end, M&A litigation will continue to recover meaningful economic benefits for stockholders who would otherwise be taken advantage of by corporate directors and officers who are supposed to represent stockholders' interests rather than their own. Moreover, Delaware courts will continue to recognize that the disclosure of material information is an important check on corporate fiduciaries, and will require its disclosure. By contrast, the Chancery Court appears to have heightened its "gatekeeper" role by disincentivizing M&A litigation that yields marginally beneficial information to stockholders while simultaneously excusing corporate fiduciaries from any potential misconduct.

This is ultimately a positive development for stockholders. There has already been a decline in new filings of merger-related litigation in Delaware since last summer. Accordingly, the Chancery Court's recent rulings appear to be having their intended effect of reducing the number of M&A cases that are filed with a disclosure only settlement in mind. This reduced caseload will, among other things, give the Chancery Court additional time and resources to consider meritorious cases filed by diligent stockholders. Stockholder plaintiffs can, therefore, remain confident that the Delaware courts will continue to serve their longstanding role as a bulwark against misconduct by corporate fiduciaries. ■

[12] *In re Trulia*, 2016 Del. Ch. LEXIS 8, at *35-36.

[13] *In re BTU Int'l, Inc. S'holders Litig.*, Consol. C.A. No. 10310-CB (Del. Ch. Feb. 18, 2016).

[14] *In re NPS Pharma. S'holders Litig.*, Consol. C.A. No. 10553-VCN (Del. Ch. Feb. 18, 2016).

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By way of background, in *American Pipe*, the Supreme Court examined the relationship between a "statute of limitations" — which serves to limit the availability of remedies to a plaintiff by prescribing the time within which he must bring a claim after the claim accrues — and the provisions of Federal Rule of Civil Procedure 23 ("Rule 23"), which regulate class actions in federal court. Specifically, the Supreme Court considered whether the timely filing of a class action complaint tolls the applicable statutes of limitations for all members of the class, as subsequently determined, or whether those unidentified class members who seek to intervene in the action must independently demonstrate that their claims are timely at the time they seek to intervene.

The Supreme Court held that after a putative class action has been filed, the time limits within which a putative class member must seek to intervene, if he so chooses, are tolled until such time as class certification is denied. *American Pipe*, 414 U.S. at 552-54. The Supreme Court later clarified that *American Pipe* applies not only to putative class members who seek to intervene in an action, but also to putative class members who later file separate suits. *See Crown Cork & Seal v. Parker*, 462 U.S. 345, 351-52 (1983)) (citing *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1974)). As the Supreme Court explained, "[a] contrary rule . . . would deprive Rule 23 class actions of the efficiency and economy of litigation which is a principal purpose of the procedure," and induce putative plaintiffs to file protective motions to intervene (or independent actions) in the event that a class was later found unsuitable. *See American Pipe*, 414 U.S. at 554.

Importantly, although the Supreme Court used the term "statute of limitations" in fashioning its ruling, "courts — including the Supreme Court . . . have long used the term 'statute of limitations' to refer also to statutes of repose." *Police & Fire Ret. Sys. of the City of Detroit v. IndyMac MBS, Inc.*, 721 F.3d 95, n.13 (2d Cir. 2013). Statutes of repose place an outer limit on a plaintiff's right to bring a civil action, by prescribing the time after the culpable act or omission of the defendant giving rise to a claim within which an action must be brought. Accordingly, some courts have interpreted *American Pipe* as applicable to both statutes of limitations and statutes of repose, while others

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take a more narrow view. At the center of this debate are the different views courts have taken regarding whether the Supreme Court's decision was grounded in principles of equitable or legal tolling based on Rule 23.

Equitable tolling is based on principles of fairness and stems from a court's exercise of its equity powers to relieve certain hardships that may arise from the adherence to more absolute legal rules. *See Holland v. Florida*, 560 U.S. 631, 130 S. Ct. 2549, 2563 (2010). It may be appropriate where, for example (i) a plaintiff timely filed a defective pleading and the applicable limitations period expired before the defect was cured, or (ii) a plaintiff was induced by his adversary into allowing the statutory deadline to pass before filing his claim. *See Joseph v. Wiles*, 223 F.3d 1155, 1167-68 (10th Cir. 2000). However, the judiciary does not have the power to enact rules that abridge, modify or enlarge a plaintiff's substantive rights, as determined by Congress. *See* 28 U.S.C. § 2072(b). Thus, courts have determined that if the tolling principle espoused is equitable in nature, it cannot apply to toll a statute of repose. *See, e.g., Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 363 (1991) (holding that the three-year repose period under the Securities Act is said to be 'absolute' and inconsistent with equitable tolling). Legal tolling, on the other hand, derives from a statutory or legal source, *Credit Suisse Sec. (USA) LLC v. Simmonds*, 132 S. Ct. 1414, 1419 n.6 (2012), such as the Federal Rules of Civil Procedure, which the Supreme Court has held have the force and effect of a federal statute. *See Bright v. United States*, 603 F.3d 1273 (citing *Sibbach v. Wilson & Co.*, 312 U.S. 1, 13 (1941)). Accordingly, if the *American Pipe* tolling principle is deemed to be based on a statutory or legal interpretation, it may be applied to toll a statute of repose.

The United States Court of Appeals for the Tenth Circuit (the first Circuit Court of Appeals to decide this issue) held that the tolling principle articulated in *American Pipe* applies to *both* statutes of limitations and statues of repose. *Joseph v. Wiles*, 223 F.3d 1155, 1167 (10th Cir. 2000). The Court reached this decision after concluding that: (1) "tolling the limitations period while class certification is pending does not compromise the purposes of statutes of limitation and repose"; and (2) tolling the limitations period for class members while class certification is pending serves the purposes of Rule 23. *Id.* at 1167-68. As the Court explained, repose statutes "are intended to demarcate a period of time within which a plaintiff must bring claims or else the defendant's liability is extinguished." *Id.* at 1168. However, it found, by virtue of the class action device, a putative class member's claims *are brought* as of the date a class action is filed on his behalf. Thus, the Court observed, applying *American Pipe* tolling does not involve "tolling" at all; the claims are deemed filed as of the date of the filing of the class action. *Id.* Further, the Court reasoned, without tolling both statutes of limitations and statutes of repose, the efficiencies of the Rule 23 class action device would be defeated, as all class members would be required to file lawsuits to preserve their claims. Moreover, the Tenth Circuit observed that absent tolling of the statute of repose during the pendency of a class action alleging the same claims, Rule 23(c)(2)'s notice requirement (of the pendency of a class action and one's right to opt-out) would be "irrelevant," as the limitations period would likely expire before such notice could occur, "making the right to pursue individual claims meaningless." *Id.*

On the other hand, the United States Court of Appeals for the Second Circuit (the only other Circuit Court of Appeals to address these issues) more recently held that *American Pipe* tolling did not apply to the statute of repose set forth in Securities Act. *Police & Fire Ret. Sys. of the City of Detroit v. IndyMac MBS, Inc.*, 721 F.3d 95, 109 (2d Cir. 2013). The Second Circuit concluded that whether the *American Pipe* tolling doctrine is deemed equitable or legal in nature was not relevant to the court's analysis. In this regard, the court explained that, if the tolling rule is properly classified as "equitable," then application to the Securities Act's repose period is foreclosed (as noted above) by *Lampf*, 501 U.S. at 363. *Id.* If, on the other hand, *American Pipe*'s tolling rule is legal in nature based upon Rule 23, the court determined that extending such tolling to the statute of repose in Section 13 of the Securities Act would run afoul of the Rules Enabling Act, 28 U.S.C. 2072(b). *Id.* As the Court explained, the Rules Enabling Act provides the Supreme Court with "the power to prescribe general rules

of practice and procedure" so long as such rules do "not abridge, enlarge or modify any substantive right." *Id.* The Second Circuit concluded that, because codified statutes of repose (such as the one set forth in Section 13 of the Securities Act at issue in *IndyMac*) "create a substantive right" — namely, that all claims against defendants will be extinguished three-years after the date of the violation at issue — "permitting a plaintiff to file a complaint or intervene after the repose period . . . has run would therefore necessarily enlarge or modify a substantive right and violate the Rules Enabling Act." *Id.*

No other federal Circuit Court of Appeals has opined on this issue. However, as noted above, the United States Court of Appeals for the Third Circuit will soon do so.

North Sound Capital LLC et al. v. Merck & Co., Inc. et al., Nos. 3:13-cv-07240 and 3:14-cv-00242 (D.N.J.), are direct actions asserting securities fraud claims under the Exchange Act based on misrepresentations and omissions made by the Schering-Plough Corporation defendants ("Schering") between January 3, 2007 and November 19, 2007, and by the Merck & Co., Inc. defendants ("Merck") between December 6, 2006 and January 30, 2008, respectively, in connection with the plaintiffs' purchases of Schering and Merck common stock. The two companies merged in 2009 and the cases are being prosecuted in tandem. The plaintiffs in *North Sound Capital* filed their lawsuits in November 2013 and January 2014, after receiving notices of certification of the related class actions against Schering and Merck, and opting out of those classes. The class actions were timely filed and North Sound Capital's direct actions were filed less than a year after the class actions were certified. At the time that the *North Sound Capital* plaintiffs filed their direct actions, however, the five-year statute of repose applicable to their claims brought under the Exchange Act had long run, absent tolling. The defendants moved to dismiss the cases for lack of jurisdiction, arguing that the plaintiff lacked standing because its claims were untimely under the Exchange Act's five-year statute of repose. The District Court denied the motion, holding that the *American Pipe* tolling doctrine was legal in nature and did not violate the Rules Enabling Act's bar against rules that abridge, enlarge or modify a substantive right. *See id.*, 2015 U.S. Dist. LEXIS 113369, at *31, 33-35 (D.N.J. Aug. 26, 2015).

As the District Court explained, the Supreme Court has "long held" that the test of whether a rule abridges, enlarges or modifies a substantive right "is not whether the rule affects a litigant's substantive rights; most procedural rules do. What matters, is what the rule itself regulates. If it governs only the manner and the means by which the litigants' rights are enforced, it is valid; if it alters the rules of decision by which the court will adjudicate [those] rights, it is not." *Id.*, 2015 U.S. Dist. LEXIS 113369, at *31-32 (quoting *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 559 U.S. 393, 406-07 (2010)). Tolling the Exchange Act's statute of repose, the District Court found, "would merely govern 'the manner and the means by which the litigants' rights are enforced'" and not "alter the rules of decision by which the court will adjudicate those rights." *Id.* at *34 (citations omitted). Thus, the District Court held that applying *American Pipe* tolling to the Exchange Act's statute of repose does not run afoul of the Rules Enabling Act.

Thereafter, the defendants in *North Sound Capital* filed a motion requesting that the District Court certify the following two questions for interlocutory appeal to the United States Court of Appeals for the Third Circuit, whether: (i) "the tolling rule set forth in [*American Pipe*] is 'legal' or 'equitable' in nature"; and (ii) interpreting *American Pipe* tolling to extend the five-year statute of repose under the Exchange Act would abridge a defendant's substantive rights, enlarge a plaintiff's substantive rights, or otherwise modify a substantive right within the meaning of the Rules Enabling Act, 28 U.S.C. § 2072(b).

The District Court granted defendants' motion, which allowed the defendants to file a petition for leave to appeal the District Court's motion to dismiss decision with the Third Circuit. On February 11, 2016, the Third Circuit granted the defendants' petition.

The Third Circuit's resolution of whether the *American Pipe* tolling rule is "legal" or "equitable" in nature, and whether tolling the Exchange Act's statute of repose would enlarge, abridge or otherwise modify a substantive right may have a significant impact (at least, initially, on cases pending or to be filed in district courts within the Third Circuit, which includes the federal district courts for the following states and territories: New Jersey; Pennsylvania; Delaware; and the United States Virgin Islands) on a putative class member's rights and obligations with respect to future claims under the federal securities laws. If the statute of repose is tolled, a plaintiff may continue to rely on the filing of a class action to toll his claims, and need not act to preserve his rights until a class is certified (or certification is denied). However, if the statute of repose is not tolled, then a plaintiff wishing to pursue individual claims must file a complaint no less than five years after the date of the first offending misstatement, regardless of whether or not such claims have been asserted in a pending class action. Otherwise, that plaintiff will lose the

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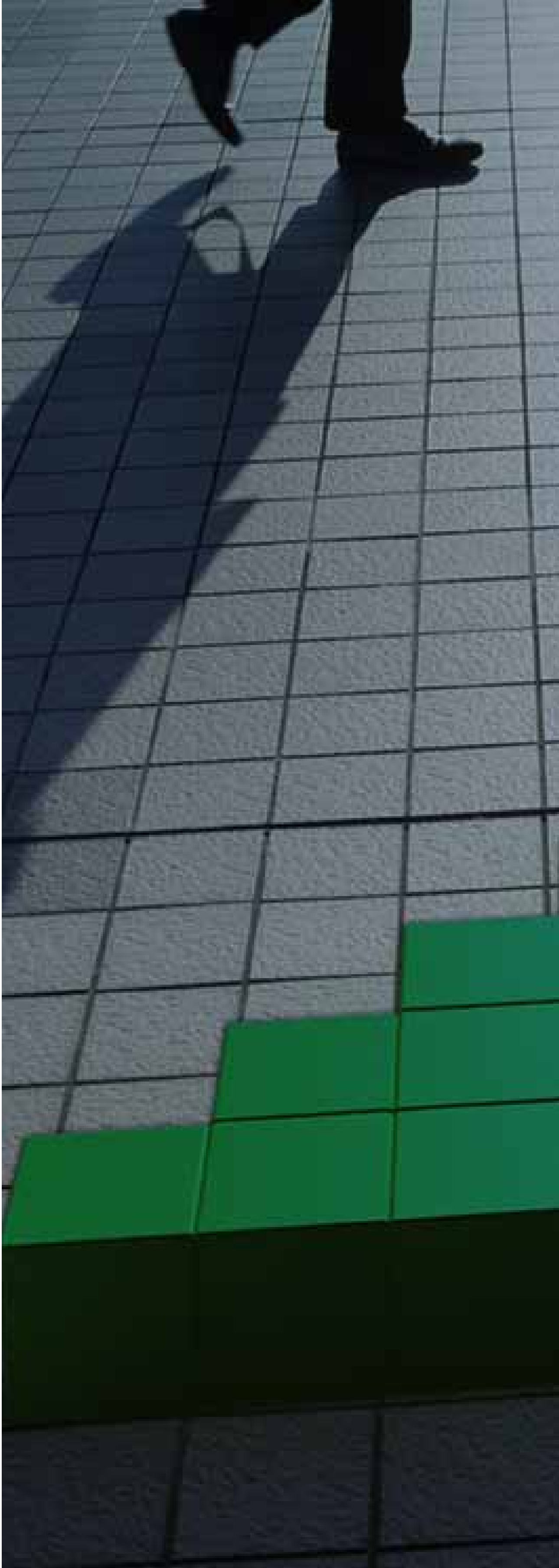

FOR WHOM THE STATUTE TOLLS

(continued from page 9)

right to pursue claims based on purchases made pursuant to that statement (i.e., any purchases made more than five years prior to the filing date of the complaint). Further, as each day goes by without the plaintiff filing suit, that plaintiff would lose the right to pursue claims based on any purchases that fall outside the new five year period.

Such a ruling would likely unnecessarily tax the federal judiciary and frustrate many of Rule 23's purposes. Given the nature of complex litigation, the extensive motion practice involved, and pace at which such actions typically proceed, such a ruling could lead to an onslaught of lawsuits as institutional and other investors are forced to file their own (largely duplicative) lawsuits merely to preserve their claims. Indeed, it is not difficult to foresee situations — and *North Sound Capital* is a clear example — where a class certification decision is not rendered for years into the litigation, well-after the statute of repose period has run.

As the *North Sound Capital* District Court noted, if it were to accept the defendants' argument that *American Pipe* tolling does not apply to the Exchange Act's five-year statute of repose, the plaintiffs' claims based on their purchases of Schering common stock (for which the last alleged misrepresentation was made on November 19, 2007) would have been extinguished less than two months after the class action was certified (on September 25, 2012) — and before the District Court even approved a form of notice to be distributed to class members advising them of their rights. *See North Sound Capital*, 2015 U.S. Dist. LEXIS 113369, at *39-40 n.19. Likewise, the plaintiffs' claims based on their purchases of Merck common stock (for which the last alleged misrepresentation was made on January 30, 2008) would have been extinguished less than a month after the Court approved the form of notice to be disseminated to the class (the "Notice") on December 28, 2012, and just days after the January 17, 2013 deadline within which the Court required the Notice to be disseminated. *See id*. In any event, all such claims would have been extinguished by the time of the March 1, 2013 deadline for opting out of the class, provided for in the Notice. Such a result, the Court found, runs counter to the dictates and purpose of Rule 23. *Id*.

The Third Circuit's decision in *North Sound Capital* (expected within the next 10-15 months) is also notable because the parties on the losing side will likely file a petition for a writ of *certiorari* with the United States Supreme Court. Indeed, the Supreme Court already agreed to decide this question once before in *Publ. Emplees' Ret. Sys. v. IndyMac MBS, Inc., et al*, No. 13-640, but withdrew its *writ of certiorari* as improvidently granted, days after the parties notified the court of a pending settlement of the underlying lawsuit. As always, investors considering whether to participate in a pending class action or to commence a direct action should consult with counsel before taking action. ■

KTMC HEADS TO NEW YORK'S HIGHEST COURT TO PROTECT SHAREHOLDER RIGHTS

(continued from page 5)

On February 23, 2012, Cole formally offered to buy all of the KCP Class A stock that he did not already own for $15.00 per share, a modest premium to the Company's closing stock price that day, before the offer was announced. He conditioned the offer on the establishment of a special committee to negotiate the deal and the approval of the majority of the Company's minority shareholders. Analysts called the offer an "opportunistic play" by Cole to acquire KCP on the cheap, estimating the Company's actual value at approximately $20 per share.

The Company's board of directors formed a special committee of four directors to negotiate the proposed deal. All four directors had been appointed to the Board by Cole and had historically approved policies and transactions that benefited Cole personally. The Special Committee carried out a perfunctory negotiation in which they made no attempt to test the market, inexplicably directed management to downwardly revise the Company's internal financial forecasts, and made clear to Cole that they would accept any price higher than his original $15 per share offer.

On June 6, 2012, KCP announced that it had signed a merger agreement with Cole, under which Cole would buy all of the minority's Class A stock for $15.25 per share. KCP then issued incomplete and misleading proxy materials recommending that the minority shareholders support the deal. The merger was approved by the minority shareholders on September 24, 2012.

The Litigation

Kessler Topaz brought suit in the New York Supreme Court on behalf of the Erie County (PA) Employees' Retirement System, an institutional shareholder of KCP. The complaint alleged that the sale process was flawed and the buyout price inadequate, and that KCP's proxy statement soliciting support for the merger was incomplete and misleading. Defendants moved to dismiss. On September 3, 2013, the trial court granted the Defendants' motion.

Kessler Topaz appealed the trial court's decision. Kessler Topaz explained that, because of the inherent danger that a controller can use his position of power against the company or its minority shareholders, New York courts have always reviewed conflicted transactions under the entire fairness standard, which requires the controller to prove that the transaction was fair in both process and price. The trial court had failed to apply entire fairness review to the merger.

On November 20, 2014, the Appellate Division, First Department affirmed the trial court's dismissal. The Appellate Division agreed that the deferential business judgment rule should apply to the transaction because a majority of the Company's minority shareholders voted for the merger.

In seeking review by the New York Court of Appeals, we argued that the Appellate Division decision significantly altered the legal principles governing conflicted transactions in New York. Instead of looking at whether the merger was fair to KCP's minority shareholders, the Appellate Division let one procedural protection — a majority-of-the-minority vote that can easily be coerced by misleading disclosures or threats by a controller — completely shield the deal from any legal challenge. It also set alarming precedent, since the First Department is a powerful appellate court; its jurisdiction includes New York County and, thus, the majority of litigation concerning New York corporations headquartered in Manhattan.

If allowed to stand, the Appellate Division's decision also effectively provides a roadmap for abusive controllers seeking to insulate conflicted transactions from any meaningful judicial review. It also took leverage away from well-intentioned independent directors who can no longer use the prospect of thorough judicial review as a pressure point in negotiations. The Appellate Division's departure from prevailing law thus created precedent that would leave minority shareholders of New York corporations unprotected from abusive controllers using their power to push unfair deals.

The decision also put the First Department out of step with Delaware, where most shareholder litigation takes place and the courts have widely respected expertise on corporate law. In contrast to the Delaware Supreme Court's holding in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) ("*MFW*") that transactions with controllers are only afforded business judgment rule review if six procedural protections are present, the Appellate Division reduced the required number of protections to one: a majority-of-the-minority vote. The Appellate Division's decision was unprecedented, as no Delaware or New York court has ever found the mere existence of a majority-of-the-minority vote to be a sufficient protection for minority shareholders against a controller squeezing them out of a corporation.

To protect the rights of KCP's minority shareholders and shareholders of New York corporations generally, Kessler Topaz moved the Court of Appeals of New York for leave to appeal. The Court of Appeals will hear the case on March 23, 2016. The Court of Appeals will decide whether controllers must prove the entire fairness of going-private transactions or whether challenges to such deals can be dismissed under the business judgment rule. Kessler Topaz looks forward to advocating for this important issue on behalf of KCP's minority shareholders as well as all of its clients who invest in New York corporations. ■

EVENTS

WHAT'S TO COME

North America's Building Trades Unions 2016 Legislative Conference
April 17 – 20, 2016
Washington Hilton & Towers Hotel — Washington, D.C.

State Association of County Retirement Systems Spring Conference
May 10 – 13, 2016
Westin South Coast Plaza — Costa Mesa, CA

NCPERS Annual Conference & Exhibition
May 15 – 19, 2016
Hilton San Diego Bayfront — San Diego, CA

Pennsylvania Association Public Employee Retirement Systems Spring Forum
May 25 – 26, 2016
Hilton Hotel — Harrisburg, PA

County Treasurer's Association of Pennsylvania 2016 Convention
June 14 – 17, 2016
The Ambassador Center — Erie, PA

National Association of Public Pension Attorneys 2016 Legal Education Conference
June 21 – 24, 2016
Astor Crowne Plaza — New Orleans, LA

Florida Public Pension Trustees Association 32nd Annual Conference
June 26 – July 29, 2016
Hyatt Regency — Orlando, FL

Missouri Association of Public Employee Retirement Systems 2016 Annual Conference
July 13 – 15, 2016
Tan-Tar-A Resort — Osage Beach, MO

County Commissioners Association of Pennsylvania Annual Conference and Trade Show
August 7 – 10, 2016
Split Rock Lodge — Lake Harmony, PA

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