Fall 2017

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

FULLY INFORMED

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FACEBOOK AND FOUNDER MARK ZUCKERBERG CAPITULATE TO KTMC ON EVE OF TRIAL

Lee D. Rudy, Esquire

Just one day before trial was set to commence over a proposed reclassification of Facebook's stock structure that KTMC challenged as harming the company's public stockholders, Facebook abandoned the proposal.

The trial sought a permanent injunction to prevent the reclassification, in lieu of damages. By agreement, the proposal had been on hold pending the outcome of the trial. By abandoning the reclassification, Facebook essentially granted the stockholders everything they could have accomplished by winning at trial.

As background, in 2010 Mark Zuckerberg signed the "Giving Pledge," which committed him to give away half of his wealth during his lifetime or at his death. He was widely quoted saying that he intended to start donating his wealth immediately.

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AMSTERDAM COURT OF APPEALS DENIES DUTCH SHAREHOLDER ASSOCIATION GROUP ACTION AGAINST BP

Emily N. Christiansen, Esquire

On November 7, 2017, the Amsterdam Court of Appeals issued a judgment that limits the ability of shareholders to bring claims in the Netherlands to recover purely financial losses against companies that are neither based in the Netherlands nor traded on the Euronext exchange. This judgment delivers the latest blow to the notion that the Netherlands may become the go-to forum for collective securities fraud actions outside the United States.

In the aftermath of the U.S. Supreme Court decision in *Morrison v. National Australia Bank* (which limits the U.S. courts' jurisdiction over securities fraud lawsuits to securities that are listed and

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FIRST SOLAR PRESENTS OPPORTUNITY FOR NINTH CIRCUIT TO SHED LIGHT ON APPROPRIATE LOSS CAUSATION STANDARD

Meredith L. Lambert, Esquire

On October 18, 2017, the U.S. Court of Appeals for the Ninth Circuit heard oral argument in *Mineworkers' Pension Scheme, et al. v. First Solar Inc., et al.*, No. 15-17282 (9th Cir.), a securities fraud class action on interlocutory appeal from an August 2015 order by the United States District Court for the District of Arizona. The district court largely denied Defendants' motion for summary judgment, but certified the ruling for immediate interlocutory appeal to resolve what the district court saw as a split between two conflicting standards applied by Ninth Circuit appellate panels for establishing loss causation under Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"). *See Smilovits v. First Solar Inc.*, 119 F. Supp. 3d 976 (D. Ariz. 2015). Under the first standard — adopted in *In re Daou Systems, Inc.*, 411 F.3d 1006 (9th Cir. 2005) and its progeny — plaintiffs were permitted to plead loss causation by alleging that disclosure of the company's true financial condition caused the plaintiffs' losses. By contrast, under the second standard — adopted in *Metzler Inv. GMBH v. Corinthian Colleges, Inc.*, 540 F.3d 1049 (9th Cir. 2008) and its progeny

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STILL HAVING TROUBLE GETTING YOUR MONEY BACK? YOU'RE NOT ALONE

Jonathan R. Davidson, Esquire and Joseph Budd, Esquire

Over the last decade, we have checked in from time to time on the current state of claims administration for institutional investors relating to securities class action settlements and judgments. At every turn, we have seen challenges confront the institutional investor community, making it harder to recover their respective share of proceeds from these cases. From difficulty maintaining historical data necessary to perfect a claim in securities cases with particularly long duration, to custodial change and general issues with service providers, to the proliferation of cases being litigated around the globe post-*Morrison v. National Australia Bank*, the issue of claims administration for institutional investors continues to be a thorny one for funds of all sizes. If not serving an active role in a particular case, the most important part of the class action process is filing a claim when you are eligible in order to meet your fiduciary obligations. This article will examine what is happening in claims administration today, dissect, in case study format, the ramifications of not getting the process right, and finally, provide suggestions for institutional investors to consider implementing in hopes of refining their procedures and ensuring all available funds are collected.

The Current State of Claims Administration

According to NERA Economic Consulting, between 2005 and 2016, over $62 billion dollars in securities class action settlements and judgment proceeds were made available to investors.[1] It is

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[1] *See* Stefan Boettrich and Svetlana Starykh, Recent Trends in Securities Class Action Litigation: 2016 Full-Year Review: Record Number of Cases Filed, Led By Growth in Merger Objections Highest Number of Dismissals in the Shortest Amount of Time, www.nera.com, (January 2017).

WAGGONER V. BARCLAYS PLC: REBUTTING THE FRAUD-ON-THE-MARKET PRESUMPTION OF RELIANCE REQUIRES A PREPONDERANCE OF THE EVIDENCE

Nathan A. Hasiuk, Esquire, Johnston de F. Whitman, Jr., Esquire, and Andy L. Zivitz, Esquire

In *Waggoner v. Barclays PLC*,[1] the Second Circuit held that in order to rebut the fraud-on-the-market presumption of reliance in a class action alleging fraud claims under the Securities Exchange Act of 1934 (the "Exchange Act"), defendants must prove by a preponderance of the evidence that the alleged misrepresentations and/or omissions did not impact the price of the security at issue, so called "price impact." Furthermore, the Second Circuit held that merely showing that the price of a security did not increase at the time of an alleged misrepresentation or omission is not sufficient to prove a lack of price impact in a case where plaintiffs alleged that the misrepresentations and/or omissions artificially maintained the price of the security. Finally, the Second Circuit ruled that in a case alleging a price maintenance theory, to disprove price impact, defendants must demonstrate that none of the price decline associated with the alleged corrective disclosure(s) was due to the disclosure of the alleged fraud.[2]

While the *Waggoner* decision is well-grounded in prior Supreme Court and Second Circuit precedent, it represents a significant clarification on how defendants may attempt to rebut the fraud-on-the-market presumption of reliance through price impact arguments, and will govern contested issues of price impact in future class certification decisions.

This article first provides an overview of the fraud-on-the-market presumption of reliance and the Supreme Court precedent addressing what defendants must establish to rebut the presumption. We next address the *Waggoner* decision, and conclude by assessing the influence the decision will likely have on future class certification decisions.

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[1] -- F.3d --, 2017 WL 5077355 (2d Cir. Nov. 6, 2017).

[2] In another significant holding that is not addressed in this article, the Second Circuit held that "a plaintiff seeking to demonstrate market efficiency need not always present direct evidence of price impact through event studies," particularly, as in the case of Barclays ADS, where indirect evidence overwhelmingly supports a finding of market efficiency. *Id.* at *13.

KESSLER TOPAZ PREPARES FOR TRIAL AGAINST ENERGY TRANSFER EQUITY

Michael Wagner, Esquire

In April 2016, Kessler Topaz commenced a lawsuit in the Delaware Court of Chancery on behalf of a class of common unitholders of the midstream oil-and-gas master limited partnership, Energy Transfer Equity (ETE). The lawsuit concerns a discriminatory distribution of convertible preferred units (CPU) to certain, but not all, ETE common unit holders, and a massive transfer of wealth from the common unit holders to those chosen few who received the CPUs. The recipients included ETE's chairman Kelcy Warren, its president John McReynolds, their family members, and certain other ETE insiders and friends of ETE management, accounting for approximately 31.5% of ETE's common units.

Our lawsuit, filed on behalf of an individual investor and the Chester County Retirement Fund, contends that the CPUs were distributed in violation of the limited partnership agreement that governs the relationship among ETE, its management, and its unitholders. Unlike cases involving corporations, the governance of limited partnerships is generally not subject to traditional fiduciary duties of loyalty and care that corporate directors owe to stockholders. Rather, the directors of ETE owe the pubic investors — the common unitholders — only those duties spelled out in the ETE limited partnership agreement.

We seek a ruling that the CPUs, essentially, be voided and rescinded. We name as defendants ETE, its general partner, Warren, McReynolds, other members of ETE's board, and other ETE insiders who received the CPUs. This article describes the fact-intensive

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Institutional Governance and Legal Symposium

A Private Forum for Senior Executives from Asset Management Firms, Sovereign Wealth Funds and Government Plans

May 2-3, 2018

The Landmark London

London, UK

Advisory Board (to date)

Rachel Wheeler, *GC*, **Aviva Investors**

Alastair Maclean, *Head of Group Legal*, **Baillie Gifford & Co.**

Fabrice Remy, *Senior Legal Counsel*, **Capital Group**

Lowell Haky, *Associate General Counsel*, **Charles Schwab**

John Forst, *Deputy General Counsel*, **Lord Abbett & Co.**

Sarah Owen, *General Counsel*, **New Zealand Superannuation Fund**

Yves Denizé, *SMD & Deputy General Counsel*, **Nuveen Legal**

David Kemp, *GC, Asset Management & Private Banking*, **Schroders**

Michael Mundt, *Partner*, **Stradley Ronon Stevens & Young LLP**

Keynote Speaker

The Rt Hon David Cameron
Former Prime Minister of the United Kingdom, 2010 – 2016

For 13 years in Europe, 9 years in the US, and 3 years in Canada, Institutional Investor has partnered with Kessler Topaz Meltzer & Check LLP (KTMC) to co-host these three events annually. Each meeting's purpose is to address growing interest in corporate governance issues globally and to explore and assess the efficacy of the ways that institutional investors are engaging with the companies they invest in.

In 2018, on May 2-3 at The Landmark Hotel in London, for the first time we are bringing together legal executives and selected, associated investment decision-makers, CEOs and CIOs from global SWFS, selected public pension plans, and asset management firms to discuss how legal and investment teams are re-assessing, re-prioritizing, and focusing their engagement strategies.

With the essential input of an Advisory Board representing the audience who will attend this event, the Institutional Governance and Legal Symposium will offer a thorough overview of the landscape affecting institutional shareholders, with a critical focus on governance, ESG(T), SRI and other interconnected investment issues. Emphasizing real-world examples of how shareholders are engaging with the companies they invest in as well as how their peers are setting their priorities and structuring their teams internally, the Symposium will review the most crucial regulatory actions, investment risks, and developments in M&A, private equity, etc., and offer insights on the approaches successful plans have implemented to meet their legal, compliance, and investment objectives.

Who will attend?

Approximately 30-40 audience members: C-Suite Executives, Legal, compliance, and related investment executives from two of Institutional Investor's exclusive membership groups, the **Legal Forum** and the **Sovereign Investor Institute**, have been enlisted for the purposes of developing an audience for this meeting, bringing to bear their long-standing relationships with decision-makers from key institutions globally.

More Information

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WHAT COULD HAVE BEEN: THE RISE AND FALL OF THE CFPB'S ARBITRATION RULE

Zachary Arbitman, Esquire

On July 19, 2017, the Bureau of Consumer Financial Protection ("CFPB") issued a final rule prohibiting covered providers of certain consumer financial products and services from using arbitration clauses barring consumers from filing or participating in class action lawsuits concerning those products and services ("Arbitration Rule").[1] The Arbitration Rule also required covered providers involved in an arbitration, pursuant to a pre-dispute arbitration agreement, to submit specified arbitral and court records to the CFPB.[2]

The regulation became effective September 18, 2017 and required compliance for all pre-dispute arbitration agreements entered into on or after March 19, 2018. Shortly after the Arbitration Rule's issuance, however, it met significant opposition — ultimately being overridden by way of a joint resolution signed by President Trump pursuant to the rarely used Congressional Review Act. In doing so, Congress and the President hastily undid a critical regulation and, effectively, slammed shut the courthouse doors to injured consumers seeking to band together to take on powerful corporate interests perpetrating widescale financial harm.

CFPB Rulemaking

Under the Dodd-Frank Act, Congress charged the CFPB with examining pre-dispute arbitration agreements.[3] In line with this directive, the CFPB published and delivered to Congress its *Arbitration Study: Report to Congress, Pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a)* (the "Study") in 2015.[4] The Dodd-Frank Act also authorized the CFPB, after completing its assessment, to issue regulations restricting or prohibiting the use of arbitration agreements if the CFPB found that such rules would be consistent with its Study, the public interest, and the protection of consumers.[5] Thus, after its review, the CFPB published a proposal on May 24, 2016 to establish the Arbitration Rule.[6] And, after a period of public comment and review

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[1] 12 C.F.R. § 1040.4(a).

[2] *Id. § 1040.4(b).*

[3] 12 U.S.C. § 5518(a).

[4] Bureau of Consumer Fin. Prot., *Arbitration Study: Report to Congress, Pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a) (2015), available at* http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf.

[5] 12 U.S.C. § 5518(b).

[6] Arbitration Agreements, 81 FR 32830.

IN RE BANCO BRADESCO: STATEMENTS CONCERNING CORPORATE CODE OF ETHICS HELD ACTIONABLE AND DISMISSAL OF PARALLEL CRIMINAL CHARGES AGAINST A DEFENDANT CARRY NO WEIGHT AT THE PLEADING STAGE

Margaret E. Mazzeo, Esquire

KTMC serves as lead counsel in *In re Banco Bradesco Sec. Litig.*, No. 1:16-cv-4155-GHW, 2017 WL 431407 (S.D.N.Y. Sept. 29, 2017) for the court-appointed lead plaintiff, the Public Employees' Retirement System of Mississippi ("Lead Plaintiff"), and a putative class of Banco Bradesco investors. In a September 29, 2017 opinion, the Honorable Gregory H. Woods of the United States District Court for the Southern District of New York granted in part and denied in part a motion to dismiss filed by the defendants in this action. Notably, in sustaining certain of Lead Plaintiff's claims, Judge Woods determined that: (i) statements regarding Banco Bradesco's ("Bradesco" or the "Company") code of ethics were actionable under Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"); and (ii) the conclusions of a Brazilian court dismissing related criminal charges against defendant Luiz Carlos Trabuco Cappi ("Trabuco"), the Company's Chief Executive Officer, had no effect on the Court's resolution of the defendants' motion to dismiss.

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FACEBOOK AND FOUNDER MARK ZUCKERBERG CAPITULATE TO KTMC ON EVE OF TRIAL

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Facebook went public in 2012 with two classes of stock: class B with 10 votes per share, and class A with 1 vote per share. Public stockholders owned class A shares, while only select insiders were permitted to own the class B shares. Zuckerberg controlled Facebook from the IPO onward by owning most of the high-vote class B shares.

Facebook's charter made clear at the IPO that if Zuckerberg sold or gave away more that a certain percentage of his shares he would fall below 50.1% of Facebook's voting control. The Giving Pledge, when read alongside Facebook's charter, made it clear that Facebook would not be a controlled company forever.

In 2015, Zuckerberg owned 15% of Facebook's economics, but though his class B shares controlled 53% of the vote. He wanted to expand his philanthropy. He knew that he could only give away approximately $6 billion in Facebook stock without his voting control dropping below 50.1%.

He asked Facebook's lawyers to recommend a plan for him. They recommended that Facebook issue a third class of stock, class C shares, with no voting rights, and distribute these shares via dividend to all class A and class B stockholders. This would allow Zuckerberg to sell all of his class C shares first without any effect on his voting control.

Facebook formed a "Special Committee" of independent directors to negotiate the terms of this "reclassification" of Facebook's stock structure with Zuckerberg. The Committee included Marc Andreeson, who was Zuckerberg's longtime friend and mentor. It also included Susan Desmond-Hellman, the CEO of the Gates Foundation, who we alleged was unlikely to stand in the way of Zuckerberg becoming one of the world's biggest philanthropists.

In the middle of his negotiations with the Special Committee, Zuckerberg made another public pledge, at the same time he and his wife Priscilla Chan announced the birth of their first child. They announced that they were forming a charitable vehicle, called the "Chan-Zuckerberg Initiative" (CZI) and that they intended to give away 99% of their wealth during their lifetime.

The Special Committee ultimately agreed to the reclassification, after negotiating certain governance restrictions on Zuckerberg's ability to leave the company while retaining voting control. We alleged that these restrictions were largely meaningless. For example, Zuckerberg was permitted to take unlimited leaves of absence to work for the government. He could also significantly reduce his role at Facebook while still controlling the company.

At the time the negotiations were complete, the reclassification allowed Zuckerberg to give away approximately $35 billion in Facebook stock without his voting power falling below 50.1%. At that point Zuckerberg would own just 4% of Facebook while being its controlling stockholder.

We alleged that the reclassification would have caused an economic harm to Facebook's public stockholders. Unlike a typical dividend, which has no economic effect on the overall value of the company, the nonvoting C shares were expected to trade at a 2-5% discount to the voting class A shares. A dividend of class C shares would thus leave A stockholders with a "bundle" of one class A share, plus 2 class C shares, and that bundle would be worth less than the original class A share. Recent similar transactions also make clear that companies lose value when a controlling stockholder increases the "wedge" between his economic ownership and voting control. Overall, we predicted that the reclassification would cause an overall harm of more than $10 billion to the class A stockholders.

The reclassification was also terrible from a corporate governance perspective. We never argued that Zuckerberg wasn't doing a good job as Facebook's CEO right now. But public stockholders never signed on to have Zuckerberg control the company for life. Indeed at the time of the IPO that was nobody's expectation. Moreover, as Zuckerberg donates more of his money to CZI, one would assume his attention would drift to CZI as well. Nobody wants a controlling stockholder whose attention is elsewhere. And with Zuckerberg firmly in control of the company, stockholders would have no recourse against him if he started to shirk his responsibilities or make bad decisions.

We sought an injunction in this case to stop the reclassification from going forward. Facebook already put it up to a vote last year, where it was

approved, but only because Zuckerberg voted his shares in favor of it. The public stockholders who voted cast 80% of their votes against the reclassification.

By abandoning the reclassification, Zuckerberg can still give away as much stock as he wants. But if he gives away more than a certain amount, now he stands to lose control. Facebook's stock price has gone up a lot since 2015, so Zuckerberg can now give away approximately $10 billion before losing control (up from $6 billion). But then he either has to stop (unlikely, in light of his public pledges), or voluntarily give up control. There is evidence that non-controlled companies typically outperform controlled companies.

KTMC believes that this litigation created an enormous benefit for Facebook's public class A stockholders. By forcing Zuckerberg to abandon the reclassification, KTMC avoided a multi-billion dollar harm. We also preserved investors' expectations about how Facebook would be governed and when it would eventually cease to be a controlled company.

KTMC represented Sjunde AP-Fonden ("AP7"), a Swedish national pension fund which held more than 2 million shares of Facebook class A stock, in the litigation. AP7 was certified as a class representative, and KTMC was certified as co-lead counsel in the case. The litigation at KTMC was led by KTMC attorneys Lee Rudy, Eric Zagar, J. Daniel Albert, Grant Goodhart, and Matt Benedict. ■

STILL HAVING TROUBLE GETTING YOUR MONEY BACK? YOU'RE NOT ALONE

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generally accepted that institutional investors have a fiduciary duty to take reasonable steps to recover these funds which are owed to them. Yet despite this fiduciary duty and the amount of money at stake, claims filing participation remain strikingly low.

Comparatively little research has been done in this area, since the seminal study conducted by Professors James D. Cox and Randall S. Thomas in 2005[2], which found that only 28% of institutional investors at that time were filing claim forms, thereby leaving billions of dollars on the table each year. That being said, recent estimates compiled from NERA Economic Consulting and Cornerstone Research suggest that those figures haven't improved by much, with only 35% of eligible institutional investors filing claims in U.S. settlements.[3] The low U.S. claims filing rates, and changes in the legal and regulatory landscape (including the U.S. Supreme Court's 2010 decision in *Morrison v. National Australia Bank*, which has forced investors to pursue a recovery outside the United States for securities fraud losses stemming from shares traded on non-U.S. exchanges) which has further complicated the issue, has meant that twelve years after Professors Cox & Thomas' study, institutional investors are still leaving billions of dollars on the table.

Recent Issues Causing Grief for Institutional Investors

In recent years, to add to the already challenging claims administration process, some new issues have arisen to further muddy the water.

Change of Custodian

Since the financial crisis, we have observed a number of institutional investors, particularly at U.S. municipal pension fund level and Taft-Hartley plans across all trades, making changes from one custodial bank to another for a variety of reasons. When an institution changes their custodial bank, this can give rise to an overlooked issue when it comes to claims administration. For example, when a class period in a securities case spans the time of the custodial transition, the outgoing custodian and the newly hired custodian might each have insufficient data to file a complete claim on behalf of the client. When this happens, and when two claim forms are submitted (one by each custodian for the data under their custody), the claims are frequently rejected by the claims administrator as deficient. If these deficiencies are not remedied (which, anecdotally we believe is almost always the case), the result can be a significant lost opportunity for the institutional investor (see the Merck case study below for further discussion).

Former Custodians Getting Out of the Claims Filing Business

In addition to the deficiency issue noted above with regard to custodian change, many custodians are simply getting out of the claims filing business altogether for former clients (or charging fees

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[2] *See* James D. Cox & Randall S. Thomas, Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Class Action Settlements, 58 Stan. L. Rev. 411 (2005).

[3] *See* Cornerstone Research and the Stanford Law School Securities Class Action Clearinghouse, Securities Class Action Filings: 2016 Year in Review, www.cornerstone.com, (January 2017).

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and/or taking a percentage of the recovery for this service). This presents institutional investors with a difficult choice. If the institution is fortunate enough to have all of their transaction history, they might be able to work with their current custodian to jointly construct claim forms which require both older and newer transaction history. If the institution does not have the old transaction data in-house (which is often the case), they are at the mercy of the former custodian — either pay a fee to have them file the claim on behalf of the fund (what if the fee to file is larger than the actual recovery?) or give up a percentage of the recovery. Many of our clients have faced this situation in the past two years. Neither scenario is particularly attractive and gives rise to a risk that institutional investors will fail to recovery proceeds owed to their plans.

Current Custodians Outsourcing Claims Filing to Third-party Vendors

Furthermore, some custodial banks are now outsourcing claims filing responsibilities to third-party filers, which present additional considerations, including the threshold question of whether the custodian has properly disclosed this to the client. We have seen multiple instances in recent years where the institutional investor was not aware that the custodian was no longer handling the claims filing process in-house. While the end result may not prove harmful, at a minimum, investors should know which vendors are doing work on their behalf Further, as discussed in recent *Bulletin* articles, we have observed significant differences in the scope and accuracy of claim filing services provided by paid third-party filers, and as such, this may be more than a simple disclosure problem, and result in an actual failure to file claims.

Case Study: Merck Settlement ($1.062 billion)

As discussed above, change in custodian is one of the biggest reasons why institutional investors fail to file claim forms in securities class action settlements and judgments. Below is an example of the issue an institutional investor faces when they have changed their custodial bank, and the class period in a particular securities class action case spans the time of the custody change. This scenario presents a problem for the institutional investor in being able to properly file a completed claim form. The resulting financial impact that can occur to the investor is presented here.

- Class Action Settlement: *In re Merck & Co., Inc. Securities, Derivative & "ERISA" Litigation*, No. 05-1151 (D.N.J.)
- Gross Settlement Amount: $1.062 billion
- Class Period: May 21, 1999 – October 29, 2004
- Custody Change from Custodian A to Custodian B occurred on August 1, 2004

In this situation, each custodian, Custodian A and Custodian B, would file a separate settlement claim for an investor's class period transactions that occurred while the investor was under its custody, resulting in the investor having two filed claims with partial class period transaction information. Custodian A would file using the transactional data from the beginning of the Class Period to the time of the custody change, and Custodian B would file for transactions made from the time of the custody change to the end of the Class Period. Although both claim forms are for transactions made by the same institutional investor (and may well have been made by the same money manager before and after the custody change), because the claims were filed separately, they would be processed separately by the claims administrator.

Please review the chart on the following page. Each claim, when processed separately, would be marked deficient because of the 4,000 shares that transferred from Custodian A to Custodian B during the Class Period. Despite the deficiency, the claims administrator would calculate a recognized loss for each claim pursuant to the court-approved plan of allocation to the extent possible. Since Custodian A's claim shows that 4,000 shares were delivered out in August 2004, and not sold or held after Merck's corrective disclosure that occurred in September 2004, the claim would calculate to no recognized loss. Custodian B's claim would have a $7,950 loss on the 1,600 shares that were purchased under Custodian B's custody. But what about the 4,000 received shares in Custodian B's claim?

In U.S. settlement claim administration, transferred shares are considered "free deliveries" and "free receipts." In this example, the cost basis for the 4,000 shares that were transferred from Custodian A to Custodian B would never be accounted for. The two separate claims distort the full picture of the institutional investor's class period trading, and even though the 4,000 shares were (after the custody change) sold or held after the disclosure, the claims administrator cannot treat them as such on two separate claims.

In this example, the recognized loss of one complete claim far outweighs the sum of its parts. Had one complete claim been filed by a single filer, the cost basis for the 4,000 shares would have been accounted for and added significant monetary value to the institutional investor's claim, resulting in a recognized loss of $37,626.10.

What Can Institutional Investors Do To Improve Their Procedures in this Area?

As discussed herein, the claims administration process continues to evolve and so must the processes that institutional investors have in place. Here are a few suggestions:

1) Ask questions: Discuss how much you have received in proceeds from securities class action settlements/judgments in the past few years? What claims have been submitted and are awaiting distribution from the claims administrator? Did you miss out on submitting a claim for a U.S. case for any reason, or were you not able to participate in the recovery of a non-U.S. jurisdiction settlement because you never registered at the outset of the action? Only by asking these questions will you get the bottom of this area of your fund's affairs.

2) Audit: Conduct both a historical (2-year) and ongoing (quarterly) audit of your custodial bank or other third-party filer to check their accuracy in the claims filing process and then, to keep them on their toes going forward, audit them every quarter thereafter. To the extent any missed claims are identified along the way, immediately contact the claims administrator for the settlement in question to see if it is possible to submit a late claim or remedy a deficient one. As long as settlement proceeds have not yet been distributed, often this can be done.

3) Insert Language into **ALL** Custodial Agreements: To help ensure that you are not put in a difficult situation when changing custodians, institutional investors should consider including a provision in all custodial agreements they execute going forward to ensure their transaction data is properly returned to you at the end of the contractual relationship. Having this data in-house will help institutional investors avoid the *Merck* problem identified above.

Analysis of Claim Form Submitted by Custodian A for transctions occurring from Start of Class Period through Custody Change

Transaction type	Claimed Shares	Proceeds/ (Expenditures)	Recognized Loss Pursuant to Plan of Allocation
Shares Purchased during Class Period	4,200	$ (265,759.00)	Recognized loss of $0 Reason: No loss of shares sold or transferred prior to the disclosure on 9/29/04
Shares Sold during Class Period	(200)	$ 9,035.50	
Shares Held at Time of Custody Change	4,000	$ (256,723.50)	
	Shares Delivered to Custodian B on 8/1/04 ↓		
		Total Recognized Loss for Claim A	$0

Analysis of Claim Form Submitted by Custodian B for transctions occurring from Start of Class Period through Custody Change

Transaction type	Shares ↑ Shares Delivered to Custodian B on 8/1/04	Proceeds/ (Expenditures)	Recognized Loss Pursuant to Plan of Allocation
Shares Received during Class Period	4,000	$ –	Recognized loss of $0 Reason: No loss on received shares. The cost basis of the transferred shares does not get claimed
Shares Sold during Class Period	(1,300)	$ 57,555.00	
Received Shares Retained past Disclosure Date	2,700		
Shares Bought during Class Period and Retained past Disclosure Date	1,600	$ (51,631.25)	Recognized loss of $7,950
		Total Recognized Loss for Claim B	$7,950

Conclusion

Claims administration in securities class action settlements and judgments will never be Agenda Item #1 at your Board meeting. Institutional investors have more important issues to deal with when it comes to running money, chief among them, meeting investment returns in often difficult market environments, ensuring the proper administration of their investments, and generally, acting as good fiduciaries for the money entrusted to them. That being said, with the truly global nature of securities litigation in this post-*Morrison* world, institutional investors should continue to be vigilant in this area. The significant proceeds generated from securities class action settlements and judgments are an asset owed to you — do what you can to ensure you are getting it back. ■

AMSTERDAM COURT OF APPEALS DENIES DUTCH SHAREHOLDER ASSOCIATION GROUP ACTION AGAINST BP

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traded on a U.S. exchange), there was a large amount of speculation that the Netherlands could provide an attractive venue for pursuing securities actions involving companies whose securities traded on non-U.S. exchanges. The reason for the Netherlands attractiveness as a venue stemmed in part from the Dutch Act on the Collective Settlement of Mass Claims (*Wet Collectieve Afwikkeling Massaschade* or "WCAM") and its high profile use in a 2008 settlement between predominantly European investors and *Royal Dutch Shell.* The WCAM looked to be a useful tool for investors to seek monetary relief on a class-wide basis because the procedure allows parties to a dispute to *voluntarily* negotiate a settlement and then apply to the Amsterdam Court of Appeals for a declaration that the settlement is legally binding on all members of a class who did not affirmatively opt-out of the settlement. In contrast, most European countries do not offer U.S. style opt-out class actions, and so in order to pursue a remedy each aggrieved investor would need to either file its own lawsuit or join a group complaint.

The WCAM requires parties to voluntarily agree to a settlement. There are no mechanisms within the WCAM that provide leverage to get the parties to a negotiating table because the WCAM does not allow the court to assess liability nor to make an award for damages or injunctive relief. However, in some previous WCAM settlements, the procedure has been used after a Foundation or Representative Organization has filed a *Collective Action* under Article 3-305a of the Dutch Civil Code. A Foundation or Representative Organization can pursue a collective action in order to establish the liability of a defendant or to seek declaratory relief, but it cannot be used to make claims for damages. Because the *Collective Action* does not rely upon the parties' voluntary submission to the jurisdiction of the Netherlands, the courts in the Netherlands must have jurisdiction over the defendant in order to hear the dispute.

In April 2015, the VEB, the Dutch shareholders association, filed a *Collective Action* complaint against BP PLC ("BP") on behalf of all persons who purchased ordinary shares of BP during the period of January 16, 2007 through June 25, 2010 and who either held or sold their shares via an investment account in the Netherlands or through an investment account with a bank or investment firm established in the Netherlands. The VEB's complaint sought a declaratory judgment regarding BP's liability towards investors and piggybacked off an investigation of the U.S. Securities and Exchange Commission and alleged that BP made misleading statements about the robustness of the company's safety program and about the size and impact of the oil leak caused by the 2010 Deepwater Horizon explosion and oil spill that occurred in the Gulf of Mexico. BP is a British multinational oil and Gas Company that is headquartered in London and has shares listed on the London Stock Exchange and secondary listings on the Frankfurt Stock Exchange and the New York Stock Exchange.

BP moved to dismiss the *Collective Action* on the grounds that the Netherlands lacked jurisdiction over it. On September 28, 2016, the Amsterdam District Court granted BP's motion and dismissed the VEB's claims against BP holding that the mere fact that investors may have held securities in the Netherlands is an insufficient connection to allow the Dutch courts to assert jurisdiction. The VEB appealed to the Amsterdam Court of Appeals. On November 7, 2017, the Amsterdam Court of Appeals upheld the lower court's dismissal and held that the Netherlands lacked the requisite jurisdiction to hear the dispute.

In reaching its decision, the Amsterdam Court of Appeals reviewed the EU Regulations pertaining to jurisdiction and the recognition and enforcement of judgments in civil and commercial matters and the case-law of the European Court of Justice ("ECJ") on the interpretation of provisions of the EU regulations.

In reviewing the European regulations, the court noted that the main rule, outlined in Article 4(1) of Regulation 1215/2012, is that a company that has its registered office, central management, or principal place of business in one EU Member State, is subject to the jurisdiction of the courts in that EU

Member state. BP, as a company headquartered in London, would fall under the jurisdiction of the courts of the United Kingdom and not the Dutch courts on the basis of this rule. The court noted, however, that the EU Regulations permit companies who are headquartered in the territory of one Member State to be sued in courts of another Member State only when specific conditions (outlined in Sections 2 through 7 of Chapter II of Regulation 1215/2012) are met.

One of the conditions that may give rise to jurisdiction (and the condition that the VEB sought to use to bring its claim against BP in the Netherlands) is the condition found that the court of the Member State where a harmful event occurred may have jurisdiction to hear the dispute against the defendant that allegedly caused that harmful event to occur. This provision applies both to the place where the event that caused the damages took place and the place where the damages actually occurred. In rendering its decision on whether the Dutch courts had jurisdiction over BP on this basis, the Amsterdam Court of Appeals noted that case law from the ECJ required that those special jurisdictional rules be interpreted strictly and that, with respect to the asserting jurisdiction in the place where a harm occurred, the regulation not be interpreted so broadly that it covers every place where the harmful effects of an act has caused damage. Instead, a court must determine, on the basis of the actual circumstances in the case, whether there is a sufficiently close connection between the Member State and the harm that occurred. In applying that strict interpretation, the Amsterdam Court of Appeals determined that the place where the harmful event occurred was not in the Netherlands. The court noted that, "[t]he root of VEB's claims is taken to the core of BP's alleged failure to fulfill its (legal) obligation to inform investors correctly and completed. It may be inferred from the case-law… that in a case where an obligation to provide information has not been complied with, the acts or omissions which the alleged infringement may give rise must in principle be situated at the place where the decision-making of the defendant has taken place."

VEB argued that although the place where the harmful event occurred was not the Netherlands, that the court could assert jurisdiction because the damages occurred in the Netherlands. VEB argued that in a case like this, a case that concerns pure financial damages, the location of the investment account is the relevant location where the damage occurred and because the investors at issue in this case all had investment accounts in the Netherlands, the Dutch courts should be found to have proper jurisdiction. The Amsterdam Court of Appeals rejected this argument. Basing its decision on the ECJ's opinion in a case involving Universal Music International Holding B.V., the Amsterdam Court noted that the ECJ had rejected extending jurisdiction to the place where the damages occurred in the absence of other factors that closely connected the Member State to the defendant. Of particular relevance to the Amsterdam Court of Appeals was the fact that the ECJ declined to find proper jurisdiction where the damage was purely financial damage that occurred in a bank account in one EU Member State but where the damage was the legal consequence of unlawful conduct that occurred in a different EU Member State.

The Amsterdam Court of Appeals reviewed the facts of the VEB's complaint to determine if there were other special circumstances that, when taken into account, would support the Dutch courts' jurisdiction on the basis that the VEB was representing shareholders who had made the investments in BP through accounts located in the Netherlands. The court noted that BP markets to global investors, that a large number of the investors with Dutch investment accounts actually reside in the Netherlands, and that no similar proceedings were being pursued in any EU Member State against BP. However, the court did not find that these facts gave rise to special circumstances from which a close link to the Netherlands could be derived and from which the Dutch courts could base an exercise of jurisdiction.

This decision by the Amsterdam Court of Appeals will have significant ramifications for a number of other actions that have recently been launched in the Netherlands. The VEB and other foundations have filed or proposed shareholder actions in the Netherlands against Volkswagen, Toshiba, and Petrobras. A number of those actions were pursued not just on behalf of Dutch shareholders, but on behalf of a global class of investors. However, this judgment suggests that the Dutch courts will not assert jurisdiction to hear those disputes because there is an insufficient nexus between the Netherlands and the defendant companies. ■

WAGGONER V. BARCLAYS PLC: REBUTTING THE FRAUD-ON-THE-MARKET PRESUMPTION OF RELIANCE REQUIRES A PREPONDERANCE OF THE EVIDENCE

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The Fraud-on-the Market Presumption under *Basic*

The fraud-on-the-market presumption enables plaintiffs pursuing securities fraud claims under Section 10(b) of the Exchange Act in a class action to establish the element of reliance on alleged false or misleading statements on a class-wide basis. As articulated by the Supreme Court in *Basic Inc. v. Levinson*,[3] the presumption is premised on the theory "that the market price of shares traded on well-developed markets reflects all publicly available information," and therefore "[a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price."[4] This judicially-created presumption has become a vital component of securities fraud class actions, allowing for the certification of classes of investors led by institutional lead plaintiffs who, despite suffering significant damages, might be unable to prove direct or actual reliance on a company's otherwise actionable false or misleading statements.
To invoke the presumption, plaintiffs must demonstrate that the market for the security that is the subject of their claims is efficient, the misrepresentation(s) were publicly known, and that they purchased the security between the time the false or misleading statement was made and the truth was allegedly revealed.

As with all presumptions, the fraud-on-the-market presumption can be rebutted. The Court in *Basic* noted that this may be accomplished by "[a]ny showing that severs the link between the alleged misrepresentation" and the market price.[5] In the years after *Basic* was decided, lower courts grappled with what types of evidence could be considered in determining whether the presumption of reliance had been rebutted and how to allocate the burden proof on this issue. Most often, defendants sought to rebut a class-wide presumption of reliance by showing that the security at issue did not trade in an efficient market, thereby "sever[ing] the link" between any alleged misrepresentation and the market price. Yet even where market efficiency could readily be established, defendants nonetheless sought to defeat the presumption by showing that the alleged misstatements purportedly did not affect the price of the security, something commonly referred to as "price impact." The latter challenge took on particular significance after the Supreme Court held that defendants were entitled to attempt to rebut the presumption of reliance by presenting evidence at class certification demonstrating a lack of price impact.

Halliburton II and the Requirement of "Price Impact"

In *Halliburton Co. v. Erica P. John Fund, Inc.* ("*Halliburton II*"),[6] the Supreme Court affirmed the continued vitality of the fraud-on-the-market presumption of reliance for claims under Section 10(b) of the Exchange Act, but reiterated that without the class-wide presumption of reliance afforded under *Basic*, class certification would be inappropriate under Rule 23 because individualized issues of reliance would necessarily predominate over common questions of law or fact. Accordingly, the Court held that "defendants must be afforded an opportunity before class certification to defeat the presumption through evidence that an alleged misrepresentation did not actually affect the market price of the stock."[7]

Notably, while the *Halliburton II* majority rejected the defendant's proposal that plaintiffs be required to prove price impact directly, the Court did not specify the quantum of evidence sufficient to rebut the presumption of reliance. Rather, the Court stated only that a district court could not "ignore a defendant's direct, more salient evidence showing that the alleged misrepresentation did not actually affect the stock's market price and, consequently, that the *Basic* presumption does not apply."[8]

The question of exactly what qualifies as "more salient evidence" for purposes of proving a lack of price impact, and whose burden it is to make (or

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[3] 485 U.S. 224 (1988).

[4] *Id*. at 246-47.

[5] *Id*. at 248.

[6] 134 S. Ct. 2398 (2014). In *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804 (2011) *("Halliburton I")*, the Court held that proof of loss causation is not a prerequisite to class certification.

[7] 134 S. Ct. at 2417.

[8] *Id*. at 2416.

refute) such a showing was not explicitly decided by *Halliburton II*.[9] In cases where plaintiffs do not allege that a defendants' false or misleading statements caused an observable increase in the price of the security at the time they were made ("front-end" price impact) but that the misstatements artificially *maintained* the current market price or prevented it from falling, the available evidence of price impact is often coextensive with evidence of loss causation — evidence that when revealed, the truth concealed by the misrepresentation caused the market price to decline ("back-end" price impact). Therefore, the allocation of the burden of proof between plaintiffs and defendants with respect to price impact is extremely consequential, especially if the Supreme Court's *Halliburton I* decision that loss causation is not a prerequisite to class certification is to be given any effect. Indeed, as the defendant in *Halliburton II* argued to the Fifth Circuit prior to the Supreme Court's opinion, "class certification was inappropriate because *the evidence it had earlier introduced to disprove loss causation* also showed that none of its alleged misrepresentations had actually affected its stock price."[10]

The *Waggoner* Decision

The claims in *Waggoner* arose out of alleged material misrepresentations and omissions by Barclays regarding the operation of its private "dark pool" trading system, Liquidity Cross ("LX"). In June 2014, the New York Attorney General filed a complaint against Barclays under New York's Martin Act, alleging that Barclays concealed information about LX. Following news of the lawsuit, Barclays' stock price fell by 7.38 percent, prompting investors in Barclays' American Depository Shares ("ADS") to bring a putative securities fraud class action in the Southern District of New York.

In support of their motion for class certification, the plaintiffs submitted an expert report that concluded that the market for Barclays ADS was efficient. This expert opinion was based on both direct evidence in the form of an event study demonstrating that the price of Barclays' ADS changed upon the release of new material information about the company, and indirect evidence, such as average weekly trading volume of Barclays ADS and the fact that the company was closely followed by market analysts. Based upon the expert evidence that the plaintiffs presented, the district court found that plaintiffs had demonstrated market efficiency, entitling them to invoke the fraud-on-the-market presumption of reliance. Furthermore, the district court determined that the defendants failed to rebut the presumption and that plaintiffs were otherwise entitled to class certification because the "fact that other factors contributed to the price decline [on the date of the alleged corrective disclosure] does not establish *by a preponderance of the evidence* that the drop in the price of Barclays['] was not caused *at least in part* by the disclosure of the fraud."[11]

On appeal, the defendants contended that they should not be required to rebut the *Basic* presumption by a preponderance of the evidence and that, in any event, they had successfully rebutted the presumption by demonstrating (i) a lack of front-end price impact[12] and (ii) that a portion of the decline on the date of the disclosure was attributable to reasons other than the revelation of the alleged fraud.

Addressing these contentions, the Second Circuit first held that "defendants must rebut the *Basic* presumption by disproving reliance by a preponderance of the evidence at the class certification stage."[13] Analyzing *Basic* and *Halliburton II*, the Second Circuit found that these decisions "recognized the importance of the presumption of reliance" without which plaintiffs in putative securities fraud class actions would face an "unrealistic evidentiary burden," noting that "presumption of reliance would [] be of little value if it were so easily overcome."[14] The Second Circuit also observed that in a concurring opinion in *Halliburton II*, three Justices stated that the Court recognizes "that it is incumbent upon the defendant to *show* the absence of price impact," and found that "[t]his Supreme Court guidance indicates that defendants seeking to rebut the *Basic* presumption must demonstrate a lack of price impact by a preponderance of the evidence."[15] Furthermore, the *Waggoner* court noted that prior to *Halliburton II*, the Second Circuit had held that defendants bear

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[9] On remand from the Supreme Court, the district court found that "based on the Court's analysis of the Supreme Court's decision in *Halliburton II,* and decisions by other district courts since *Halliburton II,* the Court finds the burdens of production and persuasion to show lack of price impact are properly placed on [defendant]." *Erica P. John Fund, Inc. v. Halliburton Co.,* 309 F.R.D. 251, 258 (N.D. Tex. 2015).

[10] 134 S. Ct. at 2406 (emphasis added).

[11] *Id.* at *8 (quoting *Strougo v. Barclays PLC*, 312 F.R.D. 307, 327 (S.D.N.Y. 2016)) (second alteration in original).

[12] Defendants had argued to the district court that the lack of a statistically significant price increase on the dates of the alleged misstatements *per se* demonstrated "no connection between the misstatements and the price of Barclays' ADS." *Id.* at *6. This position was reiterated by *amici curiae* on appeal. *See* Brief for Amici Curiae Former SEC Officials and Law Professors, 2016 WL 4151323, at *9 (Aug. 1, 2016) (contending that "direct *evidence* of no price impact at the time alleged misstatements were made" negates "a speculative *assumption* of price impact through 'price maintenance'").

[13] *Waggoner,* 2017 WL 5077355, at *14.

[14] *Id.* at *15.

[15] *Id.* at *16 (quoting *Halliburton II,* 134 S. Ct. at 2417 (Ginsburg, J., concurring)).

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the burden of disproving price impact.[16] Finally, the Second Circuit rejected the defendants' argument that Federal Rule of Evidence 301[17] required that plaintiffs retain the burden of persuasion, finding that the Supreme Court's decisions endorsing the presumption of reliance as effectuating congressional intent effectively superseded this procedural rule.

Second, the Second Circuit found that its prior decisions had endorsed a "price maintenance" theory of inflation, ruling that "statements that merely maintain inflation already extant in a company's stock price, but do not add to that inflation, nonetheless affect a company's stock price."[18] Therefore, the court held a lack of front-end price impact does not rebut the *Basic* presumption when plaintiffs are proceeding on a price maintenance theory.

Third, applying these holdings to the facts presented, the Second Circuit held that "merely suggesting that another factor *also* contributed to an impact on a security's price does not establish that the fraudulent conduct complained of did not also impact the price of the security."[19] The court noted that defendants' expert opined only that "*some* of the price reaction was independent of the specific allegations relating to LX."[20] Because the defendants' expert could not completely eliminate the impact of the alleged release of information correcting defendants' false or misleading statements on the price of Barclays ADS on the alleged corrective disclosure dates, the Second Circuit found that defendants had failed to prove a lack of price impact.

The Significance of *Waggoner* on Class Certification Practice and Procedure

The practical impact of the *Waggoner* decision, at least within the Second Circuit, will be that to rebut the presumption of reliance in securities fraud class actions where the plaintiff alleges that a defendant's misstatements artificially maintained the price of a security that traded in an efficient market, defendants must be able prove that any price decline associated with the alleged corrective disclosure(s) revealing the fraud was due *exclusively* to other factors. Notably, this procedural framework is consistent with *Halliburton I*, in that it relieves plaintiffs of having to prove that a particular disclosure is "corrective" in order to establish the price impact of an alleged misstatement. Furthermore, *Waggoner* effectuates the intent of *Halliburton II* by ensuring that only "direct, more salient" evidence be considered by district courts in assessing whether the fraud-on-the-market presumption of reliance is rebutted.

Outside the Second Circuit, defendants are likely to continue to argue that the *Basic* presumption of reliance can be rebutted solely by a showing of a lack of price impact at the time a misrepresentation was issued, and that plaintiffs bear the burden of demonstrating the price impact associated with alleged corrective disclosures.[21] Potentially lending support to these arguments is the Eight Circuit's decision in *IBEW Local 98 Pension Fund v. Best Buy Co., Inc.*,[22] which held that under Federal Rule of Evidence 301, Defendants had the burden of production in rebutting the fraud-on-the-market presumption and that under the facts presented, the presumption had been successfully rebutted by evidence of a lack of front-end price impact. If so, there could be a split among the Federal Courts of Appeal, positioning the issue of the proper burden of proof applicable to price impact arguments at the class certification stage for review by the United States Supreme Court. However, several district courts have already reached the same or similar conclusions as *Waggoner*,[23] and the sound reasoning of the Second Circuit will likely heavily influence future appellate decisions in this area. ■

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16 *Id.* at *17 (citing *In re Salomon Analyst Metromedia Litig.*, 544 F. 3d 474, 486 n.9 (2d Cir. 2008), *abrogated in part on other grounds by Amgen Inc. v. Conn. Ret. Plans & Trust Funds,* 568 U.S. 455 (2013)).

17 Federal Rule of Evidence 301 provides that in a civil case, unless a federal statute provides otherwise, "the party against whom a presumption is directed has the burden of producing evidence to rebut the presumption," but that "this rule does not shift the burden of persuasion."

18 *Id.* at *19.

19 *Id.*

20 *Id.*

21 In a pending appeal to the Fifth Circuit, the defendants and *amici curiae* in *In re Cobalt International Energy, Inc. Securities Litigation* made the same arguments. *See St. Lucie Fire District Firefighters' Pension Trust Fund et al. v. Joseph H. Bryant et al,* Case No. 17-20503 (5th Cir. Aug. 4, 2017).

22 818 F.3d 775, 782 (8th Cir. 2016).

23 *See, e.g., Willis v. Big Lots, Inc.,* 242 F. Supp. 3d 634, 659 (S.D. Ohio 2017) ("[T]he Court rejects the notion that a defendant can rebut Basic's presumption of [reliance] solely by showing that there was no statistically significant price increase after a misrepresentation was made. Defendants failed to show that there was no statistically significant price impact following the corrective disclosures in this case."); *Marcus v. J.C. Penney Co., Inc.*, 2016 WL 8604331, at *7 (E.D. Tex. Aug. 29, 2016) ("Once the Fund invoked the presumption of reliance, the burden shifted to Defendants to attempt to rebut the presumption."); *Hatamian v. Advanced Micro Devices, Inc.*, 2016 WL 1042502, at *7 (N.D. Cal. Mar. 16, 2016) ("Defendants' evidence that there was no statistically significant price impact on certain misstatement dates cannot alone persuade where, as here, expert reports show statistically significant price impacts on each disclosure date").

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— plaintiffs were arguably required to allege that the market reacted negatively to revelation of the fraud itself. Given that the application of each of these standards can yield drastically different outcomes — particularly in cases such as *First Solar*, where there are no alleged corrective disclosures that explicitly reveal the fraud — the Ninth Circuit's forthcoming decision will provide much-needed clarity on this issue.

Factual Background

The *First Solar* plaintiffs ("Plaintiffs") asserted claims against First Solar Incorporated ("First Solar" or the Company") — one of the world's largest producers of photovoltaic solar panel modules — and certain of its key officers and executives (collectively, "Defendants") for violations of Sections 10(b) and 20(a) of the Exchange Act, and Securities and Exchange Commission ("SEC") Rule 10b-5 promulgated thereunder. *See First Solar*, 119 F. Supp. 3d at 981. Plaintiffs alleged that from April 30, 2008, through February 28, 2012, Defendants misrepresented and concealed material information regarding the existence and financial impact of two significant defects in the Company's solar panel power modules related to rapid power loss in certain modules known as the "Low Power Modules" or "LPMs," and heat degradation problems affecting modules installed in hotter climates. *See id.* at 982-84.

Plaintiffs claimed that the truth regarding the LPM defect and heat degradation issue, and the financial impact of those defects on the Company, gradually leaked out over six "corrective disclosures" that revealed the effects of the fraud and caused investors to suffer loss. The first alleged corrective disclosure occurred on July 29, 2010, when the Company disclosed the LPM defect and reported costs associated with the remediation of this defect. *See id.* at 994-95. On this news, First Solar's stock price declined $10.05 per share, or 7.4%. *See id.* at 995. Thereafter, on five additional dates over the next 18 months, First Solar announced ever-increasing adverse economic results causing significant share price declines. *See id.* at 995-1000. At no point, however, did First Solar

ever acknowledge that it had withheld information about the defects or that it had known of the financial impacts prior to disclosing them. Despite the lack of any admission of fraud, Plaintiffs argued that First Solar wrongfully failed to disclose the LPM defect prior to July 29, 2010. *See id.* at 984. Plaintiffs further asserted that First Solar misrepresented the true scope of the LPM defect and the heat degradation issue by engaging in improper accounting practices and reporting false information on their financial statements. *See id.*

The District Court Order

Defendants moved for summary judgment on Plaintiffs' Section 10(b) claims, arguing that, among other things, the alleged corrective events were insufficient to establish loss causation under Ninth Circuit law, which requires plaintiffs to prove that "the market learns of a defendant's fraudulent act or practice, and plaintiff suffers a loss as a result of the market's action." *Id.* at 986 (internal quotation marks and citation omitted). Plaintiffs argued to the contrary that they had satisfied the Ninth Circuit's loss causation standard, which requires plaintiffs to show "that the defendant misrepresented or omitted the *very facts* that were a substantial factor in causing the plaintiff's economic loss." *Id.* (internal quotation marks and citation omitted).

Addressing these arguments, the district court observed that the authorities cited in support of each party's position reflect "two irreconcilable lines of cases" that had emerged in the Ninth Circuit since the Supreme Court addressed the requirement of loss causation in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 125 S.Ct. 1627, 161 L.Ed.2d 577 (2005). *Id.* Specifically, the district court noted that although the parties and the Ninth Circuit could agree on *Dura's* requirement that plaintiffs prove a "causal connection" between their loss and defendants' misrepresentations, "the parties and the Ninth Circuit cases diverge[d]" on the question of "how that connection must be proved." *Id.* at 987 (citing *Dura*, 544 U.S. at 347). To resolve this conflict, the district court went on to describe each line of Ninth Circuit cases, and then to decide which line to follow.

First, the district court discussed the Ninth Circuit's line of cases beginning with *Daou*, which was decided shortly after the Supreme Court issued its opinion in *Dura*. *See id.* at 988. In *Daou*, the plaintiffs charged the defendants with systematically reporting revenue before it was earned in violation of U.S. Generally Accepted Accounting Principles ("GAAP"). *See Daou*, 411 F.3d. at 1012. The company's stock price dropped when it was revealed that much of the revenue it purportedly had earned had consisted of amounts that the company was not entitled to bill to customers because little or no labor had yet taken place. *See id.* at 1026. The lower court had dismissed the plaintiffs' complaint for failure to plead loss causation because the plaintiff had not alleged any disclosure of the defendants' accounting violations at the time the company's stock price dropped. *See id.* Reversing this ruling, the Ninth Circuit concluded that because "the price of Daou's stock fell precipitously after defendants began to reveal figures showing the company's true financial condition[,]" plaintiffs adequately pled loss causation by alleging that "the disclosures of Daou's true financial health, the result of prematurely recognizing revenue before it was earned, led to a dramatic negative effect on the market, causing Daou's stock price to decline." *Id.* (internal quotation marks omitted).

Based on the Ninth Circuit's repeated references to "Daou's true financial health," and "Daou's true financial condition," the district court read *Daou* to hold that plaintiffs can satisfy loss causation based on "disclosure of the company's financial condition, rather than disclosure of the fraud." *First Solar*, 119 F. Supp. 3d at 988. While acknowledging that the facts in *Daou* also included the revelation of defendants' accounting violations, the district court nevertheless reasoned that "it was not the disclosure of these facts that the Ninth Circuit found sufficient for loss causation." *Id.* Rather, the district court found that the basis for the Ninth Circuit's holding on loss causation was "the disclosure of the company's true financial condition, which had been previously misrepresented by the defendants, which led to a drop in the stock price and provided the casual connection between the defendants' wrongful conduct and the plaintiffs' loss." *Id.*

Next, the district court addressed the Ninth Circuit's decision three years later in *Berson v. Applied Signal Technology, Inc.*, 527 F.3d 982 (9th Cir. 2008). *See id.* There, the plaintiffs claimed that the company's reporting of revenue backlog for government contracts was misleading because the defendants failed to disclose that certain of those contracts were subject to "stop-work orders" by the government and might never be performed. *See id.* (citing *Berson*, 527 F.3d at 984). In finding that the plaintiffs adequately pled loss causation, the Ninth Circuit credited their allegations that the company's stock price declined after it disclosed a substantial revenue reduction. *See id.* at 989 (citing *Berson*, 527 F.3d at 989). This holding, according to the district court, was consistent with the approach adopted in *Daou* because "it

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was the eventual effect of the misrepresented facts — the contracts subject to stop-work orders — that caused revenue to drop, stock prices to fall, and plaintiffs' injuries." *Id.* Specifically, the district court observed that in *Berson*, "[a]s in *Daou*, it was the revelation of the company's true financial condition, in contrast to the misleading financial condition portrayed by the defendants, that led to the stock price drop and satisfied loss causation." *Id.*

Finally, the district court discussed the test for loss causation articulated in *Nuveen Mun. High Income Opportunity Fund v. City of Alameda*, 730 F.3d 1111 (9th Cir. 2013). *See id.* In *Nuveen*, the Ninth Circuit held that "[a] plaintiff can satisfy loss causation by showing that the defendant misrepresented or omitted the *very facts* that were a substantial factor in causing the plaintiff's economic loss." *Id.* (quoting *Nuveen*, 730 F.3d at 1120) (internal quotation marks and citation omitted) (emphasis in original). This test, according to the district court, "accurately describes the holdings in *Daou* and *Berson*" because in both of those cases, the "very facts" that were misrepresented or concealed by the defendants' false or misleading statements ultimately led to the stock price declines that caused the plaintiffs' losses. *Id.*

Following its discussion of *Daou* and its progeny, the district court next addressed the second line of Ninth Circuit cases applying a more restrictive "revelation-of-the-falsity" standard for loss causation. *See id.* at 990. As the district court explained, this line of cases begins with *Metzler*, which purported to apply *Daou* in holding that to plead loss causation, "the complaint must allege that the practices that the plaintiff contends are fraudulent were revealed to the market and caused the resulting losses." *See id.* (quoting *Metzler*, 540 F.3d at 1063). The district court criticized this holding as a "misreading of *Daou*" because *Daou* emphasized that the disclosure of "the company's true financial condition" was sufficient to satisfy loss causation. *Id.* (quoting *Daou*, 411 F.3d at 1026).

Nevertheless, the district court observed that *Metlzer* spawned additional Ninth Circuit cases applying the same "revelation-of-the-fraud" standard. *See id.* The first among these cases is the Ninth Circuit's decision in *In re Oracle Corp. Sec. Litig.*, 627 F.3d 376 (9th Cir. 2010), which held that "loss causation is not adequately pled unless a plaintiff alleges that the market learned of and reacted to the practices the plaintiff contends are fraudulent, as opposed to merely reports of defendant's poor financial health generally." *See id.* (citing *Oracle*, 627 F.3d at 392). *Oracle* was followed by *Loos v. Immersion Corp.*, 762 F.3d 880 (9th Cir. 2014), and *Oregon Public Employees Retirement Fund v. Apollo Group, Inc.*, 774 F.3d 598 (9th Cir. 2014), both of which also held that loss causation requires proof that the company's fraudulent practices, as opposed to the adverse impact of those practices, was revealed to the market. *See id.*

In concluding its discussion of *Metzler* and its progeny, the district court acknowledged the potential concern underlying the narrower approach adopted in this line of cases — "that recognizing loss causation merely from a company's poor financial health may lead to the recovery of losses that were caused by factors other than the defendant's fraud." *Id.* at 991. While agreeing that the broader standard potentially could amount to "an improper form of investor insurance," the district court emphasized that this was not the standard adopted in *Daou* and its progeny. *Id.* Specifically, the district court explained that *Daou*, *Berson*, and *Nuveen* required plaintiffs to prove not only "the company's poor financial health and a resulting stock drop" but also "that the company's poor financial health was caused by the 'very facts' that the defendant misrepresented or concealed." *Id.*

After reviewing both lines of cases, the district court decided to apply the loss causation test adopted in *Daou*, *Berson*, and *Nuveen* for three reasons. First, the district court noted that *Daou* was the earliest decision to apply *Dura*, and because all of the subsequent cases were decided by three-judge panels of the Ninth Circuit, they did not have authority to overrule *Daou*. *See id.* As such, the district court concluded that the earlier panel decision in *Daou* should control. *See id.* Second, the district court reasoned that the "financial impact" test adopted in *Daou* and its progeny was more consistent with *Dura's* requirement that plaintiffs prove defendants'

misrepresentations or omissions proximately caused plaintiffs' losses. *See id.* (citing *Dura*, 544 U.S. at 342–46). Third, the district court noted that the "revelation-of-the-fraud" test adopted in *Metzler* and its progeny was too "narrowly circumscribed" because the "traditional rule" of loss causation adopted in *Dura* "does not require that the fraud become known, only that the 'facts as to the finances of the corporation' become known." *Id.* (quoting Section 548A of the Restatement (Second) of Torts).

Applying *Daou*'s loss causation test, the district court concluded that summary judgment should be denied with respect to all but one of Plaintiffs' alleged corrective events. *See id.* at 993–1000. Specifically, the district court held that a reasonable jury could find from five of these disclosures that the very facts misrepresented and omitted by Defendants regarding the existence and scope of the LPM defect and heat degradation issue and their effects on the Company's financial condition were substantial factors in causing First Solar's stock price declines and Plaintiffs' losses. *See id.* However, the district court granted summary judgment with respect to the Company's October 25, 2011 stock price decline, finding that Plaintiffs failed to provide evidence of any causal connection between the announcement of Gillette's departure from the Company and the alleged misrepresentations regarding the LPM defect or the heat degradation issue. *See id.* at 997.

The Issue Certified for Appeal

Based on the foregoing analysis, the district court found that applying the "financial impact" test adopted in *Daou* and its progeny would largely result in denial of Defendants' motion for summary judgment. *See id.* at 992. By contrast, applying the "revelation-of-the-fraud" test adopted in *Metzler* and its progeny would result in complete summary judgment for Defendants. *See id.* Given the costs associated with allowing the litigation to proceed to "expensive expert discovery and a costly complex trial," which the parties and the district court would not otherwise incur if the Ninth Circuit were to hold that the "revelation-of-the-fraud" test represents the appropriate standard, the district court decided to "take the unusual step of certifying the loss causation issue for immediate interlocutory appeal" pursuant to 28 U.S.C. § 1292(b) in order to avoid these "potentially unnecessary" costs. Accordingly, the district court certified the following question:

> [W]hat is the correct test for loss causation in the Ninth Circuit? Can a plaintiff prove loss causation by showing that the very facts misrepresented or omitted by the defendant were a substantial factor in causing the plaintiff's economic loss, even if the fraud itself was not revealed to the market, or must the market actually learn that the defendant engaged in fraud and react to the fraud itself?"
>
> *Id.* (citations omitted).

After the district court certified its ruling, the Ninth Circuit issued its decision in *Lloyd v. CVB Financial Corp.*, 811 F.3d 1200 (9th Cir. 2016), which addressed the question "whether the announcement of an investigation can 'form the basis for a viable loss causation theory' if the complaint also alleges a subsequent corrective disclosure by the defendant." *Id.* at 1210. In analyzing this issue, the Ninth Circuit held that "the announcement of an SEC investigation related to an alleged misrepresentation, coupled with a subsequent revelation of the inaccuracy of that misrepresentation, can serve as a corrective disclosure for the purpose of loss causation." *Id.* at 1203 (citing *Loos*, 762 F.3d at 890 n.3). Importantly, although *CVB* requires some later confirmation of the fraud, it also makes clear that an alleged corrective disclosure "need not precisely mirror the earlier misrepresentation, but it must at least relate back to the misrepresentation and not to some other negative information about the company." *Id.* (internal quotation marks and citation omitted).

On appeal, Defendants maintain their position that the appropriate standard for loss causation in the Ninth Circuit for fraud-on-the-market cases is the "revelation-of-falsity" test adopted in *Metzler* and its progeny. *See* Opening Brief of Appellants-Defendants, *Mineworkers' Pension Scheme*, No. 15-17282 (Mar. 25, 2016) (ECF No. 9), at 12–24. In support of this contention, Defendants argue that this test is consistent with the standard enumerated in *Daou* because there, the fact that certain alleged corrective events revealed the defendants' accounting violations, as opposed to the company's financial condition, was critical to the Ninth Circuit's holding. *See id.* at 25. Defendants further assert that both *Metzler* and *Apollo* cited *Berson*'s loss causation discussion without noting any conflict or inconsistency between the "revelation-of-the-fraud" test and the standard applied in *Berson*. *See id.* at 26. Similarly, Defendants claim that the test articulated in *Nuveen* is not in conflict with the Ninth Circuit's other loss causation decisions because *Nuveen* is not a fraud-on-the-market case. *See id.* at 27. Accordingly, Defendants contend that the district court erred in finding an "irreconcilable conflict" in the Ninth Circuit's loss causation precedents, applying the "prior panel" rule, and determining that the "financial impact" test was the appropriate standard. *See id.* at 28–35.

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FIRST SOLAR PRESENTS OPPORTUNITY FOR NINTH CIRCUIT TO SHED LIGHT ON APPROPRIATE LOSS CAUSATION STANDARD

(continued from page 19)

In response, Plaintiffs argue that the appropriate standard for loss causation merely requires plaintiffs to show a "linkage between defendants' alleged fraud and plaintiffs' loss." Appellees' Answering Brief, *Mineworkers' Pension Scheme*, No. 15-17282 (Mar. 14, 2017) (ECF No. 28), at 33. According to Plaintiffs, this standard is in line with Ninth Circuit decisions holding that loss causation does not require a specific admission or finding of fraud or a "mirror-image" corrective disclosure. *See id*. at 38 (citing *Metzler*, 540 F.3d at 1064; *CVB*, 811 F.3d at 1210). Unlike the district court's analysis, however, Plaintiffs argue that *Metzler* and its progeny did not announce a new rule for loss causation. *See id*. at 41-45. Rather, Plaintiffs claim that *Metzler*, *Oracle*, and *Loos* applied the standard of proximate causation set forth in *Daou* but reached different conclusions based on distinguishable facts. *See id*. Thus, Plaintiffs challenge Defendants' "revelation-of-the-fraud" test as inconsistent with all of the Ninth Circuit cases upon which Defendants rely. *See id*.

Potential Impact of the Ninth Circuit's Pending Decision in *First Solar*

The pending appeal in First Solar presents an opportunity for the Ninth Circuit to reconcile potential inconsistencies in its prior loss causation decisions and provide much-needed clarity as to whether, absent an admission of wrongdoing or some other corrective event that explicitly discloses the fraud, plaintiffs can satisfy loss causation. As exemplified by the district court's decision, the competing loss causation standards adopted in the Ninth Circuit can lead to completely opposite outcomes where plaintiffs rely on partial corrective disclosures or a "leakage" theory of loss causation. Critically, while the district court's analysis did not have the benefit of *CVB*'s finding that a "mirror-image" corrective disclosure is not required to satisfy loss causation, it still remains uncertain whether *CVB*'s holding is limited only to cases involving announcements of government investigations, or whether it may apply more generally to cases, such as *First Solar*, involving disclosures of the company's deteriorating financial condition. To the extent the Ninth Circuit adopts the approach it took in *CVB*, then it will likely conclude in *First Solar* that plaintiffs can satisfy loss causation under the "financial impact" test set forth in *Daou* and its progeny, so long as the plaintiffs can also show some later revelation of the fraud confirming the causal connection between the misrepresented or omitted facts and the company's true financial condition, even if that later revelation does not result in a stock price decline.

As a policy matter, this potential holding makes sense because it would not only avoid creating an improper form of "investor insurance" but also prevent defendants from averting liability by refusing to admit that their prior statements were false or misleading. Further, it would allow plaintiffs to recover their losses proximately caused by defendants' fraud, even if the company's stock price does not decline upon actual revelation of the fraud because the company's problems are already baked into its stock price as a result of the earlier disclosures. ■

WHAT COULD HAVE BEEN: THE RISE AND FALL OF THE CFPB'S ARBITRATION RULE

(continued from page 5)

of comments received, the CFPB issued the final Arbitration Rule.[7]

In accordance with the authority afforded the CFPB under the Dodd-Frank Act, the Arbitration Rule imposed two sets of limitations on the use of pre-dispute arbitration agreements by covered providers of consumer financial products and services.[8] First, the rule prohibited providers from using pre-dispute arbitration agreements blocking consumer class actions and required most providers to insert language into their arbitration agreements that informed consumers of this restriction.[9] The CFPB based this provision of the Arbitration Rule on its findings that pre-dispute arbitration agreements are being utilized to prevent consumers from seeking relief from legal violations on a classwide basis and, likewise, that consumers rarely file individual lawsuits or arbitration cases to obtain such relief.[10] Second, the Arbitration Rule required providers that use pre-dispute arbitration agreements to submit certain arbitral and court records to the CFPB so that it may determine whether there are developments that raise additional consumer protection concerns and warrant further action.[11]

Congressional Repeal of the Arbitration Rule

Almost immediately after the Arbitration Rule's issuance, Republicans in Congress initiated the process to rescind it via the Congressional Review Act ("CRA").[12] The CRA provides Congress with the power to review new federal regulations issued by government agencies and, through passage of a joint resolution, override such rules.[13] Once a rule is repealed, the CRA also prevents an agency from reissuing the rule in the substantially similar form without congressional authorization to do so.[14] In all, Congress has 60 legislative days from the effective date of a given regulation to disapprove that rule by way of a simple majority vote.[15]

On July 25, 2017, the House of Representatives voted along party lines (231-91) to repeal the Arbitration Rule. The Senate followed suit on October 24, 2017 and voted 51-50 — with Vice President Mike Pence breaking a 50-50 tie — to overrule the Arbitration Rule. Each of the 48 Democratic Senators voted against the repeal, while 50 Republican Senators (all but Senators Lindsey Graham of South Carolina and John Kennedy of Louisiana) voted in its favor. President Trump then signed the joint resolution passed by Congress disapproving the Arbitration Rule, pursuant to the CRA, on November 1, 2017.

What's Next?

Despite the downfall of the CFPB's Arbitration Rule, pre-dispute arbitration agreements very much remain on congressional Democrats' legislative radar. In fact, earlier this year, Democratic Representative Hank Johnson of Georgia and Democratic Senator Al Franken of Minnesota introduced identical bills concerning this issue in, respectively, the United States House of Representatives and Senate.[16] Those bills prove even broader than the Arbitration Rule and, among other things, prohibit the enforcement of any pre-dispute agreements requiring arbitration of an employment, consumer, antitrust, or civil rights disputes.[17]

Though both bills face uphill battles in the Republication-controlled legislature, the energy driving the CFPB's issuance of the Arbitration Rule and fight to prevent Congress's controversial repeal of that regulation should keep this issue at the forefront if Democrats regain control of Congress and the White House. This, along with additional momentum from the recent Wells Fargo banking scandal and Equifax data breach, will hopefully lead to the re-opening of courthouse doors to consumers systematically aggrieved and exploited by companies engaging in fraudulent, unfair, or deceptive business practices. ■

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[7] 12 C.F.R. § 1040.4, *et seq.*

[8] Arbitration Agreements, 82 FR 33210-01.

[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] 5 U.S.C. § 801, *et seq.*

[13] 5 U.S.C. § 801-802.

[14] 5 U.S.C. § 801(b)(2).

[15] 5 U.S.C. § 801(d)(1).

[16] *See* Arbitration Fairness Act of 2017, H.R.1374, 115th Congress (2017); Arbitration Fairness Act of 2017, S.537, 115th Congress (2017).

[17] *See id.* at § 3.

KESSLER TOPAZ PREPARES FOR TRIAL AGAINST ENERGY TRANSFER EQUITY

(continued from page 3)

claims asserted in our case, which is scheduled for trial in Georgetown, Delaware in February 2018.

The context for the CPU distribution arose from ETE's now-terminated agreement to acquire The Williams Companies, which the two pipeline owner-operators signed in September 2015. A major part of the deal consideration was to be a multi-billion cash payment to Williams' stockholders, and ETE had arranged to borrow more than $6 billion to fund that payment. The apparent expectation was that the two companies would be able to cut operating costs and generate sufficient revenue to fund both the significant payments on debt each company had committed to and the substantial cash distributions the companies paid to investors every quarter.

Between September and the end of 2015, however, oil and gas prices had plummeted, as did ETE's and Williams' revenues and stock prices. Debt ratings agencies, such as Moody's and Standard & Poor's, began to worry that the $6+ billion in debt that ETE would have to assume to close the deal with Williams would result in a downgrade of ETE's debt, increasing borrowing costs at a time of reduced revenues. Maintaining its credit rating was critical to ETE. By early 2016, ETE's management was actively looking to get out of the deal with Williams.

ETE publicly announced the CPU distribution in early March 2016, pitching it as a cash-savings measure. At the time the CPUs were issued, ETE had been paying 28.5 cents per common unit in quarterly cash distributions. The CPUs promise holders, for each common unit they own, 11 cents in cash per quarter, which has to be paid before common unitholders get paid anything. CPU holders also get 17.5 cents in value that, in May 2018, will convert into additional ETE common units, priced at $6.56 per unit, or a 5% discount to the historically low market price when ETE board approved the CPUs.

To illustrate, a hypothetical CPU recipient holding 10 common units would, over a nine-quarter, 2 ¼ year period, receive $15.75 in value (17.5 per unit x 9 quarters x 10 shares) that will convert into approximately 2.4 additional common units ($15.75 divided by the $6.56 conversion price for the CPUs). ETE contends that the accrual of 17.5 cents in value toward additional common units saves ETE cash because ETE does not have to pay 17.5 cents in cash per unit each quarter to the CPU holders, and ETE believed that the CPUs would keep the partnership in good stead with the debt ratings agencies.

Yet, the CPUs, as structured, could not save enough cash to keep ETE's debt leverage ratio at an acceptable level for the ratings agencies. Instead, the economic terms protect the CPU holders against the effects of a distribution cut and promise outsized returns if there distributions are not cut. If there is a distribution cut for the common units, the holders of CPUs would continue to get their distributions of 11 cents in cash and 17.5 cents in value accruing toward discounted units. If there is no distribution cut and the market price for common units increases above $6.56 per unit, the CPUs greatly increase in value.

Thus, the CPUs create a classic "heads I win, tails you lose" scenario for the CPU holders. The remaining common unit holders, by contrast, remained exposed to the risk of a distribution cut. And, to be sure, in an April 2016 a proxy filing for the Williams merger, ETE announced that it expected to cut quarterly distributions to zero through the first quarter of 2018 should the Williams merger close. The CPU holders would, however, continue to receive their quarterly distributions.

Because the CPU recipients were largely members of ETE's management and other insiders, ETE's board claims it formed a "Conflicts Committee" to assess the fairness of the CPU distribution and recommend to the board whether to proceed with it. However, after the board apparently formed a committee of three directors, only one of those three purported to act as the Conflicts Committee and ultimately made the recommendation to approve the distribution; this, despite the limited partnership agreement's requirement that the Committee had to act by a majority vote of all members. The Committee also purportedly completed all of its analysis and consideration of the CPUs over a mere two-day period while facing a Warren-imposed Sunday deadline.

Additionally, the limited partnership agreement required that non-cash distributions, such as the CPUs, be distributed to all limited partners in

proportion to their limited partnership interests. This requirement, in our view, prohibited this selected, discriminatory distribution of the CPUs to some, but not all, of ETE's limited partners.

Williams also believed that the CPU distribution violated its merger agreement with ETE, and Williams also filed suit in the Court of Chancery. ETE countersued Williams, claiming that ETE could terminate the merger agreement — and effectively solve all of its issues with the debt ratings agencies — because one of its lawyers could not issue a tax opinion that was a pre-condition to closing. The Court held an expedited trial on the portion of the case dealing with the tax opinion, and ultimately ruled that ETE was able to escape the merger agreement, likening ETE to a financially desperate man who won the lottery.

While the remaining aspects of that lawsuit between Williams and ETE continue today, the termination of the Williams merger has meant that ETE's market price jumped sharply higher and that there has been no need for ETE to cut its quarterly distributions.

Despite that ETE was able to terminate its merger agreement with Williams and no longer had to incur the crushing debt associated with that deal, the CPUs were not contingent on the closing of the merger. Thus, even though ETE no longer needs the CPUs to save cash or prop up its credit ratings, Warren, McReynolds, other ETE insiders, and the other CPU recipients are all slated to benefit from a massive transfer of wealth from the partnership to them, at the expense of all the common unitholders who did not receive CPUs. This is particularly so as the market price for the common units is now above $16 per unit, and the CPUs have thus substantially increased in value since they were distributed.

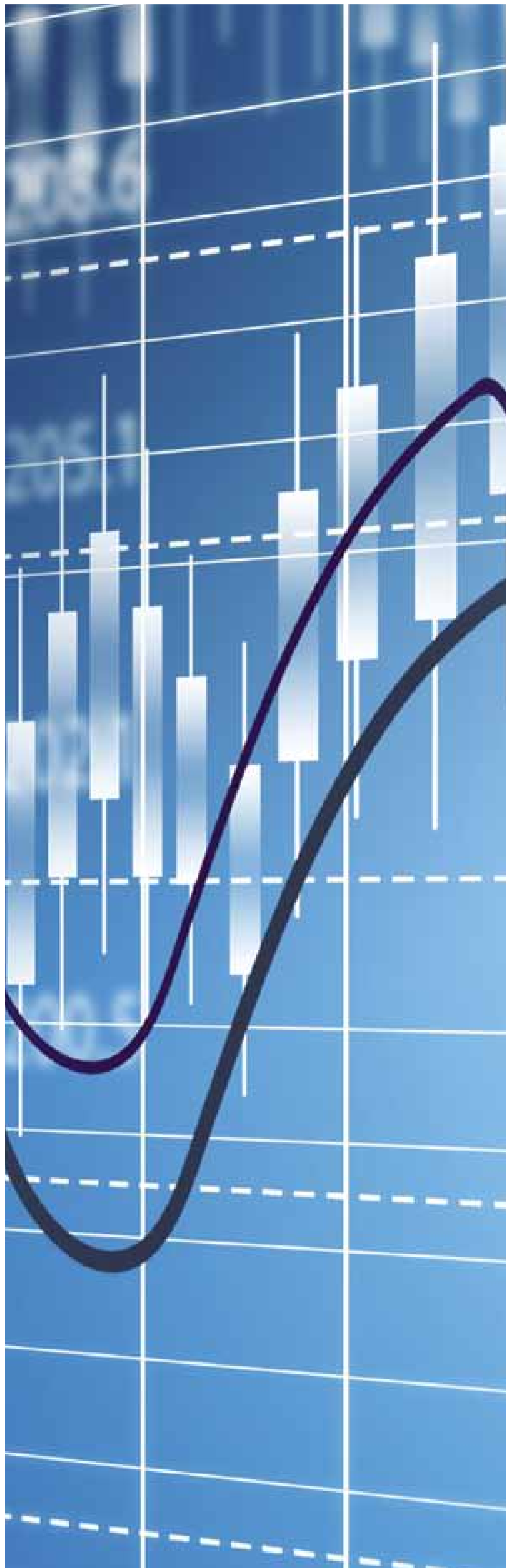
To illustrate the extent of this wealth transfer, going back to the hypothetical CPU holder with 10 common units who received approximately 2.4 additional

common units, while those units cost $15.75 to acquire through the CPU plan, they would be worth more than $38 at today's market prices. Across all 327 million CPUs, if they are allowed to convert into additional common units, the wealth transfer to these ETE insiders would total hundreds of millions of dollars. The additional units issuable upon the CPUs' conversion, additionally, would diminish each common unitholder's voting power as well as dilute each common unitholder's economic stake in the partnership. The principal beneficiary would be Warren himself, who holds approximately 18% of the common units and received most of the CPUs.

Since the filing of our lawsuit, ETE and the other defendants sought to have our lawsuit dismissed on summary judgment. The Court instead determined that the case should go to trial and that a full factual record was needed for rulings on the issues under the ETE limited partnership agreement in this case. Those issues pertain, generally, to whether the CPU distribution was a prohibited non-pro-rata distribution under the limited partnership agreement and whether the Conflicts Committee's purported approval process adhered to the agreement's requirements. Among those requirements is that the Conflicts Committee reach its determinations and recommendations in good faith, and we question in the litigation whether a two-day study-and-approval period was sufficient for the Conflicts Committee to have made any good faith decision concerning the CPUs.

At trial, we will seek to prove that Warren and McReynolds, and the other ETE insiders who conceived of and stand to benefit from the CPU distribution, decided to move forward with the CPUs to protect themselves from the quarterly distribution cut on ETE common units that would have been needed if the Williams merger closed. We will endeavor to show that the Conflicts Committee process was deeply flawed and did not adhere to the limited partnership agreement's terms. We will ask the Court to find that the CPU distribution violated the limited partnership agreement because ETE did not make them available to all common unitholders. As a result, we are asking the Court to permanently prevent the conversion of the CPUs and render them void.

A three-day trial will be held in February 2018, and the Court of Chancery has committed to issue a ruling before the following May, when the CPUs are scheduled to convert. ■



IN RE BANCO BRADESCO: STATEMENTS CONCERNING CORPORATE CODE OF ETHICS HELD ACTIONABLE AND DISMISSAL OF PARALLEL CRIMINAL CHARGES AGAINST A DEFENDANT CARRY NO WEIGHT AT THE PLEADING STAGE

(continued from page 5)

Lead Plaintiff's Claims

Lead Plaintiff alleges that the defendants, which include the Company and several of its executives and officers, engaged in a longstanding scheme of paying bribes to Brazilian tax officials in order to reduce Bradesco's tax liabilities. Specifically, Lead Plaintiff alleges that, beginning as early as 2004, Bradesco paid illicit bribes to a local Brazilian tax official in exchange for a variety of tax benefits, including tax credits. Between 2004 and 2007, Lead Plaintiff claims that Bradesco received tax credits valued at more than 260 million Brazilian Reais ("R$") in exchange for more than R$2.7 million in bribes. Lead Plaintiff further alleges that this bribery scheme continued through 2014, when Bradesco began negotiating the payment of additional bribes in exchange for as much as R$3 billion in tax credits. Also in 2014, the defendants attempted to corrupt the members of the Brazilian federal tax authority presiding over Bradesco's appeal of a tax proceeding worth approximately R$2.7 billion.

Lead Plaintiff contends that while they were actively engaged in these schemes, the defendants made materially false or misleading statements touting the Company's ethical conduct and denying any conduct designed to influence, or obtain benefits from, Brazilian officials, including that the Company had "effective" anticorruption measures and maintained a code of ethics that prohibited offering or paying bribes. Even after the announcement of the Brazilian Federal Police's investigation into the bribery scheme involving Bradesco and numerous other Brazilian corporations, Bradesco falsely denied any misconduct. In fact, Bradesco claimed that it had "never . . . negotiated . . . acts in violation of the internal rules of compliance," and claimed that "it adopts strict internal controls to ensure the compliance of its Anticorruption Corporate Policy and of its Code of Ethical Conduct, besides complying with the rules issued by Regulatory Bodies."

Based on these facts, Lead Plaintiff asserted fraud claims under Sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5 promulgated thereunder, against the defendants on behalf of all purchasers or acquirers of Bradesco's preferred American Depositary Shares between April 30, 2012 and July 27, 2016.

The Brazilian Court of Appeals Decision

Trabuco and the two other individual defendants were indicted by the Brazilian Federal Police on May 31, 2016, following a multi-year investigation into the alleged bribery scheme. Two months later, on July 27, 2016, the Brazilian Federal Prosecutor filed a criminal complaint against all three individual defendants, alleging that these executives committed the crime of active corruption. The Federal District Court in Brazil accepted the criminal complaint the same day,

noting "in this initial evaluation, there is no relevant clear piece of evidence capable of invalidating the accusation."

Following the Federal District Court's acceptance of the criminal complaint, Trabuco filed a *habeas corpus* petition with the Brazilian Federal Court of Appeals (the "Brazilian Court of Appeals") seeking dismissal of all criminal charges against him. On June 13, 2017, the Brazilian Court of Appeals granted Trabuco's *habeas corpus* petition. The defendants promptly filed a letter with the federal Court in New York overseeing the securities fraud class action, alerting Judge Woods to the Brazilian Court of Appeals' decision and advocating that, in light of the Brazilian Court's finding, all claims against Trabuco and the other defendants should be dismissed. Lead Plaintiff responded, arguing that based upon the different legal standard that the Brazilian Court of Appeals applied, its decision has no impact on the defendants' pending motion to dismiss.

The Motion to Dismiss Opinion

In ruling on the defendants' motion to dismiss, Judge Woods concluded that many of the alleged misrepresentations made after March 24, 2014 were actionable, and denied the defendants' motion to dismiss claims based on the misstatements. In sustaining these statements, Judge Woods made two particularly notable determinations. First, he held that certain of the Company's statements regarding it code of ethics were actionable, notwithstanding contrary decisions from the United States Courts of Appeals for the Sixth and Ninth Circuits. Second, he accepted Lead Plaintiff's contentions regarding the inapplicability of the Brazilian Court of Appeals' dismissal of the criminal charges against Trabuco, concluding that the decision was not relevant to the resolution of the defendants' motion to dismiss.

Code of Ethics Statements

In seeking dismissal of Lead Plaintiff's claims, the defendants relied heavily on the unreported decision from the Sixth Circuit Court of Appeals in *Bondali v. Yum! Brands, Inc.*, 620 Fed. Appx. 483 (6th Cir. 2015). In *Bondali*, the Sixth Circuit held that "a code of conduct is not a guarantee that a corporation will adhere to everything set forth in its code of conduct. Instead, a code of conduct is a declaration of corporate aspirations. To treat a corporate code of conduct as a statement of what a corporation will do, rather than what a corporation aspires to do, would turn the purpose of a code of conduct on its head." *Banco Bradesco*, 2017 WL 431407, at *41 (quoting *Bondali*, 620 Fed. Appx. at 490). Based upon this authority, the defendants argued that Bradesco's code of ethics and related statements constituted inactionable puffery that was immaterial as a matter of law and, thus, should be dismissed. *Banco Bradesco*, 2017 WL 431407, at *40. The defendants also cited to a recent decision from the Court of Appeals for the Ninth Circuit in *Retail Wholesale & Dep't Store Union Local 338 Ret. Fund* v. *Hewlett-Packard Co.*, 845 F.3d 1268 (9th Cir. 2017), where the Ninth Circuit held that "[Codes of conduct] express [] opinions as to what actions are preferable, as opposed to implying that all staff, directors, and officers always adhere to [their] aspirations." *Id.* at 1276.

Judge Woods recognized that this "general principle [regarding the aspirational nature of corporate codes of ethics] is well established in the Second Circuit as well," and concluded that Bradesco's articulation of its code of ethics and anti-corruption policy were not actionable. *Banco Bradesco*, 2017 WL 431407, at *41. He, nevertheless, declined to extend this reasoning to statements that the Company made *regarding* the code and policy. *Id.* Specifically, the Court stated: "[t]he principle that corporate statements about compliance with law, or statements of corporate optimism, are inactionable puffery, does have some acknowledged limits." *Id.* at *41. Citing to a motion to dismiss decision from another securities fraud class action in the Southern District of New York based upon a different alleged Brazilian bribery scheme, Judge Woods explained that "[w]hether a representation is 'mere puffery' depends, in part, on the context in which it is made." *Id.* (quoting *In Petrobras Sec. Litig.*, 116 F. Supp. 3d 368, 381 (S.D.N.Y. 2015)). In *Petrobras*, the court stated:

> While some of the alleged statements, viewed in isolation, may be mere puffery, nonetheless, when (as here alleged) the statements were made repeatedly in an effort to reassure the investing public about the Company's integrity, a reasonable investor could rely on them as reflective of the true state of affairs at the Company. Accordingly, the Court cannot find that all of Petrobras' alleged statements regarding its general integrity and ethical soundness were immaterial as a matter of law.

Banco Bradesco, 2017 WL 431407, at *42 (quoting *Petrobras*, 116 F. Supp. 3d at 381).

The Court rejected the defendants' reliance on cases in which courts concluded that securities fraud claims cannot be premised upon code of ethics statements, and instead held the *Petrobras* reasoning to be persuasive and applicable. In this regard, Judge Woods noted that "Bradesco did not make its statements in a vacuum, and they should not be evaluated in one." *Banco Bradesco*, 2017 WL 431407, at *42. Applying this reasoning, the Court determined that because Bradesco's statements about compliance with laws regarding bribery were

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IN RE BANCO BRADESCO: STATEMENTS CONCERNING CORPORATE CODE OF ETHICS HELD ACTIONABLE AND DISMISSAL OF PARALLEL CRIMINAL CHARGES AGAINST A DEFENDANT CARRY NO WEIGHT AT THE PLEADING STAGE

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made at the same time that the investing public learned about the alleged pervasive bribery at Petrobras, "context shows they were made in an effort to reassure the investing public about the Company's integrity, specifically with respect to bribery, during a time of concern, and that therefore 'a reasonable investor could rely on them as reflective of the true state of affairs at the Company.'" *Id.* (quoting *Petrobras*, 116 F. Supp. 3d at 381). Judge Woods further concluded that:

> By choosing to speak to its investors on the topic of bribery and other corruption, and particularly by doing so in a manner that could be reasonably interpreted as suggesting at least that the Company's senior-most executives were not at the same time engaging in such activities, Bradesco was under a duty to speak the whole truth. Because the amended complaint asserts that it did not, the Court concludes that [Lead] Plaintiff has adequately alleged that the statements about Bradesco's Code of Ethics, and its other anti-corruption statements made after March 24, 2014, were materially false or misleading.

Banco Bradesco, 2017 WL 431407, at *43.

Impact of the Brazilian Court of Appeals Decision

While the defendants argued that the Brazilian Court of Appeals' dismissal of the criminal charges against Trabuco required dismissal of Lead Plaintiff's securities fraud claims against him and the other defendants, this argument did not persuade Judge Woods. Instead, the Court largely accepted Lead Plaintiff's assertion that the difference in the applicable standards of proof rendered the Brazilian Court of Appeals' decision irrelevant at the pleading stage.

In advocating the putative import of the Brazilian Court of Appeals' decision, the defendants claimed that the dismissal of the criminal charges in Brazil against Trabuco "makes clear that Plaintiffs have not adequately alleged a claim against Trabuco and provides further support for dismissing the claims against the other Defendants." *Banco Bradesco*, 2017 WL 431407, at *23. The Court rejected this argument, stating, "[a]lthough the Brazilian court's dismissal of the criminal charges against Trabuco may be relevant at the evidentiary stage of this proceeding, the Court concludes that it has no impact at the pleading stage." *Id.* The Court explained the reasoning behind this conclusion: "[a]s [Lead] Plaintiff points out, the decision evaluated the Brazilian prosecutor's complaint against Trabuco based on the standard of proof for criminal cases in Brazil. . . . the standard of proof in this action—a civil action in a U.S. court—is only a preponderance of the evidence, and the Court is required in evaluating the sufficiency of a civil complaint in U.S. federal court to 'accept all allegations in the complaint as true and draw all inferences in the nonmoving party's favor.'" *Id.* at *23-24. Therefore, the Court held that it could not conclude that the Brazilian Court of Appeals decision "has any impact on this action at this preliminary stage." *Id.* at *23.

Conclusion

The motion to dismiss decision in *Banco Bradesco* is notable because it illustrates a potential path forward for pleading securities fraud claims based on statements regarding a company's code of ethics and related policies. With this decision, Judge Woods joined other courts in the Southern District of New York in rejecting the Sixth and Ninth Circuit's broad determinations that a plaintiff cannot adequately allege a claim for securities fraud based upon statements concerning corporate codes of ethics. In addition, Judge Woods' decision will support future arguments that dismissals of parallel criminal charges for the same misconduct underlying a plaintiff's securities fraud claims are irrelevant at the motion to dismiss stage. ■

WHAT'S TO COME

JANUARY 2018

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

January 28 – 30
Capital Hilton ■ Washington, DC

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

January 28 – 31
Hyatt Regency ■ Orlando, FL

FEBRUARY 2018

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

February 21 – 23
Tempe Mission Palms ■ Tempe, AZ

MARCH 2018

California Association of Public Retirement Systems (CALAPRS) — General Assembly

March 3 – 6
Renaissance Indian Wells Resort ■ Indian Wells, CA

Rights and Responsibilities of Institutional Investors (RRII)

March 8 – 9
NH Grand Hotel Krasnapolsky
Amsterdam, Netherlands

Council of Institutional Investors (CII) — 2018 Spring Conference

March 12 – 14
The Omni Shoreham Hotel ■ Washington, DC

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

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

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

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

APRIL 2018

Texas Association of Public Employee Retirement Systems (TEXPERS) — 29th Annual Conference

April 15 – 18
South Padre Island Convention Centre
South Padre Island, TX

MAY 2018

National Conference on Public Employee Retirement Systems (NCPERS) — Annual Conference & Exhibition

May 13 – 16
Sheraton New York ■ New York, NY

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

May 15 – 18
Anaheim Marriott ■ Anaheim, CA

Pennsylvania Association of Public Employee Retirement Systems (PAPERS) — 14th PAPERS Forum

May 22 – 23
Hilton Hotel ■ Harrisburg, PA

JUNE 2018

Florida Public Pensions Trustees Association (FPPTA) — 34th Annual Conference

June 24 – 27
Rosen Shingle Creek ■ Orlando, FL

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

June 26 – 29
Savannah Hyatt Regency ■ Savannah, GA

JULY 2018

Missouri Association of Public Employee Retirement Systems (MAPERS) — Annual Conference

July 25 – 27
Tan-Tar-A Resort ■ Osage Beach, MO

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