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

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KESSLERTOPAZ MELTZERCHECK LLP

KESSLER TOPAZ LEADS THE CHARGE IN THE CLOSELY WATCHED VIX MANIPULATION MULTIDISTRICT LITIGATION

Kimberly A. Justice and Joshua A. Materese, Esquire

This multidistrict litigation arises from over a decade of manipulation of financial instruments linked to the Chicago Board Options Exchange's ("CBOE") Volatility Index, the "VIX," and the opaque settlement process CBOE designed for certain of those instruments.[1] In September, Kessler Topaz and its co-lead counsel filed the operative consolidated complaint against "John Doe" defendants and CBOE for violations of several federal statutes based on that misconduct. The Complaint is the first step toward remedying the harm done to investors who, collectively, lost billions of dollars trading these instruments on what they were duped into believing was an even playing field.

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[1] The case is captioned *In Re: Chicago Board Options Exchange Volatility Index Manipulation Antitrust Litigation,* No. 1:18-cv-04171 (MDL No. 2842) (N.D. Ill.).

#METOO'S IMPACT ON CORPORATE LAW

Stacey A. Greenspan, Esquire

On January 27, 2018, *The Wall Street Journal* published an article revealing that Steve Wynn, the Las Vegas casino developer who built Mirage, Treasure Island, Bellagio, Wynn and Encore Casinos and then-Chairman and CEO of Wynn Resorts, Ltd., had sexually harassed and forced employees to perform sex acts on him for decades.[1] More than 150 witnesses described an atmosphere of terror at Wynn's casinos. Female employees said they would be fired if they did not succumb to Wynn's advances, faked appointments to avoid Wynn's office, asked colleagues to pose as their assistants to avoid being with Wynn alone, and hid from Wynn in bathrooms and back rooms.

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[1] Alexandra Berzon, Chris Kirkham, Elizabeth Bernstein & Kate O'Keeffe, "Dozens of People Recount Pattern of Sexual Misconduct by Las Vegas Mogul Steve Wynn," *The Wall Street Journal* (Jan. 27, 2018).

KTMC SEEKS TO HOLD AMD ACCOUNTABLE FOR SECURITY VULNERABILITIES IN ITS CPUs

Jennifer L. Joost, Esquire

On January 2, 2018, consumers learned for the first time that confidential information stored in their computer was vulnerable to a new set of security attacks known as Spectre. Spectre gets its name from "speculative execution" and the fact that these types of attacks likely will "haunt" the industry for some time.

Spectre and other similar security attacks (known as Meltdown and Foreshadow) take advantage of techniques used by semiconductor companies like Advanced Micro Devices Inc. ("AMD") to optimize the speed of central processing units ("CPUs") they design and manufacture for installation into desktops, laptops, and servers, among other devices.

CPUs are the "brains" of the devices they power, performing all the necessary calculations for each application running on the device. The CPU fetches, decodes, executes, and "writes" the result of the instructions required by the application utilizing the data temporarily stored in its "caches." Each step in the process taking at least one "clock cycle." The number of clock cycles a CPU completes per second is known as the "clock rate" and the rate at which a CPU processes instructions is known as "clock speed." AMD frequently touted the clock speed of its processors, making it an important specification for consumers deciding which CPU to purchase.

Since the mid-1990s, companies like AMD have relied on techniques to optimize the speed at which CPUs process instructions in order to achieve the advertised clock speed. For instance, to ensure that a CPU is never idle, AMD CPUs process instructions out of order based on whatever data currently is available (known as "out of order execution"), in a manner similar to how students are taught to take standardized tests (e.g., answer the questions you know first before going back to answer the questions that require more thought). However, if an instruction is conditional (e.g., "If X, then Y"), it has to be completely processed before the CPU can determine what to do next. To address this problem, AMD has equipped its CPUs with the ability to predict what it will need

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DELAWARE CHANCERY COURT DETERMINES WHETHER FEDERAL FORUM PROVISIONS IN BYLAWS CAN CURB SECURITIES CLASS ACTIONS FILED IN STATE COURTS

Stephanie Grey, Esquire

On September 28, 2018, the Delaware Chancery Court heard oral argument on the question of whether a corporation could enact a bylaw designating a federal district court as the exclusive forum for claims under the Securities Act of 1933 (the "Securities Act"). Such bylaws are the latest salvo in a long-running battle between plaintiffs seeking to litigate federal Securities Act claims in state court and defendants seeking to remove these claims to federal court. The Supreme Court recently resolved a circuit split on the removability of Securities Act claims in *Cyan, Inc. v. Beaver Cty. Emps. Retirement Fund*. The Court decided that the statutory provisions of the Securities Act, which provide for concurrent state and federal jurisdiction over Securities Act claims, were not superseded by the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), which sought to make federal courts the exclusive jurisdiction for securities class actions. Federal forum selection clauses are now the last battleground in whether plaintiffs will continue to be able to litigate Securities Act claims in state court. This article addresses the recent litigation surrounding the enforceability of these bylaws.

I. Legal Background

After the stock market crash of 1929, Congress enacted legislation to regulate securities markets and transactions. During this time, two main pieces

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KESSLER TOPAZ PENDING INJUNCTION APPLICATION PRESSURES LASALLE HOTEL PROPERTIES TO ACCEPT A VALUE-MAXIMIZING TRANSACTION WITH PEBBLEBROOK HOTEL TRUST

Michael J. Rullo, Esquire

On June 29, 2018, Kessler Topaz filed litigation in Maryland state court on behalf of Erie County Employees' Retirement System ("Erie County"), challenging the conflicted acquisition of LaSalle Hotel Properties ("LaSalle") by The Blackstone Group, L.P. ("Blackstone") for $33.50 per share in cash (the "Blackstone Transaction"). In approving the now-abandoned Blackstone Transaction, the LaSalle Board of Trustees (the "Board") had rejected a financially superior offer by its rival Pebblebrook Hotel Trust ("Pebblebrook") for a cash and stock deal valued at $35.89 per share (the "Pebblebrook Offer"). Critically, the Blackstone Transaction benefited LaSalle management who would stay on to operate the post-transaction company.

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DUTCH COURT ASSERTS JURISDICTION OVER PETROBRAS IN SHAREHOLDER FOUNDATION ACTION BUT DOUBT REMAINS OVER ULTIMATE VIABILITY OF THIS APPROACH TO RECOVERY OF PETROBRAS INVESTMENT LOSSES

Emily Christiansen, Esquire

Petroleo Brasileiro S.A. ("Petrobras"), a Brazilian state-run energy company and arguably one of the world's largest energy businesses has been mired in the largest corruption scandal in Brazilian history. An investigation dubbed "Operation Car Wash" by local Brazilian law enforcement authorities uncovered evidence that former Petrobras executives falsely inflated the value of various construction project for their own profit and that they paid kickbacks to various politicians. When news of the scandal reached the market, the prices of Petrobras's securities plummeted resulting in large losses to a number of investors. For investors who purchased Petrobras' American Depositary Receipts ("ADRs") in the U.S., the options for pursuing a recovery were well-defined: they could either participate in a U.S. class action or file their own opt-out action (and indeed eligible investors who participated in opt-out actions have already received a recovery while eligible investors who remained part of the class will receive their portion of the class recovery in the coming months). The majority of Petrobras's shareholders who purchased their shares on the Brazilian stock exchange, the BM&F Bovespa, elected to either pursue arbitration in Brazil under the auspices of the Brazilian Market Arbitration Chamber ("MAC") and pursuant to the mandatory arbitration provision in Petrobras's bylaws or to pursue a foundation action in the Netherlands. Despite a recent decision by a court in the Netherlands upholding its jurisdiction to hear the dispute, it is uncertain whether that decision will be upheld and whether damages will successfully be pursued and recovered.

On January 23, 2017, the Dutch Foundation the Stichting Petrobras Compensation Foundation (the "Foundation") filed an action before the Rotterdam District Court in the Netherlands against Petrobras, Petrobras Global Finance B.V. ("PGF"), Petrobras Oil & Gas B.V. ("POG"), Petrobras International Braspetro B.V. ("PIB") and various related individuals (collectively "the Defendants").[1] The Foundation's case is seeking a declaratory judgment[2] that the Defendants unlawfully acted against investors by concealing fraud and publishing incorrect, incomplete or misleading financial information during the fraud period (the "Dutch Action"). In response to the Foundation's complaint, the Defendants disputed the Dutch Court's jurisdiction to hear claims filed against them on both the grounds that 1) the court lacks jurisdiction over Petrobras and the individual defendants, and 2) that Article 58 of Petrobras's bylaws require all disputes between Petrobras and its shareholders to be arbitrated in front of the MAC.

In a somewhat surprising development, on September 19, 2018, the Rotterdam District Court issued a decision holding

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[1] *The Stichting Petrobras Compensation Foundation v. Petroleo Brasileiro S.A.*, et al..

[2] Under Dutch law, Foundations are not permitted to file claims for damages. Foundations can only pursue a declaratory judgment. Any claims for damages need to be filed by each individual investor either via a joint complaint (joinder) or through an individual complaint.

14TH ANNUAL

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The Dark Side of Globalization?

The 14th Annual Rights & Responsibilities of Institutional Investors will again be held in Amsterdam and co-hosted by Institutional Investor and Kessler Topaz Meltzer & Check LLP. Many of the most pressing issues for engaged investors and active shareholders covered in this day and a half agenda will consider the ways that senior management, including investment, legal and compliance officers from European and, increasingly, North American, Middle Eastern, and Asian public pension, insurance funds and mutual fund companies, are paving a path forward to meet their fiduciary obligations and engagement goals.

MORE INFORMATION

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NINTH CIRCUIT CLARIFIES CONTOURS OF JUDICIAL NOTICE AND INCORPORATION BY REFERENCE IN LIGHT OF "CONCERNING PATTERN IN SECURITIES CASES" OF "OVERUSE"

J. Whitman, Jr. and Jonathan Neumann, Esquire

I. Background

In considering a motion to dismiss under Federal Rule of Civil Procedure ("Rule") 12(b)(6), a court's review is generally "limited to the complaint." *Lee v. City of L.A.*, 250 F.3d 668, 688 (9th Cir. 2001). There are, however, two recognized exceptions to this general rule: (1) judicial notice; and (2) the incorporation by reference doctrine.

First, under Federal Rule of Evidence 201(b), a "court may judicially notice a fact that is not subject to reasonable dispute because it: (1) is generally known within the trial court's territorial jurisdiction; or (2) can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned." In order for a fact to be judicially noticed, the Ninth Circuit has explained that "indisputability is a prerequisite." *Lee*, 250 F.3d at 689. Thus, courts have explained that "the kind of things about which courts ordinarily take judicial notice are: (1) scientific facts: for instance, when does the sun rise or set; (2) matters of geography: for instance, what are the boundaries of a state; or (3) matters of political history: for instance, who was president in 1958." *Mat-Van, Inc. v. Sheldon Good & Co. Auctions, LLC*, 2008 WL 346421, at *8 (S.D. Cal. Feb. 6, 2008). Importantly, however, facts subject to judicial notice cannot be taken as true for the purpose of disputing facts within a plaintiff's complaint.

Second, a court may treat as incorporated into a complaint by reference "documents whose contents are alleged in a complaint and whose authenticity no party questions." *Davis v. HSBC Bank Nev., N.A.*, 691 F.3d 1152, 1160 (9th Cir. 2012).

To be sure, these doctrines have a legitimate purpose. Namely, both can prevent a plaintiff's complaint from surviving a Rule 12(b)(6) motion when that pleading deliberately omits references to, or selectively quotes from, documents upon which their claims are based. *See Parrino v. FHP, Inc.*, 146 F.3d 699, 706 (9th Cir. 1998) (noting "policy concerns" underpinning incorporation by reference doctrine). But they also have a downside risk. Namely, that a court will give undue weight to facts set forth in materials extrinsic to a plaintiff's complaint and improperly resolve disputed facts at the pleading stage.

This risk is heightened in the context of securities litigation under the Private Securities Litigation Reform Act of 1995 ("PSLRA"), where plaintiffs are: (1) subject to a heightened pleading standard; and (2) foreclosed from discovery, except in very limited circumstances. As the Ninth Circuit recently observed, there is a "concerning pattern in securities cases like this one: exploiting these procedures improperly to defeat what would otherwise constitute adequately stated claims at the pleading stage." *Khoja v. Orexigen Therapeutics, Inc.*, 899 F.3d 988 (9th Cir. 2018). These competing policy concerns led the Ninth Circuit to clarify the contours of the doctrines in its August 2018 *Orexigen* decision.

II. *Orexigen* Opinion

In *Orexigen*, the plaintiff brought claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. In particular, he alleged that the defendant pharmaceutical company and its officers made false or misleading statements regarding early survey results concerning the company's new drug. The district court dismissed the plaintiff's claims. In so doing, the district court granted the defendants' request to judicially notice or incorporate by reference 21 of 22 documents that defendants submitted with their motion to dismiss the complaint. The district court also relied upon the contents of certain of these documents in granting defendants' motion. The plaintiff appealed the district court's dismissal. The Ninth Circuit reversed, finding that the district court had abused its discretion in relying upon certain materials extrinsic to the complaint to resolve factual disputes and that the plaintiff had adequately stated a claim.

The Ninth Circuit began by recognizing the "concerning pattern" in securities cases — the "overuse and improper application of judicial notice and the incorporation-by-reference doctrine." *Orexigen*, 899 F.3d at 998. It acknowledged that recent trends created for defendants the "alluring temptation to pile on numerous documents to their motions to dismiss to undermine the complaint." *Id.* But the court cautioned that "the unscrupulous use of extrinsic documents to resolve competing theories against the complaint risks premature dismissals of plausible claims that may turn out to be valid after discovery. This risk is especially significant in SEC fraud matters, where there is already a heightened pleading standard, and the defendants possess materials to which the plaintiffs do not yet have access." *Id.* The Ninth Circuit further observed that if "defendants are permitted to present their own version of the facts at the pleading stage — and district courts accept those facts as uncontroverted and true — it becomes near impossible for even the most aggrieved plaintiff to

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KESSLER TOPAZ LEADS THE CHARGE IN THE CLOSELY WATCHED VIX MANIPULATION MULTIDISTRICT LITIGATION

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The VIX and Products Linked to the VIX. Since its creation in 2004, the VIX has become a widely used financial index that is now connected to billions of dollars' worth of financial products that are traded each day. The VIX's value is determined by reference to the real-time pricing of put and call option contracts linked to the S&P 500 ("SPX Options") that trade on CBOE's options exchange. The prevailing quotation levels of SPX Options, in theory, serve as a barometer for the prices people are willing to pay or accept for a 30-day SPX Option. These Options provide an estimate of how much movement in the market (i.e., volatility) investors currently anticipate over the next 30 days and, in turn, what VIX Options and VIX Futures should be worth today. As a general matter, the VIX is higher when the market is expected to be more volatile in the future (i.e., when investors fear more swings in stock prices), and lower when less volatility is expected. Thus, over time, investors have come to treat VIX as the U.S. stock market's "fear gauge."

Because investors cannot trade the VIX outright, it initially served only as benchmark figure. Investors could not take a position in the VIX, or on the direction they believed the market was moving. In response to growing demand, a universe of products allowing investors to wager on the VIX has emerged, the vast majority of which are exclusively owned by or licensed to CBOE. Prime examples, and at the core of this action, are CBOE's proprietary VIX Options and VIX Futures contracts, and the earlier mentioned SPX Options, for which CBOE holds an exclusive license. CBOE's exchanges are the only places to trade the vast majority of these products.

Moreover, because the VIX is not a physical good, VIX Options and VIX Futures can only be exercised at expiration, and all are cash-settled at that time. The cash-settlement value for both is determined through a CBOE-created and administered settlement process that is similar, but not identical to the process used to calculate the VIX itself. Specifically, when VIX Options and VIX Futures expire, a primary input into CBOE's calculated settlement values is the trading price of certain SPX Options during a short window of time on specific days, known as the Special Opening Quotation, or SOQ, auction, within which a pre-determined set of investors are permitted to partake. Since the settlement process is dependent on the value of thinly traded, out-of-the-money SPX Options, trading even a small number of such Options could result in large differences in the settlement value of VIX Options and VIX Futures. In essence, the formula CBOE created, operated, and maintained is a zero-sum game that determines who is the winner and who is the loser, and by how much, for investors in VIX Options and VIX Futures.

Of particular relevance to this case, by design, trading on CBOE's exchanges is anonymous. As a result, CBOE, and perhaps only CBOE, has the ability and means to monitor trading on its exchanges and ensure an even and fair playing field for investors. This has been a unique (and difficult) aspect of the case since inception, as the Doe Defendants remain unknown.

Procedural Background. In February 2018, Kessler Topaz brought on behalf of an individual investor the first lawsuit alleging improper trading activity in VIX-linked products.[2] Not surprisingly, following that leading complaint, investors across the country flooded the dockets with over twenty-five actions charging similar misconduct under various federal statutes. As the complaints continued to mount, in July 2018, the Judicial Panel on Multidistrict Litigation packaged all pending actions for pre-trial purposes and sent the litigation to the Northern District of Illinois before Judge Manish S. Shah, where it is now pending.

With an MDL in place, many prominent law firms vied for leadership of the litigation. In the end, Kessler Topaz, led by Kimberly A. Justice, emerged from the crowded field and was selected to co-lead the action by Judge Shah. As the first order of business, in September, co-lead counsel filed a Consolidated Class Action Complaint, asserting claims against CBOE and the Does for violations of the federal securities, commodities, and antitrust laws. The Complaint was filed on behalf of investors who held or traded SPX Options, VIX Options, VIX Futures, or exchange-traded products based on the VIX.

The Manipulation of the Settlement Process. Throughout the time period in question, investors were assured by CBOE that its settlement process was fair and balanced when, in fact, that process was

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[2] *See Samuel v. John Does,* No. 18-cv-1593 (S.D.N.Y. Feb. 21, 2018).

for years routinely hijacked by the John Does to manipulate the cash settlement values for VIX Options and VIX Futures. Specifically, because the settlement process is dependent on the value of thinly traded, out-of-the-money SPX Options, Does were able to — and did — unlawfully influence the SOQ formula.

Plaintiffs' claims are corroborated by significant empirical evidence, including a study into the relationship between the VIX settlement price and the pricing of VIX Options and VIX Futures conducted by Prof. John M. Griffin of the McCombs School of Business at The University of Texas at Austin.[3] These economic analyses show, among other things, trading abnormalities and patterns that are compelling indications of market manipulation and misconduct. Among other things, the data shows a uniquely disproportionate use of puts over calls during the settlement period, indicating that market actors just so happened to be transacting in the type of order that would maximize a manipulative effect during the precise time when such manipulative effect was possible. Data and analyses pled in the Complaint likewise show that trading volume increased during settlement days, particularly for out-of-the-money SPX Options, and that the alleged bad actors transacted in such ways to force the VIX SOQ formulate to include SPX Options that were further and further out of the money, pushing the settlement price up or down, in their favor.

The manipulation harmed investors by causing them to either pay more or receive less from VIX-related products that were affected by the wrongdoing. CBOE, as the creator, owner, and operator of the SOQ, and its proprietary suite of VIX products, knew or turned a blind eye toward the alleged misconduct, and routinely failed to enforce its own rules to prevent such malfeasance. Plaintiffs will now seek to hold the Does and CBOE accountable. Notably, multiple regulators, including the Commodities Futures Trading Commission, Securities Exchange Commission, and FINRA are now reported to be investigating the manipulation of VIX-related products. ■

[3] Prof. Griffin is co-author of a 2017 paper in *The Review of Financial Studies* entitled "Manipulation in the VIX?," available at http://www.jgriffin.info/wp-content/uploads/2017/12/vix_pub.pdf.

#METOO'S IMPACT ON CORPORATE LAW

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In the days following the expose, more women came forward. A cocktail waitress from the Golden Nugget in the 1980s said that Wynn "made a habit of going after single moms who were scared and couldn't afford to lose their jobs."[2] Another server said that after she bragged about becoming a grandmother, Wynn harassed her to have sex with him. He said that he "never had sex with a grandmother before and want[ed] to see how it feels."[3]

Like many outsized corporate leaders, in many ways Steve Wynn *was* Wynn Resorts. His signature graces each of the company's buildings as its corporate log ach of the company's annual reports for 2010 through 2016 listed as its first "Risk Factor" that:

> The loss of Stephen A. Wynn could significantly harm our business. Our ability to maintain our competitive position is dependent to a large degree on the efforts, skills and ***reputation*** of Stephen A. Wynn . . . If we lose the services of Mr. Wynn, or if he is unable to devote sufficient attention to our operations for any other reason, our business may be significantly impaired. (Emphasis added).

Indeed, the news of Wynn's misconduct led to the Company's loss of over $3 billion in market capitalization within days. Investigations by gaming regulators imperiled Wynn Resorts' $2.5 billion hotel casino in Massachusetts. The company's annual report for 2017 reframed its first "Risk Factor" as:

> The controversy, regulatory action, litigation and investigations related to Stephen A. Wynn and his separation from the company could significantly harm our business.[4]

Derivative Litigation On Behalf of Wynn Stockholders

On February 22, 2018, the New York State Common Retirement Fund filed a derivative lawsuit in Clark County, Nevada against Wynn Resorts' board of directors (the "Board") for ignoring numerous "red flags" and allowing Wynn's behavior to continue unchecked. The New York City Pension Funds joined the suit as additional plaintiffs.[5] Plaintiffs'

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[2] "Steve Wynn Described By Former Cocktail Waitress As 'Forceful, Aggressive,'" *Nevada Forward* (Feb. 7, 2018).

[3] Arthur Kane and Romona Giwargis, "Las Vegas-Review killed a story in 1998 about Steve Wynn sex misconduct claims," *LAS VEGAS-REVIEW JOURNAL* (Feb. 5, 2018).

[4] Wynn Resorts Feb. 28, 2018 Form 10-K.

[5] *Operating Engineers Construction Industry and Miscellaneous Pension Fund v. Steven Wynn*, Case No. A-18-769630-B (Nev. Distr. Ct. Clark Cnty.) ("*In re Wynn*").

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Building on the success of this year's inaugural gathering, Institutional Investor's Sovereign Investor Institute and Legal Forum membership in partnership with Kessler Topaz Meltzer & Check LLP (KTMC) will hold the second annual gathering of senior legal executives at sovereign wealth funds and asset management firms. This meeting will provide a private, closed-door environment to discuss and debate issues related to governance, shareholder engagement and related legal and compliance issues.

Preliminary Topics

We are excited to bring you the first look of our 2019 discussion topics. Topics under consideration include:

- The Brexit Reality Show: Week One and Counting
- Preparing for the Revised Shareholder Rights Directive
- The Landscape for Non-U.S. Actions Post-Morrison
- Leading the Way: SWFs take Climate Change Action
- Active Ownership and Engagement with Portfolio Companies
- Beyond Investing: Reputation Risk in a #MeToo World
- Running a Legal Department: Best Practices and Optimal Structures

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Institutional Investor

KESSLERTOPAZ MELTZERCHECK LLP

#METOO'S IMPACT ON CORPORATE LAW

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complaint alleged that the Board breached its fiduciary duties by knowingly failing to act on reports of Wynn's serial sexual misconduct.

On June 25, 2018, the Board moved to dismiss plaintiffs' complaint because, among other things, plaintiffs made no pre-suit demand on the Board. Because derivative plaintiffs seek to displace a board's role to decide whether to bring a lawsuit suit on behalf of a corporation, plaintiffs are generally required to show that a pre-suit demand on the board would have been "futile." To establish "demand futility," a derivative plaintiff typically needs to plead facts to demonstrate that a majority of the board of directors lacked independence or would not be "disinterested" in the outcome of the potential litigation. In a case like *Wynn*, courts generally require the plaintiff to plead that the board knew or should have known about the misconduct, and acted in bad faith by consciously failing to address it.[6]

When plaintiffs filed their complaint against the Board, no court had ever found demand futility based on a board's failure to address an officer's alleged sexual misconduct. But on September 5, 2018, the Nevada court upheld plaintiffs' complaint, holding that a pre-suit demand on Wynn Resorts' board would have been futile. The court found it was reasonably conceivable that the Board knew about Wynn's serial sexual misconduct based on a litany of red flags, including the sheer magnitude of his conduct (hundreds of instances over decades), numerous reports of his behavior, complaints filed with the U.S. Equal Employment Opportunity Commission ("EEOC"), and the Board's involvement in a lawsuit relating to Wynn's $7.5 million payment to settle a company manicurist's claim that Wynn raped her.[7] The Court found that the Board's failure to act in the face of credible and corroborated reports was knowing and intentional, so the Board faced a substantial likelihood of liability and would not be disinterested in considering a demand.[8]

The *Wynn* decision illustrates the impact that the #MeToo Movement — which erupted in October 2017 after Harvey Weinstein's decades-long sexual misconduct came to light — has had on corporate law. The current social climate, which encourages victims of sexual assault to break their silence, may have encouraged the *Wynn* court to draw more inferences in plaintiffs' favor about the Board's knowledge of Wynn's misconduct. A brief discussion of prior sexual misconduct-related derivative claims illustrates how the #MeToo Movement has propelled corporate law forward.

Before #MeToo

In 1998 in the Delaware Court of Chancery, an individual shareholder of ICN Pharmaceuticals filed a derivative lawsuit against ICN's board of directors based on the board's failure to address allegations of sexual misconduct against ICN's Chairman, founder and CEO Milan Panic.[9] The lawsuit, captioned *White v. Panic*, was based on a July 6, 1998 *U.S. News and World Report* cover-story entitled "Sex and the CEO," which revealed allegations that Panic sexually harassed ICN employees and ICN paid $3.5 million to settle those claims. Relying primarily on *U.S. News and World Report*'s investigation, plaintiff filed his lawsuit and alleged that ICN's board breached its fiduciary duties by failing to address Panic's misconduct.[10]

The court dismissed the case, finding that a pre-suit demand on ICN's board would not have been futile. The court held that plaintiff had failed to plead with sufficient detail that the board *knew* that Panic had engaged in misconduct, especially since Panic never admitted to it.[11]

In 2012, a federal court in California relied on *White* to dismiss a derivative complaint on similar facts. Two individual shareholders filed suit against the board of directors of American Apparel, Inc. for breaching its fiduciary duties by failing to prevent the sexually hostile and discriminatory workplace led by its Chairman and CEO Dov Charney.[12] Plaintiffs' complaint alleged that Charney walked around American Apparel in thong underwear, used highly derogatory terms with women, condoned managers' sexual relationships with junior employees whose compliant behavior was rewarded, invited a female employee to masturbate with him, ran business meetings at his home practically naked, and requested that the company "hire young women with whom he could have sex, Asians preferred."[13] American Apparel employees filed multiple complaints with the EEOC involving Charney's misconduct.

First the *American Apparel* court found that plaintiffs' allegations supported an inference that the board knew or should have known there was *possible* cause for concern. But then, relying on *White*, the court found that the board did not have knowledge of *actual* problems and, as such, did not act in bad faith.[14]

Thus under *White v. Panic* and *American Apparel*, courts had generally held that unless a corporate officer admits to perpetrating sexual misconduct, a court will not find that a board has the

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6 *See Melbourne Municipal Fighters' Pension Trust Fund on Behalf of Qualcomm, Inc.*, 2016 WL 4076369 at *8 (Del. Ch. Aug. 1, 2016) (discussing cases).

7 *In re Wynn*, Dkt. No. BL-117 at 6.

8 *Id*. at 5.

9 *White v. Panic*, 793 A.2d 356, 360-61 (Del. Ch. 2000), *aff'd* 783 A.2d 543 (Del. 2001).

10 *Id*. at 371.

11 *Id*. at 368-69.

12 *In re American Apparel, Inc. S'holder Deriv. Litig.*, 2012 WL 9506072, at *28 (C.D. Cal. July 31, 2012).

13 *Id*., at *5.

14 *Id*., at *29-30 (citing *White*, 783 A.2d at 547-58).

#METOO'S IMPACT ON CORPORATE LAW

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requisite knowledge of actual misconduct to make demand futile.

In *Wynn*, however, the Nevada court found that the Board knew about Wynn's misconduct even though Wynn, to this day, denies the allegations against him. The Nevada court found that "credible and corroborated reports" of Wynn's misconduct was sufficient to find that the Board knew about his behavior. This precedent-setting decision makes room for plaintiffs to use the outpouring of stories inspired by the #MeToo Movement to overcome a pleading-stage dismissal even if a company officer (or director) has not admitted to engaging in sexual misconduct.

The Derivative Harm in Failing to Address Sexual Misconduct

The costs of failing to address sexual misconduct can be significant, making derivative claims that seek to recoup these costs valuable. For example, on November 17, 2017, City of Monroe Employees' Retirement System settled similar claims against the board of Twenty-First Century Fox, Inc. for $90 million. The $90 million, paid by Fox and the board's insurance providers, accounted for, among other things, Fox's payment of over $130 million in sexual harassment settlements and severance. Indeed, between 2010 and 2016, American employers paid nearly $300 million to settle sexual harassment claims through the EEOC.[15]

In addition to the legal costs, sexual misconduct has substantial operational, regulatory and reputational costs. Wall Street has begun to hedge against the risks of a sexual misconduct scandal by including "Weinstein clauses" or "#MeToo reps" in merger agreements. These provisions require a target company, through its executive officers, to represent that it has no actual knowledge of sexual accusations made against company supervisors over a certain time period. If the representation is false, the acquirer may be able to terminate the merger agreement. Some "Weinstein clauses" require the target to put money in escrow for acquirers to claim if social issues arise.[16] A review of public filings indicates that at least nineteen merger agreements executed since March 15, 2018 include a Weinstein clause, including as recently as October 22, 2018 in connection with American Railcar Industries, Inc.'s $1.75 billion merger with a subsidiary of ITE Rail Fund, L.P.[17]

In addition to returning tangible value to a company, derivative cases can effectuate corporate governance reforms that reduce the risk, and thereby mitigate the costs, of sexual misconduct occurring. These reforms focus on enhancing management and advancing women in leadership.[18] For example, Monroe's settlement with Fox included creating a Fox News Workplace Professionalism and Inclusion Council (the "Inclusion Council") to ensure that Fox News' workplace has effective reporting practices and human resources training, and recruits and advances women and minorities.

These measures not only reduce the risk of sexual misconduct occurring, they increase the likelihood of long-term positive investment incomes — another illustration of the value of derivative claims. For example, a Credit Suisse study of over 2,000 companies from 2006 to 2012 found that companies with at least one female director delivered higher than average returns on equity, had lower leverage, better than average growth, and higher price/book value multiples.[19] A 2015 review by Harvard Law School's Pensions and Capital Stewardship Program found a positive correlation between human resource initiatives and positive investment outcomes

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[15] Rosemary Lally and Brandon Whitehill, "How Corporate Boards Can Combat Sexual Harassment," *Council of Institutional Investors* (March 2018).

[16] Nabila Ahmed, "Wall Street Is Adding a New 'Weinstein Clause' Before Making Deals," *Bloomberg* (Aug. 1, 2018).

[17] *See* American Railcar Industries, Inc. Oct. 22, 2018 Form 8-K at Ex. 2.1 § 3.24.

[18] *See, e.g.*, Brendan L. Smith, "What it really takes to stop sexual harassment," *AMERICAN PSYCHOLOGICAL ASSOCIATION*, Vol. 49, No. 2 (February 2018).

[19] "Gender diversity and corporate performance," *CREDIT SUISSE RESEARCH INSTITUTE* (August 2012).

such as total shareholder return, return on assets, return on earnings, return on investment, and return on capital employed.[20] A 2017 MSCI study found that over a five year-period companies with three or more female directors reported 45% higher EPS than companies with no female directors. A 2018 McKinsey & Company study of more than 1,000 companies found that companies in the top quartile for gender representation were more likely to outperform fourth quartile companies by margins of 33%.[21]

Large institutional investors are paying attention to these statistics and lobbying for the disclosure of management metrics and enhanced gender diversity in corporate leadership. The Human Capital Management Coalition, whose members include twenty-five institutional investors representing over $3 trillion in assets under management, is lobbying the SEC to require companies to disclose their management metrics.[22] The Sustainability Accounting Standards Board ("SASB"), whose Investor Advisory Group includes thirty asset managers representing over $21 trillion in AUM, has identified management as a "material" issue that requires greater disclosure.[23]

When State Street unveiled its "Fearless Girl" statue on Wall Street on March 13, 2017, it issued a letter urging companies to include women on their boards and threatening to use its proxy voting power to effect that change.[24] During the 2018 proxy season, Glass Lewis "highlight[ed] companies that have no female board members, and [stated that] beginning in 2019 [it would] recommend voting against the nominating committee chair of a board that has no female members . . . ."[25] The California State Teachers Retirement System ("CalSTRS") has been lobbying for years for companies to include more women on their boards.[26] CalSTRS' campaign influenced California's Governor to sign Senate Bill No. 826 ("SB-826") into law onto September 30, 2018, requiring California-headquartered public companies to have one to three women on their boards, depending on board size.[27] SB-826 will affect ninety-four companies that, as of September 30, 2018, had no female directors.[28]

Wynn Resorts appears to have gotten the message. Between January and May 2018, six directors of Wynn Resorts resigned, including Wynn himself. In April 2018, the Board elected three new female directors, raising its female director ratio to 4/11.

What's Next?

According to polls conducted by NBC, *The Wall Street Journal* and MSN just last year, over 45% of women are harassed at work.[29] The #MeToo Movement continues to empower victims and witnesses to speak out. Just last month, *The New York Times* exposed sexual misconduct at Google, Inc.[30] As additional victims come forward, derivative litigation will likely be filed by stockholders seeking to recover lost corporate value. Courts across the country will likely have additional opportunities to evaluate these cases, and will be asked to draw inferences about what each of those boards knew. Two cases are currently pending, including an action Kessler Topaz filed in Delaware against the board of Liberty Tax, Inc.[31] The Liberty Tax matter involves allegations that the company's CEO, Chairman and controlling stockholder engaged in inappropriate sexual activity with company employees in the workplace, and used company resources for his sexual gain. Investors will be watching the extent to which these derivative cases force companies to take action, including by enhancing management and gender diversity in corporate leadership. ■

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[20] Aaron Bernstein and Larry Beeferman, "The Materiality of Human Capital to Corporate Financial Performance," *Harvard Law School Pensions and Capital Steward Project, Labor and Worklife Program,* (Apr. 2015).

[21] Vivan Hunt, Lareina Yee, Sara Prince and Sundiatu Dixon-Fyle, "Delivering through diversity," *McKinsey & Company* (Jan. 2018).

[22] http://uawtrust.org/hcmc

[23] http://www.sasb.org/materiality/sasb-materiality-map/

[24] https://www.ssga.com/investment-topics/environmental-social-governance/2017/guidance-on-enhancing-gender-diversity-on-boards.pdf

[25] http://www.glasslewis.com/wp-content/uploads/2018/03/2018-Proxy-Season-Preview-US.pdf

[26] Heidi Welsh and Michael Passof, [proxypreview] (2018) at 61.

[27] https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180SB826.

[28] Irina Ivanoca, "Nearly 100 California companies have no women on their board of directors," *MONEYWATCH* (Oct. 1, 2018).

[29] Carrie Dan, "NBC/WSJ Poll: Nearly Half of Working Women Say They've Experienced Sexual Harassment," *NBC News* (Oct. 30, 2017); Rachel Gillett, "Sexual Harassment isn't a Hollywood media issue — it affects everyone," *BUSINESS INSIDER* (Nov. 30, 2017)

[30] Daisuke Wakabayashi and Katie Benner, "How Google Protected Andy Rubin, the 'Father of Android,'" *The New York Times* (Oct. 25, 2018).

[31] *In re Liberty Tax, Inc. Stockholder Litigation*, Consol. C.A. No. 2017-0883-AGB (Del. Ch.)

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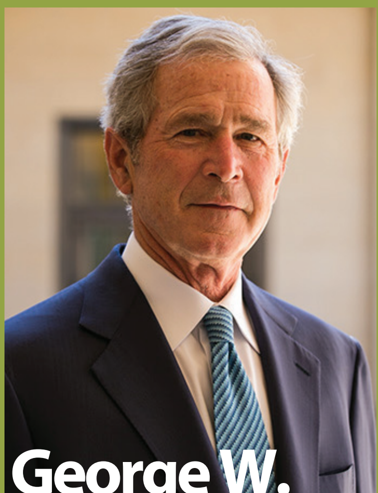

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DELAWARE CHANCERY COURT DETERMINES WHETHER FEDERAL FORUM PROVISIONS IN BYLAWS CAN CURB SECURITIES CLASS ACTIONS FILED IN STATE COURTS

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of legislation were passed, the Securities Act and the Securities and Exchange Act of 1934 (the "Exchange Act"). The Securities Act governs initial public offerings of securities and is intended to provide investors with greater transparency in a company's financial statements. This Act prohibits material misstatements and omissions in initial public offering ("IPO") materials.[1] Additionally, the Securities Act provides investors with a private right of action and concurrent jurisdiction for these claims in either state or federal court.

The Exchange Act governs open-market trading including purchases and sales of securities on securities exchanges. As enacted originally, the Exchange Act allowed for exclusive federal jurisdiction of claims brought under the Act. The U.S. Supreme Court determined this statute created an implied private right of action for investors, also exclusively in federal court.

Over sixty years after the enactment of the Securities Act and the Exchange Act, in 1995, Congress adopted the Private Securities Litigation Reform Act of 1995 ("PSLRA"). The stated purpose of the PSLRA was to limit the filings of frivolous or unwarranted securities claims. The PSLRA sought to accomplish this goal by implementing procedural and substantive requirements for class actions brought under federal securities laws. Eliminating the race-to-the-courthouse, first-to-file regime for securities fraud cases, the PSLRA imposed heightened pleading standards for securities fraud cases filed in federal court and a procedural framework for the appointment of a lead plaintiff and lead counsel. Following this legislation, there was an increase in filings of securities fraud claims in state court as plaintiffs, and their lawyers, sought to avoid the PSLRA's additional pleading requirements and the lead plaintiff appointment provisions.

In effort to prevent this state law loophole, Congress adopted SLUSA in 1998. SLUSA gave federal courts the "exclusive venue for most securities fraud class actions."[2] Congress passed SLUSA to "prevent plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State court, rather than Federal court."[3] SLUSA pre-empts state law class action securities fraud claims that allege misrepresentation or manipulation in connection with the purchase or sale of a covered security. Specifically, SLUSA precluded private parties from pursuing "covered class actions," (those seeking damages for over 50 people) in state court by making such claims removable to federal court and/or subject to dismissal on the basis of pre-emption.[4]

Nonetheless, SLUSA remained unclear as to whether covered class actions solely alleging Securities Act claims may be filed in state court given the explicit concurrent jurisdiction provision in the Securities Act and SLUSA's silence as to whether these provisions were superseded. The courts also differed in their interpretation as to whether SLUSA allowed "covered class actions" brought under the Securities Act to be removed to federal court. The language in these statutes resulted in a split among federal district courts. For example, the Ninth Circuit in *Luther v. Countrywide et al.*, concluded that SLUSA did not supersede the Securities Act's jurisdiction provisions and allowed plaintiffs to pursue claims in state court.[5] While the Second Circuit in *Knox v. Agria Corp.*, concluded that SLUSA preempted state court jurisdiction of Securities Act claims.[6] The practical reality of the *Luther* opinion was the expansion of parallel litigation in state courts within the Ninth Circuit of Securities Act claims that were simultaneously being pursued in federal court under the PSLRA's framework. Defendants attempted, with varying degrees of success, to coordinate these parallel proceedings, through pursuit of state or federal stays, and preemption doctrines like the Colorado River doctrine.[7]

In March 2018, the Supreme Court in *Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061 (2018), resolved this circuit split. The Supreme Court unanimously held that SLUSA only applied to claims arising under state law, and not federal claims brought in state court. Thus, state courts retain jurisdiction to hear claims arising under the Securities Act and these actions are not removable from state court to federal court.[8] The Supreme Court noted that SLUSA's statutory language "does nothing to deprive state courts of their jurisdiction to decide class action brought under the" Securities Act.[9] Justice Kagan further explained, "[w]e do not know why Congress declined to require as that [Securities Act] class actions be brought in federal court . . . But in any event, we will not revise that legislative choice, by reading [the statute] in a most improbable way, in an effort to make the world of securities litigation more consistent or pure."[10]

II. Case Background

In the wake of the *Luther* decision in the Ninth Circuit, and an increase in the filing of Securities Act claims in state courts within the Ninth Circuit, some companies

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1 *See* 15 U.S.C. § 77a, *et seq.*

2 H.R. Rep. No. 105-803 (1998).

3 *Id.*

4 15 U.S.C. § 78bb(f)(1); *see Merrill Lynch*, 547 U.S. 71 at 87.

5 *Luther v. Countrywide Fin. Corp.*, 195 Cal. App. 4th 789, 797-98 (2011).

6 *Knox v. Agria Corp.*, 613 F.Supp.2d 419, 425 (S.D.N.Y. 2009).

7 *See e.g.*, *Cervantes v. Dickerson*, 2015 WL 6163573. *See generally Colo. River Water Conservation Dist. v. U.S.*, 424 U.S. 800 (1976).

8 *Cyan v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061, 1078 (2018).

9 *Id.* at 1069.

10 *Id.* at 1073.

DELAWARE CHANCERY COURT DETERMINES WHETHER FEDERAL FORUM PROVISIONS IN BYLAWS CAN CURB SECURITIES CLASS ACTIONS FILED IN STATE COURTS

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adopted federal forum selection bylaws designating federal courts as the exclusive jurisdiction for claims asserting violations of the Securities Act. For example, Snap, Inc., which went public in March 2017, included a bylaw in its corporate charter assigning federal district courts as the "exclusive forum for resolving any complaint asserting a cause of action arising under the Securities Act."[11] The inclusion of forum provisions in a corporation's bylaws is not a novel idea. Professor Joseph Grundfest, a former Commissioner of the Securities and Exchange Commission and current professor at Stanford University, first introduced the idea of including an intra-corporate (i.e. relating to internal corporate affairs) forum provision in a corporation's bylaws in 2010.[12] Following this, many corporations have included these provisions in their charters. Notably, the Delaware Chancery Court has upheld the validity of these provisions under Delaware law.[13] The impetus to extend the intra-corporate forum selection bylaw to federal forum selection bylaws for claims arising under the Securities Act also appears to have originated with Professor Grundfest.[14]

In response to these bylaws, on December 29, 2017, an investor filed suit styled as *Sciabacucchi v. Salzburg et al.*, in Delaware Chancery Court against three Delaware incorporated and California based companies alleging that the federal forum bylaws their Boards adopted were improper.[15] The investor sued Blue Apron Inc., a meal kit delivery service, Roku Inc., a streaming device manufacturer, and Stitch Fix Inc., an online subscription and personal shopping service. Specifically, the plaintiff's complaint alleges that the companies' federal forum provisions are invalid under Delaware law because the bylaws purport to regulate the forum in which a claim may be brought despite the claim not relating to an internal corporate issue governed by Delaware law.

Delaware General Corporation Law ("DGCL") allows Delaware corporations' to include bylaws that govern the internal affairs of the corporation. This includes bylaws that designate Delaware state courts as the exclusive forum for claims regarding "internal corporate affairs," such as shareholder derivative claims brought under DGCL. Specifically, DGCL § 102(b)(1) states, "the [company's] certification of incorporation may also contain . . .[a]ny provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders, or any class of stockholders, or the governing body, members . . . if such provisions are not contrary to the laws of [Delaware]."[16]

Moreover, DGCL § 115 states that "no provision of the certificate of the incorporation or the bylaws may prohibit bringing such claims in the courts of this State."[17] This section was promulgated following several Delaware state court decisions permitting Delaware corporations to choose the corporation's principal place of business as the exclusive forum for litigation involving internal corporate claims.[18]

In *Sciabacucchi*, the plaintiff asserted that even if the court determines that stockholder securities class actions are internal corporate affairs, these federal forum provisions are still invalid under DGCL §115 because they purport to limit the ability of a plaintiff to bring such claims in Delaware state court. In other words, DGCL § 115 expressly

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[11] Snap Inc. Form S-1 Registration Statement p. 160 (Feb. 2, 2017).

[12] Pl. Br. Summ. J. 8.

[13] *See e.g., City of Providence v. First Citizens Bancshares, Inc.*, 99 A.2d 229 (Del. Ch. 2014); *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013).

[14] Joseph Grundfest, Presentation at the Rock Center for Corporate Governance (2016); *see* also Pl. Br. Summ. J. 9 (arguing that Professor Grundfest allegedly made this proposal in 2016 during a presentation at the Rock Center for Corporate Governance).

[15] *Sciabacucchi v. Salzberg, et al.*, No. 2017-0931 (Del. Ch. argued Sept. 28, 2018).

[16] Del. Code tit. 8, §102(b)(1) (1953).

[17] Del. Code tit. 8, §115 (2015).

[18] *See e.g., City of Providence v. First Citizens Bancshares, Inc.*, 99 A.2d 229 (Del. Ch. 2014); *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013).

prohibits corporations from drafting forum provisions that preclude claims involving "internal corporate affairs" from being brought in Delaware state courts. The plaintiff argues that as written, these federal forum provisions designate claims arising under the Securities Act as "internal corporate affairs." Because the federal forum provisions then prohibit these claims from being brought in Delaware state court, they violate DGCL § 115.[19]

III. The Arguments Before the Chancery Court

On September 27, 2018, the parties presented oral arguments regarding their cross-motions for summary judgment before the Honorable J. Travis Laster, Vice Chancellor of the Court of Chancery for the State of Delaware.[20] During oral argument, the plaintiff presented similar arguments as those summarized in the complaint. The plaintiff presented three principal reasons for the invalidity of the federal forum selection bylaws:

- DGCL § 102(b)(1)'s language did not extend beyond internal corporate matters and Delaware state courts consistently interpreted this statute to govern only the internal affairs of the corporation and intra-entity disputes. The purpose of the federal forum bylaw to regulate external affairs was evidenced by Professor Grundfest himself who was quoted as stating that the purpose of the provisions he envisioned was to "regulate a stockholder's ability to bring a securities fraud claim or any other claim that was not an intra-corporate matter."
- A federal securities claim is not "a right of stockholders" as stated in DGCL, but instead vests in the purchaser and seller of securities who may, or may not be a current stockholder. Claims under the Securities Act remain with a person even after they are no longer a stockholder. Moreover, a Securities Act claim may be brought against a person who does not traditionally manage a corporation, such as underwriters, auditors, and general counsel, and thus, cannot be said, at a minimum for such claims, to involve the internal affairs of the corporation.
- Court's applying Delaware's so-called "stay-in-your-lane policy" consistently interpreted Delaware laws so as to not conflict with the federal government's regulation of the securities markets. As drafted, these federal forum selection bylaws are in tension with this established policy.[21]

The Court did not engage with the plaintiffs' presentation of arguments but pressed the defendants on their counter. According to the defendants, DGCL § 102(b)(1) should be broadly construed to permit federal forum selection bylaws as the statute states that "the [company's] certification of incorporation may also contain . . . ***[a]ny*** provision for the management of the business and for the conduct of the affairs of the corporation, ***and any provision*** creating, defining, limiting and regulating the powers of the corporation." The defendants argued that Delaware state courts interpreted the phrase "any provision" expansively and that this language should extend to the manner in which stockholders may pursue their rights. The defendants further contended that these federal forum provisions relate to the "affairs of the corporation" and the "management of the business" because they regulate Securities Act claims that are brought following an IPO and channel these claims to the federal district court where they are heard more efficiently. This in turn regulates the manner in which stockholders may bring Securities Act claims, which arise from their stock ownership. The defendants asserted that there is nothing in DGCL § 102 that suggests the "affairs of the corporation" means only internal affairs, and as such, only claims governed strictly by Delaware law.

The defendants also urged that the bylaws did not impact any substantive right of a stockholder and was merely procedural in so far as they dictate only where and not whether a Securities Act claim may be brought.

Lastly, the defendants argued from a public policy standpoint the federal forum provisions for Securities Act claims are procedurally efficient as federal courts are in the best position to hear a federal securities claim. This forum selection clause is beneficial as it prevents almost identical claims under the Securities Act from being heard simultaneously in federal and state court. Allowing companies to include this federal forum provision in its charter will create efficiency among the courts and will not waste stockholder dollars on litigating the same claims in multiple forums.

The court seemed skeptical about the defendants' efforts to fit the federal forum provisions within the plain language of DGCL § 102(b)(1), notwithstanding the defendants' efforts to characterize federal securities claims as relating to "the management of the business," "the conduct of the affairs of the corporation," or as a provision that limits and regulates the powers of the corporation, directors, and the stockholders.

The court also queried how to frame the connection between stock ownership and the Securities Act claim, so that these claims could be regulated in charters or bylaws. The court expressed concern that if this federal forum provision is found valid then all forum provisions relating to a person's status as a stockholder would

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[19] Pl. compl. at pg. 20., para 50.

[20] Tr. (Sept. 28, 2018).

[21] *See* Pfizer Inc., SEC No-Action Letter (Feb. 22, 2012); Gannett Co., Inc., SEC No-Action Letter (Feb. 22, 2012).

DELAWARE CHANCERY COURT DETERMINES WHETHER FEDERAL FORUM PROVISIONS IN BYLAWS CAN CURB SECURITIES CLASS ACTIONS FILED IN STATE COURTS

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be valid. The court sought clarity as to what type of forum provisions would then be invalid under DGCL 102(b)(1) if this federal forum provision is allowed. The defendants responded that the framing of the connection must be broad because federal securities claims arise out of the relationship between the constituents mentioned in DGCL § 102. The defendants contested that regardless of whether the claim arises under Delaware state law, a corporation could include a federal forum provision in its bylaws as long as the claim relates to stock ownership. In the end, the court stated that it still failed to follow the defendants' logic as to how the language of DGCL § 102 could be expanded to cover any stockholder claim arising from any source of law.

The defendants also argued that the Plaintiffs' claims were not ripe for adjudication because the bylaw in question had not yet deterred a party from bringing its federal securities claims and no defendant to date had invoked the provision. The court, however, disagreed with this logic noting that it is impossible to tell whether the provision has deterred any claims as the base rates of who would have brought this claim in state court is unknown. Therefore, it is unclear how many potential claims the defendants already deterred.

Ultimately, this case will clarify how broadly Delaware state courts interpret the management and affairs of the corporation under DGCL § 102(b)(1). The decision of the court will depend on whether it interprets the "management of the business" and "the conduct of the affairs of the corporation" to extend to all claims brought by shareholders. While predicting how the court might rule on the issue is fraught, there were signs in the argument that the Court was skeptical of the defendants' arguments. During its questioning, the court appeared hesitant to extend DGCL § 102(b)(1)'s regulation of traditional intra-corporate affairs to claims explicitly created by federal law. The court recognized the tension in finding that rights endowed by federal law could be construed as part of the internal affairs of a public corporation. Or more broadly, whether any claim by a stockholder against a corporation, including a breach of contract claim, should be governed by DGCL § 102(b)(1) to include any stockholder claim brought under any source of law. The defendants sought to reassure the Court by suggesting that the forum provision is limited by a person's status and capacity as a stockholder and that the forum provision is procedural in nature because it merely dictates which court a Securities Act claim may be brought.

IV. Implications Moving Forward

The increased frequency of parallel state and federal litigation arising under the Securities Act creates some uncertainty in the litigation of securities claims, the potential for duplicative litigation, and the possibility of conflicting outcomes. Yet, there are existing mechanisms under state and federal law to stay or render irrelevant duplicative cross-jurisdictional proceedings. These mechanisms include pre-emption doctrines, state or federal litigation stays, and the class action procedural device itself, which arguably renders parallel state litigation moot once a case in a federal forum is certified as a class action or vice versa. Federal forum bylaws assume that all state law litigation of Securities Act claims is duplicative of other federal litigation (and frivolous to boot) but there are several examples of state litigation being pursued in the wake of the *Cyan* decision that do not have parallel federal cases. From an investor standpoint, having a choice of either state of federal court to prosecute claims arising from initial offerings, where the federal court dockets are increasingly over-burdened and slow-acting, is an important choice.

It is also likely that to the extent state courts begin to see more Securities Act litigation, there will be a convergence towards common procedural mechanisms between state and federal courts, such as discovery stays, consistent processes for lead plaintiff appointments, and deference to proceedings in other forums, to the extent such proceedings are truly duplicative.

In the unlikely event that the Delaware Chancery Court determines that the federal forum bylaws are permissible (and this decision is upheld on appeal to the Delaware Supreme Court and potentially the U.S. Supreme Court) we can expect these bylaws to become standard provisions in new IPOs and the marshalling of any such precedent to further erode shareholder litigation in significant and harmful ways, such as including shareholder arbitration clauses in corporate bylaws. ■

NINTH CIRCUIT CLARIFIES CONTOURS OF JUDICIAL NOTICE AND INCORPORATION BY REFERENCE IN LIGHT OF "CONCERNING PATTERN IN SECURITIES CASES" OF "OVERUSE"

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demonstrate a sufficiently 'plausible' claim for relief." *Id.* at 999.[1]

With these principles in mind, the Ninth Circuit provided what has been described as a "how-to guide" with respect to judicial notice and incorporation by reference. As to judicially noticed facts, a court must first clearly identify which facts it is judicially noticing. Then, it must determine whether or not such facts are subject to "reasonable dispute." This distinction is important because a "court may take judicial notice of matters of public record," but it notably "cannot take judicial notice of the disputed facts contained in such public records." *Id.* In other words, simply because the document itself is susceptible to judicial notice does not mean that every assertion of fact within that document is judicially noticeable for its truth.

Thus, for instance, in *Orexigen*, the district court properly took judicial notice of the existence of an investor conference call transcript filed with the SEC. The district court, however, erred in judicially noticing the facts contained in that transcript because "reasonable people could debate what exactly this conference call disclosed." *Id.* at 1000.

Moreover, the Ninth Circuit explained, incorporation by reference is appropriate "if the plaintiff refers extensively to the document or the document forms the basis of the plaintiff's claims." *Id.* at 1002. It further clarified that "mere mention" of a document within a complaint would not be sufficient for applying the incorporation by reference doctrine. *Id.* In a similar vein, documents submitted "merely to create a defense to the well-pleaded allegations in the complaint" are not properly incorporated by reference because they do not form the basis of the plaintiff's claims. *Id.* More specifically, incorporating such documents would be akin to "nothing more than another way of disputing the factual allegations in the complaint, but with a perverse added benefit: unless the district court converts the defendant's motion to dismiss into a motion for summary judgment, the plaintiff receives no opportunity to respond to the defendant's new version of the facts." *Id.* at 1003.[2]

Applying these principles, the Ninth Circuit held, for instance, that a blog entry quoted once in a two sentence footnote was not properly incorporated by reference. *Id.* at 1003 ("For 'extensively' to mean anything . . . it should, ordinarily, at least, mean more than once."). On the other hand, the district court properly incorporated by reference an analyst report cited in the complaint that discussed how the company's stock price reacted to its interim results — i.e., that supported the plaintiff's claims that the market relied on the company's statements regarding the interim study results. *Id.* at 1004.

With these considerations in mind, the Ninth Circuit reversed the district court's dismissal of the plaintiffs' Section 10(b) claims which had been based, in part, on its improper reliance on certain extrinsic documents.

III. Policy Implications

Orexigen is a welcome development for plaintiffs, especially those bringing securities fraud claims. In the Ninth Circuit in particular, motions to dismiss have become increasingly complex as a result of defendants' requests for judicial notice and incorporation by reference. Often, these requests include a vast array of documents extrinsic to the complaint they are seeking to dismiss. This has, at a minimum, led to confusion on behalf of, and additional work for, the parties and the court. In more extreme circumstances, defendants' reliance on these doctrines has caused the exception to swallow the rule.

Orexigen should permit plaintiffs to retain more control over their own complaint. More precisely, the Ninth Circuit's forceful admonitions regarding the "unscrupulous use of extrinsic documents" and its "concerning pattern" should discourage defendants from attempting to put tens or hundreds of documents before the court on a motion to dismiss. At a minimum, *Orexigen* arms plaintiffs' with powerful authority to combat any such efforts.

The case also reminds defendants that requests for judicial notice and incorporation by reference may result in an unintended consequence. Under Rule 12(d), when "matters outside the pleading are presented to and not excluded by the court," the Rule 12(b)(6) motion converts into a motion for summary judgment under Rule 56. Then, both parties must have the opportunity "to present all the material that is pertinent to the motion." *Id.* As the Ninth Circuit explained, "it is reversible error when a court considers material outside the pleading on a Rule 12(b)(6) motion and yet fails to convert it into a motion for summary judgment." *Orexigen*, 899 F.3d at 1012. Any such conversion is typically also a welcome development for plaintiffs, as it permits discovery to which securities plaintiffs ordinarily do not have access at the pleading stage. Such discovery would help alleviate the informational gap that traditionally exists between plaintiffs and defendants on a motion to dismiss.

(continued on page 21)

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[1] As Cornell Law School Professor Robert Hockett similarly explained: "If the court is taking notice of alleged facts without your even knowing what those facts are and without the opportunity to rebut those putative facts, then you haven't even really gotten your day in court." *See* https://www.law360.com/articles/1075115/9th-circ-opinion-could-spark-more-securities-settlements.

[2] The requirements for and consequences of converting a Rule 12(b)(6) motion to a motion for summary judgment are discussed in more detail in Part III, *infra*.

KESSLER TOPAZ PENDING INJUNCTION APPLICATION PRESSURES LASALLE HOTEL PROPERTIES TO ACCEPT A VALUE-MAXIMIZING TRANSACTION WITH PEBBLEBROOK HOTEL TRUST

(continued from page 3)

Kessler Topaz sought and secured expedited discovery in the litigation, and the Court scheduled a hearing on a preliminary injunction application for September 5, 2018. Ultimately, the threat of Kessler Topaz's litigation coupled with shareholder opposition caused the LaSalle Board to abandon the Blackstone Transaction and declare the Pebblebrook Offer superior on September 5, 2018, just as the Court was preparing to hear argument on Kessler Topaz's injunction application.

LaSalle stockholders will now have the opportunity to vote on the Pebblebrook transaction on November 27, 2018.

The Background

LaSalle and Pebblebrook are real estate investment trusts that own and operate hotels. Both companies were founded by Jon E. Bortz ("Bortz"), Pebblebrook's CEO and Chairman. Bortz founded LaSalle in 1998, growing it into a highly successful hotel operator in less than a decade. In 2009, however, Bortz departed LaSalle and founded Pebblebrook within weeks of his purported retirement. In Bortz's place, LaSalle named Michael D. Barnello ("Barnello") as CEO and Stuart L. Scott ("Scott") as Chairman of the Board — positions both men continue to hold. Over the subsequent decade, while Bortz grew Pebblebrook into another highly successful hotel operator, LaSalle stagnated under Barnello's leadership.

On March 6, 2018, Bortz returned to his former colleagues and submitted a proposal under which Pebblebrook would acquire LaSalle in an all-stock acquisition for $30.00 per share, representing a 17.5% premium to LaSalle's stock price. The proposal made clear that Pebblebrook management — and not LaSalle management — would lead the combined entity.

The Board rejected Pebblebrook's proposal on March 22, 2018 without even discussing with Pebblebrook a potential sales process, citing Pebblebrook's proposal as being "insufficient from both price and mix of consideration perspectives." Shortly thereafter, Pebblebrook publicly disclosed its offer and the Board's rejection of it to the market. Around this same time, Blackstone submitted an indication of interest to acquire LaSalle for $28.00 to $30.00 per share in cash, and the Board then decided to initiate a sales process.

Throughout April and May, 2018, in direct response to LaSalle's Board's criticisms of its original offer, Pebblebrook continued to submit additional offers to acquire LaSalle which raised the exchange ratio for the stock consideration and ultimately added a cash component of up to 20% of the total consideration. By May 16, 2018, the sales process had devolved into a two-horse race between Pebblebrook and Blackstone, with Pebblebrook's offer valued at $34.58 per share, while Blackstone had submitted an all-cash offer for $33.00 per share.

Despite Pebblebrook's facially superior offer, the Board continued to decry the lack of price certainty in Pebblebrook's offer (even though Pebblebrook had repeatedly increased the cash component of its offer to provide greater price certainty). Then, for the first time on May 19, 2018, LaSalle demanded that Pebblebrook agree to an asymmetrical price collar for its offer, such that if Pebblebrook's stock price declined Pebblebrook would have to provide a greater exchange ratio, but if Pebblebrook's stock price rose the exchange ratio would remain the same.

Pebblebrook rejected this unusual term, but agreed to raise the exchange ratio to 0.92 Pebblebrook shares, which valued LaSalle at $35.89 per share, and offered to continue negotiations to address the Board's purported concerns over price certainty. LaSalle, however, *never* responded to Pebblebrook's revised offer. Instead, on May 20, 2018, the Board quickly signed up a deal with Blackstone for $33.50 per share in cash, representing a nearly $2.40 discount to Pebblebrook's proposal.

On June 11, 2018, Pebblebrook publicly reasserted its offer, which now valued LaSalle at $37.80 per share, and agreed to pay the $112 million termination fee associated with the Blackstone Transaction. Inexplicably, the Board announced on June 18, 2018 that Pebblebrook's facially superior proposal could not "reasonably be expected to lead to a superior proposal" under the provisions of the Blackstone Transaction merger agreement, and refused to negotiate with Pebblebrook.

The Litigation and Subsequent Events

On June 29, 2018, following a multi-week investigation, Kessler Topaz, on behalf of Erie County, filed a class action complaint against LaSalle and the Board in the Circuit Court for Baltimore City, Maryland (the "Court"). The complaint alleged that the Board breached its fiduciary duties by, *inter alia*, rejecting Pebblebrook's proposals in bad faith and issuing false and materially misleading disclosures. Among other things, the complaint focused on the Board's inexplicable decision to appoint Barnello to lead the sales negotiations when he had an obvious conflict of interest based on his future employment (i.e. he would lose his job in a Pebblebrook transaction, but almost assuredly keep his job if LaSalle was acquired by private equity buyer Blackstone, which did not have its own management team). The complaint sought equitable relief in the form of an injunction as well as monetary damages.

On July 20, 2018, Pebblebrook reaffirmed its acquisition offer, committing to continue to pay $37.80 per share in cash for the cash consideration even though Pebblebrook's stock price had dipped slightly below that price. Ten days later, on July 30, 2018, the Board again rejected Pebblebrook's facially superior proposal, contending that it still could not "reasonably be expected to lead to a superior proposal." Simultaneously, the Board filed its definitive proxy for the Blackstone Transaction, which mooted certain disclosure claims raised in Erie County's complaint, and scheduled the shareholder vote on the Blackstone Transaction for September 6, 2018.

In light of the now-impending vote, Kessler Topaz sought to maintain pressure on LaSalle by vigorously prosecuting Erie County's claims. As a result, Kessler Topaz filed, briefed, and argued a motion to expedite proceedings, which the Court granted on August 9, 2018. Thereafter, between August 13 and August 27, 2018, Kessler Topaz obtained and reviewed expedited discovery, filed and briefed a motion to preliminarily enjoin the Blackstone Transaction, and filed an opposition brief to a motion to dismiss filed by LaSalle. From August 27 to August 29, 2018, Kessler Topaz also briefed and successfully petitioned the Court for an order requiring LaSalle to produce additional expedited discovery materials. Finally, on September 4, 2018, Kessler Topaz filed a reply brief in further support of Erie County's motion to preliminarily enjoin the Blackstone Transaction.

In the interim, on August 22, 2018, Pebblebrook announced a revised acquisition proposal for LaSalle that maintained the exchange ratio but increased the cash component of the proposed consideration from 20% to 30%. The Pebblebrook Offer valued LaSalle at $36.57 per share. On August 27, 2018, the Board announced that the revised Pebblebrook Offer, which provided only a marginal increase in price certainty compared to the prior Pebblebrook proposals that the Board rejected, could now "reasonably be expected to lead to a superior proposal."

Not until September 5, 2018, however, the day of the preliminary injunction hearing, did the LaSalle Board declare that the Pebblebrook Offer was superior and announce its intent to terminate the Blackstone Transaction. Indeed, in the courthouse on the morning of the preliminary injunction hearing, LaSalle's counsel informed Kessler Topaz that the Board intended to declare the Pebblebrook proposal superior at a meeting of the Board later that day. While LaSalle sought to avoid the hearing in its entirety, Kessler Topaz maintained that it would not withdraw the motion until the Board's determination was definitive and there were assurances that the planned shareholder vote on the Blackstone Transaction would not proceed the next day. With the threat of the Court preliminarily enjoining the Blackstone Transaction looming, the Board then officially declared the Pebblebrook Offer superior and LaSalle's counsel represented to Kessler Topaz that the shareholder vote on the Blackstone Transaction would not proceed.

The following morning, on September 6, 2018, LaSalle announced the termination of the Blackstone Transaction and the execution of a merger agreement with Pebblebrook. LaSalle and Pebblebrook stockholders are now scheduled to vote on the Pebblebrook Offer on November 27, 2018.

The Takeaways

LaSalle exemplifies how fiduciary litigation, even where a court does not enter a determination on the merits or the parties reach a settlement, can maintain critical pressure on directors to ensure that they are protecting shareholders and working to maximize shareholder value. Here, the real possibility of a court-ordered injunction played a significant role in forcing the Board to accede to shareholder demands. Indeed, while the preliminary injunction hearing did not proceed, Kessler Topaz obtained effectively all of the relief sought in the litigation (i.e., the abandonment of the Blackstone Transaction in favor of a transaction with Pebblebrook), and LaSalle shareholders now have the opportunity to vote on a value-maximizing deal. ■

DUTCH COURT ASSERTS JURISDICTION OVER PETROBRAS IN SHAREHOLDER FOUNDATION ACTION BUT DOUBT REMAINS OVER ULTIMATE VIABILITY OF THIS APPROACH TO RECOVERY OF PETROBRAS INVESTMENT LOSSES

(continued from page 3)

that the Netherlands has jurisdiction to hear the Dutch Action. The court's decision on jurisdiction over Petrobras is narrow and there is still a lot of uncertainty regarding the ultimate outcome of the Dutch Action because there are two levels of appeal available to Defendants. The District Court asserted jurisdiction over Petrobras on a narrow ground and its decision regarding the enforceability of the arbitration provision in the bylaws is contrary to the decisions of courts in Brazil and the U.S. that have addressed the identical issues. As a result, it is by no means certain that the District Court's decision will hold-up on appeal.

The Rotterdam District Court concluded that it has jurisdiction over Petrobras on the basis of Article 7(1)[3] of the Dutch Civil Code of Procedure which provides that if a Dutch court has jurisdiction over one defendant, then it can assert jurisdiction over all other defendants who are called to the same proceedings if the claims are so closely connected that joint consideration is justified for reasons of efficiency and avoiding disparate judgments. PGF, POG, and PIB are all private limited liability companies registered in the Netherlands and it was foreseeable that the Dutch court would assert jurisdiction over those entities. However, despite three Dutch entities being named as defendants, Petrobras contested jurisdiction on the grounds that the allegations against Petrobras differ from those made against the three Dutch entities. Petrobras also argued that the facts giving rise to the alleged damage occurred almost exclusively in Brazil and that to the extent that PGF worked with Petrobras to jointly issue securities, an individual analysis of jurisdiction with respect to each investor's claim (and whether they purchased securities that were offered by PGF) would be necessary. The Court disagreed and found that because the Foundation was seeking a declaratory judgment concerning the unlawful acts of the defendants and not the Defendants' liability to any investor, that the claims were all legally connected for the purposes of establishing jurisdiction. The District Court concluded, "[l]egally too, it is a single situation, as the Foundation has requested a declaratory judgment over the unlawful actions of the respondents. . . ." The subtext of the court's decision is that this conclusion is only applicable because it is an action for a declaratory judgment and it is possible that a more thorough and individual analysis could be necessary for any claims seeking damages. It is also possible that the appellate court in the Netherlands could disagree with the District Court's analysis and determine that an individual analysis is necessary at this stage in order to determine whether the claims are connected closely enough to grant jurisdiction over Petrobras.

After assessing jurisdiction over Petrobras, the Rotterdam District Court assessed whether its jurisdiction was precluded because of the arbitration clause in Petrobras's bylaws. The District Court ultimately concluded that the arbitration petition in Petrobras's bylaws did not preclude the Foundation from pursuing a declaratory judgment in the Netherlands. The Court called into question whether there was a valid agreement to arbitrate any dispute between shareholders and the Company and found that the text of Article 58 of Petrobras' bylaws did not meet the requirements under Brazilian law for valid and enforceable arbitration agreements.

The Brazilian law on corporations, law number 6.404 of 1976 (as amended in 2001), provides that a corporation may include a provision in its bylaws that requires any dispute between shareholders and the corporation to be resolved via arbitration and Petrobras adopted such a provision in 2002. Article 58 of Petrobras's bylaws arguably requires all disputes with Petrobras to be resolved by arbitration in front of the MAC.

Leading Brazilian scholars have opined that shareholders manifest their consent and agree to arbitration bylaws of a company when they purchase shares of the company on a date after the bylaw was enacted. Brazilian courts have upheld the validity of Article 58 on a similar basis. In a case filed in 2014 by Mr. José Wianey Adami against Petrobras and the Federal Union (the Brazilian government), Mr. Adami alleged that the arbitration provision was invalid because his express consent to the arbitration agreement in the bylaws was necessary. The district court disagreed with Mr. Adami's position and dismissed his complaint on the grounds that a valid

[3] The Court also reviewed other grounds for establishing jurisdiction under the Code of Civil Procedure but did not find that those grounds gave rise to jurisdiction in this case.

and enforceable arbitration agreement existed between the parties. Mr. Adami appealed but the Fourth Circuit Court of Appeal upheld the District Court's decision finding that the bylaws were publicly available to all existing and potential shareholders and that there was no requirement for any investor to purchase Petrobras's shares but rather the shareholder purchased shares of their own volition and thereby tacitly agreed to submit any dispute to arbitration. Similarly, a group of large institutional investors filed arbitration claims against Petrobras and the Federal Union in 2016 and the Federal Union objected to the arbitration (again contesting the validity of Article 58 of the bylaws). The Federal Union filed a claim for injunctive relief before the federal courts in São Paulo. The district court and appellate court in São Paulo initially found in favor of the Federal Union but the claim was appealed to the Superior Court of Justice (the final arbiter of all disputes) and earlier this year the Superior Court of Justice found that the arbitration provision was valid and that the MAC alone has jurisdiction to determine whether the Federal Union is subject to the arbitration. Judge Jed S. Rakoff, the U.S. District Court Judge who presided over the U.S. Petrobras actions, also concluded that shareholders who purchased shares on the BM&F Bovespa were subject to arbitration. In his Decision, Judge Rakoff wrote, "The Court [was] persuaded that, under Brazilian law, Petrobras' arbitration clause is valid and enforceable against purchasers of Petrobras securities on the BOVESPA."[4]

Despite the findings of Brazilian and U.S. Courts, the Rotterdam District Court held that the arbitration provision was not enforceable. The Court based its decision on the fact that the translation of Article 58 of the bylaws that appeared on Petrobras's website from 2004 – 2014 was incorrectly translated into English and read as follows: *"__**It shall be resolved obeying the rules provided by the Market Arbitration Chamber**__, the disputes or controversies that involve the Company, its shareholders, the administrators and members of the Fiscal Council*…." The correct translation of Article 58 specifically references that a dispute should be resolved by arbitration, "*It shall be resolved __**by means of arbitration**__, obeying the rules provided by the Market Arbitration Chamber, the disputes or controversies that involve the Company, its shareholders, the administrators and members of the Fiscal Council . . .*" The Court found that the lack of the specific reference to resolving the dispute by arbitration in the website translation meant that shareholders were not required to arbitrate their disputes. The Court discounted the decisions of the Brazilian courts noting that the Brazilian courts reviewed the Portuguese language version of the bylaws and that they were not tasked with determining whether the English language version was enforceable. The Court also disputed that there was any concrete information to suggest that the U.S. Court's opinion was that the arbitration clause was valid. The Court's analysis leaves open a number of questions, including, whether a translation supersedes the original.

There are two levels of appeal available to Petrobras and so whether the Netherlands has proper jurisdiction over this dispute remains to be finally determined. Even if jurisdiction is upheld on appeal, the courts will still need to assess the merits of the dispute. The merits will also likely require that the Dutch courts apply Brazilian law. Because foundations can only pursue declaratory actions, any decision on the merits in this case can only result in a declaratory judgment. After any declaratory judgment is reached, investors would be left hoping they could negotiate a settlement or they would be required to file individual actions for damages. Petrobras could once again challenge the jurisdiction of the Netherlands in each case. Ultimately it could be quite some time before the Dutch action against Petrobras reaches a conclusion and it is too soon to tell whether the Netherlands will be a viable forum for recovery for any Petrobras investors. ■

[4] *See* Judge Rakoff's findings in *In re Petrobras Securities Litigation*, 116 F.Supp. 3d 368, *387 (USDC SDNY Jun. 30, 2015).

NINTH CIRCUIT CLARIFIES CONTOURS OF JUDICIAL NOTICE AND INCORPORATION BY REFERENCE IN LIGHT OF "CONCERNING PATTERN IN SECURITIES CASES" OF "OVERUSE"

(continued from page 17)

Thus far, at least one court considering securities fraud claims has ruled on a request for judicial notice in light of *Orexigen*. In *Wochos v. Tesla, Inc.*, the court granted in part defendants' request to judicially notice certain SEC filings and investor conference call transcripts. 2018 WL 4076437, at *2 (N.D. Cal. Aug. 27, 2018). Citing to *Orexigen*, the court stated that it "considers them in evaluating the motion to dismiss for the sole purpose of determining what representations Tesla made to the market," but "is not taking notice of the __truth__ of any of the facts asserted." *Id.* (emphasis in original). *Tesla* suggests that the benefits from *Orexigen* may be more nuanced. That is, even if documents are judicially noticed or incorporated by reference, courts should not consider them for their *truth* and instead consider them primarily for the fact of their *existence*.

Of course, the precise effect from *Orexigen* remains to be seen. But the case is noteworthy both for the policy considerations it espouses and the clarity it provides for plaintiffs facing a motion to dismiss accompanied by references to documents extrinsic to the complaint at issue. ■

KTMC SEEKS TO HOLD AMD ACCOUNTABLE FOR SECURITY VULNERABILITIES IN ITS CPUs

(continued from page 2)

to do next (known as "branch prediction") and execute those instructions while it is processing the conditional instruction (known as "speculative execution"). If the CPU guesses correctly, it will have saved itself time and improved its processing speed. If the CPU guesses incorrectly, then it "flushes" all the work it has done based on the prediction, and proceeds to process the correct instructions.

Critically, without out of order execution, speculative execution, and branch prediction, AMD's CPUs would not be able to reach advertised clock speeds. But, AMD's implementation of these techniques in its CPU design created a massive security vulnerability. When a CPU mispredicts and speculatively executes instructions down the wrong path, the data associated with those instructions remains in the CPU's caches — which are completely unsecured — even after the CPU has "flushed" all the work it has done based on that data. Accordingly, if an attacker can trick the CPU into mispredicting its next steps, and speculatively executing instructions down the wrong path, he can ensure that the confidential data he is seeking to acquire is deposited in the CPU's unsecured caches, ready to be siphoned out through what is known as a "side-channel" attack.

While AMD has known about the vulnerability posed by its reliance on speculative execution and branch prediction, and the fact that it did nothing to secure its CPUs' caches, since at least 2005, consumers were not aware that the Company sacrificed security for speed in designing its CPUs until January 2018, when the Spectre exploits first became public knowledge.

Initially, AMD denied that its CPUs were vulnerable to Spectre attacks, only to concede they were impacted several days later. Barring a complete redesign of its processor, "patches" are the only solution available to address the security vulnerability created by AMD's design. The patches released to date do not fully address all Spectre variants and are not available for older processors, leaving certain consumers' sensitive information vulnerable to Spectre and similar exploits. Moreover, once installed, the patches negatively impact the processing speed of AMD's CPUs, leaving consumers with a product that performs at slower speeds than they paid for.

Two weeks after the world learned about Spectre, on January 17, 2018, Kessler Topaz Meltzer & Check LLP filed a class action lawsuit on behalf of purchasers of AMD CPUs and devices powered by AMD CPUs in the United States District Court for the Northern District of California. After the Court appointed the Firm interim co-lead counsel, Kessler Topaz filed a consolidated class action complaint ("CAC") asserting claims under the California, Florida, and Massachusetts consumer protection laws, among others, and seeking relief on behalf of a nationwide class of individuals or entities that purchased AMD CPUs or devices powered by AMD CPUs. Defendants moved to dismiss certain of the claims alleged in the CAC on July 13, 2018, which the Court recently granted with leave to amend the CAC.

Discovery is ongoing in the case, with the Court recently denying Defendant's request to stay the production of documents concerning AMD's knowledge of the security vulnerability. Plaintiffs will file an amended complaint in the next few weeks. ■

WHAT'S TO COME

JANUARY 2019

National Conference on Public Employee Retirement Systems (NCPERS) Legislative Conference
January 27 – 29
Capital Hilton Hotel ■ Washington, D.C.

Florida Public Pension Trustees Association (FPPTA) Winter Trustee School
January 28 – 31
Hyatt Regency Orlando ■ Orlando, FL

FEBRUARY 2019

National Association of Public Pension Attorneys (NAPPA) Winter Seminar
February 20 – 22
Tempe Mission Palms Hotel ■ Tempe, AZ

MARCH 2019

California Association of Public Retirement Systems (CALAPRS) General Assembly
March 2 – 5
Monterey Marriott ■ Monterey, CA

14th Annual Rights and Responsibilities of Institutional Investors (RRII)
March 7 – 8
Amsterdam, Netherlands

Council of Institutional Investors (CII) Spring Conference
March 4 – 6
Mandarin Oriental Hotel ■ Washington, D.C.

Georgia Association of Public Pension Trustees (GAPPT) Trustee School
March 18 – 20
The Classic Center ■ Athens, GA

Florida Public Pension Trustees Association (FPPTA) Wall Street Program
March 31 – April 6
Hilton New York City ■ New York, NY

APRIL 2019

2nd Annual Institutional Governance and Legal Symposium
April 3
The Landmark London ■ London, UK

Texas Association of Public Employee Retirement Systems (TEXPERS) 30th Annual Conference
April 6 – 10
Hilton Austin ■ Austin, TX

10th Annual Evolving Fiduciary Obligations of Institutional Investors (EFOII)
April 30 – May 1
Waldorf Astoria ■ Chicago, IL

MAY 2019

National Conference on Public Employee Retirement Systems (NCPERS) Annual Conference & Exhibition
May 19 – 22
Hilton Austin ■ Austin, TX

State Association of County Retirement Systems (SACRS) Spring Conference
May 7 – 10
Resort at Squaw Creek ■ Lake Tahoe, CA

Pennsylvania Association of Public Employee Retirement Systems (PAPERS) 14th PAPERS Forum
May 29 – 30
Hilton Hotel ■ Harrisburg, PA

JUNE 2019

Florida Public Pensions Trustees Association (FPPTA) 35th Annual Conference
June 30 – July 3
Marriott World Center ■ Orlando, FL

National Association of Public Pension Attorneys (NAPPA) Legal Education Conference
June 25 – 29
Sheraton San Diego ■ San Diego, CA

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