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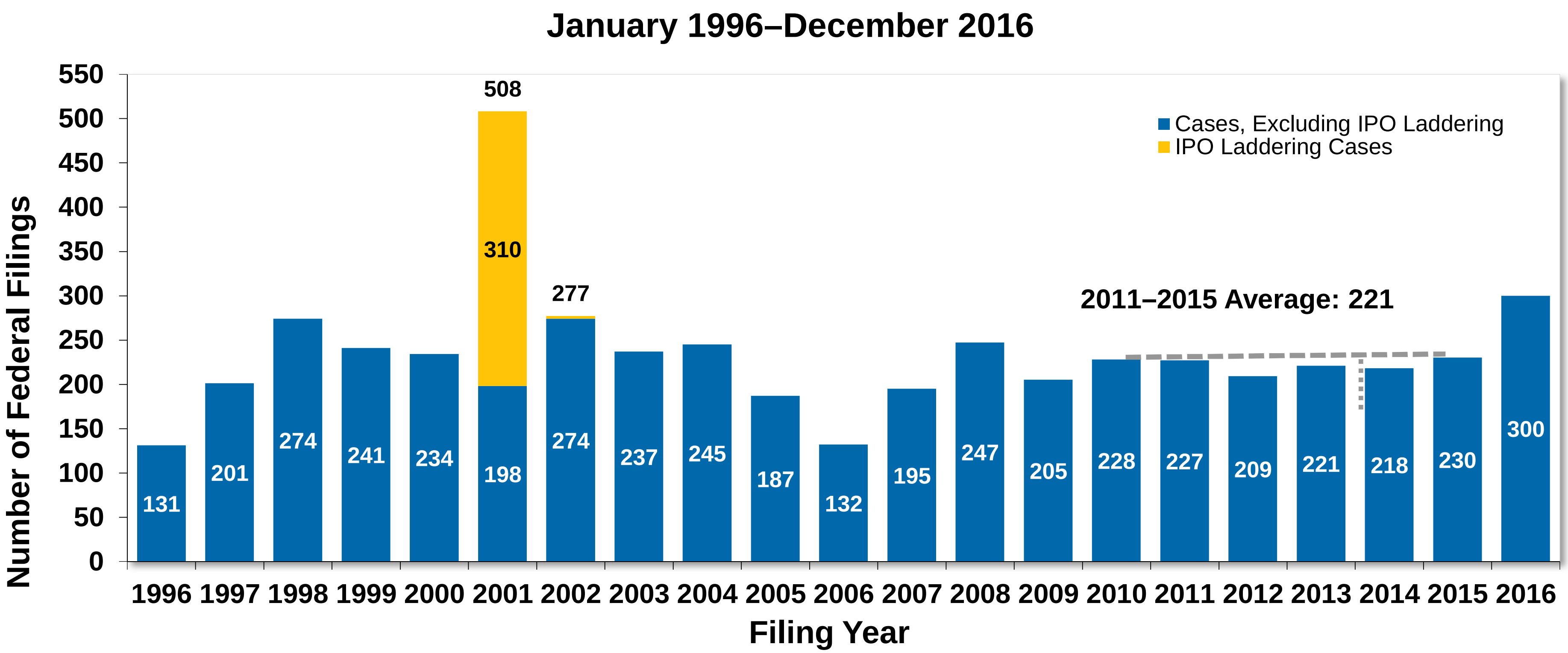
PUBLIC COMPANY ACADEMY

SECURITIES LITIGATION DEVELOPMENTS

July 25, 2017

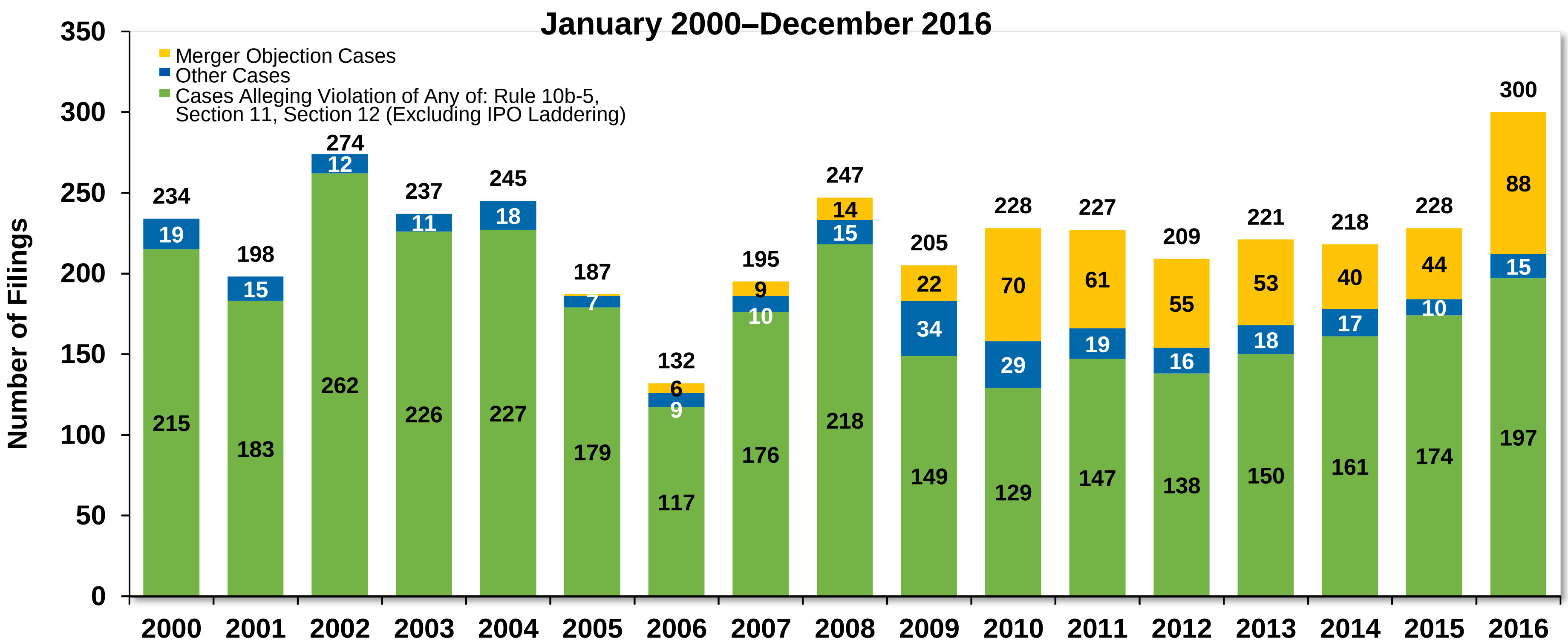
TRENDS IN SECURITIES LITIGATION

Federal Filings Are Up from Recent Years



Source: NERA, Recent Trends in Securities Class Action Litigation: 2016 Full Year Review, (Jan. 23, 2017)

In Large Part Because of Merger Objection Cases



Notes: Before 2005, merger objections (if any) were not disaggregated. This figure omits IPO laddering cases.

Source: NERA, Recent Trends in Securities Class Action Litigation: 2016 Full Year Review (Jan. 23, 2017)

The Rise of Merger Objection Cases

- The growth in filings in 2016 was driven by federal merger objection cases.
- These typically allege breaches of fiduciary duty by directors and officers.
- These suits likely would have been filed in other jurisdictions, particularly the Delaware Court of Chancery, but for various state-level decisions limiting disclosure-only settlements, most notably, *In re Trulia, Inc. Stockholder Litig.*, 129 A.3d 884 (Del. Ch. 2016).

The Rise of Merger Objection Lawsuits

- In the first quarter of 2017, there were 125 securities class action lawsuit filings.
- If this trend continues, this implies 500 lawsuits by year end, which would be by far the highest in recent years.
- 44 or 35% of these were merger objection lawsuits

Source: Kevin LaCroix, “You Need to Know This: YTD Securities Class Action Lawsuit Filings Are Off the Charts.” *The D&O Diary* (Apr. 2, 2017)

The Rate of Litigation Is Increasing

- Based on Cornerstone's 2016 year end number of U.S. listed companies (4,593) for purposes of calculation, and annualizing the number of first quarter 2017 filings (inclusive of the merger objection suits) to a projected year-end total of 500, during the first quarter of 2017 U.S. publicly traded companies were being sued at an annualized rate of nearly 11%.
  - *i.e.*, the pace of litigation in the first quarter viewed on an annualized basis means that the companies were being sued during the first quarter at an annualized pace of more than one out of ten

Source: Kevin LaCroix, "You Need to Know This: YTD Securities Class Action Lawsuit Filings are Off the Charts." *The D&O Diary* (Apr. 2, 2017) citing

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RECENT SUPREME COURT ACTIVITY

CalPERS v. ANZ Securities Inc., No. 16-373 (June 26, 2017)

- Background
  - CalPERS was a member of the putative class in a class action filed in the Southern District of New York in 2008 asserting Section 11 claims arising from securities offerings by Lehman in 2007 and 2008.
  - After a proposed settlement in the class action, CalPERS opted out to pursue a separate lawsuit in 2011 asserting identical claims against identical underwriters. The district court granted the underwriters' motion to dismiss CalPERS' Section 11 claims as untimely under the three-year bar in Section 13.
  - The Second Circuit affirmed.

CalPERS v. ANZ Securities Inc., No. 16-373 (June 26, 2017)

- Section 13 of the Securities Act provides that all claims under the Act must be brought within one year of the "discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence." 15 U.S.C. § 77m.
- Section 13 also imposes a three-year time bar: "In no event shall any action be brought to enforce a liability created under [Section 11] ... more than three years after the security" was offered to the public. 15 U.S.C. § 77m.

CalPERS v. ANZ Securities Inc., 137 S. Ct. 2042 (June 26, 2017)

- On June 26, 2017, in a 5-4 decision, the U.S. Supreme Court, in an opinion written by Justice Anthony Kennedy, ruled that the three-year time limit for filing lawsuits under the Securities Act of 1933 is a statute of repose and therefore is not subject to equitable tolling.
- The majority opined that Section 13's three-year deadline was a statute of repose, distinguishing *American Pipe* as applying only to statutes of limitations. The Court held that the statute of repose at issue reflected a legislative decision that there should be a specific time beyond which defendants should no longer be subjected to liability, and it "admits of no exception and on its face creates a fixed bar against future liability." *Id*. at 2045.

Cyan, Inc. v. Beaver County Employees Retirement Fund, No. 15-1439

- Background
  - Since the enactment of the Securities Act of 1933, state courts have had concurrent jurisdiction to decide federal law claims brought under that statute.
  - Congress passed the Securities Litigation Uniform Standards Act of 1998, which precluded certain state law securities class actions, and amended the 1933 Act to reflect that limitation on state court claims.
  - Beaver County Employees' Retirement Fund brought suit in California superior court asserting claims under the 1933 Act. Cyan Inc. moved to dismiss the claims, arguing that the amended 1933 Act precluded state courts from exercising subject matter jurisdiction over 1933 Act claims. The superior court rejected Cyan's objection to the exercise of jurisdiction.
  - Federal district courts are split as to whether state courts have subject matter jurisdiction over covered class actions that allege only 1933 Act claims.

Cyan, Inc. v. Beaver County Employees Retirement Fund, No. 15-1439

- The Supreme Court has granted *certiorari* to decide:
  - Do state courts have subject matter jurisdiction over covered class actions that allege only Securities Act of 1933 claims?

Kokesh v. SEC, 137 S. Ct. 1635 (June 5, 2017)

- Background
  - In 2009, the SEC filed a civil enforcement action against New Mexico investment adviser Charles Kokesh alleging that Kokesh misappropriated funds from four business development companies from 1995 through 2009 and concealed the misappropriation by making false and misleading SEC filings.
  - Kokesh was found liable in a jury trial and ordered in April 2015 to disgorge nearly $35 million in ill-gotten gains, in addition to a $2.4 million civil penalty and $18 million in pre-judgment interest.
  - Kokesh appealed to the U.S. Court of Appeals for the Tenth Circuit, arguing that the disgorgement order was a "penalty" and therefore subject to 28 U.S.C. § 2462, which creates a five-year statute of limitations for the enforcement of "any civil fine, penalty, or forfeiture, pecuniary or otherwise." In August 2016, the Tenth Circuit affirmed the order, holding that disgorgement of ill-gotten gains was neither a penalty nor a forfeiture and therefore was not subject to the five-year statute of limitations.
  - Circuits were split.

Kokesh v. SEC, 137 S. Ct. 1635 (June 5, 2017)

- In a unanimous decision, the U.S. Supreme Court has ruled in *Kokesh v. SEC* that the five-year statute of limitations in 28 U.S.C. § 2462 applies to claims for disgorgement in enforcement actions brought by the US Securities and Exchange Commission (SEC).
- The Supreme Court held that disgorgement is a penalty under 28 U.S.C. § 2462 because it seeks to redress a wrong against the United States instead of a private individual and because its primary purpose is as a deterrent and not compensatory.
- The opinion contains a footnote revealing a potential concern about the lack of a specific statutory basis for disgorgement:
  - Fn 3: "Nothing in this opinion should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context. The sole question presented in this case is whether disgorgement, as applied in SEC enforcement actions, is subject to § 2462's limitations period."

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DISCLOSURES

Forms 10-K and 10-Q

- Item 103 of Form S-K:
  - "Describe briefly any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the registrant or any of its subsidiaries is a party or of which any of their property is the subject. Include the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought. Include similar information as to any such proceedings known to be contemplated by governmental authorities."

Forms 10-K and 10-Q (cont'd)

- What is "material" litigation?
  - Factual determination to be made by company
  - Standard is anything an investor would want to know
  - Helpful guidelines:
    - If damages claim, seeking 10% or more of the company's current assets on a consolidated basis
    - Not material if type of claim common in line of business, but consider risk factor stating that the company is subject to such claims in its ordinary course of business
      - *e.g.,* slip and falls at a water park
    - Bankruptcy and receivership is usually material
    - Environmental claims under state or federal law require additional analysis
    - Securities Class Action and Breach of Fiduciary Duty Claims are typically disclosed in periodic reports
- Applies to subsidiaries
- When in doubt, disclose
  - Opportunity for company to disaffirm claims publicly
  - Optics
- Disclosure usually requires an update to risk factors

Form 8-K

- Item 1.03 requires disclosure of bankruptcy or receivership
- Item 8.01 Other Events
  - Optional disclosure of material litigation prior to disclosure in 10-Q or 10-K
    - 10% of current assets on a consolidated basis
    - Material determination by the company (see guidelines on previous slide)
  - Optional disclosure for material changes to litigation that has been previously disclosed:
    - Settlements, if for an amount that would be material to the company
    - Dismissals, judgments, orders, decrees typically filed with 10-Q and 10-K, unless materiality warrants earlier disclosure

Private Securities Litigation Reform Act of 1995 ("PSLRA")

- Provides a safe harbor for forward-looking statements
- Special cautionary note at beginning of Securities Act or Exchange Act filing
  - Boilerplate statement can provide additional protection for the company
  - Usually includes bullet points with risks common to industry, but tailored to the company
    - Look to risk factors to determine what might be included
    - Requires ongoing assessment in light of material developments
- Include in other public filings, *e.g.,* press releases

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INSIDER TRADING

SEC Rule 10b-5 – Insider Trading Brief Refresher

- The federal securities laws prohibit company insiders from trading in company securities, in breach of a fiduciary duty, on the basis of material nonpublic information about the company
- Prohibition includes (i) disclosing to others, or "tipping" material nonpublic information, (ii) securities trading by the person who is "tipped", and (iii) securities trading by those who misappropriate (*e.g.,* information is received in confidence) such information
- "**Fiduciary duty**": Corporate employees owe a duty of trust and confidence to company shareholders to refrain from trading when aware of material nonpublic information, and from passing such information to others (*e.g.,* not to exploit inside information for personal gain)
- "**On the basis**" of: Being "aware of" or "in possession" of the information
- "**Material**" information: Information that a reasonable investor would consider important in making an investment decision (*e.g.,* company financial results, earnings information, forecasts, mergers/acquisitions, changes in management or operations, regulatory decisions, government investigations)
- "**Nonpublic**" information: Information that has not been widely disclosed to the public and available for a period of time sufficient for the market to absorb the information

Stark SEC Focus on Insider Trading

- Insider trading continues to be an area of continued focus by the SEC (and also the Department of Justice)
- Over the last six years, the SEC charged more than 650 defendants in civil insider trading cases
- Last year, the SEC charged 78 parties in cases involving trading on the basis of inside information
- Many of these cases have also included parallel criminal actions
- Cases include civil and/or criminal charges against corporate employees for trading in company securities or tipping others who trade in company securities

Insider Trading Penalties

- Insider trading is a crime. Penalties for insider trading include:
  - Civil penalty of up to three times the profits made or losses avoided
  - Criminal fine of up to $5,000,000, jail term of up to twenty years
  - Injunction against future violations, director and officer bars
  - Private lawsuits are a risk
- The company and other “controlling persons”—including supervisory employees—are also at risk for failure to supervise (that is, to prevent insider trading)
- Internal disciplinary action can be imposed against persons who violate insider trading policies, up to and including termination, even if no actual insider trading occurred

United States Supreme Court Weighs in on Insider Trading

- In *Salman v. United States*, the U.S. Supreme Court has weighed in on insider trading law for the first time in nearly twenty years
- The Supreme Court resolved the tension between the Ninth Circuit's decision in *United States v. Salman* and the Second Circuit's decision in *United States v. Newman* on the issue of "tippee" liability
  - Corporate insiders are bound by a duty of trust and confidence not to exploit inside corporate information for their personal advantage. This includes tipping such information to others for trading
  - Tippee liability hinges on whether the tipper's disclosure breaches a fiduciary duty, which occurs when the tipper discloses the information for a "personal benefit"
  - A tippee who receives such information with the knowledge that its disclosure breached the tipper's duty, may not trade on the basis of that information
- The Supreme Court was asked to decide what constitutes a "personal benefit" for purposes of establishing tippee liability

United States Supreme Court Weighs in on Insider Trading (cont'd)

- *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014) *cert. denied*, 136 S. Ct. 438 (2015)
- The alleged insider trading scheme: The government alleged that two corporate employees tipped material nonpublic earnings information to outside analysts and friends in exchange for career advice and friendship.
- The defendants argued that career advice among casual acquaintances was insufficient evidence of a personal benefit to the tipper.
- The Second Circuit agreed, holding that evidence of a personal benefit requires that there be a meaningful close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similar valuable nature.

United States Supreme Court Weighs in on Insider Trading (cont'd)

- *United States v. Salman*, 792 F.3d 1887 (9th Cir. 2015)
- The alleged insider trading scheme: Defendant Salman received trading tips about mergers and acquisitions from an extended family member who had received the information from Salman's brother-in-law, a corporate insider.
- Salman, relying on *Newman*, argued that he could not be liable as tippee because the tipper (his brother-in-law) did not receive money or property in exchange for the tips and therefore did not personally benefit from them.
- The 9th Circuit disagreed, holding that a jury may infer that the tipper breached his duty to his company because he made a gift of confidential information to a trading relative and friend; otherwise, a corporate insider would be free to disclose confidential information to relatives, and they would be free to trade on it, provided the insider asked for no tangible compensation in return.

United States Supreme Court Weighs in on Insider Trading (cont'd)

- The Supreme Court unanimously affirmed the Ninth Circuit's holding, and squarely rejected Salman's argument that an insider must receive a pecuniary *quid pro quo* from a tippee for there to be a sufficient personal benefit.
- The Supreme Court found that a tipper breaches a fiduciary duty and receives a personal benefit by making a gift of confidential information to a trading relative or friend; Salman received inside information from his brother-in-law, who received the information from his brother.
- As to the Second Circuit's holding in *Newman*, the Court found that to the extent the Second Circuit held that the tipper must also receive something of a pecuniary or similarly valuable nature in exchange for a gift to family or friends, that holding was inconsistent with its prior holdings.

Recent SEC Insider Trading Actions

Significant insider trading actions in 2016 involving corporate insiders:

- Insider trading and beneficial ownership reporting-related charges against Leon G. Cooperman and his firm Omega Advisors
  - SEC alleged that Cooperman received confidential information from a corporate executive about Atlas Pipeline Partners (APL) in advance of the sale of its natural gas processing facility
  - Settlement agreement reached in May 2017 where Omega agreed to pay $5 million in civil penalties and forfeited profits
- Insider trading charges against William "Billy" Walters and his source Thomas C. Davis, a former Dean Foods Company board member
  - SEC alleged that Walters, a sports gambler, was owed money by then-Dean Foods Company board member Davis
  - According to the SEC complaint, Davis regularly shared inside information about Dean Foods with Walters in advance of market-moving events
  - Walters was criminally convicted of insider trading in April 2017

Best Practices to Avoid Potential Insider Trading Violations

- Comprehensive Insider Trading policies and procedures and consistent training on them is critical
- Policies should make clear that corporate employees have a duty to maintain the confidentiality of material nonpublic information and flatly prohibit insider trading
- Key components of policies and procedures:
  - Prohibition against engaging in transactions in company stock while aware of material nonpublic information
  - Clear explanation of insider trading, including guidance on what is material nonpublic information and other elements of insider trading
  - Require pre-clearance of any transaction in company securities
  - Establish blackout periods and other trading limitations, as appropriate
- Policies also should be expansive—covering family members and related entities of any covered person with equal force
- Policies should be explicit that even transactions that are considered necessary/justifiable for independent reasons (*e.g.*, such as an emergency monetary need) or small transactions, are not excepted from insider trading proscriptions
- Policies should emphasize the consequences—both criminal and civil—of trading on the basis of inside information

Best Practices to Avoid Potential Insider Trading Violations (Cont'd)

- 10b5-1 Plans: Provide a defense from potential insider trading liability that allows a corporate insider to plan, in advance, at a time when the insider is not aware of material nonpublic information, for the purchase and sale of securities so that the purchase or sale of securities can be executed later at a time when the insider may have become aware of material nonpublic information
- Corporate Insider Trading policies and procedures should address the use of 10b5-1 Plans by company insiders. Key considerations include:
  - Pre-approval of the Plan by the company
  - Must be adopted when insider is not aware of material nonpublic information
  - Plan must be in writing, and, once adopted, it should not permit the person to exercise influence over the amount, pricing, and timing of transactions under the Plan
  - Waiting periods in advance of adoption of plan, as well as between adoption of plan and initial trades
  - Avoid permitting multiple plans
  - Amendments to existing Plans should be undertaken with caution
- 10b5-1 Plans, and trading around them, have been the subject of considerable SEC scrutiny and enforcement actions

QUESTIONS?

Biography

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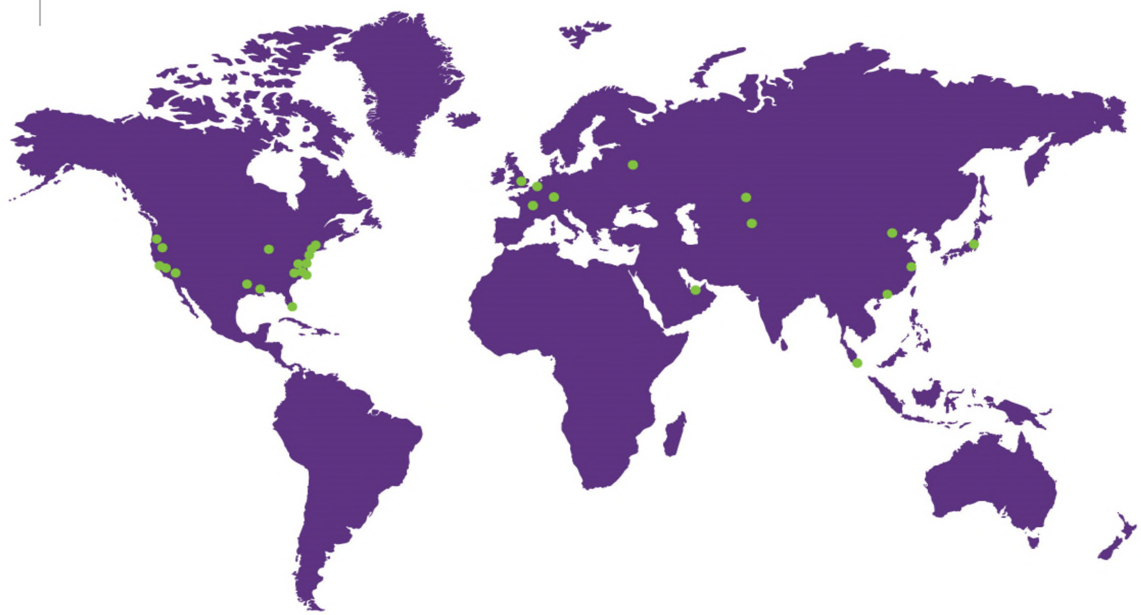

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