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## GLOBAL PUBLIC COMPANY ACADEMY

# SECURITIES LITIGATION UPDATE

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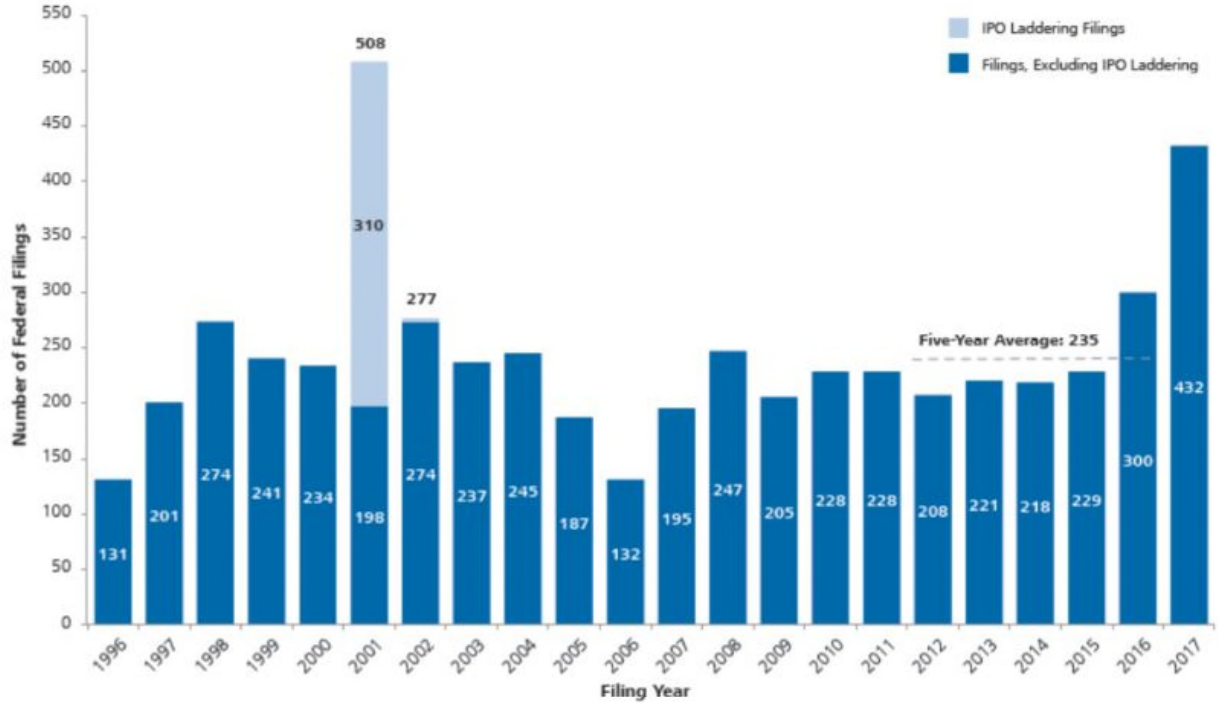
SECTION 1

# TRENDS IN SECURITIES LITIGATION

# Federal Filings Are Up from Recent Years

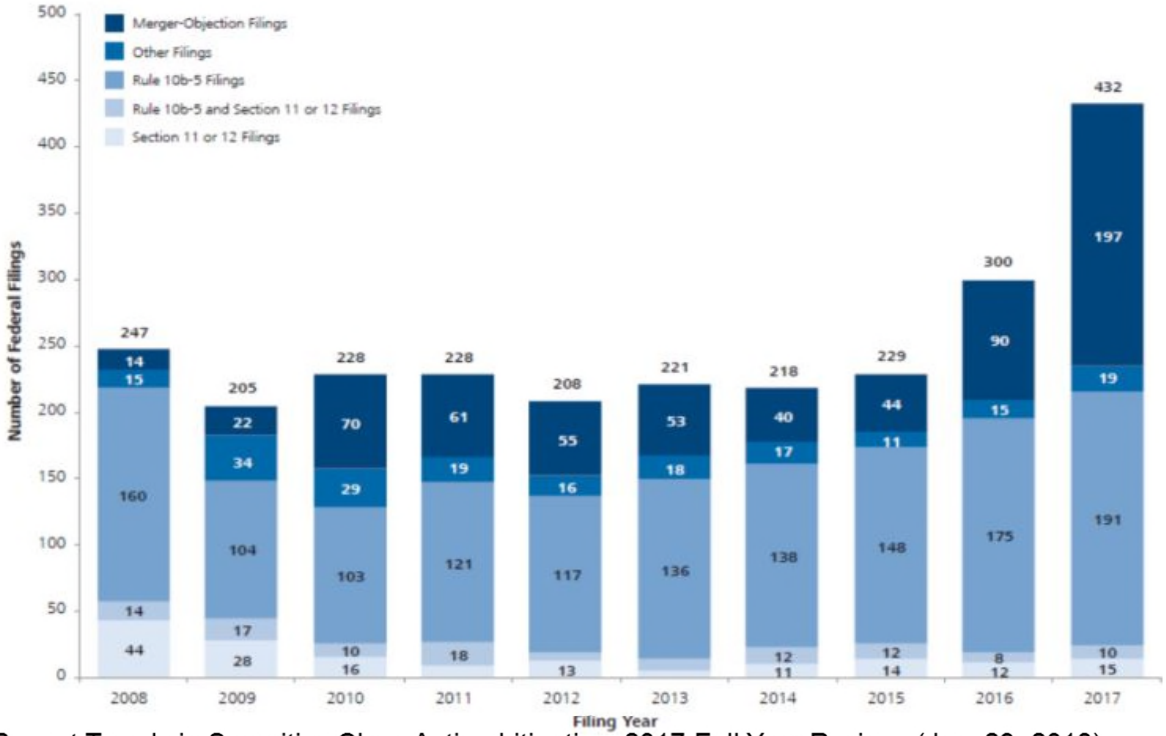
Figure 1. **Federal Securities Class Action Filings**
January 1996–December 2017




Source: NERA, Recent Trends in Securities Class Action Litigation: 2017 Full Year Review, (Jan. 29, 2018)

# In Large Part Because of Merger Objection Cases

Figure 3. **Federal Filings by Type**
January 2008–December 2017




Source: NERA, Recent Trends in Securities Class Action Litigation: 2017 Full Year Review, (Jan. 29, 2018)

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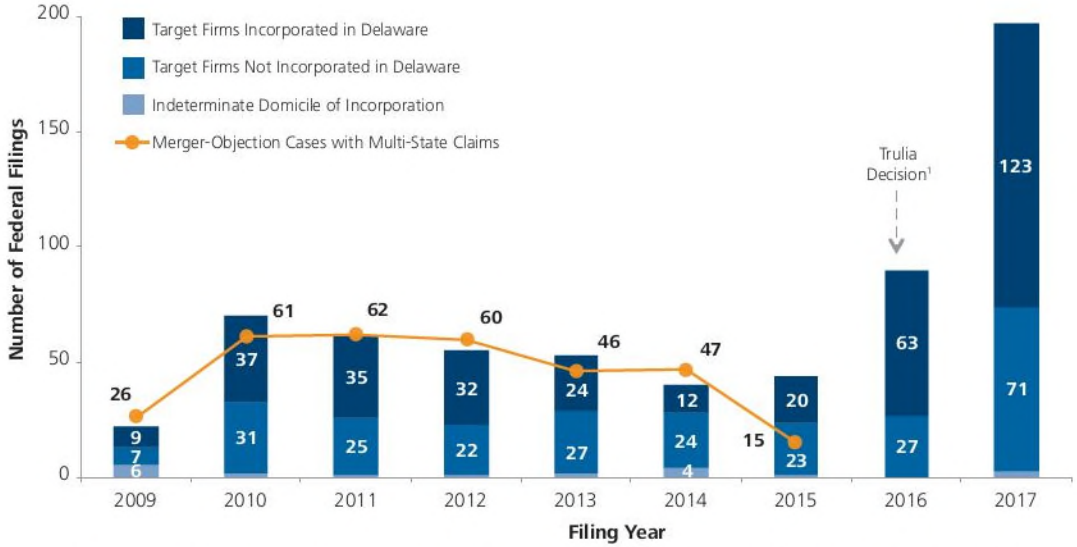
# And Because of the decision in *Trulia*

Figure 4. **Federal Merger-Objection Filings and Merger-Objection Cases with Multi-State Claims**
January 2009–December 2017




Notes: Counts of merger-objection cases with multi-state claims based on data obtained from Matthew Cain and Steven Solomon, "Takeover Litigation in 2015," Berkeley Center for Law, Business and the Economy, 14 January 2016. Data on multi-state claims unavailable for 2016 or 2017. State of incorporation obtained from the Securities and Exchange Commission.

[1] *In re Trulia, Inc. Stockholder Litigation*, C.A. No. 10020-CB (Del. Ch. Jan. 22, 2016).

# The Rise of Merger Objection Lawsuits

- The rise in M&A cases started in Delaware until *In re Trulia, Inc. Stockholder Litig.,* 129, A.3d 884 (Del. Ch. 2016), limited disclosure-only settlements. After this case, M&A filings migrated to other jurisdictions, such as Federal Courts.
- Plaintiffs filed a record of 412 new federal class action securities cases in 2017.
  - 52% greater than 2016 and more than double the 1997-2016 average.
- In 2017, the likelihood of litigation for U.S. exchange-listed companies was greater than in any previous year.
  - Heightened filing activity against public companies
  - Recent decline in number of public companies
- Federal filings of class actions involving M&A transactions = 198
  - More than double the number in 2016
- M&A filings had a higher rate of dismissal (78%) than core federal filings (48%) from 2009 to 2016.

Source: Cornerstone Research, *Securities Class Action Filings: 2017 Year in Review*

# Trends Early 2018

- In the first half of 2018, federal class action securities fraud filings have continued at near record levels. Plaintiffs have filed more than 750 federal securities class action since midyear 2016.
- In a reversal of recent trends, the number of filings involving M&A transactions decreased almost 9% (from 102 to 93) after increasing for six consecutive semiannual periods.
  - Note: The absolute number remains at historically high levels.
- The rate of M&A litigation has declined following the 2016 Delaware decision in *Trulia*.
  - Lawsuits were filed more slowly in 2016 and 2017 compared to pre-*Trulia* trends.

Sources: Cornerstone Research, *Securities Class Action Filings: 2018 Midyear Assessment;* Cornerstone Research, *Shareholder Litigation Involving Acquisitions of Public Companies: Review of 2017 M&A Litigation*

# Disclosure-Only Settlements

- In 2016, the 7th Circuit joined the Delaware Court of Chancery's call for enhanced scrutiny of "disclosure-only" M&A settlements that involve no monetary benefits to shareholders.
- Typically breach of fiduciary duty or insufficient disclosure cases are settled when defendants provide supplemental disclosures in exchange for release of claims, while plaintiffs' counsel "earns" large attorneys' fees for providing said "benefit."
- In *In re Walgreen Company Stockholder Litigation* ("In re Walgreen Co."), 832 F.3d 718 (7th Cir. 2016), Judge Posner rejected such a settlement articulated in *In re Trulia, Inc. Shareholder Litigation* ("In re Trulia"), calling the practice "a racket."
  - *"No class action settlement that yields zero benefits for the class should be approved, and a class action that seeks only worthless benefits for the class should be dismissed out of hand."*
- Recently in New York, the court held in *City Trading Fund v. Nye* that disclosure-only settlements will not be approved simply as a matter of course, as the court will still analyze the benefits of the added disclosures under the circumstances. *Id.,* 2018 NY Slip Op 28030 (N.Y. Sup. Ct. 2018)
  - The opinion also advocates for the adoption in New York of Delaware's stricter *Trulia* standard.

# Mootness Fees

- Strategy whereby attorneys collect fees in exchange for dismissing class actions that accuse merging companies of disenfranchising their shareholders. The fees come after the companies make some additional disclosures about the deal, mooting the litigation but giving the attorneys a way to get paid in exchange for its purported impact.
- On Sept. 10, the Center for Class Action Fairness ("CCAF") filed a brief with the 7th Circuit that attacks the "mootness fee racket." The suit stems from the dismissal of shareholder suits over the now-scuttled merger of Akorn Inc. with Fresenius Kabi AG, which ended with a $322,500 fee payment to the plaintiffs' attorneys, according to court records.
  - By intervening, the CCAF hopes to disgorge attorneys' fees unjustly appropriated by strike suit files, and enjoin or at least discourage the filing of frivolous strike suits nationwide.
- It is yet to be seen whether the court will take up this issue.

# Circuit Split: Scienter Requirement under Section 14(e)

- Prior to 2018, Circuit Courts generally held that Section 14(e) claims required alleging scienter.
  - 6th Cir. 1980
  - 2d Cir. 1987
  - 3d Cir. 2004
  - 11th Cir. 2004
  - 5th Cir. 2009
- However, in April 2018, the 9th Circuit split from these circuit opinions to hold that liability under Section 14(e) of the Securities Exchange Act of 1934 "require[s] a showing of negligence, rather than scienter" or fraudulent intent.
  - *Gary Varjabedian v. Emulex Corp. et al.,* 888 F.3d 399 (9th Cir. Apr. 20, 2018).
- The court rejected a "shared text" approach comparing SEC Rule 10b-5 to Section 14(e) after analyzing two items:
  - Two Supreme Court cases that noted the first clause of Section 14(e) requires a showing of negligence.
  - Section 14(e)'s legislative history, which placed more emphasis on the "quality of information shareholders receive" than state of mind.

SECTION 2

# RECENT SUPREME COURT ACTIVITY

## *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (Mar. 20, 2018)

- At last year's GPCA, we previewed *Cyan v. Beaver County Employees Retirement Fund*, a case that was then granted certiorari by the U.S. Supreme Court on the issue, do state courts have subject matter jurisdiction over covered class actions that allege only claims under the Securities Act of 1933?
  - The 1933 Act authorizes concurrent jurisdiction to federal and state courts over claims brought under that statute.
  - Congress passed the Securities Litigation Uniform Standards Act of 1998 (SLUSA), which precluded certain state law securities class actions, and amended the 1933 Act to reflect that limitation on state court claims.
- In March of this year, the Supreme Court unanimously affirmed a California Superior Court ruling that SLUSA left intact state court jurisdiction over claims under the 1933 Act.

# *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (Mar. 20, 2018)

- Beaver County Employees' Retirement Fund brought suit in California Superior Court asserting only claims under the 1933 Act. Cyan moved to dismiss, arguing that the 1933 Act, as amended by SLUSA, precluded state courts from exercising subject matter jurisdiction over 1933 Act claims. The Superior Court rejected Cyan's argument and the California appellate court denied review.
- The Supreme Court resolved a split among federal and state courts and held that SLUSA's amendments of the 1933 Act did not bar state court jurisdiction over covered class actions alleging only 1933 Act violations, nor did they authorize the removal of such suits from state to federal court.
- The Solicitor General, in an amicus brief, acknowledged that state courts had jurisdiction over the 1933 Act suits and argued that those suits are removable to federal court because "Congress would not have been content to leave" such suits "stuck in state court," where the PSLRA's protections do not apply.
- The Court did not disagree, but reasoned that the SG's position contravened the "straightforward reading" of the statute. The Court also stated, if Congress wanted to deprive state courts of jurisdiction, Congress has to act.

# *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (Mar. 20, 2018)

- This decision leaves unresolved the situation where class actions alleging *only* state claims, or both state and federal claims, *must* be removed to *federal* court, but those alleging only 1933 Act claims *must* remain in *state* court.
  - As a result, defendants may have to litigate 1933 Act class actions in multiple jurisdictions, such as in both state and federal court, or in multiple state courts.
- Litigation in multiple state courts could be a particular concern.
  - Research shows that in 2017, all 1933 Act class suits filed in California state court involved parallel state court actions.
  - In state court, the PSLRA's substantive and procedural protections may be unavailable. For example, the PSLRA imposes heightened pleading standards, if these are not applied in state court, judges are far less likely to dismiss these actions.
  - Similarly, state judges may not stay discovery pending any motion to dismiss.

## *China Agritech, Inc. v. Resh, et al.*, 138 S. Ct. 1800 (June 11, 2018)

- In *China Agritech*, the US Supreme Court unanimously reversed a Ninth Circuit Court of Appeals decision applying the class action tolling doctrine set forth in *American Pipe & Constr. Co. v. Utah*, 414 U.S. 438 (1974).
  - *American Pipe* held that the timely filing of a class action tolls the applicable federal statute of limitations for all persons encompassed by the class complaint during the pendency of the class certification decision.
  - In *China Agritech*, the Supreme Court held that, where a court denies class certification of a putative class action, the *American Pipe* tolling rule does not permit a putative class member to bring a class action anew if the applicable statute of limitations has run.
  - In so holding, the Supreme Court resolved a longstanding circuit split on the application of *American Pipe* to subsequent class litigation.

# *China Agritech, Inc. v. Resh, et al.*, 138 S. Ct. 1800 (June 11, 2018)

- The case before the Court is the third shareholder class action against China Agritech alleging—similar to the prior two complaints—violations of the Securities Exchange Act of 1934 based on fraud and misleading business practices.
- The previous two class actions were brought by two other shareholders represented by the same attorney. These actions were settled. In the prior two proceedings, as required by the PSLRA, plaintiffs' counsel had posted notice of the actions in two widely-circulated publications and invited any member of the purported class to move to serve as lead plaintiff. Michael Resh, the plaintiff in the third action, had not sought lead plaintiff status in either.
- Resh filed his action in June 2014, a year and a half after the statute of limitations would normally have expired.
- The District Court dismissed Resh's class complaint as untimely, but the Ninth Circuit reversed, reasoning that applying *American Pipe* tolling to the benefit of successive class actions would promote economy of litigation and reduce protective class suits during the pendency of an initial certification motion.

# *China Agritech, Inc. v. Resh, et al.*, 138 S. Ct. 1800 (June 11, 2018)

- This opinion cabins the application of *American Pipe* tolling.
  - The Court held that *American Pipe* only tolled the statute of limitations insofar as putative class members wished to sue *individually* after a class certification denial.
  - In contrast, where a plaintiff, like Resh, brings his or her claims as a new *class* action after the expiration of the statute of limitations, *American Pipe* does not permit a plaintiff who waits out the statute of limitations to piggyback on an earlier, timely filed class action.
- Although *China Agritech* involved class claims under 1934 Act that are subject to the PSLRA, the Court's broad ruling denies *American Pipe* tolling to all successive class actions, not just those subject to the PSLRA.
- It remains to be seen how this decision will apply in specific circumstances, such as where a court partially certifies a class or certifies an issue for class treatment, or where class certification is sought multiple times (perhaps over a period of years) in the same civil action.

# *Lucia v. SEC*, 138 S. Ct. 2044 (June 21, 2018)

- In *Lucia*, the US Supreme Court held that administrative law judges (ALJs) of the US Securities and Exchange Commission qualify as "Officers of the United States" under the Appointments Clause of the Constitution.
  - The Clause applies to a class of government officials distinct from mere employees and requires Officers to be appointed by the President, Courts of Law, or Heads of Departments.
  - ALJs are selected by SEC staff, and exercise authority comparable to that of a federal judge conducting a bench trial.
  - ALJs issue "initial decisions" that contain factual findings and legal conclusions, as well as the appropriate order, sanction, relief, or denial of relief. The SEC can review the decision upon request or *sua sponte*. If the SEC does not review the decision, it issues an order that the ALJ's initial decision has become final, and the decision is then deemed an action of the Commission.

# *Lucia v. SEC*, 138 S. Ct. 2044 (June 21, 2018)

- This case began with an SEC administrative proceeding against petitioner Raymond Lucia and his investment company. The ALJ concluded Lucia had violated the Investment Advisor Act and imposed civil penalties and a lifetime bar from the investment industry.
  - Lucia appealed the decision to the SEC, arguing the administrative proceeding was invalid because the ALJ had been appointed by SEC staff, rather than the SEC.
  - The SEC rejected Lucia's argument, and the D.C. Circuit Court of Appeals agreed.
- In reaching its decision, the Supreme Court relied on a framework established by *United States v. Germaine* and *Buckley v. Valeo*, and applied in *Freytag v. Commissioner*.
  - *Germaine* made clear that, to qualify as an officer, an individual must occupy a "continuing" position established by law.
  - *Buckley* held that members of a federal commission were officers if they "exercis[ed] significant authority pursuant to the laws of the United States."
  - In *Freytag*, the Court concluded that "special trial judges" (STJs) of the United States Tax Court are officers rather than employees because STJs serve on an ongoing basis, their duties, salaries and means of appointment are specified in the Tax Code, and they possessed significant duties and discretion.
- The Court noted that ALJs, like STJs, receive a career appointment and hold a continuing office established by law. In addition, ALJs exercise significant discretion. Moreover, ALJs have a more autonomous role than STJs, because a regular Tax Court judge must always review an STJ's opinion, whereas the SEC can decline to review an ALJ's decision. Finally, the ALJs' duties, salary, and means of appointment also are governed by statute.

# *Lucia v. SEC*, 138 S. Ct. 2044 (June 21, 2018)

- *Lucia* suggests that litigants who received a final decision through an administrative proceeding and preserved the issue of the constitutionality of the proceeding may have their cases heard by a different ALJ.
  - As to Lucia's own case. the Court remanded and required the SEC administrative proceeding against Lucia be assigned to a different ALJ or the SEC itself for a new hearing.
- This may lead to a significant number of challenges of initial decisions and may require the SEC to review numerous decisions.
- Although in November 2017, the SEC had issued an order "ratifying" the appointments of its ALJs, the Court declined to determine whether agency ratification of ALJ appointments would resolve the constitutional question.
- In light of ongoing uncertainty, in 2017 and 2018, SEC has departed from its routine use of ALJs and litigated most enforcement matters in federal court.

SECTION 3

# DEVELOPMENTS IN CIVIL LITIGATION

# Recent Developments in Delaware Appraisal Litigation

- In light of changes in M&A litigation, some plaintiffs may look at appraisal
- Appraisal remedy is statutory
- Varies by state
- Purpose is to prevent minority shareholder from being forced to sell stock at price that is too low
- Shareholder can dissent from merger and seek appraisal of stock by court
- Court awards shareholder the "fair value" of the shares
- Court receives evidence in a trial
- No claims that anyone is at "fault"

# Dissenting Shareholders Now Face Risk

- In 2018, in *Verition Partners Master Fund Ltd. v. Aruba Networks Inc.,* the Delaware Court of Chancery awarded certain dissenting shareholders **LESS** than the deal price – **30% LESS**
  - Court acknowledged that "It appears that the post-trial ruling may be the first decision to hold that the unaffected market price was the best evidence of fair value and award that figure."
  - Case is also important because deal involved significant synergies between Aruba Networks which sold wireless networks and HP which sold wired networks and bough Aruba
  - Case is on appeal to Delaware Supreme Court
  - Appellants claim that ruling has potential to "abolish" appraisal rights for publicly traded companies
  - Morgan Lewis represented the company being valued, Aruba Networks Inc.

# Recent Developments in Life Sciences Securities Litigation

- For Life Sciences companies, how FDA will act is critical
- Whether an established pharma company or a start-up, predicting what the FDA will do is central to business strategy
- Recent decision from Eastern District of Pennsylvania now on appeal to the Third Circuit has potential to answer global questions about what companies can say about FDA
- *In re Egalet Securities Litigation*
- District Court granted motion to dismiss in sweeping 58 page opinion that addressed numerous issues affecting all Life Sciences companies
- Issues include scope of safe harbor protection and state of mind analysis

# Expanded use of Corporate Books and Records Statutes?

- Expanded and frequent use of Delaware's corporate books and records statute (8 *Del. C.* § 220) has been a frequent tool of the Plaintiffs' bar
  - Recent experience suggests expanded use of Section 220 as a predicate to derivative actions and shareholder demands.
    - Impact on use of 220 actions in light of the Delaware Supreme Court's decision in *California State Teachers' Retirement System v. Alvarez*, (Del. Jan. 25, 2018).
  - Many of these cases are being aggressively defended to trial and Courts (and more regularly, Delaware Special Masters) have been grappling with the "credible basis" and "necessary and essential" standards.

# Expanded use of Corporate Books and Records Statutes?

- Recent precedential decision from New Jersey suggests a potential trend by Plaintiffs' bar to utilize other state books and records statutes to bolster potential derivative claims
  - In *R.A. Feuer v. Merck & Co., Inc.*, the New Jersey Appellate Division narrowly construed the scope of a shareholder's right to inspect a corporation's records under *N.J.S.A.* 14A:5-28 and the common law.
  - First, the court narrowly construed the plain language of *N.J.S.A.* 14A:5-28(4).
    - According to the court, "books and records of account" consist of "accounting or financial documents," not "any and all records, books and documents of a corporation."
    - The court also determined that language in the statute empowering the court, in its discretion, to "prescribe any limitations or conditions with reference to the inspection or *award any other or further relief as the court may deem just and proper*," was designed to *restrict* or *burden* inspection, not provide broad grounds for inspection.
    - Finally, the court rejected a claim for "broad-ranging inspection" under the statute in order to pursue a derivative action.
  - The Appellate Division also held that while the common-law right of inspection is not necessarily limited to the categories of documents set forth in the statute, a requesting shareholder must prove "good faith and a germane purpose."
    - On the facts presented, the court concluded that there were insufficient allegations to demonstrate the good faith, germane purpose, and substantial concern for mismanagement sufficient to warrant inspection.
    - The court also noted that the small size of the shareholder's stake in the company provided doubt as to whether all shareholders would be served by the requested inspection.
    - Finally the court questioned whether the documents requested – mainly documents the shareholder prompted the corporation to create – would fall within the scope of the common law.

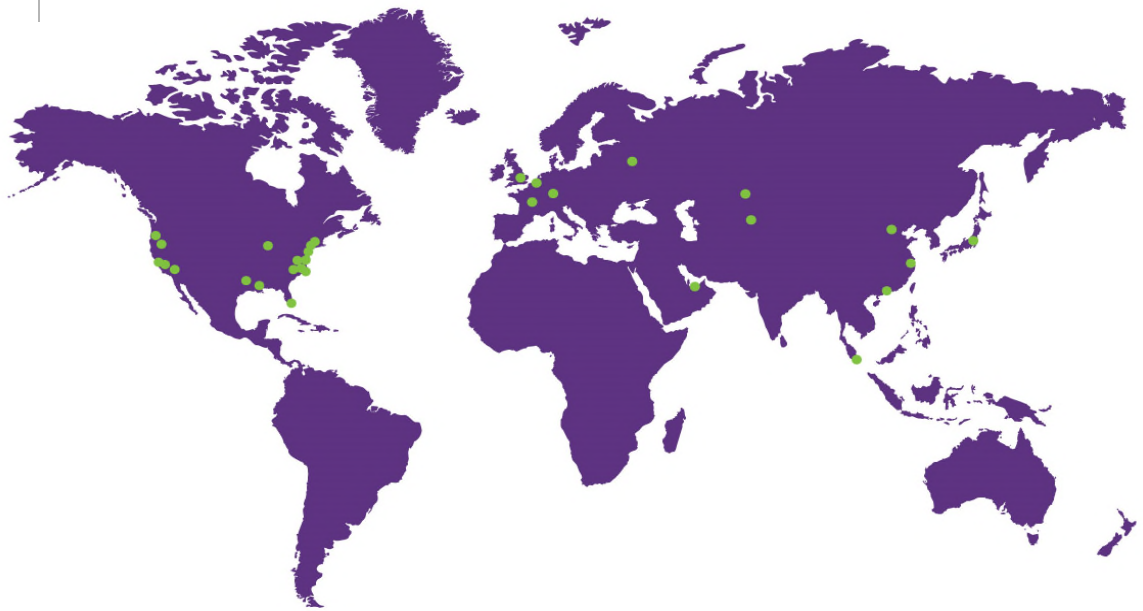
# QUESTIONS?

## Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

## Our Locations

Almaty
Astana
Beijing*
Boston
Brussels
Century City
Chicago
Dallas
Dubai
Frankfurt
Hartford
Hong Kong*
Houston
London
Los Angeles
Miami
Moscow
New York
Orange County
Paris
Philadelphia
Pittsburgh
Princeton
San Francisco
Shanghai*
Silicon Valley
Singapore
Tokyo
Washington, DC
Wilmington



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