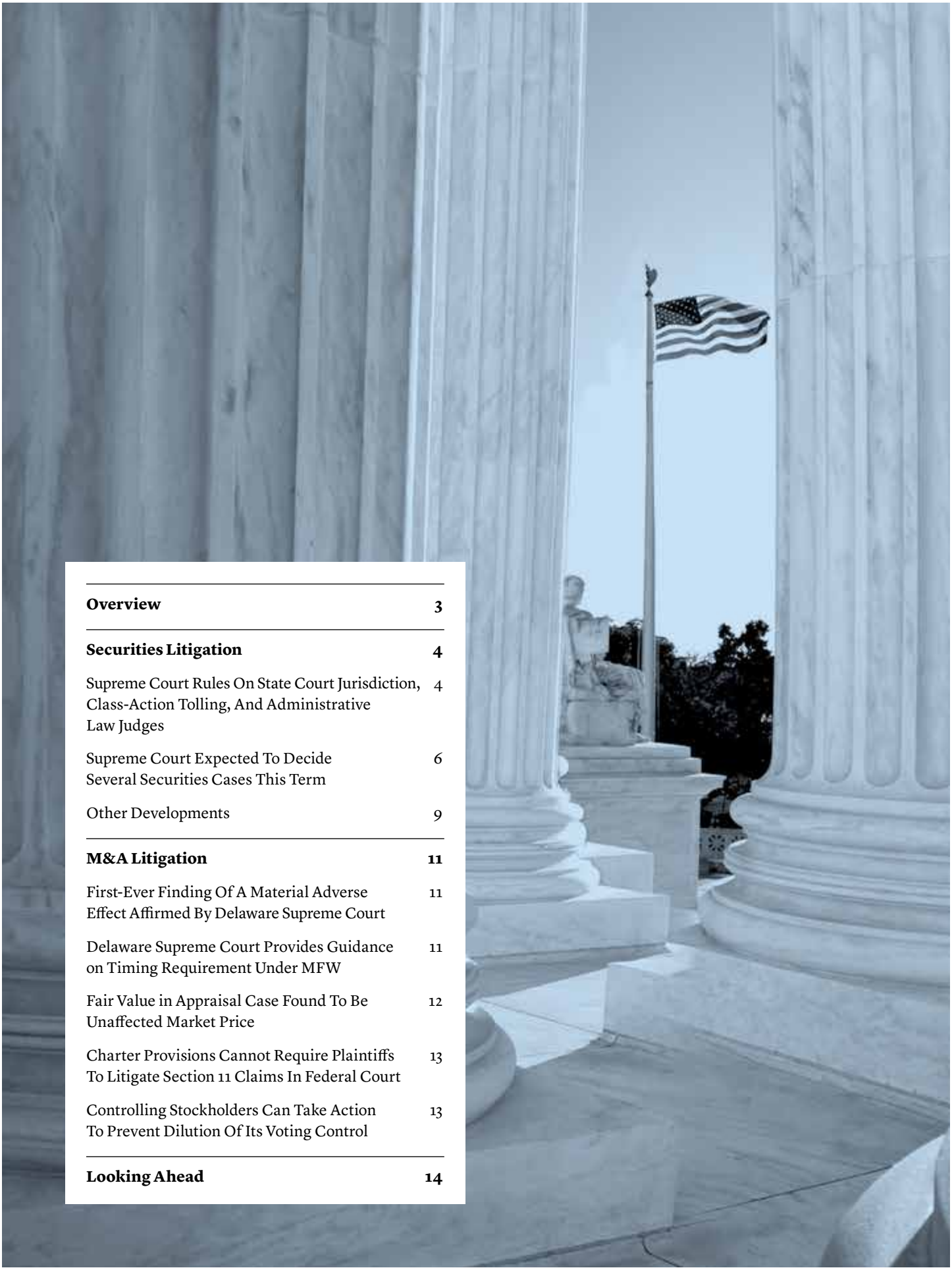
CLEARY GOTTLIEB

2018 Developments in Securities and M&A Litigation

March 2019



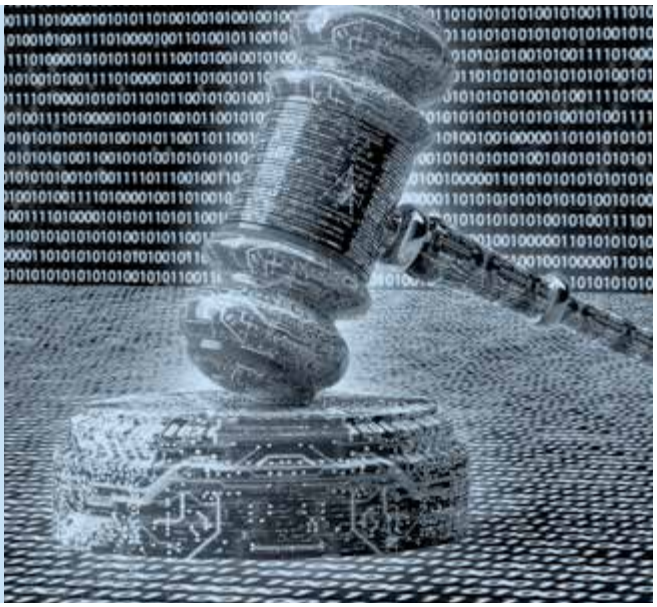
Overview

As previewed in our 2017 Year in Review, the Supreme Court issued a number of important securities law decisions in 2018. In *Cyan, Inc. v. Beaver County Employees Retirement Fund*, the Supreme Court held that state courts have subject matter jurisdiction over class actions alleging claims under the Securities Act of 1933 and that such actions may not be removed from state to federal court. In *China Agritech, Inc. v. Resh*, the Court held class-action tolling does not apply to successive class actions. Finally, in *Lucia v. SEC*, the Court confirmed that SEC Administrative Law Judges are "officers" for the purposes of the Constitution's Appointments Clause. The Court also heard oral arguments on the issue of scheme liability under Rule 10b-5 in *Lorenzo v. SEC*.

The circuit and district courts also addressed several contested securities laws topics, including the application of *Morrison* to unsponsored American Depository Receipts, loss causation where the event that triggered the price decline did not actually reveal the alleged fraud, the materials courts may consider during a motion to dismiss, and the burden for rebutting the *Basic* presumption. This year also saw the final approval of the $2.95 billion class action settlement in *In re Petrobras Securities Litigation*.

With respect to M&A litigation, in the first-ever finding of a Material Adverse Effect by a Delaware court, the Delaware Supreme Court released an acquirer from its obligation to close a transaction in *Akorn Inc. v. Fresenius KABI AG*. The Delaware Court of Chancery applied last year's *Dell* and *DFC* appraisal opinions to *Verition Partners Master Fund Ltd. et al. v. Aruba Networks Inc.*, which involved a merger that resulted in significant synergies, and found that the fair value was below the deal price because of those synergies. The Delaware courts continued to clarify the standard for the business judgment rule and to impose limits on using forum-selection clauses in charter provisions. Finally, Delaware witnessed the highly-publicized CBS and NAI litigation over board action to dilute a controlling stockholder, which resulted in a settlement in September 2018.

Securities Litigation



Supreme Court Rules On State Court Jurisdiction, Class-Action Tolling, And Administrative Law Judges

Securities Class Actions Cannot Be Removed To Federal Court

On March 20, 2018, the unanimous Supreme Court in *Cyan, Inc. v. Beaver County Employees Retirement Fund* held that state courts have subject matter jurisdiction over class actions alleging claims under the Securities Act of 1933 (the "Securities Act"') and that such actions may not be removed from state to federal court.[1] *Cyan* resolved a dispute among state and federal courts regarding whether the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") divested state courts of jurisdiction over these actions. The Supreme Court based its holding on a strict textual reading of SLUSA, concluding that Congress did not clearly express a desire to strip state courts of their historical jurisdiction over Securities Act claims.

Cyan subjects defendants to increased uncertainty in Securities Act class actions, raising the specter of duplicative litigation in state and federal courts, as well as potentially weakening the procedural protections of the Private Securities Litigation Reform Act of 1995 ("PSLRA"), some of which may not be available in state courts. *Cyan* may also lead to forum-shopping and inconsistent, unpredictable standards across various jurisdictions. The decision contained an express invitation to Congress to address this issue and revise SLUSA's imprecise language to eliminate state court jurisdiction over Securities Act class actions, to clarify that the PSLRA's procedural protections apply in state court, or to provide mechanisms to avoid duplicative litigation across jurisdictions.[2]

Class-Action Tolling Does Not Apply To Subsequent Class Actions

On June 11, 2018, the Supreme Court ruled in *China Agritech, Inc. v. Resh* that class-action tolling does not apply to successive class actions for several reasons.[3] First, the Court based its holding on the "watchwords" of *American Pipe & Construction Co. v. Utah*: "efficiency and economy of litigation."[4] The Court observed that these interests support the early assertion of competing class claims because district courts should have the

[1] 138 S. Ct. 1061 (2018).

[2] For more information, see our Alert Memorandum. Cleary Gottlieb, *Supreme Court Holds That Securities Act Class Actions May Be Brought In State Court* (March 27, 2018), https://www.clearygottlieb.com/-/media/files/alert-memos-2018/supreme-court-holds-that-securities-act-class-actions-may-be-brought-in-state-court.pdf.

[3] *China Agritech, Inc. v. Resh*, 138 S. Ct. 1800 (2018).

[4] *Id.*(citing *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974)).

"full roster of contenders" in front of them when selecting the most adequate plaintiff to represent the class. Thus, in contrast to individual actions, early class filings should be encouraged and may even aid a district court in determining whether class treatment is appropriate in the first place.[5] Second, the Court reasoned that the Private Securities Litigation Reform Act of 1995 ("PSLRA") shows a congressional preference against permitting piggyback class actions through its lead plaintiff selection process.[6] Third, the Court said that applying tolling to successive class actions would, in many cases, allow class action litigation to continue indefinitely—which was "not a result envisioned by *American Pipe*" or the PSLRA.[7] Although the Court acknowledged that statutes of repose mitigate concerns about endless re-litigation in some cases, it noted that statutes of repose are relatively rare in federal statutes and, therefore, would not prevent against the possibility of serial class litigation.

The Court's decision provides comfort to class action defendants that, if they successfully defeat a class action, they will not have to face another one based on the same claims after the statutory deadline has expired. It also assures defendants that they will be able to mount the best defenses to class claims with evidence that is still fresh. Even if *China Agritech* leads to a flood of "protective suit" class-action filings, defendants have plenty of tools to stem the tide, including consolidation of related actions and the multi-district litigation procedure. Viewed in tandem with *California Public Employees' Retirement System (CalPERS) v. ANZ Securities, Inc.*,[8] which held that *American Pipe* tolling does not apply to statutes of repose, *China Agritech* suggests that the Court is unlikely to extend *American Pipe* any further, and may support arguments against applying tolling where the class plaintiff lacks standing or where different claims are asserted.[9]

Cleary Gottlieb submitted an amicus brief in *China Agritech* on behalf of the Securities Industry and Financial Markets Association,[10] which was cited in the Court's decision.[11]

SEC Administrative Law Judges Were Unconstitutionally Appointed

On June 21, 2018, the Supreme Court ruled in *Lucia v. SEC* that Securities and Exchange Commission Administrative Law Judges (ALJs) are "officers" for the purposes of the Constitution's Appointments Clause.[12] After Dodd-Frank expanded the universe of cases the SEC could file in its administrative forum, the SEC began to bring more cases in administrative proceedings before ALJs. Unlike federal court, administrative proceedings do not require the SEC to go through lengthy discovery, allow for a trial by jury, or subject the SEC to federal evidentiary and procedural rules more generally. Lucia argued that the ALJs were not merely federal employees, but officers who had to be appointed by the Commission. At the time, ALJs were appointed by the chief ALJ and ultimately approved by the Commission's Office of Human Resources. The Supreme Court held that ALJs are officers because they "exercise significant authority pursuant to the laws of the United States."[13]

The Court's decision in *Lucia* will require the SEC to, at minimum: (1) ensure its current ALJs are validly appointed, (2) chart a course forward to achieve prompt and final resolution of the remaining constitutional issue, and (3) face a host of related challenges to past and pending cases. On August 22, 2018, the SEC issued an order entitled *In re: Pending Administrative Proceedings*, which provided litigants the opportunity to have a new hearing before a properly appointed official and ratified the appointment of certain ALJs, including the ALJ who presided over the *Lucia* case. Of course, there are likely to be "spill-over" effects from *Lucia* that will force the

[5] *Id.* at 1807.

[6] *Id.* at 1807-08.

[7] *Id.* at 1809.

[8] *California Pub. Employees' Ret. Sys. v. ANZ Sec., Inc.*, 137 S. Ct. 2042 (2017).

[9] For more information, see our Alert Memorandum. Cleary Gottlieb, *Supreme Court Holds That American Pipe Tolling Does Not Apply to Successive Class Actions* (June 14, 2018), https://www.clearygottlieb.com/news-and-insights/publication-listing/scotus-american-pipe-tolling-doesnt-apply-to-successive-class-actions.

[10] Brief for the Securities Industry and Financial Markets Association as Amicus Curiae Supporting Petitioner, China Agritech, *China Agritech, Inc. v. Resh*, No. 17-432 (Jan. 29, 2018).

[11] *Resh*, 138 S. Ct. at 1807-08.

[12] 138 S. Ct. 2044 (2018).

[13] *Id.* at 2051 (quoting *Buckley v. Valeo*, 424 U.S. 1, 126 (1976)).

other agencies that use ALJs to grapple with the legitimacy of their own administrative proceedings.[14]

Supreme Court Expected To Decide Several Securities Cases This Term

Scheme Liability under Rule 10b-5

On December 3, 2018, the Supreme Court heard oral arguments in *Lorenzo v. SEC* to decide whether the scheme liability provisions of Section 10(b) of the Securities Exchange Act and Rules 10b-5(a) and (c) thereunder may be used to find liability for a misleading statement against a defendant who was not the maker of the statement.[15] In *Janus Capital Group, Inc. v. First Derivatives Traders*, the Court held that only the maker or the person with "ultimate authority" over a misleading statement could be held liable under Rule 10b-5(b).[16] Unlike Rule 10b-5(b), however, Rules 10b-5(a) and (c) impose liability on anyone who "employ[s] any device, scheme, or artifice to defraud" or who "engage[s] in any act" that would operate as a fraud or deceit.[17]

The decision may bring clarity to the case law that has developed after the Supreme Court held in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A* that private plaintiffs may not maintain aiding-and-abetting suits brought under Section 10(b) and Rule 10b-5.[18] Since *Central Bank*, a number of courts have taken the position that each clause of Rule 10b-5 is meant to capture different types of conduct, and, therefore, cases based primarily on misstatements or omissions that give rise to liability under Rule 10b-5(b) could not also be charged under the scheme liability provisions of (a) and (c) of that same Rule, which would, in effect, be an impermissible aiding-and-abetting claim.[19]

The case arose when Francis Lorenzo, a registered representative of a broker-dealer, allegedly emailed false and misleading statements to investors that were originally drafted by his supervisor.[20] After administrative and Commission findings of liability, a divided panel of the D.C. Circuit determined that, although Lorenzo was not the "maker" of the statements, and thus not liable under Rule 10b-5(b), he did use them to deceive investors, and thereby violated Rules 10b-5(a) and (c).[21] The court rejected Lorenzo's argument that his conduct amounted to aidingandabetting and not primary liability, because he interacted directly with investors in supplying the false emails. The court also found that claims involving false statements did not need to sit exclusively within Rule 10b-5(b): "Rules 10b-5(a) and (c), as well as Sections 10(b) and 17(a)(1), may encompass certain conduct involving the dissemination of false statements even if the same conduct lies beyond the reach of Rule 10b-5(b)."[22]

During oral argument, several Justices seemed to indicate that Lorenzo's conduct fell squarely within the relevant statutory language, and Justice Alito in particular seemed skeptical of Lorenzo's attempt to extend *Janus*.[23] The questioning during oral argument also suggested that some Justices view the provisions of Rule 10b-5 as "overlapping" and "meant to essentially address the same thing."[24] If the Court adopts the D.C. Circuit's majority decision, it would take a more expansive view

[14] For more information, see our Alert Memo. Cleary Gottlieb, *Supreme Court Holds that SEC Administrative Law Judges Are Unconstitutionally Appointed* (June 26, 2018), https://www.clearygottlieb.com/news-and-insights/publication-listing/supreme-court-holds-that-sec-administrative-law-judges-are-unconstitutionally-appointed.

[15] *Lorenzo v. SEC*, No. 17-1077 (Dec. 3, 2018).

[16] *Janus Capital Grp., Inc. v. First Derivatives Traders*, 564 U.S. 135, 142 (2011).

[17] 17 C.F.R. § 240.10b-5(a), (c); 15 U.S.C. § 77q(a)(1).

[18] *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994).

[19] *See, e.g., Pub. Pension Fund Grp. v. KV Pharm. Co.*, 679 F.3d 972, 987 (8th Cir. 2012) ("[A] scheme liability claim must be based on conduct beyond misrepresentations or omissions actionable under Rule 10b-5(b)"); *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039, 1057 (9th Cir. 2011) ("[A] defendant may only be liable as part of a fraudulent scheme based upon misrepresentations and omissions under Rule 10b-5(a) or (c) when the scheme also encompasses conduct beyond those misrepresentations or omissions."); *Lentell v. Merrill Lynch & Co., Inc.*, 396 F.3d 161, 177 (2d Cir. 2005) ("We hold that where the sole basis for such claims is alleged misrepresentations or omissions, plaintiffs have not made out a market manipulation claim under Rule 10b–5(a) and (c), and remain subject to the heightened pleading requirements of the PSLRA.").

[20] For more information, see our blog post. Cleary Enforcement Watch Blog, *Lorenzo v. SEC: Will the Supreme Court Further Curtail Rule 10b-5?* (July 18, 2018), https://www.clearyenforcementwatch.com/2018/07/lorenzo-v-sec-will-supreme-court-curtail-rule-10b-5/.

[21] *Lorenzo v. SEC*, 872 F.3d 578 (D.C. Cir. 2017).

[22] *Id.* at 592.

[23] Justice Kavanaugh recused himself on the basis that he heard the case on the D.C. Circuit. Justice Kavanaugh dissented in that court's decision.

[24] Transcript of Oral Argument at 26, *Lorenzo v. SEC*, No. 17-1077 (Dec. 3, 2018).

of the scope of Rule 10b-5 liability, allowing the SEC and private plaintiffs to bring primary liability claims involving misrepresentations as scheme liability claims, even without additional deceptive conduct, against someone who is not the statement's maker.

Application Of *Morrison* To Unsponsored ADRs

On July 17, 2018, the Ninth Circuit, in *Stoyas v. Toshiba Corporation*,[25] held that the Supreme Court's ruling in *Morrison v. National Australia Bank Ltd.*[26] did not preclude the assertion of claims under the U.S. federal securities laws against foreign issuers with respect to domestic transactions in unsponsored American Depository Receipts ("ADRs"). The Ninth Circuit, however, further held that even though a domestic transaction is necessary for the federal securities law to apply under *Morrison*, it is not sufficient to plead a claim under the Exchange Act against a foreign company with unsponsored ADRs. In order to state such a claim, a plaintiff must also allege sufficient facts to demonstrate that the defendant's actions were committed "in connection with" the domestic transaction at issue. In short, the plaintiff must allege facts showing that the foreign issuer committed the fraud to induce the domestic transaction.

Toshiba did not challenge that the transactions were domestic on their face, but, instead, relied on the Second Circuit's decision in *Parkcentral Global Hub Ltd. v. Porsche Automobile Holdings* to argue that a domestic transaction was necessary, but not sufficient, to conclude that the transactions were within the scope of the federal securities laws under *Morrison* where the alleged wrongdoing was predominantly foreign in nature.[27] Toshiba posited that the Funds' inability to allege any connection between Toshiba and the ADR transactions put the transactions outside Section 10(b)'s reach.

The Ninth Circuit rejected the *Parkcentral* test, holding that it was "contrary to Section 10(b) and *Morrison* itself" because it is an "open-ended, under-defined multi-factor test," which is the very type of analysis that *Morrison* sought to correct with a "clear, administrable" rule.[28] Consequently, the court found Toshiba's arguments and the district court's reasoning unavailing, explicitly stating that the involvement, or lack thereof, of a foreign entity in a transaction is irrelevant to the analysis whether a transaction is domestic and, therefore, under the ambit of the Exchange Act pursuant to *Morrison*. The court noted that under its interpretation of *Morrison*, there very possibly could be cases where the Exchange Act would be applied to "claims of manipulation of share value from afar."

The Ninth Circuit, however, further held that, while a domestic transaction is necessary, it is not sufficient to state an Exchange Act claim. The court noted the Ninth Circuit's long held precedent that Section 10(b)'s "'*in connection with*'" language requires that a plaintiff must allege that the fraud was committed to induce the purchase at issue. The court found several deficiencies in the operative complaint and remanded to the district court to provide the plaintiffs an opportunity to amend.

In rejecting *Parkcentral*, the Ninth Circuit has adopted a test that is in some ways narrower than the Second Circuit's, and, therefore, may make it harder for foreign defendants to argue that domestic transactions in their securities do not satisfy *Morrison*. By looking solely to whether the transaction was domestic, and if the alleged fraud was committed to induce the domestic transactions, *Stoyas* exposes foreign defendants to liability they might be able to avoid under *Parkcentral*, particularly in cases where the entirety of the alleged fraud occurs abroad.[29] Defendants have filed a petition for certiorari, which is currently pending. On January 14, 2019, the Supreme Court invited the Solicitor General to file a brief expressing the views of the United States.

[25] *Stoyas v. Toshiba Corp.*, 896 F.3d 933 (9th Cir. 2018).

[26] 561 U.S. 247 (2010).

[27] 763 F.3d 198 (2d. Cir. 2014).

[28] *Stoyas*, 896 F.3d at 950.

[29] For more information, see our Alert Memo. Cleary Gottlieb, *Ninth Circuit Addresses Requirements for Pleading Section 10(b) Claims Concerning Unsponsored ADRs and Rejects Second Circuit's Parkcentral Decision* (July 26, 2018), https://www.clearygottlieb.com/news-and-insights/publication-listing/ninth-circuit-addresses-requirements-for-pleading-section-10b-claims-concerning-unsponsored-adrs.

Establishing Loss Causation

In *Mineworks' Pension Scheme v. First Solar Inc.*, the Ninth Circuit addressed the issue of whether a private securities-fraud plaintiff may establish loss causation based on a decline in the market price of a security where the event or disclosure that triggered the decline did not reveal the fraud on which the plaintiff's claim is based.[30] The plaintiffs alleged that First Solar wrongfully concealed manufacturing and design defects, and made false statements in their financial reporting, which resulted in a sharp decline of the company's stock price both before and after these defects and false reports were disclosed to the market. The Ninth Circuit permitted plaintiffs to recover based on the drop in the stock's value before the fraud was revealed to the market because "the underlying facts concealed by the fraud [. . . affected] the stock price."[31]

The Ninth Circuit affirmed the rule put forth by the district court, stating that "[a] plaintiff can satisfy loss causation by showing that the defendant misrepresented or omitted the *very facts* that were a substantial factor in causing the plaintiff's economic loss."[32] In so holding, the court refused to adopt a more restrictive test for loss causation that would require revelation of the fraud itself to the market for plaintiffs to able to recover. The court reasoned that revelation of fraud in the marketplace is one of many theories of causation that a plaintiff may use to satisfy the proximate cause element of a Rule 10b-5 claim. However, the ultimate issue for loss causation is "whether the defendant's misstatement, as opposed to some other fact, foreseeably caused the plaintiff's loss."[33]

This is an important case to watch because the standard for loss causation endorsed by the Ninth Circuit, if adopted nationally, could open the door for more creative theories by securities class action plaintiffs to establish loss through facts that are not revealed to the market. First Solar has filed a petition for certiorari, which is currently pending. On October 9, 2018, the Supreme Court invited the Solicitor General to file a brief expressing the views of the United States.

Resolving Circuit Split Over 14(e) Pleading Requirement

In *Varjabedian v. Emulex*, the Ninth Circuit held that plaintiffs bringing claims under Section 14(e) of the Exchange Act—which prohibits misstatements, omissions, or fraudulent conduct in connection with a tender offer—need only show that defendants acted negligently, rather than with scienter.[34] This decision marks a conspicuous divergence from the decisions of every other circuit court to consider the issue. Those other courts have uniformly held that Section 14(e) claims require a plaintiff to demonstrate that defendants acted knowingly or with a reckless disregard of the truth, a significantly higher burden.

Although the Ninth Circuit acknowledged the long-standing out-of-circuit precedent, it rejected the district court's analysis that the "shared text" between Section 14(e) and Rule 10b-5 justified reading a scienter requirement into the first clause of Section 14(e) due to what the Ninth Circuit found to be "important distinctions" between the context of Rule 10b-5 and Section 14(e).[35] The Ninth Circuit relied on the Supreme Court's decisions in *Ernst & Ernst v. Hochfelder*[36] to distinguish Rule 10b-5 from Section 14(e) and *Aaron v. SEC*[37] to analogize the interpretation of Section 14(e) to that of Section 17(a)(2).

The Supreme Court granted certiorari in January 2019, and will have the chance to resolve the circuit split on this important issue. Despite the reliance of the Ninth Circuit's analysis of Supreme Court precedent, it remains to be seen whether the Supreme Court will agree with the Ninth Circuit's reasoning. The Supreme Court has previously been wary of interpreting the

[30] 881 F.3d 750 (9th Cir. 2018).

[31] *Id.* at 754.

[32] *Id.* at 753 (internal citations omitted).

[33] *Id.* at 752 (quoting *Lloyd v. CVB Fin. Corp.*, 811 F.3d 1200, 1210 (9th Cir. 2016)).

[34] 888 F.3d 399 (9th Cir. 2018).

[35] *Id.* at 405.

[36] 425 U.S. 185 (1976).

[37] 446 U.S. 680 (1980).

federal securities laws in ways that expand the scope of private litigation in the absence of explicit congressional authority to do so. On February 26, 2019, the Solicitor General filed an amicus brief arguing that, although it agreed with the Ninth Circuit that Section 14(e) did not require scienter, there is no implied private right of action to enforce that provision.[38] The Supreme Court's decision could thus have far reaching consequences, and may affect the volume of merger litigation that is currently brought under another provision of Section 14 in federal court (and that has largely migrated from the Delaware Court of Chancery).

Other Developments

What Materials Courts Can Consider On A Motion To Dismiss

On August 13, 2018, the Ninth Circuit issued *Khoja v. Orexigen Therapeutics, Inc.*,[39] an important decision regarding the manner in which courts may—and may not—consider documents outside the four corners of a complaint when deciding a motion to dismiss in a securities case, either through incorporation by reference or judicial notice. In its decision reversing the lower court's dismissal of the case, the court discussed what it perceived to be a "concerning pattern in securities cases" where defendants take advantage of incorporation by reference and judicial notice in order to "improperly" defeat an otherwise adequately plead complaint.

The *Orexigen* decision may make it more difficult for defendants to win a motion to dismiss within the Ninth Circuit and may lead to extensive litigation over what documents are appropriate for courts to consider.[40] Properly read, however, it should not foreclose defendants from presenting meritorious defenses in a motion to dismiss where the meaning or import of the documents relied on is unambiguous.

Rebutting The Fraud-On-The-Market Presumption Of Reliance

In *Arkansas Teachers Retirement System v. Goldman Sachs Group*, the Second Circuit vacated a class certification decision, reaffirmed that the burden for rebutting the *Basic* presumption is a preponderance of the evidence, and clarified that to meet this standard, defendants need not provide "conclusive evidence" that there was no link between the price decline and the alleged misrepresentation.[41] The Second Circuit also held that the district court, in determining whether the defendants successfully rebutted the *Basic* presumption, erred in refusing to consider an event study showing that there was no price decline in response to earlier disclosures.

The Second Circuit's decision on price impact is significant because it kept the ultimate burden of persuasion on defendants to disprove price impact while clarifying that the lower standard of preponderance of the evidence applies. On remand, the district court again granted class certification, this time applying the proper standard of review.[42] In December of 2018, the Second Circuit granted a second appeal of class certification. The court's next opinion will provide additional guidance about how defendants may be able to rebut the *Basic* presumption.

District Court Approves Petrobras Securities Litigation Class Action Settlement

On June 22, 2018, the Southern District of New York approved a $2.95 billion class action settlement in *In re Petrobras Securities Litigation*.[43] The court rejected various objections to the settlement, including that the class definition was overbroad, that common issues of law and fact did not predominate over issues subject only to individualized proof, and that the class was not

[38] Brief for the United States as Amicus Curiae in Support of Neither Party, *Emulex Corp. v. Varjabedian*, No. 18-459 (Feb. 26, 2019).

[39] 889 F. 3d 988 (9th Cir. 2018)

[40] For more information, see our Alert Memo. Cleary Gottlieb, *Ninth Circuit Addresses When Courts May Consider Materials Outside the Complaint in Motions to Dismiss* (August 28, 2018), https://www.clearygottlieb.com/news-and-insights/publication-listing/ninth-circuit-addresses-when-courts-may-consider-materials-outside-the-complaint-in-motions.

[41] 879 F.3d 474 (2d Cir. 2018).

[42] *In re Goldman Sachs Grp., Inc. Sec. Litig.*, No. 10 Civ. 3461 (PAC), 2018 WL 3854757 (S.D.N.Y. Aug. 14, 2018).

[43] *In re Petrobras Securities Litig.*, 317 F. Supp. 3d 858 (2018).

adequately represented because it included both persons who had U.S. claims and those who did not. One objector has appealed approval of the settlement, which is currently pending before the Second Circuit.[44] Cleary Gottlieb represented Petrobras throughout the litigation and settlement.

The court first held that the settlement class could include claims by non-domestic purchasers that were not actionable under *Morrison v. National Australia Bank*, 561 U.S. 247 (2010) because "plaintiffs are entitled to settle even entirely non-meritorious claims" so long as they have Article III standing, which is consistent with Second Circuit precedent.[45] The court recognized that inclusion of such class members, "irrespective of whether their injuries are sufficient to sustain any cause of action," had been necessary for defendants to enter into the settlement and buy "global peace."[46] The court also held that common issues predominated to satisfy Rule 23(b)(3) for purposes of settlement, because although a class including purchasers in foreign transactions may have created manageability problems at trial, such concerns would "disappear" in the settlement context.[47] Finally, the court rejected objectors' argument that it was necessary to divide purchasers of Petrobras securities into two subclasses, one of domestic purchasers and another of nondomestic purchasers. The court found that there would be "substantial administrative costs of differentiating between the comparatively small number of DTC claimants and the overwhelming majority of domestic claimants," which would have reduced the settlement fund.[48]

[44] *In re Petrobras Sec. Litig.*, No. 18-2270 (2d Cir.).

[45] *In re Petrobras Sec. Litig.*, 317 F. Supp. 3d at 866; *see In re Am. Int'l Grp., Inc. Sec. Litig. ("AIG")*, 689 F.3d 229 (2d Cir. 2012); *Denney v. Deutsche Bank AG*, 443 F.3d 253 (2d Cir. 2006); *see also Sullivan v. DB Investments, Inc.*, 667 F.3d 273 (3d Cir. 2011).

[46] *In re Petrobras Sec. Litig*, 317 F. Supp. 3d at 866 (quoting *Denney*, 443 F.3d at 265-65).

[47] *Id.* at 870 (quoting *AIG*, 689 F.3d at 241); *see also Amchem Prod., Inc. v. Windsor*, 521 U.S. 591, 620 (1997).

[48] *In re Petrobras Sec. Litig*, 317 F. Supp. 3d at 869.

M&A Litigation

First-Ever Finding Of A Material Adverse Effect Affirmed By Delaware Supreme Court

The Delaware Court of Chancery's post-trial opinion in *Akorn Inc. v. Fresenius KABI AG* was the first time a Delaware court had released an acquiror from its obligation to close a transaction as a result of the occurrence of a "Material Adverse Effect" or "MAE."[49] Vice Chancellor Laster found that there was a "a dramatic, unexpected, and company-specific downturn in Akorn's business" and held that the underlying causes of the decline were durationally significant, and were specific to Akorn, rather than the result of industry-wide conditions.

Previous cases in Delaware all had required the acquiror to close, often despite a significant diminishment in target value and, in some, the court criticized the acquiror for seeking to avoid its obligations based on little more than buyer's remorse. Nonetheless, after a careful examination of the facts, Vice Chancellor Laster found that the grievous decline of generics pharmaceutical company Akorn, Inc., after it agreed to be acquired by Fresenius, constituted an MAE, and his decision was affirmed by the Delaware Supreme Court in a unanimous order.[50]

Akorn presented a particularly unhappy set of facts, and likely does not indicate a radical reinterpretation of MAEs under Delaware law. It will be the rare case in which the deterioration in the target's financial performance is as unexpected and dramatic or the alleged malfeasance as pervasive and clear-cut as it was in *Akorn*. We thus expect the conventional wisdom to continue to hold true – it is extremely difficult for an acquiror to establish the occurrence of a MAE.[51]

Delaware Supreme Court Provides Guidance on Timing Requirement Under *MFW*

On October 9, 2018, the Delaware Supreme Court clarified that controlling stockholder take-private transactions will be reviewed under the deferential business judgment rule, rather than the less deferential entire fairness standard, if the controlling stockholder self-disables by committing to special committee and

[49] *Akorn, Inc. v. Fresenius Kabi AG et al.*, No. 2018-0300-JTL, 2018 WL 4719347 (Del. Ch. Oct. 1, 2018).

[50] *Akorn, Inc. v. Fresenius Kabi AG et al.*, No. 535, 2018, 2018 WL 6427137 (Del. Dec. 7, 2018).

[51] For additional information, see our blog post. Cleary Gottlieb, Akorn v. Fresenius: *A MAC in Delaware* (Oct. 11, 2018), https://www.clearymawatch.com/2018/10/akorn-v-fresenius-mac-delaware/.

majority-of-the-minority approval before "economic negotiations" take place, even if the controlling stockholder fails to do so in its initial written offer.[52]

The Delaware Supreme Court announced in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) ("*MFW*") that business judgment review applies to a merger proposed by a controlling stockholder conditioned "*ab initio*" on two procedural protections: (1) the approval of an independent, adequately empowered Special Committee that fulfills its duty of care; and (2) the uncoerced, informed vote of a majority of the minority stockholders.[53] Since then, several Delaware cases have involved questions about whether the *MFW* conditions were in place "*ab initio*."

Writing for a majority of the court, Chief Justice Strine explained that "what is critical for the application of the business judgment rule is that the controller accept that no transaction goes forward without special committee and disinterested stockholder approval early in the process and before there has been any economic horse trading." He reasoned that the key concern of *MFW*—"ensuring that controllers could not use the conditions as bargaining chips during economic negotiations"—would still be addressed as long as the protections were in place before any economic negotiations commenced. The court thus held that "so long as the controller conditions its offer on the key protections at the germination stage of the Special Committee process, when it is selecting its advisors, establishing its method of proceeding, beginning its due diligence, and has not yet commenced substantive economic negotiations with the controller, the purpose of the pre-condition requirement of *MFW* is satisfied." Underlying the court's holding was its recognition that "*MFW*'s dual conditions create 'a potent tool to extract good value for the minority'" and that a flexible approach that incentivizes controlling stockholders to precommit to these conditions benefits minority stockholders.

Cleary Gottlieb represented Synutra's special committee throughout the litigation and appeal.

Fair Value in Appraisal Case Found To Be Unaffected Market Price

In *Verition Partners Master Fund Ltd. et al. v. Aruba Networks Inc.*,[54] Vice Chancellor Laster issued the Delaware Court of Chancery's first significant appraisal decision applying the Delaware Supreme Court's recent *Dell*[55] and *DFC*[56] opinions. Although *Dell* and *DFC* both emphasized that deal price will often be the best evidence of fair value in appraisal actions involving open, competitive, and arm's-length mergers of publicly-traded targets, neither case involved a merger where the transaction resulted in significant synergies, which are excluded statutorily from the determination of fair value. Picking up where those cases left off, the court in *Aruba*—despite finding that the deal price was the product of an uncompetitive and flawed process—nonetheless found fair value to be significantly below the deal price because the merger resulted in significant synergies.

The court found fair value to be equal to the pre-announcement market trading price of the public shares, which was 30% below deal price. On market price, the court noted that the market for Aruba's unaffected public shares had the "attributes associated with market efficiency" identified in *Dell*—including that it had "many stockholders; no controlling stockholder; highly active trading; and . . . information about the company [wa]s widely available and easily disseminated to the market"—which indicates that the market price is "likely a possible proxy for fair value."

[52] *Flood v. Synutra Int'l, Inc.*, 195 A.3d 754 (Del. 2018).

[53] 128 A.3d 992 (Del. 2015) (TABLE).

[54] *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, C.A. No. 11448-VCL, 2018 WL 922139 (Del. Ch. Feb. 15, 2018) (hereinafter "*Aruba*").

[55] *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd.*, 177 A.3d 1, (Del. Dec. 14, 2017). For more information, see our blog post. Cleary Gottlieb, *Delaware Supreme Court's Dell Decision Further Reduces Appraisal Risks for Buyers* (Dec. 18, 2017), https://www.clearymawatch.com/2017/12/delaware-supreme-courts-dell-decision-reduces-appraisal-risks-buyers/.

[56] *DFC Global Corp. v. Muirfield Value Partners, L.P.*, 172 A.3d 346 (Del. 2017). For more information, see our blog post. Cleary Gottlieb, *Delaware Supreme Court Declines To Establish A Presumption In Favor Of Deal Price In Appraisal Actions—Or Did It?* (Aug. 8, 2017), https://www.clearymawatch.com/2017/08/delaware-supreme-court-declines-establish-presumption-favor-deal-price-appraisal-actions/.

Aruba's holding, of course, may not be extended to transactions involving privately-held companies, companies trading on markets that can be demonstrated to be inefficient, take-private transactions with a controlling stockholder, or acquisitions by financial buyers without synergies. But if affirmed on appeal, the decision will have a substantial effect on appraisal litigation involving widely held and actively traded public companies, and it continues the trend of reducing appraisal risk for buyers of public companies. We expect the Delaware Supreme Court will provide further guidance on this key issue in 2019.

Charter Provisions Cannot Require Plaintiffs To Litigate Section 11 Claims In Federal Court

On December 19, 2018, the Delaware Court of Chancery issued an opinion holding that Delaware law does not permit corporations to use charter provisions to require stockholders to litigate certain claims brought under the federal securities laws in a specific forum. In *Sciabacucchi v. Salzberg*, Vice Chancellor Laster determined that such forum-selection provisions are invalid and unenforceable to the extent that they require any claim under the Securities Act of 1933 (the "1933 Act") to be filed only in federal court.[57]

The decision built on case law providing that a corporation may include forum-selection clauses in its governing documents where the claims involve internal disputes stemming from the rights and relationships established under Delaware corporate law (including between corporations and stockholders), but may not do so for claims that are external to the corporate relationship, like those based on tort, contract, labor, or environmental law. It may have implications for the use of other forum-selection provisions that mandate arbitration or contain class action waivers. An appeal would give the Delaware Supreme Court a chance to provide guidance on this important issue.

Controlling Stockholders Can Take Action To Prevent Dilution Of Its Voting Control

In the high-profile litigation between CBS Corporation and its controlling stockholder, which was resolved in connection with the resignation of CBS's CEO Les Moonves, the Delaware Court of Chancery denied a request to enjoin a controlling shareholder from taking action to prevent the dilution of its voting control. National Amusements, Inc. ("NAI") is the 80% controlling stockholder of CBS Corporation. In May 2018, a special committee of the CBS board called a special meeting of the full CBS board to consider and vote on a stock dividend intended to dilute NAI's voting control. CBS simultaneously filed a lawsuit against NAI in the Delaware Court of Chancery seeking approval of such dividend, alleging that the dividend was necessary to prevent NAI from breaching its fiduciary duties as a controlling stockholder (which they claimed included threatened removal of directors to force a purportedly unfair merger with Viacom, which is also controlled by NAI). CBS also immediately moved for a temporary restraining order ("TRO") preventing NAI from taking action to protect its controlling stake.

After expedited briefing and oral argument, the Court of Chancery denied CBS's request.[58] In so ruling, the Court of Chancery resolved an "apparent tension" in the law between, on the one hand, past decisions suggesting the possibility that a board might be justified in diluting a controlling stockholder in extraordinary circumstances (arguably implying that, in such circumstances, the board should be permitted to act without interference by the controlling stockholder) and, on the other hand, cases recognizing the right of a controlling stockholder to have the opportunity to take action to avoid being disenfranchised. The court found the wellestablished right of a controlling stockholder to take measures to protect its voting control "weigh[ed] heavily" against granting a TRO that would restrain it from doing so, and that "truly extraordinary circumstances" would therefore be required to support such a TRO. At the same time, the court noted that it had the power to

[57] *Sciabacucchi v. Salzberg*, C.A. No. 2017-0931-JTL, 2018 WL 6719718 (Del. Ch. Dec. 19, 2018).

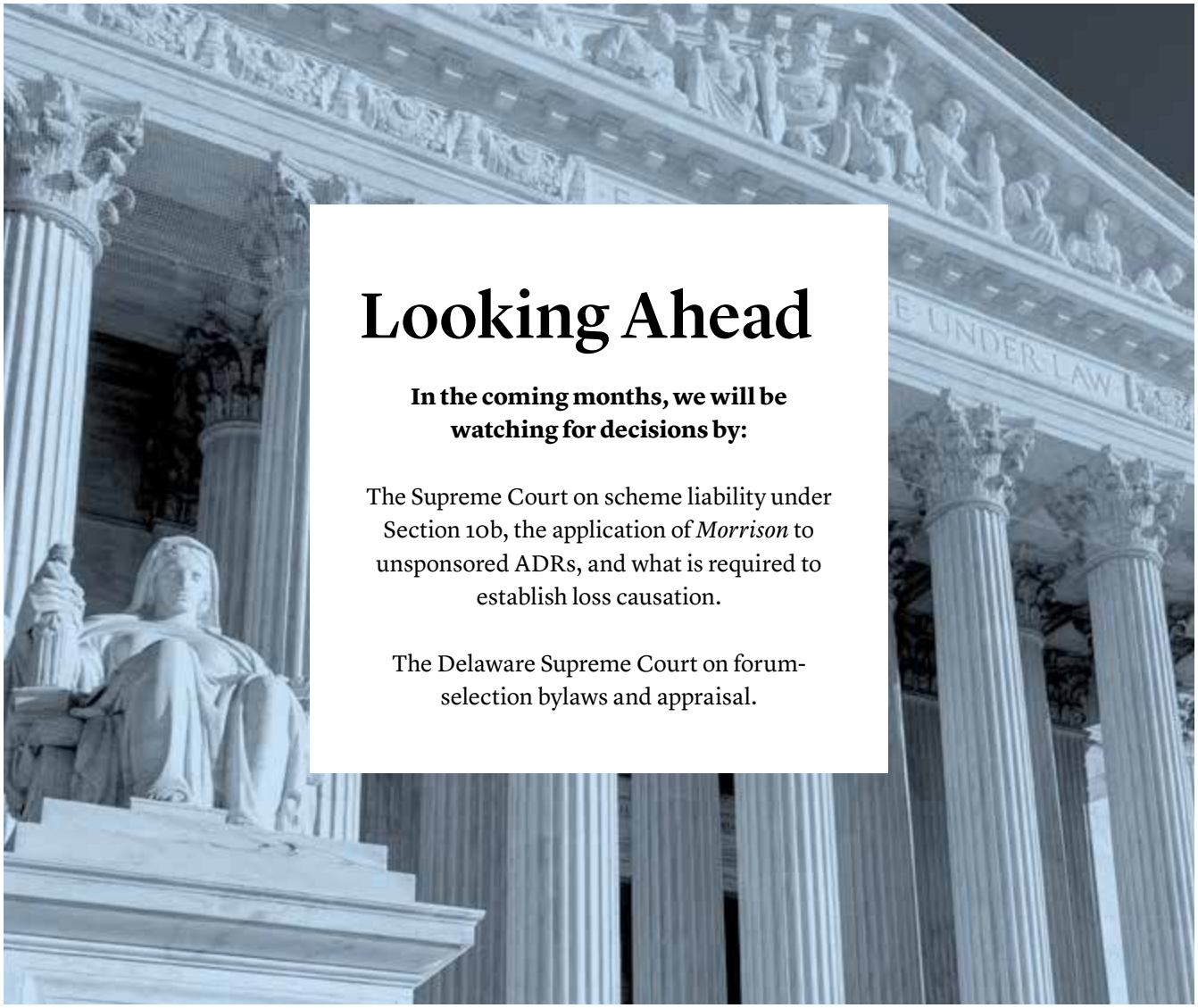
[58] *CBS Corp. v. Nat'l Amusements, Inc.*, C.A. No. 2018-0342-AGB (Del. Ch. May 17, 2018).

review and, if necessary, "set aside" any such action taken by the controlling stockholder after the fact, and thus there would be no irreparable injury in the absence of a TRO.

Litigation over board action to dilute a controlling stockholder is rare, and may become rarer still after this decision. The focus of any such litigation is likely to be on the ultimate issues, including whether the board had "compelling justification" to dilute the controlling stockholder, and whether the controlling stockholder was justified in taking steps to protect itself.[59]

Cleary Gottlieb was litigation and corporate counsel for NAI in these matters.

[59] For more information, read our blog post. Cleary Gottlieb, Lessons from the CBS-NAI Dispute: When (If Ever) Will the Court of Chancery Grant a TRO To Restrain a Controlling Stockholder From Taking Action to Prevent a Board From Diluting Its Voting Control? (October 15, 2018), https://www.clearymawatch.com/2018/10/lessons-cbs-nai-dispute-ever-will-court-chancery-grant-tro-restrain-controlling-stockholder-taking-action-prevent-board-diluting-voting-control/.



Looking Ahead

In the coming months, we will be watching for decisions by:

The Supreme Court on scheme liability under Section 10b, the application of *Morrison* to unsponsored ADRs, and what is required to establish loss causation.

The Delaware Supreme Court on forum-selection bylaws and appraisal.

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We'd like to recognize that **Kimberly Black**, **Kristin Corbett** and **Miranda Gonzalez** contributed to Cleary's *2018 Developments in Securities and M&A Litigation* publication.

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