

2016 Developments in Securities and M&A Litigation

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Overview

Federal securities class action filings rose by over 40 percent in 2016.¹ A surge in federal court filings of class actions related to merger and acquisition (M&A) transactions contributed to the increase, as discussed below.² Federal securities class actions against foreign issuers also continued to be prominent, with frequent targets of such actions including companies headquartered in Israel, Ireland, Canada, China, and Brazil.³

In 2016, the federal courts issued several significant securities decisions and are currently considering cases presenting important contested securities law issues. The U.S. Supreme Court issued its first merits ruling in an insider trading case in two decades, *Salman v. United States*, clarifying certain aspects of tipper-tippee liability. Several circuit courts decided that the statutes of repose applicable to federal securities claims are not subject to class action tolling, and the Supreme Court recently granted a petition for certiorari on that issue. Petitions for certiorari were also filed in 2016 regarding state courts' jurisdiction over class actions asserting Securities Act claims. In addition, the circuit and district courts issued, or are poised to issue, several decisions applying the Supreme Court's recent decisions in *Halliburton II* (concerning the fraud-on-the-market presumption), *Omnicare* (concerning liability for statements of opinion), and *Morrison* (concerning the extraterritoriality of the federal securities laws). The Second Circuit further decided appeals raising significant securities law issues arising from a class action—one of the few securities class actions that went to trial—and an opt-out action filed against Vivendi. Another securities class action that went to trial—*Jaffe v. Household International, Inc.*—settled in 2016, ahead of a second trial in the case.

¹ Kevin M. LaCroix, *2016 Securities Lawsuit Filings Surge to Record Levels*, The D&O Diary (Jan. 2, 2017), <http://www.dandodiary.com/2017/01/articles/securities-litigation/2016-securities-lawsuit-filings-surge-record-levels/>.

² *Id.*

³ *Id.*



There were significant M&A-related developments in 2016 as well. The Delaware Court of Chancery's refusal in January 2016 to approve a disclosure-only settlement in *In re Trulia* had wide ramifications in Delaware and beyond. The Court of Chancery also issued noteworthy decisions addressing claim extinguishment, the standard of review for "going private" transactions, and the proper timing of disclosure claims. Advisors' liability for aiding and abetting was discussed in the Delaware Supreme Court's decision in *Singh v. Attenborough*. In addition, there were significant developments regarding appraisal claims.

Securities Litigation

Insider Trading

In *Salman v. United States*,⁴ the Supreme Court unanimously affirmed the Ninth Circuit's holding that a tipper's gift of inside information to a trading relative or friend provided a "personal benefit" to the tipper, such that the tipper could be considered to have breached his fiduciary duty and the tippee could be liable for trading on the information.⁵ *Salman* resolved the split between the Ninth Circuit's decision below and the Second Circuit's prior decision in *United States v. Newman*, which instead held that such a gift of inside information could only support an insider trading conviction if the tipper received something "of a pecuniary or similarly valuable nature" in exchange for the gift.⁶

As the Court explained, its earlier decision in *Dirks v. SEC*⁷ stands for the principle that a tipper's gift of confidential information to a trading relative or friend in itself provides a personal benefit to the tipper, and *Newman*'s additional requirement of a "pecuniary or similarly valuable" exchange was "inconsistent with *Dirks*."⁸ The Court reasoned that a tipper's gift of

inside information to a trading relative or friend is functionally equivalent to the tipper trading on the inside information himself and giving the proceeds as a gift.⁹

The *Salman* decision has reduced the hurdles that *Newman* raised against insider trading prosecutions, and it may have the effect of renewing prosecutors' focus on such cases.

The Court concluded that *Dirks* squarely applied to the facts presented in *Salman*, declining to address issues such as the government's position that a gift of confidential trading information to any person (not just family or friends) can establish liability.¹⁰ While several open questions remain, *Salman* has clarified the law by confirming that gifts of confidential information by a tipper to trading relatives or friends—even if the tipper does not receive anything of pecuniary or similar value in return—can provide a basis for insider trading liability.

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Statutes of Repose

In 2016, several circuit courts joined the Second Circuit in holding that the class action tolling rule established in *American Pipe & Construction Co. v. Utah*¹¹ does not apply to the statutes of repose applicable to federal securities claims.

Under *American Pipe*'s tolling rule, "the commencement of a class action suspends the applicable statute of limitations as to all asserted members of the class who would have been parties had

⁴ 137 S. Ct. 420 (2016).

⁵ *Id.* at 423-24.

⁶ *Id.* at 425 (quoting *United States v. Newman*, 773 F.3d 438, 452 (2d Cir. 2014)).

⁷ 463 U.S. 646 (1983).

⁸ *Salman*, 137 S. Ct. at 428.

⁹ *Id.*

¹⁰ *See id.* at 426-27.

¹¹ 414 U.S. 538 (1974).

the suit been permitted to continue as a class action.”¹² Previously, the Second Circuit held that this tolling rule does not apply to the Securities Act’s statute of repose, reasoning that statutes of repose are not subject to equitable tolling and that the Rules Enabling Act prohibits applying Rule 23 in a way to abridge the substantive right provided by a statute of repose.¹³ In 2016, the Second Circuit extended this holding to other statutes of repose in the federal securities laws and reaffirmed that the holding applied to individual investors opting out of class actions.¹⁴ The Sixth Circuit and the Eleventh Circuit likewise held in 2016 that the statutes of repose are not subject to class action tolling, reasoning (in part) that subsequent Supreme Court authority concerning statutes of repose further supported the Second Circuit’s holding.¹⁵

The Supreme Court recently granted a petition for certiorari on the issue.¹⁶ The principal questions raised in the petition are whether *American Pipe* is an equitable tolling rule (which is thus inapplicable to repose periods) or, even if *American Pipe* tolling were based on an interpretation of the federal rules rather than equity, whether its application to a repose period would violate the Rules Enabling Act’s proscription against interpreting the federal rules to abridge, enlarge, or modify any substantive rights.

This issue is significant because it affects the potential liability of securities defendants for actions filed after repose periods expire.

SLUSA & Securities Act Jurisdiction

Two petitions for certiorari are currently pending before the Supreme Court on the issue of whether the Securities Litigation Uniform Standards Act of 1998 (SLUSA) eliminated state courts’ concurrent subject matter jurisdiction over covered class actions alleging only Securities Act claims.¹⁷ The petitions were filed by defendants challenging a California state court’s jurisdiction over class actions asserting Securities Act claims.

The issue of whether state courts retain concurrent jurisdiction in such cases determines if the procedural protections established by the Private Securities Litigation Reform Act apply uniformly to class actions involving Securities Act claims.

Federal district courts continued to be sharply divided on this issue in 2016, with some district courts holding that state courts lack jurisdiction over class actions asserting Securities Act claims¹⁸ and others remanding such cases to state court (and even imposing sanctions against defendants for removing such cases).¹⁹ The only appellate court to address the issue, a California intermediate appeals court, has held that state courts’ concurrent jurisdiction over covered class actions

¹² *Id.* at 554.

¹³ *Police and Fire Ret. Sys. of the City of Detroit v. IndyMac MBS, Inc.*, 721 F.3d 95, 109 (2d Cir. 2013).

¹⁴ *DeKalb Cty. Pension Fund v. Transocean Ltd.*, 817 F.3d 393, 414 (2d Cir. 2016); *SRM Glob. Master Fund v. The Bear Stearns Cos.*, 829 F.3d 173, 177 (2d Cir. 2016); *In re Lehman Bros. Sec. & Erisa Litig.*, 655 F. App’x 13, 15 (2d Cir. 2016).

¹⁵ *Stein v. Regions Morgan Keegan Select High Income Fund, Inc.*, 821 F.3d 780, 793-95 (6th Cir. 2016); *Dusek v. JPMorgan Chase & Co.*, 832 F.3d 1243, 1248-49 (11th Cir. 2016).

¹⁶ *In re Lehman Bros. Sec. & Erisa Litig.*, 655 F. App’x 13 (2d Cir. 2016), *cert. granted* (U.S. Jan. 13, 2017) (No. 16-373).

¹⁷ *Cyan, Inc. v. Superior Court of the City and County of San Francisco*, No. A146891 (Cal. Ct. App. Dec. 10, 2015), *petition for cert. filed*, 84 U.S.L.W. 3669 (U.S. May 24, 2016) (No. 15-1439); *FireEye, Inc. v. Superior Court of Santa Clara County*, No. H043576 (Cal. Ct. App. Sep. 8, 2016), *petition for cert. filed*, 85 U.S.L.W. 3300 (U.S. Dec. 5, 2016) (No. 16-744).

¹⁸ *See Hung v. Idreamsky Tech. Ltd.*, No. 15-CV-2514 (JPO), 2016 WL 299034, at *4 (S.D.N.Y. Jan. 25, 2016); *Gaynor v. Miller*, No. 3:15-CV-545-TAV-CCS, 2016 WL 6078340, at *8 (E.D. Tenn. Sept. 8, 2016).

¹⁹ *See Iron Workers Mid-S. Pension Fund v. Terraform Glob., Inc.*, No. 15-cv-6328-BLF, 2016 WL 827374, at *3, *6 (N.D. Cal. Mar. 3, 2016) (granting plaintiff’s motion to remand and request for attorneys’ fees and costs); *Fortunato v. Akebia Therapeutics, Inc.*, 183 F. Supp. 3d 326, 332 (D. Mass. 2016).

alleging only Securities Act claims survived SLUSA's amendments to the Securities Act.²⁰

The petitions raise various questions of congressional intent and statutory interpretation regarding whether SLUSA's amendment to Section 22(a) of the Securities Act—to provide for concurrent state court jurisdiction over Securities Act claims “except as provided in [Section 16] with respect to covered class actions”—eliminated state courts' concurrent jurisdiction over all covered class actions or only over covered class actions based on the specific state law claims precluded by Section 16. The Supreme Court's conference on the first filed petition was originally scheduled for September 2016. In October, the Court invited the Acting Solicitor General to file a brief presenting the federal government's views, which has not been filed to date. The second petition has not been fully briefed.

The issue of whether state courts retain concurrent jurisdiction in such cases determines if the procedural protections established by the Private Securities Litigation Reform Act apply uniformly to class actions involving Securities Act claims.

Application of *Halliburton II*

In 2016, several district and circuit courts also continued to address issues left open by the Supreme Court's 2014 decision in *Halliburton Co. v. Erica P. John Fund, Inc.*²¹ (*Halliburton II*), which held that defendants may rebut the fraud-on-the-market presumption of reliance established in *Basic Inc. v. Levinson*²² at the class certification stage with evidence that alleged misrepresentations did not affect the stock's market price.²³ A decision by the Eighth Circuit—*IBEW Local 98 Pension Fund v. Best Buy Co.*²⁴—and several decisions from the Southern District of New York that are now subject to appeals

before the Second Circuit—*In re Petrobras Securities Litigation*,²⁵ *Strougo v. Barclays PLC*,²⁶ and *In re Goldman Sachs Group, Inc. Securities Litigation*²⁷—considered the circumstances under which plaintiffs can satisfy their burden to invoke the fraud-on-the-market presumption and defendants can satisfy their burden to rebut that presumption.²⁸

The cases are important because class certification may hinge on whether the fraud-on-the-market presumption applies. Without the presumption, individualized questions of reliance would predominate over common questions, precluding class certification under Rule 23(b)(3) of the Federal Rules of Civil Procedure.

— **Best Buy.** In an April 2016 decision, the Eighth Circuit held that defendants rebutted the fraud-on-the-market presumption by showing that the alleged misstatements did not have any “front-end” price impact, meaning that the stock price did not move at the time of the alleged misstatements.²⁹ This decision is significant because, to date, *Best Buy* is the only appellate decision that has interpreted *Halliburton II*'s price impact analysis, and it holds that Federal Rule of Evidence 301's burden-shifting framework, under which plaintiffs maintain the ultimate burden of persuasion, applies to the fraud-on-the-market presumption.³⁰ *Best Buy* also provides a precedent for rejecting the “price maintenance” theory—under which an alleged misstatement can be actionable if it maintains prior inflation rather than

²⁰ *Luther v. Countrywide Fin. Corp.*, 195 Cal. App. 4th 789, 797 (Cal. Ct. App. 2011).

²¹ 134 S. Ct. 2398 (2014).

²² 485 U.S. 224 (1988).

²³ *Halliburton II*, 134 S. Ct. at 2417.

²⁴ 818 F.3d 775 (8th Cir. 2016).

²⁵ 312 F.R.D. 354 (S.D.N.Y. 2016).

²⁶ 312 F.R.D. 307 (S.D.N.Y. 2016).

²⁷ No. 10 Civ. 3461(PAC), 2015 WL 5613150 (S.D.N.Y. Sept. 24, 2015).

²⁸ An appeal before the Fifth Circuit—of the district court's decision on remand from the Supreme Court in *Erica P. John Fund, Inc. v. Halliburton Co.*, 309 F.R.D. 251 (N.D. Tex. 2015)—was stayed in late December 2016 after the parties announced a settlement.

²⁹ *Best Buy*, 818 F.3d at 782-83.

³⁰ *Id.*

directly increasing a stock price—in certain circumstances.

- **Petrobras.** The district court in *Petrobras* held that direct evidence of market efficiency is not necessary for a plaintiff to invoke the fraud-on-the-market presumption, and that if the indirect evidence shows a large and well-functioning market for a stock, “common sense” suggests that the market price will respond to material disclosures.³¹ Although it considered direct evidence unnecessary, the court nonetheless concluded that plaintiffs had presented sufficient direct evidence of market efficiency even though their expert performed an empirical test that did not consider whether the stock price moved in the appropriate direction in response to news, reasoning that such “directionality” is not essential because it goes to whether the price accurately reflects the security’s underlying value.³² This ruling is significant because it could allow a plaintiff to invoke the fraud-on-the-market presumption even if the stock price does not move in the appropriate direction following the release of news, which is an indication of market inefficiency. This decision is before the Second Circuit on a Rule 23(f) appeal.
- **Strougo.** In *Strougo*, the district court found that plaintiffs’ indirect evidence of market efficiency, including the high volume of stock traded on a large national market and heavy analyst coverage, was sufficient to invoke the fraud-on-the-market presumption without any direct empirical evidence of cause and effect (such as could be shown with an event study).³³ This holding is noteworthy because it could allow a plaintiff to obtain class certification against any large company that is publicly traded without any direct evidence of market efficiency. The court also held that defendants did not show lack of price impact, notwithstanding the absence of front-end impact,

because they failed to establish by a preponderance of the evidence that alleged corrective disclosures had not contributed to a drop in the stock price.³⁴

- **Goldman.** Applying a preponderance of evidence standard, the district court in *Goldman* likewise held that defendants failed to show lack of price impact despite the lack of front-end impact because they did not “provide conclusive evidence that no link exists between” the alleged corrective disclosures and a drop in the stock price.³⁵ The district court’s decisions on price impact in *Strougo* and *Goldman* are significant, in part because they placed the ultimate burden of persuasion on defendants to disprove price impact, rather than merely placing a burden of production on defendants to offer evidence that would support a finding of lack of price impact. The Second Circuit is also considering Rule 23(f) appeals in *Strougo* and *Goldman*.

Application of *Omnicare*

In *Tongue v. Sanofi*,³⁶ the Second Circuit applied the standards set out in the Supreme Court’s 2015 *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund* decision³⁷ in affirming the dismissal of plaintiffs’ Exchange Act and Securities Act claims concerning statements of opinion.³⁸ The circuit court explained that it agreed with the district court and was writing principally to consider the impact of *Omnicare*, which was decided after the district court issued its decision.³⁹ *Sanofi* is one of the first circuit court decisions applying *Omnicare*.

³⁴ *Id.* at 325, 327.

³⁵ *In re Goldman Sachs Grp., Inc. Sec. Litig.*, 2015 WL 5613150, at *4 n.3, *6-7.

³⁶ 816 F.3d 199 (2d Cir. 2016).

³⁷ 135 S. Ct. 1318 (2015).

³⁸ *Sanofi*, 816 F.3d at 214.

³⁹ *Id.* at 203.

³¹ *In re Petrobras Sec. Litig.*, 312 F.R.D. at 367.

³² *Id.* at 367, 370.

³³ *Strougo*, 312 F.R.D. at 322-23.

Omnicare held that a statement of opinion may be actionable as a material misstatement if the opinion is not truly held or contains embedded facts that are untrue, and may be actionable as a material omission if a reasonable investor would understand the statement to convey facts about how the speaker formed the opinion that are inconsistent with actual facts that are not disclosed.⁴⁰ In applying this standard in *Sanofi*, the Second Circuit emphasized it does not require an issuer to disclose every fact cutting against its projections.⁴¹ Instead, a court applying *Omnicare* should consider whether the alleged omissions would conflict with the statements or a reasonable investor's interpretation of the statements, taking into account the full context of the statements, plaintiffs' level of sophistication, the customs and practices of the industry, the caveats and disclaimers to the statements, and other publicly available information.⁴²

The Second Circuit thus confirmed that while *Omnicare* may have expanded the potential bases for liability for opinion statements, satisfying that standard remains "no small task."⁴³

Application of *Morrison*

District and circuit courts in 2016 also continued to grapple with the framework set out in the Supreme Court's watershed 2010 decision in *Morrison v. National Australia Bank Ltd.*⁴⁴ regarding the extraterritorial application of the securities laws. *Morrison* established that the federal securities laws apply only in connection with: (1) transactions in securities listed on domestic exchanges; and (2) domestic transactions in other securities.⁴⁵

In 2016, courts considered how this framework should apply to (i) unsponsored American Depositary Receipts (ADRs), (ii) securities that are listed, but not

traded, on a U.S. exchange and settled through a clearinghouse in the United States, and (iii) securities obtained through a merger agreement.

— **Stoyas.** In *Stoyas v. Toshiba Corp.*,⁴⁶ the Central District of California held that the Exchange Act did not apply to plaintiffs' over-the-counter (OTC) transactions in unsponsored ADRs, which are securities traded in the United States without the issuer's authorization or involvement.⁴⁷ In declining to extend the federal securities laws to issuers of the securities underlying such unsponsored ADRs, the court disagreed with plaintiffs' claim that the OTC market constituted a domestic exchange under *Morrison*'s first prong. As the court explained, the Exchange Act "recognizes a distinction between securities exchanges and OTC markets," and plaintiffs did not plead that the OTC market satisfied the requirements for an "exchange" under the statute or the SEC's regulations.⁴⁸ The court also rejected plaintiffs' argument that their transactions fell within *Morrison*'s second prong, because plaintiffs did not plead that Toshiba listed securities in the United States or undertook any affirmative act in connection with the sale of securities in the United States.⁴⁹ While Exchange Act claims do not require privity and *Morrison* did not squarely address the issue presented, its reasoning and policy rationale indicate that "[s]ome affirmative act" by a foreign issuer "in relation to the purchase or sale of securities is required" to satisfy *Morrison*'s second prong.⁵⁰ *Stoyas* is currently on appeal before the Ninth Circuit. The decision likely will impact securities litigation concerning domestic purchases of unsponsored ADRs.

⁴⁰ *Omnicare*, 135 S. Ct. at 1332.

⁴¹ *Sanofi*, 816 F.3d at 212.

⁴² *Id.* at 211, 214.

⁴³ *Id.* at 210 (quoting *Omnicare*, 135 S. Ct. at 1332).

⁴⁴ 561 U.S. 247 (2010).

⁴⁵ *Id.* at 267.

⁴⁶ No. CV 15-04194 DDP (JCx), 2016 WL 3563084 (C.D. Cal. May 20, 2016).

⁴⁷ *Id.* at *11.

⁴⁸ *Id.* at *7.

⁴⁹ *Id.* at *11.

⁵⁰ *Id.*

— **Petrobras.** The district court in *In re Petrobras Securities Litigation*⁵¹ dismissed certain claims of individual plaintiffs regarding purchases of Petrobras global notes that did not occur on a U.S. exchange, following an earlier decision dismissing similar claims by class plaintiffs.⁵² In the decision on the class claims, the district court held that transactions must actually take place on a U.S. exchange to satisfy the first prong of *Morrison*—i.e., transactions in securities listed on domestic exchanges—and allegations that securities are merely listed on domestic exchanges are not enough.⁵³ Reviewing the individual plaintiffs’ complaints, the district court noted that since plaintiffs did not allege that they purchased their Petrobras notes on a U.S. exchange, their claims were precluded unless they satisfied *Morrison*’s second prong—i.e., domestic transactions in other securities.⁵⁴ Under the Second Circuit’s interpretation of *Morrison*’s second prong, plaintiffs were required to affirmatively plead that (1) they incurred irrevocable liability in the United States; or (2) title was transferred in the United States.⁵⁵ The district court held that plaintiffs could not satisfy this standard with “conclusory assertions that irrevocable liability was incurred or that title passed,” and instead were required to “allege more specific facts, ‘including, but not limited to, facts concerning the formation of the contracts, the placement of purchase orders, the passing of title, or the exchange of money.’”⁵⁶ Plaintiffs’ allegations that their purchases settled through the Depository Trust Company (DTC) in New York did not suffice, because “the mechanics of DTC settlement involve neither the substantive

indicia of a contractual commitment necessary to satisfy *Absolute Activist*’s first prong nor the formal weight of a transfer of title necessary for its second.”⁵⁷ The *Petrobras* decisions are significant because they reject efforts to bypass *Morrison* through conclusory assertions or proxies such as the domestic listing of securities or DTC settlement. The court’s holding regarding DTC settlement is particularly significant, as many securities transactions settle through DTC.

— **Vivendi.** In addition to ruling on various other issues, the Second Circuit in *In re Vivendi, S.A. Securities Litigation*⁵⁸ agreed with the district court’s decision to dismiss under *Morrison* the securities fraud claims of American shareholders who acquired shares in the course of a merger between French company Vivendi and two other foreign companies.⁵⁹ Plaintiffs contended that the shareholders incurred “irrevocable liability” in the United States because they were located in the United States when the merger was completed.⁶⁰ The Second Circuit disagreed, however. The court explained that incurring irrevocable liability means “‘becom[ing] bound to effectuate the transaction’ or ‘entering into a binding contract to purchase or sell securities.’”⁶¹ Since the American shareholders who acquired Vivendi shares through the merger were not parties to the merger agreement, their location in the United States was insufficient to qualify the merger as a domestic transaction.⁶² *Vivendi* is an important reminder of the transaction-specific focus of *Morrison*’s domestic transaction test as interpreted by the circuit and district courts.

⁵¹ 152 F. Supp. 3d 186 (S.D.N.Y. 2016).

⁵² *Id.* at 192.

⁵³ *In re Petrobras Sec. Litig.*, 150 F. Supp. 3d 337, 340 (S.D.N.Y. 2015).

⁵⁴ *In re Petrobras Sec. Litig.*, 152 F. Supp. 3d at 192-93.

⁵⁵ *Id.* (quoting *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 69 (2d Cir. 2012)).

⁵⁶ *Id.* at 193 (quoting *Absolute Activist*, 677 F.3d at 70).

⁵⁷ *Id.*

⁵⁸ 838 F.3d 223 (2d Cir. 2016).

⁵⁹ *Id.* at 265.

⁶⁰ *Id.*

⁶¹ *Id.* (quoting *Absolute Activist*, 677 F.3d at 67).

⁶² *Id.*

Vivendi Class Action and Opt-Out Action

The Second Circuit also decided several securities law issues in appeals of the district court's partial final judgment after a jury verdict against Vivendi on class plaintiffs' Exchange Act claims, as well as the district court's decision excluding certain foreign shareholders from the class.⁶³ In a related opt-out action, *GAMCO Investors, Inc. v. Vivendi Universal, S.A.*,⁶⁴ the Second Circuit decided plaintiffs' appeal of the district court's judgment for Vivendi following a bench trial on Vivendi's rebuttal of the fraud-on-the-market presumption.⁶⁵ The Second Circuit affirmed the district court's rulings in both actions.

The Second Circuit's decisions in the class action and opt-out litigation against Vivendi may impact class certification in particular. The decision in the class action has implications for challenges to the fraud-on-the-market presumption and efforts to narrow a class. In addition, the decision in the *GAMCO* opt-out litigation shows one way to rebut the fraud-on-the-market presumption.

Class Action. Among other issues in the appeal in the class action, the Second Circuit rejected the company's argument that alleged misstatements must correlate with simultaneous increases in inflation to have price impact, joining the Seventh and Eleventh Circuits in concluding that defendants may not defeat securities fraud claims based on the fact that the alleged misstatements are not associated with increases in inflation.⁶⁶ According to the court, the company assumed incorrectly that preexisting inflation in its stock price would have remained, even absent the alleged misstatements.⁶⁷ The court stated that the

company's position also rested on the erroneous premise that because the company lacked a duty to disclose, it should be shielded from liability for the statements it chose to make.⁶⁸

The court also disagreed with defendant's position that plaintiffs failed to prove loss causation because the liquidity risk concealed by the alleged misstatements never materialized into an actual liquidity crisis.⁶⁹ The court held that the evidence supported the jury's finding that plaintiffs suffered loss on the days when the truth about the liquidity risk was revealed, notwithstanding that the risk never actually materialized.⁷⁰

For their part, class plaintiffs cross-appealed the district court's decision to exclude certain foreign shareholders from the class based on concerns that a class judgment would be denied preclusive effect in the courts of their countries.⁷¹ The Second Circuit concluded that it was within the district court's discretion to consider—as part of its assessment under Rule 23(b)(3) whether a class action would be superior—the risk that a foreign court will deny preclusive effect to a class judgment.⁷² As the Second Circuit explained, in the event of a judgment in a defendant's favor, it is “entitled to a victory no less broad than a defeat would have been.”⁷³ The Second Circuit upheld the district court's decision since plaintiffs failed to identify evidence suggesting that courts in the relevant countries would recognize a class judgment.⁷⁴

Opt-Out Action. In the appeal in the *GAMCO* opt-out litigation, the Second Circuit held that there was sufficient evidence supporting the district court's

⁶³ *Id.* at 232-33.

⁶⁴ 838 F.3d 214 (2d Cir. 2016).

⁶⁵ *Id.* at 216.

⁶⁶ *In re Vivendi, S.A. Sec. Litig.*, 838 F.3d at 259.

⁶⁷ *Id.* at 257-58.

⁶⁸ *Id.*

⁶⁹ *Id.* at 261.

⁷⁰ *Id.* at 263.

⁷¹ *Id.*

⁷² *Id.* at 263-64.

⁷³ *Id.* at 264 (quoting *Bersch v. Drexel Firestone Inc.*, 519 F.2d 974, 996-97 (2d Cir. 1975), abrogated on other grounds by *Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247 (2010)).

⁷⁴ *Id.*

determination that the company rebutted the fraud-on-the-market presumption by proving that plaintiff would still have purchased the securities even if it had known of the alleged fraud.⁷⁵ After reviewing the evidence regarding the fundamentals of plaintiff's investment analysis and how plaintiff would have analyzed the allegedly concealed liquidity problems, the Second Circuit concluded that it was not clearly erroneous for the district court to find that knowledge of the liquidity problems would not have impacted plaintiff's investment decisions.⁷⁶

The Second Circuit's decisions in the class action and opt-out litigation against Vivendi may impact class certification in particular. The decision in the class action has implications for challenges to the fraud-on-the-market presumption and efforts to narrow a class. In addition, the decision in the *GAMCO* opt-out litigation shows one way to rebut the fraud-on-the-market presumption.

Household Settlement

In 2016, defendants reached a \$1.575 billion settlement resolving a 14-year securities class action, *Jaffe v. Household International, Inc.*⁷⁷ After a \$2.46 billion jury verdict for plaintiffs following a trial on Exchange Act claims against the company and certain of its executives, the Seventh Circuit reversed and remanded for a new trial on whether firm-specific non-fraud factors had contributed to the stock price drop and the executives were liable for certain allegedly fraudulent statements.⁷⁸ The parties settled the case before the second trial was set to begin.

Household is significant both because it is one of the few securities class actions that proceeded to trial and because of the size of the settlement, which is one of the largest ever in a securities case.

⁷⁵ *GAMCO Inv'rs, Inc.*, 838 F.3d at 218-19.

⁷⁶ *Id.* at 220-21.

⁷⁷ No. 02-C-05893 (N.D. Ill.).

⁷⁸ *Glickenhau & Co. v. Household Int'l, Inc.*, 787 F.3d 408, 433 (7th Cir. 2015).

M&A Litigation

Trends in Disclosure-Only Settlements After *Trulia*

The Delaware Court of Chancery's January 2016 decision in *In re Trulia, Inc. Stockholder Litigation*⁷⁹ made it clear that the court would no longer approve disclosure-only settlements unless the supplemental disclosures were "plainly material."⁸⁰ Since the decision, far fewer lawsuits challenging mergers have been filed in Delaware. A report from Cornerstone Research found that only 64 percent of all public deals valued at over \$100 million faced litigation during the first half of 2016, which was the lowest rate since 2009.⁸¹

We expect that this trend will continue and that other plaintiffs will attempt to file suit in forums that may be more willing to approve disclosure-only settlements. Such attempts, however, may be hampered by exclusive forum bylaws, which have been widely adopted by public companies. While some corporations may be willing to waive such bylaws in the hope of securing a quick, disclosure-only settlement in another forum, this may be of limited value because it remains to be seen how receptive courts outside of Delaware will be to that approach. Furthermore, some state courts have indicated that they may adopt *Trulia*'s enhanced scrutiny of disclosure-only settlements.⁸²

As a likely result of *Trulia*, an increased number of merger challenges were filed in federal court in 2016, as noted above.⁸³ A decision by the Seventh Circuit in

⁷⁹ 129 A.3d 884 (Del. Ch. 2016).

⁸⁰ *Id.* at 898.

⁸¹ Cornerstone Research, *Shareholder Litigation Involving Acquisitions of Public Companies—Review of 2015 and 1H 2016 M&A Litigation* 1 (2016), <https://www.cornerstone.com/Publications/Reports/Shareholder-Litigation-Involving-Acquisitions-2016>.

⁸² See, e.g., *In re NewBridge Bancorp S'holder Litig.*, No. 15 CVS 10047, 2016 WL 6885882, at *1 (N.C. Super. Ct. Nov. 22, 2016).

⁸³ Kevin M. LaCroix, *2016 Securities Lawsuit Filings Surge to Record Levels*, The D&O Diary (Jan. 2, 2017), <http://www.dandodiary.com/2017/01/articles/securities-litigation/2016-securities-lawsuit-filings-surge-record-levels/>.

August suggests, however, that plaintiffs' forum-shopping efforts may be unsuccessful. In *In re Walgreen Co. Stockholder Litigation*,⁸⁴ Judge Posner endorsed the "plainly material" standard set forth in *Trulia* and was highly critical of disclosure-only settlements.⁸⁵ We expect that this opinion will be cited by other federal judges reviewing such settlements.

Defendants, for their part, responded to courts' continued disapproval of disclosure-only settlements by increasingly using supplemental disclosures to moot any disclosure claims brought by plaintiffs in merger challenges. Of course, to the extent plaintiffs' counsel manages to obtain supplemental disclosures on behalf of stockholders, counsel may seek a mootness fee reflecting the "benefit" achieved for stockholders of the additional disclosures. Applications for mootness fees are subject to a lower standard—a disclosure that is merely "helpful," which "provides some benefit" to stockholders, may support a mootness fee award, even if it is not material.⁸⁶ Nonetheless, mootness fee applications will no doubt continue to be carefully reviewed by the Court of Chancery to ensure that they do not simply replace disclosure-only settlements.⁸⁷

Claim Extinguishment, MFW, and the Proper Timing of Disclosure Claims

In the wake of the Delaware Supreme Court's 2015 decision in *Corwin v. KKR Financial Holdings*,⁸⁸ decisions by the Delaware Supreme Court and the Court of Chancery further strengthened the deference afforded to merger transactions approved by informed,

disinterested, and uncoerced stockholders. In *Singh v. Attenborough (Zales III)*,⁸⁹ the Delaware Supreme Court explained that such stockholder approval has a cleansing effect on a transaction and makes it subject to the irrebuttable business judgment rule, which extinguishes all claims except those for waste.⁹⁰

Questions nevertheless remain regarding the applicability of *Corwin*'s cleansing effect. In *City of Miami General Employees v. Comstock (C&J Energy)*,⁹¹ Chancellor Bouchard implied that claim extinguishment could be precluded by several different triggers for entire fairness review, including alleged conflicts of target board members.⁹² In *Larkin v. Shah*,⁹³ however, Vice Chancellor Slight took the view that claim extinguishment could apply to all transactions except those involving controlling stockholders.⁹⁴

We expect that the court will continue to focus on ensuring that stockholders receive the most complete disclosure possible before any vote takes place. This may facilitate claim extinguishment and redound to the benefit of defendants.

In any event, both opinions highlight the importance of preventing or at least identifying and promptly disclosing conflicts or any deficiencies in sales processes. Robust and timely disclosures of conflicts should be sufficient to prevent post-closing damages awards, although it is likely that controlling stockholder transactions still will be subjected to a

⁸⁴ 832 F.3d 718 (7th Cir. 2016).

⁸⁵ *Id.* at 721, 725.

⁸⁶ *In re Xoom Corp. S'holder Litig.*, C.A. No. 11263-VCG, 2016 WL 4146425, at *3 (Del. Ch. Aug. 4, 2016); *see also La. Mun. Police Emps.' Ret. Sys. v. Black*, C.A. No. 9410-VCN, 2016 WL 790898, at *7 n.53 (Del. Ch. Feb. 19, 2016).

⁸⁷ *In re Xoom Corp. S'holder Litig.*, 2016 WL 4146425, at *4-5 (awarding \$50,000 for fees and costs in ruling on plaintiffs' application for \$275,000 fee); *In re Keurig Green Mountain, Inc. S'holders Litig.*, C.A. No. 11815-CB (Del. Ch. July 22, 2016) (TRANSCRIPT) (denying application for a mootness fee award).

⁸⁸ 125 A.3d 304 (Del. 2015).

⁸⁹ 137 A.3d 151 (Del. 2016).

⁹⁰ *Id.* at 151-52 & n.3.

⁹¹ C.A. No. 9980-CB, 2016 WL 4464156 (Del. Ch. Aug. 24, 2016).

⁹² *Id.* at *1.

⁹³ C.A. No. 10918-VCS, 2016 WL 4485447 (Del. Ch. Aug. 25, 2016).

⁹⁴ *Id.* at *1.

high degree of scrutiny. At least one appeal concerning *Corwin*'s cleansing effect is pending.⁹⁵

Thus, in the coming year the Delaware Supreme Court will likely provide further guidance on the post-closing application of the irrebuttable business judgment rule. In addition, we expect that future opinions will more clearly articulate a framework for determining whether any disclosed acts or omissions are so problematic that they cannot be cleansed through approval by informed and disinterested stockholders.

The Delaware courts also clarified issues regarding the framework adopted in the Delaware Supreme Court's 2014 decision in *Kahn v. M&F Worldwide Corp. (MFW)*⁹⁶ for reviewing "going private" transactions. In *In re Books-A-Million, Inc. Stockholders Litigation*,⁹⁷ Vice Chancellor Laster found that a controlling stockholder's proposal to take the company private had complied with the conditions set forth in *MFW*, such that the transaction would benefit from the "business judgment" level of review.⁹⁸ As a result, defendants prevailed on their motion to dismiss plaintiffs' fiduciary duty claims, avoiding costly and time-consuming discovery and a trial.⁹⁹

The *Books-A-Million* opinion also confirmed that a controlling stockholder has no obligation to sell its shares and does not breach fiduciary duties simply by offering to acquire the minority's shares—even at a price lower than the price that might be available from a third-party bidder—so long as the price offered is within a rational range.¹⁰⁰ The Delaware Supreme Court also strengthened the safe harbor provided to controlling stockholders by *MFW* in one of the court's last opinions of the year, noting that "the pleading stage is an appropriate point to determine if a

transaction complied with *MFW*'s procedural requirements."¹⁰¹

In *Nguyen v. Barrett*,¹⁰² the Delaware Court of Chancery reaffirmed the importance of bringing disclosure claims before closing, when steps can still be taken to achieve an informed stockholder vote. As Vice Chancellor Glasscock stated: "To be clear, where a plaintiff has a claim, pre-close, that a disclosure is either misleading or incomplete in a way that is material to stockholders, that claim should be brought pre-close, not post-close."¹⁰³ The court emphasized that stockholders have a right to a fully informed vote, which cannot be remedied after the vote.¹⁰⁴

We expect that the courts will continue to focus on ensuring that stockholders receive the most complete disclosure possible before any vote takes place. This may facilitate claim extinguishment and redound to the benefit of defendants.

Developments Relating to Aiding and Abetting Liability

In *Zales III*, the Delaware Supreme Court disagreed with the view that "an advisor can only be held liable if it aids and abets a non-exculpated breach of fiduciary duty."¹⁰⁵ While acknowledging that Delaware's "defendant-friendly standard" largely insulates advisors from liability by requiring proof of scienter and effectively immunizing advisors from due-care liability, the court reiterated that an advisor is still subject to aiding and abetting liability if its "bad-faith actions cause its board clients to breach their situational fiduciary duties."¹⁰⁶

⁹⁵ *Comstock*, Notice of Appeal (Del. Ch. Sept. 23, 2016).

⁹⁶ 88 A.3d 635 (Del. 2014).

⁹⁷ C.A. No. 11343-VCL, 2016 WL 5874974 (Del. Ch. Oct. 10, 2016).

⁹⁸ *Id.* at *1.

⁹⁹ *Id.*

¹⁰⁰ *Id.* at *15-16.

¹⁰¹ *Emps. Ret. Sys. of the City of St. Louis v. TC Pipelines GP, Inc.*, No. 291, 2016, 2016 WL 7338592, at *2 n.9 (Del. Dec. 19, 2016).

¹⁰² C.A. No. 11511-VCG, 2016 WL 5404095 (Del. Ch. Sept. 28, 2016).

¹⁰³ *Id.* at *7.

¹⁰⁴ *Ibid.*

¹⁰⁵ *Singh v. Attenborough*, 137 A.3d 151, 152 (Del. 2016).

¹⁰⁶ *Id.* at 152-53 & n.7 (citing *RBC Capital Mkts., LLC v. Jervis*, 129 A.3d 816, 865 (Del. 2015), which upheld advisor's liability on aiding and abetting claim that was based on advisor's "fraud on the board" and allegations that advisor "intentionally duped"

This is a high standard for plaintiffs to meet.¹⁰⁷ Furthermore, as discussed above, prompt and adequate disclosure to the shareholders should result in the application of the business judgment rule to extinguish claims against the advisor just as against the directors. This again highlights the importance for advisors of identifying and disclosing potential conflicts early and completely, as well as repeating those disclosures at appropriate stages of the transaction (e.g., at engagement, when narrowing the field of bidders in an auction, or at signing).

Thus, well-run board processes, including advance inquiries into and consideration of advisor conflicts, in addition to adequate disclosure of any issues in these processes, are now of more value than ever to directors and their advisors.

Developments Regarding Appraisal Rights

Recent Delaware Amendments. In June 2016, certain provisions of the Delaware General Corporation Law governing appraisal proceedings were amended. First, appraisal claims in respect of less than 1 percent of the total outstanding shares of any class or less than \$1 million in consideration will now be dismissed, unless the transaction is a short-form merger.¹⁰⁸ Second, corporations may now make preliminary payments in respect of appraisal claims, thus cutting off statutory interest on the amount of the preliminary payment.¹⁰⁹

The General Assembly did not adopt, however, other proposals intended to reduce “appraisal arbitrage,” such as preventing investors who purchase their shares after the announcement of a merger agreement from exercising appraisal rights. Moreover, although the ability to cut off interest accrual through preliminary payments may reduce appraisal arbitrage somewhat, it

and “purposely misled” directors to cause breach of their duty of care).

¹⁰⁷ See *In re Volcano Corp. S’holder Litig.*, 143 A.3d 727, 750 (Del. Ch. 2016) (a plaintiff faces a high burden “in attempting to plead facts from which a court could reasonably infer that a financial advisor acted with the requisite scienter for an aiding and abetting claim”).

¹⁰⁸ 8 Del. C. § 262(g).

¹⁰⁹ 8 Del. C. § 262(h).

is not likely to eliminate it. That is particularly true if no auction was held, there is a private equity or other financial buyer, or there is a controlling stockholder buyer.

Recent Delaware Opinions. Departing from a trend of accepting the merger price as presumptively representative of fair value in an appraisal action,¹¹⁰ two recent appraisal decisions found that fair value was higher than the merger price. In *In re Appraisal of Dell Inc.*,¹¹¹ Vice Chancellor Laster found that the fair value was 28 percent higher than the merger price (already a 30 percent premium to the market price), and in *In re Appraisal of DFC Global Corp.*,¹¹² Chancellor Bouchard found that the fair value was 7 percent higher than the merger price. The court explained in *Dell* that even if the merger process would pass a traditional fiduciary duty analysis, it still may not be the best measure of value.¹¹³ In *DFC*, the court asserted that the merger price “is reliable only when the market conditions leading to the transaction are conducive to achieving a fair price.”¹¹⁴

Thus, in the absence of a third-party, arms-length sale process or a meaningful go-shop, the court appears to be less likely to accept the merger price. The risk that the court will determine that fair value is significantly above the deal price may be greatest in controlling stockholder “going private” transactions and private equity (or other financial sponsor) acquisitions, if a robust market check is not always feasible, if

¹¹⁰ See, e.g., *Merion Capital LP v. BMC Software, Inc.*, C.A. No. 8900-VCG, 2015 WL 6164771 (Del. Ch. Oct. 21, 2015); *LongPath Capital, LLC v. Ramtron Int’l Corp.*, C.A. No. 8094-VCP, 2015 WL 4540443 (Del. Ch. June 30, 2015); *Merlin Partners LP v. AutoInfo, Inc.*, C.A. No. 8509-VCN, 2015 WL 2069417 (Del. Ch. Apr. 30, 2015); *In re Appraisal of Ancestry.com, Inc.*, C.A. No. 8173-VCG, 2015 WL 399726 (Del. Ch. Jan. 30, 2015).

¹¹¹ *In re Appraisal of Dell Inc.*, C.A. No. 9322-VCL, 2016 WL 3186538 (Del. Ch. May 31, 2016).

¹¹² *In re Appraisal of DFC Global Corp.*, C.A. No. 10107-CB, 2016 WL 3753123 (Del. Ch. July 8, 2016) (using discounted cash flow model, comparable company analysis, and the transaction price).

¹¹³ *Dell*, 2016 WL 3186538, at *26-27.

¹¹⁴ *DFC*, 2016 WL 3753123, at *1.

management may not be fully committed to facilitating alternative bidders, or if the valuation is tied to hurdle rates rather than company fundamentals.

As a result of this increased appraisal risk, practitioners are considering the possible inclusion of a closing condition in certain transactions so that the acquiror is not required to close if appraisal rights are exercised by more than a specified percentage of the outstanding shares.

Although the recent appraisal opinions do not preclude a finding that merger price equals fair value in these types of transactions, they do indicate that such transactions will be subject to additional scrutiny. *DFC* and *Dell* are currently on appeal to the Delaware Supreme Court—we expect that the court will provide additional guidance regarding appraisal rights.¹¹⁵

In any event, appraisal actions such as *Dell* and *DFC* have caused parties to consider negotiating appraisal conditions in a transaction. Although in an appraisal action the higher price is only payable to those stockholders who validly exercise appraisal rights, the exercise of those rights by a meaningful percentage of the outstanding shares can materially increase the total cost of an acquisition.

As a result of this increased appraisal risk, practitioners are considering the possible inclusion of a closing condition in certain transactions so that the acquiror is not required to close if appraisal rights are exercised by more than a specified percentage of the outstanding shares.¹¹⁶

¹¹⁵ *DFC*, Notice of Appeal (Del. Ch. Oct. 21, 2016); *Dell*, Notice of Appeal (Del. Ch. Nov. 22, 2016).

¹¹⁶ Victor Lewkow & Rob Gruszecki, *Negotiating Appraisal Conditions in Public M&A Transactions*, Cleary M&A and Corporate Governance Watch Blog (Oct. 26, 2016), <http://www.clearymawatch.com/2016/10/negotiating-appraisal-conditions-public-ma-transactions/#more-2254>.

Looking Ahead

In the coming months, we will be closely monitoring the dockets for decisions by:

The Supreme Court on the extension of *American Pipe* tolling to the statutes of repose applicable to securities claims.

The Supreme Court on the petitions for certiorari regarding state courts' jurisdiction over class actions asserting Securities Act claims.

The Second Circuit in *Petrobras*, *Strougo*, and *Goldman* regarding the fraud-on-the-market presumption.

The Delaware courts and federal and state courts regarding *Trulia*'s application to disclosure-only settlements.

The Delaware Supreme Court in *C&J Energy*, on claim extinguishment, and *DFC* and *Dell*, on appraisal rights.