KESSLERTOPAZ MELTZERCHECK LLP

Closing the Courtroom Doors on Shareholders

PAPERS 10th Annual Spring Forum

The Hilton Hotel – Harrisburg, PA

Wednesday, May 28, 2014 – 3:45PM – 4:45PM

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Introduction

- *Halliburton* Oral Argument
- The Lingering Effects of *Morrison v. National Australia Bank*
- Mandatory Arbitration

The Fraud-on-the-Market Presumption

- Created in *Basic v. Levinson* (1988).
- Presumption is available to establish reliance in a securities fraud claim in situations where the security is traded on a well organized, and presumably efficient, market.
- Plaintiffs need not prove actual ("eyeball") reliance on a particular statement.

2 Questions Before Court

- Should the Court overrule or substantially modify the fraud-on-the-market presumption established in *Basic v. Levinson?*
- Where plaintiff invokes the presumption of reliance to seek class certification, may defendant rebut the presumption by introducing evidence the alleged misrepresentations did not distort market price of stock?

Oral Argument – March 5th

- Lasted 61 minutes.
- The Justices were active and prepared.
- Aaron Streett argued on behalf of Petitioner, David Boies on behalf of Respondent, Malcolm Stewart on behalf of the United States and supporting Respondent.

Justice Roberts: The Deciding Vote?

- Prior to oral arguments, Justice Roberts was the only Justice who had not indicated how he may vote.
- In 2013 Justices Thomas, Scalia, Kennedy, and Alito all indicated that they were willing to revisit *Basic.*
- Justices Kagan, Sotomayor, Ginsburg, and Breyer presumed less likely to overrule *Basic.*

Question 1: Should the court overrule or substantially modify the fraud-on-the-market presumption established in *Basic v. Levinson?*

- **Streett:** "We're saying both that [Basic] was wrong when decided and that certain things have changed."
- "[T]he Basic-generated regime of class actions is harming the very investors that it's supposed to help."
- **Boies:** "[T]he premise of the Basic decision was not economic theory…"
- **Stewart:** "[I]f Basic were overruled…certainly the consequences are potentially dramatic."
  - Institutional investor amicus brief

Private v. Public

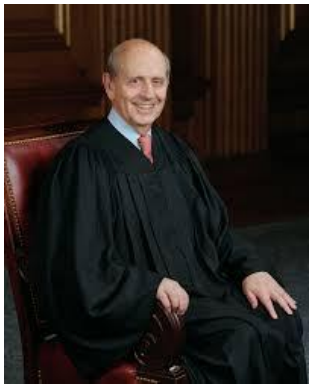
Case	SEC/DOJ Recovery/ Fine	Private Action Settlement Year	Private Action Settlement Amount
Enron Corporation	$515 Million	2010	$7.242 Billion
WorldCom, Inc.	$750 Million	2012	$6.194 Billion
Freddie Mac	$50 Million	2007	$410 Million
Tyco International Ltd.	$53 Million	2007	$3.2 Billion
AOL Time Warner, Inc.	$300 Million	2006	$2.5 Billion
Bank of America	$150 Million	2012	$2.425 Billion

The Justices' Questions

Justice Ginsburg: "I believe that in Basic, Justice Blackmun said that there is this economic theory, but also…probability and common sense would lead to this presumption – this rebuttable presumption. So he wasn't relying strictly on an economic theory."

"You admitted that the 23(a) factors are met, commonality and typicality…if you have someone to whom a direct representation was made, that person is not a proper member of this class as a discrete question…The typical investor in a Basic class is somebody who no representation was made to that person directly."

Justice Kagan: "Are you just saying Basic is wrong, or are you saying that something has changed since Basic? Because usually that's what we look for when we decide whether to reverse a case, something that makes the question fundamentally different now than when we decided it."



Justice Breyer: "All we're trying to say is, is it a common issue and it's not a red herring to throw in whether the markets incorporate information because normally they do, period."

The Justices' Questions

- **Justice Scalia:** "I…agree that the PSLRA assumes Basic…so those provisions would sort of be useless if Basic were entirely overruled."

Justice Alito: "To say that false representation affects the market price is quite different from saying that if affects the market price almost immediately, and it's hard to see how the Basic theory can be sustained unless it does affect the market price almost immediately in what Basic described as an efficient market."

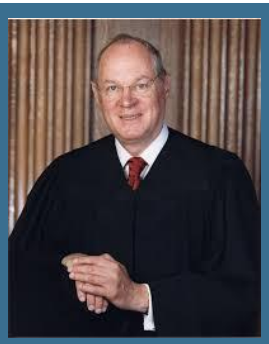
- **Chief Justice Roberts:** "How am I supposed to review the economic literature and decide which of you is correct [on interpretation of the efficient market theory]."

Question 2: Where plaintiff invokes the presumption of reliance to seek class certification, may defendant rebut the presumption by introducing evidence the alleged misrepresentations did not distort market price of stock?

- **Streett:** "Because even in a generically efficient market in a binary sense, misrepresentations may not distort the market price."
- **Boies:** "[I]t would inevitably put off the class certification stage because now you would have to have a discovery on issues that are ordinarily considered to be merits issues."
- "The idea that the class certification is not a – a important step is simply wrong."
- **Stewart:** "I don't think that the consequences would be nearly so dramatic. In fact if anything, that would be a net gain to plaintiff's because plaintiffs already have to prove price impact at the end of the day."

Question 2 Continued

The Court spent the majority of the time discussing (and debating) the so called "midway position."



Justice Kennedy: "Would you address briefly the position taken by the law professors, I call it the midway position, that says there should be an event study."

- Concerned with whether an event study would be more costly and time consuming.

"And so then the question would be since you're going to have it anyway, why not have it at the class certification stage?"

Justice Sotomayor: "I don't see how this is a midpoint. If you're going to require proof of price impact, why not do away with market efficiency?"

"So why bother with Basic at all if we're going to do what you're suggesting – turn the class certification into a full-blown merits hearing on whether loss causation has been proven?

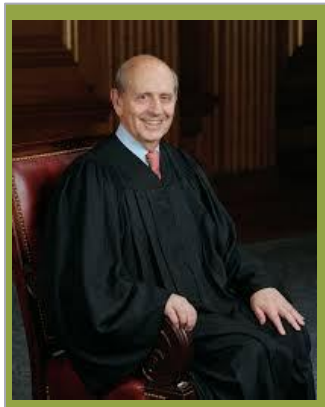
The Justices' Questions

Justice Alito: "Do we know how often defendants have been successful in rebutting the presumption?"

Justice Scalia: "How many of these cases continue once there has been class certification? Do you have any idea?...Very Few. Once you get the class certified, the case is over, right?"

Justice Ginsburg: "What difference does it make at what stage the rebuttal is allowed? What practical difference does it make if the inquiry is made at the certification stage rather than the merits stage?

The Justices' Questions



Justice Breyer: "Now what reason is there for purposes of certification to go beyond the efficient market? […]They all bought on the exchange. It's not an irrelevancy. Everybody would have to say it's certainly relevant to the case and they all have the issue in common.

Justice Sotomayor: "So your preference would be to make the plaintiff bear the burden or just for defendants to be able to rebut the price impact at a class certification?"

Chief Justice Roberts: "Well how hard is it to show that the New York Stock Exchange is an efficient market?"

"So I would think the event study they are talking about would be a lot more difficult and laborious to demonstrate than market efficiency in a typical case."

"You don't dispute, though, that you usually don't get to the merits stage once the class has been certified, do you?"

Possible Outcomes

- **Option 1:** The Supreme Court leaves *Basic* intact and securities litigation continues in its current form.
- **Option 2:** The Supreme Court overrules *Basic* and plaintiffs will be required to prove *actual* reliance.
- **Option 3:** The Supreme Court adopts some sort of middle ground in which evidence of price impact might be required at the certification stage.

Predictions

- Decision expected by June 2014.

Increasing Non-U.S. Litigation/ Importance of Monitoring

- The Supreme Court ruled in *Morrison v. National Australia Bank* (2010) that the Securities Exchange Act of 1934 only applies to transactions on domestic exchanges and domestic transactions in other securities.
- We are not aware of any custodians that provide advice on non-U.S. cases or that will ever file claims in cases that settle outside the U.S. This is very important considering the size of many of these cases.

Morrison Radically Reshaped Landscape For Global Investors

- Supreme Court Did Away with 40 Years of Jurisprudence
- U.S. investors are **NOT** protected by U.S. law when making investments on non-U.S. exchanges (even when defrauded in U.S.).
  - Conduct and Effect Test Gone
  - Replaced with Transactional Test

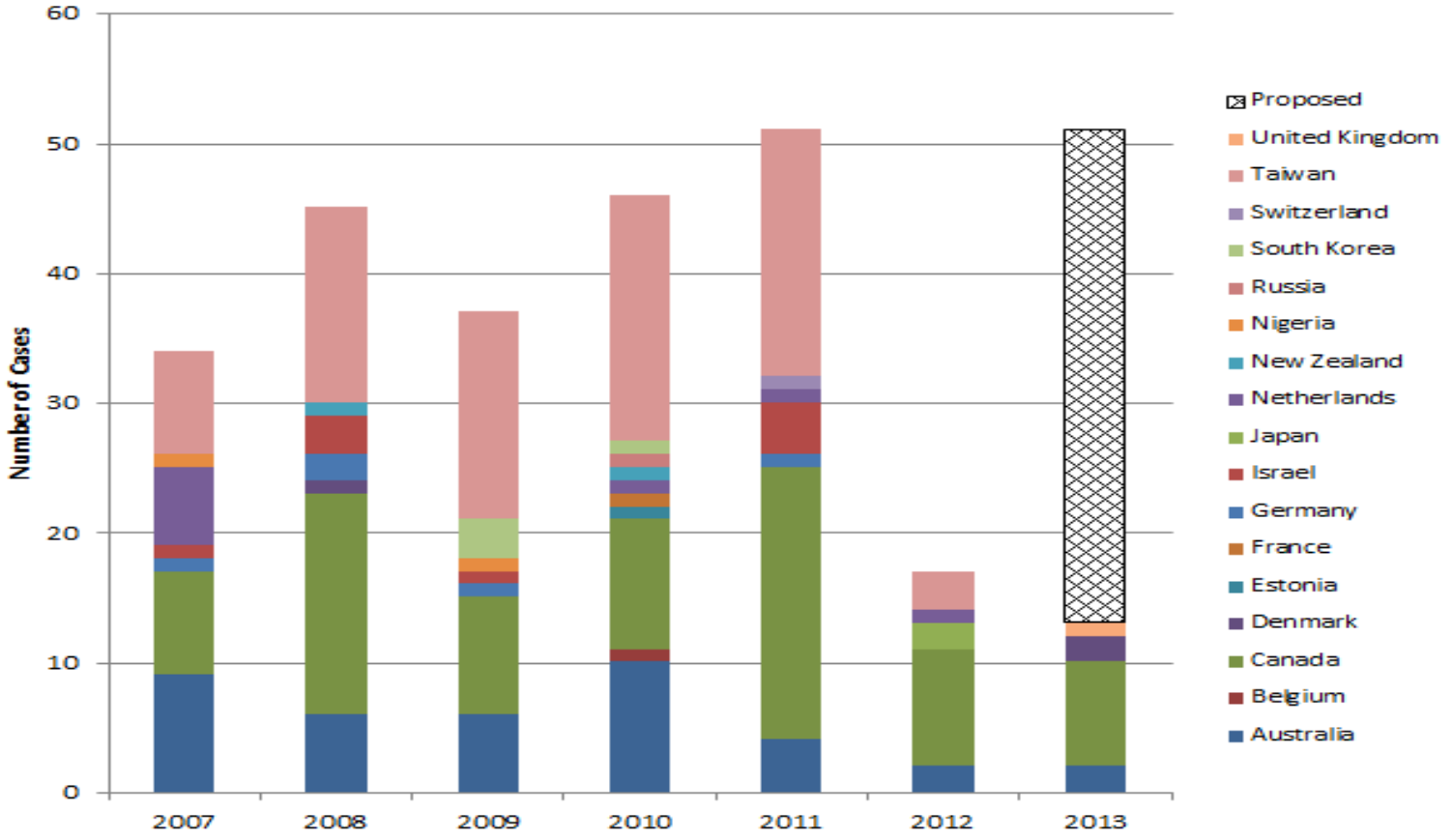
Allocation to Non-U.S. Equities

- Non-U.S. securities play an important diversification role.
  - NCPERS 2013 Study: average allocation to international equity is 17%.

Possible Solutions

- Invest only (more) in U.S. listed securities.
  - Contrary to current asset allocations for most public pension funds.
- Pursue claims in state courts (e.g. BP).
  - Only available in limited cases.
- Monitor actions worldwide (currently more than 90 actions in 13 countries).
- Pursue claims for fraud in non-U.S. courts (under proper circumstances) and file claim forms (U.S.-based custodians not doing this).
  - If the rates of non-participation are the same as in the U.S., the GOAL Group estimates that $2.02 billion will be left on the table each year.
- Lobby Congress/SEC/Others for a legislative fix that would overturn *Morrison.*

Non-U.S. Securities Fraud Actions



Global Settlement Estimates

According to the GOAL Group, settlements in securities class actions outside the U.S. are estimated to reach USD $8.3 Billion annually by 2020.

Company Domiciled/Quoted	Predicted Annual Class Action Settlements 2020
	U.S. $ billions
South & Central America	**USD $ 0.620 bn**
Includes: Argentina, Brazil, Chile, Colombia, Mexico and Peru	
Canada	**USD $ 0.542 bn**
Asia - Pacific (minus China)	**USD $ 3.435 bn**
Includes: Australia, India, Indonesia, Japan, Korea, Malaysia, Philippines, Singapore, Sri Lanka, Taiwan and Thailand	
Europe	**USD $ 3.288 bn**
Includes: Austria, Belgium, Cyprus, Eire, France, Germany, Greece, Hungary, Italy, Luxembourg, Malta, Netherlands, Poland, Portugal, Russia, Scandinavia, Slovenia, Spain, Switzerland, Turkey and UK	
Africa	**USD $ 0.258 bn**
Includes: Egypt, Morocco and South Africa	
Middle East	**USD $ 0.150 bn**
Includes: Israel, Jordan and Saudi Arabia	
Total World (minus China)	**USD $ 8.293 bn**

Difficulties Associated with Foreign Jurisdiction Litigation

1. Less developed securities laws (than in the United States).
2. Identifying and retaining counsel experienced local counsel.
3. Time differences and travel requirements.
4. Difficulty in obtaining and enforcing a judgment.
5. Communication and language barriers.
6. Loser pay models.
7. Limited or lack of contingency arrangements in most jurisdictions.
8. Necessity of litigation funders or insurance.
9. Different discovery obligations and burdens of proof (than in the United States).
10. Most of these cases are cases of first impression.

Notable Non-U.S. Cases

The Netherlands

- **Royal Dutch Shell –** Groundbreaking case. $352 million recovered on behalf of non-US investors.
- **Fortis** - Misrepresented the value of its collateralized debt obligations, exposure to subprime RMBS, and the failure of its acquisition of ABN Amro Holding NV.

Australia

- **Centro Properties Group and Centro Retail Trust -**False and misleading statements regarding $3.1 billion in misclassified debts. Settled in aggregate for ~$200M (largest corporate settlement in Australia's history).
- **National Australian Bank -** Investors claimed NAB had failed to diligently disclose the true extent of its exposure to the toxic subprime investments. Settled for $115M.

Notable Non-U.S. Cases

- **Canada**
  - ***Silver v. Imax*** - Ontario court certified a "global" class but dismissed U.S. purchasers after U.S. case settlement ($12 mill).
  - ***Sino Forest*** - Chinese company accused of false and misleading statements relating to ownership of timber plantations. $117 million settlement with auditors (largest ever made in Canada) – case continues against Sino-Forest.
- **Japan**
  - **Olympus -** Litigation related to the revelation that it was involved in a fraudulent scheme aimed at removing toxic assets.
- **France**
  - **Vivendi -** Action by non-ADR investors alleging Vivendi engaged in a scheme to inflate its share prices artificially by materially and fraudulently misstating its financial results. Follows a U.S. class action that was limited to purchasers of Vivendi ADRs on U.S. exchanges.
- **United Kingdom**
  - **RBS -** Recently filed action for £44 billion loss in market value stemming from facts suggesting that RBS mislead investors with respect to its true exposure to subprime-related assets and collateralized debt obligations.

Take Aways on Non-U.S. Litigation

- Request foreign jurisdiction monitoring and litigation information in RFPs.
  - Many public pension funds have begun to do so (e.g. LACERA, ACERA, SFERS, Oregon DOJ, State of Rhode Island, Illinois SURS, Arizona State Retirement System, Fort Worth ERS, Kansas City ERS).

- **Further reading**: Living in a Post-*Morrison* World: How to Protect Your Assets Against Securities Fraud (NAPPA *Morrison* Working Group – June 2012)
  - http://nappa.org/docuserfiles/files/3_Living%20in%20A%20Post-Morrison%20World.pdf

Mandatory Arbitration

- Publicly traded companies are inserting mandatory arbitration clauses into corporate bylaws and investment-advisor contracts (which often also contain class action waivers) in order to bypass judicial oversight of the companies' compliance with federal securities laws.
- Mandatory arbitration provisions let defendants dictate the rules:
  - Limited discovery and remedies
  - Fee award limitations
- Potential to eliminate all shareholder litigation, regardless of merit.

Commonwealth REIT

- Commonwealth is a Maryland REIT.
- Board unlawfully transferred hundreds of millions to Company's founder.
- Hedge fund, with $270 million stake, begins effort to oust incumbent trustees.
- Board went to incredible length to entrench itself:
  - Rewrote bylaws.
  - Lobbied Maryland legislate to rewrite State Corporation law.
  - Misled shareholders about removal rights.

Commonwealth Continued

- Hedge fund and shareholders file suit in 2013 against trustees.
- Trustees move to have all lawsuits arbitrated (limited discovery, no fee award possible).
- Maryland state court upholds validity of mandatory arbitration bylaw.
  - Will this embolden other companies to insert similar bylaws?
  - Impact of *Chevron* decision (forum selection bylaws) in Delaware.

Mandatory Arbitration

- Significant effort by investors to preserve the ability to access judicial system for enforcement and protection of legal rights.
  - Lobby State and Federal lawmakers
  - Push proxy advisors (ISS, Glass Lewis) to recommend shareholders vote against directors who try to impose arbitration without shareholder approval
- Senate Hearing held on Capitol Hill in December 2013.

Questions & Thank You!

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