Securities and Shareholder Litigation

2015 YEAR-END REVIEW

BASS BERRY SIMS PLC

Tennessee Establishes Specialized Business Court

On March 15, 2015, the Tennessee Supreme Court, led by Chief Justice Sharon Lee, established the Tennessee Business Court Pilot Project – a study to determine whether a statewide Business Court would benefit Tennesseans, how that court should operate and its appropriate jurisdiction.[1] The Pilot Project instituted a separate Business Court docket within the existing Court of Chancery in Nashville, Tennessee, which is being overseen by Chancellor Ellen Hobbs Lyle, who is known for her expertise in complex commercial and corporate disputes. Chancellor Lyle's unique experience in these matters, coupled with Davidson County's central location, made Nashville an obvious choice for the Pilot Project. The Business Court is designed to offer corporate entities and individuals fast, efficient resolutions in complex commercial disputes before a specialized judge who can decide complicated questions of law, and ultimately create a reliable body of precedent that offers clarity and predictability to Tennessee businesses. Chief Justice Lee noted that "[b]usiness cases can be complicated, often with procedural and substantive complexities that respond particularly well to specialization. For this reason, commercial disputes benefit from having their own specialized courts."[2]

CASES ELIGIBLE FOR THE BUSINESS COURT

The Business Court began accepting cases filed after May 1, 2015. Presently, the Business Court is permitted to hear claims in the following subject matter areas if parties allege more than $50,000 in damages or seek preliminary injunctive or declaratory relief:

- Internal affairs of businesses (corporations, LLCs, general partnerships, LLPs, REITs, joint ventures, etc.);
- Breach of contract, breach of fiduciary duty, statutory violations arising out of business transactions or relationships, commercial fraud and misrepresentation;
- Shareholder derivative claims and commercial class actions;
- Commercial real property disputes;
- Claims relating to business and investment activities;
- Claims arising from technology licensing agreements or other intellectual property rights;
- Non-compete or non-solicitation actions;
- Claims relating to antitrust, trade secrets, or securities-related actions; and
- Commercial construction claims.

Other types of cases have been specifically excluded from the Business Court's jurisdiction, including personal injury claims, residential landlord-tenant matters, labor claims, healthcare liability, cases where the State will be a party and administrative appeals from State or County agencies. Currently, parties must elect to transfer the case to the Business Court by seeking a transfer to the venue, which must be approved by the Supreme Court.

WHY A BUSINESS COURT?

Commercial and corporate litigants choosing to transfer matters to the new Business Court can expect several advantages:

Expense Reduction. The Business Court hopes to decrease the cost of trying large cases through improved discovery rules and processes, which should minimize attorney hours. The Business Court hopes to cut down on hefty discovery bills through tailored discovery plans and proportionality principles, which aim to prevent

1. *See* Order of the Supreme Court of Tennessee Establishing the Davidson County Business Court Pilot Project, No. ADM2015-00467 (Mar. 16, 2015).
2. Chief Justice Sharon Lee and Justin Seamon, "Tennessee is Open for Business: What You Need to Know About Tennessee's New Business Court," *Tennessee Bar Journal*, Vol. 51, No. 9 (Aug. 31, 2015).

excessive discovery and reduce the burden and expense created by overreaching discovery requests. Chancellor Lyle also aims to reduce or eliminate unnecessary attorney fees and expenses. For example, scheduled hearings will eliminate hours billed by attorneys (often entire teams of attorneys in corporate cases) who must sit through a general docket call before a hearing — an expense that can add up to thousands of dollars during the life of a corporate case. Chancellor Lyle also hopes to minimize costs associated with attorney travel through use of existing court technology, noting that many hearings can be held via teleconference or videoconferencing. Customized case management plans also target early disposition and seek to streamline litigation, reducing expenses and fast-tracking resolution.

Expertise and Predictability. By specializing Chancellor Lyle's docket, the Supreme Court has created the opportunity to build upon her existing knowledge-base in corporate and commercial matters. Litigants can expect Chancellor Lyle to be up-to-speed on corporate principles and contract construction, eliminating unnecessary work to "educate the judge." Over time, Business Court rulings also will create a body of precedent that businesses can rely upon in structuring their affairs. The written opinions that result from the Business Court will facilitate the resolution of future litigation concerning similar issues, offering businesses predictability and clarity with respect to Tennessee law.

E-filing. Many state courts still lack the option to file and serve papers electronically. Chancellor Lyle hopes that the Business Court will be among the first courts in Tennessee to offer full-service electronic filing, making it easier for attorneys outside of Nashville and Tennessee to submit and access papers.

Expedition. The Business Court was created with the understanding that corporate litigants need to put disputes to rest as quickly as possible. The Business Court promises litigants a compressed timeline, with cases being set for trial within 12 months, unless the parties request longer pretrial discovery. Pretrial motions will be streamlined and written rulings and orders will be issued promptly. Customized Case Litigation Plans will frontload resolution of dispositive issues and Litigation Plan Conferences will be used to shore up issues that may arise during the life of the case, allowing the parties to collaborate from an early stage to keep the case on track for an efficient disposition.

OPERATIONS OF THE BUSINESS COURT TO DATE

In its first nine months, the Business Court "exceeded case filing expectations" with more than 28 requests for transfer to the Business Court.[3] Of these cases, many sought expedited relief or discovery and six have already been resolved, taking only 30–164 days to conclude.[4] Chancellor Lyle noted that many of the cases presently pending in the Business Court relate to contract interpretation, breach of fiduciary duty, fraud, interference with contracts, corporate and LLC governance disputes and non-compete agreements.[5]

The performance of the Business Court is being monitored by an Advisory Commission, which is surveying litigants and counsel and reviewing data associated with the Business Court's proceedings. The Advisory Commission plans to monitor the pilot Business Court throughout 2016 and determine whether there is a statewide need and demand for this separate court.[6]

> "Successful business courts operate in numerous states today. These courts give litigants in commercial disputes access to judges who are familiar with the complex subject matters their cases often entail, manage the cases before them from cradle to grave, recognize the importance of controlling wide-ranging discovery, and contribute to and benefit from the development of more extensive commercial case-law in their states."
>
> *Vice Chancellor Donald F. Parsons, Jr.*

3. Press Release, Tennessee Courts, "At 6-Month Mark, Business Pilot Project Building on Swift Success," (Nov. 24, 2015) (http://www.tsc.state.tn.us/news/2015/11/24/6-month-mark-business-pilot-project-building-swift-success).
4. *Id.*; Chancellor Ellen Hobbs Lyle, "Report from the Business Court," *Nashville Bar Journal*, October 2015 at 10-11.
5. *Id.*
6. *See* n.3 *supra*.

THE SUCCESS OF BUSINESS COURTS IN OTHER STATES

The idea for the Business Court is not unique — more than two dozen other states have established business courts or a specialized docket for business matters.[7] Delaware's Court of Chancery is widely regarded as the nation's premier venue for resolving corporate issues and boasts an extensive track record of offering corporate litigants preeminent jurists, an established body of law and immediate access to its courts. Delaware's judiciary is often cited as the reason businesses choose to incorporate in Delaware. Other states hope to convince businesses to incorporate locally and several have created business courts that will seek to replicate the success of the Chancery Court.

Specialized business tribunals in states other than Deleware were first created in 1993, when both New York and Chicago developed commercial and business dockets.[8] Now, more than 40 court programs in 27 states are operational.[9] North Carolina was one of the first states to establish a business court, which is now widely regarded as a model for other states, having served the needs of business litigants for 20 years.[10] One of Delaware's most respected corporate jurists, Vice Chancellor Donald F. Parsons, Jr., who recently retired from the Delaware Court of Chancery, is a Past President and serves on the board of directors of the American College of Business Court Judges, a network that seeks to empower business court judges across the country. Vice Chancellor Parsons recently explained the importance of business courts across the country:

> Successful business courts operate in numerous states today. These courts give litigants in commercial disputes access to judges who are familiar with the complex subject matters their cases often entail, manage the cases before them from cradle to grave, recognize the importance of controlling wide-ranging discovery, and contribute to and benefit from the development of more extensive commercial case-law in their states.

For more information on the Tennessee Business Court, visit www.tncourts.gov/bizcourt.

Courts Grapple with Whether *Omnicare* Applies to Claims Brought Outside the 1933 Act

INTRODUCTION

On March 24, 2015, the Supreme Court issued a decision in ***Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund***, 135 S. Ct. 1318 (2015), that articulated a two-part test for determining when a statement of opinion can give rise to liability under Section 11 of the Securities Act of 1933, which addresses misrepresentations and omissions contained in a registration statement.

Now, nearly a year later, lower courts have had the opportunity to apply and interpret the ***Omnicare*** decision, offering greater visibility as to the scope of the Supreme Court's ruling and what, if any, unresolved legal issues remain. One uncertainty concerns whether the ***Omnicare*** holding applies to claims other than those brought under Section 11. Namely, to what extent does ***Omnicare*** also apply to claims brought under Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act") and Rule 10b-5, securities fraud provisions that typically require a showing of fraudulent intent? Most courts that have addressed this issue have applied the ***Omnicare*** analysis to such claims, though the impact of courts' doing so does not appear to be significant.

THE *OMNICARE* DECISION

The alleged false statements at issue in ***Omnicare*** were legal opinions in the company's registration statement about whether the company's pharmaceutical contracts complied with applicable laws. Plaintiff took issue with statements indicating that the company's contracts with healthcare providers, pharmaceutical suppliers, pharmacy practices and pharmaceutical manufacturers were in compliance with applicable anti-kickback laws when the federal government had suggested otherwise.

Section 11 effectively imposes strict liability for false or misleading registration statements (subject to certain statutory affirmative defenses). The ***Omnicare*** Court considered whether the facts pled in the complaint could establish liability based on these legal compliance opinions under either of two theories: (1) that the opinions

7. *See* n.2 *supra*.
8. *Id.*
9. *Id.*
10. Lee Applebaum, "The Steady Growth of Business Courts," Future Trends in State Courts 2011, National Conference of State Legislatures, *available at* http://www.ncsc.org/sitecore/content/microsites/future-trends-2011/home/Specialized-Courts-Services/~/media/Microsites/Files/Future%20Trends/Author%20PDFs/Applebaum.ashx (last accessed Jan. 31, 2015).

Now, nearly a year later, lower courts have had the opportunity to apply and interpret the *Omnicare* decision, offering greater visibility as to the scope of the Supreme Court's ruling and what, if any, unresolved legal issues remain.

constituted affirmative untrue statements of material fact because the opinions were not sincerely held; or (2) that the opinions were misleading to a reasonable investor because they omitted other material facts.

First, the Supreme Court held that the complaint did not allege false statements of fact because it did not establish that the defendant subjectively disbelieved the stated opinions. The Court explained that it did not matter if the stated opinion turned out to be wrong, so long as it was sincerely held at the time it was made. In other words, a plaintiff attempting to bring a Section 11 claim typically must plead the speaker's subjective disbelief of the stated opinion in order to show an affirmative misstatement.

Second, the Court nevertheless held that the complaint could have sufficiently stated a claim if the legal opinions in the registration statement "omitted to state facts necessary" to make the opinion "not misleading." The Court reasoned that a reasonable investor could interpret "an opinion statement to convey facts about how the speaker has formed the opinion" and that, "if the real facts are otherwise, but not provided, the opinion statement will mislead its audience." ***Omnicare***, 135 S. Ct. at 1328. It held, "if a registration statement omits material facts about the issuer's inquiry into or knowledge concerning a statement of opinion, and if those facts conflict with what a reasonable investor would take from the statement itself, then Section 11's omissions clause creates liability." *Id.* at 1329. Still, the Court cautioned that a complaint must specifically "identify particular (and material) facts going to the basis for the issuer's opinion – facts about the inquiry the issuer did or did not conduct or the knowledge it did or did not have – whose omission makes the opinion statement at issue misleading to a reasonable person reading the statement fairly and in context." *Id*. at 1332. While the Court recognized that this pleading requirement would be "no small task for an investor" to satisfy, it arguably broadened the scope of potential liability under Section 11. *Id*.

Because the claims asserted in the ***Omnicare*** case were limited to alleged Section 11 violations, the ***Omnicare*** court did not explicitly address whether its analysis of allegedly actionable statements of opinions would apply to securities fraud claims brought under Section 10(b) of the 1934 Act and Rule 10b–5. Since the ***Omnicare*** case, lower courts have had the opportunity to interpret and apply the Supreme Court's ruling. While at least one court has expressed doubt as to whether ***Omnicare*** directly applies to Section 10(b) claims, other courts have found the holding applicable to some degree.

THE ARGUMENT FOR LIMITING *OMNICARE* TO THE SECTION 11 CONTEXT

Unlike Section 11, intent is an essential element of a claim for securities fraud under Section 10(b). For this reason, at least one court has expressed skepticism that ***Omnicare*** applies in the Section 10(b) context. In ***Firefighters Pension & Relief Fund of the City of New Orleans v. Bulmahn***, No. CV 13-3935, 2015 WL 7454598, at *25 (E.D. La. Nov. 23, 2015), the court remarked "[t]hat ***Omnicare*** concerned a strict liability statute suggests that the Supreme Court's reasoning – which contemplates liability for statements of opinions that are genuinely held but misleading to a reasonable investor — does not directly apply to" Section 10(b). The district court also noted that ***Omnicare*** should not apply to "forward-looking statements" of opinion, because Section 10(b) claims based on such statements are already governed by the safe harbor provisions of the Private Securities Litigation Reform Act ("PSLRA"), which imposes its own set of pleading requirements. "[T]he PSLRA effectively requires proof of actual knowledge [of falsity]—not just recklessness—in the case of every forward-looking statement." *Id.* at *25. The ***Bulmahn*** court, therefore, explicitly declined to apply ***Omnicare*** to "forward-looking statements of opinion" that supposedly gave rise to Section 10(b) liability. *Id*. at *26. Nevertheless, the district court did indicate that with respect to non-forward-looking statements, it considered ***Omnicare*** "as guidance" and took into account "the relevant principles articulated in the Supreme Court's decision." *Id*. (citing ***In re Merck & Co., Inc. Sec., Deriv. & ERISA Litig.***, 2015 WL 2250472, at *11 n.7 (D.N.J. May 13, 2015) (holding that while "***Omnicare***, actually, is not directly applicable," to Section 10(b) claims, "***Omnicare's*** analysis of its discussion of misleading opinions is, to some extent, instructive on the viability of [such] claims as to the opinion-based" statements)). The district court did not specifically elaborate as to how, exactly, it took ***Omnicare***

into consideration although it cited ***Omnicare*** for the provision that "[a]n investor cannot state a claim by alleging only that the opinion was wrong." *Id*. at *26 (quoting ***Omnicare***, 135 S. Ct. at 1332).

OTHER COURTS HAVE READILY APPLIED *OMNICARE* TO SECTION 10(B) CLAIMS

Other courts have found the Supreme Court's holding in ***Omnicare*** relevant to determining whether a statement of opinion is false or misleading for purposes of a Section 10(b) claim, though they mostly have been careful to respect the separate requirement that the plaintiff show fraudulent intent. In ***Nakkhumpun v. Taylor***, 782 F.3d 1142, 1159 (10th Cir.) cert. dismissed, 136 S. Ct. 499 (2015), which was decided just a couple of weeks after ***Omnicare***, the Tenth Circuit considered, among other things, whether an alleged statement of opinion about the company's liquidity by its COO and president could be actionable under Section 10(b) and Rule 10b–5. Citing ***Omnicare***, the ***Nakkhumpun*** court upheld dismissal of plaintiff's claims "based on the failure to adequately allege falsity" given that plaintiff did "not allege[] any facts that would cast doubt on the sincerity or reasonableness of [defendant's] statement of his opinion." 782 F.3d at 1159-1160.

The Tenth Circuit's opinion demonstrates what is probably the best case for ***Omnicare*** having at least some relevance in the Section 10(b) context. Under ***Omnicare***, when a court is addressing a pure statement of opinion, and the plaintiff is making the argument that the opinion was false because the opinion was not honestly held, the falsity analysis necessarily incorporates an element of intent that makes it not incompatible with the requirements of Section 10(b). *See id.* at 1159 (discussing whether defendant's opinion was sincere, and noting that "Mr. Nakkhumpun's factual allegations do not suggest scienter").[11] The ***Nakkhumpun*** court did not provide a detailed analysis of the ***Omnicare*** decision, and importantly, did not expressly analyze whether the alleged opinion could have been misleading under ***Omnicare's*** "second prong" (*i.e.*, based on omitted facts). Had the court analyzed the plaintiff's claim from the perspective that a statement of opinion was misleading because it omitted to state certain facts regarding the context in which the opinion was formed or given, then the court arguably would have had a more difficult time relying exclusively on ***Omnicare*** because it would not have adequately addressed the element of intent.

Other courts have applied ***Omnicare***'s second prong in the Section 10(b) context for purposes of addressing the "falsity" element of a Section 10(b) claim, and have addressed scienter separately. In ***In re BioScrip Inc. Sec. Litig.***, 95 F. Supp. 3d 711 (S.D.N.Y. 2015), the court found that alleged opinions about government investigations and compliance were not "accurate and complete" and, therefore, actionable under Section 10(b) and Rule 10b–5. The district court found that the company's stated opinions that it was legally compliant, including that it "believes it is in substantial compliance with all laws, rules and regulations," could be materially misleading both because certain facts relating to the circumstances surrounding the opinion had not been disclosed and plaintiffs had adequately pled that defendants did not actually believe their statements of opinion. The court cited ***Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund***, 135 S. Ct. 1318 (2015), and noted, "the Court understands ***Omnicare*** to stand for the proposition that a legal compliance statement may be deemed misleading if, although sincerely held, it is formed on the basis of an omitted fact, not disclosed by the speaker, that would likely conflict with a reasonable investor's own understanding of the facts conveyed by that statement." *Id*. at 729.

The ***BioScrip*** court also noted in *dicta* that the ***Omnicare*** decision may have called into question the Second Circuit's holding in ***Fait v. Regions Fin. Corp.***, 655 F.3d 105 (2d Cir. 2011), to the extent that opinion has been construed as requiring subjective disbelief of a legal compliance opinion to establish that it was materially misleading. Nevertheless, the court held that plaintiffs' pleadings satisfied both ***Omnicare*** and ***Fait*** because it found that, assuming the truth of plaintiffs' allegations, the company's legal compliance statements were "both objectively false and disbelieved at the time they were made." *Id*. at 729. Importantly, the court separately concluded that plaintiffs adequately pled scienter for purposes of Section 10(b) and Rule 10b–5 because that company "had [the CID] in hand when it made the legal compliance statements, yet elected not to disclose the CID's existence in order to make fully clear the basis for its opinions." *Id*. at 733. The court went ahead and discussed intent as a separate element of a Section 10(b) claim even though "the question of scienter largely turns on the same considerations as those concerning the defendants' statements of opinion." *Id*.

Other district courts have engaged in a similar analysis with regard to 10(b) claims, concluding that a statement of opinion, even if sincerely held, may be materially

11. *See also Special Situations Fund III OP, L.P. v. Deloitte Touche Tohmatsu CPA, Ltd.*, 2015 U.S. Dist LEXIS 43323 (S.D.N.Y. Mar. 31, 2015) (applying *Omnicare* and dismissing claims under Section 10(b), on the grounds that opinion was not alleged to be subjectively false); *Corban v. Sarepta Therapeutics, Inc.*, 2015 U.S. Dist LEXIS 42688 (D. Mass. Mar. 31, 2015) (same).

misleading if it did not rest on a meaningful inquiry or otherwise omits facts that a reasonable person would require to read the statement fairly and in context. *See e.g.*, ***City of Westland Police & Fire Ret. Sys. v. MetLife, Inc.***, No. 12-CV-0256 LAK, 2015 WL 5311196, at *13 (S.D.N.Y. Sept. 11, 2015). Again, these courts recognized that intent is an independent element under Section 10(b) that plaintiffs must satisfy.

PRACTICAL IMPLICATIONS

Where a claim is based on the theory that a statement of opinion is false or misleading because it was not honestly held at the time it was given, there are few practical implications for courts applying ***Omnicare*** in the Section 10(b) context. In this context, ***Omnicare*** is more easily read as imposing an intent requirement on a Section 11 claim than altering the Section 10(b) analysis in any meaningful way. Nevertheless, plaintiffs' attorneys are likely to rely on ***Omnicare*** to argue that recklessly or negligently omitted facts can render a statement of opinion materially false or misleading, even if the opinion is sincerely held, and in this context ***Omnicare*** should not be reflexively applied outside of the Section 11 context. Even where a court accepts the argument that this second prong of the ***Omnicare*** holding can be instructive for purposes of determining whether a statement is false or misleading, a plaintiff must still establish intent to prevail under Section 10(b), and must account for any additional applicable pleading requirements unique to Section 10(b) claims, such as those applicable to forward-looking statements under the PSLRA.

Given that ***Omnicare*** has opened the door — and, arguably, somewhat expanded — the potential for liability in connection with statements of opinion, drafters of registration statements and other corporate disclosures may be advised to be more cautious about expressing blanket opinions and consider whether additional contextual facts need to be disclosed as well, along with disclaimers sufficient to negate any implication that the issuer of the registration statement has done more than it actually has done in forming that opinion. The degree of such concern, however, should be limited. At least with respect to potential Section 10(b) claims, the Supreme Court's ***Omnicare*** decision should not create a greater likelihood of liability in the absence of additional facts that could establish intent. Expect further guidance on the scope of ***Omnicare*** from district and appellate courts in the future, as they continue to examine and interpret the decision.

Disclosure-Only Settlements: Extinction or Migration?

Arguably the biggest corporate law issue in the past year was the ostensible death of disclosure-only settlements in Delaware — the favored forum for merger objection lawsuits. In 2015, Delaware's Court of Chancery turned from bark to bite, and began rejecting disclosure-only settlements after years of voicing concerns about class settlements that provide stockholders with little-to-no consideration in exchange for valuable all-encompassing releases, while disproportionately compensating plaintiffs' counsel for achieving what the Court considered to be minimal results. In 2016, practitioners are left wondering whether the routine flurry of litigation that follows the announcement of any public company merger will survive by migrating to other states, or face near-extinction.

WHAT ARE DISCLOSURE-ONLY SETTLEMENTS?

The Delaware Court of Chancery considers disclosure-only settlements to be "the most common method for quickly resolving stockholder lawsuits that are filed routinely in response to the announcement of virtually every transaction involving the acquisition of a public corporation." ***In re Trulia, Inc. Stockholder Litig.***, C.A. No. 10020-CB (Slip Op. at 1-2) (Del. Ch. Jan. 22, 2016). In a disclosure-only settlement, the acquired company typically agrees "to supplement the proxy materials disseminated to its stockholders before they vote[] on the proposed transaction to include some additional information that theoretically would allow the stockholders to be better informed in exercising their franchise rights. In exchange, plaintiffs drop[] their motion to preliminarily enjoin the transaction and agree[] to provide a release of claims on behalf of a proposed class of [the target's] stockholders . . . The only money that would change hands is the payment of a fee to plaintiffs' counsel." *Id.* at 1. Many have referred to disclosure-only settlements as a "deal-tax" — a predictable payment of attorneys' fees that has come to be viewed as part of the routine cost of getting the deal done. Others call such settlements "deal insurance," noting that "defendants may be happy to 'purchase,' at the bargain basement price of disclosures of marginal benefit to the class and payment of the plaintiffs' attorneys fees, a broad release from liability." ***In re Riverbed Technology, Inc. Stockholders Litigation***, C.A. No. 10484-VCG (Slip Op. at 9) (Del. Ch. Sept. 17, 2015).

THE "SYSTEMIC" PROBLEM IN DELAWARE

For years, Delaware jurists have expressed concern about the "systemic" problem

with merger objection lawsuits that settle quickly for nothing more than supplemental disclosures. Vice Chancellor J. Travis Laster, a frontrunner among judges seeking to eradicate unnecessary M&A suits, lamented that "we have reached a point where we have to acknowledge that settling for disclosure only and giving the type of expansive release that has been given has created a real systemic problem." Transcript of Settlement Hearing and Rulings of the Court at 66, In re Aruba Networks, Inc. Stockholder Litigation, C.A. No. 10765-VCL (Del. Ch. Oct. 9, 2015). "[W]hen you get the sue-on-every-deal phenomenon . . . [i]t is a systemic problem." Id.

Likewise, Chancellor Andre G. Bouchard acknowledged that "[e]very deal basically is the subject of litigation" and "[i]t just can't be that there are meaningful disclosure violations in every single M&A case that's being filed in this court." Transcript of Settlement Hearing and Rulings of the Court at 38, ***Assad v. World Energy Solutions, Inc.***, C.A. No. 10324-CB (Del. Ch. Aug. 20, 2015). The ***Trulia*** opinion provides data substantiating the bench's concerns over this merger litigation:

> Today, the public announcement of virtually every transaction involving the acquisition of a public corporation provokes a flurry of class action lawsuits alleging that the target's directors breached their fiduciary duties by agreeing to sell the corporation for an unfair price. . .
>
> In just the past decade, the percentage of transactions of $100 million or more that have triggered stockholder litigation in this country has more than doubled, from 39.3% in 2005 to a peak of 94.9% in 2014.

Trulia, at 11, 16. The Court went on to note that, "In Delaware, the percentage of such cases settled solely on the basis of supplemental disclosures grew significantly from 45.4% in 2005 to a high of 76% in 2012, and only recently has seen some decline." *Id.* at 16-17.

Many believe this systemic problem creates a real danger that meritorious claims will be foreclosed by "intergalactic" releases obtained in these routine boilerplate lawsuits. In fact, a prominent member of the Delaware bar, Joel Friedlander, argues that "routine disclosure settlements undermined in various respects the proper functioning of a system for the judicial enforcement of fiduciary duties[.]" Joel Edan Friedlander, "How ***Rural/Metro*** Exposed the Systemic Problem of Disclosure Settlements," (January 23, 2016), Del. J. Corp. L. (forthcoming 2016) (available at SSRN: http://ssrn.com/abstract=2689877). Friedlander explained that the pursuit of disclosure-only settlements by firms that place "a premium on maximizing the number of disclosure settlements and minimizing the costs associated with each settlement" prompts early settlements without thorough discovery, thus depriving stockholders of opportunities to uncover and pursue claims of value.

One notable example of valuable claims that were nearly extinguished by a release in exchange for supplemental disclosures and a modest fee is a case concerning financial advisor liability– ***In re Rural/Metro Corp. S'holders Litig.***, 88 A.3d 54 (Del. Ch. Mar. 7, 2014); Cons. C.A. No. 6350-VCL (Del. Ch. Oct. 10, 2014). There, an objector narrowly convinced Vice Chancellor Laster to reject a disclosure-only settlement and then proceeded to litigate claims related to conflicts of interest present in the transaction and recover over $93 million for the class. *See* Friedlander, at 23.

Another concern expressed by the courts is that "ubiquitous merger litigation" may "undercut[] the credibility of the litigation process" as an effective enforcement tool and reduce the pressure on transactional attorneys and their clients to carefully scrutinize potential conflicts and the disclosures made to stockholders. Transcript of Settlement Hearing and Request for Attorneys' Fees and the Court's Rulings at 65, ***Acevedo v. Aeroflex Holding Corp.***, C.A. No. 7930-VCL (Del. Ch. July 8, 2015). Along these same lines, Friedlander notes that "[s]ell-side fiduciaries, financial advisors, third-party buyers, and their respective counsel became complacent about whether stockholder litigation will uncover conflicts of interest," because they came to "expect that much M&A litigation can be resolved by means of a disclosure settlement," weakening their incentive "to uncover or police conflicts of interest while a sale process or transaction is pending." Friedlander, at 7, 46.

THE DELAWARE JUDICIARY'S RESPONSE

In response to the perceived systemic issues created by disclosure-only settlements, the Delaware judiciary began rejecting settlements *sua sponte*, exercising its power as the fiduciary that protects the rights of absent class members, who were being asked to release all possible claims – known and unknown – without being educated on the value or merits of those potential claims.

One of the earliest rebukes came from the now-Chief Justice of the Delaware Supreme Court, Leo Strine, Jr., in ***In re Transatlantic Holdings, Inc. Shareholders Litig.***, Cons. C.A. No. 6574-CS (Del. Ch. Feb. 23, 2013). There, Chancellor Strine noted that the Court must "have some confidence that the class is actually represented in the right way" when it is "going to release claims on the part of absent parties." Transcript of Teleconference, ***Transatlantic***, at 6-7. Chancellor Strine rejected the settlement because "what the class is getting is of so little apparent utility that the

option value of having some more diligent plaintiff be able to come forward with a damages action in the future" exceeded the value of the settlement. *Id.* at 8.

Vice Chancellor Laster followed suit in rejecting settlements and voicing his concerns about the scope of releases obtained, noting that there were too many "unknown unknowns" encompassed in those releases. ***Rubin v. Obagi Medical Prods., Inc.***, C.A. No. 8433-VCL (Del. Ch. Apr. 30, 2014). Most recently, Vice Chancellor Laster rejected settlements in ***Aeroflex*** and ***Aruba***, and while Vice Chancellor Glasscock approved the ***Riverbed*** disclosure-settlement, he substantially trimmed the fee award and warned parties that they should no longer rely on the expectation that the Court would approve a very broad release. These decisions created the momentum that culminated in the pivotal ruling in ***Trulia***.

In ***Trulia***, Chancellor Bouchard rejected a disclosure-only settlement on the grounds that the disclosures obtained by plaintiffs, which purportedly served as consideration for the release, were not material "or even helpful to Trulia's stockholders." ***Trulia***, at 41. Thus, the disclosures did not warrant the class "give" of releasing all other potential claims. *Id.* In rejecting the deal, Chancellor Bouchard reasoned that because of "the rapid proliferation and current ubiquity of deal litigation," together with "mounting evidence that supplemental disclosures rarely yield genuine benefits for stockholders, the risk of stockholders losing potentially valuable claims that have not been investigated with rigor, and the challenges of assessing disclosure claims in a non-adversarial settlement process, the Court's historical predisposition toward approving disclosure settlements needs to be reexamined." *Id.* at 19. He warned that, following ***Trulia***, litigants "can expect that the Court will be increasingly vigilant in scrutinizing the 'give' and the 'get' of such settlements to ensure that they are genuinely fair and reasonable to the absent class members." *Id.* at 2.

Chancellor Bouchard and Vice Chancellor Laster have provided litigants with a roadmap for dealing with future disclosure cases, including identifying appropriate ways to resolve cases on a disclosure-only basis without impairing the rights of absent class members:

- **Enjoin the transaction**. If material disclosures were omitted from proxy materials, stockholders can seek to delay the stockholder vote until supplemental disclosures are made. This adversarial process at the preliminary injunction stage will help the judiciary assess the true "materiality" of the disclosures at issue.

- **Moot the claims through voluntary disclosures**. Defendants may choose to supplement proxy materials voluntarily to avoid an injunction, then "reframe [the settlement] as a mootness dismissal," which would not foreclose future claims by other class members. ***Acevedo*** tr. at 74. Plaintiffs' counsel is then free to apply to the court for a fee award, but the parties are incentivized to assist the court in determining the true value of the disclosures in an adversarial context. This option does not involve releasing other claims and does not impair the rights of absent class members. *See e.g.*, ***Kaniecki v. O'Charley's Inc.***,* No. M2012-02221, 2014 Tenn. App. LEXIS 69 (Tenn. Ct. App. Feb. 11, 2014) (applying Tennessee law and affirming the denial of the plaintiffs' request for attorneys' fees based only on supplemental disclosures made by the Company, which mooted plaintiffs' disclosure claims).

- **Whittling away at the Release**. Parties wishing to present a disclosure-only settlement can narrow the scope of the release defendants receive as consideration. In ***Aruba***, Vice Chancellor Laster commented, "I think that if you'd only released disclosure claims, I would have given you that. I don't know why you get to release for nothing these other claims." ***Aruba*** tr. at 66. *See also* ***Aeroflex***, at 74-75 ("come back with a release that's limited … that would match up with what the plaintiff actually investigated, what they actually addressed, and [we] would not have these problems of providing protection against a vast universe of unknown claims"). Defendants will be less incentivized to assist plaintiffs' attorneys in collecting a fee on settlements with proportional releases because they are offered no assurance against future litigation, leaving the adversarial process intact and attorneys' fees commensurate with the benefit obtained.

- **Obtain Dismissal**. Defendants can move to dismiss any cases that lack substantive merit.

THE AFTERMATH

Following the Delaware judiciary's denunciation of disclosure-only settlements, the number of merger objection lawsuits has declined. In fact, the last quarter of 2015 saw a significant decline in the number of public mergers that were challenged in the Delaware Court of Chancery. In the first half of 2015, public mergers were challenged 78% of the time; that figure dropped to 34% in Q4. Gregory A. Markel, Martin L. Seidel and Gillian G. Burns, "Delaware Judges Have Been Heard," Law360 (Feb. 2, 2016). The Chancery Daily, a publication that monitors proceedings in the Delaware Court of Chancery noted, "a pronounced decline in the number of class action complaints filed [Post-***Aruba***] compared to prior months in the year 2014." "Post-***Aruba*** Class Action Filings in the Court of Chancery," The Chancery Daily

*Denotes a matter handled by Bass, Berry and Sims attorneys.

(Nov. 13, 2015) (available at http://tinyurl.com/prf2xvl). The Chancery Daily also observed an "abrupt decline" in "class action filings in October and the first half of November" despite the fact that total filings and deal volume remained constant, which "is consistent with plaintiffs' reluctance to file in Delaware following the ***Aruba*** holding." *Id.*

There are also anecdotal examples of the recent rulings affecting litigants' behavior. In early November, stockholders of Procera Networks, Inc. filed a stipulation and proposed order with the Delaware Court of Chancery seeking to dismiss their consolidated class action claim in connection with Francisco Partners Management, L.P.'s acquisition of Procera. After having reached a settlement that would provide the class with nothing more than additional financial projections, the parties decided not to bring the settlement before their judge – Vice Chancellor Laster – and requested cancellation of the scheduled fairness hearing and abandoned the claim for attorneys' fees. Kurt Orzeck, "Procera Investors Drop Suit Seeking to Block $240M Merger," Law360 (Nov. 4, 2015). Cornerstone Research's Olga Koumrian noted that, "Delaware-incorporated companies are [] starting to steer away from the Delaware Court of Chancery. . . The percentage of such companies settling in the court decreased from 50 percent in previous years to just 41 percent in 2013." Stephanie Russell-Kraft, "Shareholders Face Lower Odds in M&A Settlements," Law360 (Apr. 15, 2014).

WILL THE PLAINTIFFS' BAR MIGRATE TO MORE FRIENDLY FORUMS?

Outside of Delaware, some practitioners expect the Delaware rulings to have wide-reaching effects and predict "a significant drop in the number of lawsuits filed relating to public mergers." Many observers believe that the decline "will be steepest for the weaker lawsuits that previously may have been filed with the hope on the part of plaintiffs' counsel that they could extract a quick settlement and attorneys' fees." Benjamin Horney, "M&A Policy to Watch in 2016," Law360 (Dec. 24, 2015). Professor Sean Griffith – the academic objector known for his contribution to the ***Riverbed*** ruling – noted that the ***Trulia*** opinion is likely to be adopted in other forums because it "is a clear roadmap for out-of-state judges on how to apply Delaware law on these points [and] it is extremely clear in its reasoning." Michael Greene, "Del. Court Applies Heightened Review in Rejecting Proposed Trulia Settlement," BNA's Corporate Counsel Weekly (Jan. 27, 2016).

In fact, New York — another preferred forum for merger litigation — already appears to be in line with the recent Delaware opinions, having rejected two proposed disclosure-only settlements: ***Gordon v. Verizon Comm'n, Inc.***, 2014 WL 7250212 (Sup. Ct. N.Y. Dec. 19, 2014) and ***City Trading Fund v. Nye***, 9 N.Y.S. 592 (Sup. Ct. N.Y. 2015). In both cases, New York state judges determined that the additional disclosures sought by plaintiffs were immaterial, "tell me more" disclosures that could not sustain a class-wide settlement. *See* Deborah S. Birnback and Adam Slutsky, "Goodwin Proctor discusses Two New York Decisions Rejecting Disclosure-Based Settlements of Merger Lawsuits," CLS Blue Sky Blog (Feb. 9, 2015).

It is clear, however, that other states will remain open to considering disclosure-only settlements. For example, Nevada practitioners report that its business court offers efficient litigation and predictable application of corporate law, yet routinely approves disclosure-only settlements and awards plaintiffs' counsel attorney's fees and approves global releases. *See* Jeffrey Rugg, "Strike Suit Certainty Remains the Status Quo in Nevada," Law360 (Aug. 11, 2015) (discussing litigation in connection with the acquisitions of ***NV Energy Inc.; Medistem Inc.; and AirTran Holdings, Inc.***). Vice Chancellor Laster addressed those expressing concern over the possible exodus of the plaintiffs' bar from Delaware: "there may be states that want to be in the business of facilitating file on every deal, settle on every deal situations," but Delaware wanted "to be in the business of seeing good cases litigated, and we don't want people to file junky cases." ***Aeroflex***, tr. at 59. Chancellor Bouchard echoed those sentiments, stating that the law on "disclosure settlements must evolve. . . We hope and trust that our sister courts will reach the same conclusion if confronted with the issue." ***Trulia***, at 25.

It appears that, at least in the near future, merger objection lawsuits will continue to be filed and courts in many states will continue to approve settlements on a disclosure-only basis. It is harder to predict, however, whether the developments in Delaware will affect how plaintiffs' attorneys present these cases and proposed settlements to courts outside of Delaware.

WILL DELAWARE'S ONE-TWO PUNCH RESULT IN EXTINCTION OF DISCLOSURE-ONLY SUITS?

No matter how other states handle disclosure settlements going forward, plaintiffs may be unable to escape the new precedent. While this year's headlines concerned the death blows to disclosure-only settlements, the lead story in 2014 was the Court of Chancery's endorsement of a board of directors' authority to unilaterally adopt a forum-selection bylaw, which requires stockholders to litigate in a specified forum, generally Delaware. *See* ***City of Providence v. First Citizens Bancshares, Inc.***, Cons. C.A. No. 9795-CB (Del. Ch. Sept. 8, 2014). If boards invoke their power to adopt a forum-selection bylaw that mandates litigating in Delaware, stockholders (and their

counsel) may be foreclosed from migrating to more friendly fora. In other words, Chancellor Bouchard's ***First Citizens*** and ***Trulia*** opinions may have been the "one-two punch" that knocked out an entire category of litigation.

The recent rulings concerning disclosure-only settlements might, however, temper a board's desire to adopt or retain a forum-selection bylaw mandating Delaware litigation. After all, defendants contributed to the "systemic problem" for years, complacent in purchasing their "deal insurance" (i.e., broad releases) with supplemental disclosures and payments to the plaintiffs' bar. Defendants may prefer litigating in forums where they can still obtain global releases and decide to forego the forum selection bylaw. Undoubtedly, others will adopt or retain a Delaware forum selection bylaw in the hopes of eliminating unnecessary litigation.

Financial Advisor Liability

Corporate boards and directors – of both public and private companies – regularly rely on the advice of outside financial advisors. Indeed, in the world of modern mergers, acquisitions and other corporate transactions, it is commonplace, if not essential, for boards and directors to engage a financial advisor to assist in nearly every major aspect of a buy-side or sell-side process. Historically, these financial advisors could go about their work with the confidence that they were relatively immune from liability to stockholders so long as they were not negligent and the company's board and its directors did not breach any fiduciary duties when working with the advisor. Beginning with the Delaware Court of Chancery's decision in ***In re Rural/Metro Corp.***, 88 A.3d 54 (Del. Ch. 2014), that dynamic began to change – and in a dramatic way. That change continued with the Court of Chancery's October 2015 decision in ***In re Zale Corporation Stockholders Litigation***, C.A. No. 9388-VCP (Del. Ch. Oct. 1, 2015), which made clear that financial advisors now face new risks and responsibilities when giving advice to corporate boards in the context of M&A transactions, regardless of any actionable wrongdoing by the directors.

The stage for the decision in ***Zale*** was set with the beginning of the 2008 financial crisis. The crisis severely impacted Zale, which experienced serious declines in retail sales operations and was forced to close several of its retail stores. In response, the Zale board adopted a comprehensive turnaround strategy in 2010 that was designed to return the company to profitability. The strategy worked. By 2013, Zale was able to report net earnings of $10 million for that fiscal year.

This success did not go unnoticed. In early November 2013, Signet Jewelers Ltd. made an all-cash offer to acquire Zale for $19 per share. Upon receiving the offer, Zale's nine-person board formed a special committee comprised of four non-management directors. The special committee, then, considered potential financial advisors to assist the company in evaluating the Signet proposal. Based on the input from the company's largest stockholder – a private equity company – Zale invited Merrill Lynch to make a presentation to the board regarding its ability to act as financial advisor. On November 11, 2013, Merrill Lynch made its initial presentation to the Zale directors. As a part of that presentation, Merrill Lynch stated that it had worked with Signet on only a limited basis in the past and had no other conflicts that would prevent it from advising Zale. On the basis of that presentation, the Zale board went forward with engaging Merrill Lynch. Zale's directors did not interview or consider any other financial advisors.

With Merrill Lynch in place as its financial advisor, Zale engaged in several months of negotiations with Signet. Ultimately, the parties announced that they had agreed to a merger in which Signet would acquire Zale for $21 per share. The merger announcement was not universally well received. Several of Zale's larger stockholders spoke out against the deal, as did the Glass Lewis & Co. stockholder advisory firm. Most of this opposition centered on the fact that Merrill Lynch had been an active advisor to Signet in the months leading up to Signet's offer for Zale. Specifically, it was revealed that, in 2012-13, Signet had paid Merrill Lynch approximately $2 million in fees, and, more importantly, that Merrill Lynch had made a presentation to Signet's board in October 2013 regarding a possible acquisition of Zale in the range of $17-$21 per share. It also was revealed that a senior member of the Merrill Lynch team advising Zale had participated in the October 2013 presentation to Signet's board. Finally, it was revealed that Zale's board had not learned of these conflicts until after the merger agreement was signed. Despite these revelations and the prominent opposition, the merger transaction was nonetheless approved by more than 53% of Zale's disinterested stockholders in May 2014. A series of substantially similar stockholder lawsuits followed in September 2014.

In addition to the customary claims against the Zale directors for breach of fiduciary duties, all of the stockholder lawsuits included claims against Merrill Lynch for aiding and abetting these breaches. In general, the lawsuits claimed that Merrill Lynch's undisclosed conflicts had compromised the board and resulted in a tainted sales process. The defendants moved to dismiss. Vice Chancellor Donald F. Parsons, Jr. issued a 59-page decision that dismissed all claims against the individual director defendants. The court, however, refused to dismiss the claim against Merrill Lynch.

According to Vice Chancellor Parsons, apart from any diligence the Zale board could or should have conducted into Merrill Lynch's possible conflicts, Merrill Lynch had an independent and affirmative obligation to disclose its conflicts to the Zale board no matter how immaterial or "ordinary course" the actions giving rise to the conflict may have seemed. The court also concluded that, notwithstanding the fact that Merrill Lynch did eventually disclose its prior work with Signet to the Zale board, and that disclosures about that work were included in the proxy statement sent to stockholders, the conflict was not necessarily cleansed. According to the court, as a matter of law, certain financial advisor conflicts may not be waived by the board given that stockholders may have been damaged prior to the disclosure of the conflict in the form of "money [left] on the table" during merger negotiations.

Reasonable people can disagree as to whether the decision in ***Zale*** represents new precedent or is merely a reiteration of standards that have always applied. Regardless of one's view, it is now very clear that financial advisors and their counsel need to have in place clear procedures for detecting potential conflicts – or even the appearance of a conflict – and for disclosing any conflicts that are found prior to accepting engagements in M&A transactions. Indeed, it is safe to assume that Delaware courts (and those courts that look to Delaware for guidance) will be especially unforgiving when sell-side advisors are found to have undisclosed connections to the potential buyer in the transaction under review.

The decision in ***Zale*** also is instructive for what it reveals about the threshold pleading standards that stockholder-plaintiffs likely will be expected to satisfy going forward when making conflict-related allegations of aiding and abetting against financial advisors. Simply stated, in light of Vice Chancellor Parsons' reasoning in ***Zale***, financial advisors and their counsel should assume that the pleading threshold will be low in cases involving undisclosed advisor conflicts. Indeed, as Vice Chancellor Parsons explained, it is the advisor's undisclosed conflict that casts doubt on whether the directors adequately fulfilled their duty of care. Thus, where there are undisclosed conflicts, it is now likely that a court will be reluctant to dismiss aiding and abetting claims and, instead, view it as "reasonably conceivable" that the financial advisor and, ultimately, the board, have been "hampered" in their respective abilities to negotiate for a higher price. This, again, emphasizes the importance of full disclosure of conflicts ahead of any engagement in order to give both advisors and the directors they serve the best opportunity for a dismissal of claims of aiding and abetting in any stockholder litigation.

Significant Securities Cases Decided by the Sixth Circuit in 2015

In 2015, the Sixth Circuit affirmed the dismissal of two putative securities class actions asserting claims under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.

PENSION FUND GROUP V. TEMPUR-PEDIC INT'L, INC.

In ***Pension Fund Group. v. Tempur-Pedic International, Inc.***, 614 F. App'x 237 (6th Cir. 2015), plaintiffs alleged that Tempur-Pedic and two of its executives issued misleading statements and rosy financial projections despite the fact, and without disclosing, that sales growth had slowed at retailers that carried competitor Serta's new product that is similar to Tempur-Pedic's "memory foam" mattresses. According to plaintiffs, Tempur-Pedic's stock price declined approximately 75% during a seven-week period after the full extent of the risk posed by this new competition from Serta materialized, ultimately forcing the company to revise its yearly financial projections downward. In dismissing the claims, the Sixth Circuit held that the company's financial guidance fell within the PSLRA's safe harbor for forward-looking statements, and that the plaintiffs could not avoid the safe harbor because defendants had adequately alerted investors to the underlying risks. The Sixth Circuit further held that the defendants did not mislead investors by failing to disclose the specific effect of competition from Serta on the company's growth rate, where plaintiffs did not challenge the accuracy of the company's reported sales figures and where the risk posed by competition generally was disclosed.

BONDALI V. YUM! BRANDS, INC.

In ***Bondali v. Yum! Brands, Inc.***, 620 F. App'x 483 (6th Cir. 2015), the Sixth Circuit held that the plaintiffs asserting claims under Section 10(b) and Rule 10b-5 failed to adequately plead a material misrepresentation (or omission) and scienter surrounding activities in China concerning the restaurant chain, Kentucky Fried Chicken ("KFC"). The plaintiffs alleged that the company and its senior officers knew batches of chicken being supplied to Yum's KFC China subsidiary had tested positive for drug and antibiotic residues, and Yum made false or misleading statements by not disclosing the adverse test results, which resulted in a 17% drop in stock price after the media began exposing the issues. In affirming dismissal, the court held that the plaintiffs failed to "assert facts showing Yum's statements were 'objectively

false or misleading in light of the information now known.'" As to the company's 10-Q risk disclosures, the court held that "a reasonable investor would be unlikely to infer anything regarding the current state of a corporation's compliance, safety, or other operations from a statement intended to educate the investor on *future* harms." (emphasis in original). As to intent, the court affirmed the district court's finding that no alleged facts gave rise to a strong inference that defendants "received the test results and, thus, knew or should have known that Yum's statements discussing investment risks or touting its safety protocols were false or misleading."

VERBLE V. MORGAN STANLEY SMITH BARNEY, LLC

In a case now on appeal to the Sixth Circuit, Chief Judge Thomas Varlan in the Eastern District of Tennessee dismissed a Dodd-Frank Act whistleblower retaliation claim, limiting the possible reach of the Act's protections. ***Verble v. Morgan Stanley Smith Barney, LLC***, No. 3:15-CV-74-TAV-CCS, 2015 WL 8328561 (E.D. Tenn. Dec. 8, 2015). Notably, the United States Securities and Exchange Commission ("SEC") also tried to weigh in and filed an *Amicus Curiae* brief for this matter of first impression in the Sixth Circuit, and which is currently subject to a circuit split. Judge Varlan analyzed whether an employee who is retaliated against by his employer because he reported wrongdoing to the FBI, but not to the SEC, could still avail himself of the anti-retaliation provisions of the Dodd-Frank Act. The issue centered on the tension between the definition of "whistleblower" in the Dodd-Frank Act, subsection 21F(a)(6), which requires an individual to report "a violation of the securities laws *to the Commission*" (15 U.S.C. § 78u-6(a)(6) (emphasis added)) and subsection 21F(h)(1)(A)(iii), which provides that no employer may retaliate against a "whistleblower . . . in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002:" (15 U.S.C. § 78u-6(h)(1)(A)). The SEC interprets subsection three as applying to individuals "'who report to persons or governmental authorities other than the Commission.'" *Id.* at *5 (citation omitted). In finding the statute unambiguous, Judge Varlan refused to to give ***Chevron*** deference to the SEC's interpretive rule. In so doing, the district court sided with the Fifth Circuit and other district courts, finding the statute clear and requiring a whistleblower first to report to the Commission before he or she falls under the statutory protections. The Second Circuit and other district courts disagree and defer to the SEC in holding that an employee does not necessarily have to report to the Commission in order to bring a retaliation claim. The plaintiff in ***Verble*** has appealed the district court's decision to the Sixth Circuit, which will now have an opportunity to weigh in on the current circuit split on the interpretation of the Dodd-Frank Act's anti-retaliation provisions.

Navigating the Attorney-Client Privilege at Home and Abroad

Last year, we explored recent legal trends and developments relating to the treatment of the attorney-client privilege in the context of mergers and acquisitions, with a special focus on the steps companies can take to protect the privilege in the context of a potential sale of the company where sensitive information is being exchanged between the parties to a potential transaction. We also looked at whether the buyer or the seller subsequently controls the privilege, should a change of control occur.

This year, we turn our attention to the thorny issues faced by in-house counsel when navigating the attorney-client privilege and the work-product protection. We will also specifically address the unique challenges facing in-house counsel for companies with international operations and/or foreign affiliates. While most jurisdictions, both in the United States and abroad, treat communications with a company's outside counsel as privileged or subject to a high degree of protection, at least where the communications relate to the provision of legal advice or pending or anticipated litigation, a more complex question is presented when one considers the communications between the company's *in-house* counsel and executives and employees of the company and its affiliates.

SCOPE OF THE ATTORNEY-CLIENT PRIVILEGE AND WORK-PRODUCT PROTECTION UNDER U.S. LAW

Attorney-Client Privilege. Under U.S. federal law, the attorney-client privilege is generally defined as protecting "communications (1) between a client and his or her attorney; (2) that are intended to be, and in fact were, kept confidential; (3) for the purpose of obtaining or providing legal advice." ***U.S. v. Mejia***, 655 F.3d 126, 132 (2d Cir. 2011).[12] The purpose of the privilege has been "to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice." ***Upjohn Co. v. United States***, 449 U.S. 383, 389 (1981).

12. Most U.S. jurisdictions, state and federal, apply some variation of this formula. *See, e.g.* Tenn. Code Ann. § 23-3-105 (codifying the attorney-client privilege under Tennessee law); Del. R. Evidence 502(b) (codifying the attorney-client privilege under Delaware law). A comprehensive survey of the attorney-client privilege and attorney work-product protection across all U.S. jurisdictions is outside the scope of this article. Practitioners should take note that the scope of any privilege or choice of law analysis may differ across jurisdictions, depending on where a matter is being litigated.

Work-Product Protection. Under U.S. federal law, Federal Rule of Civil Procedure 26(b)(3) defines the scope of the attorney work-product protection. To briefly summarize, an adverse party typically cannot obtain through discovery "(1) a document or tangible thing, (2) that was prepared in anticipation of litigation, and (3) was prepared by or for a party, or by or for his representative." ***In re Grand Jury Subpoenas Dated Dec. 18, 1981 & Jan. 4, 1982***, 561 F. Supp. 1247, 1257 (E.D.N.Y. 1982). "Prepared in anticipation of litigation" generally means that "in light of the nature of the document and the factual situation in the particular case, the document can fairly be said to have been prepared or obtained because of the prospect of litigation." ***United States v. Adlman***, 134 F.3d 1194, 1202 (2d Cir. 1998). Moreover, work-product that does not involve attorney opinion is not given absolute protection, and may become discoverable upon showing of substantial need. FED. R. CIV. P. 26(b)(3)(a)(ii). Protection under the work-product doctrine does not extend to "documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation." *Id.*

As Applied to In-House Counsel. Both federal and state law extend the attorney-client privilege (and the work product doctrine) to communications between in-house counsel and their "client," the corporation. *See* ***In re Vioxx Products Liab. Litig., 501 F. Supp. 789, 796 (E.D. La. 2007)*** (It is "[w]ell accepted . . . that the attorney-client privilege applies to corporations," and is understood to "protect[] communications between those employees and corporate legal counsel on matters within the scope of their corporate responsibilities, as well as communications between corporate employees in which prior advice received is being transmitted to those who have a need to know in the scope of their corporate responsibilities."); ***Upjohn Co. v. United States***, 449 U.S. 383, 397-401 (1981) (applying work-product doctrine to notes and interview memoranda prepared by in-house counsel).

But in-house counsel should pay careful attention to who qualifies as the "corporation" for purposes of communications with the company's attorneys. A minority of U.S. jurisdictions apply the "Control Group Test," which is relatively restrictive and limits protected communications to those involving a limited group of employees who have the power to control the company's operations, or who otherwise play a significant role in making a decision utilizing the legal advice being furnished. *See, e.g.,* ***Hayes v. Burlington N. & Santa Fe Ry. Co.,*** 323 Ill. App. 3d 474, 476-478 (Ill. 2001). A majority of jurisdictions, however, apply some version of the "Subject Matter Test," in which communications are protected as privileged if they are made for the purpose of securing legal advice for the corporation, if a corporate employee communicates with counsel at the direction of his or her superiors, and the subject matter of that communication relates to the employee's performance of duties, within the scope of his or her employment. *See, e.g.*, ***Union Planters Nat. Bank of Memphis v. ABC Records, Inc.***, 82 F.R.D. 472 (W.D. Tenn. 1979) (applying Tennessee law). A version of this test was adopted by the U.S. Supreme Court in ***Upjohn v. United States***, 449 U.S. 383 (1981) (holding that attorney-client privilege protects communications between a corporation's employees and the corporation's attorneys, provided (1) corporate employees made the communication to corporate counsel acting as such, for the purpose of providing legal advice to the corporation; (2) the substance of the communication involved matters that fall within the scope of the corporate employee's official duties; (3) the employees themselves were sufficiently aware that their statements were being provided for the purpose of obtaining legal advice for the corporation; and (4) the communications were confidential when made and have been kept confidential by the company); *see also*, ***Deutsch v. Cogan***, 580 A.2d 100, 106 (Del. Ch. 1990) (positively citing to the test from ***Upjohn*** without definitively adopting it).

> Even some foreign jurisdictions who do recognize some variation on the attorney-client privilege or work-product doctrine limit the protection offered to communications with in-house corporate attorneys.

In-house counsel should also take care to ensure that sensitive legal communications that the corporation wishes to remain subject to a privilege actually satisfy applicable legal requirements. For one thing, steps must be taken to ensure that "legal" communications are clearly identifiable as such. Courts have remarked that "modern corporate counsel have become involved in all facets of the enterprises for which they work," and therefore it has become difficult to distinguish communications about "purely legal issues" from "decisions about business, technical, scientific, public relations, and advertising issues." ***In re Vioxx***, 501 F. Supp. 2d at 797. As the Delaware Court of Chancery recently observed, "[a]n attorney performing a business function 'cannot avail himself of the protection

associated with the attorney-client privilege or the work-product doctrine.'" ***In re Appraisal of Dole Food Co., Inc.***, 114 A.3d 541, 561 (Del. Ch. 2014) (quoting ***Lee v. Engle***, 1995 WL 761222, at *3 (Del. Ch. Dec. 15, 1995)). Commonly, however, whether the primary purpose of the communication is predominantly "legal" or "business" is not clear cut and is highly context-specific. "A particular task may be a business function in one context and a legal function in another context without any changes in the task itself." *Id.* at 562. Nevertheless, "[a] party seeking to withhold discovery based upon the attorney-client privilege must prove that all of the communications it seeks to protect were made primarily for the purpose of generating legal advice." ***United States v. Chevron Corp.,*** 1996 U.S. Dist. LEXIS 4154 (N.D. Cal. Mar. 13, 1996).

SCOPE OF THE ATTORNEY-CLIENT PRIVILEGE ABROAD

As noted above, while there are slight differences in how various U.S. federal and state jurisdictions articulate the legal standards governing attorney-client privilege and work-product protection, the general concepts are universally recognized and applied relatively consistently. That is simply not the case in many foreign jurisdictions (such as China), but even some foreign jurisdictions **that do** recognize some variation on the attorney-client privilege or work product doctrine limit it's applicability to in-house attorneys. *See, e.g.,* Lex Mundi, "In-House Counsel and the Attorney-Client Privilege," (available at http://www.lexmundi.com/images/lexmundi/PracticeGroups/LADR/Attorney_Client_Update8.09_Main_Document.pdf (2009). For example, many European countries (such as France) recognize a general obligation of confidentiality with respect to confidential business information, but do not recognize any legal privilege at all with respect to communications between employees of a company and in-house counsel. *Id.* at 63-65. In jurisdictions that recognize an obligation of "professional secrecy" with respect to in-house counsel, such obligations typically are not coterminous with the attorney-client privilege. *See* ***Gucci AM., Inc. v Guess?, Inc.***, *271* F.R.D. 58, 67 (S.D.N.Y. 2010) ("[A] professional secrecy obligation is not an evidentiary privilege — a critical distinction.") "In many jurisdictions around the world, a court may order disclosure if it determines that the need for the information is sufficient to outweigh the secrecy obligation, while the privilege, in contrast, is absolute and inviolate." ***In re Rivastigmine Patent Litig.***, 237 F.R.D. 69, 75 (S.D.N.Y. 2006).

APPLYING PRIVILEGE LAW IN THE CONTEXT OF U.S.-BASED LITIGATION INVOLVING FOREIGN AFFILIATES OR SUBSIDIARIES

One doesn't need to look very far to seek examples of U.S. litigation — whether it be federal securities fraud actions, SEC investigations or shareholder derivative litigation — where the underlying facts forming the basis of the action took place abroad. In contexts such as these, it is easy to see why a plaintiff might seek to take discovery of relevant communications involving the company's in-house counsel, especially if the subsidiary or affiliate that is the subject of the action is located in a jurisdiction that does not recognize communications with in-house attorneys as privileged.

What would a court in the United States do under these circumstances? For purposes of this discussion, assume that the issue arises in a federal securities action, pursuant to the federal securities laws and pending in a U.S. District Court. A federal court would first determine which jurisdiction's law governs the privilege dispute involving the attorney-client communication.[13] Most U.S. federal jurisdictions apply the "touch base" analysis, in which "the Court applies 'the law of the country that has the 'predominant' or 'the most direct and compelling interest' in whether [the] communications should remain confidential, unless that foreign law is contrary to the public policy of this forum.'" ***Anwar v. Fairfield Greenwich, Ltd.***, 306 F.R.D. 117, 119 (S.D.N.Y. 2013) (quoting ***Astra Aktiebolag v. Andrx Pharm., Inc.***, 208 F.R.D. 92, 98 (S.D.N.Y. 2002)) (emphasis in original). Generally, the jurisdiction with the "predominant interest" is either the location where the allegedly privileged relationship was entered into, or "the place in which that relationship was centered

> In-house counsel representing companies that operate in multiple jurisdictions should take care to make sure that communications that take place abroad actually comply with the requirements of U.S. privilege law.

13. Because it is governed by Fed.R.Civ.P. (26)(b)(3), courts have found that the work product doctrine is "procedural in nature," and therefore "the rules of the forum court [i.e., U.S. Law] apply..." *Gucci Am., Inc.* 271 F.R.D. at 73. Documents expressly prepared in anticipation of litigation should be protected in U.S. federal court.

at the time the communication was sent." *Id.* While there is no hard and fast rule, many courts also have found that if the communications at issue concern U.S. legal proceedings or investigations, or provide advice on compliance with U.S. law, then U.S. law controls the issue of whether the communication in question is privileged. If the communications relate entirely to foreign proceedings, then foreign privilege law likely applies.[14] *See id.; see also* ***In re Philip Servs. Corp. Sec. Litig.***, 2005 WL 2482494, at *2 (S.D.N.Y. Oct. 7, 2005) (finding communications to "touch base" with the United States where "letters were authored by United States and Canadian attorneys in order to render legal advice concerning a public offering of securities in the United States. Although the opinion letters were disclosed by a Canadian corporation to its Canadian auditors in Canada, the United States retains the most direct and compelling interest in whether those communications should remain confidential." (quotations omitted)); ***Gucci Am., Inc. v. Guess?, Inc.***, 271 F.R.D. 58, 64 (S.D.N.Y. 2010) ("Communications relating to legal proceedings in the U.S., or that reflect the provision of advice regarding American law, 'touch base' with the U.S. and, therefore, are governed by American law, even though the communication may involve foreign attorneys or a foreign proceeding."); ***Golden Trade S.r.l. v. Lee Apparel Group***, 143 F.R.D. 514, 520 (S.D.N.Y. 1992) (same).

Even where there is some degree of comfort that U.S. law might govern privilege, in-house counsel representing companies that operate in multiple jurisdictions should make sure that communications that take place abroad actually comply with the requirements of U.S. privilege law. One potential pitfall relates to the licensing of in-house attorneys. In ***Anwar v. Fairfield Greenwich, Ltd.,*** 306 F.R.D. 117 (S.D.N.Y. 2013), multi-district litigation involving claims by investors against various financial institutions and others to recover losses arising out of the Bernie Madoff investment scandal, the U.S. district court held that communications involving an unlicensed Dutch in-house counsel were not privileged because the attorney was not licensed. While licensure as an attorney is not a requirement for serving as in-house counsel in the Netherlands, the attorney-client privilege — under both Dutch and U.S. law — typically extends only to communications with *licensed* in-house counsel. *Id.* at 119. If a company is operating in a jurisdiction that permits unlicensed attorneys to serve as in-house counsel, it should be aware that most U.S. jurisdictions will not find communications with such individuals to be privileged unless they involved or took place at the direction of a licensed attorney.

While there is no hard and fast rule, many courts also have found that if the communications at issue concern U.S. legal proceedings or investigations, or provide advice on compliance with U.S. law, then U.S. law controls the issue of whether the communication in question is privileged.

PRIVILEGE IN THE CONTEXT OF NON-U.S. LITIGATION AND CRIMINAL OR REGULATORY PROCEEDINGS

In the context of a non-U.S. proceeding, or if a U.S. court were to determine that communications did not "touch base" with the U.S., then foreign privilege law applies and the analysis becomes jurisdiction-specific. As previously discussed, some European countries either do not recognize attorney-client privilege as it relates to in-house counsel, and others only recognize it under limited circumstances, especially if the communications at issue relate to government investigations. In the European Union, the rules can be especially harsh as they pertain to in-house counsel. For example, the Court of Justice of the European Union rejected the assertion of privilege over communications between in-house counsel and employees of a company in the context of EU antitrust/anti-competition law proceedings. *See* ***Akzo Nobel Chemicals, Ltd. v. European Commission***, Case C-550/07 P0 (2010). The Commission found that in-house counsel, as an employee of his "client," was not entitled to claim privilege because an in-house attorney is not sufficiently independent to address conflicts between his or her professional obligations as an attorney and the company, which is the attorney's "client."[15]

14. *But see Astra Aktiebolag v. Andrx Pharm., Inc.*, 208 F.R.D. 92, 100-102 (S.D.N.Y. 2002), in which the court refused to compel the production of communications relating to Korean proceedings, despite the fact that Korea did not have an applicable statutory attorney-client privilege or work-product protection. Because Korea permits only minimal civil discovery, none of the documents at issue would have been discoverable in a Korean proceeding, regardless of whether a legal privilege applied. The Court applied U.S. privilege law and found documents at issue subject to the attorney-client privilege even though the documents did not "touch base" with the United States, on the grounds that permitting the requested discovery would offend not only the public policy of the forum, but "the very principles of comity that choice-of-law rules were intended to protect." *Id.* at 102.
15. There is no reason to believe that the ECJ's opinion regarding the independence of in-house counsel would not extend to U.S.-based in-house attorneys as well. Therefore, U.S.-based in-house counsel communicating with a European subsidiary should take note that in certain proceedings their communications might not be regarded as privileged.

TAKEAWAYS AND PRACTICAL CONSIDERATIONS

Both outside and in-house counsel representing companies that operate in multiple jurisdictions should familiarize themselves with the law governing attorney-client privilege in the jurisdictions/countries in which their client primarily operates, paying special attention to rulings governing privilege in specific areas of law where the client might have exposure — such as antitrust/anti-competition law, as reflected in the ***Akzo*** opinion. Additionally, there are other practical steps that can be taken to minimize the risk of an adverse privilege ruling under U.S. or foreign law, and if such a ruling does occur, to minimize its adverse effects.

First, separate "legal" communications from "business" communications whenever it is possible and/or practical to do so. Even U.S. jurisdictions do not protect communications between attorneys and their clients if the communications do not relate to the provision of legal advice, but rather relate to general business issues. While most courts look to the "primary purpose" of the communication when deciding whether or not dual-purpose communications are privileged, it is best to avoid the issue on the front end. Employees should also be advised to avoid routinely copying in-house counsel on non-legal internal communications, which may undermine otherwise legitimate claims of privilege.

Second, where possible, create a record memorializing privileged communications and provide basic information that would allow a court to subsequently determine that the communication was indeed legal in nature and deserving of protection. This includes clearly labeling a communication "attorney/client communication," and including outside counsel on the communication if it relates to pending litigation or an ongoing investigation. While copying external counsel may not offer absolute protection depending on the jurisdiction in which the company operates, practically every jurisdiction that recognizes attorney-client privilege or work-product doctrine will protect communications between outside counsel and their clients to some degree.

Third, take steps to minimize unnecessary written work product relating to sensitive legal issues. Where written communication is necessary, limit written correspondence to a select group of executives or other employees on a need-to-know basis. If the company operates in a situation where the applicable privilege law is unclear or ambiguous, it may be advisable to provide legal advice orally where feasible. Ensure that those executives and employees who frequently request and/or receive legal advice have a basic understanding of the scope of attorney-client privilege in the relevant jurisdictions.

Finally, where possible, use contractual choice-of-law and forum selection provisions to the company's advantage, making sure that any business agreements to which the company is a party are governed by law that affords strong protection to attorney-client communications, including communications with in-house counsel. Keep in mind that such choice-of-law and forum selection provisions may have no effect in any criminal or regulatory proceedings that may arise.

Even keeping these considerations in mind, and understanding the law in the jurisdictions in which a company operates, it is not always possible to have complete certainty over whether legal privilege protection applies, especially where rules are inconsistent across jurisdictions. It is possible, however, to identify where risk lies ahead of time and plan accordingly to minimize potential fallout.

About Bass, Berry & Sims PLC
Securities & Shareholder Litigation Practice Group

Bass, Berry & Sims' Securities & Shareholder Litigation team members are recognized in *Chambers USA* for corporate and securities litigation and shareholder class actions. Our clients include more than 35 publicly traded companies, some of the country's largest privately held companies and their officers, directors, issuers, underwriters, special committees, and financial and investment advisors. In recent years, we have represented these clients in litigation matters arising out of corporate transactions valued at more than $75 billion, as well as litigation matters related to alleged violations of federal and state securities laws and alleged breaches of fiduciary duty by corporate officers and directors. We currently serve as lead counsel in a large MDL involving dozens of matters related to structured investment products. Our team has significant experience resolving insurance coverage disputes, including working with D&O insurance carriers and their counsel on securities litigation matters filed against corporate clients and directors and officers.

Our work on behalf of clients takes us to state and federal trial and appellate courts throughout the United States. We also defend clients nationwide in securities-related arbitrations, as well as other forms of alternative dispute resolution.

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Joe Crace is the co-chair of the firm's Securities & Shareholder Litigation Practice Group. He has handled securities and shareholder litigation matters for both public and private companies in various industries, including healthcare, financial services and food services. Joe also works with companies and their directors and officers to achieve favorable results in high-stakes cases and claims related to mergers and acquisitions. Over the past several years, Joe has represented multiple healthcare-related companies and their directors and officers in litigation related to mergers and acquisitions with valuations exceeding $3.6 billion.

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Overton Thompson has represented a multitude of clients in bet-the-company matters where hundreds of millions, and sometimes billions, of dollars have been in dispute. Overton works with officers, directors and leaders of companies on disputes involving securities and shareholder class actions; derivative actions; merger and acquisition litigation; officer and director liability; breach of fiduciary duty; and breach of securities laws, including claims brought under Section 10-b and Rule 10b-5.

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