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This month's Alert addresses three decisions from the Second Circuit: one setting forth the requirements for pleading a "domestic transaction" within the meaning of the Supreme Court's opinion in *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S.Ct 2869 (2010); another staying the Southern District of New York's order rejecting the SEC's proposed consent judgment with Citigroup pending appeal; and a third holding that an Article 77 proceeding falls within the securities exception to the Class Action Fairness Act.

We also discuss rulings from the Delaware Chancery Court denying motions to preliminarily enjoin the Delphi/Tokio Marine and Micromet/Amgen transactions. In addition, we address a Southern District of New York order requiring the plaintiffs in the AIG securities fraud suit to reveal the identities of confidential witnesses cited in the complaint. Finally, we discuss decisions granting motions to dismiss "Say on Pay" shareholder suits brought derivatively on behalf of Intersil Corporation, BioMed Realty Trust, Jacobs Engineering Group and Umpqua Holdings Corporation.

The Second Circuit Sets Forth the Requirements for Pleading a "Domestic Transaction" Under *Morrison*

In *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S.Ct 2869 (2010), the Supreme Court held that Section 10(b) only applies to "transactions in securities listed on domestic exchanges, and domestic transactions in other securities." *Id.* at 2884.

On March 1, 2012, the Second Circuit held that in order "to sufficiently allege a domestic securities transaction in securities not listed on a domestic exchange" within the meaning of *Morrison*, "a plaintiff must allege facts suggesting that irrevocable liability was incurred or title was transferred within the United States." *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 2012 WL 661771, at *6 (2d Cir. Mar. 1, 2012) (Katzmann, J.) ("*Absolute Activist II*").

Background

Nine Cayman Islands hedge funds (the "Funds") brought suit against certain foreign and domestic defendants, including employees of their investment adviser, Absolute Capital Management Holdings Limited, as well as the owner of a U.S.-based broker-dealer. According to the complaint, the defendants "first caused the Funds to purchase billions of shares of thinly capitalized U.S.-based [penny stock] companies" in private placement transactions. *Id.* at *2. "[T]he defendants [then allegedly] engaged in a variation on the classic 'pump[-]and-dump' scheme, causing the

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Funds to suffer losses of at least $195 million through cycles of fraudulent trading of securities." *Id.* The penny stock companies at issue registered their shares with the SEC, but the securities were not traded on any U.S. exchange.

On December 22, 2010, the Southern District of New York dismissed the complaint in its entirety on *Morrison* grounds. *Absolute Activist Value Master Fund Ltd. v. Homm*, 2010 WL 5415885, at *1 (S.D.N.Y. Dec. 22, 2010) (Daniels, J.). The district court found it significant that the case "involve[d] foreign investors suing foreign and domestic defendants regarding private transactions in securities that were not listed on a United States domestic exchange." *Id.* at *5. "This appears to be precisely the type of case the Supreme Court had in mind when it issued *Morrison*." *Id.* (To read our brief discussion of the district court's decision in the January 2011 edition of the Alert, please click here.) The Funds appealed.

The Second Circuit Holds That Plaintiffs May Plead a "Domestic Transaction" by Alleging that Irrevocable Liability Was Incurred or Title Was Transferred within the United States

The Second Circuit explained that "[t]his case requires us to determine whether foreign funds' purchases and sales of securities issued by U.S. companies brokered through a U.S. broker-dealer constitute 'domestic transactions' pursuant to *Morrison*." *Absolute Activist II*, 2012 WL 661771, at *1. The court noted that "[t]he case at hand does not concern the first prong of *Morrison*—whether a transaction involves a security listed on a domestic exchange." *Id.* at *5. "Rather, we must interpret *Morrison*'s second prong and determine under what circumstances the purchase or sale of a security that is not listed on a domestic exchange should be considered 'domestic'

within the meaning of *Morrison*." *Id.*

The Second Circuit observed that the *Morrison* opinion itself "provides little guidance as to what constitutes a domestic purchase or sale." *Id.* at *6. Accordingly, the *Absolute Activist II* court looked first to "how these terms are defined in the Exchange Act." *Id.*[1] The court found that the Exchange Act "definitions suggest that the 'purchase' and 'sale' take place when the parties become bound to effectuate the transaction." *Id.*

The *Absolute Activist II* court also considered Second Circuit precedent. In *Radiation Dynamics, Inc. v. Goldmuntz*, 464 F.2d 876 (2d Cir. 1972) (Waterman, J.), the Second Circuit held that "the point at which the parties become irrevocably bound" can be "used to determine the timing of a purchase and sale[.]" *Absolute Activist II*, 2012 WL 661771, at *6. The *Absolute Activist II* court concluded that "the point of irrevocable liability can [also] be used to determine the locus of a securities purchase or sale." *Id.* The Second Circuit noted that "this test has already been adopted and applied by district courts within this circuit." *Id.* (citing *SEC v. Goldman Sachs & Co.*, 790 F. Supp. 2d 147, 159 (S.D.N.Y. 2011); *Plumbers' Union Local No. 12 Pension Fund v. Swiss

1. The Second Circuit cited 15 U.S.C. § 78c, which provides that the terms "'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire" and "[t]he terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of." 15 U.S.C. § 78c(a)(13- 14).

Reins. Co., 753 F. Supp. 2d 166, 177 (S.D.N.Y. 2010)).

The *Absolute Activist II* court explained that the incurrence of irrevocable liability within the United States is not "the only way to locate a securities transaction." *Id.* "[A] sale of securities can [also] be understood to take place at the location in which title is transferred." *Id.* The Second Circuit noted that "the Eleventh Circuit has held that, in order to survive a motion to dismiss premised on *Morrison*, it is sufficient for the plaintiff to allege that title to the shares was transferred within the United States." *Id.* (citing *Quail Cruises Ship Mgmt. Ltd. v. Agencia de Viagens CVC Tur Limitada*, 645 F.3d 1307, 1310-11 (11th Cir. 2011)). (To read our discussion of the *Quail* decision in the July 2011 edition of the Alert, please click here.)

The Second Circuit Rejects Other Tests Proposed by the Parties for Pleading a "Domestic Transaction"

The Second Circuit explicitly "reject[ed] other potential tests proposed by the parties" for determining the existence of a "domestic transaction" within the meaning of the *Morrison* opinion. *Id.* at *7. First, as to the plaintiffs' claim that "the location of the broker-dealer should be used to locate securities transactions," the court held that "the location of the broker alone does not necessarily demonstrate where a contract was executed." *Id.*

With respect to the plaintiffs' assertion that "the identity of the securities should be used to determine whether a securities transaction is domestic," the court found that this argument is "belied by the wording of the test announced in *Morrison*." *Id.* "The second prong of that test refers to 'domestic transactions in other securities,' not 'transactions in domestic securities' or 'transactions in securities that are registered with the SEC.'" *Id.* (internal citation omitted).

As to the defendants' argument that "a transaction cannot be considered domestic" where "the buyer and seller are both foreign entities," the Second Circuit explained that "'[a] purchaser's citizenship or residency does not affect where a transaction occurs; a foreign resident can make a purchase within the United States, and a United States resident can make a purchase outside the United States.'" *Id.* (quoting *Plumbers Union*, 753 F. Supp. 2d at 178).

Finally, the Second Circuit found no basis for one defendant's argument that "it is still necessary to determine whether each individual defendant engaged in at least some conduct in the United States." *Id.* The *Absolute Activist II* court observed that a defendant's "lack of contact with the United States may provide a basis for dismissing the case against him for lack of personal jurisdiction." *Id.* However, the court emphasized that "the transactional test announced in *Morrison* does not require that each defendant alleged to be involved in a fraudulent scheme engage in conduct in the United States." *Id.*

The Second Circuit Dismisses the Complaint with Leave to Amend

"[U]pon careful review of the complaint," the Second Circuit determined that "the allegations do not sufficiently allege that purchases or sales took place in the United States." *Id.* at *8. The court noted that there were no allegations "suggesting that the Funds became

irrevocably bound within the United States or that title was transferred within the United States, including, but not limited to, facts concerning the formation of the contracts, the placement of purchase orders, the passing of title, or the exchange of money." *Id.*

Nonetheless, because "the Funds' complaint was filed before the Supreme Court issued its decision in *Morrison* and before [the Second Circuit] provided guidance about how to adequately plead a domestic purchase or sale," the *Absolute Activist II* court "conclude[d] that the Funds should be given leave to amend their complaint." *Id.* at *9.

The Second Circuit Stays the Southern District of New York's Order Rejecting the SEC's Proposed Consent Judgment with Citigroup Pending Appeal

On November 28, 2011, the Southern District of New York refused to approve a proposed consent judgment in the SEC's action against Citigroup Global Markets Inc. ("Citigroup") on the grounds that the settlement was "neither fair, nor reasonable, nor adequate, nor in the public interest." *U.S. Sec. & Exch. Comm'n v. Citigroup Global Mkts. Inc.*, 2011 WL 5903733, at *4 (S.D.N.Y. Nov. 28, 2011) (Rakoff, J.). (To read our discussion of the district court's decision in the December edition of the Alert, please click here.) The SEC and Citigroup filed interlocutory appeals of the district court's order; the SEC alternatively petitioned for a writ of mandamus. Both parties moved for a stay of the district court proceedings.

On March 15, 2012, a three judge-panel of the Second Circuit granted a stay pending resolution of the consolidated appeals. *U.S. Sec. & Exch. Comm'n*

v. Citigroup Global Mkts. Inc., 2012 WL 851807 (2d Cir. Mar. 15, 2012) (*per curiam*) ("*Citigroup II*"). The Second Circuit found that the parties had "made a strong showing of likelihood of success in setting aside the district court's rejection of their settlement" and had "shown serious, perhaps irreparable, harm sufficient to justify grant of a stay[.]" *Id.* at *9.

Background

Following "several years of investigation, discovery, and discussions with Citigroup" regarding the company's marketing of collateralized debt obligations ("CDOs"), the SEC filed a complaint charging Citigroup with negligent misrepresentation and simultaneously requested district court approval of a proposed consent judgment. *Id.* at *1. The settlement provided for a $285 million payment by Citigroup to an SEC-administered fund, as well as injunctive and preventative relief.

The district court rejected the proposed consent judgment for "three main reasons[.]" *Id.* at *2. "First, the court expressed strong disapproval of what it called 'the [SEC]'s long-standing policy—hallowed by history but not by reason—of allowing defendants to enter into [c]onsent [j]udgments without admitting or denying the underlying allegations.'" *Id.* The district court found that a settlement without any admission of liability by Citigroup "'serves various narrow

interests of the parties,' but not the public interest." *Id.* Second, the court cited the "perceived unfairness" to Citigroup "'because how can it ever be reasonable to impose substantial relief [on Citigroup] on the basis of mere allegations?'" *Id.* Third, the court found that "without admission of liability, a consent judgment involving only modest penalties gives no 'indication of where the real truth lies.'" *Id.*

The Second Circuit Finds That the Parties Have Shown a Strong Likelihood of Succeeding in Their Efforts to Overturn the District Court's Ruling

"In determining whether to issue a stay," a court must consider "'(1) whether the stay applicant has made a strong showing that he is likely to succeed on the merits; (2) whether the applicant will be irreparably injured absent a stay; (3) whether issuance of the stay will substantially injure the other parties interested in the proceeding; and (4) where the public interest lies.'" *Id.* at *3.

The Second Circuit Finds "Several Problems" with the District Court's Rejection of the Proposed Consent Judgment On Public Interest Grounds

The Second Circuit first considered "whether the [SEC] and Citigroup have a strong likelihood of success on the merits in their effort to overturn the [district] court's ruling." *Id.* The *Citigroup II* court found "several problems" with the district court's determination that "a consent judgment without Citigroup's admission of liability is bad policy and fails to serve the public interest because defrauded investors cannot use the judgment to establish Citigroup's liability in civil suits to recover the investors' losses." *Id.* In assuming that the SEC "had a readily available option to obtain a judgment that established Citigroup's liability, either by trial or settlement," the district court "overlook[ed] the possibilities (i) that Citigroup might well not consent to settle on a basis that requires it to admit liability, (ii) that the [SEC] might fail to win a judgment at trial, and (iii) that Citigroup perhaps did not mislead investors." *Id.*

An even "more significant problem" with the district court's rationale was its failure to "give[] deference to the [SEC's] judgment on wholly discretionary matters of policy." *Id.* at *4. The Second Circuit emphasized that "the scope of a court's authority to second-guess an agency's discretionary and policy-based decision to settle is at best minimal." *Id.* Here, the district court did "not appear to have considered the [SEC's] discretionary assessment of its prospects of doing better or worse, or … the optimal allocation of [the SEC's] limited resources." *Id.* at *5. "Instead, the district court imposed what it considered to be the best policy to enforce the securities laws." *Id.*

The Second Circuit also took issue with "the district court's apparent view that the public interest is disserved by an agency settlement that does not require the defendant's admission of liability." *Id.* "Requiring such an admission would in most cases undermine any chance for compromise." *Id.*

The Second Circuit Questions Whether the District Court Had Discretion to Reject the Proposed Consent Judgment on Grounds of Unfairness to Citigroup

With respect to the district court's finding that "the settlement was unfair to *Citigroup*," the Second Circuit questioned "whether it is a proper part of the court's legitimate concern to protect a private, sophisticated, counseled litigant from a settlement to which it freely consents." *Id.* at *5 (emphasis in the original). The Second Circuit "doubt[ed] that a court's discretion extends to refusing to allow such a litigant to reach a voluntary settlement in which it gives up things of value without admitting liability." *Id.*

The Second Circuit Questions Whether the District Court Had Discretion to Reject the Proposed Consent Judgment Based on a Lack of Conclusive Evidence of Liability

As to the district court's holding that "it could not properly evaluate the fairness of the settlement unless the underlying facts were conclusively established either by a trial or by binding admission of liability," the Second Circuit questioned "whether it lies within a court's proper discretion to reject a settlement on [that] basis." *Id.* at *6. The court explained that "[i]t is commonplace for settlements to include no binding admission of liability." *Id.* "We know of no precedent that supports the proposition that a settlement will not be found to be fair, adequate, reasonable, or in the public interest unless liability has been conceded or proved and is embodied in the judgment." *Id.*

The Second Circuit Finds That the Parties Will Suffer Significant Harm without a Stay

The Second Circuit determined that both the SEC and Citigroup will "incur significant harm absent a stay if they are prevented from settling their dispute and are ordered to prompt trial." *Id.* "Here, the district court's rejection of the settlement cannot be cured by the parties returning to the bargaining table to make relatively minor adjustments to the terms of the settlement to address the district court's concern." *Id.* at *8. "The district court's intimation that it will not approve a settlement that does not involve Citigroup's admission of liability, a condition that Citigroup is unlikely to satisfy, substantially reduces the possibilities of the parties reaching settlement." *Id.*

The Second Circuit Finds No Reason to Doubt That the Settlement Is in the Public Interest

Noting that it was "bound in such matters to give deference to an executive agency's assessment of the public interest," the Second Circuit found "no reason to doubt the [SEC's] representation that the settlement it reached [was] in the public interest … [or] that the stay the [SEC] seeks … [was] also in the public interest." *Id.* at *9.

The Second Circuit Provides for the Appointment of Counsel to Argue In Support of the District Court's Position at a Merits Hearing

"[B]ecause both parties to the litigation [were] united in seeking the stay and opposing the district court's order," the Second Circuit directed that "counsel [would] be appointed to argue in support of the district court's position" before a merits panel responsible for determining "whether the district court's order should in fact be overturned." *Id.* at *1. The Second Circuit clarified that the merits panel would be "free to resolve all issues without preclusive effect from this ruling." *Id.*

The Second Circuit Holds That an Article 77 Proceeding Concerning a Countrywide Home Loans Settlement Falls within CAFA's Securities Exception

On February 27, 2012, the Second Circuit held that an Article 77 proceeding brought in New York state court to sanction a trustee's settlement of a dispute concerning loans sold to certain residential mortgage-securitization trusts was not removable under the Class Action Fairness Act ("CAFA") because it "[fell] within CAFA's securities exception." *Blackrock Fin. Mgmt. Inc. v. Segregated Account of AMBAC Assurance Corp.*, 2011 WL 611401, at *1 (2d Cir. Feb. 27, 2012) ("*Blackrock*").

Background

The Bank of New York Mellon ("BNYM") serves as trustee of over five hundred residential mortgage-securitization trusts. Countrywide Home Loans, Inc. (now a subsidiary of Bank of America) sold the underlying mortgages, and its servicing arm serviced the mortgages. The applicable Pooling and Servicing Agreements ("PSA") provided that BNYM had the "'right to require [Countrywide] to cure any breach of a representation or warranty made … or to repurchase or substitute for any affected [m]ortgage [l]oan in accordance herewith.'" *Id.*

In 2010, a group of certificate holders (the "Institutional Investors") "complained to [BNYM] that a large number of mortgages that Countrywide [had] sold into the trusts failed to comply with the PSA's representations and warranties" and that "the servicer had also breached its obligations." *Id.* at *2. A separate group of certificate holders ("Walnut Place") "complained to [BNYM] that … Countrywide had refused Walnut Place's direct demand that Countrywide repurchase the nonconforming loans" and "demanded that [BNYM] sue Countrywide to enforce the terms of the PSA." *Id.*

On June 28, 2011, BNYM entered into a settlement agreement with Countrywide and Bank of America on behalf of the trusts. The following day, in accordance with the terms of the agreement, BNYM brought an Article 77 proceeding in New York state court seeking an entry of judgment "sanctioning its execution" of the settlement agreement.[2] *Id.*

Walnut Place "moved to intervene in the Article 77 proceeding, chiefly to exclude the three trusts that it invested in from the proposed settlement." *Id.* at *3. Among other claims, Walnut Place contended that BNYM had "negotiated the [s]ettlement [a]greement 'in secret,' working only with the Institutional Investors" and that "the parties had conflicts of interest: [BNYM] obtained for itself an expanded indemnity, and the Institutional Investors had other business relationships with Bank of America." *Id.*

On August 26, 2011, Walnut Place removed the Article 77 proceeding to the Southern District of New York on the grounds that the proceeding constituted a "mass action" under CAFA, 28 U.S.C. § 1332(d)(11), and was "therefore removable under 28 U.S.C. § 1446 and § 1453." *Id.* BNYM and the Institutional Investors moved to remand, but the district court denied the motion.

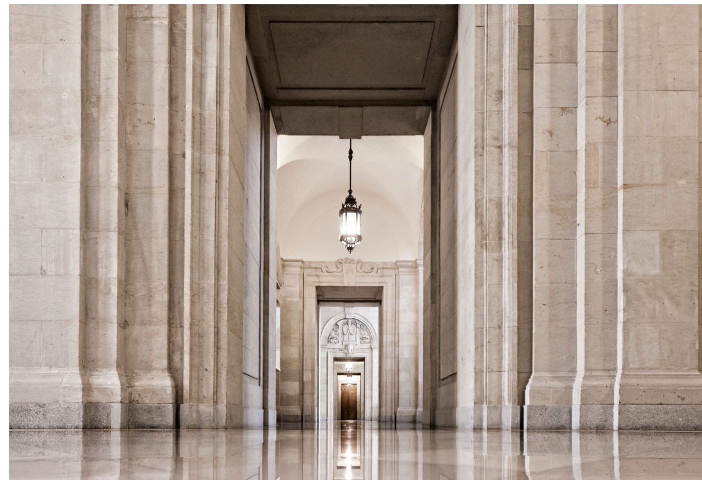
2. Article 77 provides that "[a] special proceeding may be brought to determine a matter relating to any express trust … Any party to the proceeding shall have the right to examine the trustees … as to any matter related to their administration of the trust." N.Y. C.P.L.R. § 7701.

The Second Circuit "granted leave to appeal [the district court's order] to consider," *inter alia*, "whether the case falls within CAFA's securities exception." *Id.*

The Second Circuit Finds No Jurisdiction under CAFA and Remands the Case to State Court

The securities exception provides that CAFA does not "apply to any class action that solely involves a claim … that relates to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to any security." 28 U.S.C. § 1332(d)(9)(C); *see also* 28 U.S.C. § 1453(d). The Second Circuit has "twice before construed the [securities] exception," first in *Estate of Pew v. Cardarelli*, 527 F.3d 25 (2d Cir. 2008), and then in *Greenwich Fin. Servs. Distressed Mortgs. Fund 3 LLC v. Countrywide Fin. Corp.*, 603 F.3d 23 (2d Cir. 2010). *Blackrock*, 2012 WL 611401, at *4. These "precedents explain that [the securities exception] carves out from [the Second Circuit's] jurisdiction claims based either on the terms of the instruments that create and define securities or on the duties imposed on persons who administer securities, while leaving unaffected federal jurisdiction over claims based on rights arising from independent sources of state law." *Id.* (internal quotations omitted).

The *Blackrock* court explained that the "first step" in its analysis was "to determine what claims [are] asserted" in the Article 77 proceeding. *Id.* at *5. The court "conclude[d] that [BNYM] is seeking a judicial determination [i] that it has the authority to assert and settle claims on behalf of the trusts and [ii] that it 'acted in good faith, within its discretion, and within the bounds of reasonableness in determining that the [s]ettlement [a]greement was in the best interests of the [c]overed [t]rusts." *Id.* "Thus, [BNYM] asks for a construction of the PSA and an instruction that its planned course of action complies with its obligations under that document and the law of trusts—consistent with other proceedings brought under Article 77." *Id.*



"Having characterized the claim as a declaration authorizing the exercise of a trustee's powers," the *Blackrock* court then turned to the question of whether the claim falls within CAFA's securities exception. *Id.* at *6. The *Blackrock* court noted that in *Greenwich Financial*, the Second Circuit "held that a suit by security holders attempting to enforce the terms of a PSA fit within" the securities exception. *Id.*

Moreover, the *Blackrock* court found it significant that "[t]he sole claim presented in the Article 77 proceeding … concerns the relationship between the entity which administers the securities, [BNYM], and the certificateholders." *Id.* The court explained that "[i]n *Cardarelli*, [the Second Circuit] drew no distinction between suits that relate to 'the terms of instruments that create and define securities' and those that relate to the 'duties imposed on persons who administer securities.'" *Id.* (quoting *Cardarelli*, 527 F.3d at 33).

The *Blackrock* court determined that "the district court [had] erred insofar as it reasoned that the securities exception does not apply if 'the trustee's conduct in approving the settlement must also be evaluated under some' source of law other than the PSA, 'such as New York's common law of trusts.'" *Id.* "[D]uties superimposed by state law as a result of the relationship created by or underlying the security fall within the plain meaning of the statute, which expressly references 'duties (including fiduciary duties).'" *Id.*

Because the *Blackrock* court found that BNYM's Article 77 proceeding fell within CAFA's securities exception, the court held that "the case was not removable from state court and must be remanded." *Id*. at *3.

The Delaware Chancery Court Denies a Motion to Preliminarily Enjoin The Delphi/Tokio Marine Transaction

On March 6, 2012, in a decision denying a preliminary injunction motion by a shareholder challenging the proposed takeover of Delphi Financial Group, Inc. by Tokio Marine Holdings, Inc. ("TMH"), the Delaware Chancery Court determined that the plaintiffs "are reasonably likely to be able to demonstrate at trial" that Robert Rosenkranz, Delphi's Chairman and CEO, "violated duties to the stockholders" by "negotiating for disparate consideration and only agreeing to support the merger if he received it." *In re Delphi Fin. Grp. S'holder Litig.*, 2012 WL 729232 at *17 (Del. Ch. Mar. 6, 2012) (Glasscock, V.C.). "However, because the deal represents a large premium over market price, because damages are available as a remedy, and because no other potential purchaser has come forth or seems likely to come forth to match, let alone best,

the TMH offer," the court held that "the balance of the equities" does not "favor[ ] an injunction over letting the stockholders exercise their franchise." *Id*. at *2.

Background

When Rosenkranz took Delphi public in 1990, he "created two classes of stock, Class A, largely held by the public, and Class B, retained by Rosenkranz." *Id*. at *1. "Although Rosenkranz retained less than 13% of the shares outstanding, each share of Class B stock represented the right to ten votes in stockholder matters, while each share of Class A stock entitled the holder to one vote." *Id*. A charter provision "directed that, on sale of the company, each share of Class B stock would be converted to Class A, entitled to the same consideration as any other Class A stock." *Id*. "In other words, though Rosenkranz retained voting control, he sold his right to a control premium to the Class A stockholders via the [c]harter." *Id*. at *16.

In 2011, TMH reached out to Rosenkranz about the possible purchase of Delphi. "While negotiating with TMH on behalf of Delphi, Rosenkranz … made it clear to Delphi's board that, notwithstanding the charter provision, he would not consent to the sale without a premium paid for his Class B stock." *Id*. at *1. The parties ultimately agreed to a deal "structured to provide a differential: $44.875 per share for the Class A shares; $53.875 per share for the Class B shares." *Id*. The deal was "conditioned, at Rosenkranz's insistence, on a Charter Amendment removing the requirement" that "the Class A stockholders and the Class B stockholders must be treated equally." *Id*. at *15.

Delphi shareholders subsequently brought suit seeking a preliminary injunction of the TMH takeover on the grounds that, *inter alia*, "Rosenkranz [was] not entitled to the stock price differential" and "the Delphi Board breached its duty to the stockholders in structuring the deal to include such a differential at the Class A stockholders' expense." *Id*. at *2.

The *Delphi* Court Finds That the Plaintiffs Have a Reasonable Likelihood of Succeeding on Their Breach of Fiduciary Duty Claims Against Rosenkranz

The *Delphi* court found that the plaintiffs' "most persuasive argument … is that despite a contrary provision in the Delphi Charter, Rosenkranz, in breach of his contractual and fiduciary duties, sought and obtained a control premium for his shares." *Id*. at *14. The court explained that letting Rosenkranz "coerce" shareholders into approving a charter amendment allowing disparate treatment of Class A and Class B shares "would permit Rosenkranz, who benefited by selling his control premium to the Class A stockholders at Delphi's IPO, to sell the same control premium again in connection with this [m]erger." *Id*. at *16. "That would amount to a wrongful transfer of merger consideration from the Class A stockholders to Rosenkranz." *Id*. Therefore, the *Delphi* court held that "the [p]laintiffs have demonstrated a likelihood of success on the merits" of their breach of fiduciary duty claims "at least with respect to the allegations against Rosenkranz." *Id*. at *2.

The *Delphi* Court Declines to Preliminarily Enjoin the Merger

In considering whether to grant a preliminary injunction, the *Delphi* court noted that the Chancery Court had "recently addressed a situation similar to the present action in" *In re El Paso Corp. Shareholder Litigation*, 2012 WL 653845 (Del Ch. Feb 29, 2012) (Strine, C.). *Delphi*, 2012 WL 729232, at *19. There, the Chancery Court declined to preliminarily enjoin a merger between El Paso Corp. and Kinder Morgan, Inc. even though the court found that "the plaintiffs ha[d] a reasonable likelihood of proving that the [m]erger was tainted by disloyalty." *El Paso*, 2012 WL 653845, at *2. The *El Paso* court held that "the balance of harms counsel[ed] against a preliminary injunction" because "there [was] no other bid on the table and the stockholders of El Paso, as the seller, [had] a choice whether to turn down the [m]erger themselves." *Id*.

The *Delphi* court explained that in *El Paso*, "[t]he proposed transaction offered a premium of 37% over El Paso's stock price … and was the only bid on the table." *Delphi*, 2012 WL 729232, at *19. "Here, the 76% premium offered by TMH dwarfs the premium percentage in *El Paso*." *Id*. Moreover, "[n]o party has suggested that another suitor [for Delphi] is in the wings or is likely to be developed at a greater, or even equal, price." *Id*. at *20.

While the *Delphi* court found it "reasonably likely that Rosenkranz [had] violated a duty in his role as lead negotiator," the court noted that "his interests were at least in some respects aligned with those of the Class A stockholders." *Id*. at *19. "Given these considerations, and the fact that … money damages can largely remedy the threatened harm," the *Delphi* court held that "the stockholders' potential loss of a substantial premium on their shares outweighs the value of an injunction." *Id*. The court determined that "it is preferable to allow the stockholders to decide whether they wish to go forward with the [m]erger despite the imperfections of the process leading to its formulation." *Id*. at *20.

The Delaware Chancery Court Denies a Motion to Preliminarily Enjoin the Micromet/Amgen Merger

On February 29, 2012, in a shareholder suit challenging the proposed acquisition of Micromet, Inc. by a wholly-owned subsidiary of Amgen, Inc., the Delaware Chancery Court denied the plaintiffs' motion for a preliminary injunction on the grounds that the plaintiffs "have failed to show a reasonable likelihood that they will succeed in proving that the challenged transaction is unfair or that the directors breached their fiduciary duties of care or loyalty, including their disclosure obligations, in approving the transaction." *In re Micromet Inc. S'holders Litig.*, 2012 WL 681785, at *1 (Del. Ch. Feb. 29, 2012) (Parsons, V.C.). The court also determined that that "the balance of the equities weighs against enjoining the proposed transaction" because "no other bidder has emerged." *Id.* at *13.

Background

"[O]n July 18, 2011, Amgen submitted a proposal to acquire Micromet at $9 per share." *Id.* at *2. On January 3, 2012, the Micromet Board "informed Amgen that it would work with Amgen on its due diligence if it was willing to increase its offer to $11 per share." *Id.* at *3. That same day, Micromet's financial advisor, Goldman Sachs, "contacted seven large pharmaceutical companies that the Board determined might be interested in and capable of acquiring Micromet." *Id.* at *4. Beginning on January 13, 2012, Micromet held due diligence sessions with three of these companies. "By January 24, 2012, however, all three companies had indicated they were not interested in an acquisition." *Id.* On January 25, 2012, the Micromet Board approved the merger with Amgen at a price of $11 per share. The agreement was announced the following day, and the tender offer commenced on February 2, 2012.

After the merger was announced, Micromet shareholders brought suit challenging the transaction on the grounds that "the [Micromet] Board [had] breached its fiduciary duties by favoring Amgen as a bidder and failing to do any meaningful market check until immediately before the announcement of the proposed transaction." *Id.* The "[p]laintiffs also claim[ed] that the deal protections agreed to under the [m]erger [a]greement unreasonably have shortened the tender offer period and collectively … precluded other competing bids from emerging." *Id.* "Additionally, [the] [p]laintiffs assert[ed] that the [Micromet] Board breached its fiduciary duties of disclosure by making materially incomplete and misleading statements in the Recommendation Statement it disseminated to shareholders." *Id.*

The *Micromet* Court Finds That the Plaintiffs Failed to Show a Reasonable Likelihood of Success on the Merits

The court found that "the scope of the market check was adequate and consistent with the [Micromet] Board's well-informed understanding of the industry and Micromet's needs." *Id.* at *7. Moreover, the court determined that the plaintiffs "have not shown that

they are likely to succeed on their claims that … the deal protections agreed to under the [m]erger [a]greement, at least collectively, were preclusive." *Id.* at *10.

With respect to the plaintiffs' claims that "the Board breached its fiduciary duties by failing to disclose its basis for applying probability of success rates for its clinical trial drugs that were below reported industry norms," the court found that "what matters is that investors received a summary that adequately described management's well-informed projections as to the viability of its drug pipeline." *Id.* at *11.

The court found "[e]qually unavailing" the plaintiffs' "claims that the [Micromet] Board breached its fiduciary duties by failing to disclose the fees paid by Micromet to Goldman Sachs over the past two years, as well as Goldman's interest in Amgen stock." *Id*. The court noted that "Goldman's Amgen holdings equal approximately 0.16% of its overall investment holdings and 3.8% of its healthcare sector investments." *Id*. "Moreover, Goldman owns … substantially larger stake[s]" in two companies that were considered as potential acquirers during the market check. *Id.*

The *Micromet* Court Finds That the Plaintiffs Failed to Show Irreparable Harm Warranting a Preliminary Injunction

Because the plaintiffs had "failed to show a reasonable likelihood that they will succeed on the merits of their claims," the court held that "the shareholders will not suffer irreparable harm if the tender offer is not enjoined." *Id.* at *13. The court also found that "the balance of equities weigh[ed] against enjoining the proposed transaction" because there was no competing bid on the table and thus "the proposed transaction may represent the shareholders' only and best opportunity to receive a substantial premium for their shares." *Id.*

The Southern District of New York Orders Plaintiffs in the *AIG* Case to Disclose the Identities of Confidential Witnesses Quoted in the Complaint

On March 6, 2012, the Southern District of New York ordered the plaintiffs in a securities fraud action against American International Group, Inc. ("AIG") "to reveal the identities of confidential witnesses, whose statements [were] incorporated into the [c]omplaint." *In re Am. Int'l Grp, Inc. 2008 Sec. Litig.*, No. 08 Civ. 4772, slip op. at 1 (S.D.N.Y. Mar. 6, 2012) (Freeman, M.J.) ("*AIG*").[3] The court held that plaintiffs "should not be permitted to rely on the testimony of confidential witnesses to state their claims, and then withhold the identities of [those] confidential witnesses during discovery." *Id.* at 6.

Background

In May 2009, plaintiffs brought a securities fraud action against AIG and various current or former AIG executives, directors, accountants and underwriters. The complaint "reference[d] testimony made by … confidential witnesses." *Id.* at 1. On September 27, 2010, the Southern District of New York denied the defendants' motion to dismiss. "[T]he [c]ourt cited to [confidential witness] testimony in finding that [the] [p]laintiffs had adequately pleaded material misstatements and omissions, scienter, and a control person liability claim[.]" *Id.* at 2.

"After the denial of [the] [d]efendants' motion to dismiss, the [d]efendants issued discovery requests

3. Simpson Thacher represents current and former outside directors of AIG in this matter.

concerning, *inter alia*, the identities of the [confidential witnesses]." *Id*. at 3. The plaintiffs objected, claiming that "disclosure of the identities of the [confidential witnesses] [would] reveal confidential attorney work product." *Id*. at 4. In addition, the plaintiffs argued that protecting the identities of the confidential witnesses was "'necessary to maintain the deterrent effect of the federal securities laws.'" *Id*.

The *AIG* Court Holds That the Attorney Work Product Doctrine Does Not Protect the Identities of the Confidential Witnesses In This Case

At the outset of its analysis, the *AIG* court emphasized that "[t]he attorney work product doctrine is a qualified protection, rather than an absolute one, and can be overcome by a showing that the party seeking discovery (1) 'has a substantial need of the materials,' and (2) 'is unable, without undue hardship, to obtain the substantial equivalent of the materials by other means.'" *Id*. at 5.

The *AIG* court noted that the Southern District of New York considered similar arguments in *In re Bear Stearns Companies, Inc. Securities, Derivative and ERISA Litigation*, 2012 WL 259326 (S.D.N.Y. Jan. 27, 2012) (Sweet, J.). The *Bear Stearns* court concluded that "'the work product doctrine [could not] be employed to protect the identities of [the plaintiffs'] confidential witnesses.'" *AIG*, slip op. at 5-6 (quoting *Bear Stearns*, 2012 WL 259326, at *3).

In reaching its decision, the *Bear Stearns* court relied on the Southern District of New York's opinion in *Plumbers and Pipefitters Local Union No. 630 Pension-Annuity Trust Fund v. Arbitron, Inc.*, 2011 WL 5519840 (S.D.N.Y. Nov. 14, 2011) ("*Arbitron*"). The *Arbitron* court held that "where a party has attempted to satisfy the pleading requirements of the [Private Securities Litigation Reform Act] 'by 'showcasing' statements from a limited number of confidential witnesses, it

may not thereafter refuse to disclose who they are' on grounds of work product." 2011 WL 5519840, at *6.

Apart from the *Arbitron* and *Bear Stearns* opinions, the *AIG* court acknowledged that case law addressing attorney work product protection for the identities of confidential witnesses "'is not uniform.'" Slip op. at 6 (quoting *Bear Stearns*, 2012 WL 259326, at *3). Nonetheless, the *AIG* court determined that "substantial case law and the circumstances of this particular case" warrant the disclosure of the confidential witness identities at issue. *Id*.

The *AIG* court found that "[e]ven if the identity of these witnesses qualifie[d] as work product, the difficulty [the] [d]efendants would face in trying to ascertain the identity of these witnesses from otherwise available information is a burden that overcomes [the] [p]laintiffs' need for protection." *Id*. at 7. Based on the brief descriptions of the confidential witnesses provided by the plaintiffs, "there is no manageable universe of potential confidential witnesses." *Id*. at 8. The defendants "would [therefore] face a significant hardship, if they were forced to rely on their own efforts to identify the three [confidential witnesses] whose testimony [the] [p]laintiffs used in the [c]omplaint." *Id*.

The *AIG* Court Directs the Parties to Use the Existing the Confidentiality Order to Address Witness-Specific Confidentiality Concerns

The plaintiffs "contend[ed] that maintaining witness confidentiality [was] necessary to protect the [confidential witnesses] from retaliation from their past, current or future employers." *Id*. The *AIG* court noted that in *Arbitron*, the Southern District of New York "rejected the plaintiff's 'generic[ ]' assertions of retaliation, but acknowledged a confidential witness's legitimate interest in non-disclosure, and suggested that an appropriate protective order could address such a concern." *Id*. (quoting *Arbitron*, 2011 WL 5519840, at *8).

The *AIG* court observed that the plaintiffs "have not submitted any specific retaliation concerns, and thus the record before the [c]ourt does not reflect that any of the [confidential witnesses] face an actual risk of retaliation sufficient to justify non-disclosure of their names[.]" *Id*. at 8-9. Nevertheless, the court "direct[ed] the parties to confer in good faith and to utilize the existing confidentiality order … to address any *specific* confidentiality concerns of any individual [confidential witness]." *Id*. at 9.

Courts Dismiss Four Separate "Say on Pay" Suits

As we have previously reported, the Dodd-Frank Wall Street Reform and Consumer Protection Act provides for advisory shareholder votes on the compensation awarded to executives of publicly traded companies. *See* 15 U.S.C. § 78n-1(a)(1). The statute expressly states that "Say on Pay" votes may not be construed as "overruling a decision" by the company or its board of directors, "creat[ing] or imply[ing] any change to [their] fiduciary duties," or imposing "any additional fiduciary duties." 15 U.S.C. § 78n-1(c). Notwithstanding the advisory nature of "Say on Pay" votes, shareholders have been filing derivative suits on the heels of negative votes. To date, most courts that have ruled on dismissal motions in "Say on Pay" suits have issued decisions in the defendants' favor. This trend has continued in the past several weeks.

The Northern District of California Dismisses the Intersil "Say on Pay" Suit

On March 7, 2012, the Northern District of California granted a motion to dismiss a "Say on Pay" suit brought derivatively on behalf of Intersil Corporation on the grounds that the plaintiff had not adequately pled demand futility under applicable Delaware law. *Laborers' Local v. Intersil*, 2012 WL 762319 (N.D. Cal. Mar. 7, 2012) (Davila, J.) ("*Intersil*"). The court granted the plaintiff leave to amend the complaint to plead "[a]dditional facts … sufficient to prove that demand is excused." *Id*. at *8.

Background

On May 4, 2011, 56% of voting Intersil shareholders rejected the company's 2010 CEO and top executive compensation. On August 19, 2011, the plaintiff filed

a derivative suit against Intersil's directors and several of its current executives, alleging claims for breach of fiduciary duty and unjust enrichment in connection with the company's 2010 executive compensation. The plaintiff did not make a pre-suit demand on Intersil's Board.

The *Intersil* Court Holds That the Plaintiff Failed to Establish Demand Futility

"[B]ecause Intersil is incorporated in Delaware," the Northern District of California "applie[d] Delaware law to determine whether demand [was] excused." *Id*. at *4. Delaware law provides that "failure to make a demand may be excused if a plaintiff can raise a reasonable doubt that (1) a majority of the board is disinterested or independent, or (2) the challenged act was a product of the board's valid exercise of business judgment." *Id*. (citing *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000)). The *Intersil* court held that the plaintiff "ha[d] not met the first prong of the *Aronson* test for demand futility." *Id*. at *6.

"To rebut the business judgment rule presumption" under the second prong of Delaware's demand futility test, "'plaintiffs must plead particularized facts sufficient to raise (1) a reason to doubt that the action was taken honestly and in good faith or (2) a reason to doubt that the board was adequately informed in making the decision.'" *Id*. at *6. The *Intersil* court found that "[t]he complaint fails to allege facts showing that Intersil's Board was not adequately informed in making the decision regarding the 2010 executive compensation." *Id*.

"With regards to the honesty and good faith of the [Intersil] Board, [the] [p]laintiff point[ed] to the shareholder vote to call the directors' decision into question." *Id*. The "[p]laintiff claim[ed] that the negative '[S]ay on [P]ay' shareholder vote is evidence showing that [Intersil's] directors failed to act in the shareholders' best interests and rebuts the presumption that the [Intersil] Board's decision regarding compensation is entitled to business judgment protection." *Id*.

In considering the plaintiffs' claims, the *Intersil* court noted that "Congress was explicit that the shareholder vote on executive pay is non-binding." *Id*. at *7. However, the court found that the Dodd-Frank Act "is silent on what consideration courts should give to the shareholder vote." *Id*. The *Intersil* court reasoned that "Congress must have intended for the shareholder vote to have some weight." *Id*. "[I]f the shareholder vote approving executive compensation [was] meant to have no effect whatsoever, it seems unlikely that Congress would have included a specific provision requiring such a vote." *Id*.

The *Intersil* court "conclude[d] that a shareholder vote on executive compensation under the [Dodd-Frank] Act has substantial evidentiary weight and *may* be used as evidence by a court in determining whether the second prong of the *Aronson* test has been met." *Id*. at *8 (emphasis in the original). "Ruling only on the particular facts presented in the case before the court, where 56 percent of shareholders disapproved of Intersil's 2010 executive compensation package," the *Intersil* court found "that the shareholder vote *alone* [was] not enough to rebut the presumption of the business judgment rule." *Id*. The court determined that "[a]dditional facts are required for [the] plaintiff

to raise a reasonable doubt that the decision was not a valid exercise of business judgment." *Id*. Accordingly, the *Intersil* court dismissed the plaintiffs' complaint with leave to amend.

The District of Maryland Dismisses the Biomed Realty Trust "Say on Pay" Suit

On March 12, 2012, the District of Maryland granted a motion to dismiss a "Say on Pay" suit brought derivatively on behalf of BioMed Realty Trust, Inc. on the grounds that the plaintiff had failed to plead demand futility under applicable Maryland law. *Weinberg v. Gold*, 2012 WL 812348 (D. Md. Mar. 12, 2012) (Bredar, J.) ("*BioMed*").

Background

On May 25, 2011, "a majority of the shares [that were] voted rejected [BioMed's] 2010 executive compensation plan." *Id*. at *1. A shareholder subsequently brought suit against certain of BioMed's officers and directors alleging, *inter alia*, breach of fiduciary duty and unjust enrichment claims. The plaintiff did not make a pre-suit demand on the BioMet Board.

The *BioMed* Court Finds That the Allegations Do Not Pass Muster Under Maryland's Demand Futility Test

Because BioMed is a Maryland corporation, the *BioMed* court "look[ed] to Maryland law to determine whether demand should be excused." *Id*. at *2. In *Werbowsky v. Collomb*, 766 A.2d 123 (Md. 2001), the Maryland Court of Appeals held that the demand futility exception is "very limited" and may be "applied only when the allegations or evidence clearly demonstrate, in a very particular manner, either that (1) a demand, or a delay in awaiting a response to a demand, would cause irreparable harm to the corporation, or (2) a majority of the directors are so personally and directly conflicted or committed to the decision in dispute that they cannot reasonably be expected to respond to a demand in good faith and within the ambit of the business judgment rule." 766 A.2d at 144. The *Werbowsky* court made it clear that it would be unwilling to excuse demand "simply because a majority of the directors approved or participated in some way in the challenged transaction or decision." *Id*. at 143-44.

Applying the *Werbowsky* standard, the *BioMed* court held that the plaintiffs' allegations were "insufficient to justify application of the futility exception." *BioMed*, 2012 WL 812348, at *5. First, the court noted that only two of BioMed's seven directors were "beneficiaries of the [challenged 2010] compensation plan." *Id*.

Second, the *BioMed* court explained that "merely because directors are named in the instant suit does not mean that *prior to the suit*, a demand would have been futile." *Id*. (emphasis in the original). If "simply naming [directors] as parties provided excuse for pre-suit demand," then the requirement "would be nullified in every shareholder's derivative suit that named directors as defendants." *Id*.

Third, the *BioMed* court declined to delve into questions of "whether the directors' actions were the product of valid business judgment" because

"*Werbowsky* implicitly disallows consideration of the merits of the case in analyzing demand futility." *Id*. at *6. The *BioMed* court found that "a '[S]ay on [P]ay' vote may be reasonably considered as a factor in the demand futility analysis," but held that "it is not conclusive in this case." *Id*.

"In sum," the *Biomed* court held that the plaintiff did "not offer sufficient allegations in his complaint to excuse demand under the futility exception recognized by Maryland law." *Id*. at *7. The court accordingly granted Biomed's motion to dismiss the complaint.

A California Superior Court Dismisses the Jacobs Engineering "Say on Pay" Suit

On March 6, 2012, the Superior Court of California sustained for the second time a demurrer to a "Say on Pay" complaint brought derivatively on behalf of Jacobs Engineering Group, but this time the court dismissed the complaint without leave to amend. *Jacobs Eng'g Grp., Inc. Consol. S'holder Deriv. Litig.*, No. BC454543 (Cal. Super. Ct. Mar. 6, 2012) (Freeman, J.) ("*Jacobs*").

Background

The Jacobs Board allegedly "authorized significant pay increases for Jacobs' senior officers in 2010, despite 'abysmal 2010 revenues and earnings performances.'" *Id*. at 2. According to the plaintiffs, "a majority of the [c]ompany's shareholders [53.7%] rejected the Board's business judgment by voting against the Board's recommended approval of the allegedly excessive 2010 executive compensation awards." *Id*. at 1-2. The plaintiffs brought suit against the Jacobs Board for breach of fiduciary duties and unjust enrichment. No pre-suit demand was made.

The defendants "demurred to the derivative complaint." *Id*. at 2. On November 10, 2011, the court sustained the demurrer with leave to amend the complaint as to all claims except for the unjust enrichment claim. The court "determined that [the] [p]laintiffs [had] failed to adequately plead demand futility, since they [had] failed to allege the disinterestedness of the directors." *Id*. The court also "stated that it had 'reservations' concerning the sufficiency of the allegations of the [c]omplaint to state a claim for breach of fiduciary duty that would not be precluded by the business judgment rule." *Id*.

The plaintiffs filed a second amended complaint, and the defendants demurred again on the grounds that the plaintiffs "still have not alleged demand futility and otherwise fail to state facts sufficient to constitute their claims." *Id*. at 3.

The *Jacobs* Court Finds That the Complaint Fails to Raise a Reasonable Doubt as to the Directors' Disinterestedness or Independence

The *Jacobs* court applied California law in reviewing the plaintiffs' demand futility allegations. To plead demand futility under California law, plaintiffs "must show particularized facts creating a *reasonable doubt* that" (1) "[t]he directors are *disinterested* in and *independent* of the challenged transaction;" or (2) "[t]he challenged transaction was otherwise the product of a valid exercise of *business judgment*." *Id*. at 5 (emphasis in the original). California courts "'rely on corporate

law developed in the state of Delaware … [because] it is identical to California corporate law for all practical purposes[.]'" *Id*.

Applying the first prong of the demand futility test, the court found that the plaintiffs had "pled a reasonable doubt" only as to one of the directors who "personally benefited from the pay plan." *Id*. at 7. With respect to the remaining directors, the court found that there was "nothing [in the complaint] which demonstrates how a majority of the directors face[ ] a substantial risk of personal liability." *Id*.

The *Jacobs* court emphasized that "the Dodd-Frank Act creates no binding effect on a shareholder compensation vote when construing a board's fiduciary duties in approving such compensation." *Id*. at 8. "More is required under the Dodd-Frank Act to demonstrate the directors' breach of their fiduciary duties when the board votes in favor of further compensation, in light of a contrary shareholder vote." *Id*. "Merely ignoring a non-binding vote of the shareholders and approving an increase in executive compensation is decidedly not a breach of fiduciary duty, by itself, under Dodd-Frank." *Id*.

The *Jacobs* Court Determines That the Complaint Fails to Raise a Reasonable Doubt That the Board's 2010 Compensation Plan Was the Product of a Valid Exercise of Business Judgment

Under the second prong of the demand futility test, the *Jacobs* court found that the plaintiffs had failed to allege "facts showing that the Board's decision on the pay plan was not the product of business judgment." *Id*. at 12. The court explained that the negative "Say on Pay" vote "was advisory only pursuant to the explicit terms of the Dodd-Frank Act." *Id*. Moreover, the *Jacobs* court noted that the Board had "award[ed] a mix of stock options and longer-vesting restricted stock instead of relying predominantly on options" as it had in past years. *Id*. at 13. Finally, the court emphasized that "[e]xecutive compensation is generally a matter of business judgment" and it "generally is not entrusted with 'second-guessing' the business judgment of the [b]oard." *Id*.

"For all of these reasons," the *Jacobs* court concluded that the plaintiffs "ha[d] not cured the defects in the prior pleading, and ha[d] still not alleged facts to rise to the level of a violation of the business judgment rule." *Id*. "Even if … [the] [p]laintiffs [had] adequately alleged demand futility," the court explained that "it would still find that [the] [p]laintiffs do not otherwise allege facts sufficient to constitute their claims." *Id*. at 14.

The District of Oregon Dismisses the Umpqua "Say on Pay" Suit

In the January edition of the Alert, we reported on a magistrate judge's recommendation that the District of Oregon dismiss a "Say on Pay" action brought derivatively on behalf of Umpqua Holdings Corporation. On February 23, 2012, the District of Oregon adopted the magistrate judge's Findings and Recommendation and dismissed the complaint without prejudice and with leave to amend. *Plumbers' Local No. 137 Pension Fund v. Davis*, 2012 WL 602391 (D. Or. Feb. 23, 2012) (Mosman, J.).

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