Robbins Geller Rudman & Dowd LLP

Corporate Governance Bulletin

3rd Quarter 2012

IN THIS ISSUE

FEATURES

DEPARTMENTS

Merchants Obtain Largest Ever Antitrust Settlement in Payment Card Litigation

On July 13, 2012, **Robbins Geller Rudman & Dowd LLP** announced the largest antitrust cash settlement in history. If approved by the court, the settlement will create a fund of **$7.25 billion** to provide refunds to approximately seven million merchants to settle claims that Visa, MasterCard, and more than a dozen of the nation's largest banks conspired to restrain competition.

The case charged that Visa, MasterCard, and a number of the country's largest banks conspired to keep prices merchants pay to accept credit and debit cards artificially high. "Swipe" fees or interchange fees account for approximately two percent of every sale and are added to every credit and debit transaction. Merchants have paid ever-increasing rates, despite technological advancements that should have brought down prices. The lawsuit also claimed that a number of the payment card networks' rules stifled competition and raised prices paid by merchants accepting credit cards.

In addition to cash, the settlement requires Visa and MasterCard to modify their merchant rules, the most important of which frees retailers to encourage consumers to use cheaper forms of payment. "These new rules will give merchants the tools they need to put pressure on the credit card networks to lower interchange or 'swipe' fees, which are the second or third highest cost of doing business for many retailers," said **Patrick J. Coughlin**, senior trial counsel at Robbins Geller and one of the lawyers for the plaintiffs. "Reducing these fees will reduce costs, ultimately resulting in lower prices for consumers."

Visa, MasterCard and the banks have agreed to establish a fund of $6.05 billion to pay merchant claims. In addition, Visa and MasterCard will reduce interchange, or "swipe," fees that would otherwise be paid by merchants on Visa and MasterCard credit card transactions over an eight-month period while the new rules are implemented. The settlement still needs preliminary approval from the court. This pool of reduced "swipe" fees is valued at approximately $1.2 billion.

"This is a historic settlement. In addition to refunding billions of dollars to merchants, the settlement will create real price competition and lead to reduced card-acceptance costs for merchants," said **Bonny E. Sweeney**, the firm's senior antitrust partner and its principal litigator in the case.

The case was scheduled for trial in September. During the course of the litigation, more than 400 depositions were taken and more than 50 million pages of documents were reviewed by the plaintiffs.

Robbins Geller attorneys **Patrick J. Coughlin**, **Bonny E. Sweeney**, **David W. Mitchell**, **Alexandra S. Bernay** and **Carmen A. Medici** prosecuted the case for the firm.

The case is pending in the Eastern District of New York before District Judge John Gleeson and Magistrate Judge James Orenstein. **Robbins Geller Rudman & Dowd LLP** is co-lead counsel for the plaintiffs, together with Robins, Kaplan, Miller & Ciresi, L.L.P. and Berger & Montague, P.C.

In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation, MDL 1720 (E.D.N.Y.). ■

Facebook's Problem with Corporate Governance

Shareholders of Facebook, Inc. have more to worry about than just the company's flopped IPO and subsequent stock price drop. Facebook's corporate governance practices are riddled with conflicted board relationships, strong takeover defenses and excessive executive compensation. So shareholders should be warned: if you want to invest in Facebook, you had better be ready to give up your rights.

The board's director conflicts remain one of the biggest corporate governance issues for Facebook. The board consists of Marc Andreessen, Erskine Bowles, James Breyer, Donald Graham, Reed Hastings, Peter Thiel, and of course Mark Zuckerberg, Facebook's founder, Chairman and CEO. Andreessen, Graham, and Hastings were elected as designees of Zuckerberg, meaning they are serving on his behalf. Breyer and Thiel, on the other hand, were elected by stockholders of a majority of the shares of preferred stock. They are investor directors, which is not necessarily a bad thing to have on a board at this stage of a company's development. But Breyer and Thiel also have entered into irrevocable proxy agreements with Zuckerberg, whereby they have agreed to vote their shares in accordance with Zuckerberg's recommendation, so it's unlikely that they will ever act independently of Zuckerberg, even if they would like to.[1]

But that's not all. Two other directors, Graham and Hastings, have relationships with the company that go beyond the boardroom. Mr. Hastings is the CEO of Netflix. According to Facebook's registration statement, Netflix purchased $7.3 million of advertisements on Facebook's website between 2009 and 2011.[2] And Mr. Graham has not one, not two, but three relationships beyond the boardroom. Graham is CEO of The Washington Post Company, which bought $9.6 million of advertisements on Facebook's website between 2009 and 2011, and which is affiliated with an advertising agency, Social Code LLC, that has advertising clients doing business with Facebook. Lastly, Mr. Graham's daughter, Molly Graham, is employed by Facebook and earned more than $420,000 in compensation between 2009 and 2011.[3] Ironically, Donald Graham has been designated as Facebook's "Lead Independent Director."

Another big issue involves the strong takeover defenses, primarily the controlling ownership of Mark Zuckerberg. Typically a corporation consists of one class of voting stock with one vote per share. Facebook consists of two classes of voting stock – Class A shares are entitled to one vote per share and Class B shares are entitled to 10 votes per share. Zuckerberg controls approximately 57% of the company's voting power, mostly through the ownership of Class B shares. In addition to controlling 57% of the voting power, other shareholders representing about 28% of the total voting power entered into irrevocable proxy agreements giving Zuckerberg the authority to vote their shares using his sole discretion.[4] So this essentially gives Zuckerberg control over 85% of the company's total voting power.

And as if that were not enough power, Facebook has supermajority provisions in its charter and bylaws. Typically a corporation can amend its bylaws or charter with a simple majority (51%) of shares when requested. Facebook has "supermajority" voting provisions, whereby any provisions relating to matters involving the board or shareholders cannot be amended without approval of at least 67% of the company's total voting power, a move that assures no amendments can be made unless Zuckerberg wants them to be.[5] They also have a staggered board provision that kicks in if Class B shares ever fail to control a majority of the voting power. Normally directors at a company stand for election each year. But in the case of Facebook, if for some reason Zuckerberg lost control over a majority of the company's total voting power, Facebook's directors would automatically be elected in separate classes every three years, rather than annually, a move that completely entrenches board members and makes it extremely hard for shareholders to replace them.[6]

And finally we come to the issue of excessive compensation, and one of the many offensive actions that officially makes Mark Zuckerberg a billionaire. As of the date of the IPO, Zuckerberg held 120 million stock options with an exercise price of $0.06 per share.[7] On the date of the IPO, Zuckerberg exercised 60 million of those options and sold about half of them immediately. He instantly netted approximately $1 billion from that sale.[8] While Zuckerberg is enjoying the enormous profit he received, Facebook's shareholders have lost more than 20% of the value of their shares since the date of the company's IPO.[9] Not only have they lost a large fraction of their investment, they are powerless to effect any change in the company.

Despite what management might think, corporate governance does matter, especially in the case of Facebook. Bad governance erodes investor confidence, removes any alignment between the interests of management and shareholders, and weakens the rights that shareholders should have as owners of a corporation. Management is given free reign to act in their own interests, and if something goes wrong with the company, then shareholders are left footing the bill. There is a complete disregard of oversight and accountability.

Facebook is the classic example of a company that is set up with high expectations and then delivers weak performance. Its poor governance structure is only widening a path for failure by attempting to do what many companies have tried and failed to do before – enjoy the benefits of being a publicly traded corporation while continuing to run itself as if it were a private company. Facebook may soon learn that it would have been better off just staying private.

[1] "Mr. Zuckerberg has the authority (and irrevocable proxy) to vote these investors' shares at his discretion on all matters to be voted upon by stockholders . . . ." *See* Facebook, Inc. Form S-1/A, 151 (May 16, 2012), *available at*: http://www.sec.gov/Archives/edgar/data/1326801/000119312512235588/d287954ds1a.htm.

[2] *Id.* at 139-148.

[3] *Id.*

[4] *Id.*

[5] *See* Article X of Facebook, Inc. Restated Certificate of Incorporation (Apr. 23, 2012), *available at*: http://www.sec.gov/Archives/edgar/data/1326801/000119312512175673/d287954dex33.htm.

[6] *Id.*

[7] *See* Facebook, Inc. Form S-1/A at 128.

[8] *See Mark Zuckerberg earns $1billion in ten minutes as Facebook floats on US stock market*, The Sun (May 19, 2012), *available at*: http://www.thesun.co.uk/sol/homepage/news/4325470/Mark-Zuckerberg-earns-1billion-in-ten-minutes-as-Facebook-floats-on-US-stock-market.html.

[9] On May 23, 2012, Robbins Geller Rudman & Dowd LLP filed a complaint on behalf of investors who purchased shares of Facebook pursuant and/or traceable to its IPO, against Facebook, its underwriters and certain of its officers and/or directors. ■

JPMorgan and the Volcker Rule

JPMorgan's $2 billion loss has put a fresh focus on one of Dodd-Frank's most controversial reforms: a ban on banks from engaging in proprietary trading, also known as the "Volcker Rule." For all its famed complexity, the law simply states that "a banking entity shall not engage in proprietary trading." But the law goes on to create an exemption for "[r]isk-mitigating hedging activities in connection with and related to individual or aggregated positions, contracts, or other holdings of a banking entity that are designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings."[1]

In simpler terms, the issue is whether a bank uses a large trade to hedge risks in other investments, which is allowed, or whether a bank uses a large trade to speculate for profit, which is forbidden. Still, the multi-billion dollar loss puts the spotlight squarely on the issue of how to distinguish between hedges and proprietary trades. And the SEC is still no closer to issuing a final rule on the matter.

JPMorgan is attempting to cast doubt on whether the Volcker Rule would have precluded its trading activity, and has insisted that the bank was not speculating under the guise of hedging. But its fierce opposition to the Volcker Rule over the last several months begs the question: if its trading was not proprietary, then why oppose the legislation?

JPMorgan's CEO Jamie Dimon made it clear exactly how JPMorgan was using the trades. At a hearing before the U.S. Senate Committee on Banking, Housing and Urban Affairs on June 13, 2012, Mr. Dimon admitted that the purchase of credit default swaps was "designed to generate modest returns in a benign credit environment and more substantial returns in a stressed environment."[2] Reports now indicate that JPMorgan's losses may reach as high as $9 billion.[3]

On February 13, 2012, JPMorgan sent the SEC a 65-page comment letter on implementing the Volcker Rule, blasting it as "flawed" and doing "unnecessary harm" to U.S. firms and investors.[4] The SEC's draft rule on the law states that a transaction would count as a hedge only if it satisfied certain substantive requirements, including that the hedge must be "reasonably correlated" to the risks the transaction is intended to hedge.[5] Despite this broad language, JPMorgan vigorously contested these restrictions and it is now much clearer why it did.

The term "reasonable" is one of the vaguest words in the law, which can be stretched to cover almost any eventuality. Still, JPMorgan thought the language was too restrictive and insisted that the bank should be able to claim a hedging exemption if it can "reasonably demonstrate through its stress testing program that the position reduces tail risks."[6] This type of exemption would be highly convenient for JPMorgan, especially given that the most alarming aspect of this entire episode is the simple fact that JPMorgan managed to pass the Federal Reserve's stress test in March, despite having a ticking time bomb sitting on its balance sheet.

JPMorgan's disaster not only raises questions about whether broad regulatory actions will be effective enough to address the potential disasters that are still lurking throughout Wall Street, but also raises questions about whether the Volcker Rule would be effective enough to prevent losses associated with specific trading activity. While JPMorgan has thus far survived the losses, those losses are expected to continue to rise. Further losses may not be sustainable, and regulations may not be strong enough to prevent another collapse.

"We made a terrible, egregious mistake."
- Jamie Dimon, JPMorgan CEO

[1] *See* 12 USC §1851(a)(1)(A) and (d)(1)(C).

[2] *See* Testimony of Jamie Dimon, Chairman & CEO, JPMorgan Chase & Co., Before the U.S. Senate Committee on Banking, Housing and Urban Affairs, Washington, D.C., June 13, 2012, *available at*: http://www.sec.gov/Archives/edgar/data/19617/000119312512268992/d366030dex991.htm.

[3] *See* Jessica Silver-Greenberg and Susanne Craig, *JPMorgan Trading Loss May Reach $9 Billion*, The New York Times DealBook Blog (June 28, 2012), *available at*: http://dealbook.nytimes.com/2012/06/28/jpmorgan-trading-loss-may-reach-9-billion.

[4] *See* JPMorgan Chase & Co., *Comment Letter on the Notice of Proposed Rulemaking Implementing Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, dated February 13, 2012.

[5] *See* 76 Fed. Reg. 68948 and 77 Fed. Reg. 8427.

[6] *See* John Kemp, *RPT-COLUMN-JPMorgan's fight against hedging restriction: Kemp*, Reuters (May 22, 2012), *available at*: http://www.reuters.com/article/2012/05/22/column-jpmorgan-portfolio-hedging-idUSL5E8GM3Q220120522. ■

Attorney in the News

Sanford Svetcov

Robbins Geller Rudman & Dowd LLP

Sanford Svetcov

A cancer diagnosis can't keep **Sanford "Sandy" Svetcov** from a good argument. In between rounds of exhausting chemotherapy for a pancreatic tumor discovered last fall, the Robbins Geller Rudman & Dowd LLP partner continues to do what he loves: appellate practice in the U.S. Court of Appeals. In May, Svetcov was doing just that – arguing in front of the Ninth Circuit, pleading with the judges regarding a summary judgment decision that had gone against his client, pulling out all the stops in his arguments, with a legal mind honed by decades of appellate work.

As noted by *The Recorder* in a recent profile, Svetcov pioneered the role of appellate chief within the San Francisco U.S. Attorney's office, hired by then-U.S. Attorney Billy Hunter. It was there that Svetcov tutored a law student named **Patrick J. Coughlin**, Of Counsel at Robbins Geller, who commented, "I learned how to do appeals with Sandy."

If Svetcov has to step down from his appellate practice, the Ninth Circuit won't be the same anymore. "He's a giant among the lawyers who practice in the Ninth Circuit," said Rory Little, a Professor of Law at UC Hastings who succeeded Svetcov as appellate chief. "He has only one gear and it's top gear."

A valued mentor at Robbins Geller, Svetcov refuses to dwell on his diagnosis, instead staying busy with the work he loves. "Appellate practice is great emotional therapy," Svetcov says. "Trying to solve the problem in the briefing and getting the physical strength to prepare for the argument and give the argument has been fabulous."

Litigation Update

Motion to Dismiss
Goldman, Sacked?

On June 21, 2012, U.S. District Judge Paul A. Crotty upheld a securities class action against Goldman Sachs for its business practices in selling mortgage-backed securities to investors as investment grade products at the same time it was shorting those same securities (the Abacus, Timberwolf, Anderson, and Hudson deals) and favoring certain clients' interests over others. These practices were the subject of a congressional investigation. Judge Crotty made it clear that Goldman cannot evade liability by arguing that its public statements concerning the firm's "honesty," "integrity" and "fair dealing" were simply "puffery," and therefore not actionable. "Goldman's arguments in this respect are Orwellian," Judge Crotty wrote in a footnote to his 27-page order. "Words such as 'honesty,' 'integrity,' and 'fair dealing' apparently do not mean what they say; they do not set standards; they are mere shibboleths. If Goldman's claim of 'honesty' and 'integrity' are simply puffery, the world of finance may be in more trouble than we recognize."

In April 2010, shareholders filed a securities class action against Goldman in the wake of the SEC's lawsuit against Goldman for its infamous Abacus deal. Goldman eventually agreed to pay $550 million in July 2010 to settle the SEC's suit. The lead plaintiffs in the securities class action are the **Arkansas Teacher Retirement System**, the **West Virginia Investment Management Board** and **Plumbers and Pipefitters National Pension Fund**.

At the time, the SEC called it the largest penalty a Wall Street firm ever paid, with $300 million going to the U.S. Treasury and the rest going to investor restitution. But the settlement did not resolve plaintiffs' securities class action, which alleges that statements the bank made about its business practices materially misled Goldman's own shareholders and artificially inflated Goldman's stock price.

Some of those allegedly misleading statements include a Form 10-K stating, "We have extensive procedures and controls that are designed to . . . address conflicts of interest"; and annual reports stating, "Integrity and honesty are at the heart of our business," and "We are dedicated to complying fully with the letter and spirit of the laws, rules and ethical principles that govern us."

Goldman argued in its motion to dismiss that "[e]xpressions of puffery and corporate optimism do not give rise to securities violations." Judge Crotty explicitly rejected that argument, stating that "Goldman must not be allowed to pass off its repeated assertions that it complies with the letter and spirit of the law, values its reputation, and is able to address 'potential' conflicts of interest as mere puffery or statements of opinion." Judge Crotty went on to conclude that "[a]ssuming the truth of plaintiffs' allegations, they involve 'misrepresentations of existing facts.'" Plaintiffs' allegations included internal e-mails, such as CEO Lloyd Blankfein's request that Goldman get rid of all the poor quality CDOs on its books – the "cats and dogs" – and sell them to clients as investment grade products. Another internal e-mail referred to the Timberwolf deal as "one sh@#%y deal."

Judge Crotty added that Goldman's refusal to admit guilt about the Abacus deal in the SEC settlement rang hollow in light of the company's subsequent statements: "Goldman's assertion that it 'neither admitted, nor denied' that its Abacus disclosures were fraudulent is eviscerated by its concession that 'it was a mistake for the Goldman marketing materials to state that the reference portfolio was "selected by" ACA Management LLC without disclosing the role of Paulson & Co. Inc. in the portfolio selection process and that Paulson's economic interests were adverse to CDO investors.'" Judge Crotty further opined that "Goldman paid a $550 Million settlement to the SEC – the largest SEC penalty in history – because of the 'mistake' it acknowledged."

Judge Crotty even rejected the notion that it was a "mistake" at all. "With respect to Abacus, Goldman certainly knew that Paulson played an active role in the asset selection process," Judge Crotty held. "How else could Goldman admit that it was a 'mistake' not to have disclosed such information."

Executives Lloyd Blankfein, David Viniar and Gary Cohn also knew, Judge Crotty held. "These allegations, taken as true, show that each Individual Defendant actively monitored the status of Goldman's subprime assets and subprime deals during the relevant time, and that each knew that Goldman was trying to purge these assets from its books and stay on the short side," the order states. "These allegations create a strong inference that the Individual Defendants knew that Goldman was making material misstatements in the Abacus, Hudson, Anderson, and Timberwolf I CDOs, when it sold poor quality assets to investors without disclosing its or Paulson's substantial short positions."

The bank and its executives were not obligated, however, to disclose the Wells Notice informing them that the SEC would bring an enforcement action against them, Judge Crotty decided, in the only part of the ruling favorable to the banks. The case now proceeds into discovery and towards trial.

In re Goldman Sachs Group, Inc. Securities Litigation, No. 1:10-CV-03461-PAC, Opinion & Order (S.D.N.Y. June 21, 2012).

Motion for Class Certification
Chesapeake Energy

In February 2009, a securities class action was filed against Chesapeake Energy Corp. over its secondary offering in July 2008 of 28.75 million shares, priced at $57.25 per share. This is the first of many actions that have been filed against the now notorious Aubrey McClendon arising out of Chesapeake's failure to disclose certain of McClendon's financial dealings that posed conflicts of interest with the company. The class of purchasers of Chesapeake's stock issued pursuant to its July 2008 offering has been certified by Western District of Oklahoma Judge Timothy D. DeGiusti.

The action arises out of misstatements and omissions made in the July 2008 offering. The eventual revelation of significant risks undisclosed to investors prior to the offering caused Chesapeake's stock to crater over 70%. Chesapeake failed to disclose that almost all of McClendon's Chesapeake stock was purchased on margin, and that McClendon would be unable to prevent the forcible sale of this stock by providing additional capital in the event of margin calls on his stock. That is exactly what occurred when over 30 million of McClendon's shares flooded the market, causing the stock's price to decline at an alarming rate.

Chesapeake also failed to disclose risks involving its contracts used to hedge against the volatility of natural gas prices. A significant number of these contracts were with Lehman Brothers. At the time of the offering, Lehman Brothers was in financial ruin and facing almost inevitable collapse. Regardless, Chesapeake failed to disclose in the offering that Lehman Brothers was a counterparty to these contracts, and thus, if the financial institution went bankrupt (as it did), Chesapeake would be left unhedged. Chesapeake also failed to update the nature and extent of certain of its hedges – referred to as knockout or kickout swaps – at the time of the offering. Instead, it provided data that was months old. When the risks hidden by these omissions materialized, Chesapeake's stock price faltered.

Continued on p. 6

Settlement Update

The Subprime Mortgage Fallout Yields $75 Million Settlement in *CIT*

Following on the heels of other successful settlements achieved in actions filed in the wake of the subprime mortgage crisis, lead plaintiff **Pensioenfonds Horeca & Catering** ("PH&C"), a Dutch pension fund, achieved an outstanding result for CIT Group, Inc. shareholders. With **Robbins Geller Rudman & Dowd LLP** at the helm, PH&C was able to obtain a $75 million settlement despite CIT's bankruptcy filing in 2009 during the pendency of the litigation.

During the class period, defendants understated the risks and impairments to CIT's subprime home loan and private student loan portfolios and failed to adequately reserve for the impairments to those portfolios. Specifically, as Robbins Geller uncovered during discovery, while the subprime market was collapsing and the delinquency rate on CIT's home loans was spiking, defendants refused to adopt adequate reserve methodologies recommended by the company's own Risk Management department, under-reserved for impairments to the subprime home loans, and continued originating billions of dollars in risky loans to mask the disastrous state of CIT's aging portfolio. Nevertheless, defendants reassured investors that CIT was "much more conservative" than other lenders, had "tightened home lending underwriting," and that the "subprime profile is strong" and adequately reserved for. Beginning on July 18, 2007, however, defendants were forced to disclose the truth about CIT's subprime home loans, announcing that the company would have to take a $765 million write-down on the loan portfolio and completely exit the home lending business. CIT's stock price plunged on the news, but the revelations were far from over.

Even as investors began to learn the truth about CIT's subprime home loans, defendants were busy covering up the risks to the company's student loan portfolio. While defendants again assured investors that "there's almost no credit risk" to student loans, that "non-performing assets are insignificant" and that they "don't really emphasize the private loan at all," CIT had already built up a portfolio of more than $113 million in loans to students of the sham Silver State Helicopters LLC vocational school. The entire Silver State portfolio was comprised of private, non-guaranteed loans which, by mid-2007, represented more than 31% of CIT's total private student loans and over 20% of the company's "at-risk" student loans. Unbeknownst to investors, by May 2007, CIT ceased issuing new loans to Silver State and placed it on the internal Suspended Accounts list as the school's graduation rate fell below 10% and the delinquency rate on the loans rose above 30% – nearly seven times the average delinquency rate for student loans. While defendants desperately tried to sell the Silver State loan portfolio, investors were told nothing about the portfolio, and defendants failed to reserve for impairments to the loans. Even after defendants realized that they could not sell the loan portfolio and CIT's auditor specifically told former CEO Jeff Peek that the company was "woefully under reserved," investors were still kept in the dark. It was only at the end of February that defendants were finally forced to reveal CIT's exposure to the Silver State loans and their failure to properly account for those loans. And again, CIT's share price plunged on these disclosures, falling to under $16 per share.

In January 2012, after years of intense litigation, Robbins Geller obtained a $75 million cash settlement from CIT and certain officers and directors who were at the helm prior to bankruptcy. The $75 million settlement is a result of the excellent and tenacious work by Robbins Geller. The Honorable Barbara S. Jones, who presided over the litigation, commented during the final approval of the settlement that "class counsel's representation, from the work that I saw, appeared to me to be of the highest quality."

According to Robbins Geller partner **Henry Rosen**, "This settlement is a real testament to the talented team who worked tirelessly on behalf of CIT investors. Our firm has the brightest people in the field, and without the dedication of the firm's lawyers, investigators, forensic accountants and support staff, we would not have been able to develop the strong evidence of defendants' falsity and liability and prepare the case for trial. In addition, without the significant contributions of time and attention by our client and lead plaintiff, PH&C, this settlement would not have occurred. They sought lead plaintiff status, led the investigation and prosecution of this action, and did whatever was necessary to get a class certified on behalf of damaged CIT investors."

According to **Tor Gronborg**, one of the lead partners on the case, "Although it has become common for defendants in subprime lending cases to blame their company's demise on the economy, the evidence developed before filing this action and during discovery demonstrated the individual defendants' liability for the harm done to investors." **Matthew Alpert**, a senior associate on the case, added that "whenever corporate defendants rely on the economic crisis of 2007/2008 as an explanation for why their loan portfolios and stock price imploded, investors are at risk of recovering nothing for the damage done to them. Through the review of millions of pages of CIT-related documents, interviews and depositions of more than 70 fact witnesses, and the tireless efforts of our in-house forensic accountants, plaintiffs were prepared to take this case to trial and prove that shareholders were defrauded. Outstanding settlements like this put corporate wrongdoers on notice as to the force this firm brings with it when it is retained to prosecute a securities fraud action."

The litigation team at Robbins Geller Rudman & Dowd LLP, consisting of **Henry Rosen**, **Tor Gronborg**, **Brian O'Mara**, **Robert Henssler**, **Matthew Alpert**, **Francis DiGiacco**, and forensic accountants **Christopher Yurcek** and **Terry Koelbl**, together with lead plaintiff PH&C, was responsible for obtaining this extraordinary settlement on behalf of the class.

In re CIT Group Inc. Securities Litigation, No. 1:08-CV-06613 (S.D.N.Y.).

Delphi Shareholders Receive $49 Million Settlement

Shareholders of Delphi Financial Group scored an important victory in April when they wrested an additional $49 million for Delphi investors in connection with Tokio Marine Holdings, Inc.'s ("TMH") buyout of the company. Delphi, a financial services holding company whose principal subsidiaries are insurance and insurance-related entities, was founded by Robert Rosenkranz in 1987. Delphi went public in 1990, with equity ownership divided into two stock classes: The Class A shares were publicly traded and each worth one vote. The Class B shares were all held by Chairman and CEO Rosenkranz and his affiliates, and each share of this class was worth ten votes. Through the agreement that created these share types, Rosenkranz held approximately 12.9% of Delphi's equity, but he held 49.9% of Delphi's voting power. Furthermore, any Class B shares sold or transferred by Rosenkranz automatically became single-vote Class A shares.

In July 2011, TMH announced to Delphi its interest and intent to acquire the company as part of a plan to expand into U.S. insurance markets. Meetings began between TMH and Delphi's senior management (including Rosenkranz). When,

Continued on p. 6

Combining the Roles of Chairman and CEO Costs Shareholders

The two most authoritative positions in a boardroom are the CEO and the chairman. However, when these roles are combined, all the authority is vested in one individual; there are no checks and balances, and no balance of power. The chairman is charged with monitoring the CEO, presenting an obvious conflict of interest. Indeed, if the CEO is responsible for running the company, and the board is tasked with overseeing the CEO's decisions in the interests of shareholders, how can the board properly monitor the CEO's conduct if the CEO is also serving as board chair?

While the theory behind separating the two roles has been the subject of much shareholder and governance activist protest and commentary, an analysis done by GMI Ratings, a corporate governance research firm, suggests that other, more practical considerations would support the separation of the two roles.

This report focused on 180 North American mega-caps, companies with a market capitalization of $20 billion or more. The report found that in addition to the inherent conflict of interest already discussed, CEOs who also command the title of chairman are more expensive than their counterparts serving solely as CEO. In fact, the value of executive compensation for a CEO who is also chairman is often higher than the combined cost of compensating a CEO and a chairman separately.

Furthermore, in addition to presenting a greater risk in ESG (environmental, social and governance) and accounting, companies with a combined CEO and chairman appear to present a greater financial risk for investors and provide lower stock returns over the longer term than companies that have separated the roles. The report concludes that having a separate chairman and CEO costs less, is less risky, and is a better investment for shareholders.

Some of the main findings of the report are as follows:

- The median total compensation for a CEO who also serves as chairman is more than $16 million.
- The median for a CEO who does not serve as chairman is $9.8 million.
- Five-year shareholders returns are nearly 28% higher at companies with a separate CEO and chairman. ■

Settlement Update continued from page 5

in September 2011, TMH offered $45 per share for Delphi when it was trading in the low $20 per share range at the time, Rosenkranz told Delphi's board that it was insufficient and that he would not vote his shares in favor of the deal. He would eventually come up with a counterproposal to Delphi's board that reallocated the purchase price paid by TMH so that Class A shares would sell for $43 per share while his Class B shares would sell for $59. The board, through a special sub-committee authorized to negotiate internally with Rosenkranz, was unable to get him to reconsider the differential consideration but, despite the internal conflict, kept Rosenkranz as the company "point person" with TMH, since replacing him in the midst of negotiations might "spook" TMH. TMH would ultimately offer $46 per share, and Rosenkranz and the sub-committee then began to finalize the division of the merger consideration. The $46 per share offer was eventually to be allocated as $43.875 for each Class A share and $52.875 for each of Rosenkranz's Class B shares, despite the fact that Delphi's charter forbade such an unequal distribution. The board decided that the Class A shareholders would have to vote to amend the charter as part of the deal's approval.

When the details of the proposed acquisition became public, a number of Class A shareholders sued. Plaintiffs were outraged that Rosenkranz had been allowed to remain Delphi's point of contact with TMH even after he insisted on a disparate pricing arrangement. They alleged that the defendants had breached their fiduciary duty to obtain the highest price reasonably possible for their shares in the overall deal, and also that the resulting price differential for the Class A and B shares was a breach of fiduciary duty and a breach of Delphi's charter, which required equal treatment of the share classes.

On March 6, 2012, Delaware Vice Chancellor Sam Glasscock III agreed in large part with plaintiffs. While he wrote that he would not issue a preliminary injunction, he did find many of the plaintiffs' arguments that Rosenkranz and the other defendants breached their contractual and fiduciary duties persuasive, writing, "I therefore find that the Plaintiffs are reasonably likely to be able to demonstrate at trial that in negotiating for disparate consideration and only agreeing to support the merger if he received it, Rosenkranz violated duties to the stockholders." In lieu of an injunction, Vice Chancellor Glasscock wrote that the threatened harm could still be remedied financially, because "[m]uch of the alleged misconduct … is remediable by readily ascertainable damages," and that ultimately he could, if necessary, order Rosenkranz to disgorge any improper amount he gained through the merger. Just weeks later, in light of the evidence and Vice Chancellor Glasscock's order, the parties reached the $49 million settlement for the Delphi investors.

In re Delphi Financial Group Shareholder Litigation, No. 7144-VCG (Del. Ch.). ■

Litigation Update continued from page 4

After these allegations were upheld in the face of defendants' motion to dismiss the complaint, the parties began discovery on matters including whether the proposed class should be certified. Among the issues surrounding class certification was whether the **United Food and Commercial Workers Union Local 880 – Retail Food Employers Joint Pension Fund** was an adequate class representative. Rejecting each of defendants' arguments, the court held that the Pension Fund is an adequate class representative, particularly because of its selection of **Robbins Geller Rudman & Dowd LLP** as class counsel in this matter.

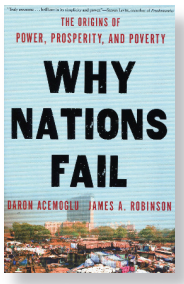
As part of the class certification process, the court also defined the members of the class – an issue hotly debated by the parties. Defendants argued that the class should exclude anyone who did not purchase shares in the offering directly from Chesapeake or one of the underwriters and at the price of $57.25. Judge DeGiusti rejected these limitations as inappropriate under the law, especially given the contemplation by the parties that "aftermarket purchasers" would be included in the class. The class definition certified by the court promotes the representation in this action of all those harmed by defendants' conduct. "It is important for public investors in the stock offering at issue to have a potential class remedy, and class certification was a necessary step in that process," said Robbins Geller partner **James Jaconette** in describing the decision. "We are now moving on to the next battle."

United Food and Commercial Workers Union Local 880 – Retail Food Employers Joint Pension Fund v. Chesapeake Energy Corp., No. CIV-09-1114-D, Order (W.D. Okla. March 30, 2012). ■

Recommended Reading

Investor and corporate governance advocates spend a lot of time analyzing why some corporations produce long-term value and others boom and later go bust, like Enron or Merrill Lynch. Unsurprisingly, long-term value in the corporate world often correlates with the degree to which the boards of directors are responsive to shareholders, rather than acting as captives of management. *Why Nations Fail* is an extension of that thesis – that nations that develop more "inclusive institutions" tend to be more prosperous, and countries in which "extractive institutions" prevail are often mired in poverty. These inclusive economic institutions (as defined by the authors) "are those that allow and encourage participation by the great mass of people in economic activities that make best use of their talents and skills." The authors argue that these inclusive economic institutions are only made possible through inclusive political institutions, which spread political power across a wide base, versus absolutist political power, which tends to focus control in a narrow ruling class or elites. To support their case, the authors cite the example of Great Britain, where, since 1688 (the Glorious Revolution), a parliament has tempered the monarchy and spread political power to a greater number of people, in contrast with impoverished sub-Saharan African nations such as Nigeria or Sierra Leone, which are led by corrupt rulers who prefer self-serving "extractive" political and economic systems, despite natural resource wealth, in which labor's production and wealth are confiscated by an elite or foreign colonial state.

Once entrenched in power, extractive institutions and rulers will viciously pursue their own perpetuation, even at the cost of growth or general economic improvement of the nation as a whole. Examples of extractive institutions are slavery and colonization (such as of the New World and Africa) in which elite classes exploit and suppress any efforts at redistributing political power or wealth, until forced by popular unrest. Acemoglu and Robinson are at their best when describing a lengthy catalog of historical examples to support their thesis. The book's ambition is praiseworthy, but the topic deserves more than a book – a semester-length college course might be more appropriate, as the devil is in the details. As Jared Diamond (author of *Collapse: How Societies Choose to Fail or Succeed*) points out, the authors give short shrift to important issues of geography, soil productivity, indigenous farmable crops, and years of intensive agriculture – such as came together in the Fertile Crescent – in favor of a hypothetical political revolution that brought "inclusive institutions." Yet there is a strong correlation between the length of a nation's history in rich and productive agriculture and its modern level of prosperity, such as in modern Europe, where power-sharing institutions arose only after thousands of years. In contrast, wheat and barley are not indigenous to the poorer quality tropical soils in Africa, and moreover, sub-Saharan African nations suffered from years of tropical disease such as malaria, not to mention the loss of human capital via 18th century warfare and slavery. Democratic institutions, however, cannot be forced on nations accustomed to tribal leadership overnight, either by NGOs or via regime change. The monomaniacal focus on the authors' thesis of institutions being the strongest determinant of prosperity is the book's biggest shortcoming, and strength. The insistence with which the authors make their case is enough to assert the power of inclusive institutions as one of the strongest forces in prosperity and survival vs. failure. *Why Nations Fail* is recommended reading for anyone in the field of international aid and development. ■



Why Nations Fail:
The Origins of Power, Prosperity, and Poverty

Daron Acemoglu & James Robinson

Crown Publishers, 2012

This Year's Must-Attend Conference: The Future of Corporate Reform 2012 Public Funds Forum September 4-6, 2012 - Montage Deer Valley - Park City, Utah

This September, representatives from public funds across the country will gather to share new tools critical to help create a future that includes robust oversight and accountability in corporate practice and financial markets. Informative panel sessions over three days will permit attendees to hear analyses from corporate governance thought-leaders, share their experiences, and enjoy networking opportunities centered around the natural beauty of Utah's Wasatch mountains.

The emergence of new and stronger investor advocates is a positive development resulting from the financial crisis. Public funds are partnering with investor advocates to reclaim their power to repair and strengthen the investment climate by taking increasingly active roles in monitoring corporate malfeasance, reforming dysfunctional corporate boards, and safeguarding investor assets for the benefit of plan participants.

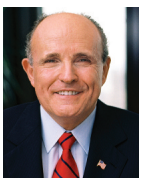
In furtherance of this mission, GMI Ratings will host the fourth annual Future of Corporate Reform Public Funds Forum from September 4-6 at the Montage Deer Valley in Park City, Utah. Sponsors of the conference include **Robbins Geller Rudman & Dowd LLP**, the premier plaintiffs' securities litigation firm, and class-action administration experts **Gilardi & Co. LLC**. Conference sessions are designed to give representatives of public pension systems the knowledge and tools to help repair the markets, reshape corporate reform, and create and protect long-term value. ■

Opening remarks will be given by Robert A.G. Monks, referred to by *The Economist* and *Fortune* magazines as the leading shareholder activist and governance advocate in the world. The keynote address on exploring global risks will be given by General Colin Powell, USA (Ret.). Panel leaders, including Anne Simpson, Director of Corporate Governance at CalPERS, corporate governance expert Nell Minow, GMI Ratings' Chief Executive Officer Richard A. Bennett, and shareholder litigation expert Darren J. Robbins, will explore a variety of issues of keen interest to public fund representatives. Other notable speakers include, but are not limited to, Aron Ralston, outdoorsman and inspiration for the film *127 Hours*; Jonathan Feigelson, General Counsel and Head of Corporate Governance at TIAA-CREF; Walter Smiechewicz, Chief Risk Officer, First Niagara Bank and First Niagara Financial Group, Inc.; David R. Beatty, Chair of Inmet Mining Limited; and Rudy Giuliani, former Mayor of New York City.


General Colin Powell, USA (Ret.)


Aron Ralston

The long-term success of investment strategies that emphasize a focus on corporate governance has been borne out by the recent crisis. For representatives of public funds and corporate governance leaders, the fourth annual Future of Corporate Reform Forum is shaping up to be this year's must-attend conference. Participants and speakers alike will exchange views and make new contacts while taking advantage of networking activities, including themed dinners and outdoor activities in the Wasatch mountains.


Rudy Giuliani

For the most current information about the conference agenda and to register, please visit www.GMIconferences.com.

Calendar of Upcoming Events

August 4-8, 2012

National Association of State Retirement Administrators (NASRA) 58th Annual Conference

Resort at Squaw Creek
Olympic Valley, California

The NASRA annual conference will include sessions on a variety of subjects, including investment management, world events applicable to the pension industry, actuarial, data processing, health care and significant happenings in each of the states and territories.

For more information, visit: www.nasra.org

September 4-6, 2012

GMI Ratings
The Future of Corporate Reform 2012 Public Funds Forum

Montage Deer Valley
Park City, Utah

Featured Speakers: **Darren J. Robbins, Paul Geller, Michael J. Dowd, Patrick W. Daniels, Randall J. Baron** and **Shawn Williams**, Robbins Geller Rudman & Dowd LLP

This is an invitation-only educational conference designed to educate public fund representatives on practices to best fulfill fiduciary duties, protect portfolio assets and create long-term value. This three-day event is intended for executive directors, chief executives, administrators, general counsel, investment officers, finance officers, fund trustees, corporate governance officials and other representatives of public funds across the United States and Europe.

For more information, visit: www.GMIconferences.com

September 8-12, 2012

National Association of State Treasurers (NAST)
2012 Annual Conference

Hotel Captain Cook
Anchorage, Alaska

The brightest minds in the country will gather to discuss the latest trends in investment, public policy, and how emerging issues may affect the nation's treasuries. This high-level exchange of ideas will herald the future of the states' public finance programs. This annual conference will include renowned speakers, cutting-edge topics, and the latest information.

For more information, visit: www.nast.net

September 9-11, 2012

Michigan Association of Public Employee Retirement Systems (MAPERS)
Fall 2012 Conference

Grand Hotel
Mackinac Island, Michigan

This annual conference will provide educational training and legislative updates to trustees of public employee retirement systems within the State of Michigan.

For more information, visit: www.mapers.org

September 29-October 3, 2012

National Association of Government Defined Contribution Administrators (NAGDCA)
2012 Annual Conference

Sheraton San Diego Hotel & Marina
San Diego, California

This annual conference will focus on issues facing the public sector defined contribution community, including sessions on deferred compensation basics and plan administration issues.

For more information, visit: www.nagdca.org

October 3-5, 2012

Council of Institutional Investors (CII)
2012 Fall Meeting

The Westin Seattle
Seattle, Washington

This conference will bring together public, union and corporate pension funds and educate members, policymakers and the public about good corporate governance, shareowner rights and related investment issues.

For more information, visit: www.cii.org

October 8-10, 2012

National Coordinating Committee for Multiemployer Plans (NCCMP)
2012 Annual Conference

The Diplomat Hotel
Hollywood, Florida

Participants in multiemployer plans will discuss legislative, regulatory and legal developments from conception to implementation to enforcement. By communicating with government officials, members of Congress and staff about the unique characteristics of multiemployer plans, the NCCMP has saved multiemployer plans hundreds of millions of dollars in regulatory and administrative costs. These savings enable plans to remain financially secure and healthy, while providing enhanced benefits to plan participants.

For more information, visit: www.nccmp.org

October 21-23, 2012

Information Management Network (IMN)
The 18th Annual ABS East Conference

Fontainebleau Miami Beach
Miami, Florida

Featured Speaker: **Patrick W. Daniels**, Robbins Geller Rudman & Dowd LLP

Over 2,700 structured finance and securitization professionals, regulators, government officials and private sector participants will discuss what the markets should look like in the future, given the importance of securitization to the real economy. Topics include how regulatory changes will shape the ABS Market; new capital requirements and the impact of banking; mortgage legislation update and the future of the mortgage funding market; outlook for consumer ABS, including autos, credit cards, student loans and equipment leases; protecting investor rights and rebuilding investor confidence; and the changed landscape for credit ratings.

For more information, visit: www.imn.org

Robbins Geller Rudman & Dowd LLP

Atlanta
Boca Raton
Chicago
Melville
New York
Philadelphia
San Diego
San Francisco
Washington, D.C.

(800) 449-4900
www.rgrdlaw.com

Please direct all inquiries to:
Randi D. Bandman
randib@rgrdlaw.com

The material contained in this publication is informational only and does not constitute legal advice.

Copyright © 2012 Robbins Geller Rudman & Dowd LLP. All rights reserved. Quotation permitted, if with attribution.