

Metro Detroit counties are first in Michigan to file insulin price-fixing suits

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Metro Detroit counties are the first in Michigan to file insulin price-fixing lawsuits



Hannah Mackay

The Detroit News

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Detroit — Four Michigan counties filed lawsuits against pharmacy benefit managers and pharmaceutical manufacturers Wednesday, claiming "excessive costs" for insulin in what are the first diabetes drug price-fixing lawsuits by governmental bodies in the state.

Wayne, Washtenaw, Macomb and Monroe officials announced the lawsuits at a news conference Wednesday at the Detroit Rescue Mission Ministries. Though they are the initial price-fixing lawsuits for the drug to be filed in Michigan, attorneys expect more to follow.

Detroit Mayor Mike Duggan said the city also plans to file a lawsuit, and requested on Wednesday that the City Council authorize it.



"In the city of Detroit, we have more than one out of six of our residents who are suffering from diabetes today," Duggan said. "If they are not on Medicare, they're subject to the same gouging."

The lawsuits come as the price of insulin has increased dramatically, nearly tripling between 2002 and 2013, according to the Journal of the American Medical Association Network website. The issue has drawn the attention of the Biden administration, which capped out-of-pocket insulin costs for Medicare patients at \$35 last year. Biden said in 2023 that benefit should be expanded to everyone and not just those on Medicare.

The complaints were filed in the U.S. District Court for the District of New Jersey, where previous insulin price-fixing lawsuits were consolidated along with future municipal cases. The counties are suing to recover damages associated with the costs that county employees, retirees and their dependents, and other county programs have paid for insulin over the last 20 years.

Three manufacturers dominate the insulin market worldwide, pushing up the price and forcing many diabetic people to forgo treatment or limit their insulin use, critics have said.

The counties allege three insulin producers, Indiana-based Eli Lilly and Co., Delaware-based Sanofi-Aventis U.S. LLC and Novo Nordisk Inc., have engaged in a scheme with at least 15 pharmacy benefit managers to artificially inflate the price of insulin, according to court filings.

"Wayne County pays an awful lot of money for drugs, particularly insulin in this case for its employees, and we've been gouged and we know we've been gouged, and that money needs to be recouped," Wayne County Executive Warren Evans said. "We want that money back. We want to be able to use that money for the kinds of things that will help make health care in Wayne County an easier thing to tackle and deal with."

Macomb County expects to spend about \$64 million in the 2024 budget for employees' and retirees' health care benefits. Roughly 2% of that will go for insulin costs, Hackel said.

"But it's not just with our retirees and those that are active employees," Hackel said. "We have a jail to maintain and we have to deal with managed care for inmates."

The pharmacy benefit managers and manufacturers are accused of violating the Racketeer Influenced and Corrupt Organizations Act, the Sherman Anti-Trust Act, the Michigan Anti-Trust Act and the Consumer Protection Act, said Melvin Butch Hollowell, an attorney with the Miller Law Firm in Rochester, Michigan, at the news conference.

PBMs are third-party administrators of prescription drug programs for health plans including state government employee plans, commercial health plans and self-insured employer plans.

The counties claim in the lawsuit that the PBMs demand large rebates from the manufacturers in exchange for putting their insulin products on their preferred drug list and increasing sales. The local governments claim that the rebate amounts are kept secret, and the manufacturers continuously increase insulin prices and pass the costs on to the public, according to the Washtenaw County filing.

"CVS Caremark, Express Scripts, and OptumRx are PBMs that work in concert with the manufacturer defendants to dictate the availability and price of the at-issue drugs for most of the U.S. market," the filing asserts.

The three manufacturers controlled roughly 92% and 96%, by volume and revenue respectively, of the global market for diabetes drugs in 2020, according to the filing by Washtenaw County. The three main pharmacy benefit manager defendants, CVS Caremark, Express Scripts, and OptumRx, control more than 80% of the PBM market.

The lawsuits, which are similar, seek injunctive relief or the suspension of alleged price gouging conduct that has caused insulin prices to "explode" in the U.S., according to the Washtenaw County filing.

Sanofi did not comment on the specific allegations in the lawsuits but said its pricing practices always have complied with the law and it is committed to helping patients access their medicine at the lowest possible price.

"Under the current system, fees and savings negotiated by health insurance companies and PBMs through rebates are not consistently passed through to patients in the form of lower co-pays or coinsurance," Sanofi said. "As a result, patients' out-of-pocket costs continue to rise while — between 2012 and 2022 — the average net price of our insulins declined by 58%."

Sanofi also said that no one should struggle to pay for insulin. The company offers several patient-centric savings programs to help people reduce their prescription medicine costs, it said.

"While we will not comment further about ongoing litigation, we recognize that not all patient situations are the same and we have a number of different insulin affordability offerings available through NovoCare," the company said. "Importantly, we continually review and revise our offerings as well as work with diverse stakeholders to create solutions for differing patient needs."

Novo Nordisk said it offers affordable insulin options, some in conjunction with national pharmacies, ranging in price from \$35 to \$25 per vial.

"Novo Nordisk also has an Immediate Supply program in the U.S. where eligible patients at risk of rationing can receive a one-time, free, short-term supply of insulin (up to three vials or two packs of pens)," the company said.

The company announced a price reduction last month for several insulin products. The price of two legacy insulin brands, for example, was reduced by 75% and now costs \$72.34 for a vial and \$139.71 for a flex pen, or pre-loaded insulin dispenser.

Novo Nordisk said the allegations in the lawsuits are without merit and the company intends to "vigorously" defend itself.

Eli Lilly said the company has been working to reduce out-of-pocket costs for insulin and that the health care system incentivizes local governments to choose higher list-price medicines over lower-priced options. Last year the company capped out-of-pocket costs for their insulins at \$35 a month and the average monthly cost for customers is \$20.48, it said.

"These complaints are baseless and should be dismissed, just like cases brought by other local governments have been," the company said. "It's the local governments filing these lawsuits — not Lilly — who decide the terms of the rebate arrangements they now say are improper, including whether to pass rebates on to people who take insulin."

CVS Caremark said pharmaceutical companies, not PBMs, are responsible for setting market prices.

"Nothing in our agreements prevents drug manufacturers from lowering the prices of their insulin products and we would welcome such an action," the company said. "Allegations that we play any role in determining the prices charged by manufacturers for their products are false, and we intend to vigorously defend against this baseless suit."

Express Scripts and OptumRx, did not immediately respond to requests for comment.

Insulin is naturally produced by the body in response to high blood sugar. People with diabetes either cannot produce enough insulin or cannot use it as well as they should, according to the Centers for Disease Control and Prevention.

Nearly 1 million people in Michigan, about 12% of the population, had diabetes in 2023, according to the American Diabetes Association. Evans said residents often have to forgo insulin treatment because they can't afford it.

"If you're not getting enough insulin, your blood pressure your blood sugar is routinely too high and that you are running the risk of long-term consequences: loss of hearing loss of sensation in your legs, cardiovascular disease, stroke," said Abdul El-Sayed, Wayne County medical director.

When it was first awarded over 100 years ago, the patent for insulin was sold to the University of Toronto for \$1 to ensure it was accessible and affordable.

"The normal drivers of cost increases in the pharmaceutical arena, which is primarily research and development, does not exist with insulin in any meaningful way," said Mark Bernstein, an attorney in the case. "The cost increases that we're talking about is not supported by that type of justification."

The local governments have retained Bernstein, Miller, Weitz and Luxenberg, and Robbins Geller law firms. Hollowell said that a win in the lawsuit likely will change the behavior of the pharmaceutical companies.

"Every dollar that a city or the county spends for this overcharge is \$1 less that's available for a firefighter, or a police officer, or to fix a road," Hollowell said.

For many political leaders, it's more about increasing transparency and lowering the cost of insulin than seeking damages. "I'm not looking for a check for the city of Detroit. I'm looking for a settlement that allows our residents to be able to afford that treatment," Duggan said.

Several officials drew comparisons to a recent settlement with the nation's largest opioid manufacturers and distributors. It took at least six years for the litigation to play out, and Michigan municipalities began seeing millions in payouts last year.

"(Opioid litigation) wasn't about trying to figure out how do we make money and how do we get a settlement from that, although we knew that was a potential or possibility," Hackel said. "It was to try to figure out how do we stop ... the influx of opioids coming into our communities."

The local governments are not asking for a specific amount in damages yet, which would require a model to estimate how to allocate funds among the plaintiffs, attorney Bernstein said.

"These counties and the city of Detroit ... are the head of we think, of probably a very significant wave of litigation related to this," Bernstein said.

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NYCB Hit With First Investor Lawsuit Over Share Price Collapse

news.bloomberglaw.com/product/blaw/bloomberglawnews/exp/eyJpZCI6IjAwMDAwMThkLTg0OTgtZDUyYi1hM2FmLWU3ZmUyOWY2MDAwMCIsImN0eHQiOiJTTE5XliwidXVpZCI6Ik0weFFPL0QzRk5GVVMvUU9IOHFIZIE9PTY4Yk5RS0hwaGllWIVhZ3FhWINEK3c9PSIsInRpbWUiOiIxNzA3Mzk0NDcyMDgxliwic2InIjoOUdzaWJhMWs0L1JuWlo0Zk5SNStGTEVZaEdFPSIsInYiOiIxN0=

- Bank announced massive possible losses in Jan. 31 earnings
- NYCB shares have fallen more than 60% over the past week

New York Community Bancorp is facing the first of what are likely to be several securities fraud lawsuits alleging the bank and its top executives misled shareholders about the health of its commercial real estate loan portfolio.

Shareholder Walter Edward Lemm, Jr. filed a proposed class action Tuesday in federal court in Brooklyn, New York. Along with the bank itself, the suit names NYCB Chief Executive Officer **Thomas Cangemi** and Chief Financial Officer **John Pinto** as defendants.

NYCB shares have plummeted since it said in its Jan. 31 earnings announcement that it was setting aside \$552 million for possible loan losses, far above estimates. The Hicksville, New York-based bank's stock was down around 12% in Wednesday morning trading, and by more than 60% over the past week.

The shareholder suit, which was first reported by Reuters, highlights several instances in the past when the company had reassured investors about the quality of its loans and underestimated expected losses.

WATCH: New York Community Bancorp has reportedly been reaching out to investors for capital to finance a large portfolio of residential mortgages. Matthew Monks reports.

Source: Bloomberg

"Defendants' positive statements about the Company's business, operations, and prospects were materially misleading and/or lacked a reasonable basis," plaintiffs allege.

NYCB representatives didn't immediately respond to requests for comment on the suit. In a statement issued Tuesday, Cangemi said the bank had taken "decisive actions to fortify our balance sheet and strengthen our risk management processes during the fourth quarter," calling the charge "an investment in enhancing a risk management framework commensurate with the size and complexity of our bank and providing a solid foundation going forward."

The case is Lemm v. New York Community Bancorp, 24-cv-903, US District Court, Eastern District of New York (Brooklyn).

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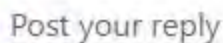
iv. **The 10/21/21 Press Release**

The 10/21 Press Release's statements regarding Lottery's preliminary earnings are, on point. In relevant part, the case involved a press release issued on 10/21/21 Press Release's statements regarding Lottery's preliminary earnings regarding the company's "preliminary earnings results." *Id.* "[T]he release announced the company's 'expected' earnings per share of \$0.06 to \$0.08 per share for [the quarter ending 9/30/21]." *Id.* The court rejected as "incorrect" the plaintiff's argument that the release's statements were "forward-looking" because they did not "qualify as a forward-looking statement, because they addressed the company's actual performance for the quarter." *Id.* It noted that just because "a quarter has concluded does not mean that the company's results have yet been tabulated." *Id.* And it explained that the release's statement of preliminary results "was a forward-looking projection, insofar as it represented the company's calculation of what the final quarterly financial results would be based on the company's available financial and operating information and management's preliminary projections of the unaudited financial results for the quarter." *Id.* at 40 (quoting the press release).

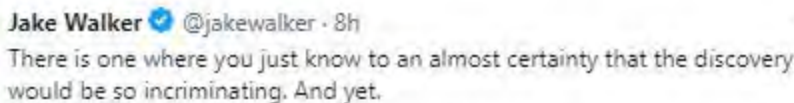
In other words, the preliminary results were a prediction, based on incomplete information, of what the company would ultimately declare its financial results to have been." *Id.*

Search Inc., 173 F. Supp. 3d 12, 39 (S.D.N.Y. 2016).

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iv. The 10/21/21 Press Release

The 10/21/21 Press Release's statements regarding Lottery's preliminary revenue results are nonactionable under the bespeaks-caution doctrine because they, too, are "statements whose truth [could not] be ascertained until some time after the time they [we]re made." *In re Philip Morris*, 89 F.4th at 428 (citation omitted). Plaintiffs contend that these statements were "simply not forward-looking" because they "concern[ed] revenue results for Q3 2021, a quarter that had already closed when the statement was made." Lottery Class Opp. at 13. Although this line of reasoning has some intuitive appeal, the Court disagrees. When applying the bespeaks-caution doctrine, courts in the Second Circuit generally treat "corporate statements of projections as to corporate earnings" as forward-looking statements, "without regard to whether the last day of the covered earnings period had passed." *Lopez v. Ctpartners Exec. Search Inc.*, 173 F. Supp. 3d 12, 39 (S.D.N.Y. 2016).

Lopez is on point. In relevant part, the case involved a press release issued on January 21, 2015, announcing the company's "preliminary earnings results." *Id.* "[T]he release said that the [c]ompany 'expected' earnings per share of \$0.06 to \$0.08 per share for [the fourth quarter of 2014]." *Id.* The court rejected as "incorrect" the plaintiff's argument that these preliminary results did not "qualify as a forward-looking statement, because they addressed a quarter that was complete." *Id.* It noted that just because "a quarter has concluded does not mean that the quarter's results have yet been tabulated." *Id.* And it explained that the press release's statement of preliminary results "was a forward-looking projection, insofar as it gave a 'preliminary' calculation of what the final quarterly financial results would be 'based on currently available financial and operating information and management's preliminary analysis of the unaudited financial results for the quarter.'" *Id.* at 40 (quoting the press release at issue). "In other words, the preliminary results were a prediction, based on incomplete or provisional information, of what the [c]ompany would ultimately declare its financial performance to have been." *Id.*

The Court agrees with *Lopez*'s reasoning and adopts it here. Accordingly, the Court

Exxon's \$60 Billion Pioneer Buyout Draws Pension Fund Lawsuit

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- **COURT:** Del. Ch.
- **TRACK DOCKET:** No. 2024-0101

A pension fund is suing Pioneer Natural Resources Co. ahead of a planned \$60 billion sale to ExxonMobil Corp., citing fears Pioneer's leaders may have hidden news about Exxon's finances that threatened the deal's value to Pioneer shareholders.

The lawsuit was docketed in Delaware's Chancery Court on Wednesday, the same day the all-stock transaction was set to receive a vote from Pioneer's investors. The sale is expected to close in the first half of the year, according to a Feb. 2 statement by ExxonMobil, which isn't named as a defendant. The companies announced the deal in October.

The Operating Engineers Construction Industry and Miscellaneous Pension Fund, the shareholder that filed the lawsuit, is seeking internal files from the Texas-based energy exploration and production company to investigate allegations that CEO Richard Dealy and former chief Scott Sheffield concealed a looming impairment charge at Exxon worth \$2.4 billion to \$2.6 billion.

According to the lawsuit, revelations of the charge in January tanked Exxon's share price by 5.5% and its market cap by \$20 billion—and the all-stock deal's returns to Pioneer shareholders. Meanwhile, Sheffield and Dealy "got everything they wanted" with each receiving massive payments of nearly \$29 million for Sheffield and \$15 million for Dealy, the complaint says.

It seems unlikely neither man knew the impairment charge was coming because they were central to the negotiations, according to the court filing.

Pioneer didn't immediately respond to a request for comment.

The suit, which stops short of formally alleging wrongdoing, is pursuing the documents under a statute giving investors broad access to corporate records if they credibly suspect self-dealing. Shareholder records cases often reflect an attempt to drum up fiduciary breach claims for future litigation.

The pension fund is represented by Grant & Eisenhofer PA.

The case is Op. Eng'rs Constr. Indus. & Misc. Pension Fund v. Pioneer Nat. Res. Co. , Del. Ch., No. 2024-0101, complaint filed 2/7/24 .

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Apple Defeats Investor's Lawsuit Over Executive Compensation

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Feb. 7, 2024, 6:02 PM PST

Mike Vilensky

- Investor alleged Apple misled on Cook's compensation
- Company disclosed proper pay information, court says

Apple Inc. didn't misrepresent the value of stock-based compensation for Tim Cook and other executives to shareholders ahead of a vote on Cook's pay, a federal judge said, dismissing an investor's lawsuit against the tech giant and its top leaders.

Apple's disclosures to shareholders didn't unlawfully lead the Teamsters pension fund that brought the lawsuit to lose money through inflated executive pay, Judge Jennifer L. Rochon said, because the investor only took a non-binding vote on executive pay after reviewing the proxy statement.

The International Brotherhood of Teamsters pension fund, an institutional investor in Apple, sued Cook and other high-level Apple executives in the US District Court for the Southern District of New York last year, alleging violations of the Securities Exchange Act of 1934 and SEC regulations.

Apple directors failed to use the proper, "somewhat complicated" analytical model to determine the values of performance-based stock compensation for Cook and others, the Teamsters said in the complaint. Apple then presented the lower values in part of a proxy statement to stockholders ahead of a non-binding shareholder vote on Cook's pay, "grossly understat[ing] the known costs of this compensation," the Teamsters had said.

Instead of awarding \$77.5 million for several executives per fiscal year, Apple actually awarded about \$92.7 million in restricted stock units for FY 2021 and about \$94 million in FY 2022. The plaintiffs had sought a reduction of the executives' compensation and damages.

Rochon rejected as "impermissibly speculative" the fund's cause of action based on the theory that had Apple calculated executive compensation with a different model and presented that calculation in the proxy statement, then shareholders would have voiced feedback that would have caused Apple to change the compensation.

The value of stock-based executive compensation in Apple's proxy statement doesn't constitute an actionable material misrepresentation, the judge said.

The fund alleges "only that the method of calculation employed is 'improper,' but not that it was in any way inaccurate," Rochon said. "There is no SEC rule requiring that a specific method for determining executive compensation be used, so long as the chosen method is disclosed...Apple did precisely what [SEC rules] require—presented its compensation process and methods."

The case was dismissed with prejudice.

Barrack, Rodos & Bacine represents the Teamsters. Latham & Watkins LLP represents Apple, Cook and other Apple executives.

The case is Int'l Brotherhood of Teamsters, Garage Emp. Local 272 Labor Mgmt. Pension Fund v. Apple Inc. , S.D.N.Y., 1:23-cv-01867, 2/7/24 .

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Apple defeats lawsuit claiming it overpaid CEO Tim Cook, others

 [reuters.com/legal/apple-defeats-lawsuit-claiming-it-overpaid-ceo-tim-cook-others-2024-02-07](https://www.reuters.com/legal/apple-defeats-lawsuit-claiming-it-overpaid-ceo-tim-cook-others-2024-02-07)

Jonathan Stempel

Apple CEO Tim Cook walks at the Apple Fifth Avenue store as customers queue to buy Apple's Vision Pro headset, in Manhattan in New York City, U.S., February 2, 2024.
REUTERS/Brendan McDermid/File Photo Purchase Licensing Rights , opens new tab

NEW YORK, Feb 7 (Reuters) - A federal judge on Wednesday dismissed a lawsuit accusing Apple (AAPL.O) , opens new tab of overpaying Chief Executive Tim Cook and other top executives by tens of millions of dollars by miscalculating the value of performance-based stock awards.

U.S. District Judge Jennifer Rochon in Manhattan said the iPhone maker described its pay methods in detailed compensation tables in its 2023 proxy statement, "precisely" as securities laws and U.S. Securities and Exchange Commission rules require.

Rochon also found no proof that Apple's board of directors acted improperly in awarding pay, and said the plaintiff, a pension fund affiliated with the International Brotherhood of Teamsters, did not give the board enough time to consider its objections before suing.

Lawyers for the pension fund did not immediately respond to requests for comment.

The plaintiff said Apple in 2021 and 2022 awarded a respective \$92.7 million and \$94 million of performance-based restricted stock units to Cook and four other executives, though its compensation committee intended to award just \$77.5 million each year.

It attributed the alleged error to the committee's improper calculation of the RSUs' fair values at the time of the grants, and said it misled shareholders who would be casting advisory votes on executive compensation, known as "say-on-pay."

Cook's compensation , opens new tab totaled about \$99 million in both 2021 and 2022, including more than \$82 million of stock awards each year, Apple proxy filings show. His total pay declined to \$63.2 million for 2023. The four other Apple executives were each awarded more than \$26 million in each of the three years.

The case is International Brotherhood of Teamsters, Garage Employees Local 272 Labor Management Pension Fund v Apple Inc et al, U.S. District Court, Southern District of New York, No. 23-01867.

Reporting by Jonathan Stempel in New York; Editing by Stephen Coates

Musk Case Lays Blueprint for Companies to Safeguard Executive Pay

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Feb. 8, 2024, 1:30 AM PST

Gail Weinstein

Fried Frank

Philip Richter

Fried Frank

Steven Epstein

Fried Frank

Fried Frank attorneys say the opinion striking Elon Musk's compensation plan provides clues for companies so that their executive comp decisions receive greater deference in court.

The blockbuster decision rescinding Elon Musk's nearly \$56 billion compensation plan at Tesla Inc. relates to an extraordinary amount of consideration paid to a superstar, billionaire CEO. But the case also offers important lessons for boards and compensation committees beyond the specific context.

In *Torretta v. Musk*, the Delaware Court of Chancery issued a post-trial decision Jan. 30 ruling that the directors of Tesla breached their fiduciary duties when, in 2018, they adopted a \$55.8 billion 10-year equity-based compensation plan for Musk, Tesla's CEO. The plan was 250 times larger than the contemporaneous median peer compensation plan and over 33 times larger than the plan's closest comparison (Musk's prior compensation plan).

By 2021, Tesla had achieved all of the plan's milestone targets and Musk had been granted all the options. Chancellor Kathaleen St. Jude McCormick ordered rescission of the entire plan, eliminating all the compensation Musk had earned.

Process Is Key

The court found Musk was a controller of Tesla (at least with respect to the compensation plan) and therefore that “entire fairness”—Delaware’s most exacting standard of review—applied to the court’s review of his compensation plan. Under this standard, the plan had to be fair to the corporation and its minority stockholders both as to price and process.

Although the plan was approved by a majority of the minority stockholders, there was no shift of the burden of proof to the plaintiff to establish unfairness of the plan, as the court found that the proxy disclosure was materially flawed, which rendered the stockholder vote not “fully informed.” Therefore, the burden of proof remained with the defendants to prove fairness.

We would note that, if either the plan (a) had been approved by a committee of independent directors, or (b) the disclosure to stockholders had been adequate, and the defendants would not have had the heavy burden of proving fairness of “the largest compensation plan in the history of public markets.” And if both(a) and (b) had been satisfied, the business judgment rule would have applied, requiring judicial deference to the board’s decision (absent waste).

Accordingly, boards and board committees should keep in mind that their process determines the judicial standard of review, and the standard of review can be outcome-determinative.

Directors’ Independence

In the court’s view, there was no approval of the compensation plan by anyone independent of Musk. The court found that the purportedly independent Compensation Committee members had strong business and personal ties to Musk such that they were “ beholden ” to him. That conclusion was reinforced, the court said, by the directors acting with a “controlled mindset,” based on their testimony that they viewed their role as providing Musk with compensation that would be “fair to him” and make him “happy.”

The decision highlights there’s a clear benefit to having at least one clearly independent director to avoid this kind of result. And continuing review of directors’ independence as to a particular individual or issue is critical, as, for example, a compensation committee may be independent with respect to compensation generally but not for a particular executive.

Compensation Committees

The court viewed Tesla’s Compensation Committee as having failed to ask the critical question whether this extraordinary amount of compensation was necessary to achieve the board’s objectives of retaining and incentivizing Musk. The court found the committee hadn’t

engaged “at all” in negotiations with Musk to determine if a lesser amount would have sufficed. Most interestingly, the court said Musk already was well-compensated for his efforts at Tesla through his pre-existing 21.9% stake in the company, the value of which would increase as a result of his efforts.

Accordingly, compensation committees should engage in an active, “adversarial” (the court’s word) negotiation process with an executive to set compensation—and should maintain a record of those efforts.

The decision makes clear that, even in the context of a superstar CEO or controller-CEO, the committee should make “asks”—as, even if the answer will be “no,” the asks may change the negotiating dynamics. In addition, based on *Tornetta*, compensation committees should consider the extent to which an executive’s pre-existing equity stake may already provide incentive to the executive.

Rescission Remedy

The court held that nothing in the record provided a basis for it to order rescission only to the extent the compensation plan was unfair. Accordingly, in litigation over a compensation plan, defendants should consider, in addition to addressing the fairness of the plan or grant overall, seeking to reduce the risk of a remedy requiring disgorgement of the entire amount by identifying that portion that is most defensible.

Controller Status

The court found that Musk was a controller of Tesla, at least with respect to the compensation plan. It noted a constellation of factors, including his 21.9% equity stake in the company.

The court referenced the mathematical analysis in its 2020 *Voigt v. Metcalf* decision, which illustrated that, given that not all stockholders vote, minority stockholders with less-than-majority stakes have a more meaningful advantage than may initially be evident.

For example, if a 21.9% stockholder favors a particular outcome, the holder will “win” as long as holders of approximately one-in-three shares vote the same way, whereas an opponent would have to garner about 71% of the other shares to win. Not only does such a stake provide a meaningful “leg up” on voting, the court stated in *Tornetta*, but at a minimum it “supplies a powerful rhetorical calling card to play in the boardroom.”

The court’s discussion may signal increased openness to finding control status of less-than-majority stockholders, when there are other features suggesting control.

Emails and Jokes

It can't be emphasized enough that emails, although informal communications, should be drafted with the same care as formal corporate communications. Notably, the 201-page *Tornetta* opinion contains 939 footnotes, many of which quote from internal emails of Tesla directors and executives to support or refute the plaintiff's claims.

In addition, we would suggest jokes should be avoided in the context of serious corporate matters. As one example in this case, Musk testified that his giving himself the title "Technoking," which he compared to "being a monarch," was "intended as a joke." The court, crediting that testimony, decided to not take the comment into account in its control analysis—but the court stated that "organizational structures, including titles, promote accountability by clarifying responsibilities. They are not a joke."

Observations

The opinion suggests judicial skepticism as to the unique value of a superstar CEO to justify this level of compensation. We would emphasize, however, that the plan at issue essentially offered Musk the opportunity to obtain an additional 6% equity interest in exchange for \$600 billion of growth in stockholder value. The company had a market capitalization of \$55 billion when the plan was adopted. Thus, \$600 billion reflected growing the company's market capitalization about thirteen-fold.

We would expect that many companies would gladly take the 6%-for-\$600 billion deal. Indeed, Tesla is one of less than a handful of companies that from 2018 to 2022 achieved thirteen-times growth in their market capitalization. The decision highlights the benefits of a process that permits the court to defer to the business judgment of independent directors.

The case is *Tornetta v. Musk*, Del. Ch., No. 2018-0408, 1/30/24 .

This article does not necessarily reflect the opinion of Bloomberg Industry Group, Inc., the publisher of Bloomberg Law and Bloomberg Tax, or its owners.

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Write for Us: Author Guidelines

What Elon Musk's Ties to Some Board Members Mean for the Companies

WSJ [wsj.com/podcasts/tech-news-briefing/what-elon-musks-ties-to-some-board-members-mean-for-the-companies/87cb1bcf-6824-4fe3-84e5-da8c82f9e59d](https://www.wsj.com/podcasts/tech-news-briefing/what-elon-musks-ties-to-some-board-members-mean-for-the-companies/87cb1bcf-6824-4fe3-84e5-da8c82f9e59d)

February 8, 2024

Money and drugs tie Elon Musk to some Tesla directors, and some shareholders have questioned whether the board of directors is truly independent. Some board members have invested in Musk's other companies, and, as The Wall Street Journal exclusively reports, they have deep personal ties to Musk, too. WSJ reporter Emily Glazer tells host Alex Ossola more about these personal and financial relationships, and how they could affect the companies' business.

00:00 / 11:58

Full Transcript

This transcript was prepared by a transcription service. This version may not be in its final form and may be updated.

Alex Ossola: Welcome to Tech News Briefing. It's Thursday, February 8th. I'm Alex Ossola for The Wall Street Journal. Coming up on today's show, Apple's hardware and software simply work better with other Apple products. This is a feature, not a bug, and it's made the company a lot of money, but has it become a liability? WSJ Technology Columnist, Christopher Mims joins us. And then, Elon Musk's companies, including Tesla and SpaceX, have helped make him the richest man in the world. They've also enriched the company's board members, some of whom also have close personal relationships with Musk. WSJ Reporter, Emily Glazer tells us about the money and drugs that tie Musk to some Tesla and SpaceX directors and how those relationships could impact the companies. But first, Apple has long protected, its so-called walled garden, or its closed ecosystem of hardware and software. That makes it very difficult for Apple customers to use devices outside of the ecosystem or switch to a competitor. This policy has generated enormous profits for the company, but now, that walled garden is under pressure and it may even be a liability. WSJ Tech Columnist, Christopher Mims joins us now with more. Christopher, is this walled garden typical among big tech companies?

Christopher Mims: Google tries to do this. Meta even tries to do it with their VR Metaverse, but no one really gets away with it the way that Apple does. All of those other companies are forced to, in some way or another, play nicer with other ecosystems.

Alex Ossola: How has this integration benefited Apple?

Christopher Mims: Up to this point, this walled garden has really helped Apple sell us more devices. So if you have an iPhone, then you're much more likely to buy AirPods. It really helps Apple just grab a bigger share of wallet.

Alex Ossola: But more recently, people have been critical of Apple's Walled Garden policy. Who are its critics?

Christopher Mims: Apple's critics include, of course, developers who don't want to give it that 30% cut on the App Store. Notably, Epic Games, maker of Fortnite, has had this multi-year lawsuit. It's not even resolved now because Apple just complied with one of the directives that came out of that lawsuit, and Epic claimed that it was a bad-faith compliance. So now that judge is going to review that yet again. There are regulators and senators who are saying that the cut that Apple and Google takes in their respective App Stores is too high, and there is apparently an antitrust case against Apple about these issues that's in the works of the Department of Justice.

Alex Ossola: So given that Apple is coming under more regulatory scrutiny, is the walled garden now becoming more of a liability than an asset?

Christopher Mims: It is becoming more and more of a liability the way that Apple is running it. The walled garden is still a tremendous asset for Apple, in that it props up its hardware revenue, it's the reason that its services' revenue just keeps going up and up, it's the reason that Apple's worth more than \$2 trillion. But Apple's relatively tight grip on how that walled garden works is just leading to all of this regulatory pushback in the US, and also especially in the EU. And it's also just leading to pushback from developers. I mean, when the Apple Vision Pro launched, it didn't have Netflix on it, it didn't have YouTube on it. But a lot of developers that I talked to said to me, "Yeah, this is a huge moment, but I'm not keen to jump on this platform right away because of the so-called Apple Tax in the App Store and because of the way the headset is locked down."

Alex Ossola: Does it seem likely that Apple could change this policy anytime soon?

Christopher Mims: In, for example, Europe, they're going to offer, it sounds like, another way to load apps onto the iPhone other than through its App Store, because regulators are just forcing it to. So there are these carve-outs, and it's possible that regulatory pressure and just public opinion could force Apple to here and there take a brick out of the wall around its walled garden.

Alex Ossola: That was our tech columnist, Christopher Mims. Coming up, some Tesla and SpaceX directors have deep ties to Elon Musk. How could those relationships affect shareholders and the companies' futures? We'll find out next after the break. Typically, a company's board members provide checks and balances, including, in some cases, hiring and firing the CEO. Companies traded on the New York Stock Exchange and NASDAQ are

required to have majority-independent boards. But at Tesla, some shareholders have questioned whether the board is truly independent. Several of its eight members have received stock options worth more than \$100 million. Some have invested in other companies run by CEO Elon Musk and, as The Wall Street Journal exclusively reports, they have deep personal ties to Musk too. WSJ Reporter, Emily Glazer joins us now with more. Emily, what does the financial relationship between some of these board members and Elon Musk look like?

Emily Glazer: Well, let's take one person, Antonio Gracias. He has been a good friend of Musk's for decades and he's a venture capitalist, and he and his venture capital firm have held investments recently valued at about \$1.5 billion in Musk companies. Now, of course, venture capitalists invest in a lot of different places, and in Silicon Valley there are a lot of VCs that are on boards of companies, but our reporting and the hundreds and hundreds of pages of court documents and SEC filings and other public records that we went through shows that this is at a new extreme. In fact, probably something we haven't seen before in modern history in terms of the extent of the funds. Antonio is just one example. Larry Ellison, who is the co-founder of Oracle, its current chief technology officer and was a former Tesla board member, he actually has investments in Tesla of \$16.2 billion. We've got James Murdoch, one of the sons of Rupert Murdoch, who happens to be Chairman Emeritus of News Corp, which owns The Wall Street Journal. James Murdoch is a current Tesla director and he has poured 20 million into SpaceX, and a company controlled by him has invested 50 million into SpaceX. So basically, there's just a lot of different people and a lot of different investments at play. And you've got someone like Elon Musk who is very unique in that he has either founded or is overseeing six different companies.

Alex Ossola: How have these relationships benefited the board members?

Emily Glazer: I mean, I can't emphasize these numbers enough. The average compensation for board members at US public companies is about \$320,000 a year. If you take Alphabet, which is the parent company of Google, that's about 450,000. We're talking hundreds of millions of dollars over time that these Tesla board members are making. It is just leaps and bounds higher than anything we are seeing.

Alex Ossola: Let's talk about the personal relationship. What does that look like between these board members and Elon Musk?

Emily Glazer: Last month, The Wall Street Journal reported that Elon Musk uses illegal drugs, including cocaine, LSD, magic mushrooms. And we wrote in this latest investigation that not only does Elon Musk use those drugs, sometimes he also uses drugs with some of his board members. And so, our reporting shows that Elon has used drugs with Steve Jurvetson, who is a current SpaceX board member, former Tesla board member. He's consumed drugs with Antonio Gracias, who is a former Tesla board member, current SpaceX

board member. And his brother Kimbal Musk, he's used drugs with him as well. Some of them also may be enabling him. So, we reported that Elon has attended social gatherings at the Austin Proper Hotel in Texas in recent years with Tesla board member Joe Gebbia, who's classified as independent. Gebbia is the Airbnb co-founder and a friend of Musk's, and Musk took ketamine recreationally through a nasal spray bottle multiple times according to our sources.

Alex Ossola: How does the drug use in question affect the business relationship between board members and Musk?

Emily Glazer: It's highly unusual to have board members do drugs with the CEO. In fact, just doing the drugs in general, Elon Musk is violating the strict anti-drug policies that Tesla and SpaceX have, but it shows a substantial personal relationship beyond just hanging out, going to parties, going on vacation.

Alex Ossola: Last week, a Delaware judge struck down Musk's multimillion dollar pay package at Tesla saying, "Board members who signed off on it in 2018 were beholden to Musk." So what does this legal ruling tell us about these relationships and potentially the future of Musk and his companies?

Emily Glazer: So the fact that the judge struck that down is showing a lot more pressure, and certainly questions whether it can move forward and what this board looks like. But time will tell. Another point to just take a step back is from our reporting in this culture that Elon Musk has created around him. Some friends, including directors, feel that there is an expectation to consume drugs with Elon Musk, because they think refraining could upset Musk. Musk has not only made these people an enormous amount of money, but also they don't want to lose social capital or social currency that comes from being close to Musk. Someone described him to me as having the proximity to a king or an emperor.

Alex Ossola: What did Elon Musk say about your reporting?

Emily Glazer: So, Elon Musk and his lawyer, Alex Spiro, did not respond to many requests for comment. Elon Musk and his lawyer, when we first reported about his drug use a couple of weeks ago, had said that he has passed all of his drug tests. Elon Musk tweeted after that article came out, "That in three years of undergoing random drug testing after a pot smoking incident in 2018, that not even trace quantities were found of any drugs or alcohol." He also later tweeted, "If drugs actually helped improve my net productivity over time, I would definitely take them."

Alex Ossola: What about Tesla and SpaceX? Did they have any comment?

Emily Glazer: We reached out to Tesla and SpaceX quite a bit, and Tesla's general counsel and a SpaceX spokesman both did not respond to many requests for comment.

Alex Ossola: What kinds of concerns might the closeness of board members to Musk bring up among shareholders?

Emily Glazer: When it comes to shareholders, the connections about an extreme blurring of fortune and friendship definitely raise questions about the independence of board members, because they are charged with overseeing the chief executive of the company. Tesla pays its directors mostly in stock options, and the current board, not including Musk himself, collectively has made more than 650 million selling shares from their options. They hold an additional options valued at nearly \$1 billion. This is not Monopoly money. This is real money.

Alex Ossola: That was our reporter, Emily Glazer. And that's it for Tech News Briefing. Today's show was produced by Julie Chang, with supervising producer, Katherine Milsop. I'm Alex Ossola for The Wall Street Journal. We'll be back this afternoon with TNB Tech Minute. Thanks for listening.

Labaton picked lead counsel for shareholder suit against Okta

 legalnewsline.com/stories/654315545-labaton-picked-lead-counsel-for-shareholder-suit-against-okta

February 8, 2024

Susan Illston | cand.uscourts.gov

SAN FRANCISCO (Legal Newsline) - Labaton Sucharow will lead shareholder litigation against a cybersecurity company that suffered a stock drop in 2022 thanks to a hacking incident.

While Okta has called the case "meritless," U.S. District Judge Susan Illston on Feb. 5 granted Labaton's motion to be made lead counsel. The case is pending in U.S. District Court for the Northern District of California.

In approving a motion for class certification, Illston also made the Nebraska Investment Council and North Carolina Retirement Systems the lead plaintiffs.

Litigation started in May 2022. The complaint says the company had inadequate safety measures during the class period, which led to hackers known as LAPSUS\$ posting screenshots of Okta's internal company environment.

The company on March 22, 2022, declared 2.5% of customers had potentially been impacted. News coverage noted the company had more than 15,000 customers at the time.

Raymond James downgraded the company from "strong buy" to "market perform," citing concerns over the security incident. Its stock price fell \$17.88 per share - nearly 11% - to \$148.55 after the downgrade.

Okta said it promptly reported everything it knew about the cyberattack, but litigants "reflexively" sued despite the company claiming the incident had no impact on its financial state.

"Although its themes are well worn, Plaintiff faced particularly unfavorable facts because the security incident at the heart of this case never even breached Okta's or its customers' systems, caused minimal harm, and was broadly disclosed soon after Okta learned about it," a motion to dismiss says.

Class action targets Publix for selling NyQuil with ineffective ingredient

 flarecord.com/stories/654138490-class-action-targets-publix-for-selling-nyquil-with-ineffective-ingredient

February 7, 2024

A person with a cold | Pixabay/Mojpe

WEST PALM BEACH — A class action complaint was filed in Florida federal court alleging that Procter & Gamble and Publix Supermarkets knowingly marketed and sold ineffective products for nasal and sinus congestion relief.

Jay Valinsky claims the marketing and selling of ineffective products resulted in financial harm to consumers who relied on these products based on deceptive advertising, according to a complaint filed on Jan. 16 in U.S. District Court for the Southern District of Florida.

Valinsky alleges fraud, false marketing, false advertising, breach of contract, breach of warranty and breaches of state law consumer protection statutes regarding phenylephrine medicine products.

The products, including Vicks Dayquil and some Nyquil branded products, are marketed to combat sinus congestion but are alleged to be ineffective and no better than a placebo, according to the suit.

Valinsky claims that despite extensive marketing efforts and significant sales, the active ingredient phenylephrine in these products is ineffective at alleviating nasal and sinus congestion, as supported by studies published in scientific journals.

P&G and Publix continued to market and sell the products as effective treatments for congestion despite knowing or reasonably should have known about their ineffectiveness, according to the suit.

"To add insult to injury, Products marketed and sold by Defendants containing phenylephrine replaced other medicines containing a different active ingredient, pseudoephedrine, that were truly effective products for treating sinus and nasal congestion," the complaint states.

Valinsky claims this misconduct resulted in financial harm to consumers who purchased these products expecting relief from their symptoms.

Valinsky claims in his personal experience, he purchased and used the products, asserting that they provided no relief from nasal and sinus conditions.

Moreover, the lawsuit suggests that consumers were misled by the defendants' marketing efforts, which positioned these products as effective remedies for congestion, according to the suit.

Valinsky claims the defendants replaced previous medications containing pseudoephedrine, which were effective for treating congestion, with phenylephrine products due to legal restrictions on pseudoephedrine.

"Despite knowing that products containing phenylephrine are ineffective for the treatment of sinus and nasal congestion, Publix marketed and sold to consumers in Florida and throughout the United States PG family of Products as effective for treating and relieving nasal and sinus congestion," the complaint states. "To get relief from the pain and discomfort from nasal and sinus congestion, consumers like the Plaintiff take sinus medicines that are marketed and advertised as helping to relieve congestion, such as the Products."

However, the plaintiff argues that phenylephrine was chosen despite evidence of its ineffectiveness, driven by profit motives rather than consumer well-being, according to the suit.

Valinsky seeks various forms of relief, including class action status, injunctions to prevent the sale and false advertising of the products, corrective advertising campaigns, damages to compensate consumers, restitution of funds acquired through unlawful practices and attorneys' fees and costs.

Valinsky also seeks legal remedies to address the alleged wrongdoings and provide compensation to affected consumers. Valinsky is represented by David P. Milian of the Milian Legal Group in Miami.

Milian declined to comment on the class action lawsuit, noting his firm does not comment on pending litigation.

U.S. District Court for the Southern District of Florida case number: 9:24-cv-80046

ORGANIZATIONS IN THIS STORY

U.S. District Court For The Southern District Of Florida West Palm Beach Division

Class Action Claims Johnson & Johnson Prescription Plan Overcharges Plan

 [law.com/njlawjournal/2024/02/08/class-action-claims-johnson-johnson-prescription-plan-overcharges-participants](https://www.law.com/njlawjournal/2024/02/08/class-action-claims-johnson-johnson-prescription-plan-overcharges-participants)

By Colleen Murphy

Johnson & Johnson was named in an ERISA class action on Feb. 5 in New Jersey federal court filed by Wheeler, DiUlio & Barnabei and Fairmark Partners that accused the company and its pension and benefits committee of failing to prudently manage its prescription drug benefits plan.

This suit was surfaced by Law.com Radar, ALM's source for immediate alerting on just-filed cases in state and federal courts. Law.com Radar now offers state court coverage nationwide. Sign up today and be among the first to know about new suits in your region, practice area or client sector.

The named plaintiff in the proposed class action, Ann Lewandowski, is a Johnson & Johnson employee and therefore a "participant" in the Employee Retirement Income Security Act plans at issue. Lewandowski joined the company in November 2021 as a health care policy and advocacy director for Wisconsin and Minnesota. While she is still employed by the company, she is currently on leave due to a dispute over accommodations for a medical condition, according to the complaint.

"She brings this lawsuit on behalf of herself and all others similarly situated, serving as a whistleblower to bring to light defendants' mismanagement of the ERISA plans at issue here and to help recover the millions of dollars in plan assets and beneficiaries' money that have been lost as a result of defendants' fiduciary breaches," the complaint said.

The three-count complaint was filed against Johnson & Johnson, the company's pension and benefits committee, and individual members of that committee, including Peter Fasolo, Warren Luther and Lisa Blair Davis, for breaches of fiduciary duties and other violations under ERISA.

The case, *Lewandowski v. Johnson and Johnson*, is about the mismanagement of prescription drug benefits, according to the complaint, which has cost Johnson & Johnson's ERISA plans and their employees millions in the form of higher payments for prescription drugs, premiums, deductibles, coinsurance and copays, and lower wages or limited wage growth, according to the complaint.

At issue are the prices that Johnson & Johnson agreed to pay its pharmacy benefit manager for many generic drugs that are widely available at lower prices. In one example, the complaint described a scenario involving a 90-pill prescription for the generic drug teriflunomide, which is used to treat multiple sclerosis. Even without using insurance, that

prescription can be filled at Wegmans for \$40.55, ShopRite for \$41.05, Walmart for \$76.41, Rite Aid for \$77.41, or from Cost Plus Drugs online pharmacy for \$28.40, according to the complaint.

“Defendants, however, agreed to make their ERISA plans and their beneficiaries pay \$10,239.69—not a typo—for each 90-pill teriflunomide prescription,” the complaint said.

The burden of that price, according to the complaint, falls on the ERISA plan for Johnson & Johnson, which shoulders the majority of the burden from plan assets, and on beneficiaries who pay an out-of-pocket portion of that price. Lewandowski alleged that the difference between what pharmacies pay to acquire teriflunomide and what the defendants agreed to have their ERISA plans and beneficiaries pay for the exact same drug goes largely into the pockets of the PBM at the expense of the ERISA plans and their beneficiaries, according to the complaint.

“No prudent fiduciary would agree to make its plan and beneficiaries pay a price that is two-hundred-and-fifty times higher than the price available to any individual who just walks into a pharmacy and pays out-of-pocket,” the complaint said.

Lewandowski is represented by Michael Casper of Wheeler DiUlio and Jamie Crooks and Michael Lieberman of Fairmark Partners. Counsel have not yet appeared for the defendants.

In a statement emailed to the Law Journal, Lieberman said: “For too long, some large corporations have agreed to patently unreasonable contracts with PBMs that force employees and their health plans to drastically overpay for prescription drugs. We’re committed to shining a light on the opaque world of pharmacy benefits and working to lower the cost of healthcare for American workers.”

The complaint alleged counts for breach of fiduciary duties on behalf of the plaintiff and the class against all defendants under two separate sections of ERISA, as well as a third count for failure to provide plan documents on behalf of Lewandowski against the committee.

“The allegations and legal theories asserted in the complaint are meritless and, therefore, we will be moving to dismiss the complaint,” a Johnson & Johnson spokesperson said in an email to the Law Journal. “As a company, we are committed to our employees and we seek to provide the best coverage for the best medicines at the lowest cost. In evaluating our options, we seek to secure the best combination of cost and other terms from the pharmacy benefit managers that control the market and set reimbursement levels for medicines.”

NOT FOR REPRINT

Facebook Privacy Suit Over Photos of Nonusers Hits Ninth Circuit

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Meta Platforms Inc. clashed with nonusers of the social media giant before a federal appeals court Wednesday over whether collection of their biometric information from photos uploaded by Facebook users violated the Illinois Biometric Information Privacy Act.

A lower court was wrong to dismiss Clayton Zellmer's lawsuit after holding that the act didn't impose liability on Facebook for its collection of data from nonusers, his attorney, John Carey, told the US Court of Appeals for the Ninth Circuit during oral argument.

The court erred in "creating a judicial exception to the plain language of the statute" and writing nonusers out of its protections, said Carey, a partner with Carey Rodriguez LLP in Miami.

But Meta's attorney—Lauren R. Goldman, a partner with Gibson, Dunn & Crutcher LLP—said the company wasn't arguing that the BIPA exempted all claims of nonusers, but rather that it didn't apply to the "incidental processing" of a photograph of a nonuser in the course of recognizing an enrolled and consenting user.

"That's the narrow rule that we asked for in the court below, and that's what we are asking for on appeal," Goldman said.

Facebook previously agreed to pay \$650 million to settle a class action bringing similar biometric-privacy claims on behalf of Facebook users.

Consent From Nonusers

Judge James Donato of the US District Court for the Northern District of California dismissed the lawsuit in November 2022, rejecting Zellmer's argument that Facebook needed to obtain consent from nonusers before collecting their biometric data from uploaded photos.

Requiring Facebook to identify every person without a Facebook account in Illinois and figure out a way to communicate with them to provide notice and obtain consent would be "patently unreasonable," Donato said.

Ninth Circuit Judge Ryan D. Nelson said he had doubts about the lower court's ruling on the application of BIPA to nonusers, but pressed Carey on whether the Facebook violated the act by matching nonusers' face scans with facial templates it had created of users.

"If I were not on Facebook, they couldn't use that information to come and identify me as an individual—do I have the facts wrong in my understanding?" he asked.

Carey replied that the issue was that the facial scans—known by Facebook as "face signatures"—qualified as biometric identifiers under the act, not whether the information could be used by the company to identify someone. The provision of BIPA related to biometric identifiers doesn't include a requirement that they be able to be used to identify someone, Carey said.

Judge Gabriel P. Sanchez asked Carey if BIPA created a cause of action for information that's "temporarily grabbed in order to see if there's a match, and then deleted."

"There's no temporal requirement in the statute for how long you have to keep something in order for there to be a violation," he said.

Biometric Identifier

Goldman challenged Carey's argument that the BIPA imposed liability for the collection of biometric identifiers even when the data couldn't be used to identify someone.

"The reason that the legislature didn't have to make clear that a biometric identifier had to be something that identified a person is that it's right there in the name: biometric identifier," she said.

Zellmer's broader argument also failed because it implied a complete ban on biometric technologies, which was plainly not the intent of the Illinois legislature in passing BIPA, she said.

"If you have a rule that a company can't try to match a face to a database, that pertains to how all of these systems work," Goldman said.

Nelson asked if the analysis would change if Facebook had access to a database it could use to identify nonusers in photos uploaded by users.

"These aren't the facts of this case, but the plaintiffs still wouldn't win because they would have to show that Facebook did this in such a way that would constitute 'collect, capture or otherwise obtained'" under BIPA, she said.

That would mean showing "intentionality and control," rather than ephemeral capture, she said.

Judge Danielle J. Forrest was also on the panel.

Milian Legal Group and Bottini & Bottini Inc. also represent Zellmer. Cooley LLP and Mayer Brown LLP also represent Meta.

The case is Zellmer v. Meta Platforms Inc., 9th Cir., No. 22-16925, oral argument 2/7/24 .

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Meta's \$90 Million Tracking Deal Challenged Before Ninth Circuit

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Objectors to Facebook's \$90 million settlement of a class action over its tracking of users on non-Facebook websites told a skeptical federal appeals court on Wednesday that deal should be tossed because the lower court failed to properly value the class's statutory claims.

The plaintiffs in the consolidated litigation alleged that Facebook, now known as Meta Platforms Inc., tracked their online activities without their consent even when they were no longer logged into the social media service.

The settlement was reached after the Ninth Circuit held that the plaintiffs had adequately pleaded claims under the Federal Wiretap Act, the California Invasion of Privacy Act, and the California Computer Data Access and Fraud Act. Objectors Sarah Feldman and Hondo Jan appealed to the Ninth Circuit after Judge Edward J. Davila of the US District Court for the Northern District of California gave final approval to the deal in November 2022.

The total value of the statutory damages available to the 124 million class members was \$1.24 trillion, meaning the settlement provided a recovery of just .0073% of the maximum statutory damages, an inadequate result under federal rules for approving class-action settlements, John J. Pentz of Wayland, Mass., who represented the objectors, said during oral argument before the US Court of Appeals for the Ninth Circuit.

David A. Straite, a partner with DiCello Levitt LLP, who represents the non-objecting class members, asked the court to affirm the judgment of the lower court. "We believe this to be an "historic settlement with overwhelmingly positive reaction from the class," as shown by the 1.5 million submitted claims as against nine objectors.

Like Button

Perrin Davis, Brian Lentz and the other plaintiffs claimed in the 2011-filed lawsuit that Facebook tracked users' internet activity on pages that displayed a Facebook "Like" button using "cookies," or small text files the server creates and stores on the user's computer.

The case consolidated similar complaints filed on behalf of U.S. residents in 10 states, including Alabama, California and Texas.

Ninth Circuit Judge Ryan D. Nelson said the size of the statutory damages under the objectors' calculation, which would lead to bankruptcy even for a company the size of Meta, would create problems for the objectors' argument under the Due Process clause of the

Constitution.

"The district court said that that would violate Meta's due process, if it were subject to that amount of damages," the judge said.

The proposed settlement amount of \$90 million was 10% of the class's own estimate of its maximum damages, which Ninth Circuit case law has held to be reasonable, Nelson said.

Pentz agreed that a 10% recovery on the facts of the case may be a reasonable amount, but said "it has to be 10% of what the class would realistically recover after trial in front of a jury."

Pentz added that settlement amount also needed to be large enough to serve the statutory purpose of deterring Facebook's behavior.

"And you know, Facebook stopped doing it, that was part of the settlement," said Nelson. "I'd say that was pretty good deterrence."

Christopher Chorba, a partner with Gibson, Dunn & Crutcher LLP and who represents Meta, said that a district court isn't required under Ninth Circuit precedent to consider every available form of relief in evaluating the adequacy of a settlement.

"For the purposes of settlement the class engaged a damages expert who calculated that \$90 million was 10% of the available disgorgement," he said. "This was one of their principal theories of damages—and it's within class counsel's discretion to consider what relief to seek because of the obvious due process problems."

The district court was also well aware of those problems after extensive discussion at the hearing for final approval of the settlement, Chorba said.

Judges Danielle J. Forrest and Gabriel P. Sanchez were also on the panel.

Simmons Hanly Conroy and Grygiel Law LLC also represent the non-objectors. Kendrick M. Jan of San Diego, Cal., and Eric A. Isaacson of San Diego, Cal. also represent the objectors. Cooley LLP also represents Meta.

The case is *Davis v. Meta Platforms Inc.*, 9th Cir., Nos. 22-16903, 22-16904, oral argument 2/7/24.

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Mass Arbitration Abuse Boosts Attorneys' Fees, Not Fair Results

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The United States Law Week
A view of American currency.

Photographer: Tomohiro Ohsumi/Bloomberg via Getty Images

Feb. 8, 2024, 1:30 AM PST

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Mayer Brown attorneys say some plaintiffs' attorneys are piling up mass arbitration claims without investigating the merits so that arbitration filing fees alone force businesses to settle.

Some commentators are celebrating the rise of mass arbitrations, but there's little cause for celebration. The sole beneficiaries of most mass arbitrations are the plaintiffs' lawyers who reap huge fees from settlements. Often the settlement amounts are wholly unrelated to the merits of the underlying claims.

Who's hurt? Parties with legitimate claims and the consumers and workers who foot the bill for these unjustified settlements and the accompanying attorneys' fees.

Here's how the mass arbitration gambit works:

- Plaintiffs' lawyers enroll thousands of clients, typically through an online process with minimal screening, to prosecute the same or similar claims.

- Plaintiffs' lawyers then threaten to file all the arbitrations at the same time, which can trigger the target company's immediate obligation to pay tens or hundreds of millions of dollars in upfront arbitration fees—even though the lawyers have neither the intent nor the resources to arbitrate each claim.

The goal is to put enormous pressure on companies to settle. Because the settlement pressure increases with the number of filed or threatened claims, there's powerful incentive for plaintiffs' lawyers to focus on the quantity of claims without regard to their quality. Our profession demands better: Lawyers shouldn't blindly act on unverified information typed into online forms by strangers who are recruited to be arbitration claimants. Mass arbitrations harm everyone: not just businesses, consumers, and workers—but also the integrity of our civil justice system.

As we explain in a US Chamber of Commerce Institute for Legal Reform report, mass arbitration coercion is working. Who wouldn't feel constrained to pay \$10 million to settle a case when the alternative is to pay more than that in arbitration filing fees.

And that's before paying lawyers to handle the arbitrations, paying additional arbitration fees, and paying amounts awarded by the arbitrators. The merits of the claim go by the wayside.

The only winners are plaintiffs' lawyers—and those who fund their efforts—who are enriched by forcing hefty settlements regardless how weak the underlying claims might be or whether the claimants are even legitimate customers of the target business.

The fact that some plaintiffs' lawyers try to abuse the system isn't new. A half-century ago, Judge Henry Friendly famously recognized that class actions could, and did, lead to blackmail settlements. The mass arbitration gambit is an updated version of the class action abuses that characterized the last part of the 20th century: claims that leverage the threat of huge costs to extract a settlement unrelated to the claims' merits.

A Georgetown Law School professor interviewed plaintiffs' lawyers who popularized the mass-arbitration strategy, and candidly acknowledged that the mass arbitration model operates through “significant in terrorem settlement pressure” that can be even greater than a class action, even when the mass arbitration asserts “more dubious claims.”

In the past, Congress responded to class action abuses by enacting the Private Securities Litigation Reform Act and the Class Action Fairness Act.

Because arbitration is a matter of contract, businesses have responded to abusive mass arbitrations by developing fair and reasonable countermeasures—modeled on approaches used by courts in multi-district litigation.

For example, the use of bellwether and batch proceedings, allowing 25 or 50 arbitrations to proceed at a time, to obtain merits outcomes that can lead to informed settlement of the remaining claims.

When plaintiffs' lawyers assert that these procedures make it harder for consumers to bring claims en masse, they're just complaining about common-sense steps to respond to abusive efforts to coerce settlements. It's surprising because many of the same lawyers advocate for bellwether trials in multidistrict litigations—precisely because they frequently lead to settlements of the remaining lawsuits.

In reality, arbitration delivers results for claimants. Consumers, workers, and businesses all benefit from arbitration's streamlined procedures, which enable prompt resolution of consumer and worker disputes on the merits.

Numerous empirical studies, including one sponsored by the US Chamber of Commerce Institute for Legal Reform, show consumers and workers do as well or better in arbitration compared to litigation—they prevail on their claims more quickly and more often, and they recover as much or more when they prevail.

Businesses also frequently make consumers or workers with legitimate concerns more than whole before the dispute even reaches a formal arbitration.

The reduced expense and complexity of arbitration allow consumers and workers to seek redress for claims they could not practically bring in court.

There's nothing inherently wrong with one lawyer or one firm representing multiple claimants asserting the same or similar claims. But those claims should be addressed in a way that ensures that the merits, not the threat of massive arbitration fees, drive the results.

This article does not necessarily reflect the opinion of Bloomberg Industry Group, Inc., the publisher of Bloomberg Law and Bloomberg Tax, or its owners.

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Expert Perspectives on Biggest Court Cases

 [law.com/litigationdaily/2024/02/08/big-law-and-litigation-finance-seem-to-be-having-a-moment](https://www.law.com/litigationdaily/2024/02/08/big-law-and-litigation-finance-seem-to-be-having-a-moment)

By Ross Todd

Aviva Will of Burford Capital. Courtesy photo

ANALYSIS

Big Law and Litigation Finance Seem to Be Having a Moment

In a recent webcast hosted by Burford Capital, Co-COO Aviva Will said the publicly traded litigation finance firm has seen a recent uptick in interest from companies and large law firms.

February 08, 2024 at 07:30 AM

Ross Todd
Editor/columnist

Have we reached something of an inflection point when it comes to large law firms and litigation finance?

That was the question that crossed my mind as I tuned into a webcast hosted last week by funder Burford Capital featuring law firm management consultant **Brad Hildebrandt** discussing the latest annual Citi Hildebrandt Client Advisory. While I'm sure plenty in the audience tuned in for a free helping of Hildebrandt's thoughts on the financial year that was for large law firms in 2023 and what to expect in 2024, I was more interested in what Burford co-COO **Aviva Will** had to say about what she and her colleagues are seeing in the litigation market.

Will said that Am Law 200 firms that haven't been active on the claimant side of litigation historically are "starting to do more and more business in that space." She said firms are often coming to Burford to figure out how to bridge the gap between their traditional hourly work on the defense-side and plaintiff-side work, where clients are looking for more flexible alternative fee structures of full-on contingency fee work.

"That is largely driven by corporates who are moving in that direction," Will said. "We're seeing very significant development there."

In Burford's most recently published annual report, the publicly traded litigation funder reported that it had "received funding inquiries" from 93 of the firms in 2022's Am Law 100 and 89 in that year's Global 100. A Burford spokesperson told us yesterday via email those numbers have ticked up to 94 firms in the 2023 Am Law 100 2023 and 92 of the Global 100. All those numbers are in line with what Burford has reported for a few years now.

But some firms also have been a bit more open about their own efforts at taking on affirmative litigation for clients. As we previously noted, Burford published a roundtable this past fall with four litigation department leaders at Am Law 50 firms who spoke about a growing appetite among both clients and firms to share risk via plaintiff-side contingency work and partial contingency fee arrangements.

In last week's webcast, Will said that much of the thrust of what's going on in the market has come at clients' urging. She said five-to-seven years ago there were no such things as "quote unquote affirmative recovery programs." Now, she said, in certain large companies you can actually find someone in-house focusing on potential litigation assets.

"There is a title and a person whose job it is to focus on affirmative recovery at large corporates, and I think that is in some ways driving the move for law firms to be responsive to their clients who are historically defense-side clients," she said. She said that companies are looking for ways to unlock what they see as potential assets both through flexible, risk-sharing fee arrangements with their law firms and through monetization with funders such as Burford. "Those things sort of tend to move in tandem, she said. "Law firms obviously want to be responsive to their clients. So as clients are looking to unlock that value on the affirmative-side, law firms, I think, are following suit."

Will said in some instances law firms are even beginning to "sound like finance people" and talk about "their risk business."

Hildebrandt said that he does see a shift going on as well. But he cautioned that firms that haven't traditionally done contingency fee work need to think it through and have the right controls in place to make it work. He said firms have to think through how they're going to compensate partners who are working on contingency fee matters and how they will distribute any potential proceeds. Hildebrandt said that he's been involved in a couple of cases where firms landed a big recovery on contingency before they had plotted out how it would affect partner compensation.

"They had no plan for how to deal with that money and it was very, very disruptive," Hildebrandt said.

Some disruptions are better than others.

Florida Lawmakers Move to Restrict Litigation Finance Industry

news.bloomberglaw.com/product/blaw/bloomberglawnews/exp/eyJpZCI6IjAwMDAwMThkLTg0ODItZGNkMC1hN2ZmLWFIZjY3MTdiMDAwMSIsImN0eHQiOiJTTE5XliwidXVpZCI6Ilh1MU96dytkUDduRHR3SU5FZ01ES2c9PVB4cnduMEpBUkI4MTIDRUhwSWVRcXc9PSIsInRpbWUiOiIxNzA3Mzk0NDcyMDkwliwic2lnIjoik3psUmp2dnh5WHp5MFFCUDdzS0RjSjhNOUtVP SIsInYiOiXln0=

- Senate committee votes favorably
- US Chamber backs the legislation

Florida lawmakers moved to regulate the litigation finance industry on Wednesday, as some argued that investor involvement in lawsuits leaves courts open to domestic or foreign manipulation.

A state Senate committee voted favorably on proposed legislation by Senator Jay Collins, a Republican, that would require litigants to disclose when their lawsuits are financed by investors who seek a financial return if cases are successful.

“The ability to step in and have sway in our court system, that’s frightening,” Collins said. The Senate Committee on Fiscal Policy approved the bill, 15 to six.

The bill (SB 1276) is among a cluster of proposals backed by groups including the US Chamber of Commerce that have been introduced in states this year in an effort to restrain the \$13.5 billion litigation finance industry. Kansas, Rhode Island and Arizona also introduced litigation finance bills in January.

The Florida bill includes more than just disclosure of a litigation finance agreement. It also takes a cue from the federal bill introduced last year by Senators John Kennedy (R-La.) and Joe Manchin (D-W.Va.) by requiring the disclosure of foreign investments.

“Floridians should know when and how outsiders, like hedge funds and foreign governments, are funding lawsuits in exchange for big pieces of settlements or awards,” said Nathan Morris, a senior vice president at the Chamber’s Institute for Legal Reform.

During Wednesday’s hearing in Florida, Collins added an amendment that would allow redaction of the amount of financing and expanded protections for nonprofits.

The bill also takes aim at funder’s returns by not allowing investors to receive a larger share of the proceeds than the plaintiff being funded. There is also a requirement that litigation funders indemnify the plaintiffs against any adverse costs, attorney fees, damages or sanctions. Without these inclusions, a litigation finance agreement would be void and unenforceable.

Kansas is the only other state where legislation has gone before a committee. The International Legal Finance Association, the trade association for the industry, has been lobbying against the bills in Florida and Kansas but does not have lobbyists registered in Arizona or Rhode Island. The industry group did not testify at the Florida hearing.

“ILFA has strong relationships with legislators across the country and is educating them on the shameful misinformation being spread by the U.S. Chamber of Commerce and the insurance industry,” ILFA said in a statement. “We will continue to fight for greater access to the court system within a balanced regulatory environment that prioritizes the rule of law, not special interests.”

The Florida bill is the furthest along of the state efforts, with the committee passage Wednesday and an earlier approval in the Senate Judiciary Committee.

The parallel bill in the Florida House was voted favorably in the Civil Justice Subcommittee, though it has been postponed twice for consideration in the on the agenda for the House Justice Appropriations Subcommittee.

The bill must win approval on the House and Senate floors before it can go to Republican Governor Ron DeSantis for his possible signature.

Democratic State Senator Shevrin Jones suggested during Wednesday’s hearing that the bill is unnecessary. “I don’t buy the national security concern that we’re speaking of or any foreign manipulation,” he said.

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Judges Slam 9th Circuit's 'Minimum Contacts' Rule as 'Needless Roadblock' for Plaintiffs

 [law.com/nationallawjournal/2024/02/07/judges-slam-9th-circuits-minimum-contacts-rule-as-needless-roadblock-for-plaintiffs](https://www.law.com/nationallawjournal/2024/02/07/judges-slam-9th-circuits-minimum-contacts-rule-as-needless-roadblock-for-plaintiffs)

What You Need to Know

- Judge Patrick Bumatay urged the 9th Circuit to overturn its 'minimum contacts' rule.
- 5 other judges of the court's 29 active judges joined Bumatay's dissent to en banc denial.

Six judges on the U.S. Court of Appeals for the Ninth Circuit urged their colleagues in vain Tuesday to overturn the court's precedent that requires plaintiffs show a foreign defendant has "minimum contacts" with the United States before a federal court can have jurisdiction to hear the case.

A Ninth Circuit panel last year said a district court lacked jurisdiction over satellite company Devas' lawsuit seeking to confirm a \$1.3 billion arbitration award against Indian state-owned entity Antrix. In a 1980 precedential ruling, the circuit held foreign states may be sued in federal court under the Foreign Sovereign Immunities Act for certain types of claims only after there's a showing that a defendant had minimum contacts with the United States.

In a dissent to a denial of en banc review Tuesday, Judge Patrick Bumatay said the court's 29 active judges should rehear the case and discard that requirement, which he said no other federal appeals court requires.

"After all, how many would-be plaintiffs gave up valid claims in the Ninth Circuit because of our out-of-sync rule? How many plaintiffs had to seek redress in other courts to sidestep our precedent? And how many plaintiffs were simply kicked out of our courts by the minimum-contacts requirement?," Bumatay wrote. "The effect of our ruling is unquestionably significant. Under a proper reading of the FSIA, those plaintiffs should be welcome to bring their claims in our circuit."

He was joined by five other judges: Consuelo Callahan, Sandra Ikuta, Mark Bennett, Ryan Nelson and Lawrence VanDyke.

Judge Diarmuid O'Scannlain, who as a senior judge cannot vote on calls for rehearing, wrote separately that he agreed with the dissent.

Devas, a private U.S. company, sought to confirm an arbitration award by a foreign arbitration tribunal against Antrix over the termination of a deal between the two. Antrix, which markets goods made by India's Department of Space and the Indian Space Research Organization, contracted with Devas to help build, launch and manage telecommunication satellites, according to the Ninth Circuit decision.

U.S. District Judge Thomas S. Zilly of the Western District of Washington said a minimum contacts analysis wasn't needed to exercise jurisdiction over Antrix, and even if it was, Devas met the requirement.

But the Ninth Circuit panel disagreed, saying a showing of minimum contact was needed for the federal court to have jurisdiction. Devas then sought en banc review, which the full appeals court denied.

Baker Botts partner Aaron Streett, who represents Devas, declined to comment on Tuesday's denial.

In his dissent from that denial, Bumatay stated that the panel strayed from the plain text of the FSIA and wrongly relied on a House Committee Report to determine the law requires a showing of minimum contacts.

"Our atextual reading creates a needless roadblock for plaintiffs seeking to assert their rights against foreign states and their agents. And we are simply incompetent to interfere in these matters of foreign affairs." Bumatay wrote.

"Imagine requiring a state sponsor of terrorism to have minimum contacts with our country before allowing our citizens to vindicate the death or injury of a loved one at the hands of a terrorist," he continued. "But that is the regime that the Ninth Circuit erects."

Judges Eric Miller, Lucy Koh and U.S. District Judge Donald W. Molloy, sitting by designation, sat on the panel that ruled last year that the lower court lacked jurisdiction over the case.

The panel said Devas didn't prove Antrix "purposefully availed itself of the privilege of conducting activities in the United States," as needed to establish minimum contacts.

But in a concurrence, Miller and Koh acknowledged that the text of the FSIA doesn't describe a minimum-contacts requirement and said the court should revisit its precedent "in an appropriate case."

"In sum, our precedent applying the minimum-contacts test to the exercise of personal jurisdiction over foreign states has no foundation in the Constitution or the FSIA, and it is contrary to the views of other courts of appeals," the concurrence read. "In an appropriate case, we should reconsider it en banc."

Neither Miller nor Koh joined Bumatay's dissent from the denial of en banc review.

The Ninth Circuit case is *Devas Multimedia Private Ltd. v. Antrix Corp. Ltd.*, No. 20-36024.

NOT FOR REPRINT

Republican US senators seek info on Illinois judges' diversity policies

 [reuters.com/legal/government/republican-us-senators-seek-info-illinois-judges-diversity-policies-2024-02-08](https://www.reuters.com/legal/government/republican-us-senators-seek-info-illinois-judges-diversity-policies-2024-02-08)

Nate Raymond

U.S. Senator Ted Cruz (R-TX) speaks to reporters, during a vote, regarding a bipartisan border security bill that would also provide aid to Ukraine and Israel, on Capitol Hill in Washington, U.S., February 7, 2024. REUTERS/Elizabeth Frantz/File Photo Purchase Licensing Rights , opens new tab

Summary

- Senators John Kennedy and Ted Cruz ask 7th Circuit's chief judge for more info
- Letter focuses on orders by three judges in Illinois' Southern District

Feb 8 (Reuters) - Two Republican U.S. senators have requested more information about policies adopted by three federal judges in Illinois that aim to give young women and minority lawyers more opportunities to argue cases in court.

Senators John Kennedy of Louisiana and Ted Cruz of Texas, both members of the Senate Judiciary Committee's Republican minority, called the policies "unethical" and "discriminatory" in a letter on Wednesday , opens new tab to the chief judge of the 7th U.S. Circuit Court of Appeals, Diane Sykes.

U.S. District Judges Nancy Rosenstengel, Staci Yandle and David Dugan in Illinois' Southern District issued orders in 2020 encouraging the participation of "newer, female, and minority attorneys" in court proceedings.

Under the policies, parties can alert the judges if they intend to have a less-experienced, female, or minority attorney argue a motion. The judges in turn "strongly consider" giving extra time for oral argument and allowing more experienced attorneys to provide the newer ones assistance.

The senators' letter cited a misconduct complaint that America First Legal, a conservative legal group founded by former Trump White House adviser Stephen Miller, filed last week with the 7th Circuit alleging the policies discriminated based on race and sex.

Kennedy and Cruz wrote that the standing orders established "a policy under which oral argument requests are granted based on an attorney's race or sex rather than the substantive merits of the case or the importance of oral argument in clarifying the issue before the court."

Kennedy and Cruz asked Sykes how often oral argument had been granted giving extra time based on a lawyer's race or sex since the policies' adoption, what practices the 7th Circuit has adopted to evaluate "facially discriminatory" policies like these and what training the courts have provided.

Sarah Schrup, the 7th Circuit's circuit executive, in an email on Thursday declined to comment, citing the ongoing judicial misconduct complaint, but said Sykes will "respond to the Senators' letter in due course."

Several federal judges nationally in recent years have adopted orders that encourage senior lawyers to give younger attorneys a chance to argue cases, citing a lack of in-court advocacy opportunities as fewer cases go to trial.

The American Bar Association since 2017 has urged courts to implement plans to give new lawyers courtroom experience, and last year passed a resolution calling on courts to allow two attorneys to argue for each client to foster that goal.

But while policies adopted by many judges to promote young lawyer participation are silent on race or gender, the orders issued by the three Illinois judges specifically focus on boosting participation by women and underrepresented minorities.

Read more:

Ex-Trump aide's group files complaints over judges' diversity pushes

Ex-Trump administration officials target corporate diversity efforts

ABA to judges: Give junior lawyers their day in court

Reporting by Nate Raymond in Boston

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Black workers can sue Harley-Davidson over claims of nooses, racist graffiti at plant

 legalnewline.com/stories/654134589-black-workers-can-sue-harley-davidson-over-claims-of-nooses-racist-graffiti-at-plant

February 8, 2024

Judge Brent Powell authored the court's decision | <https://www.courts.mo.gov/>

JEFFERSON CITY, Mo. (Legal Newline) - Claims that African-American workers were subjected to nooses, Confederate flags and racist graffiti at a Harley-Davidson factory are enough to allow a hostile workplace suit to proceed even if the plaintiffs never saw such things themselves, the Missouri Supreme Court ruled.

It is enough to allege some Black workers suffered racial harassment to meet the requirements for suing under the Missouri Human Rights Act and equivalent federal laws, the court ruled in a Jan. 30 decision by Judge W. Brent Powell.

Plaintiff Emanuel Matthews and other workers were employed by Harley-Davidson and Syncreon at factory in Kansas City, which closed in 2019 with the loss of 800 jobs. The plaintiffs claimed numerous violations including forcing Syncreon employees, who were mostly Black, to stay within certain areas of the plant while white Harley-Davidson workers could go wherever they wanted and managers telling workers to delete photographs of nooses and racist graffiti in a Syncreon bathroom.

The plaintiffs also claimed a white female Syncreon employee showed a Black worker “a family photo bordered by Confederate flags” and white family members “depicting racist signs.” And they said Syncreon hired a white male manager who had previously been fired by Harley-Davidson for discriminating against Black employees.

A trial judge dismissed the lawsuit after Harley-Davidson and Syncreon argued plaintiffs didn't meet two of the four elements required in a discrimination suit: That none of the named plaintiffs actually witnessed the harassment they were suing over and it didn't affect their employment.

The Supreme Court rejected both arguments.

“While the petition did not specifically allege appellants witnessed or experienced the racially charged incidents, these incidents – such as nooses, graffitied swastikas, and racist threats written on bathroom walls – by their very nature, targeted and preyed on all black employees in the plant,” the court said. “The harassment affected their dignity, work performance, and physiological well-being.”

The court also said the allegations supported a claim Harley-Davidson aided and abetted the discrimination, defining for the first time the facts necessary to support such a claim under Missouri law. It adopted the definition in the Restatement (Second) of Torts, which asks whether the defendant encouraged the discrimination, was present when it occurred and displayed the state of mind to support it.

The facts in this case were enough to support an aiding and abetting claim and it shouldn't have been dismissed before trial, the court concluded.

PacifiCorp Fails to Dodge Liability Claim for California Fire

B [bloomberglaw.com/product/blaw/bloomberglawnews/litigation/XAP2KCJG000000](https://www.bloomberglaw.com/product/blaw/bloomberglawnews/litigation/XAP2KCJG000000)

Litigation

Feb. 7, 2024, 8:48 AM PST

Shayna Greene

- Magistrate judge recommends denying PacifiCorp's motion
- Public utility allegedly knew risks but kept power lines on

PacifiCorp should still be required to face the claims brought by a California county that blames it for the September 2020 Slater Fire, a federal magistrate judge said.

The court couldn't find that PacifiCorp was entitled to judgment on Siskiyou County's inverse condemnation claim, Magistrate Judge Deborah Barnes of the US District Court for the Eastern District of California said in an opinion released Tuesday.

The Northern California county sued the public utility for allegedly leaving its power lines energized during conditions expected to increase the risk of fire, such as strong winds.

The Slater Fire burned about 158,000 acres, damaged more than 700 structures, and caused multiple injuries and fatalities, the order said.

Inverse condemnation liability depends on whether property damage was the probable result of an inherent risk associated with the construction or maintenance of the relevant public improvement.

Barnes recommended denying PacifiCorp's motion because the complaint adequately alleged that the utility knew that its electrical distribution system was vulnerable to weather conditions, had acknowledged that active deenergization policies were critical to preventing wildfires, and kept their power lines energized despite warnings of extreme fire risk.

PacifiCorp argued that wildfires aren't an inherent risk of its equipment, but that requirement also includes risks from the maintenance of the public work, Barnes said.

"If a plaintiff's property is damaged as a result of the defendant's design, construction, or maintenance of a public improvement then the plaintiff is entitled to compensation for the damage 'whether it was intentional or the result of negligence by the public entity,'" Barnes said, citing a 2019 California Supreme Court decision.

The county is represented by Baron & Budd PC and Diab & Chambers LLP. PacifiCorp is represented by Hueston Hennigan LLP.

The case is Siskiyou Cty. v. PacifiCorp , E.D. Cal., No. 2:22-cv-01582, 2/5/24 .

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Top tire makers are sued in US over alleged price fixing

[reuters.com/legal/litigation/top-tire-makers-are-sued-us-over-alleged-price-fixing-2024-02-07](https://www.reuters.com/legal/litigation/top-tire-makers-are-sued-us-over-alleged-price-fixing-2024-02-07)

Mike Scarcella

The Michelin logo is displayed at the 54th International Paris Air Show at Le Bourget Airport near Paris, France, June 22, 2023. REUTERS/Benoit Tessier/File Photo Purchase Licensing Rights [↗](#), opens new tab

Feb 7 (Reuters) - Major tire manufacturers including Pirelli (PIRC.MI) [↗](#), opens new tab, Continental (CONG.DE) [↗](#), opens new tab, Michelin (MICP.PA) [↗](#), opens new tab and Nokian (TYRES.HE) [↗](#), opens new tab were sued on Wednesday in U.S. federal court for alleged price-fixing, days after European Union competition authorities announced an investigation into a possible cartel.

The lawsuit [↗](#), opens new tab was filed by a California resident in Manhattan federal court and seeks class-action status for U.S. purchasers of tires from the tire makers since January 2020. Other companies sued in the case include Bridgestone (5108.T) [↗](#), opens new tab and Goodyear (GT.O) [↗](#), opens new tab.

The six companies and a group of affiliated entities are accused of artificially inflating the price of new replacement tires in the United States for vehicles including cars, trucks and buses.

Continental said it has a "zero-tolerance policy when it comes to compliance and thoroughly follow up on and investigate all alleged allegations."

The other defendants either declined to comment or did not immediately respond to a request for comment.

Milan, Italy-based Pirelli previously said it had acted "always in total compliance with all rules and regulations." France's Michelin has said it strictly complies with competition rules.

Attorneys for the plaintiff did not immediately respond to a request for comment.

The European Commission, which is the EU's antitrust enforcement arm, on Jan. 30 announced its investigation of leading tire manufacturers.

"The Commission is concerned that price coordination took place amongst the inspected companies, including via public communications," the EU executive said in a statement.

It is common for private civil antitrust lawsuits to follow European Commission cartel investigations.

Federal courts in the United States have been flooded with lawsuits against major building materials companies after the commission in November said it was investigating potential price-fixing in the industry.

The tire industry lawsuit alleged the “U.S. tire industry for years has been highly concentrated, and there is a history of antitrust violations by tire manufacturers.”

The lawsuit seeks to recover unspecified three-fold damages and an injunction against alleged anticompetitive practices.

The case is Rena Sampayan v. Continental AG et al, U.S. District Court, Southern District of New York, No. 1:24-cv-00881.

For plaintiffs: Gregory Linkh of Glancy Prongay & Murray; and Dena Sharp of Girard Sharp

For defendants: No appearances yet

Read more:

Pirelli, Continental, Michelin and Nokian targeted in EU raids

France's Saint-Gobain, others hit with price-fixing claims in US court

Flavor, fragrance makers face wave of US antitrust lawsuits after EU cartel raids

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Reporting by Mike Scarcella. Additional reporting by Jonathan Stempel in New York.



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"Such Conduct Has Occurred With Respect To Certain Contracts"

 fcpprofessor.com/conduct-occurred-respect-certain-contracts

February 8, 2024

Raytheon (which changed its name to RTX in 2003) has been under Foreign Corrupt Practices Act scrutiny for several years.

The company recently disclosed:

"As previously disclosed, in 2019, Raytheon Company received a subpoena from the Securities and Exchange Commission (SEC) seeking information in connection with an investigation into whether there were improper payments made by Raytheon Company, our joint venture known as Thales-Raytheon Systems (TRS), or anyone acting on their behalf, in connection with TRS or Raytheon Company contracts in certain Middle East countries since 2014. In the first quarter of 2020, the DOJ advised Raytheon Company it had opened a parallel criminal investigation. In the third quarter of 2020, Raytheon Company received an additional subpoena from the SEC, seeking information and documents as part of its ongoing investigation. The Company maintains a rigorous anti-corruption compliance program, and continues to cooperate fully with the SEC's and DOJ's inquiries, and to examine through our own investigation whether there were any improper payments or any such conduct that was in violation of Raytheon Company policy.

Although the investigation of these issues remains ongoing, information indicating that such conduct has occurred with respect to certain contracts has been identified. However, at this time, the Company is unable to predict the outcome of the SEC's or DOJ's inquiries. Further, based on the information available to date, we cannot reasonably estimate the range of potential loss or impact to the business that may result, but do not believe that the results of these inquiries will have a material adverse effect on our results of operations, financial condition, or liquidity." (Emphasis added)."

Gen AI Could Force Lawyers, Clients to Talk Differently About Billable Hour, Legal Pricing

 [law.com/nationallawjournal/2024/02/07/gen-ai-could-force-lawyers-clients-to-talk-differently-about-the-billable-hour-legal-pricing](https://www.law.com/nationallawjournal/2024/02/07/gen-ai-could-force-lawyers-clients-to-talk-differently-about-the-billable-hour-legal-pricing)

ANALYSIS

Lawyers have historically stayed mum about the value of their work and the resources needed to perform it. But if they want to move away from the billable hour, that's going to have to change.

February 07, 2024 at 05:15 PM

Pricing/Billing Rates

Isha Marathe
Legal Tech Reporter

The original version of this story was published on Legaltech News

When a latte in Manhattan can cost close to a lunch in San Antonio, for any customer, the concept of how expensive something is, and how much it *should* cost, can get murky.

For many lawyers and clients, this incongruence is at the crux of an obstinate pricing model, the billable hour, that many deem responsible for making legal work tedious and the legal market resistant to change.

And while the potential of legal technology to disrupt the billable hour is often touted, this traditional pricing model has, of course, survived—and in some ways, even thrived.

But the current moment brings with it a technology, generative artificial intelligence, that is unlike many past innovations, reviving not only the potential to hamper the billable hour, but also the impetus for legal teams to better communicate with their clients about pricing dynamics.

In a session last Thursday at Legalweek 2024 entitled, “Aligning Technology, Pricing, and Compensation to Create the Sustainable Engagement of the Future,” panelists discussed which stars would have to align in order to rescue legal from its archaic pricing structure—and how much upheaval could be caused by emerging tech, or legal professionals themselves.

The panel was, in many ways, split. But they shared a common opinion: generative AI, combined with client education, could signal the slow death knell of the billable hour, akin to “a frog getting boiled,” as one panelist said.

‘How Do You Bill That?’

While some have tried new pricing models, law firms have often fallen back on the billable hour.

As Jessica Gichner, chief value and solutions officer at Pillsbury Winthrop Shaw Pittman, pointed out, her firm has come up with myriad creative options for pricing that move away from the old structure but to no avail.

“At the end of the day, a good number of our clients will say, ‘That looks really interesting. I have no idea how to evaluate that. So, I feel safer going back to the billable hour,’” she noted. “So we’ve created a construct that we’re all bound by and I think we all hate it, but we don’t know what else to do—it’s going to stick around unless some technology magically helps us assess how much value” a certain task is worth, and “value is really subjective.”

Generative AI brings with it a further complication in assessing the value of legal work, because it is word-based and sits “squarely in the sweet spot where law firms live,” Gichner noted.

But that additional snag in assessing value might be just the catalyst to meaningful conversations about moving away from the billable hour.

Gina Lynch, chief knowledge and innovation officer at Paul, Weiss, Rifkind, Wharton & Garrison echoed Gichner’s quandary: “How do you bill AI-assisted judgement? Some of the potential that we see in [generative] AI is that ideation,” being able to ask a tool, “tell me another way I can answer that complaint. How do you bill that?,” she said.

One way is to talk with clients about what the technology is doing and how it’s being used. And being able to discuss the tech with clients with a level of transparency could be the key to facilitating the conversations about a new value proposition, Lynch noted.

“If you think about some of the most profitable law firms in the world, it’s not really about saving the partners like two minutes here, five minutes here. ... It’s about getting to the answer faster. It’s about speed to insight; it’s about winning,” said Jae Um, Baker McKenzie’s former director of pricing strategy and founder and executive director at Six Parsecs.

“So [generative AI] is going to be impossible to bill... the shift of value is often about shifting from pricing effort and inputs [to] pricing the business value at stake, the risk profile of the work, the outcomes that we deliver to our clients. That’s value pricing.”

Is the Juice Worth the Squeeze?

Small or big, clients can likely agree on one thing—legal services have become more expensive over the years. As a result, many have come to their law firms asking about generative AI, and its potential to cut down on costs, panelists said.

At the end of the day, the problem many clients have isn’t with billing model itself.

“The pricing model is not why clients are unhappy, clients aren’t happy with the pricing level,” Um said. “They need those services to be cheaper, because they don’t see the value in what you’re doing. The value of the problems being solved doesn’t merit this price level.”

A part of that could be a fundamental disconnect between lawyers’ and clients’ understanding of laborious legal tasks, while another part could simply be that attorneys haven’t been adept at voicing the complexities of their work, or the costs they bear, such as subscriptions to tools like Lexis AI+, Westlaw and even Pitchbook, Lynch said.

But as Um noted, this historical smokescreen between attorneys and clients plays a big role in the ubiquity of the billable hour.

“For law firms to shift a significant revenue to a different pricing model, the buyers have to learn how to buy and consume differently,” Um said. Essentially, “the juice has to be worth the squeeze,” she noted, and for that, “the lawyers have to learn to talk about value differently. They have to articulate what it is that’s important to them and we just have not had those conversations in the industry. And so I think that that is the key barrier.”

Here is where generative AI, which Um refers to as “the fourth industrial revolution,” and AI as a whole, can help, she said.

“One of the most interesting applications [of AI] in legal business is going to be creating better structured data out of unstructured data because that is actually going to help us get after some of these problems with much more clarity on what the data is suggesting,” Um noted.

Creating strategies to thoughtfully collect data around legal work, and using AI-tools to present it in a more accessible and visual way, can provide transparency into the value proposition of legal work “beyond how much time is saved,” she noted.

NOT FOR REPRINT

AI Disclosures to SEC Jump as Agency Warns of Misleading Claims

By Matthew Bultman

Deep Dive

- AI mentions in companies' annual securities reports have risen
- Securities regulators are on the lookout for misleading claims

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AI Disclosures to SEC Jump as Agency Warns of Misleading Claims

By Matthew Bultman 2024-02-08T05:00:46000-05:00

- AI mentions in companies' annual securities reports have risen
- Securities regulators are on the lookout for misleading claims

Allstate Corp., Starbucks Corp., and other major companies are talking more about artificial intelligence in disclosures to investors—and securities regulators are paying close attention.

Just over 40% of S&P 500 companies mentioned AI in their most recent annual report with the Securities and Exchange Commission, according to Bloomberg Law's review of the disclosures. That continues an upward trend since 2018, when AI was mentioned only sporadically.

Companies as varied as used car dealer CarMax Inc. and CVS Health Corp. highlighted their use of AI in various business initiatives, while others focused on competitive and security risks from the technology.

These discussions about the opportunities, and risks, of AI for businesses are in the SEC's crosshairs. SEC Chair Gary Gensler and other agency officials have repeatedly warned companies about making misleading AI-related claims, including so-called AI-washing, which could lead to legal action.

"Don't do it," Gensler warned at a December conference. "One shouldn't greenwash and one shouldn't AI-wash."

Public companies could also find themselves in hot water if the SEC determines they didn't do enough to warn investors about AI-related risks. The SEC's heightened scrutiny follows enforcement actions and shareholder suits in recent years targeting companies for climate-related disclosures and cybersecurity-related risk disclosures.

"AI disclosures should be top of mind in preparing SEC reports," said P.J. Himelfarb, a Weil, Gotshal & Manges LLP partner and former SEC attorney.

Disclosure Uptick

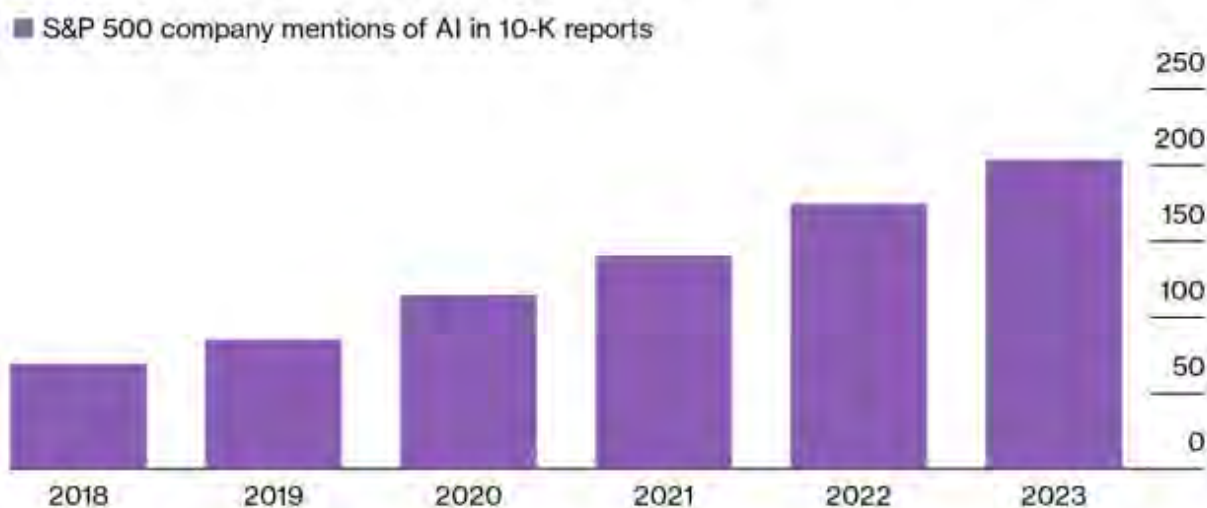
Rapid advances in AI have fueled optimism among corporations about its potential uses—but also increasing acknowledgment of its risks to their business.

Bloomberg Law reviewed the 10-K annual reports that S&P 500 companies filed with the SEC for mentions of "artificial intelligence," "AI," and "A.I." from 2018 through 2023.

At least 203, or 41%, of the S&P 500 companies mentioned AI in their most recent 10-K report, Bloomberg Law's review found. That's up from 35% in 2022 and 28% in 2021. A majority of the disclosures focused on the risks of the technology, while others focused on its benefit to their business.

Artificial Intelligence Disclosures on the Rise

The number of Form 10-Ks filed by S&P 500 companies mentioning artificial intelligence has increased every year since 2018.



Source: Bloomberg Law search of 10-K filings

Bloomberg Law

Companies are also talking more about AI on earnings calls, a recent analysis by financial software company FactSet found. And it isn't just tech companies. Bloomberg Law found AI was mentioned in 10-Ks filed by a range of businesses, from insurers and automakers to tobacco companies.

"A wide range of companies and industries are dealing with it and addressing it," said Ropes & Gray LLP partner Jeremiah Williams, who focuses on securities enforcement. "This is something that is going to effect every company in some way or another in the future."

Securities laws require public companies to disclose information deemed "material" to investors. The SEC is taking a close look at what companies are saying about AI, including the risk it poses to their business, Carolyn Welshhans, associate director of the SEC's Division of Enforcement, said at a recent securities conference.

Welshhans drew parallels to cybersecurity, where some of the SEC's early actions against companies alleged a failure to adequately disclose risks. Blackbaud Inc., for example, was fined \$3 million last year because the SEC said it made misleading disclosures about a ransomware attack.

"Like cybersecurity, I think it's something that companies are going to have to deal with because there could be risks posed to companies," Welshhans said at the Securities Enforcement Forum last year in Washington.

The risk could be "from AI being used by others," she said.

AI-Washing

Securities regulators are also warning companies not to make bogus or exaggerated claims about their use of AI to investors. The SEC is "on the lookout" for AI-washing, Tejal Shah, an associate regional director in the SEC's New York office, said during an event for corporate compliance lawyers in October.

The focus mirrors the SEC's prior warnings about greenwashing, where companies make overhyped climate claims. Allegedly misleading climate statements have led to regulatory actions and lawsuits from investors and others.

Enviva Inc., for example, was hit with a shareholder lawsuit accusing the renewable energy company of overstating the sustainability of its wood pellet production. Enviva has asked a federal judge to dismiss the complaint, which alleges securities fraud.

Companies touting their use of AI could face their own legal headaches if it turns out the technology is "not that transformative or it's not doing that much to change their operations," Kevin LaCroix, executive vice president at insurance broker R-T Specialty LLC, said in a recent webinar about top issues for director and officer insurance.

"Time will tell, but I suspect that when we get together next year we will have examples of cases," LaCroix said.

Opportunities and Risks

Not everyone is talking about AI the same way.

CVS said it was making concerted investments in AI and other emerging technologies “to further automate, reduce cost and improve the experience” for users in its Health Care Benefits segment. Carmax, the used car retailer, similarly said it uses AI to “optimize our business and the customer experience.”

But over half the companies that mentioned AI in their annual report discussed possible risks related to the technology.

“More and more companies are discussing whether they need an AI risk factor,” Himelfarb said.

That’s an easy decision for companies dealing with AI risks that go to the core of their business. Online travel company Expedia Group Inc., for example, said expanded AI capabilities by search engines could hurt Expedia’s business if they negatively affect the company’s search traffic.

Nvidia Corp., which makes computer chips, warned of possible legal and regulatory issues associated with the technology. And Cisco Systems Inc. said its reputation could take a hit if it can’t “identify and mitigate ethical and legal issues” before they arise.

“AI presents risks, challenges, and unintended consequences that could affect our and our customers’ adoption and use of this technology,” Cisco said in its filing.

For other companies, the risks are more remote.

Many cited security threats related to AI. Campbell Soup Co. and Starbucks Corp., for example, each warned the “the rapid evolution and increased adoption of artificial intelligence technologies may intensify our cybersecurity risks.”

Meanwhile, Allstate said it could become less competitive if it isn’t able to deploy technology like AI and machine learning in its underwriting process. Allstate, Campbell Soup, and Starbucks hadn’t mentioned AI in annual reports prior to 2023.

Companies are still finding their footing with AI-related disclosures, including weighing whether to mention certain risks at all. Some have opted for a more conservative approach, choosing to err on the side of inclusion.

“There’s much more risk to omitting something than including it,” Ropes & Gray’s Williams, a former SEC attorney, said.

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US Supreme Court in UBS case makes it easier for whistleblowers to win suits

 [reuters.com/legal/us-supreme-court-ubs-case-makes-it-easier-whistleblowers-win-suits-2024-02-08](https://www.reuters.com/legal/us-supreme-court-ubs-case-makes-it-easier-whistleblowers-win-suits-2024-02-08)

Daniel Wiessner

A UBS logo is seen next to Credit Suisse at the Bahnhofstrasse before a news conference of Swiss bank UBS in Zurich Switzerland, August 30, 2023. REUTERS/Denis Balibouse/File Photo Purchase Licensing Rights , opens new tab

Feb 8 (Reuters) - The U.S. Supreme Court on Thursday made it easier for financial sector whistleblowers to win lawsuits accusing companies of unlawfully firing them as retaliation for disclosing wrongdoing, rejecting a bid by Switzerland's UBS Group (UBSG.S) , opens new tab to impose a higher bar.

The unanimous decision by the justices reinstated a \$1.7 million jury verdict for former UBS bond strategist Trevor Murray, who has accused the company of firing him in retaliation for refusing to publish misleading research reports and complaining about being pressured to do so. A lower court had thrown out the jury verdict.

UBS had wanted the Supreme Court to require plaintiffs in whistleblower lawsuits to prove a company's retaliatory motives, a difficult task.

UBS has said Murray was fired as part of a cost-cutting campaign that eliminated thousands of jobs, not because of his complaints. A jury in federal court in Manhattan sided with Murray in 2020, and U.S. District Judge Katherine Polk Failla, who presided over the trial, rejected a bid by UBS to set aside the verdict.

But the New York-based 2nd U.S. Circuit Court of Appeals, in overturning the verdict in 2022, ruled that the jury should have been instructed by the trial judge that in order to hold UBS liable under a 2002 federal law called the Sarbanes-Oxley Act, Murray had to prove that the company had acted with retaliatory intent.

Sarbanes-Oxley created enhanced accounting standards for publicly traded U.S. companies after a series of accounting scandals, along with new legal protections for employees who report illegal conduct. Named after its bipartisan sponsors - Democratic U.S. Senator Paul Sarbanes and Republican U.S. Representative Michael Oxley - it was intended to help protect investors from fraudulent corporate financial reporting.

The 2nd Circuit ruling had created a split with at least two other federal appeals courts that decided that the lack of intent can be raised as a defense in a Sarbanes-Oxley case, but must be proven by the defendant.

Murray, who worked in UBS's mortgage securitization unit, accused UBS officials of pressuring him to issue skewed and bullish research on commercial mortgage-backed securities in order to support the bank's trading and underwriting operations. He has said he was fired in 2012 about two months after complaining to supervisors and despite receiving excellent performance reviews.

President Joe Biden's administration had backed Murray in the appeal. The Supreme Court heard arguments in the case in October.

UBS was represented by Eugene Scalia of the firm Gibson Dunn & Crutcher, the son of late Supreme Court Justice Antonin Scalia and a former U.S. labor secretary, who was making his first appearance before the Supreme Court.

Reporting by Daniel Wiessner in Albany, New York; Editing by Will Dunham

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By Alice Huang, Dorothy Ma and Pearl Liu

While global money managers have long known that the Chinese government exerts influence over corporate affairs in ways that are uncommon across the developed world, Evergrande was nonetheless a first-hand education for many of them in just how much authorities will intervene for the sake of political and economic expediency.

The 1-cent-on-the-dollar price on the bonds, they say, sends a warning to investors as other Chinese companies, including Country Garden Holdings Co., follow Evergrande into default amid an economic slump that officials have struggled to fix. And the country's disregard for foreign creditors almost certainly means more of them will get sold for parts.

[Read More: China Limpes Into Year of Dragon, Stalked by Deflation](#)

"Investors probably did not fully appreciate the risk of state intervention," said **David Knutson**, chair of The Credit Roundtable, an organization of investors that works to respond to corporate actions averse to bondholders. "Apportioning losses between domestic creditors and foreign creditors will be political."



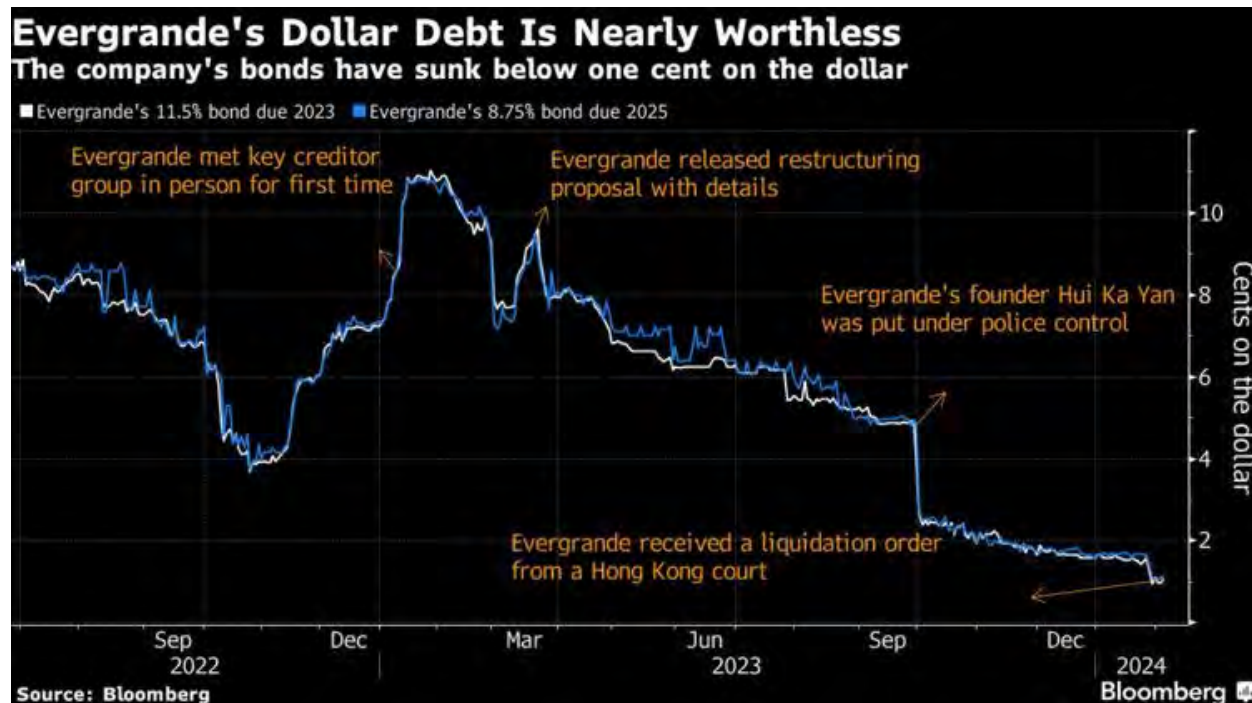
An abandoned construction site at the near-deserted Evergrande City Plaza shopping mall, developed by China Evergrande Group, in Beijing, on Jan. 31, 2024. Evergrande creditors are set to recover just a fraction of the billions of dollars worth of the builder's debt they hold.

Source: Bloomberg

Of course, it's more than just Beijing's involvement that caused Evergrande's bonds to crater.

The nation's deepening property-market [slump](#), a \$7 trillion stock rout and a tepid policy [response](#) are all weighing on broader sentiment. The fact that the bulk of the company's [assets](#) are either already seized or located not in Hong Kong but mainland China – potentially out of reach of bondholders including Davidson Kempner Capital Management, King Street Capital Management and Contrarian Capital Management, has also contributed to rock-bottom recovery expectations.

Representatives for Davidson Kempner and King Street declined to comment, while Contrarian Capital didn't respond to requests seeking comment.



Among the litany of grievances raised by those close to the negotiations, almost all pointed to a lack of clarity over who was calling the shots for Evergrande.

Soon after the company's 2021 default, a [risk-management committee](#) dominated by officials from Evergrande's home province of Guangdong – in part made up of company executives and state-affiliated debt managers – was formed to guide the overhaul. Provincial authorities also [said](#) in that year that they would send a working group to strengthen internal controls and management of Evergrande.

Over the course of the negotiations, Evergrande representatives would sometimes refer to "Guangzhou" (the capital of Guangdong province) as responsible for vetting virtually all key decisions, yet it remained unclear to creditors which combination of entities or individuals they were alluding to.

Investors and advisers lamented not being fully aware of whose interests were being prioritized in negotiations, nor which layers of government they were dealing with.

The secretive yet omnipresent group never directly interacted with the those involved in offshore debt talks, said the people familiar. Their views were relayed to the company's financial advisers China International Capital Corp. and Bank of China International Holdings, which would then pass information on to bondholders via a convoluted web of communications that consisted of lawyers and advisers both in Hong Kong and the mainland, the people said.

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The group could, and did, veto creditor proposals with minimal explanation, the people added.

In one example, it balked at an early offer that would've given offshore creditors access to the future income streams generated from Evergrande's onshore projects. That cash instead was to be preserved for ensuring the delivery of other company projects, the people said. That reasoning wasn't communicated to investors, who were only told the terms were not acceptable, they added.

Representatives for Evergrande, CICC, BOCI and the Guangdong government didn't respond to requests seeking comment.

Still, early last year, Evergrande and its creditors were seemingly [near an agreement](#) to overhaul the company's offshore debt load. Its \$4.7 billion of dollar bonds due 2025 spiked as high as 11 cents.

But a series of setbacks, including weaker than expected property sales, [push back](#) from regulators and the [detention](#) of Evergrande billionaire chairman **Hui Ka Yan**, ultimately torpedoed a deal, fueling further frustration and leading to a significant breakdown in talks, the people said.

In early December, when a Hong Kong court gave Evergrande one last chance to strike a deal, the company's representatives largely fell silent. Over a month went by before they finally contacted the offshore creditor group again – via email.

When they did, their proposal shocked bondholders. Not only did it do little to strengthen their offer, it crossed a number of red lines the creditor group thought were clearly laid out, people with knowledge of the situation said.

One key sticking point was the claims of a [group](#) of creditors identified as class C, which consists of some state-run banks, according to the people.

While Evergrande eventually agreed to give creditors controlling stakes in two offshore listed units' equity – a compromise it previously [refused](#) to make, the plan would have put the foreign bondholder claims and the debt held by the banks on equal footing, shrinking the pie for the international investors, multiple people familiar said. Offshore bondholders deemed the plan particularly objectionable because class C creditors also have access to onshore assets that they have little recourse to.

A counteroffer was quickly made, and the company sent over another proposal on Jan. 29, just hours before the latest scheduled wind-up hearing.

Still, progress was scant. While heading into the hearing the creditor group was amenable to giving the company more time to work out an agreement, it neither asked for another adjournment or requested a wind-up order, the people said.

In the end, the judge overseeing the case, frustrated by the lack of progress on a deal, ordered the company's liquidation.

'Serious Setback'

One Evergrande adviser said that while he's relieved the negotiations are over, how they ended has left him feeling like he wasted two years of his life. It's a sentiment shared by many.

The company's court-ordered liquidators from Alvarez & Marsal now begin the process of seizing and carving up the developer's 1.74 trillion yuan (\$242 billion) of assets. Yet given Hong Kong's insolvency proceedings have limited recognition in China, creditors face an uphill battle recouping losses.

"Authorities are not likely to allow offshore claimants to secure valuable onshore assets while effectively insolvent developers struggle to meet politically tense onshore obligations," said **Brock Silvers**, managing director at private equity firm Kaiyuan Capital. "This is a serious setback for China's still-developing credit markets and can only exacerbate declining market sentiment as foreign capital increasingly seeks lower risk outlets."

--With assistance from **Eliza Ronalds-Hannon**, **Erin Hudson**, **Dong Cao** and **Zheng Wu**.

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Matt Levine's Money Stuff: Hedge Funds Are Dealers Now

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Feb. 7, 2024, 10:56 AM PST

Opinion

Matt Levine

Dealers

In the olden days, there were two sorts of people who traded stocks or bonds for a living. We can call them “dealers” and “investors,” though those terms are imperfect. An investor is someone who buys stocks or bonds because she thinks they are a good investment, and sells them when she thinks they aren’t. She does analysis, decides that Bond X is worth \$80, sees it trading at \$78, and goes out to buy some Bond X. When it trades up to \$82, she sells it. She makes her money by buying low and selling high, by predicting price trends or understanding fundamental value. Investors include ordinary retail investors, but mutual funds and hedge funds are also in this category. Their job is to buy stuff that they think will go up.

A dealer is the person the investors buy from and sell to. A dealer is not looking to buy stocks or bonds that she thinks are a good investment, or to sell ones that she thinks are a bad investment. A bond dealer has some list of bonds, and she is always willing to buy or sell each of those bonds. She is in a customer service business: Customers come to her looking to buy or sell bonds, and she sells them the bonds they want to buy and buys the bonds they want to sell. She makes money not by predicting price moves but by charging the customers (investors) a bit of money (called the “spread”) for each trade, buying from them at a lower price (her “bid”) than she will sell to them (her “offer” or “ask”). An investor thinks “Bond X trades at \$78 and is worth \$80, so I will buy it.” A dealer thinks “Bond X trades at \$78, so I will buy it at \$77.75 or sell it at \$78.25, whichever customers want.” She doesn’t care what it’s worth. She cares about charging a bit more to sell than she pays to buy.

Investors could theoretically exist without dealers, and in some markets they do. Investors who think that Bond X is worth \$80 could just buy it from investors who think it’s worth \$75, without a middleman. But in practice it is often helpful for there to be a middleman — a dealer — to “provide liquidity.” An investor who thinks Bond X is worth \$80 probably wants to

buy it *now*; an investor who thinks it is worth \$75 probably wants to sell it *now*. If they each come to that conclusion at exactly the same time, they can trade with each other and that's great. But if the seller decides to sell an hour before the buyer decides to buy, it is helpful for there to be a middleman to buy from the seller and sell to the buyer. And the seller and buyer might each be happy to pay \$0.25 to get what they want when they want it.

In the olden days the dealer also provided an even more important service, which is that you knew where to find her. She was in the *business* of dealing stocks or bonds. She made her money by having lots of customers. She *advertised*. She *wanted* you to call her to buy or sell bonds. Dealers were traditionally big brokerage firms and investment banks; they took big investors out for drinks to get to know them and win their business. Before, like, the internet, if some investor owned Bond X and thought it was worth \$75 and wanted to sell it, and some other investor didn't own Bond X and thought it was worth \$80 and wanted to buy it, how would they *know* about each other? They wouldn't. The investor who owned Bond X would call the dealer and sell to her, and the investor who wanted Bond X would call the dealer and buy from her, because they had the dealer's phone number and knew she would be happy to buy or sell.

This was pretty true about the *bond* market, but less true about the stock market. In the stock market there were (and are!) *exchanges*, where all the investors could meet up and buy and sell stocks. Investors could put *orders* into the stock market, saying "I want to buy 100 shares of Stock Y for \$78," and if some other investor put an order in saying "I want to sell 100 shares of Stock Y for \$78" then they could trade with each other without involving a dealer at all. In practice stock exchanges normally do involve dealers, because there is often some imbalance between investors who want to buy and those who want to sell. But at least the exchange is a way of coordinating investor buyers and investor sellers without having to call a dealer. If you wanted to sell a bond, you knew to call Bear Stearns or Lehman Brothers or whoever; if you wanted to sell a New York Stock Exchange-listed stock, you knew to send an order to NYSE. (In practice you would do that through a *broker* — like Bear Stearns or Lehman Brothers — because you couldn't just stroll out on the floor of the stock exchange, but still.)

But at least in the bond markets there was a pretty clear distinction between investors and dealers, which is that dealers advertised "We Buy And Sell Bonds, Call Us!" and investors did not.

But then the internet arrived, communications technology became vastly better, and everything went electronic. And now if you want to buy or sell bonds — or currencies, or interest-rate swaps, or cryptocurrencies, etc. — you can often go to some electronic platform and put in an order, just like you would on the stock exchange. And that platform will collect your orders, and the orders of lots of other people, and it will show the orders to everyone else on the platform and match up buyers and sellers. You don't need to remember "I want to

sell bonds and I happen to know Morgan Stanley is in the business of buying bonds, I should call them.” You can just type “Sell bonds at \$78” into the electronic system and Morgan Stanley or BlackRock or Pimco or Fidelity or Citadel Securities or anyone else can buy them.

One possible outcome of this widespread electronification would be that investors would trade directly with investors and dealers would wither away in bond (currency, swaps, crypto, etc.) markets. There would be no bid/ask spreads, no intermediation; long-term owners would sell directly to other long-term owners at the mid-market price. You often see predictions like this, but they rarely come true. Even in open electronic all-to-all markets, dealers seem to provide some value by buying immediately when investors want to sell and selling immediately when investors want to buy. And investors are generally willing to pay a spread to get that immediacy.

But another, maybe more surprising outcome is that investors *can be dealers now*. If you run a hedge fund and try to buy bonds that you think will go up, and you connect to an electronic trading platform and trade a lot on it, you might notice some short-term opportunities. You know Bond X is trading at \$78, you think it’s worth \$80, but someone comes onto the platform with an order to buy a lot of Bond X. You might say “well okay I’ll sell her some Bond X at \$78.25, because she’s desperate to buy it now and will pay a bit more than the current market price, and then in 10 minutes someone else will come along looking to sell it and I’ll buy it back from him at \$77.75 and make a quick 50 cents.” Maybe you also have a big long-term investment position in Bond X that you won’t close out until it hits \$80, but you know that people make money by buying at the bid and selling at the offer and collecting the spread, and you figure you can do a little bit of that too.

You can conceive of this as “dealing,” or “market making,” or “collecting the spread.” You can do what dealers do, and put *orders* into the electronic platform on *both sides* of the market: You can put in an order to buy 100 bonds at \$77.75 and another order to sell 100 bonds at \$78.25 and hope that both of those orders will be executed and you’ll collect the spread. But you can also conceive of it in other ways. You can think of it as just short-term day-trading, just spotting opportunities, just buying low (from someone looking to unload bonds at a bit below the fair market price) and selling high (minutes earlier or later, to someone looking to buy bonds at a bit above the fair market price). There is some continuum between “put in orders on both sides of the market to collect the spread” and “buy and sell quickly to capitalize on small temporary mispricings.”

Also, again, technology has improved, and probably what you have actually done is program a computer to recognize patterns in the market and put in these orders for you. Your algorithm might be of the form “put in buy and sell orders \$0.25 away from the fair price in either direction,” or it might be of the form “if the bond falls \$0.25 below the fair price, buy it, but if it rises \$0.25 above the fair price, sell it.” But those are the same algorithm.

And you can end up doing this as your entire business, or you can do some of it alongside your normal investor-y business of making longer-term directional bets on bonds that you think will go up. And you can evolve over time to do more of one or the other as markets change or as you hire different personnel or whatever.

And you can do all this *without* advertising. You don't have to be in a customer service business; you don't have to hang out a big sign saying "We Buy And Sell Bonds, Call Us!" Nobody calls anyone anymore. You just send little electronic messages to the trading platform, saying the prices at which you want to buy or sell bonds, and that is all the advertising you need.

You *could* get into customer service — if you start doing enough of this sort of trading, you might decide to set up meetings with big investors to see what they want to buy and sell and to try to trade with them more — and some firms do, but it is not strictly necessary. You can have the *trading model* of a dealer (making markets, providing liquidity, making the bid/ask spread) without the traditional *business model* of a dealer (salespeople, customer service, advertising).

In other words, in the olden days, there was a distinction between dealers, who provided liquidity and advertised, and investors, who made directional bets and did not advertise. Now, there are dealers who provide liquidity and advertise, and investors who make directional bets and don't advertise, and also some other people (quasi-dealers?) who provide liquidity and don't advertise, and some people (investor-dealers?) who sometimes provide liquidity and other times just make directional bets and never advertise. The distinctions are less sharp, because modern technology lets everyone do a little of everything and change their strategies as circumstances change.

I mostly just think this is sort of an interesting sociological fact, that the trading model of providing liquidity has become much more anonymous and electronic and divorced from the social model of having drinks with customers, and that non-traditional dealers can now do it. And it is probably good for competition: If everyone can compete to buy from sellers and sell to buyers, then the costs of liquidity should go down.

But there is a news hook. The US Securities and Exchange Commission *regulates dealers* more strictly than it regulates regular investors. Dealers have to register with the SEC and be members of self-regulatory organizations (mainly the stock exchanges and Finra); they are subject to various risk and capital and recordkeeping rules. It is more expensive to be an SEC-registered dealer than not to be.

In the olden days, this was pretty straightforward: If you wanted to go around advertising your bond-dealing services, you had to register with the SEC, and the SEC would keep an eye on you to make sure that you were doing a fine upstanding job of serving investors and

not blowing yourself up. The investors were the customers, and the SEC protected them; the dealers were the industry, and the SEC regulated them.

But now the distinction is much less clear, and yesterday the SEC published new rules about who is and isn't a dealer. The old rule — in the text of the Securities Exchange Act of 1934 — says that “the term ‘dealer’ means any person engaged in the business of buying and selling securities for such person’s own account,” *unless* that person “buys or sells securities ... for such person’s own account, either individually or in a fiduciary capacity, *but not as a part of a regular business.*” (Emphasis added.)

In 1934 everyone kind of knew what that meant: If you bought securities and held them, you were not buying and selling “as part of a regular business,” but if you went around advertising “I’ll buy or sell bonds, call me,” you were. In 2024 things are less clear, so the SEC wants to clarify them. The new rules say:

A person that is engaged in buying and selling securities for its own account is engaged in such activity “as a part of a regular business” ... if that person:

(1) Engages in a regular pattern of buying and selling securities that has the effect of providing liquidity to other market participants by:

(i) Regularly expressing trading interest that is at or near the best available prices on both sides of the market for the same security and that is communicated and represented in a way that makes it accessible to other market participants; or

(ii) Earning revenue primarily from capturing bid-ask spreads, by buying at the bid and selling at the offer, or from capturing any incentives offered by trading venues to liquidity-supplying trading interest.

There are exceptions, including for central banks, registered investment companies (mutual funds) and people with under \$50 million of assets. But the point of this is pretty clearly to capture hedge funds and proprietary trading firms that make markets (often electronically) in bond markets, particularly Treasury markets. If those firms regularly post interest on both sides of the market (if they regularly say “I’ll buy Bond X at \$77.75 or sell it at \$78.25”), or if they make money mostly from bid-ask spreads, then they are dealers.

This strikes me as more or less conceptually correct, in the narrow sense: Yes, making two-sided markets and collecting the spread is the traditional model of the dealer, and this definition is clearer than the “regular business” thing.

In the broader sense, it strikes me as a bit incoherent: *Why* should people who make two-sided markets be regulated more strictly than people who make directional bets? The old reason — the dealers were the industry and the directional bettors were the customers — is

no longer really true.

The apparent reason is something like “firms that run dealer-type strategies in the Treasury bond market are much more *levered* than firms that just buy and hold Treasury bonds.” SEC Chair Gary Gensler’s statement about the new rules reminisces about old-time Treasury dealer collapses, and goes on:

In 2021, when I arrived at the SEC, I was told that though numerous firms have registered with the SEC as government securities dealers, some market participants have not. I think that leaves potential regulatory gaps and risk in the system.

The markets also have evolved in other ways, such as electronification, the use of algorithmic trading, and market participants transacting faster than ever before. Some market participants, such as principal-trading firms (PTFs) that use high-frequency trading strategies, started participating significantly in the Treasury cash market. In 2019, for example, PTFs represented around 60 percent of the volume on the inter-dealer broker (IDB) platforms in the Treasury markets.

In essence, these PTFs and other firms are acting in a manner consistent with dealers in the securities markets. Nevertheless, despite these firms acting as de facto market makers, and despite their regularity of participation consistent with buying and selling securities or government securities “as a part of a regular business,” a number of these firms have not registered with the Commission as dealers.

This deprives investors and the markets themselves of important protections—protections that benefit market integrity, resiliency, transparency, and more.

I suppose there is some truth to this, that the trading business of making markets in Treasury bonds tends to be more leveraged than the investing business of buying Treasuries because you think they are valuable. But it’s still pretty porous. The Wall Street Journal reports:

An earlier version of the SEC’s dealer rule would have likely roped in many large hedge funds. Any person or firm that bought or sold more than \$25 billion in government bonds in four of the preceding six months would have automatically been classified as a securities dealer under a March 2022 proposal from the SEC. So would firms that routinely made “roughly comparable” purchases or sales of similar securities in one day.

Hedge funds and their trade groups howled at the proposal and felt it threatened the profitability of investing strategies like quant, arbitrage and relative-value trading, which seeks to capitalize on pricing discrepancies between different securities.

In comments submitted to the SEC, hedge-fund firms argued that requiring them to register as dealers would deprive them of certain investor protections. They argued there would be unintended consequences, including the prevention of them from participating in initial public offerings. Hedge-fund firms also complained that the SEC was exempting mutual funds and other types of asset managers from the additional requirements.

The SEC ultimately scrapped the \$25 billion threshold and some other parts that the industry criticized. ... Nevertheless, an SEC analysis identified up to 16 private funds, a category that includes hedge funds, that could fit its revised definition of a dealer, an agency official said at the meeting.

The basic business is using borrowed money to buy and sell lots of Treasuries, fairly quickly, because you have a computer model that tries to take advantage of pricing discrepancies. If those pricing discrepancies are bid/ask spreads, you're a dealer; if they're not, you're not.

Weeeeeeeeeeeeeee

We talked yesterday about Adam Neumann's apparent desire to buy WeWork Inc. out of bankruptcy. Neumann's lawyer sent WeWork's lawyers a letter on Monday "to express our dismay with WeWork's lack of engagement even to provide information to my clients in what is intended to be a value-maximizing transaction for all stakeholders": WeWork does not seem to be talking constructively with Neumann, even though he "consistently expressed [his] sincere interest in purchasing WeWork or its assets out of bankruptcy, and/or providing the Debtors with DIP financing." The letter also notes that Neumann is "partnering with well-known capital sources including Dan Loeb's Third Point LLC and others" to try to buy or finance WeWork.

Here is an amazing fact about that partnership:

Third Point told the Financial Times it had held "only preliminary conversations with Flow [Neumann's property company] and Adam Neumann about their ideas for WeWork, and has not made a commitment to participate in any transaction".

Executives from Third Point, Japanese conglomerate SoftBank and Neumann last held an official meeting to discuss a potential bid for the company in October, people familiar with the process said.

It's February! If you are dropping Third Point's name now, and you last had "preliminary conversations" with them in October, that suggests that your bid is not all *that* real. If you had any better meetings with anyone else since October, you'd be dropping *their* name rather than Third Point's.

There is always a chicken-and-egg quality to these things: Neumann obviously can't line up committed financing to buy WeWork without getting due diligence information and some engagement from WeWork, and he can't get serious engagement from WeWork without credible financing. Still, you can sort of understand why WeWork is not engaging with Neumann. Besides the obvious reasons!

Elsewhere, the Wall Street Journal reports that "Neumann courted a group of WeWork's largest creditors to try and convince them that they should support his efforts to line up a bid for the company, but they declined, according to people familiar with the talks." Did that group include SoftBank Group Corp.? I feel like if I ran SoftBank's WeWork investment at this point, I would sell it all to Adam Neumann for \$1 and a legally binding promise that I would never hear from him again.

Carlyle

Stereotypically, shareholders of publicly traded financial firms really value steady recurring earnings, and really distrust lumpy performance-based earnings. They put a high multiple on annual fee income, and a low multiple on one-time trading profits. So if you are a private equity firm charging clients annual management fees of 2% of assets, and performance fees of 20% of profits, the shareholders will like the management fees and dislike the performance fees.

Stereotypically, if you want to keep your employees hungry and motivated, you should pay them with a lot of lumpy performance-based bonuses and not a lot of steady recurring salaries. Don't pay them to coast; make them earn their money. If you are a private equity firm charging 2 and 20, you can use some of those management fees to pay salaries, but your employees should expect to make most of their money from performance, from the 20% performance fees.

Obviously there is a trade there: You give the shareholders the recurring fees that *they* like, and you give the employees the profit interest that you like for them. Bloomberg's Dawn Lim reports:

Carlyle Group Inc. is overhauling how it pays dealmakers to free up steadier cash flows for shareholders and authorized a plan to repurchase as much as \$1.4 billion of stock.

The private equity giant, which reported fourth-quarter earnings that beat Wall Street estimates, said Wednesday that it will give rainmakers and senior employees a greater share of gains tied to investment exits. ...

The move frees up more stable sources of cash known as fee-related income to shareholders. ... Carlyle plans to lift employees' share of profits tied to deal exits to 60% to 70%, up from an average of 47%, the company said in a statement. The portion of their

compensation tied to fee-related earnings will fall.

Plausibly the dealmakers would also prefer to have more steady fee-related income, but you want to keep them hungry.

Bankroll size

The Kelly criterion tells you what percentage of your money you should put on some favorable bet. If you work in financial markets, you want to make a bunch of bets where you think the odds are in your favor, and if you can estimate the odds then Kelly gives you a guide to how much of your money you should put on each bet. Kelly gives you an answer that is a percentage of your current bankroll. But what is your bankroll?

We talked a few times last year about a dumb story from Sam Bankman-Fried's internship at Jane Street, where he kept making the maximum bet on slightly favorable coin flips, and I was like "well that's not very Kelly is it." But probably I was wrong. Jane Street interns were limited to losing \$100 per day, so I sort of took \$100 to be the size of his bankroll and thought he was aggressive to bet it all on a 51% coin flip. But readers pointed out, no, come on, his *net worth* at the time was not \$100; \$100 was nothing to him even though it was all he could bet that day. As a percentage of his *actual bankroll* that was a fine bet.

Anyway here is a fun post from Byrne Hobart titled "What's the True Bankroll?" Sometimes the true bankroll is much bigger than the obvious bankroll: Sam Bankman-Fried's \$100 daily betting allowance was much smaller than his true bankroll, and Hobart points out that if you start your first job and have \$1,000 to invest, your true bankroll is more like your lifetime expected savings than it is your current \$1,000. Other times the true bankroll might be smaller than the obvious bankroll: If you are a portfolio manager at a multi-manager hedge fund, and you run a \$500 million portfolio, you might think that your bankroll is \$500 million. But if you know that you'll get fired for a 10% decline in your portfolio, is your actual bankroll \$50 million? No, but also maybe a little bit yes.

Things happen

Litquidity Unmasked. NYCB's Credit Grade Is Cut to Junk by Moody's. UBS to Restart Buybacks After Progress on Credit Suisse Integration. UBS Offers \$1 Billion AT1s in Fast Start to Its Funding Plan. How India's Education Tech Giant Got Schooled and Lost \$20 Billion in Value. US Commercial Real Estate Contagion Is Now Moving to Europe. China Replaces Top Markets Regulator as Xi Tries to End Rout. Shein seeks Chinese regulators' tacit approval for US public offering. Star China Banker's Disappearance Made His Firm a Buyout Target. McKinsey and BCG warn staff face jail if they reveal Saudi work. HSBC's

New 'Wise Killer' App Vies for FX Customers. Woodside, Santos End Talks on Merger to Create \$57 Billion Energy Giant. Tesla Asks Which Jobs Are Critical, Stoking Layoff Fears. Organ playing 639-year-long piece changes chord.

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- 1. The US Securities and Exchange literature sometimes calls them “dealers” and “traders,” but “trader” to me feels more generic; a “trader” at a bank is ordinarily a dealer. “Investor” is imperfect because it has a bit of a long-term connotation, which I don’t intend. “Speculator” would be fine for “investor” but people sometimes take it as pejorative. “Market maker” is, I think, generally a good synonym for “dealer.”
- 2. Perhaps some markets are totally disintermediated and fundamental investors just trade with each other. But many markets are intermediated only by brokers, not dealers: The brokers match up the fundamental buyers and sellers, but do not trade for their own account. These patterns are not always stable. US single-family housing has historically been almost entirely a broker-intermediated market: The person who owns a house usually lives there (or owns it as a long-term investment), and then sells it to someone else who wants to live there (or own it as an investment). There are brokers to match buyers and sellers, who take a cut, but the brokers don’t *buy* the house from the seller with their own money and then sell it to the buyer. But that has changed a little bit, with e.g. Zillow Group Inc. getting into (and then out of) algorithmic house market-making in recent years.
- 3. Or it won’t, it will have hidden orders, etc., but in any case your orders will have some way of interacting with other people’s orders.
- 4. I am exaggerating for simplicity; in the bond markets lots of people call each other. The text more accurately describes Treasury trading than, like, high-yield corporate trading. But even in Treasuries people use the phone, or at least Bloomberg chats.
- 5. There is a similar definition of “government securities dealer,” which is not the same thing as a regular “dealer” but is a parallel definition for Treasury bonds. And this one is probably more important for this week’s rulemaking, which seems *primarily* focused on Treasury trading.
- 6. The lawyer is Alex Spiro, who is also Elon Musk’s lawyer, and who seems to have a lot of fun.

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...

Everybody's dropping excerpts from their forthcoming Twitter takeover books, but this one struck me bc it is more evidence that Musk always bought shares expecting to influence mgmt. making his 13G disclosures false from the outset

[bloomberg.com/news/features/...](https://www.bloomberg.com/news/features/...)

This was probably wishful thinking. Musk was already peeved with Agrawal, with whom he'd had a terse text exchange weeks earlier after Agrawal chastised Musk for some of his tweets. Musk had also unsuccessfully petitioned Agrawal to remove a Twitter account that was tracking his private plane; the billionaire started buying Twitter shares shortly after Agrawal denied his request.

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30



7



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PSA [@LisaMonaco](#) [@SDNYnews](#) [@DOJCrImDiv](#): not indicting a white-collar racketeer doesn't protect investors. Every day you don't do your job you are allowing the lies and harm to increase. • •



2



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How Jack Dorsey's Plan for Elon Musk to Save Twitter Went South

By Kurt Wagner

Bloomberg Law News 2024-02-08T10:23:31902555408-05:00

How Jack Dorsey's Plan for Elon Musk to Save Twitter Went South

By Kurt Wagner2024-02-08T00:01:13028-05:00

Elon Musk was growing irritable on Friday evening, Nov. 4, 2022. It had been just over a week since he'd closed his \$44 billion deal for Twitter, and advertisers were bailing on the company in droves. Many brand-conscious marketers were worried that Twitter's historical reputation for nastiness would return as a result of Musk's pledge to defeat the "woke mind virus," his derisive term for the censorious attitude he felt had sucked the joy out of his favorite social network.

Musk said the way to save Twitter was to restore what he saw as freedom of speech. He hadn't actually changed any of Twitter's speech policies by that Friday, but the list of advertisers who had paused their Twitter ads already included United Airlines, REI and Volkswagen and was steadily growing. This was a major concern, considering Twitter made roughly 90% of its revenue from advertising.

Musk told his staff he couldn't understand why things had already gone sideways. He'd spent his first full week as Twitter's "Chief Twit" kowtowing to its most important advertising partners. He'd flown his Gulfstream to New York for a slate of meetings that included advertising industry heavy hitters like WPP's Mark Read and Horizon Media's Bill Koenigsberg. NFL Commissioner Roger Goodell had visited Twitter's office in Chelsea, where Musk promised him in person that Twitter would still be a safe place for the league's valuable highlight videos.

Now Musk was demanding answers. He called Robin Wheeler, his top sales executive, and asked how bad the business was. Wheeler had to be delicate. In a meeting a few days earlier, her predecessor had pushed back on Musk's decision to tweet a joke about Donald Trump, and had been escorted out of the building by security just 24 hours later. It was clear Musk still didn't appreciate just how anxious advertisers were about the new direction he was taking Twitter. He also seemed oblivious to how his own behavior was contributing to this feeling. One of the things that made Musk such a popular Twitter user was his lack of filter, but that was proving to be a liability now that he was the face of the operation.

Wheeler tried to explain this to her new boss by bringing up a tweet he'd posted just a few hours earlier in which he'd threatened to go "thermonuclear" on advertisers who stopped spending money on Twitter ads. "You don't want to go to war with advertisers," she warned.

"Oh, I will go to war," he replied. "And I win wars."



Illustrations: Alex Kiesling for Bloomberg Businessweek

Wheeler also told Musk some Twitter users had begun harassing advertisers who were still running ads on the service in an attempt to get them to stop. Musk was incensed. Soon after his call with Wheeler ended, he sent her a text and included Yoel Roth, Twitter's head of Trust and Safety, who managed the teams in charge of enforcing Twitter's rulebook. "Yoel, please suspend all Twitter accounts that are engaged in harassment of our advertisers to get them to stop advertising on Twitter," he wrote. "That is not OK."

Pressuring an advertiser to stop spending money was certainly not against Twitter's rules—it wasn't even unusual. Suspending Twitter users for doing so would be impossible to justify under the company's rules, and it certainly didn't align with Musk's stated pledge to uphold free speech. But Musk made clear that if the company didn't have the rules he needed to exert his will, he'd create them. He then called Roth shortly after sending the text and spent the brief conversation ranting that trolling Twitter's advertisers was akin to blackmailing the company. "Blackmail is against our rules now," he declared.

Roth hung up and contemplated quitting right then and there. Instead, he called Wheeler and asked her to talk Musk off the ledge. Wheeler succeeded, and Musk quickly moved on to other problems. But the strains that have defined Musk's tenure ever since were already emerging in those first few weeks on the job, according to several people familiar with Musk's interactions and decisions at the time, who spoke on the condition of anonymity to avoid retaliation. Within that first week, he was learning how his stated principles of absolute free speech didn't mix well with an advertising business. And the people trying to help him implement his vision were learning how quickly the new boss would abandon those principles once they didn't work in his favor.

Nobody understood the tension inherent in running Twitter better than Jack Dorsey, who'd helped start the company, served two stints as chief executive officer and played a role in orchestrating Musk's acquisition. As the deal with Musk came together, Dorsey, who still sat on Twitter's board, texted and spoke with him regularly, according to private messages included in court documents related to litigation over the acquisition. Dorsey shared his concerns about Twitter's reliance on advertising revenue and told Musk the company would be better served if it was no longer publicly traded. "It can't have an advertising model," Dorsey texted in March 2022, weeks before Musk first made his offer. "Otherwise you have a surface area that governments and advertisers will try to influence and control. If it has a centralized entity behind it, it will be attacked."

Dorsey's own tenure at Twitter hadn't always gone smoothly, and he believed that if anyone could fix Twitter's problems, it was Musk. But if Dorsey's analysis of Twitter's flawed business model was spot on, his solution has missed the mark. Musk engulfed Twitter in chaos even before he took over. After agreeing to buy the company in April 2022, Musk had a change of heart and tried to torpedo his own deal. He spent much of the year fighting with Twitter in court. When he abandoned his legal fight and reluctantly closed the deal that October, he immediately fired half the employees, including most of the executive team Dorsey had hired and worked with for years.

This bumpy start was a taste of things to come. About 16 months into the Musk era, the company's revenue is now just a fraction of what it was before he arrived. Musk's plan to restore free speech to the service—which he presented as a straightforward hands-off policy—has come with all kinds of asterisks and stumbles.

Dorsey has acknowledged that his attempt to hand off the company has been bungled. In April 2023, he spent some time responding to questions about Twitter on Bluesky, a competing social network he'd helped envision long before Musk ever entered the picture. Jason Goldman, an early Twitter board member, asked Dorsey a simple but loaded question: "Do you think Elon has proven to be the best possible steward" for Twitter?

Dorsey, as he tends to do, answered earnestly. "No," he wrote back. "Nor do I think he acted right after realizing his timing was bad. Nor do I think the board should have forced the sale.

"It all went south."

There was already plenty of upheaval at Twitter by the time Musk showed up with \$44 billion in early 2022. In the two years leading up to the acquisition, activist investors tried to push Dorsey out; Twitter permanently banned a sitting US president; the company set a series of lofty financial goals it never came close to hitting; and Dorsey mentally checked out before resigning as CEO in November 2021. The conditions were ideal for someone like Musk to swoop in and take advantage.

Dorsey was eager to woo Musk, a business leader he greatly admired—and someone he often referred to as his favorite tweeter. Dorsey had tried unsuccessfully to get Musk to give a companywide pep talk in 2018, and then succeeded in getting him to do so in 2020. In 2021 Dorsey visited Musk at his Texas rocket launch facility, Starbase, and brought along his friend, the music producer Rick Rubin.

Dorsey and Musk kept an open dialogue as the acquisition was coming together, and Dorsey ultimately retained his nearly \$1 billion stake in Twitter when Musk took it private. When the terms of the deal were finalized, Dorsey cheered publicly, and congratulated Musk privately. "I basically followed your advice!" Musk texted Dorsey just minutes after the deal was announced in April 2022. "I know," Dorsey replied, "and I appreciate you."

The day after, Dorsey sent Musk a private message in hopes of setting up a call with Parag Agrawal, whom Dorsey had hand-picked as his own replacement as CEO a few months earlier. "I want to make sure Parag is doing everything possible to build towards your goals until close," Dorsey wrote to Musk. "He is really great at getting things done when tasked with specific direction."



Dorsey drew up an agenda that included problems Twitter was working on, short-term action items and long-term priorities. He sent it to Musk for review, along with a Google Meet link. "Getting this nailed will increase velocity," Dorsey wrote. He was clearly hoping his new pick for owner would like his old pick for CEO.

This was probably wishful thinking. Musk was already peeved with Agrawal, with whom he'd had a terse text exchange weeks earlier after Agrawal chastised Musk for some of his tweets. Musk had also unsuccessfully petitioned Agrawal to remove a Twitter account that was tracking his private plane; the billionaire started buying Twitter shares shortly after Agrawal denied his request.

So it was no surprise that the call Dorsey arranged was a disaster. Agrawal's vision for Twitter fell flat with his soon-to-be boss. There was a particularly uncomfortable moment that centered on Vijaya Gadde, Twitter's top lawyer and policy exec, who had been deeply involved in decisions to ban Trump and block a news story about Joe Biden and his son Hunter in the final days of the 2020 presidential election. Musk saw Gadde as representing everything he disliked about Twitter's speech policies, and he demanded that Agrawal fire her. Agrawal refused. It wasn't clear if such an action would be appropriate, given that Musk didn't own the company yet and wasn't supposed to be making demands.

Dorsey didn't jump in to defend Gadde, with whom he'd worked for the better part of a decade, nor did he advocate for his colleagues afterward. "You and I are in complete agreement," Musk wrote to Dorsey after the call ended. "Parag is just moving far too slowly and trying to please people who will not be happy no matter what he does."

"At least it became clear that you can't work together," Dorsey replied. "That was clarifying."



The phone call telegraphed Musk's willingness to clean house. Once he formally took over, he fired people on a whim, bad-mouthed Twitter's business and publicly attacked those employees who disagreed with him. Musk eliminated the Covid-era policy of granting mental health days and required everyone back in the office full time.

He also abandoned the system Twitter used to verify prominent users and eliminated many of the company's fact-checking operations. Twitter had leaned hard into fact-checking and other content moderation policies in 2020 as the rise of Covid-19 and the contentious US presidential election led to widespread misinformation on the service; Musk quickly reversed that approach, offering users more freedom to say whatever they wanted but damaging Twitter's reputation as the go-to place for breaking news in the process.

For all his flaws as a businessman, Dorsey had made working at Twitter feel special, preaching to employees the power of the service and its place in the world. Many Twitter employees accepted less money than they could have made at other major tech companies such as Meta Platforms Inc. or Alphabet Inc.'s Google because Dorsey helped instill the sense that Twitter was more than another company selling targeted ads. Dorsey routinely told Twitter employees that he loved them, and for many years those feelings were reciprocated.

That connection was essentially severed as Dorsey held firm in his support for Musk while the new owner dismantled the company. While Dorsey didn't directly object to Musk's approach, he acknowledged its impact. Shortly after Musk fired half of Twitter's employees just one week after taking over, Dorsey sent a melancholy tweet of apology. "I am grateful for, and love, everyone who has ever worked on Twitter," he added. "I don't expect that to be mutual in this moment ... or ever ... and I understand."

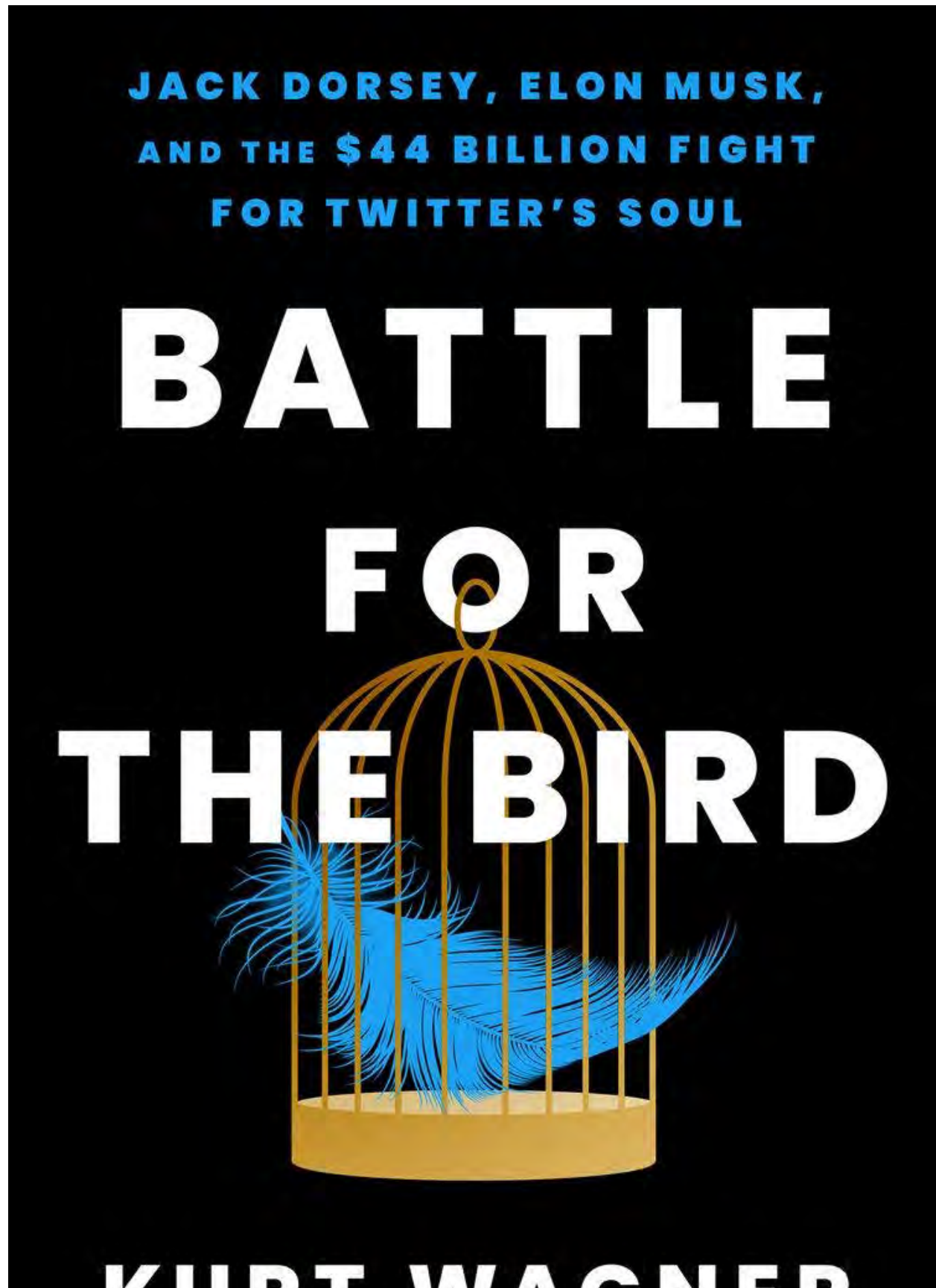
A lot has happened since Musk first walked into Twitter's San Francisco headquarters carrying a porcelain sink and a plan to turn the company inside out. Working with the skeleton crew that remains after laying off or running off most of the nearly 8,000 employees, he's aiming to transform Twitter into an "everything app" where people can shop, tweet, find dates and manage their money.

Musk changed Twitter's official name to X in July 2023. "The Twitter name made sense when it was just 140 character messages going back and forth—like birds tweeting," he wrote that month. As an everything app, X will be something different entirely, Musk has said, and "so we must bid adieu to the bird."

In the meantime, X's advertising business continues to suffer from his commitment to tweeting whatever he wants whenever he wants. In April, Musk changed his Twitter username to "Harry Bolz." In July he called Meta CEO Mark Zuckerberg a "cuck" and then challenged him to a "literal dick measuring contest."

In November he posted support for an antisemitic tweet, which was the final straw for some major advertisers including Apple Inc. and Walt Disney Co. Musk offered an apology from the conference stage at DealBook a few days later, but didn't put much effort into coming off as particularly apologetic. "Go f--- yourself," he announced to boycotting advertisers just minutes later from that same stage.

Musk's approach seems self-defeating, given that advertising still makes up roughly 75% of his company's revenue. Unlike Meta and Google, which have enormous direct-response advertising businesses whose clients are often small businesses, Twitter is mostly dependent on brand advertising—the type of ads that stalwarts such as Coca-Cola, Apple and Disney use to shape their public image without necessarily expecting immediate sales.





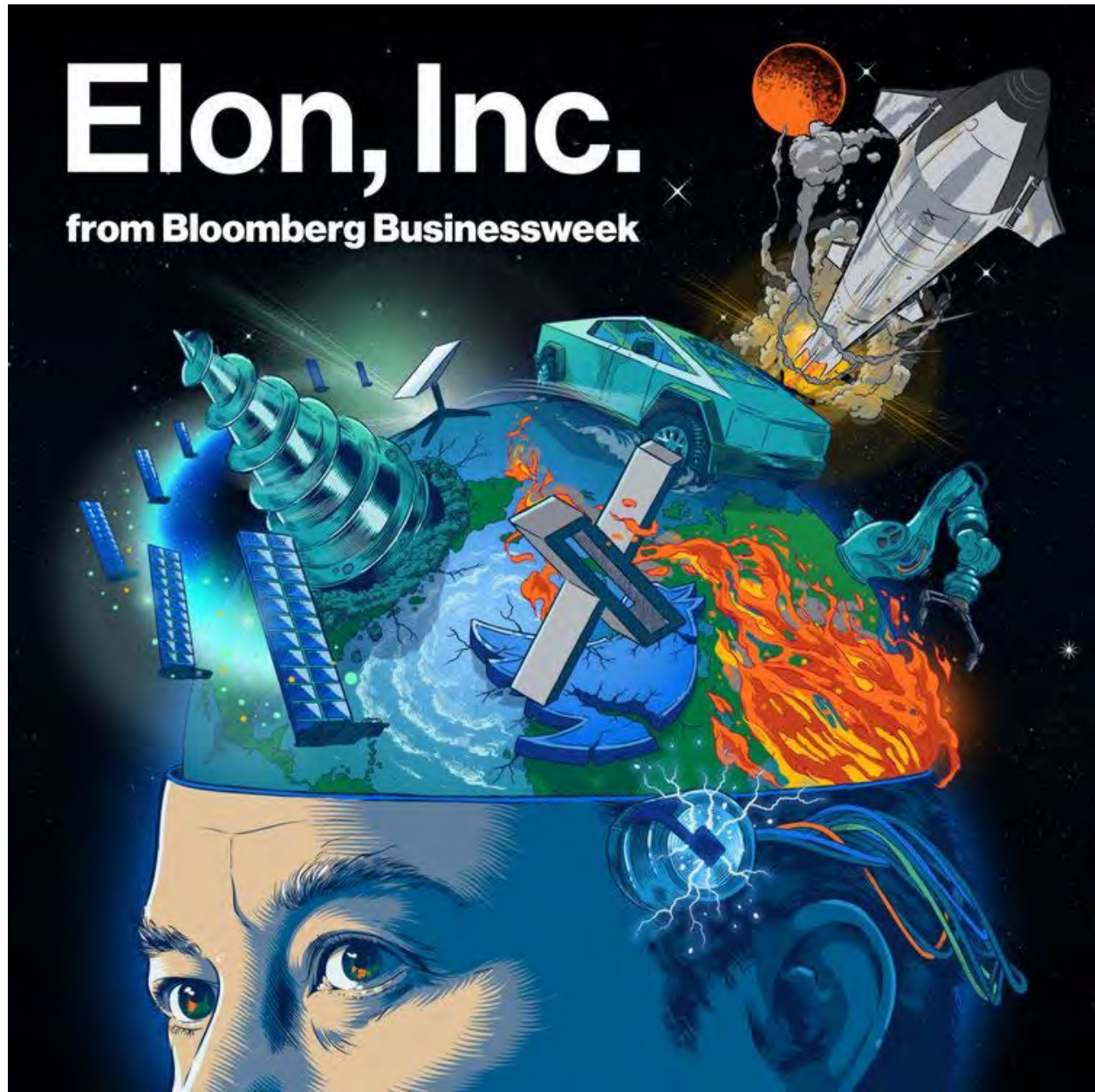
Adapted from *Battle for the Bird: Jack Dorsey, Elon Musk, and the \$44 Billion Fight for Twitter's Soul*, published by Atria Books, an imprint of Simon & Schuster LLC. Copyright © by J. Kurt Wagner
Courtesy: Simon & Schuster

Before the antisemitic tweet and the DealBook conference, X's target for advertising revenue in 2023 was about \$2.5 billion, or just over half what the company made in the last full year before Musk bought it, according to people familiar with X's business, who didn't want to be named as they weren't authorized to speak publicly for the company. At the DealBook conference, he blamed advertisers who were reluctant to spend on X for the company's financial issues. "What this advertising boycott is gonna do is it's gonna kill the company," Musk said. "And the whole world will know that those advertisers killed the company."

Of course, it won't be Disney's fault if X fails. That will fall on Musk's shoulders, because of his unwillingness to adjust to the realities of running an advertising business. X operates differently from companies such as Tesla Inc. and SpaceX, where he's had such success. A global speech platform can't be fixed or perfected simply by writing better code, improving manufacturing processes or pushing employees to work longer hours.

"I learned a ton from watching Elon up close—the good, the bad and the ugly," tweeted Esther Crawford, a product executive who survived a few months under Musk before she was laid off in a round of cost cuts last February. "His boldness, passion and storytelling is inspiring, but his lack of process and empathy is painful."

"Elon has an exceptional talent for tackling hard physics-based problems," she continued, "but products that facilitate human connection and communication require a different type of social-emotional intelligence."



Listen and subscribe to Elon, Inc. on Apple , Spotify , iHeart and the Bloomberg Terminal.

Dorsey rarely tweets anymore, and when he does, it's often related to his personal interests, which include Bitcoin, music and supporting the presidential campaign of Robert F. Kennedy Jr. It's easy to see, though, that he hasn't gotten what he envisioned when he encouraged Musk to buy his company.

Dorsey made a lot of the idea that one of Twitter's flaws was it had too much power and control over global speech, and that the world would run better if such power was distributed. When it comes to what is said on X, there's still a company holding the power, but that company is controlled by the richest man in the world with no board of directors, no public shareholders and seemingly no concerns about creating globally significant speech policies on a whim.

In an interview with the online political show *Breaking Points* in June, Dorsey admitted that the Musk era had gone wrong even before it officially started, when Musk accused the company of lying about how many users it had and Twitter responded by suing him. "I think it set up a dynamic where he had to be very hasty, he had to be impatient, he had to move as quickly as possible with features even if they weren't fully thought out," Dorsey said. "It all looked fairly reckless."

Still, Dorsey maintained something that many of his former colleagues have long since abandoned: hope. "I do have confidence that he'll figure it out," he continued. "I own 3% of this new company, so I'm supportive."



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<https://www.wsj.com/business/media/elon-musk-opens-new-front-in-disney-fight-2425f063>

BUSINESS | MEDIA

Elon Musk Opens New Front in Disney Fight

Billionaire's willingness to pay legal bills for people who want to sue Disney is latest foray against the company and CEO Bob Iger

By [Joseph De Avila](#) [Follow](#)

Updated Feb. 8, 2024 11:06 am ET



Elon Musk, left, has been in a monthslong feud with Disney CEO Bob Iger. PHOTO: MANDEL NGAN/AFP/GETTY IMAGES; ANGELA WEISS/AFP/GETTY IMAGES

Elon Musk is intensifying his feud with Disney **DIS 12.27%** ▲ .

Musk, the billionaire owner of X, is soliciting people who want to sue Disney for discrimination. He says he is willing to help pay for their cases.

“If you were discriminated against by Disney or its subsidiaries (ABC, ESPN, Marvel, etc), just reply to this post to receive legal support,” Musk said Tuesday in a post on X.

The outreach came the same day actress Gina Carano sued Disney and Lucasfilm, with Musk’s financial backing, for wrongful termination from “The Mandalorian,” a television series inspired by the Star Wars franchise.

The lawsuit and solicitation of additional complaints are the latest escalations in Musk's beef with Disney and its CEO Bob Iger, a feud that kicked off several months ago and has shown little sign of letting up. On Tuesday and Wednesday, Musk published several tweets that were critical of Disney.

In an interview with CNBC Wednesday, Iger declined to comment about Musk.

Debra Aho Williamson, an independent tech analyst, said Musk's Disney fight is a warning sign for brands that advertise on X, as it shows he is willing to target companies that anger him.

"He clearly wanted to call out Disney," she said. "Does an advertiser want to get caught up in that? Do they want to be the next Disney that is going to be the target of Musk's ire? I think a lot of brand advertisers don't want to be in that position."

Since the feud started, Musk has called for Iger to be fired. He has also thrown his support behind Nelson Peltz, the activist shareholder trying to shake up Disney who is seeking a seat on the company's board.

Representatives for X, Disney and Peltz didn't respond to requests for comment.



Gina Carano in 'The Mandalorian.' PHOTO: JUSTIN LUBIN/DISNEY+/LUCASFILM/EVERETT COLLECTION

On Tuesday, Carano alleged in a lawsuit that she was wrongfully terminated from "The Mandalorian" over her social-media posts and the ensuing backlash. Carano shared an Instagram story in 2021 that said, "most people today don't

realize that to get to the point where Nazi soldiers could easily round up thousands of Jews, the government first made their own neighbors hate them simply for being Jews. How is that any different from hating someone for their political views.”

She also made comments about pronouns and transgender people that drew criticism.

Carano said Musk’s platform was assisting with the lawsuit against Disney and Lucasfilm.

The financial backing to Carano comes after Musk said last year that X would fund lawsuits from people who claimed they were unfairly fired for their posts on the social-media platform.



Elon Musk has backed Nelson Peltz, who is seeking a seat on Disney’s board. PHOTO: LISA O’CONNOR/AGENCE FRANCE-PRESSE/GETTY IMAGES

“As a sign of X Corp’s commitment to free speech, we’re proud to provide financial support for Gina Carano’s lawsuit, empowering her to seek vindication of her free speech rights on X and the ability to work without bullying, harassment, or discrimination,” X said in a statement.

Lawyers for Carano didn’t respond to a request for comment.

The fight between Musk and Disney started in November after the company was part of an advertiser exodus from his social-media platform. The move followed Musk supporting an antisemitic tweet and a liberal watchdog group saying pro-Nazi content was running near advertisements from major companies on the platform.

X later sued the group, Media Matters for America, alleging the publication misrepresented how content appears on the platform and was trying to scare away advertisers. A representative for Media Matters said at the time that the organization stood behind its reporting.

During an interview at the New York Times DealBook Summit in November, Iger was asked about suspending Disney's advertising on X.

"We just felt that the association with that position, and with Elon Musk, and X, was not necessarily a positive one for us," Iger said.

In a separate interview at the same conference, Musk singled out Disney as one of several companies that he said were trying to blackmail him by suspending their advertising campaigns.

"Go f— yourself," Musk told those advertisers. "Is that clear? I hope it is. Hey Bob," he said, which many observers interpreted as a response to Iger.

Musk said at the conference that he had previously tried to clarify that he hadn't meant anything antisemitic by his post. "Essentially, I handed a loaded gun to those who hate me, and arguably, to those who are antisemitic," Musk said. He added: "I'm quite sorry. That was not my intention."

In December, Musk called for Iger to be fired, saying "Walt Disney is turning in his grave over what Bob has done to his company." Disney declined to comment on Musk's comments at the time.

Musk has also thrown his support behind Peltz, the activist shareholder seeking a seat on Disney's board. Peltz has pushed for better management of the Disney+ streaming service, an improved strategy for ESPN and greater investment in the company's theme parks.

"Brutal track record," Musk said about Disney's board in January, responding to a post by Peltz's Trian Group. "Shareholders have been incredibly poorly served by the @Disney board!"

Musk and Peltz were photographed together in Los Angeles over the weekend at the movie premiere of "Lola," a film that Peltz's daughter, Nicola Peltz Beckham, wrote, directed and starred in.

The feud shows how Musk will use his own platform to his advantage, said Williamson, the tech analyst.

“For many years it has been his mouthpiece,” she said. “Now that it’s his company, he is continuing to use X to promote the causes that he believes in.”

Write to Joseph De Avila at joseph.deavila@wsj.com

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<https://www.wsj.com/business/media/disneys-moves-give-bob-iger-a-sporting-chance-74b4950e>

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Disney's Moves Give Bob Iger a Sporting Chance

Strong results, Epic investment and new sports superapp lessen the case for activist challenges

By [Dan Gallagher](#) [Follow](#)

Feb. 8, 2024 5:30 am ET



Bob Iger returned to Disney's CEO role in November 2022. PHOTO: LEV RADIN/ZUMA PRESS

Bob Iger has plenty to worry about these days. Nelson Peltz should no longer be one of them.

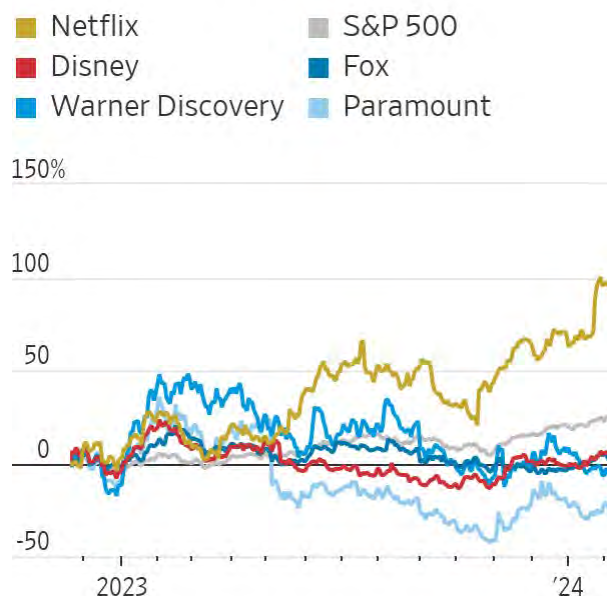
Disney's **DIS 12.25%** ▲ fiscal first-quarter results Wednesday afternoon were notable for two reasons that have nothing to do with the actual numbers. It is the company's last report before facing two proxy challenges at its annual shareholder meeting in early April, one of which is being backed by Peltz's Trian activist fund.

The report also comes a day after a surprising announcement that Disney will be teaming up with Warner Bros. Discovery **WBD 0.87%** ▲ and Fox to launch a new

streaming service that will combine the three companies' extensive sports rights into one app, expected to launch this fall. Disney also announced a new deal with Epic Games on Wednesday to build a new "entertainment universe" based on the blockbuster "Fortnite" game. That deal includes a \$1.5 billion investment by Disney for an equity stake in Epic.

Nothing Personal

Share price and index performance since Bob Iger returned to Disney



Source: FactSet

sunk 11% over the 12 months before Wednesday's report while the Dow and S&P 500 gained 13% and 20%, respectively, in that time.

Disney's strong results for the December quarter don't fully end those problems. But they do show a company on the right path, and in less need of outside intervention. Most notable was the sharp reduction in streaming red ink; operating losses of \$138 million for the company's direct-to-consumer segment were about a third of what analysts had expected and were a vast improvement from the nearly \$1 billion in losses for the same period the previous year.

Up Streams

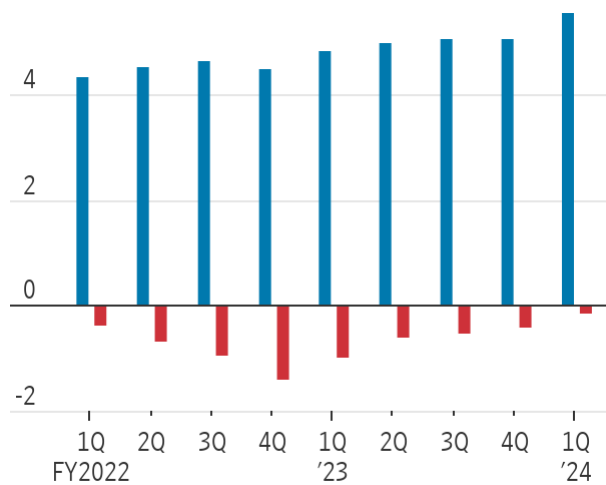
Disney's direct-to-consumer segment results per fiscal quarter

■ revenue ■ operating loss

\$6 billion

The seemingly disparate events have a common thread: Disney is facing existential challenges that have hurt its media empire, crushed its earnings and upset shareholders. The rise of streaming is sinking the once-lucrative cable-TV businesses of Disney and its peers, while the theatrical movie business still hasn't fully recovered from its pandemic-induced closures. Disney's pretax margin was 5.4% in its latest fiscal year that ended in September compared with an average of nearly 25% for the five years before the pandemic. And its stock price had

Another lift came from domestic parks, which saw revenue rise 4% year-over-year to \$6.3 billion compared with consensus estimates from Visible Alpha that had projected



Source: the company

no growth for that key segment. Disney's total segment operating income jumped 27% year-over-year to \$3.9 billion—beating Wall Street's consensus target by nearly 13%. The company also boosted its recently restored dividend by 50% and announced a \$3 billion stock buyback.

Not surprisingly, Disney's stock price jumped 6% in after-hours trading following Wednesday's results and conference call. That should help Iger make his case to shareholders, as Disney's underperforming stock has been a key issue for activists. But media peers such as Warner, Paramount and Fox face the same core challenge of shrinking cable-TV businesses—and their stocks have performed even worse than Disney's since Iger returned to Disney's CEO role in November 2022.

Disney's results still had plenty of weak spots; the company's linear networks revenue fell more than 12% year-over-year—nearly double the rate of decline from a year ago. And the weaker movie market, plus some recent misfires with its own films, caused Disney's theatrical distribution revenue to sink 78% year-over-year to \$251 million for the December quarter.

But the new team-up with Warner and Fox to create what will effectively be a sports superapp shows Disney and Iger are willing to think outside the box. The transition to streaming has made a mess of sports viewing options, with various leagues and games spread across several streamers that even the most devout fans are hard-pressed to follow. While many questions remain on the key details—including price—analysts roundly cheered the move. Peter Supino of Wolfe Research estimates the new service “will immediately provide access to roughly half of sports currently on television in the U.S.”

Disney's streaming business also will be helped by a crackdown on password sharing coming later this year—and possibly even by a deal announced by Iger Wednesday to put the blockbuster Taylor Swift concert film “The Eras Tour” on Disney+ exclusively next month. That movie racked up nearly \$181 million in

domestic box office alone for an artist who also seems able to boost NFL viewership simply by being in a skybox.

Even Taylor Swift can't solve all of Disney's challenges. But, faced with restive activists who have so far offered little in the way of specific alternatives, a bit of glitz could give Iger and his board the shine they need.

Write to Dan Gallagher at dan.gallagher@wsj.com

ExxonMobil

ExxonMobil takes legal hammer to climate shareholder groups

Oil supermajor's case against Follow This and Arjuna Capital grabs attention of corporate America

Patrick Temple-West in New York, Myles McCormick in Houston and Attracta Mooney in London YESTERDAY



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ExxonMobil's market capitalisation exceeds \$400bn. Follow This, a Dutch climate activist group, controls shares in the oil supermajor that at last count were worth less than \$4,000.

Follow This has repeatedly tried to use its tiny holding as a [lever](#) to force Exxon to expand pledges to cut greenhouse gas emissions. This year the oil company has had enough.

Minutes after midnight in Amsterdam on January 22, Exxon hit Follow This and another investor, Arjuna Capital, with a lawsuit alleging their [climate petition breached US securities rules](#).

The small investors backed off and [dropped their proposal](#), but Exxon is pressing ahead. This week its lawyers told a federal judge that the case was not moot, saying that Follow This and Arjuna have manipulated shareholder activism “for the sole purpose of attacking ExxonMobil from within” and adding: “There is no good reason to believe they will stop.”

The showdown between the largest western oil company and an activist group follows a proliferation of shareholder resolutions on an array of environmental, social and governance matters in recent years. It is a new flank in a broader conflict over ESG investing.

“Companies writ large are watching to see how this case progresses,” said Charles Crain, a vice-president at the National Association of Manufacturers, a Washington-based industry group that counts an Exxon representative on its board. He expressed concern over “the extreme degree to which activists have hijacked the proxy ballot with politically motivated proposals”.



An Esso refinery, operated by Exxon, in France. Follow This has tried to use its tiny holding as a lever to force Exxon to expand pledges to cut emissions © Jeremy Suykur/Bloomberg

Exxon is pursuing its legal case three years after suffering [a historic proxy defeat](#) to upstart hedge fund Engine No. 1, which managed to oust three of its board members with a demand for more serious plans to address climate change.

But while Engine No. 1 held more than 944,000 shares, Follow This represents shareholders who own 37, according to the latest number reported to Exxon. On Wednesday, Follow This said its stake now totals 505 shares, worth about \$51,000 at market prices.

Follow This is led by Mark van Baal, a Dutchman who has long argued that investors should use their voting rights to press oil companies into reducing emissions and risks associated with climate change.

His group relies on a strategy where climate-conscious, typically small investors buy shares with the explicit purpose of introducing proposals at annual meetings. The “Trojan horse” approach holds that if an oil company followed its resolutions it would “conclude that there is no room for further investments in exploring for more oil and gas”, Follow This said.

Follow This initially targeted Shell, formerly headquartered in the Netherlands, filing its first climate resolutions there in 2016.

In the years since, it began making proposals at BP and Chevron, where in 2021 more than 60 per cent of shareholders backed a resolution to force the group to cut its carbon emissions. The majority of shareholders at oil producer ConocoPhillips and refiner Phillips 66 also backed similar Follow This resolutions in 2021.

Some past efforts to throw out its proposals have failed, notably at Occidental Petroleum in 2022. However, investor support for climate proposals has more recently declined.

Van Baal started his group as a one-man operation, and it still counts just a handful of staff. But its agenda has proven popular in Europe. Katharina Lindmeier, senior responsible investment manager at Nest, which divested from Exxon in 2021, said Follow This “do a lot of the heavy lifting” when it comes to the resolutions, making it easier for other big investors to co-file with them.

Exxon’s lawsuit was not a huge surprise, she said, because there had been a large increase in shareholder proposals following the Securities and Exchange Commission’s 2021 decision to allow more of the petitions to be put to a vote.

The company filed suit in the US district court of northern Texas, arguing that Follow This and Arjuna's proposal was "driven by an extreme agenda" and "calculated to diminish the company's existing business". Exxon says the proposal is in breach of SEC rules that prohibit repeat motions that fail to meet a certain threshold of votes and prevent investors from "micromanaging" business.

The company enlisted a legal team that includes David Woodcock, the former head of the SEC's Texas office, and Noel Francisco, a former solicitor-general in the Donald Trump administration.

The now-withdrawn resolution called on Exxon to set accelerated targets to reduce emissions from its own operations and those that come from its products. The company has pledged to reduce the former to net zero by 2050, but does not have a goal for the latter.

"What Exxon is trying to do here is to really try to fundamentally shift the balance of corporate power between corporations and their investors by making investors think twice about exercising their rights to file a shareholder proposal," said Andrew Logan, senior director at Ceres, a coalition of investors and environmental groups.

"What is particularly pernicious about the way they're going about this is the way they are trying to make this as expensive as possible for the filers . . . Exxon is going out of its way to maximise what those costs are."

Natasha Lamb, a managing partner and chief investment officer at Arjuna Capital, last week accused the company of resorting to "tactics of intimidation and bullying".

Exxon, van Baal and Lamb declined to comment further on the litigation on Tuesday.

Submitting shareholder proposals has been relatively inexpensive for environmental activists, but the cost of defending them in court could run into hundreds of thousands of dollars, said Josh Zinner, chief executive of the Interfaith Center on Corporate Responsibility, which represents religious organisations that file such proposals.

"That is part of the goal here of [Exxon] is to make it prohibitively costly, for particularly smaller investors to make their voices heard," he said, comparing the lawsuit to so-called strategic lawsuits against public participation.

Exxon's litigation is not the only live case involving shareholder proposals. The right-leaning National Center for Public Policy Research has sued the SEC, arguing a shareholder proposal it filed at the supermarket chain Kroger concerning equal opportunities for employees should not have been blocked by the regulator. Oral arguments are scheduled next month.

Climate Capital



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Norway's Oil Fund

Norway oil fund boss criticises ExxonMobil's 'aggressive' climate lawsuit

Top-10 shareholder weighs in on supermajor's case against now-withdrawn emissions targets proposal



Nicolai Tangen, chief executive of Norway's \$1.5tn oil fund, called ExxonMobil's litigation 'worrisome' © Fredrik Solstad/Bloomberg

Richard Milne in Oslo and **Myles McCormick** in Houston YESTERDAY



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The world's largest sovereign wealth fund has sharply criticised ExxonMobil's decision to sue two shareholders that filed a climate proposal at the US oil major, pursuing the litigation even after they dropped the resolution.

Nicolai Tangen, chief executive of Norway's \$1.5tn [oil fund](#), told the Financial Times he was concerned about Exxon's action against Follow This and Arjuna Capital, which submitted the motion calling on the company to set more ambitious emissions targets at its annual meeting.

Tangen said: "It's a worrisome development. We think it's very aggressive and we are concerned about the implications for shareholders rights."

His intervention is significant as the oil fund is one of Exxon's top-10 shareholders with a 1.4 per cent stake worth \$5.4bn at the end of 2023.

Follow This and Arjuna [withdrew their proposal](#) last week, but [Exxon](#) — valued at more than \$400bn — has insisted it will [proceed with the case](#), arguing they could return with similar motions in future years. The oil company has argued the petition is in breach of rules prohibiting repeat motions that fail to win a minimum number of votes and preventing investors from “micromanaging” businesses.

The decision by the biggest western oil company to persist with what is likely to be an expensive legal case has provoked concern in the investor community that it will discourage small investors filing similar petitions in the future.

The Norwegian fund is increasingly active on climate issues and has backed shareholder resolutions on the environment at several oil and gas groups. It also filed its own proposals for the first time last year at four companies.

Carine Smith Ihenacho, the fund's chief governance and compliance officer, said: “We are concerned with anything that takes away shareholder rights . . . This is a shareholder proposal that is quite similar to shareholder proposals we have supported earlier.”

Environmental, social and governance motions have proliferated at US companies after regulators made it easier for small shareholders to file petitions.

Exxon's lawsuit is unusual because companies rarely go to court over such petitions, usually turning instead to the Securities and Exchange Commission for permission to throw them out. But the company argued the US regulator has become too willing to let them advance to a vote.

“We share the same concerns about shareholder rights being preserved, which is why we want clarity on a process that has become ripe for abuse,” Exxon told the Financial Times.

“Proposals like this are obviously not in investors' best interests. We hope our suit motivates the SEC to go back to applying the proxy rules as they were written, not as they've been interpreting them over the last few years,” the company said.

The Norwegian oil fund voted in favour of a Follow This proposal at Exxon's annual meeting last May to adopt a medium-term greenhouse gas reduction plan. It backed some other shareholder proposals on issues such as tax and plastics demand, and voted against re-electing chief executive Darren Woods because he also holds the role of board chair.

The fund, which was set up in 1996 to invest the proceeds of Norway's oil and gas industry, also backed similar shareholder proposals last year at Chevron, the second-biggest western oil group, where it owns a 1 per cent stake.

Asked about Chevron's decision to not back a decarbonisation pledge at the recent COP climate summit, Wilhelm Mohn, global head of active ownership at the Norwegian fund, said: "We like that charter, that pledge."

He added: "What we would like to see is a clear path, good intermediate targets, and an acknowledgment that we need to be at net zero around 2050. Some companies are not there yet and then we would vote for a well-crafted shareholder proposal."

Chevron did not respond to a request for comment.

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Einhorn Says Markets 'Fundamentally Broken' by Passive Investors

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Feb. 8, 2024, 4:00 AM PST

Matthew Griffin

- Greenlight Capital adapted as investors ignored value stocks
- Einhorn also said the SEC stopped policing corporate behavior

was forced to shift its strategy as the growth of passive investing and algorithmic trading transformed markets, founder David Einhorn said.

"I view the markets as fundamentally broken," Einhorn, 55, said on **Barry Ritholtz's *Masters in Business***

podcast. "Passive investors have no opinion about value. They're going to assume everybody else has done the work."

WATCH: David Einhorn says "I view the markets as fundamentally broken."

Source: Bloomberg

Investors have increasingly looked beyond active money managers, instead opting for passive strategies with lower fees. By late 2019, passive vehicles such as index funds accounted for

of publicly traded assets in US equity funds.

That means fewer people are paying attention to individual stocks, posing a problem for funds looking to invest in undervalued companies, according to Einhorn. Value strategies pay off when others notice a company's potential, driving up its stock.

At the same time, Einhorn said that quants base their trades on short-term price moves rather than a company's actual worth. Algorithmic investing "has an opinion about price," he said. "Like, what is the price going to be in 15 minutes?"

Greenlight, which is known for value investing, gained 36.6% in 2022 — recouping losses that began in 2015. Greenlight gained 22.1% last year.

The fund changed course after Einhorn realized the problem: As money flowed out of value-investing strategies and into index funds, investment managers were selling companies the fund owned and buying equities in which Greenlight held short positions.

Greenlight still bets on undervalued companies, but it looks for even lower market capitalizations relative to earnings than before, as well as strong cash flows that can fund share buybacks.

“We can’t count on other long-only investors to buy our things after us,” Einhorn said. “We’re going to have to get paid by the company.”

SEC Criticism

Einhorn also took aim at the

, contending it has stopped policing corporate behavior unless a company has filed for bankruptcy.

“The regulatory infrastructure is essentially gone,” he said.

If the SEC takes action against a public company, the stock might take a hit and the regulator could get blamed — and the SEC doesn’t want that responsibility, Einhorn said.

Instead, the SEC focuses on regulating hedge funds and crypto and going after individuals for violations such as insider trading, in Einhorn’s view.

“If you have some inside information and you tip off your brother-in-law and he makes \$50,000,” the SEC will come down like “a ton of bricks on that,” he said.

Einhorn takes a rosier view of the US economy.

With the economy still strong, Einhorn said, the

will cut rates fewer times this year than expected. Near-zero rates actually slowed the economy, according to the investor, who likened excessive rate cuts to feeding jelly doughnuts to a diabetic.

Einhorn contends that recent rate increases have actually contributed to strong GDP growth.

“It’s really weird that everybody thinks that they’re going to lower rates,” Einhorn said.

“Things are pretty good.”

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Erin Fuchs, Matthew Griffin

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First Citizens claims HSBC execs knew of plot to poach Silicon Valley Bank workers

 [reuters.com/legal/first-citizens-claims-hsbc-execs-knew-plot-poach-silicon-valley-bank-workers-2024-02-08](https://www.reuters.com/legal/first-citizens-claims-hsbc-execs-knew-plot-poach-silicon-valley-bank-workers-2024-02-08)

Daniel Wiessner

[1/2]HSBC logo is seen in this illustration taken December 22, 2023. REUTERS/Dado Ruvic/Illustration/File Photo Purchase Licensing Rights , opens new tab

Feb 8 (Reuters) - First Citizens BancShares (FCNCA.O) , opens new tab claims in a new court filing that executives at HSBC Holdings (HSBA.L) , opens new tab, including CEO Noel Quinn, condoned a plan to steal employees and confidential information from Silicon Valley Bank after it collapsed last year and was acquired by First Citizens.

In an amended lawsuit filed in San Francisco federal court on Wednesday, First Citizens said David Sabow, who led SVB's technology and healthcare banking segment before moving to HSBC, met with Quinn and other top executives numerous times and shared plans to poach workers in order to launch a competing venture capital business.

First Citizens had initially filed the \$1 billion lawsuit against HSBC, Sabow and others last May. A federal judge in January declined to dismiss the case but ordered North Carolina-based First Citizens to "clean up" its complaint, saying it was unclear what role some of the defendants played in the alleged scheme.

The bank says Sabow and five other former Silicon Valley Bank officials took client information and other trade secrets and convinced more than 40 employees of the failed bank to jump to HSBC last April. According to the new complaint, the trade secrets allegedly included profit data, estimates of the value of individual clients to the bank, and reports on employees' performance and potential.

HSBC in a statement said it is "strongly committed to the innovation banking space and to our employees, and will continue to vigorously defend against the lawsuit brought by First Citizens."

In court filings, HSBC has denied wrongdoing and said Sabow's efforts to recruit from Silicon Valley Bank, which had about 8,500 employees when it collapsed, were legitimate and predated First Citizens' takeover of the bank.

Many other former Silicon Valley Bank staffers and executives have reportedly joined JPMorgan Chase and investment bank Stifel, among other firms.

The U.S. Federal Deposit Insurance Corporation took over Silicon Valley Bank in March after a bank run in which depositors rushed to pull out their money.

First Citizens then purchased Silicon Valley Bank's assets and deposits for a fraction of what the bank was worth before it failed. HSBC last year separately acquired the lender's UK arm and said it had hired dozens of SVB employees to help the bank set up a dedicated practice focused on serving technology and healthcare companies and investors who support them. Reporting by Daniel Wiessner in Albany, New York; Editing by David Gregorio

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Thomson Reuters

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FT Magazine Social Media

'Enshittification' is coming for absolutely everything

The term describes the slow decay of online platforms such as Facebook. But what if we've entered the 'enshittocene'?

Cory Doctorow YESTERDAY



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Last year, I coined the term “enshittification” to describe the way that platforms decay. That obscene little word did big numbers; it really hit the zeitgeist.

The American Dialect Society made it its [Word of the Year](#) for 2023 (which, I suppose, means that now I'm definitely getting a poop emoji on my tombstone).

So what's enshittification and why did it catch fire? It's my theory explaining how the internet was colonised by platforms, why all those platforms are degrading so quickly and thoroughly, why it matters and what we can do about it. We're all living through a great enshittening, in which the services that matter to us, that we rely on, are turning into giant piles of shit. It's frustrating. It's demoralising. It's even terrifying.

I think that the enshittification framework goes a long way to explaining it, moving us out of the mysterious realm of the “great forces of history”, and into the material world of specific decisions made by real people; decisions we can reverse and people whose names and pitchfork sizes we can learn.

Enshittification names the problem and proposes a solution. It's not just a way to say "things are getting worse", though, of course, it's fine with me if you want to use it that way. (It's an English word. We don't have *ein Rat für englische Rechtschreibung*. English is a free-for-all. Go nuts, *meine Kerle*.) But in case you want to be more precise, let's examine how enshittification works. It's a three-stage process: first, platforms are good to their users. Then they abuse their users to make things better for their business customers. Finally, they abuse those business customers to claw back all the value for themselves. Then, there is a fourth stage: they die.

Let's do a case study. What could be better than Facebook?

Facebook arose from a website developed to rate the fuckability of Harvard undergrads, and it only got worse after that. When Facebook started off, it was only open to US college and high-school kids with .edu and K-12.us addresses. But in 2006, it opened up to the general public. It effectively told them: *Yes, I know you're all using MySpace. But MySpace is owned by a billionaire who spies on you with every hour that God sends. Sign up with Facebook and we will never spy on you. Come and tell us who matters to you in this world.*

That was stage one. Facebook had a surplus — its investors' cash — and it allocated that surplus to its end users. Those end users proceeded to lock themselves into Facebook. Facebook, like most tech businesses, had network effects on its side. A product or service enjoys network effects when it improves as more people sign up to use it. You joined Facebook because your friends were there, and then others signed up because you were there.

But Facebook didn't just have high network effects, it had high switching costs. Switching costs are everything you have to give up when you leave a product or service. In Facebook's case, it was all the friends there that you followed and who followed you. In theory, you could have all just left for somewhere else; in practice, you were hamstrung by the collective action problem.

It's hard to get lots of people to do the same thing at the same time. So Facebook's end users engaged in a mutual hostage-taking that kept them glued to the platform. Then Facebook exploited that hostage situation, withdrawing the surplus from end users and allocating it to two groups of business customers: advertisers and publishers.

To the advertisers, Facebook said: *Remember when we told those rubes we wouldn't spy on them? Well, we do. And we will sell you access to that data in the form of fine-grained ad-targeting. Your ads are dirt cheap to serve, and we'll spare no expense to make sure that when you pay for an ad, a real human sees it.*

To the publishers, Facebook said: *Remember when we told those rubes we would only show them the things they asked to see? Ha! Upload short excerpts from your website, append a link and we will cram it into the eyeballs of users who never asked to see it. We are offering you a free traffic funnel that will drive millions of users to your website to monetise as you please.* And so advertisers and publishers became stuck to the platform, too.

Users, advertisers, publishers — everyone was locked in. Which meant it was time for the third stage of enshittification: withdrawing surplus from everyone and handing it to Facebook's shareholders.

For the users, that meant dialling down the share of content from accounts you followed to a homeopathic dose, and filling the resulting void with ads and pay-to-boost content from publishers. For advertisers, that meant jacking up prices and drawing down anti-fraud enforcement, so advertisers paid much more for ads that were far less likely to be seen. For publishers, this meant algorithmically suppressing the reach of their posts unless they included an ever-larger share of their articles in the excerpt. And then Facebook started to punish publishers for including a link back to their own sites, so they were corralled into posting full text feeds with no links, meaning they became commodity suppliers to Facebook, entirely dependent on the company both for reach and for monetisation.

When any of these groups squawked, Facebook just repeated the lesson that every tech executive learnt in the Darth Vader MBA:

"I have altered the deal. Pray I don't alter it any further."

Facebook now enters the most dangerous phase of enshittification. It wants to withdraw all available surplus and leave just enough residual value in the service to keep end users stuck to each other, and business customers stuck to end users, without leaving anything extra on the table, so that every extractable penny is drawn out and returned to its shareholders. (This continued last week, when the company announced a quarterly dividend of 50 cents per share and that it would [increase share buybacks by \\$50bn](#). The stock jumped.)

But that's a very brittle equilibrium, because the difference between "I hate this service, but I can't bring myself to quit," and "Jesus Christ, why did I wait so long to quit?" is razor-thin.

All it takes is one Cambridge Analytica scandal, one whistleblower, one livestreamed mass-shooting, and users bolt for the exits, and then Facebook discovers that network effects are a double-edged sword. If users can't leave because everyone else is staying, when everyone starts to leave, there's no reason not to go. That's terminal enshittification.

This phase is usually accompanied by panic, which tech euphemistically calls "pivoting". Which is how we get pivots such as: *In the future, all internet users will be transformed into legless, sexless, low-polygon, heavily surveilled cartoon characters in a virtual world called the "metaverse"*.

That's the procession of enshittification. But that doesn't tell you why everything is enshittifying right now and, without those details, we can't know what to do about it. What is it about this moment that led to the Great Enshittening? Was it the end of the zero-interest rate policy (ZIRP)? Was it a change in leadership at the tech giants?

Is Mercury in retrograde?

Nope.



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The period of free Fed money certainly led to tech companies having a lot of surplus to toss around. But Facebook started enshittifying long before ZIRP ended, so did Amazon, Microsoft and Google. Some of the tech giants got new leaders. But Google's enshittification got worse when the founders came back to oversee the company's AI panic — excuse me, AI pivot. And it can't be Mercury in retrograde, because I'm a Cancer, and as everyone knows, Cancers don't believe in astrology.

When a whole bunch of independent entities all change in the same way at once, that's a sign that the environment has changed, and that's what happened to tech. Tech companies, like all companies, have conflicting imperatives. On the one hand, they want to make money. On the other hand, making money involves hiring and motivating competent staff, and making products that customers want to buy. The more value a company permits its employees and customers to carve off, the less value it can give to its shareholders.

The equilibrium in which companies produce things we like in honourable ways at a fair price is one in which charging more, worsening quality and harming workers costs more than the company would make by playing dirty.

There are four forces that discipline companies, serving as constraints on their enshittificatory impulses:

Competition. Companies that fear you will take your business elsewhere are cautious about worsening quality or raising prices.

Regulation. Companies that fear a regulator will fine them more than they expect to make from cheating, will cheat less.

These two forces affect all industries, but the next two are far more tech-specific.

Self-help. Computers are extremely flexible and so are the digital products and services we make from them. The only computer we know how to make is the Turing-Complete Von Neumann Machine, a computer that can run every valid program.

That means that users can always avail themselves of programs that undo the anti-features that shift value from them to a company's shareholders. Think of a boardroom table where someone says, "I've calculated that making our ads 20 per cent more invasive will net us 2 per cent more revenue per user."

In a digital world, someone else might well say, "Yes, but if we do that, 20 per cent of our users will install ad blockers, and our revenue from those users will drop to zero, for ever." This means that digital companies are constrained by the fear that some enshittificatory manoeuvre will prompt their users to google, "How do I disenshittify this?"

And, finally, **workers**. Tech workers have very low union density, but that doesn't mean that tech workers don't have labour power. The historical "talent shortage" of the tech sector meant that workers enjoyed a lot of leverage. Workers who disagreed with their bosses could quit and walk across the street and get another, better job.

They knew it and their bosses knew it. Ironically, this made tech workers highly exploitable. Tech workers overwhelmingly saw themselves as founders in waiting, entrepreneurs who were temporarily drawing a salary, heroic figures to be.

That's why mottoes such as Google's "Don't be evil" and Facebook's "Make the world more open and connected" mattered; they instilled a sense of mission in workers. It's what the American academic Fobazi Ettarh calls "vocational awe" or Elon Musk calls being "extremely hardcore".

Tech workers had lots of bargaining power, but they didn't flex it when their bosses demanded that they sacrifice their health, their families, their sleep to meet arbitrary deadlines. So long as their bosses transformed their workplaces into whimsical "campuses", with gyms, gourmet cafeterias, laundry service, massages and egg-freezing, workers could tell themselves that they were being pampered, rather than being made to work like government mules.

For bosses, there's a downside to motivating your workers with appeals to a sense of mission. Namely, your workers will feel a sense of mission. So when you ask them to enshittify the products they ruined their health to ship, workers will experience a sense of profound moral injury, respond with outrage and threaten to quit. Thus tech workers themselves were the final bulwark against enshittification.

The pre-enshittification era wasn't a time of better leadership. The executives weren't better. They were constrained. Their worst impulses were checked by competition, regulation, self-help and worker power. So what happened?

One by one, each of these constraints was eroded, leaving the enshittificatory impulse unchecked, ushering in the enshittoscene.

It started with competition. From the Gilded Age until the Reagan years, the purpose of competition law was to promote competition between companies. US antitrust law treated corporate power as dangerous and sought to blunt it. European antitrust laws were modelled on US ones, imported by the architects of the Marshall Plan. But starting in the 1980s, with the rise of neoliberalism, competition authorities all over the world adopted a doctrine called “consumer welfare”, which essentially held that monopolies were evidence of quality. If everyone was shopping at the same store and buying the same product, that meant that was the best store, selling the best product — not that anyone was cheating.

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Executives weren't better before. They were constrained . . . by competition, regulation, self-help and worker power

And so, all over the world, governments stopped enforcing their competition laws. They just ignored them as companies flouted them. Those companies merged with their major competitors, absorbed smaller companies before they could grow to be big threats. They held an orgy of consolidation that produced the most inbred industries imaginable, whole sectors grown so incestuous they developed

Habsburg jaws, from eyeglasses to sea freight, glass bottles to payment processing, vitamin C to beer.

Most of our global economy is dominated by five or fewer global companies. If smaller companies refuse to sell themselves to these cartels, the giants have free rein to flout competition law further, with “predatory pricing” that keeps an independent rival from gaining a foothold. When Diapers.com refused Amazon's acquisition offer, Amazon lit \$100mn on fire, selling diapers way below cost for months, until Diapers.com went bust, and Amazon bought them for pennies on the dollar.

Lily Tomlin used to do a character on the TV show *Rowan & Martin's Laugh-In*, an AT&T telephone operator who'd do commercials for the Bell system. Each one would end with her saying: “We don't care. We don't have to. We're the phone company.”

Today's giants are not constrained by competition. They don't care. They don't have to. They're Google.

That's the first constraint gone, and as it slipped away, the second constraint — regulation — was also doomed.

When an industry consists of hundreds of small- and medium-sized enterprises, it is a mob, a rabble. Hundreds of companies can't agree on what to tell Parliament or Congress or the Commission. They can't even agree on how to cater a meeting where they'd discuss the matter.

But when a sector dwindles to a bare handful of dominant firms, it ceases to be a rabble and it becomes a cartel. Five companies, or four, or three, or two or just one company can easily converge on a single message for their regulators, and without "wasteful competition" eroding their profits, they have plenty of cash to spread around.

This is why competition matters: it's not just because competition makes companies work harder and share value with customers and workers; it's because competition keeps companies from becoming too big to fail, and too big to jail.

Now, there are plenty of things we don't want improved through competition, like privacy invasions. After the EU passed its landmark privacy law, the GDPR, there was a mass-extinction event for small EU ad-tech companies. These companies disappeared en masse and that's a good thing. They were even more invasive and reckless than US-based Big Tech companies. We don't want to produce increasing efficiency in violating our human rights.

But: Google and Facebook have been unscathed by European privacy law. That's not because they don't violate the GDPR. It's because they pretend they are headquartered in Ireland, one of the EU's most notorious corporate crime havens. And Ireland competes with the EU's other crime havens — Malta, Luxembourg, Cyprus and, sometimes, the Netherlands — to see which country can offer the most hospitable environment.

The Irish Data Protection Commission rules on very few cases, and more than two-thirds of its rulings are overturned by the EU courts, even though Ireland is the nominal home to the most privacy-invasive companies on the continent. So Google and Facebook get to act as though they are immune to privacy law, because they violate the law with an app.



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This is where that third constraint, self-help, would surely come in handy. If you don't want your privacy violated, you don't need to wait for the Irish privacy regulator to act, you can just install an ad blocker.

More than half of all web users are blocking ads. But the web is an open platform, developed in the age when tech was hundreds of companies at each other's throats, unable to capture their regulators. Today, the web is being devoured by apps, and apps are ripe for enshittification. Regulatory capture isn't just the ability to flout regulation, it's also the ability to co-opt regulation, to wield regulation against your adversaries.

Today's tech giants got big by exploiting self-help measures. When Facebook was telling MySpace users they needed to escape Murdoch's crapulent Australian social media panopticon, it didn't just say to those Myspacers, "Screw your friends, come to Facebook and just hang out looking at the cool privacy policy until they get here." It gave them a bot. You fed the bot your MySpace username and password, and it would login to MySpace and pretend to be you, scraping everything waiting in your inbox and copying it to your Facebook inbox.

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When Facebook, Apple and Google were doing this adversarial interoperability, it was progress. If you try to do it to them, it's piracy

When Microsoft was choking off Apple's market oxygen by refusing to ship a functional version of Microsoft Office for the Mac in the 1990s — so that offices were throwing away their designers' Macs and giving them PCs with upgraded graphics cards and Windows versions of Photoshop and Illustrator — Steve Jobs didn't beg Bill Gates to update Mac Office. He got his technologists to reverse-engineer Microsoft

Office and make a compatible suite, the iWork Suite, whose apps, Pages, Numbers and Keynote could read and write Microsoft's Word, Excel and PowerPoint files.

When Google entered the market, it sent its crawler to every web server on earth, where it presented itself as a web-user: "Hi! Hello! Do you have any web pages? Thanks! How about some more? How about more?"

But every pirate wants to be an admiral. When Facebook, Apple and Google were doing this adversarial interoperability, that was progress. If you try to do it to them, that's piracy.

Try to make an alternative client for Facebook and they'll say you violated US laws such as the Digital Millennium Copyright Act and EU laws like Article 6 of the EU Copyright Directive. Try to make an Android program that can run iPhone apps and play back the data from Apple's media stores and they'd bomb you until the rubble bounced. Try to scrape all of Google and they'll nuke you until you glow.

Tech's regulatory capture is mind-boggling. Take that law I mentioned earlier, Section 1201 of the Digital Millennium Copyright Act or DMCA. Bill Clinton signed it in 1998, and the EU imported it as Article 6 of the EUCD in 2001. It is a blanket prohibition on removing any kind of encryption that restricts access to a copyrighted work — things such as ripping DVDs or jailbreaking a phone — with penalties of a five-year prison sentence and a \$500,000 fine for a first offence. This law has been so broadened that it can be used to imprison creators for granting access to their own creations. Here's how that works: In 2008, Amazon bought Audible, an audiobook platform. Today, Audible is a monopolist with more than 90 per cent of the audiobook market. Audible requires that all creators on its platform sell with Amazon's "digital rights management", which locks it to Amazon's apps.

So say I write a book, then I read it into a mic, then I pay a director and an engineer thousands of dollars to turn that into an audiobook, and sell it to you on the monopoly platform, Audible, that controls more than 90 per cent of the market. If I later decide to leave Amazon and want to let you come with me to a rival platform, I am out of luck. If I supply you with a tool to remove Amazon's encryption from my audiobook, so you can play it in another app, I commit a felony, punishable by a five-year sentence and a half-million-dollar fine, for a first offence.

That's a stiffer penalty than you would face if you simply pirated the audiobook from a torrent site. But it's also harsher than the punishment you'd get for shoplifting the audiobook on CD from a truck stop. It's harsher than the sentence you'd get for hijacking the truck that delivered the CD.

Think of our ad blockers again. Fifty per cent of web users are running ad blockers. Zero per cent of app users are running ad blockers, because adding a blocker to an app requires that you first remove its encryption, and that's a felony. (Jay Freeman, the American businessman and engineer, calls this "felony contempt of business-model".)

So when someone in a boardroom says, “Let’s make our ads 20 per cent more obnoxious and get a 2 per cent revenue increase,” no one objects that this might prompt users to google, “How do I block ads?” After all, the answer is, you can’t. Indeed, it’s more likely that someone in that boardroom will say, “Let’s make our ads 100 per cent more obnoxious and get a 10 per cent revenue increase.” (This is why every company wants you to install an app instead of using its website.)

There’s no reason that gig workers who are facing algorithmic wage discrimination couldn’t install a counter-app that co-ordinated among all the Uber drivers to reject all jobs unless they reach a certain pay threshold. No reason except felony contempt of business model, the threat that the toolsmiths who built that counter-app would go broke or land in prison, for violating DMCA 1201, the Computer Fraud and Abuse Act, trademark, copyright, patent, contract, trade secrecy, nondisclosure and noncompete or, in other words, “IP law”.

IP isn’t just short for intellectual property. It’s a euphemism for “a law that lets me reach beyond the walls of my company and control the conduct of my critics, competitors and customers”. And “app” is just a euphemism for “a web page wrapped in enough IP to make it a felony to mod it, to protect the labour, consumer and privacy rights of its user”.

We don’t care. We don’t have to. We’re the phone company.

What about that fourth constraint: workers? For decades, tech workers’ bargaining power and vocational awe put a ceiling on enshittification. Even after the tech sector shrank to a handful of giants. Even after they captured their regulators. Even after “felony contempt of business model” and extinguished self-help for tech users. Tech was still constrained by their workers’ sense of moral injury in the face of the imperative to enshittify.

Remember when tech workers dreamt of working for a big company for a few years, before striking out on their own to start their own company that would knock that tech giant over? That dream shrank to: work for a giant for a few years, quit, do a fake start-up, get “acqui-hired” by your old employer, as a complicated way of getting a bonus and a promotion. Then the dream shrank further: work for a tech giant for your whole life, get free kombucha and massages on Wednesdays.

And now, the dream is over. All that's left is: work for a tech giant until they fire you, like those 12,000 Googlers who got fired last year, eight months after a stock buyback that would have paid their salaries for the next 27 years.

Workers are no longer a check on their bosses' worst impulses. Today, the response to "I refuse to make this product worse" is "turn in your badge and don't let the door hit you in the ass on the way out".

I get that this is all a little depressing. OK, really depressing. But hear me out! We've identified the disease. We've identified its underlying mechanism. Now we can get to work on a cure.

There are four constraints that prevent enshittification: competition, regulation, self-help and labour. To reverse enshittification and guard against its re-emergence, we must restore and strengthen each of these.

On competition, it's actually looking pretty good. The EU, the UK, the US, Canada, Australia, Japan and China are all doing more on competition than they have in two generations. They're blocking mergers, unwinding existing ones, taking action on predatory pricing and other sleazy tactics. Remember, in the US and Europe, we already have the laws to do this; we just stopped enforcing them.

I've been fighting these fights with the Electronic Frontier Foundation for 22 years now, and I've never seen a more hopeful moment for sound, informed tech policy.

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My big hope here is that Stein's Law will take hold: anything that can't go on for ever will eventually stop

Now, the enshittifiers aren't taking this lying down. Take Lina Khan, the brilliant head of the US Federal Trade Commission, who has done more in three years on antitrust than the combined efforts of all her predecessors over the past 40 years. The Wall Street Journal's editorial page has run more than 80 pieces trashing Khan, insisting that she's an ineffectual ideologue who can't get anything done. Sure, that's

why you ran 80 editorials about her. Because she can't get anything done.

Reagan and Thatcher put antitrust law in a coma in the 1980s. But it's awake, it's back and it's pissed off.

What about regulation? How will we get tech companies to stop doing that one weird trick of adding “with an app” to escape enforcement?

Well, here in the EU, they’re starting to figure it out. Recently, the main body of the Digital Markets Act and the Digital Services Act went into effect, and they let people who get screwed by tech companies go straight to the European courts, bypassing the toothless watchdogs in places like Ireland.

In the US, they might finally get a digital privacy law. You probably have no idea how backwards US privacy law is. The last time the US Congress enacted a broadly applicable privacy law was in 1988. The Video Privacy Protection Act makes it a crime for video-store clerks to leak your video-rental history. It was passed after a rightwing judge who was up for the Supreme Court had his rentals published in a DC newspaper. The rentals weren’t even all that embarrassing.

Sure, that judge, Robert Bork, wasn’t confirmed for the Supreme Court, but that was because he was a virulent loudmouth who served as Nixon’s solicitor-general. Still, Congress got the idea that their own video records might be next, freaked out and passed the VPPA. That was the last time Americans got a big, national privacy law. And the thing is, there are a lot of people who are angry about it. Worried that Facebook turned Grampy into a QAnon? That Insta made your teen anorexic? That TikTok is brainwashing Gen Z into quoting Osama bin Laden?

Or that cops are rolling up the identities of everyone at a Black Lives Matter protest or the Jan 6 riots by getting location data from Google?

Or that red state attorneys-general are tracking teen girls to out-of-state abortion clinics?

Or that Black people are being discriminated against by online lending or hiring platforms?

Or that someone is making AI deepfake porn of you?

Having a federal privacy law with a private right of action — which means that individuals can sue companies that violate their privacy — would go a long way to rectifying all of these problems. There’s a big coalition for that kind of privacy law.

What about self-help? That's a lot farther away, alas. The EU's DMA will force tech companies to open up their walled gardens for interoperation. You'll be able to use WhatsApp to message people on iMessage, or quit Facebook and move to Mastodon, but still send messages to the people left behind. But if you want to reverse-engineer one of those Big Tech products and mod it to work for you, not them, the EU's got nothing for you. This is an area ripe for improvement. My big hope here is that Stein's Law will take hold: anything that can't go on forever will eventually stop.

Finally, there's labour. Here in Europe, there's much higher union density than in the US, which American tech barons are learning the hard way. There is nothing more satisfying in the daily news than the recent salvo by Nordic unions against that Tesla guy. But even in the US, there's a massive surge in tech unions. Tech workers have realised they're not founders-in-waiting. In Seattle, Amazon's tech workers walked out in sympathy with Amazon's warehouse workers, because they're all workers.

We're seeing bold, muscular, global action on competition, regulation and labour, with self-help bringing up the rear. It's not a moment too soon, because the bad news is enshittification is coming to every industry. If it's got a networked computer in it, the people who made it can run the Darth Vader MBA playbook on it, changing the rules from moment to moment, violating your rights and then saying: "It's OK, we did it with an app."

From Mercedes effectively renting you your accelerator pedal by the month to Internet of Things dishwashers that lock you into proprietary dish soap, enshittification is metastasising into every corner of our lives. Software doesn't eat the world, it just enshittifies it.

There's a bright side to all this: if everyone is threatened by enshittification, then everyone has a stake in disenshittification. Just as with privacy law in the US, the potential anti-enshittification coalition is massive. It's unstoppable.

The cynics among you might be sceptical that this will make a difference. After all, isn't "enshittification" the same as "capitalism"? Well, no.

I'm not going to cape for capitalism. I'm hardly a true believer in markets as the most efficient allocators of resources and arbiters of policy. But the capitalism of 20 years ago made space for a wild and woolly internet, a space where people with disfavoured views could find each other, offer mutual aid and organise. The capitalism of today has produced a global, digital ghost mall, filled with botshit, crap gadgets from companies with consonant-heavy brand names and cryptocurrency scams.

The internet isn't more important than the climate emergency, gender justice, racial justice, genocide or inequality. But the internet is the terrain we'll fight those fights on. Without a free, fair and open internet, the fight is lost before it's joined.

We can reverse the enshittification of the internet. We can halt the creeping enshittification of every digital device. We can build a better, enshittification-resistant digital nervous system, one that is fit to co-ordinate the mass movements we will need to fight fascism, end genocide, save our planet and our species.

Martin Luther King said: "It may be true that the law cannot make a man love me, but it can stop him from lynching me, and I think that's pretty important." And it may be true that the law can't force corporations to conceive of you as a human being entitled to dignity and fair treatment, and not just an ambulatory wallet, a supply of gut bacteria for the immortal colony organism that is a limited liability corporation. But it can make them fear you enough to treat you fairly and afford you dignity — even if they don't think you deserve it.

Cory Doctorow is a special adviser to the Electronic Frontier Foundation and a visiting professor of computer science at the Open University. His next book 'The Bezzle', published by Head of Zeus, is out this month. This piece is adapted from his Marshall McLuhan Lecture, delivered at the Embassy of Canada in Berlin last month

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TECHNOLOGY

Top U.S. Venture Firms Funded Blacklisted Chinese Companies, House Committee Says

Report says five firms invested billions of dollars in companies developing technology allegedly used in human-rights abuses and by the Chinese military

By [Heather Somerville](#) [Follow](#)

Feb. 8, 2024 9:00 am ET



A new report called for further restrictions on outbound investment by U.S. firms in Chinese companies such as TikTok parent ByteDance. PHOTO: ANDREA VERDELLI/BLOOMBERG NEWS

Five U.S. venture-capital firms invested a total of at least \$3 billion in Chinese companies developing technology allegedly used in human-rights abuses and to benefit the Chinese military and government, according to a Congressional investigation.

A new report from the House Select Committee on the Chinese Communist Party looks at years of investment from venture-capital firms into artificial intelligence and semiconductor startups in China. Nearly two-thirds of the total invested by those firms, or \$1.9 billion, went to AI companies whose technology

is contributing to China's military buildup and human-rights abuses, the report says. In some cases, the companies have been blacklisted by the U.S. government.

"Decades of investment—including funding, knowledge transfer, and other intangible benefits—from U.S. VCs have helped build and strengthen the PRC's priority sectors," says the report.

The committee doesn't challenge the legality of the investments but calls for policy changes to ensure U.S. venture capital isn't allowed to bolster Chinese national security and surveillance efforts.

The investigation began last year when the committee requested information from venture-capital investors, including some of the largest in the U.S.: Sequoia Capital, Qualcomm's QCOM 1.62% ▲ venture-capital arm, Walden International, GGV Capital and GSR Ventures. The firms invested money in China from U.S. limited partners such as pension funds and university endowments, the report says.

Many of the startup investments in the report occurred years ago, before Washington had designated the companies as national security threats and, in some cases, the venture firms have sold their stakes, the report says.

Sequoia said most of its China investments had been managed by its China arm, which has now become a separate, independent company. Qualcomm said it only had small investments in China. GGV Capital said it has screens for problematic investments and that it, too, is splitting off its China operation into a separate entity.

Walden and GSR didn't respond to requests for comment on the report. GSR said previously the venture partners who worked on the deals scrutinized by the House committee are no longer at the firm.



Washington has sanctioned drone maker SZ DJI Technology as being a surveillance tool used by Beijing. PHOTO: CFOTO/ZUMA PRESS

The report says those five firms combined invested more than \$140 million in AI companies that supply technology to the Chinese military or its contractors and more than \$130 million into AI startups that are flagged by the U.S. government as aiding human-rights abuses.

The committee, set up last year, is increasingly trying to keep American businesses from aiding Beijing's technology ambitions. It aims to slow China's progress in technology that could end up being used against the U.S. in a military conflict or assist Beijing in building up a surveillance state.

"At least in advanced technology sectors, we need to cut off the flow of funds," said the committee's chairman, Republican Rep. Mike Gallagher of Wisconsin. "We can't afford to keep funding our own destruction."

The committee's actions represent a shift in thinking in Washington about U.S. investment ties with China that has put some venture-capital firms in the hot seat. Many in Silicon Valley's venture-capital community, in years past, were eager to invest in China to seize the opportunity of nascent tech companies selling to a large population and growing middle class of eager tech adopters. Washington used to support such investment as a way to encourage reform in China.

Years ago, Sequoia and GGV set up China arms, and others such as GSR and Walden invested in China while keeping their headquarters in the U.S. American

firms provided the seed money for Chinese venture capital to blossom.

A Sequoia Capital spokeswoman said that the company's China unit has always operated with a separate team managing a separate fund and making its own investment decisions, and as of December, the China business had been split off into an independent firm with a new name, HongShan. Sequoia Capital invests in the U.S. and Europe.

"We take U.S. national security issues seriously and have always had processes in place to ensure compliance with U.S. law," the spokeswoman said.

A Qualcomm spokeswoman said its investments are generally small and constitute less than 2% of the total investments in the committee's report.

A GGV Capital spokeswoman said the firm would complete its separation from its China fund by next month and that it has "been in compliance with all applicable laws and regulations" and will abide by any future investment regulations. It is also trying to sell its stake in some Chinese startups.

China has become a less attractive place to invest as U.S.-China tensions have intensified and Beijing's control over the tech sector and capital flows have made investments riskier. U.S. venture-capital investments in China surged from about \$1.2 billion in 2010 to a peak of more than \$19 billion in 2018 and then collapsed to \$1.3 billion in 2022, according to data provided by Rhodium Group.

President Biden last year issued an executive order to prohibit Americans from investing in some Chinese companies developing advanced semiconductors and quantum computers. The Senate last year passed a bill requiring U.S. investors to notify the government when they make certain large investments in certain critical technology from China and other adversaries. The legislation, however, failed after it was cut out of the national defense policy bill.

The new report calls for further restrictions on outbound investment.

It flags more than two dozen artificial-intelligence companies ranging from small startups to large multinational corporations, including ByteDance, the parent company of video-sharing app TikTok, and drone maker SZ DJI Technology.

ByteDance, the report says, raised more than \$1.4 billion from Sequoia's U.S. and China funds and an additional \$600,000 from GGV Capital. ByteDance has raised more than \$9 billion in total. The report says ByteDance has collaborated with companies involved in the repression of China's minority Uyghur population in Xinjiang. DJI has raised tens of millions of dollars from Sequoia's China unit and Walden International, the report says, and has provided drones to the Xinjiang public-security force. Washington has sanctioned DJI as being a surveillance tool used by Beijing.

ByteDance declined to comment.

DJI says it has no ties to the military and discourages the use of its drones in any combat.

"We strongly deny any allegations against DJI regarding human-rights abuses. We have not engaged in any activities that violate or abuse human rights," the company said.

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2nd Circ. Skeptical Of Reviving Investors' Breast Implant Suit

By **Jessica Corso**

Law360 (February 7, 2024, 10:55 PM EST) -- The Second Circuit on Wednesday wondered whether there was enough evidence to revive a class action lawsuit accusing Allergan Ltd. of downplaying cancer risks linked to the company's breast implants, with the judges questioning investor claims that public statements addressing the concerns left out necessary information.

A three-judge panel of the court heard oral arguments in a case filed after French regulators removed Allergan's textured breast implants from the market in 2018 due to concerns that they could cause a form of cancer known as anaplastic large cell lymphoma, or ALCL.

A New York federal judge **granted summary judgment** to Allergan in 2022, ruling that the class hadn't plausibly alleged that the company misled investors in statements made prior to the recall.

The appellate court seemed unwilling to second-guess that opinion, with U.S. Circuit Judges Richard Sullivan and Susan Carney repeatedly asking class attorney Robert Killorin of Faruqi & Faruqi LLP to detail the misleading statements he felt the company had made.

Killorin pointed to a May 2018 press release in which the company responded to media reports about the potential dangers of the implants, accusing Allergan of failing to warn investors about studies showing that its breast implants were more likely to cause cancer than those of its competitors.

"The statement that you focused on was that ALCL has been reported with multiple different implant manufacturers. That is a true statement, right?" Judge Sullivan asked.

"Yes, that is true," Killorin responded.

"But your view is that somehow left the door open for them to then disclose the relative association levels of the different manufacturers?" Judge Sullivan asked.

The judge also responded critically to Killorin's claim that Allergan disregarded the seriousness of the problem by suggesting in a U.S. Securities and Exchange Commission filing that a competing breast implant manufacturer was facing worse problems.

"It doesn't say that. It says there were negative reports in Europe about a breast implant manufacturer not affiliated with the company, that's not what you just said," Judge Sullivan said in remarks about the SEC filing. "That's a false statement?"

Killorin said the remarks were misleading because they referred to allegations against an unnamed manufacturer that occurred years before the SEC filing.

Allergan attorney Jared Gerber of Cleary Gottlieb Steen & Hamilton LLP said that the company highlighted the old controversy concerning another manufacturer because it was a known scandal in Europe and that the statement was meant to highlight for investors that "breast implants are a very sensationalized and politically-fraught area."

Though Gerber faced less pushback from the judges on the nature of the company's statements, Judge Sullivan did refer to Allergan's arguments on the materiality of the statements as "squishy."

Gerber said that, according to the SEC and the Second Circuit, courts need to take into account the importance of a product to a company's bottom line alongside the seriousness of any misstatements allegedly made. Allergan has said in court documents that the breast implants accounted for less than 1% of their annual revenue.

Gerber's balancing standard "seems like a difficult thing for courts to apply," Judge Sullivan said.

After the class, led by DeKalb County Pension Fund, appealed to the Second Circuit for reversal of the summary judgment motion, Allergan counter-appealed to overturn class certification under the 2021 standard set by the U.S. Supreme Court in [Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System](#) .

The class was certified shortly after that decision was handed down, but the circuit didn't address the issue during oral arguments Wednesday.

U.S. Circuit Judges Susan Carney, Richard Sullivan and Eunice Lee sat on Wednesday's panel.

The investors are represented by Robert Killorin and James Wilson of Faruqi & Faruqi LLP.

Allergan is represented by Jared Gerber, Roger Cooper, Abena Mainoo and Sabrina Singer of Cleary Gottlieb Steen & Hamilton LLP.

The case is In Re: Allergan PLC Securities Litigation, case number 23-59, in the U.S. Court of Appeals for the Second Circuit. The underlying case is In re: Allergan PLC Securities Litigation, case number 1:18-cv-12089, in the U.S. District Court for the Southern District of New York.

—Additional reporting by Brian Steele and Hailey Konnath. Editing by Michael Watanabe.

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NYCB Faces Investor Suit Over Signature Bank Takeover

By **Katryna Perera**

Law360 (February 7, 2024, 10:32 PM EST) -- New York Community Bancorp has been hit with a class action by an investor who claims the bank failed to disclose that it had a deteriorating book of loans which would, in turn, cause major losses and force it to cut its quarterly dividend to preserve capital, following its acquisition of assets from the now-defunct Signature Bank.

Walter Edward Lemm Jr. filed a **complaint** Tuesday in New York federal court against NYCB, the bank's CEO Thomas Cangemi, and its Chief Financial Officer John Pinto. The complaint is on behalf of a proposed class of individuals and entities that purchased or acquired NYCB securities between March 1, 2023, and Jan. 30, 2024.

The suit centers on a Jan. 31 disclosure of sharp losses and other developments that NYCB attributed in part to its acquisition of assets from the much larger Signature Bank. Lemm says following this disclosure, NYCB's stock fell \$3.90, or 37.57%, to close at \$6.47 per share on Jan. 31, 2024.

NYCB is a commercial real estate lender in New York City that specializes in rent-regulated, non-luxury apartment buildings, according to the complaint. In March 2023, NYCB acquired certain assets and assumed certain liabilities of the collapsed Signature Bank.

Signature, founded in 2001, had roughly \$110.4 billion in total assets before it was **shut down** last March by the New York State Department of Financial Services, making it the third-largest bank failure in U.S. history. It was the second in a string of bank failures starting days earlier with the collapse of the California-based Silicon Valley Bank, whose operation was popular with technology startups but was rattled by rising interest rates.

Lemm says throughout the proposed class period, NYCB and the individual defendants made several false and misleading statements and specifically failed to tell investors that NYCB was experiencing higher net charge-offs and deterioration in its office portfolio, which in turn would likely lead to higher loan losses. And, as a result, that would likely increase its allowance for credit losses, all of which would adversely affect the bank's financial results.

These omissions began to reveal themselves last month when NYCB announced its fiscal fourth quarter 2023 financial results and reported a net loss of \$252 million due to "a \$552 million provision for loan losses," which was "primarily attributable to higher net charge-offs" and "a significant increase in the ACL [allowance for credit losses]" coverage ratio, according to the complaint.

NYCB also disclosed that it would cut its quarterly dividend to 5 cents per common share to preserve capital and said the reasoning behind its actions was that they were "necessary enhancements" after NYCB "crossed the important threshold [of becoming a \$100 billion bank] sooner than anticipated as a result of the Signature transaction."

Lemm says crossing this \$100 billion threshold subjected NYCB to enhanced banking standards and requirements.

Lemm seeks damages, attorney fees and a jury trial.

Representatives for the parties did not immediately respond to requests for comment on Wednesday.

Lemm is represented by Gregory B. Linkh, Rebecca Dawson, Robert V. Prongay and Charles H. Linehan of Glancy Prongay & Murray LLP and Howard G. Smith of the Law Offices of Howard G. Smith.

Counsel information for the defendants was not immediately available.

The case is Lemm Jr. v. New York Community Bancorp Inc. et al., case number 1:24-cv-00903, in the U.S. District Court for the Eastern District of New York.

--Editing by Jay Jackson Jr.

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Lottery.com Beats Investor Suit Over Pre-IPO Disclosures

By **Sydney Price**

Law360 (February 7, 2024, 8:28 PM EST) -- A New York federal judge has dismissed consolidated securities class actions against third-party lottery website Lottery.com Inc., ruling that while some statements ahead of its 2021 initial public offering were false, the proposed class members failed to allege the defendants intended to defraud investors.

U.S. District Judge Jennifer L. Rochon will allow the investors to file a second amended complaint within 21 days, according to Tuesday's order.

The investors' suit alleges Lottery.com and a few of its executives made fraudulent statements about its internal financial controls before and after its 2021 IPO via a merger with a special-purpose acquisition company, leading to share price damage following the announcement of the major financial restatement.

Judge Rochon said the premerger statements were inactionable puffery, though some post-merger statements were false at the time they were made.

According to the two consolidated suits, Lottery.com acknowledged in July 2022 that its earlier financial statements improperly recognized approximately \$30 million in revenue.

That announcement and others, including news that the company had "substantial doubt" about its ability to operate, caused trading prices for the company's shares to fall from \$1.22 to 29 cents within the month, the suit alleges.

The investors allege Lottery.com's 2021 premerger regulatory-compliance statements were false and misleading when they were made, but Judge Rochon said they do not rise above "generic, indefinite statements of corporate optimism." She also said the premerger proxy statement's projections are protected by the bespeaks-caution doctrine, which says forward-looking statements are not misleading if they are accompanied by sufficient risk disclosures, which Lottery.com had provided.

"The proxy warned that Lottery 'had not been required to document and test [its] internal controls over financial reporting,' and that Lottery's management and auditors had not previously spoken publicly about the effectiveness of the company's internal controls," Judge Rochon said.

However, Judge Rochon said the plaintiffs do adequately allege some of Lottery's post-merger statements over a purported \$30 million sale that never actually occurred, led to overstated revenue and were false or misleading statements of opinion.

"Unlike the financial projections in the [premerger statements], none of the post-merger financial-performance-related statements labeled itself a preliminary estimate," Judge Rochon said.

The suit's individual defendants include, Ryan Dickinson, the company's former president, treasurer and acting chief financial officer; Lawrence Anthony "Tony" DiMatteo III, its CEO and board chairperson; and Matthew Clemenson, its chief revenue officer. Shortly after the July 2022 financial restatement, Clemenson announced his resignation.

The suit alleges the individual defendants knowingly made false or misleading statements given the magnitude of the restatement of revenue and Clemenson's resignation, but according to Judge

Rochon, this is not enough to prove ill-intent.

"If scienter could be pleaded based solely on such allegations, virtually every company that issues a large restatement of revenue could be forced to defend securities-fraud actions – a result that is hard to square with this Circuit's understanding of the law," the opinion said.

Counsel for Lottery.com and counsel for Clemenson and Dickinson declined to comment Wednesday. Counsel for the other defendants and investors did not immediately respond to requests for comment.

The proposed class is represented by Casey E. Sadler, Gregory B. Linkh and Kevin F. Ruf of Glancy Prongay & Murray LLP.

Lottery.com is represented by Lars L. Berg of Kelly Hart & Hallman LLP and Steven P. Benenson of Porzio Bromberg & Newman PC.

Matthew Clemenson and Ryan Dickinson are represented by Franklin Monsour Jr. and Aaron Brecher of Orrick Herrington & Sutcliffe LLP.

Anthony DiMatteo is represented by Tara N. Tighe and Danny C. Onorato of Schertler Onorato Mead & Sears.

The case is In Re Lottery.com Inc. Securities Litigation, case number 1:22-cv-07111, in the U.S. District Court for the Southern District of New York.

--Additional reporting by Katryna Perera and Emilie Ruscoe. Editing by Drashti Mehta.

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Apple Beats Claims It Overpaid CEO Tim Cook, Other Brass

By **Lauren Berg**

Law360 (February 7, 2024, 11:32 PM EST) -- Apple does not have to face an investor lawsuit accusing it of overpaying CEO Tim Cook and other top brass by tens of millions of dollars by improperly calculating the value of performance-based stock compensation, a New York federal judge ruled Wednesday.

U.S. District Judge Jennifer L. Rochon, in a 25-page order, granted the motion to dismiss brought by Apple Inc. and Cook, as well as other executives and board members, finding that shareholder International Brotherhood of Teamsters, Garage Employees Local 272 Labor Management Pension Fund hasn't plausibly alleged any actionable misrepresentations in a U.S. Securities and Exchange Commission filing.

The SEC does not require that a specific method be used to calculate executive compensation — only that the chosen method is disclosed — and the pension fund hasn't shown that Apple broke that rule or that it should have disclosed more information, the order stated.

"The complaint effectively admits (by pasting excerpts of Apple's disclosures in support of its claims) that Apple did precisely what ... SEC rules require — presented its compensation process and methods through detailed compensation tables," Judge Rochon said.

The dispute stems from January 2023 when Apple filed its proxy statement for a March 2023 shareholder meeting, which included disclosures about a vote on executive compensation, according to the order. Apple's executives receive equity compensation in the form of restricted stock units, which are a right to receive Apple stock in the future as long as certain conditions are met, the order stated.

Apple RSUs can vest in two ways: time-based, which usually vest as long as the executive provides services to Apple for a specified period of time, and performance-based, which vest if Apple achieves certain milestones, the order said.

According to the proxy statement, the target equity compensation for officers other than Cook was \$20 million per fiscal year, divided between time-based and performance-based RSUs. For Cook, the target compensation for 2021 and 2022 was \$75 million, divided between time-based and performance-based RSUs.

The target amount for Cook was then lowered to \$40 million for 2023, split 75% as performance-based and 25% as time-based, the order stated. According to the proxy statement, Apple intended to award the other officers \$77.5 million in performance-based compensation in 2021 as well as 2022, and intended to award them \$70 million in performance-based compensation in 2023.

When the fair value of the performance-based RSUs was calculated, the officers were awarded nearly \$93 million in performance-based shares for 2021 and a little more than \$94 million for 2022, according to the order.

The pension fund sued Apple and Cook, as well as other officers and board members, in March 2023, alleging that Apple paid the executives nearly \$32 million more than the intended compensation amount disclosed in the proxy statement. The fund said Apple's compensation committee improperly calculated the fair value of the performance-based RSUs.

"As a result, Apple's [officers] have been improperly awarded excess compensation in the form of RSUs," the complaint stated.

Apple, Cook and the other defendants filed their motion to dismiss in May, arguing that the pension fund ignores law recognizing a company's discretion regarding compensation and that the company's disclosures fully comply with legal and regulatory requirements.

Judge Rochon issued her ruling on Wednesday, just a day after both parties offered arguments at a Tuesday hearing.

Representatives for the parties did not immediately respond to requests for comment late Wednesday.

The pension fund is represented by Jeffrey A. Barrack, Michael A. Toomey and A. Arnold Gershon of Barrack Rodos & Bacine.

Apple, Cook, the other executives and the board members are represented by Jason C. Hegt, Melanie M. Blunschi, Michele D. Johnson and Daniel R. Gherardi of Latham & Watkins LLP.

The case is International Brotherhood of Teamsters, Garage Employees Local 272 Labor Management Pension Fund v. Apple Inc. et al., case number 1:23-cv-01867, in the U.S. District Court for the Southern District of New York.

--Editing by Kristen Becker.

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Bybit Wants \$953M FTX Suit Axed For 'Threadbare' US Ties

By **Alex Wittenberg**

Law360 (February 7, 2024, 5:10 PM EST) -- Cryptocurrency exchange Bybit Fintech Ltd. has urged a Delaware bankruptcy judge to throw out an FTX lawsuit that aims to recover \$953 million that Bybit and affiliates allegedly raced to withdraw before FTX collapsed, arguing that the case has "no connection" to the U.S. and even if it did, FTX's claims all fail.

In briefs filed Tuesday, Bybit and its investment unit Mirana Corp. said that they are incorporated in Seychelles and that FTX's Chapter 11 lawsuit centers on transfers made from one foreign entity, FTX.com, to another. FTX's fraud claims tied to supposedly preferential treatment Mirana received in the lead-up to the exchange's failure are also "specious," Mirana said.

"This case has no connection to the United States and only the barest connection to the underlying Chapter 11 cases," Bybit said in its brief.

Bybit and Mirana said the Delaware court should dismiss the suit because of its "threadbare" connections to the U.S. Mirana also argues that its efforts to retrieve assets from a "'dumpster fire'" of a company do not in fact constitute fraud.

"Such conduct is not fraud — it is common sense," Mirana said in its filing.

FTX **sued Bybit and its affiliates** in November and alleged that Mirana used connections as a "VIP" on the exchange to prioritize its withdrawal requests over those of non-VIP customers. The withdrawals amounted to fraudulent or preferential transfers, according to FTX.

But Mirana said it was simply doing the same thing as scores of other FTX customers, and even if FTX gave it a leg up in the withdrawal process, a "debtor's intent to prefer one customer over another is not fraudulent."

FTX's lawsuit also accused Bybit of seizing FTX Group assets held on the Bybit exchange and refusing to release them until Mirana could finish recovering its cryptocurrency. It said Bybit hadn't returned \$125 million held on the platform and will not until FTX transfers the remaining \$20 million of funds in Mirana's account on the FTX exchange.

Yet according to Bybit, all the accounts held on its platform belong to non-U.S. entities, and only one of them, Alameda, is a debtor in FTX's Chapter 11 case or a party to the lawsuit. The company's terms and conditions state that the platform isn't available to U.S. customers and that any withdrawal disputes must be settled in Singapore, according to the brief.

"The assets in the five non-debtor accounts constitute a majority of the assets in the Bybit accounts at issue — approximately \$103 million of \$122 million, or 84%," Bybit said.

FTX **filed for Chapter 11 protection** in November 2022 and has since launched numerous lawsuits to recover funds for creditors and customers.

In September, FTX **launched a clawback suit** similar to the one aimed at Bybit, alleging that four former employees of an affiliate used insider connections to skip the line for withdrawals in the days and hours before the exchange failed.

Representatives of Bybit and Mirana declined to comment Wednesday. Counsel for FTX didn't immediately respond to requests for comment.

FTX is represented by Adam G. Landis, Matthew B. McGuire, Kimberly A. Brown and Matthew R. Pierce of Landis Rath & Cobb LLP and Steven L. Holley, Stephanie G. Wheeler, Brian D. Glueckstein, Justin J. DeCamp, Christopher J. Dunne and Jacob M. Croke of Sullivan & Cromwell LLP.

Bybit is represented by Karen C. Bifferato of Connolly Gallagher LLP and Peter Friedman, Daniel S. Shamah, Caitlyn Holuta, William K. Pao, Jonathan B. Waxman and Kaitie Farrell of O'Melveny & Myers LLP.

Mirana Corp. is represented by Eric Daucher, Steve Dollar and Victoria Corder of Norton Rose Fulbright and Matthew P. Ward and Morgan L. Patterson of Womble Bond Dickinson.

The adversary case is FTX Trading Ltd. et al. v. Mirana Corp. et al., case number 1:23-ap-50759, and the underlying bankruptcy case is In re: FTX Trading Ltd. et al., case number 1:22-bk-11068, both in the U.S. Bankruptcy Court for the District of Delaware.

--Additional reporting by Lauren Berg. Editing by Rich Mills.

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Matterport Stockholders Say Officials Wrongly Cashed \$225M

By **Nate Beck**

Law360 (February 7, 2024, 8:11 PM EST) -- Shareholders of 3D model maker Matterport Inc. accused top company officials in Delaware Chancery Court of self-dealing by paying themselves performance rewards following a 2021 merger, even though the company hadn't met benchmarks to allow them to cash out \$225 million in shares.

In a partially redacted derivative complaint made public Tuesday, shareholders Laurie Hanna and Vasana Smith accused 30 top company officials of wrongly taking so-called "earn out shares" intended as an incentive for strong stock performance following a 2021 merger that took Matterport public.

Hanna and Smith, however, claim the company never met any of the performance targets that would have allowed company officials to claim the earn out shares.

After a "rigged" process not disclosed in the redacted complaint, the company's board approved the payments anyway in late January 2022, with the company's CEO and board chairman R.J. Pittman and Chief Technology Officer Japjit Tulsı each taking more than a million dollars, the shareholders claim.

The shareholders **filed their lawsuit last week**, naming company investors as defendants, along with funds affiliated with semiconductor and wireless venture Qualcomm and venture capital and investment firms Lux Capital, Navitas Capital, Zigg Capital, Wafra and Felicis.

Hanna and Smith argue a 2021 merger agreement with investment firm The Gores Group LLC provided that earn out shares could be claimed if Matterport's stock exceeded a series of six targets for 10 of 30 consecutive trading days during a five-year period that began on Jan. 18, 2022.

Since the period began, the company hasn't met any of the six targets "even on one day," the shareholders argue.

Company officials, however, knew Matterport stock would face downward pressure ahead of the Jan. 18 deadline since 69 million shares of the company locked up after the 2021 merger were set to be released on that date.

Matterport's former CEO, William Brown, **won a separate case** in Delaware's Chancery Court that allowed him to unload all of his 5.7 million company shares at an average price of about \$14.09 a share before the lockout period ended. The sale depressed the company's stock price even further, Hanna and Smith claim.

In his lawsuit, Brown claimed Matterport had imposed restrictions on his company shares in violation of several agreements, including by attempting to limit his trading of the stock during the lockout period. Delaware's Supreme Court in July 2022 upheld a lower court ruling allowing him to trade his shares.

Other claims from Brown alleging breach of fiduciary duty against the company's former directors are set for post-trial arguments in Chancery Court later this month.

On Jan. 18, 2022, the first day of the earn out period, Matterport's stock closed at \$12.89 a share.

The stock needed to hit \$13 a share in order to meet the first benchmark triggering earn out period payments. Hanna and Smith said the company's stock price has never reached that threshold.

The company nonetheless used a faulty process to count fake triggering events in order to issue the earn out shares on Jan. 31, 2022. Hanna and Smith argue that on Feb. 1, 2022 — the day the earn out shares were issued — Pittman, Tulsi, Chief Revenue Officer Jay Remley and Chief Financial Officer James Daniel Fay each sold their shares for \$9.59 per share.

The complaint redacts the amount that shareholders argue top company officials received from cashing out 23.4 million in company shares.

Matterport that same day reported in a filing with the U.S. Securities and Exchange Commission that each triggering event needed to claim the earn out shares had been met.

None of the parties immediately responded to messages seeking comment Wednesday.

The shareholders are represented by Andrew S. Dupre of McCarter & English LLP, Edward S. Haber of Shapiro Haber & Urmy LLP, Steven J. Toll, Julie Goldsmith Reiser, Richard Speirs and Amy Miller of Cohen Milstein Sellers & Toll PLLC and Peretz Bronstein of Bronstein Gewirtz & Grossman LLC.

Counsel information for the defendants was not available.

The case is Laurie Hanna et al., v. R.J. Pittman et al., case number 2024-0088, in the Court of Chancery of the State of Delaware.

The earlier case is Brown v. Matterport Inc. et al., case number 2021-0595, in the Court of Chancery of the State of Delaware.

--Additional reporting by Dave Simpson and Leslie A. Pappas. Editing by Michael Watanabe.

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Del. Dispatch: Clarification On Fiduciary Duties Of Controllers

By **Gail Weinstein, Philip Richter and Steven Steinman** (February 8, 2024, 10:11 AM EST)

On Jan. 24, the Delaware Court of Chancery issued an important post-trial opinion in *In re: Sears Hometown and Outlet Stores Stockholder Litigation* that **clearly set forth** for the first time the fiduciary duties and standard of review applicable when a controller uses stockholder-level voting power to block actions the company's board has determined to be in the company's best interest.

The court held that Eddie Lampert, the controller of Sears Hometown and Outlet Stores Inc., had fiduciary duties, albeit of a limited nature, when he acted by written consent to amend the company's bylaws and remove two directors in an effort to block a plan, adopted by an independent committee of the board, to liquidate the company's unprofitable Hometown segment and continue its profitable outlet segment.

The court, applying enhanced scrutiny review, found that Lampert had complied with his fiduciary duties.

Key Points

Controllers have limited fiduciary duties when voting to block board actions.

The court, for the first time, clearly established that controllers have certain limited fiduciary duties when exercising their stockholder voting power to alter the status quo.

In this context, the court held, controllers have duties of good faith and due care that demand that they not harm the corporation or its minority stockholders intentionally or through grossly negligent actions. They do not have the higher-level duty that directors have to act affirmatively to promote what they believe is in the best interest of the corporation.

The court observed that there have been conflicting strains of Delaware authority as to whether controllers acting in this context have fiduciary duties. Some decisions assert that a controller can exercise stockholder-level rights free of fiduciary constraint, just as noncontrolling stockholders can. Other decisions assert that fiduciary duties do apply when a controller exercises stockholder-level rights, though they do not define these duties well.

Controllers have other fiduciary duties when influencing the board.

The court noted the other, more familiar, context in which a controller's actions implicate fiduciary duties, which was not at issue in this case. In this other context, Delaware authority has been clearer.

When a controller uses "its influence over the board and management to wield corporate power indirectly and cause the corporation to act," the controller, as it has "effectively move[d] into the boardroom," becomes subject to the same fiduciary standards that apply to directors.



Gail Weinstein



Philip Richter



Steven Steinman

Enhanced scrutiny review applies.

The court also held, for the first time, that enhanced scrutiny review will apply to evaluate controllers' conduct when they exercise stockholder-level voting power to change the status quo.

Enhanced scrutiny, which is Delaware's intermediate standard of review, will apply, the court ruled, when a controller:

- May have had subtle conflicts — that is, no conflicts so stark, such as in a self-interested transaction, that they would give rise to stricter entire fairness review; and
- Also took action in areas traditionally reserved for the board.

Under the enhanced scrutiny standard, controllers bear the burden of proving that they acted in good faith, after a reasonable investigation, to achieve a legitimate objective, and that they used reasonable means to achieve the objective.

In this case, "While the actions [Lampert] took affected all stockholders equally, he had business agreements with the corporation [namely, certain related-party agreements entered into when the company was spun off from Sears Holdings Corp.] that could have skewed his judgment" — although these agreements tended to favor the company, the court noted. Lampert also acted in an area traditionally within the board's province, namely, deciding whether to liquidate a business.

Controllers can use stockholder-level powers to block board actions.

The decision confirms that a controller can intervene to block a board from pursuing its chosen course of action — subject to the limited fiduciary duties discussed above when the controller is affirmatively exercising voting power to change the status quo.

The court expressly rejected the plaintiffs' argument that such an intervention is inherently inequitable and always constitutes a breach of duty because it trespasses on the board's right to manage the affairs of the corporation.

Based on this decision, it appears that when a controller amends bylaws or removes directors — that is, changes the company's governance — to block a board's chosen course of action, the court will view the controller as having used its voting power to affirmatively change the status quo, even if the controller blocked the board action in order to preserve the company's operational status quo.

Lampert had, and complied with, limited fiduciary duties.

The court held that, as Lampert affirmatively exercised his voting power to change the status quo, he was subject to limited fiduciary duties. Under enhanced scrutiny review, he satisfied those duties.

The court found that Lampert acted in good faith, with the legitimate objective of blocking what he believed, after a reasonable investigation, to be a value-destroying plan. He used reasonable means, as the bylaw amendment and director removals "were drastic but necessary" to achieve his objective, given that the board could not be convinced to drop its plan; was not open to negotiating alternative routes, such as Lampert's acquiring Homeland's inventory, Homeland itself or the entire company; and was moving unilaterally to implement its plan.

Limited fiduciary duties should not present a significant obstacle to controller actions.

We note that duties not to harm intentionally or through gross negligence should not present a significant obstacle to controller actions. These fiduciary duties are far more limited than those that apply to directors.

The court observed that, while some controller interventions involve "'bad guys' seeking with guile to protect or advance private interests," others simply involve a board and a controller having "differing,

but plausible, conceptions of what constitutes right action in the circumstances."

Background

The Sears Hometown and Outlet Stores company was spun off from Sears Holdings Corp. in 2012 and became a separate, publicly traded entity. In the spin-off, the group of investment funds controlled by Lampert, which held a majority of Sears Holdings' common stock, received a majority of the Sears Hometown and Outlet Stores' common stock.

Lampert had been a largely supportive and passive investor, although the company had performed poorly. Neither Lampert nor any of his affiliates or close associates sat on the company's board of directors.

The company's Hometown segment, which represented about two-thirds of the company's assets and revenues, had been unprofitable for years — a bad business, in the board's view, and the outlet segment had recently become profitable after several years of unprofitability — a good business.

The committee endorsed a plan to liquidate Hometown and continue to operate the outlet branch. Lampert believed, and tried to convince the board, that this plan would destroy value. The board disagreed.

To avoid the board implementing the liquidation unilaterally, Lampert offered to buy the company for \$2.25 per share. The board rejected the offer and ultimately countered by asking for \$9.50 per share, which Lampert viewed as totally unrealistic.

Lampert suggested alternate routes, but the board rejected them. Lampert then effected the controller intervention.

Minority stockholders brought suit, claiming that Lampert had breached his fiduciary duties by using his stockholder voting power to block the liquidation plan. Vice Chancellor J. Travis Laster held that while Lampert did indeed have limited fiduciary duties, he had fulfilled them.

Discussion

Lampert believed the board's plan would be value-destroying.

Lampert believed that the committee was overestimating the proceeds that the Hometown liquidation could generate — as it would involve over 500 stores being liquidated over just eight weeks, while the company's valuation was based on its prior liquidations that had involved no more than 20 to 30 stores at a time and had taken place over a period of years.

Lampert also believed that the committee was underestimating the liabilities that would arise as a result of the liquidation, as it would cause the stores' dealer agreements to be breached, and thought that the committee was overestimating the performance of the outlet segment going forward. The outlet segment had just become successful after years of unprofitability; it might not have the necessary scale as a stand-alone entity, and it would have to assume all the liabilities arising from the liquidation.

Lampert's concerns intensified after he found no detailed analyses in the company's data room that addressed these critical issues.

Lampert acted by written consent to amend the bylaws and remove two directors.

The bylaw amendment required that a Hometown liquidation receive approval from 90% of the board at two separate board votes taken at least 30 business days apart. If the liquidation received the necessary votes at the first meeting, the board would be required to disclose the result to the stockholders.

The amendment thus did not prevent the board from pursuing the Hometown liquidation, but, as a practical matter, created a window during which Lampert could take additional actions to stop the liquidation before the second meeting. Lampert acknowledged at trial that he intended to not let the

liquidation go through.

Lampert removed the two directors who, when he had met with the committee, were the most vocal supporters of the liquidation. He filled the resulting vacancies with two individuals whom he did not know personally but had been suggested to him by a friend who was a managing partner at a private equity firm. The court commented that "Lampert could be confident that [they] would support his interests, even without any direct ties between them."

Lampert sent a letter to stockholders announcing the bylaw amendment and removal of directors, and explaining his strong disagreement with the board's liquidation plan.

Consider these observations about Lampert's fiduciary duties.

The court found Lampert's true objective was not self-interested.

The board ultimately negotiated with Lampert for him to buy the company, given that Lampert had blocked the Hometown liquidation and the board believed it was not sustainable to continue with both segments. We note that if the court had viewed this end-stage transaction or some other self-interested transaction as Lampert's real or ultimate objective, the court likely would not have concluded that he had complied with his fiduciary duties in blocking the liquidation plan.

The court emphasized that it was the committee that ultimately wanted Lampert to acquire the company, while Lampert's true objective all along was simply to block the liquidation plan that he believed was value-destroying.

The court agreed Lampert's liquidation analysis was correct.

Query to what extent the court's result was influenced by its view, which it expressly stated, that Lampert was correct that the liquidation plan would be value-destroying.

Certainly, a correct view is not required for a finding of compliance with fiduciary duties, but the court's view of the correctness, or lack thereof, of a controller's decision may influence the judicial result.

These factors may distinguish the case.

We see three potentially distinguishing features of this case.

1. Lampert had such a high level of expertise and experience, including specifically with liquidations, and the committee had apparently ignored some important real-world implications of the liquidation plan.
2. Lampert had been a largely passive investor in the company — and, indeed, in all the public companies in which he had invested. He had never before acted by written consent to amend bylaws or remove directors.
3. As the court noted, Lampert took action that was less drastic than he might have taken. His bylaw amendment did not prevent the liquidation plan, and regarding the board of directors, he removed only two directors, whom he did not replace with himself or individuals he controlled.

Practice Points

Controllers may have limited fiduciary duties when exercising stockholder voting power.

Based on this case, a controller has no fiduciary duties to the corporation and its minority stockholders when the controller:

- Decides not to sell its shares;
- Decides not to vote its shares;
- Acts to prevent dilution by the board of its control position; or

- Votes its shares against "a transaction that would alter the status quo."

However, a controller likely has limited fiduciary duties — that is, not to harm the corporation or its minority stockholders intentionally or through gross negligence — when the controller is:

- Deciding to sell shares; or
- Exercising voting power "affirmatively to change the status quo."

Of note, the decision seems to indicate that the court would view a controller's amending the bylaws or removing directors as exercising voting power affirmatively to change the status quo — even if the controller is seeking to preserve the company's operational status quo by blocking a board plan that would change the status quo.

Take appropriate care when voting to block board actions.

In Sears Hometown, although the controller had not prepared detailed analyses supporting his view, he had engaged in discussions with the committee, management and the board; understood the board's plan; and had sufficient information — including, from his own experience, about the perils of retail store liquidations, especially in a nonbankruptcy context, to make an assessment that was not grossly negligent.

Consider not fully blocking a board plan.

In Sears Hometown, the court viewed it as a factor in Lampert's favor that the bylaw amendment did not block the liquidation plan, although this provided Lampert with another opportunity to block it.

The court also noted that only two directors were removed, and they were replaced with individuals not closely associated with Lampert, although the court viewed them as likely to support the controller's interests.

Where a controller takes a series of actions, different levels of fiduciary duties may apply.

If, for example, a controller seeks to block a board plan and also seeks to buy the company, limited fiduciary duties may apply to intervening with the board plan, while buying the company would be subject to entire fairness.

In this situation, a controller should maintain a record that reflects that the objective to block the board plan is motivated by the controller's views about the plan, not by a desire to acquire the company.

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This article is part of a monthly column that delves into the most significant corporate law cases emerging from Delaware and offers practice points arising from recent court decisions.

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Insurer's Suit Over Class Action Coverage Early, Covisint Says

By **Emily Enfinger**

Law360 (February 7, 2024, 6:21 PM EST) -- An insurer's lawsuit seeking to dodge coverage for an underlying shareholder class action alleging an unfair merger should be dismissed, former Covisint executives told a Michigan federal court, saying the issue of coverage is not ripe for dispute.

The group of former Covisint Corp. officers and directors **argued Tuesday** that Wesco Insurance Co.'s lawsuit lacks subject matter jurisdiction, saying the underlying action is still roughly four months out from trial.

"At this point, this case is seeking nothing but an improper advisory opinion," the former executives said.

Should the court decide not to toss the insurer's lawsuit, the former executives urged the court to consider halting the coverage fight until the shareholder suit is resolved.

The coverage fight began in July when Wesco asked the court to agree that the policy it issued to Covisint does not provide coverage for the underlying suit because the damages it sought are excluded from the policy's definition of "loss."

The shareholder action was first filed in 2017, shortly after the agreement with OpenText to acquire Covisint at \$2.45 per share was announced. The suit, **which won class certification in October**, alleged that Covisint's cash-out merger was unfair for shareholders and was "significantly below the indications of interest the company received from other bidders between February 2016 and February 2017, which ranged as high as \$3.75 per share."

Representatives for Wesco, Covisint's parent company, OpenText, and the Covisint executives did not immediately respond to requests for comment.

Wesco Insurance Co. is represented by Nicole E. Wilinski of Collins Einhorn Farrell PC and April H. Gassler of Sperduto Thompson & Gassler PLC.

Samuel M. Inman III, John F. Smith, Bernard M. Goldsmith, William O. Grabe, Lawrence David Hansen and Enrico Digirolamo are represented by William H. Horton and John R. Fleming of Giarmarco Mullins & Horton PC.

OpenText is represented by Edwin M. Baum of Perkins Coie LLP and Jewel Haji Boelster and Nick Gorga of Honigman LLP.

The case is Wesco Insurance Co. v. OpenText Corp. et al., case number 2:23-cv-11816, in the U.S. District Court for the Eastern District of Michigan.

--Additional reporting by Carolyn Muyskens. Editing by Emma Brauer.