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TRANSCRIPT

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Life Sciences Quarterly – Preparing for and Managing a Stock Drop

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Randy Bodner: Good morning, everybody. I have done securities litigation and various types of SEC and government enforcement work at Ropes for a long time. I used to run our BSL group—our Business Securities Litigation group—and then, consistent with the Peter principle, I'm now on our management committee, but with me are actually a few people who really know what they're talking about.

Jeremiah Williams is just fresh over from the SEC Staff in Washington, out of our DC office. And we're going to talk a little bit about SEC enforcement, although that's not the main topic, but if anybody has any questions about what's going on at the SEC, that's fair game as well. I mean the real answer to that is who the hell knows with Trump in terms of what's going to be going on at the SEC. And then Matt McGinnis is one of our young star partners who does a lot of M&A and securities litigation.

This is a topic that is, especially in the biotech health care pharma space, is something that if it's not on your radar screen, it should be. And I'm going to go through generally what's going on in the securities litigation market and, in particular, what we're seeing and what we're going to see in terms of pharma biotech in the health care space.

Securities litigation has really been ramping up over the last several years. And 2016 was very much a record-setting year. And what happens is that effectively what is going on within any public company is whenever you have a stock drop, more likely than not, anywhere from 5% and above these days . . . if you have a stock drop you're very likely going to get a securities litigation suit. And I can talk about why in a few minutes.

The one thing to keep in mind is that even though a securities class action is supposedly based on fraud, it doesn't matter why, or what led to the precipitous drop in your stock. They don't care. The plaintiffs' lawyers—you need to think of them more as entrepreneurs and you need to think of them more as muggers than anything else. What they do is they see a stock drop and they're going to sue you, and they'll come up with the theory later. I mean, the comparison I've made to the class action plaintiffs' lawyers is that they're ambulance chasers, although I think that's an insult to ambulance chasers, because with ambulance chasers at least there is an accident, and there need not be an accident in securities litigation.

What there needs to be is a stock drop and what you'll find and experience—and one in twenty public companies have experienced this in 2016 alone, so it is rampant. One in twenty public companies in this country in 2016 either were dealing with or were at the target of various types of the class action securities bar. And what happens, you get a dip in your stock, then what happens is you'll see the plaintiffs' lawyer start trolling for various clients. They'll send out releases announcing that they're doing an investigation of this particular company and if you have any information, or even better, if you own the stock at that particular time, it's literally, you know sort of, like the medical mal[practice] people. I mean they're out advertising for clients.

Then what will happen is that—usually it's within two weeks of a stock drop; sometimes, it's a little longer—you'll have a complaint that's filed. It's a placeholder. It says a lot of nothing, but it sets in motion a food fight among various plaintiffs' lawyers under the statute that regulates this as to who is going to be the lead plaintiff in the litigation. And who becomes the lead plaintiff is who has the most clients or the single client who has the most shares at issue. Pension funds have jumped into this. You see a lot of cases that are headed by pension funds, mainly because the pension funds have liaisons with the plaintiffs' counsels and relationships with them, and effectively it's a system where the plaintiffs' lawyers and the pension funds are very tapped in to sue. And again, they're not suing based on fraud.

The good thing that happens under the statute, and Jeremiah will talk about it a little bit more, is what you do have in your favor is a thing called the PSLRA, which requires the plaintiffs to get over a larger hurdle than most plaintiffs have to do in litigation, and there's a discovery stay which is critical because that's where the millions and millions of dollars are spent in litigation if they can get beyond the threshold on a complaint. Jeremiah, why don't we get into some of the statistics now.

What I was saying is that in 2016 there were 300 class actions that were filed in that year alone. That is, over the last several years, the run rate has typically been around 220, 221 cases. It was 300 in this past year. I was out with some insurance executives last night—D&O insurance executives last night in New York—and at the current run rate, it looks as though there could be upwards of 400 actions that are going to be filed in 2017 if the current pace is at it. So there is a lot going on out there, and if we can show the trend, some of the increase has been due to, and I won't bore you with too much of it, but because Delaware has finally—the chancery court—dropped, set higher standards and prevented some of the abuse that's going on in bump-up litigation and M&A litigation. You're finding a lot of plaintiffs now leaving the chancery court in Delaware and bringing Section 14 cases in the federal court. [*Referring to slide titled "Recent Trends in Stock Drop Cases":*] That's the yellow that explains a little bit of the uptick, but even if you look at sort of the traditional type of 10b-5 class action, there is a definite trend that's going up. Part of it, I think the trend, particularly you've seen an uptick since November, and there's a little bit of silver lining here. Not to get into any politics and maybe the only silver lining and as far as I'm concerned with the Trump election is that I think there is an anticipation that there is going to be some class action and tort reform that's going to be taking place. So the plaintiffs' lawyers are literally out trying to get a pipeline of cases going before the Republican White House and the Republican Congress put in place, it's anticipated, some type of class action and tort reform. So the plaintiffs lawyers are really out bringing even more marginal cases than usual to try to get a pipeline going, so we think that a lot of the uptick in part is driven by, believe it or not, the election dynamics.

Now, for people in the pharmaceutical, biotech, and health care area, we've had the bad news of the uptick in litigation, it's worse news as far as you're concerned because in 2016 alone, there were 85 of the 300 securities lawsuits were filed in your space. That is double what it was the year before. So the health care space and the pharma space are getting a lot of attention from the plaintiffs' bar. I mean you are the flavor du jour. We've not seen that kind of concentration in an industry since post-2008 and the financial crises among financial stocks. So you guys are very much in the crosshairs of the plaintiffs' bar. And they're getting smart on FDA processes. They're getting smart on the industry. They know the weak spots. They know what to look for, and that's not good news for you. So it is one of those things that, you know, being a little forewarned is being forearmed for anybody who's in the industry these days in terms of the securities plaintiffs. And this is just a graph in terms of the biotech pharma and health care area. This is showing—you know, you'd like to see your stock do this, but this is not a good growth chart. Um, this is the attention that everyone in your space is getting from the plaintiffs' bar.

Matt McGinnis: So I let Randy give you a bit of horrible, horrible news, and at least I get to start with one tiny piece of good news here, which is the one bright spot in 2016 is that it was the first year since the Private Securities Litigation Reform Act was passed in 1995 where the number of dismissals actually exceeded the number of settlements. So the number is going up, but we are seeing at least some positive development that, you know, courts are willing to dismiss these at the outset at a motion to dismiss rather than necessarily go into discovery. Not to say that, you know, there's a truly definitive trend there, but, you know, it's good to see, for example, that there's 149 dismissals out of compared to that roughly 300 securities filings in 2016. In terms of settlement amounts, you know, I think there is a steady trend here where the median and the average continue to go up a little bit compared to prior years. You'll see that there's a pretty big discrepancy there between the median and the average. The reason for that is most years there's typically a small number of truly mega settlements, but if you throw those out, I think that the settlement range for most securities class actions is pretty predictable.

Randy Bodner: The median is really the number that you look at, cause it gets so skewed, you know, you've got to throw out the East German judge and the U.S. judge because of the mega settlements, but the median is really the number you look at.

Matt McGinnis: And that median is pretty predictable and stays pretty steady year-to-year. The average will change because of a few mega settlements. You know, in terms of what prompts the stock drop, obviously I think you guys know this probably better or at least as well, if not better than we do. I mean I think for most public companies there's obviously a standard set of things that can prompt a stock drop, which is, you know, earnings or results that are lower than expectations. What's unique about your space is I think there's an additional set of triggers, which are a series of bilateral events such as a regulatory event, you know, a PDUFA date, a clinical trial outcome that doesn't turn out the way that you expect. All of those, as many of you probably know, can provoke a stock drop, and it may be a blip on the radar screen, it may only last a couple of days, but it may be enough to at least prompt the attention of some plaintiffs' firms and at least for them to begin to consider whether or not a securities class action should be filed.

So what do they look at? You know, to Randy's point, you'll see a long list of things appear that plaintiffs focus on when they consider whether to file a complaint. Nowhere on this list is fraud or any suggestion that somebody lied or that some information was withheld. What plaintiffs' firms are focused on is whether or not they can write a complaint in a way that will get over a motion to dismiss. They aren't necessarily focused on what they can prove at trial, which may or may not ever happen, but if they can get over a motion to dismiss, they know they have some settlement leverage down the road. And so what they're focused on isn't necessarily even just the statements that were made that purportedly inflated a stock and may have, you know, resulted in a corrective disclosure down the road, but really a lot of smoke around the complaint. So for example, they may look at the market cap loss that's at issue here, first of all, just to sort of get a sense of what the settlement leverage may be down the road. They're going to look at Form 4 filings to get a sense of when people are trading—executive officers and management are trading up to the corrective disclosure date. They're going to look at a history of regulatory issues. The regulatory issues may have nothing to do with the actual issues and the alleged stock drop, but if they can throw that in and suggest that there is a pattern of regulatory enforcement issues or a pattern of compliance issues, or even a historical restatement, they're going to throw all of that in, and it's essentially, they're throwing spaghetti against the wall to see what they can get a judge to consider to get over the motion to dismiss.

Randy Bodner: And where they particularly make cases in the clinical trials context—because you're going to be saying good, nice things about the progress of the clinical trials as a forward-looking statement, but if the results come out that there, you know, when it's unblinded and it's disclosed and it leads to a stock drop, you know, plaintiffs love grabbing on to the flowery language that your CEO was talking about the clinical trials in order to take a run at the company.

Matt McGinnis: And then, just one note on the last point here, the 90-day bounce-back rule, this isn't necessarily so much relevant to whether or not a first plaintiff will file a complaint within a couple of weeks after a stock drop, but more as to how things play out down the road. So essentially the 90-day bounce back rule in the PSLRA limits the damages that a class action plaintiff can recover to the average trading price in the 90-day period after that stock drop, which means that if you have a short momentary drop followed by a steady increase, it can actually limit the damages quite significantly. The way that plays out in the litigation is, you know, Randy mentioned that there's sort of this food fight between competing plaintiffs' firms to figure out who's going to be the lead plaintiff, you know, that process takes 60 to 90 days to play out which means that a lot of plaintiffs' firms and potential plaintiffs may be sitting on the sidelines to see how that stock price plays out before they decide whether or not to file that motion for lead plaintiff. So even though the stock drop may be significant right away, the subsequent performance can actually have a meaningful impact on, you know, what plaintiffs, firms jump into them.

Randy Bodner: And if you have a stock repurchase plan, it's not a bad time with that 90-day period to, you know, pursue that program, particularly if you think the drop has your stock undervalued, because it has a therapeutic effect of, you know, helping bring your price per share back up, which can help you on the 90-day bounce-back.

Jeremiah Williams: So, now we're going to talk about preparation that you can take and steps you can take before the stock price drop happens. So, we have an action plan here. The first step of the plan is to make sure the board is informed and make sure they're prepared for what's going to happen. You know, Randy talked about the press releases. So if you have plaintiffs' firms sending press releases out looking for clients, these press releases are going to be talking about your company, your products—make sure that's not a surprise for the board. You also want to think about overall messaging for employees. This can be a little bit tricky because unlike with the board, where those communications can be protected under the attorney-client privilege, that's generally not going to be the case for broad messaging to employees. You just want to be very thoughtful about that. You want to be consistent about that.

Randy Bodner: You have to assume whatever you say to your employees is going to get out into the public market. You just have to assume that.

Jeremiah Williams: And, insurance—so this is really the right time to be thinking about insurance. You don't want to wait until later when you're actually in litigation, and Randy's going to talk about insurance a lot more in a minute, but you want to assess your insurance coverage. And then you also want to think about other various external constituencies as well—regulators, auditors. And then the last point I have here in terms of potential individual defendants: sometimes, plaintiffs' firms will look and think about identifying some senior officers—the CEO, the CFO, the chief medical officer. You want to start thinking about that, and one thing that you can do there is to look at trading history, look at statements and see if there's anything that you can do as far as looking at that.

So thinking ahead—the first thing we have here is, you know, the attorney work product and attorney-client privilege. This is very important during this period. One thing you can do to make sure that you're as protected as you can be is to loop in internal or external counsel into your communications, to really try and give yourself the full protection. On the previous slide we talked about how you can have individuals named and how senior officers can be involved in this. So, looking at trading activity, seeing who is trading, what trading they've done, taking a look at your policies and procedures in terms of insider trading—do you have a 10b5-1 plan, do you want to think about having a black-out period during this time if there's been an event or something is coming up? And the last point here is particularly important where I have email, and the concern about email is that a lot of these emails are going to become discoverable at some point, and you don't want emails where something can be taken out of context that would hurt you. If you have emails where someone is saying, you know, gee, I knew this was going to happen. Or, you know, emails that someone can get, like, a sound bite that appears in a motion someplace, that can be troubling. So just be very thoughtful about communications.

Randy Bodner: But don't send out the email telling your people not to do things by email, which I see in a lot of cases.

Matt McGinnis: Yeah, "We shouldn't discuss this in email" looks not so good.

Jeremiah Williams: Yeah, just take it offline.

Audience member: Is there something you can put in the "Re:" line as far as, like, attorney-client privilege or things like that that will help make it not as discoverable?

Randy Bodner: Yes, you can put attorney-client privilege on that.

Audience member: But does that help you?

Randy Bodner: It does, especially if you have—for the most part, you have to have counsel on that correspondence. So what I would do—what you don't want to do is see a lot of C-suite chatter in your email around a stock drop that at least doesn't have your general counsel or even your outside counsel. You know, you would like to have a lawyer because if people wanted—and look, at these companies everybody does things—it used to be people did it by conversations. You know, I'm an old mob prosecutor, my ill-spent youth and if you—you know, the saying is that you would rather talk than write, you'd rather nod than talk, and you'd rather wink than nod. You know, that's—you'd love to have things—now everybody has to put everything in an email. And at a minimum—and that's not going to change—but at a minimum, when it really gets to a situation where you have a stock drop or, God forbid, you're anticipating a stock drop, that chatter you'd like covered under a privilege as much as possible. The other little—yes, sir?

Audience member: Should you have an email policy where you eliminate email just as a—?

Randy Bodner: Number one, good luck with that. Good luck with that, because there's no such thing as eliminating an email. And that's what we put here, you know, email is both your friend and your enemy because at the end of the day, you know—they talk to me about "What's the email policy that this company should have?" It's like, "Well, do you have good emails or bad emails?" Because if you have good emails, you'd want to keep them because that's really helpful when I go to deal with this case. If they're bad, then you really don't want to have it. What you don't want to do is destroy emails, and we'll get to that in a little bit, but preserving evidence is really, really critical. Once the crap hits the fan and the lawsuit starts, if you have a record of executives destroying emails, that is not where you want to be.

Audience member: That's not what I was saying—

Randy Bodner: No, no, I understand. Of course not, of course not. I'm just saying you want to make sure that you're preserving things once it hits, and we'll get into that.

The second little practical thing I'd say is your Section 16 officers who are going to be trading and presumably, hopefully most of them are going to be doing it on a 10b5-1 plan, I would really recommend, even though you're not required to put on the Form 4 that they're filing that this was pursuant to, if it's true, that it was pursuant to a 10b5-1 plan, because what plaintiffs love to do is talk about motive and opportunity, and where you had insider sales before a precipitous stock drop, that's manna from heaven for the plaintiffs' bar because it looks like they were trying to dump their stock, knowing that the decrease was going to come, when this was done to a preprogrammed 10b5-1 plan. If you put it on the Form 4 itself, that helps me as the litigator before the court saying, "This was a preprogrammed trade." You can't draw an inference from this. It's harder to do that and argue that in a motion to dismiss if it's not on the Form 4.

Matt McGinnis: Just one practical point back to your question about the emails. The reason it can be often useful just to use the word "privileged" even if the lawyer is on it, is that when it comes to discovery, typically you're running search terms on all of these things, and then one of the first things that we do as litigators is take a list of standard search terms like attorney-client, privilege, work product, and then take all of those emails and put them to the side. And sometimes they're going to be in agreement that we don't even have to review each of them individually or we don't have to log them individually, but if you don't have those words on there, even if an attorney is on there, they may still be subject to the typical review process and then you get into this fact-based debate as to whether or not it's privileged or not.

Randy Bodner: I can't emphasize this enough, is that there are—you can count—the 300 cases and the thousands of 10b-5 class actions that have been filed over the years, I can count on one hand and have fingers leftover how many of those cases ever really ultimately get tried. They either get dismissed at an early stage in a motion to dismiss or at summary judgment, or they get settled. And the vast majority of them get settled. And you would much rather settle those cases with insurance money than you would with your company's money. And having a really good D&O policy—and remember, my philosophy is that insurance companies are in the business of not paying insurance, and you need to have a very good policy in order to protect you. If you look at just one thing you take away from today, it's everybody in this space is under, you know, in the crosshairs of the plaintiffs' bar, a lot of people are getting sued. It doesn't require bad people to do bad things. All you need is a stock drop, and at the end of the day you're going to want to have really good insurance, and you're going to want to look at your insurance policy to make sure that there aren't any landmines or holes in there. Most of the policies that are out there today, because it's a competitive market with a lot of capacity, have good terms, but I can't tell you how many, sort of, new clients where I've stepped in and I've looked at their D&O policy and they've got problems with them. And I'll tell you, when you look at your policy for the first time when you've been sued, that's the first minute it's too late to do a damn thing about it. So you really, really want to make sure that your D&O policy is in good shape, because even in the best of worlds where you get it dismissed, it will cost you a lot of money just to get rid of this litigation, even at a motion-to-dismiss stage, and that should be more on your insurance company than it should be on you.

Matt McGinnis: So everything that we just talked about are, you know, ideally, things that you should be thinking about before you're sued. You know, one thing I think to really try to hammer home today is that there is a fairly standard choreography to the way these things play out after a stock drop, and especially if you're at a company that has not, for example, been subject to a securities class action lawsuit before, the more you can do to be proactive and think about these things before that lawsuit hits so you're not acting purely reactively, you can set expectations for, you know, management and, to the extent possible, employees. Everybody is going to be better prepared for what exactly is going to come down the road. So, you know, now after the complaint hits, hopefully you've already sort of through a lot of these things and you're prepared and, you know, been able to advise your board to the extent possible on what exactly is going to happen.

We've talked about a lot of these already, just a couple of—actually, three points to make on this. One, you know, to Randy's point on the D&O stack, hopefully you've already done that analysis. You know, the more you can communicate proactively with them up front and have your counsel communicating with them, the better it's going to play out down the road. You know, in my experience, and I'm sure you guys would agree with this—well, we'll find out, I guess—is if you can be proactive in communicating with them, letting them know what's going on, it's going to help make sure that they feel like, you know, the folks at your insurers can be working with their management, so that in the event that you need to settle some point down the road with insurance money, everybody's expectations are set and it's not—you're sort of not digging yourself out of a hole to make sure that everybody knows exactly what the risk is.

The second point there—targeted merits assessment. Remember that when you get that first complaint, that is highly unlikely to be the complaint that will actually be litigated down the road. The first complaint is a placeholder complaint that somebody has put together probably in 48 hours based on what they've seen in public disclosures and what they can pull together from EDGAR. You know, what will then happen is the process whereby, you know, there will be this competition among lead plaintiffs to figure out who's going to be the lead plaintiff. They will then go prepare an amended complaint. So you can spend some time focusing on the strengths and weaknesses of that up-front complaint, but do not assume that because that's a weak complaint, that the ultimate complaint that will be litigated will also be weak. At some point down the road, they're going to invest much more significant resources which we're going to talk about in a minute and, you know, may or may not be able to come up with a much more fulsome, amended complaint.

Final point on this slide – you know, federal securities class action lawsuits are not the only venue, obviously, that plaintiffs' firms look at to, you know, potentially seek a recovery. They can consider a derivative demand or a derivative lawsuit in Delaware or wherever you're incorporated. That could actually just be a straight-up derivative demand to conduct an investigation. It could also be a Delaware §220 books-and-records demand for books and records. That can get somewhat complicated because it can be viewed as a way to circumvent the stay of discovery in the securities class action lawsuit, but it's helpful to keep in mind that just because you've got your securities class action lawsuit, that's not going to be the only avenue that plaintiffs are pursuing.

Randy Bodner: You've got to love the creativity on the plaintiffs' part because the class action is alleging a violation of the federal securities laws, and then you'll get another crew of plaintiffs' lawyers who will sue the board for breach of fiduciary duty for allowing a violation of the federal securities laws. I mean, it's the bottom-feeders on the bottom-feeders. And they're just looking to get invited to the table when and if money starts changing hands at a settlement. I've tended to be—it depends on the board's situation, and if there's actually, you know, something really did happen at a company, you handle things very differently, or if there's a regulatory investigation, you have to handle that very differently. But in the vast majority of circumstances where there is not really fraud or anything close to fraud involved, I tend to be very aggressive with the derivative plaintiffs, and I don't pay them money. There are a lot of tools that a company has in their chest in order to beat them back, and I tend to not let them pick anybody's, even including the insurer's, pocket, and I'm very aggressive with them, even when I've had a settlement in the class action context.

Matt McGinnis: So, two other notes about things to consider post-filing of the initial complaint. One is, if this is a new event for your company, if this is the first time this has happened, there's going to likely be some discussion or interest in, you know, sending out proactive communications to employees, for example, about, you know, what the circumstances are. Somebody's going to want to explain why this happened. Be very careful about doing that. Assume again, as Jeremiah and Randy said, that everything that goes into writing is going to be discoverable at this point. To the extent you need to make a proactive communication to employees, it's best to keep it very general, you know, one thing that, you know, I recommended before, for example, is to use Randy's point about one, this happens to one in twenty companies over the last year. You want employees and your staff to know that this is a routine occurrence for publicly traded companies, but don't send out a lengthy communication where you talk about the facts.

Second point on here is start thinking about, you know, who are the current and former employees who may be relevant to the underlying facts here, and keep—you know, be mindful of employees that may depart over the next few months or so, as the litigation process plays out. The reason for that, which I think Randy will talk about in a moment, is that former employees are a common target of investigators for plaintiffs' firms—so-called confidential witnesses. And if you can think about who those likely former employees are before they become former employees, you can help manage your discovery record a bit better.

Randy Bodner: And one thing, especially if you're a youngish company, you know, your CEO or CFO could say, "Oh my God, what is the market going to think?" In most circumstances, when you're sued in a class action, the market doesn't care. I mean, they get it, they understand. They'll want to focus on, why did the stock drop and what are the substance and merits on that in terms of your business; but the mere fact that a class action has come in, everything being equal, the market is not going to care about that, because it's just sort of ordinary course in many ways. So, you know, if you're new to this or your CEO is hyperventilating about they've been alleged for fraud, you know, the market is not going to react. If you have a regulatory investigation and an SEC or a DOJ investigation, yeah, the market's going to react to that and be worried about that, but the mere fact you've been sued in a class action, you know, 99 out of 100 times the market, the street, is not really going to care about that.

Jeremiah Williams: So the next stage is to gear up for the motion to dismiss, and this is where some of the things we've talked about in terms of PSLRA are very helpful, and I just want to reiterate a couple things we've already mentioned. We talked about the stay of discovery—so this is helpful to not have discovery costs being run up at the early stage. The height and pleading standard is something else that's very important here, and what this means is that it's not enough for the plaintiff to say the 10-K had misleading information. They have to identify specific statements that were misleading. They have to explain why it was misleading. And they also have to put forth some facts that would suggest wrongful intent, fraudulent intent or, as a legal term, is known as scienter. So that is helpful, and what that means is that this is a different type of motion to dismiss than you have in other types of civil litigation. The facts are coming into play much more. It's a chance to really educate the court about your industry and your product and so, even though you're on defense and you're trying to defeat the motion, you're actually a little bit on offense as well, as far as educating, and one of the important things here—there's a bullet here saying "Arming defense counsel with facts"—particularly for your industry, given the regulatory process that you go through, it's very important that counsel is aware of that and uses it to your advantage, and I'll give you an example. You know, one of the things I talked about as far as a PSLRA is the heightened pleading standard and the fact that plaintiffs have to produce facts that show some type of wrongful intent. So the law says that the facts that would suggest wrongful intent have to be at least as plausible as an alternative set of facts that would show innocent intent or a lack of fraud. And so that could very much be dependent upon the process that you go through. So if the allegation is that you didn't say something that you should have said earlier about some drug trial, well, educating the court about how these things work, about the process, about how this is just one part of it, about how you typically wouldn't say something like that at this point. That could be very helpful as far as showing that the lack of information, the lack of a disclosure is not any indication of fraud or a fraudulent intent.

Randy Bodner: And the First Circuit is a very good circuit. I mean, there are some very sophisticated decisions out of the District of Massachusetts and out of the First Circuit where they kind of get the clinical trial regimen and routine much more than a lot of other circuits. So we're in a good circuit as far as the sophistication of the court on those issues.

Jeremiah Williams: So, risk mitigation, so we've talked about how the initial complaint is really a placeholder and many complaints are going to come, and so you have this interim period, usually about three to six months, between the initial complaint and the amended complaint. And the whole point of this slide is where you just make sure that you're on guard here, that you're not giving any ammunition to the plaintiffs' counsel, that you're being careful about your messaging, social media being on point in terms of statements. You don't want to give them anything more that they could put into the amended complaint to make that stronger.

Randy Bodner: The main source of information besides your public filings are going to be your former employees who have left. And, I think as we alluded to earlier, the plaintiffs will file with a stock drop within a couple of weeks, most likely they'll be a placeholder complaint, then there will be this food fight as to who actually gets to control the litigation on the plaintiffs' side. After the lead counsel is appointed, that's when these entrepreneurial class action lawyers, that's when they start investing in a case. And, so it's after they—they're not going to invest a lot until they've been named the lead plaintiff, because they're just doing work possibly for somebody else. The minute that they've been named the lead plaintiff, then they start investing in the case, and what do they do? They have a lot of investigators out there who are very good in LinkedIn and all the social media things have given them so many potent weapons that, particularly if you've had a riff—and a lot of times you're going to stock drop and you know you were, you know, shedding employees along the way—they will reach out, and they will talk to as many former employees as they possibly can in order to be able to beef up their allegations that you're going to challenge in a motion to dismiss. It's very important to make sure that you have a coordination between—and there are laws in most states where the company is represented, they can't contact current employees, but some states are a little looser than others; some of these plaintiffs are a little shadier than others, and they may contact that, you certainly, if you get any hint of anybody contacting a current employee, you need to shut down that very quickly through your lawyers, but, you know, the former employees, for the most part, are fair game. That's where you want to really make sure you have good coordination between your HR function and your legal function because it's not the lawyers at the company are not the ones that are probably going to hear contact by people being interviewed by investigators. And, they'll try to pass themselves off as they're working for the, I've had one, the Attorney General of Mississippi is contacting them. And, they'll make it sound as though they're working for the government or they're working for a newspaper, you know, they're not going to say they're part of a plaintiff's lawyer. But, if you get any hint through your HR function, the HR function should be very attuned to making sure that the legal function, that the legal group hears any contact from any former employees.

The other thing I would do is, depending on the size and the practicality of it, if you are, you know, look, there are just going to be some employees you are going to want to keep under the Witness Protection Program, and you're going to want to keep them on for a little bit of time, frankly, and you need to be somewhat sophisticated about that. You don't want to be penny-wise and pound-foolish if that particular employee is sort of an essential witness on the particular issue. So, you need to be—in terms of, if you're going to let employees go, I would really recommend doing exit interviews, you know, either by your legal staff or your outside counsel so that you're able to debrief the people that are leaving to see if they are going to be a problem, because the minute they leave they're going to become fair game to the plaintiffs' lawyers, and it's a good idea to know what they would have to say. And, God forbid, if they went off the reservation and said other things, but they didn't say it in their exit interview, that could be useful in litigation.

Matt McGinnis: Can I just add one point on that? Do not underestimate some individuals' willingness or eagerness to talk to somebody who randomly calls them on the phone and asks them questions that flatter them. This is a message—Randy's message about talking to employees that are leaving applies, I think, both to very senior sophisticated employees as well as lower level employees who may know something relevant here. You know, these investigators are very good at calling up folks and flattering them and making them sound like they have something that they want to hear about the work that they did. They may even be very explicit and say we're working for the plaintiffs in this lawsuit and are trying to understand. I have seen executives that take that as an opportunity to try to persuade the plaintiffs' investigator as to why their lawsuit, you know, is a fool's errand and why they are totally misunderstanding the facts, and they think they're helping because what they're trying to do is say, "No, we had the best of intentions, we knew exactly what we were doing, xyz." But the plaintiffs' investigators are not interested and are not looking to be persuaded. What they're looking for is a sound bite that they can put in a complaint. So the best policy there—

Randy Bodner: And, they will misquote and cherry-pick.

Matt McGinnis: They will misquote, absolutely, and so the best policy is not to speak to them whatsoever.

Randy Bodner: Don't say nothing to nobody. Yes, ma'am?

Audience member: Can you say in an exit interview, can you warn people that these calls could be coming, or—?

Randy Bodner: You need to be—yes, you can, and you can say, look, you can, you know, you need to be very careful how you phrase that, particularly when you get into SEC land, because if you're, because they're, as Jeremiah will talk about it in a minute, because you need to be aware of the Whistleblower Program with the SEC that is really, as we've predicted, ramped-up in terms of the number of whistleblowers. If you as a public company can be perceived as somehow telling someone not to talk to the SEC, or it's vague, that can get you in a lot of trouble with the SEC. So, you just need to be very artful in terms of how you have those conversations. And is this a friendly employee or an unfriendly employee? Because if it's an unfriendly leave the best you can do and hope for is to have an exit interview, but any instruction you give to them will be turned back against you as though you were telling them not to tell the truth to somebody. If it's a—

[Inaudible comment from audience member]

Randy Bodner: That's right. You know, but if it's a friendly, if it's a friendly situation, then you can say, "Look, I'm assuming, you know, someone from the private plaintiffs' bar, you know, what you should do is just refer them to me. You know, just, you know, tell them that they should call me, or if they call you, call me and I'll interact with them. You know, we would prefer, but it's your choice in order to have a conversation." But, I'd be artful in how I do that, careful how I do that.

Audience member: Yeah, a lot of the biotechs went public in '14, more so in '15, maybe to a lesser extent in '16, so an employee requirement for talking about 10b-5, but you would just make a little distinction between the requirements on a '33 Act case and there is a mediation between them.

Randy Bodner: Yeah, and what John [*referring to audience member*] is mentioning is that when a company goes public or has a secondary offering, there's a window in which you don't have to prove—all you have to prove as a plaintiff, is that there was a false statement, a materially false statement. It doesn't matter whether it was meant to be false or not false. And, then that can create strict liability for the issuer, and it can be strict-ish liability for the directors or people who have signed the registration statement with a due diligence defense. And, that's, you know, if you have a precipitous stock drop after you've issued stock, is not a good place to be and that's treated differently, but that's where you want to have really good insurance, because that's where the insurers try to get out from covering that kind of case, and you want to make sure that you have someone who knows what they're doing and spank your policy to cover the eventuality of a drop after an issuance of stock. And, that's a really good time to focus on your D&O policy when you're going to have either an IPO or a secondary offering. John is that okay, or, yep?

Matt McGinnis: So, in being mindful of time, I'm going to cover this very quickly. You know, one question you may obviously get internally is what sort of, what are the dollars that we're talking about here. There is three numbers to keep in mind. There's the loss in market cap. That can be different than the estimated damages, and then, obviously, the settlement range is obviously going to be a very different number. You know, your counsel can help you figure out what the estimated damages are and how that may differ from loss in market cap. The key thing to keep in mind is that as a general matter, you know, the plaintiffs' firms are suing on behalf of a class typically of purchasers for a particular period of time, so the damages are essentially going to be the extent to which those purchasers during a certain period of time purchased at an elevated price and then experienced losses when the stock dropped. There are complicated damages models to figure out how that may differ from market cap, but it's usually a subset of market cap, needless to say. Once you actually have a sense of that estimated damages, you can actually, you know, again look at some of the data to get a sense of what the typical settlement range is and begin to set expectations internally as to what sort of amounts we're looking at. Again, hopefully with insurance money, but, you know. At a very high level, once you sort of look at the estimated damages, if it's a smaller amount—you know, less than twenty million dollars of estimated damages—you're going to pay at a higher percentage in a settlement, if you can't get it dismissed, and if it's a bigger dollar amount, you're going to pay out a lower percentage.

Randy Bodner: And, a lot of it is driven by various factors. You know, you look down at the stock price drop, but if that involves a restatement of your financial statements, the price tag isn't going to go up. If you had a lot of insider selling before the stock drop, the price tag is going to go up. If you have a DOJ or an SEC investigation hanging out there, the price tag is going to go up in terms of what the potential settlement amount is.

Jeremiah Williams: So, now we're going to talk about regulatory enforcement considerations with a specific focus on the SEC. So, I was in SEC enforcement, and, if I had a situation where there is a sharp drop in price, and I was looking at it, what would I be looking for? Well, basically, there's kind of two questions the SEC's going to ask. First of all, looking at like, what caused the drop? Obvious. The second question though is, well, what were the disclosures like leading up to the drop? And, they key thing that the SEC is going to look at is, can you point to any situation in which the company was aware of something and, you know, did not disclose it earlier than they should have. Or, did they say something earlier that was incomplete? Did they say something where there is potentially an omission that made the statement misleading at the time? So, you know, bottom line here is that a stock drop in and of itself is not a problem. A stock drop in an of itself is not something that the SEC will necessarily care about. Unlike the plaintiffs' counsel, the SEC is not, you know, paid more for looking at this stuff, so they're usually, usually honest brokers as far as looking—

Randy Bodner: So they say.

Jeremiah Williams: So, yeah, so this is where they're going to be very much focused on disclosures, and what were the disclosures like leading up to the drop.

Randy Bodner: When I was in the government, I always thought they did the right thing. It took me just a couple of bad interactions before I had a very different view.

Jeremiah Williams: In most cases. In most cases. Not all cases. So, I have a slide here on whistleblowers, and this is actually broader than just a stock-drop context, but it's important, and we talked about this a little bit before when we were talking about confidential witnesses. The whistleblower program has really exploded since Dodd-Frank. It is now really a very important means for the SEC to find out and to initiate cases and to get information. And, I think one thing is—it's very stark on this slide—there's been one hundred and eleven million dollars awarded under the program since it began in

2011. More than half of that was just last year. There was one award of like more than thirty million, a couple of twenty million-plus awards. So, you have some really big awards that have happened recently.

Randy Bodner: And there's a whole plaintiffs' bar out there now, or a whole bar of whistleblower lawyers, who don't even pursue the litigation *per se*. They shepherd-find the whistleblowers to bring them into the SEC to let the SEC do their dirty work for them, and then their client and that lawyer collects the vig off of what the SEC got. And, for many of you, you know, you have the benefit of also being subject to the False Claims Act, you know, in the health care space and the whistleblower program that goes on there. Lucky you, now the SEC is doing that, and, to Jeremiah's point, it's accelerating. If you were to look at the history of the False Claims Act, it increased—once it got traction, it increased exponentially. That's what we're beginning to see with the whistleblower process in terms of with the SEC environment. And, I will tell you, I've done this a lot, employers underestimate the value of and the impact of whistleblowers, and the government overestimates the impact of whistleblowers. And, you'll say, you know to the, like you'll hear from your C-suite, "That person? That's crazy. They were fired for being incompetent. They were disgruntled, blah, blah, blah." And somehow they think that's a defense. And, the SEC or the regulators' response is, "Well who the hell do you think does talk to us? Of course they're disgruntled. You know, of course they were fired. I mean otherwise they wouldn't come and tell us the truth." So, you know, you really need to, you know, when you're dealing with your C-suite, or if you are the C-suite, don't underestimate the impact of whistleblowers can have for your company and don't do stupid things early with regard to whistleblowers.

Jeremiah Williams: So, most whistleblowers are company insiders. And, one thing to keep in mind is that they do not need to go through your internal process in order to get a whistleblower award. They can, but they don't need to. And whistleblowers have strong protections. We've talked about this a little bit before. Whistleblowers are kept confidential. There are anti-retaliation provisions, and there have actually been some enforcement actions along those lines where companies have been found to retaliate against whistleblowers, and—and this last point I think is also important—you cannot impede a person's ability to come to the SEC and give information. This ties to a point we talked about before as far as exit interviews and being careful there. Also, this comes up in severance agreements: be careful about clauses in severance agreements that restricts someone's ability to come and give information to the government.

Randy Bodner: And, we'll see how, what, if that changes over time. I mean, you know, we know that Dodd-Frank is going to go through some changes, you know, with the Republican Congress and our esteemed President. So, we'll have to see how that works. But for now, you know, the whistle[blower] program is ramping up, and I think you're going to see an increase in whistleblowers, and it's because, the same way in the dynamic of the civil litigation, people were trying to get into the pipeline before there are statutory changes.

And I think that is sort of the topics that we had to cover. I don't know if anyone has any other questions, but otherwise, thank you very much.