UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF VIRGINIA
ALEXANDRIA DIVISION

DAVID HOPPAUGH, Individually and On Behalf of All Others Similarly Situated, Plaintiff, vs. K12 INC., RONALD J. PACKARD, and HARRY T. HAWKS, Defendants.	)	Civ. A. No. 1:12-cv-00103-CMH-IDD

MEMORANDUM OF LAW IN SUPPORT OF LEAD PLAINTIFF'S UNOPPOSED MOTION FOR FINAL APPROVAL OF PROPOSED CLASS ACTION SETTLEMENT AND PLAN OF ALLOCATION

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Pursuant to Rule 23(e) of the Federal Rules of Civil Procedure, Lead Plaintiff Arkansas Teacher Retirement System ("Arkansas"), on behalf of the Class[1] in the above-captioned action (the "Litigation"), respectfully submits this memorandum of law in support of its unopposed motion for (i) final approval of the proposed Settlement of this class action; (ii) approval of the proposed Plan of Allocation for the Net Settlement Fund; and (iii) approval of the Parties' Stipulation of Partial Voluntary Dismissal with Prejudice (ECF No. 135), so-ordered by the Court on March 11, 2013 (ECF No. 139).

PRELIMINARY STATEMENT

The Settlement, which the Court preliminarily approved in its March 22, 2013 Preliminary Approval Order Providing for Notice and Hearing in Connection With Proposed Class Action Settlement (ECF No. 141, the "Preliminary Approval Order"), provides for the gross payment of $6,750,000 to secure a settlement of the claims remaining in the Litigation against Defendants K12, Inc. ("K12" or the "Company"), its Chief Executive Officer Ronald J. Packard ("Packard"), and its Chief Financial Officer, Harry T. Hawks ("Hawks").[2] In consideration for this payment, the Settlement will result in the dismissal with prejudice of the June 22, 2012 Amended Class Action Complaint (the "Amended Complaint"), along with the

[1] Capitalized terms not otherwise defined herein shall have the same meanings set forth and defined in the Stipulation and Agreement of Settlement, dated March 4, 2013 (ECF No. 138-2, the "Stipulation").

[2] On March 11, 2013, the Court entered the Parties' Stipulation of Partial Voluntary Dismissal with Prejudice of the claims that Defendants failed to disclose (1) the poor academic performance of K12 schools relative to brick and mortar public schools; (2) the quality of education at K12 schools was negatively affected by high student-teacher ratios and unqualified teachers; (3) that K12's special education programs did not comply with federal and state requirements; and (4) high parent/student dissatisfaction (collectively, the "non-churn related claims"). ECF No. 139. The Stipulation resolves all remaining claims in the Litigation, which center on Defendants' alleged failure to adequately disclose high student churn rates at K12-managed virtual public schools.

release of all related claims (the "Released Claims") by plaintiffs and the members of the Class against the Defendants and their affiliated persons and entities (the "Released Defendant Parties").

As detailed *infra*, in deciding whether to approve a proposed settlement, the Court must find that it is "fair, reasonable, and adequate." Fed. R. Civ. P. 23(e)(2). Lead Plaintiff submits that the Settlement is a favorable result for the Class, both quantitatively and when balancing the benefits of immediate relief with the risk of less or no recovery years into the future. The Stipulation was reached only after thorough litigation, thoughtful negotiation and discovery, including the depositions of fourteen fact witnesses, concerning myriad issues common to members of the Class. The Settlement is the culmination of extensive, good faith, and arm's-length negotiations between experienced counsel for the Parties.

For the reasons set forth herein, Lead Plaintiff respectfully submits that the Settlement is fair, reasonable, adequate, and should be approved.

THE HISTORY OF THE LITIGATION

Lead Plaintiff submits herewith the Declaration of Jonathan Gardner in Support of Lead Plaintiff's Unopposed Motion for Final Approval of Proposed Class Action Settlement and Plan of Allocation and Lead Counsel's Motion for an Award of Attorneys' Fees and Payment of Litigation Expenses ("Gardner Declaration" or "Gardner Declaration") in support of the instant motion. The Gardner Declaration, and the exhibits thereto, are an integral part of this submission. To avoid repetition, Lead Counsel respectfully refers the Court to the Gardner Declaration for a recitation of the relevant facts, history of the Litigation and settlement efforts, value of the Settlement, and the risks and uncertainties that support Lead Plaintiff's motion.

The Settlement was reached when Lead Plaintiff and Lead Counsel had a thorough understanding, supplemented by extensive discovery and multiple depositions, of the facts and

challenges posed by the claims and defenses, as well as the factors impacting a future recovery.

Briefly, the proceedings to date have included:

- Extensive investigation and analysis of the relevant claims, including a review of all relevant public information such as K12's press releases, public statements, filings with the United States Securities and Exchange Commission ("SEC"), regulatory filings and reports, and securities analysts' reports, advisories, and media reports about the Company. Gardner Decl. ¶42.

- Locating and interviewing confidential witnesses ("CWs") with knowledge of the relevant issues, including identifying 183 potential witnesses, contacting 113 potential witnesses and conducting in-depth interviews with 50 individuals. *Id*. ¶43.

- Preparing the Amended Complaint and successfully opposing Defendants' motion to dismiss. *Id*. ¶44.

- Formal discovery including serving initial disclosures, requests for production of documents, interrogatories, requests for admissions, and third party subpoenas; engaging in regular and frequent meet and confer sessions with Defendants' Counsel regarding the scope of discovery throughout the discovery period; submitting several discovery motions for resolution by the Court; reviewing more than one million pages of documents produced by Defendants and third-parties; reviewing four expert reports submitted by Defendants; preparing and submitting two reports from experts in damages and loss causation and in education; the Parties taking fourteen depositions and preparing to take additional fact and expert depositions. *Id*. ¶¶35, 44-45.

- Preparing and serving a motion for class certification and negotiating the stipulation for class certification. *Id*. ¶¶36, 44.

- Extensive analysis of the claims and defenses, with the assistance of an experienced expert in assessing damages and loss causation issues in securities class action cases and an expert in the education field, and the various risks attendant to continued litigation. *Id*. ¶¶44-45.

- Preparing Lead Plaintiff's mediation statement and 47 joint exhibits for the January 8, 2013 mediation session before former Judge Daniel Weinstein ("Judge Weinstein"), an experienced and respected professional mediator. *Id*. ¶¶10, 47.

- Further settlement negotiations through discussions with Judge Weinstein and direct negotiations between counsel for the Parties that resulted in the Stipulation. *Id*. ¶48.

ARGUMENT

I. THE COURT SHOULD APPROVE THE PROPOSED SETTLEMENT

A. The Court's Role in Final Approval

"Rule 23(e) provides that 'a class action shall not be dismissed without the approval of the court.' The primary concern addressed by Rule 23(e) is the protection of class members whose rights may not have been given adequate consideration during the settlement negotiations." *In re Jiffy Lube Sec. Litig.,* 927 F.2d 155, 158 (4th Cir. 1991) (citation omitted). To approve a proposed settlement, the Court must find that it is "fair, reasonable, and adequate." Fed. R. Civ. P. 23(e)(2); *In re Royal Ahold N. V. Sec. & ERISA Litig.,* 437 F. Supp. 2d 467, 468 (D. Md. 2006); *S.C. Nat'l Bank v. Stone,* 749 F. Supp. 1419, 1435 (D.S.C. 1990).

However, when determining whether a given settlement meets this standard, "the settlement hearing is not a trial, and a court's role is more a 'balancing of likelihoods rather than an actual determination of the facts and law in passing upon whether the proposed settlement is fair, reasonable and adequate.'" *Lomascolo v. Parons Brinckerhoff, Inc.*, No. 1:08cv1310 (AJT/JFA), 2009 WL 3094955, at *10 (E.D. Va. Sept. 28, 2009) (citation omitted). In evaluating the reasonableness of the result reached, the Court must recognize that "after all, settlement is a compromise, a yielding of the highest hopes in exchange for certainty and resolution." *In re The Mills Corp. Sec. Litig.,* 265 F.R.D. 246, 258 (E.D. Va. 2009) (quoting *In re GMC Pick-up Truck Fuel Tank Prods. Liab. Litig.,* 55 F.3d 768, 806 (3d Cir. 1995)).

Moreover, the "voluntary resolution of litigation through settlement is strongly favored." *Stone,* 749 F. Supp. at 1423; *accord Hoffman v. First Student, Inc.*, No. WDQ-06-1882, 2010 WL 1176641, at *2 (D. Md. Mar. 23, 2010) ("There is a 'strong presumption in favor of finding a settlement fair.'"). This judicial policy favoring settlement is particularly strong in class actions

and other complex litigation. *See, e.g., Lomascolo,* 2009 WL 3094955, at *10 ("there is an overriding public interest in favor of settlement, particularly in class action suits").

B. Applicable Standards

In determining whether the proposed settlement is "fair, reasonable and adequate," thus warranting final approval, the Fourth Circuit has directed district courts to separate the inquiry into two analyses: "fairness" and "adequacy." *See In re Microstrategy Inc. Sec. Litig.*, 148 F. Supp. 2d 654, 664 (E.D. Va. 2001) ("*Microstrategy I*") (citing *Jiffy Lube*, 927 F. 2d at 158-59).

In assessing the *fairness* of a proposed settlement the Court should consider: "(1) the posture of the case at the time settlement was proposed, (2) the extent of discovery that had been conducted, (3) the circumstances surrounding the negotiations, and (4) the experience of counsel in the area of securities class action litigation." *Jiffy Lube,* 927 F.2d at 159.

The Court's assessment of the *adequacy* of a settlement is informed by: (1) the relative strength of the plaintiffs' case on the merits, (2) the existence of any difficulties of proof or strong defenses the plaintiffs are likely to encounter if the case goes to trial, (3) the anticipated duration and expense of additional litigation, (4) the solvency of the defendants and the likelihood of recovery on a litigated judgment, and (5) the degree of opposition to the settlement.[3] *Id.*

Ultimately, the final approval of a class action settlement is "committed to 'the sound discretion of the district courts to appraise the reasonableness of particular class-action settlements on a case-by-case basis, in light of relevant circumstances.'" *Microstrategy I,* 148

[3] The deadline for objecting to the Settlement or the attorneys' fees request or to request exclusion from the Class is June 10, 2013. If objections or exclusion requests are received, they will be addressed in Lead Plaintiff's reply submission, due to be filed on July 5, 2013.

F. Supp. 2d at 663 (quoting *Evans v. Jeff D.,* 475 U.S. 717, 742 (1986)); *see also Flinn v. F.M.C. Corp.*, 528 F.2d 1169, 1172 (4th Cir. 1975).

C. The Proposed Settlement is Fair

1. The Posture of the Case and Extent of Discovery Supports Fairness

The Parties were actively litigating the case and nearing completion of fact discovery at the time the proposed settlement was reached, having engaged in regular and frequent meet and confer sessions regarding the scope of discovery; processed and reviewed hundreds of thousands of documents constituting more than one million pages; conducted fourteen fact depositions; submitted industry expert and damages expert reports; prepared to take additional fact and expert depositions; and briefed several discovery motions. *See* Gardner Decl. ¶¶43-45. This voluminous information concerning liability and damages issues, enabled Lead Plaintiff to competently evaluate the strengths and weaknesses of the claims and associated litigation risks, and accordingly to enter into the Settlement on a fully informed basis. *Cf. Flinn,* 528 F.2d at 1173 (evaluating the strength of a case for settlement purposes at the close of discovery is beneficial); *Mills*, 265 F.R.D. at 254 ("where all defendants had answered the complaint and all motions to dismiss had been ruled upon at the time of these settlements . . . . [and] discovery was largely completed as to all issues and parties" weighs in favor of approval of settlement). This factor supports final approval of the Settlement.

2. The Circumstances of Settlement Negotiations Support Fairness

The Court's consideration of the "negotiating process by which the settlement was reached" "ensure[s] that 'counsel entered into settlement negotiations on behalf of their clients after becoming fully informed of all pertinent factual and legal issues in the case.'" *Mills*, 265 F.R.D. at 255 (citing *Stone*, 749 F. Supp. at 1424).

As detailed in the Gardner Declaration (*see* Gardner Decl. ¶¶9, 47-50), the Parties have acted independently and negotiated at arm's length to develop the proposed Settlement. The docket further supports a finding of arm's length negotiations, reflecting numerous filings on contested matters. Indeed, an agreement was only reached after a full mediation session with an experienced and impartial mediator, Judge Weinstein, and continued negotiations in the weeks following the mediation session, both through Judge Weinstein and direct negotiations between counsel for the Parties. *Id*. Accordingly, the terms of the proposed Settlement were hard-fought, with each side actively advocating its position.

3. The Experience of Counsel Supports Fairness

By approving Lead Plaintiff's selection of counsel, the Court already has found that Lead Counsel has the experience and qualifications necessary to serve as counsel for the Class. *See* Gardner Decl. ¶33.

Lead Counsel believe that the proposed Settlement is fair, reasonable and adequate. *See In re Red Hat Sec. Litig.*, No. 5:04-CV-473-BR, 2010 WL 2710517, at *3 (E.D.N.C. June 11, 2010) (citing *Isley v. Bayh*, 75 F.3d 1191, 1200 (7th Cir. 1996)) (a court is "entitled to give consideration to the opinion of competent counsel that the settlement is fair, reasonable, and adequate"); *see also In re Microstrategy, Inc. Sec. Litig*., 150 F. Supp. 2d 896, 903 (E.D. Va. 2001) ("*Microstrategy II*") (when it appears that a settlement results from extensive arm's length negotiations that were conducted in good faith, "it is 'appropriate…to give significant weight to the judgment of class counsel that the proposed settlement is in the interest of their clients and the class as a whole'"). Indeed, "when Class Counsel are 'nationally recognized members of the securities litigation bar,'" as Lead Counsel are here, "it is entirely warranted for [the] [c]ourt to pay heed to their judgment in approving, negotiating, and entering into a putative settlement."

Mills, 265 F.R.D. at 255 (quoting *Microstrategy I*, 148 F. Supp. 2d at 665); *see also* Exs. 4-C, 5-C, and 6-C. Accordingly, this factor supports final approval of the Settlement.

D. The Proposed Settlement is Adequate

1. The Strength of Lead Plaintiff's Claims and the Existence of Defenses Lead Plaintiff May Encounter if the Case Goes to Trial Supports Adequacy

"Evaluating the force[of] Plaintiffs' case is of the utmost importance because 'if the settlement offer was grossly inadequate. . . . it can be inadequate only in light of the strength of the case presented by the plaintiffs.'" *Mills*, 265 F.R.D. at 256 (quoting *Flinn*, 528 F.2d at 1172).

While Lead Plaintiff believes its claims regarding non-disclosure of churn and student withdrawal rates are strong on the merits, the outcome of any litigation is never a certainty and there were significant risks in bringing this action before a jury. *Mills*, 265 F.R.D. at 255-56 ("Securities cases. . . are notably difficult and notoriously uncertain" [and] "no matter how confident one may be of the outcome of litigation, such confidence is often misplaced") (citation omitted). Given the complexities of determinative issues such as the calculation of churn rates, the facts regarding student enrollment, withdrawal, and re-enrollment, Lead Plaintiff's entitlement to recovery absent a settlement would be uncertain. *See* Gardner Decl. ¶¶54-57. There is also considerable dispute between the Parties over whether the Company had a duty to disclose churn rates. Defendants would contend on summary judgment and at trial that K12 had disclosed sufficient information to enable churn rate calculations and had no further duty to disclose particular churn rates. *Id*. ¶58.

Likewise, there are also risks concerning loss causation and damages including, *inter alia*, whether and/or to what extent the alleged disclosures were corrective, in light of several preceding media reports. *See* Gardner Decl. ¶¶60-61. Indeed, these disputes precipitated the

submission of reports from *five* different experts. *See, e.g.*, *Microstrategy I*, 148 F. Supp. 2d at 667 ("the damages issue would have become a battle of experts at trial, with no guarantee of the outcome in the eyes of the jury") (internal citation omitted). In contrast, the proposed Settlement achieves the certainty of a substantial distribution to Class Members.

2. The Minimal Degree of Opposition to the Settlement Supports Approval

The reaction of class members to a proposed settlement "as expressed directly or by failure to object" is also "a proper consideration for the trial court." *Flinn,* 528 F.2d at 1173. A low number of objections or opt-outs in comparison to the size of the settlement class evidences the fairness of the proposed settlement. *See, e.g., Mills*, 265 F.R.D. at 257-58 (noting that the lack of any objections to the settlement and the small number of opt-outs strongly compels a finding of adequacy).

In accordance with the Court's Preliminary Approval Order, Lead Counsel has caused the Claims Administrator to mail approximately 27,111 Notices and Proof of Claim forms to potential Class Members. *See* Ex. 3 ¶¶3-6. Additionally, Summary Notice was published in *Investor's Business Daily* and transmitted over *PR Newswire*. *Id*. ¶7. While the deadline for Class Members to submit objections to the Settlement or exclude themselves from the Settlement has not yet passed, to date, *no* objections or requests for exclusion have been received. The deadline for submitting objections and requesting exclusion from the Class is June 10, 2013. Lead Plaintiff's counsel will address any objections in its reply brief, which will be filed with the Court on or before July 5, 2013, after the objection deadline has passed.[4]

[4] Concurrent with the Settlement, Lead Plaintiff has voluntarily dismissed its non-churn related claims with prejudice. As more fully explained in Lead Plaintiff's brief in support of its motion for preliminary approval of the Settlement, Lead Plaintiff's voluntary dismissal of these other claims does not prejudice Class Members, because courts "analyze each of the alleged (*continued*…)

3. The Anticipated Duration and Expense of Continued Litigation Supports Adequacy

If the Litigation were to continue, further discovery would include the depositions of at least five experts and ten fact witnesses, extensive summary judgment briefing, and numerous motions in *limine*. The eventual trial would entail significant additional costs for all involved, with success for Class Members far from assured. *See* Gardner Decl. ¶¶57-61. Even if successful at trial, the Class faces the likelihood of appeal, with concomitant costs and delay. *See, e.g.*, *Microstrategy I*, 148 F. Supp. 2d at 667 ("there is little doubt that a jury verdict for either side would only have ushered in a new round of litigation in the Fourth Circuit and beyond, thus extending the duration of the case and significantly delaying any relief for plaintiffs"). This factor, therefore, supports final approval of the Settlement.

4. The Solvency of Defendants and Likelihood of Recovery on a Litigated Judgment Support Adequacy

The high costs associated with trial, together with Lead Plaintiff's damages estimate in excess of $100 million, would likely exceed the limits of the Company's liability insurance, adding to the uncertainty over whether the Litigation could recover a substantial amount for Class Members. The Settlement allows Lead Plaintiff to avoid both this risk and the other risks described *supra*, and helps ensure a substantial and immediate payment, thus conferring favorable benefits on the Class that are preferable to the very real possibility of a smaller recovery or no recovery at all. This factor, like the others discussed above, supports final

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(…*continued*)
misrepresentations or omissions separately to determine whether [a plaintiff] has stated a claim under § 10(b) as to that misrepresentation or omission." *Morris v. Wachovia Sec., Inc.*, 277 F. Supp. 2d 622, 630 (E.D. Va. 2003); *see also* ECF No. 138 at 7-8. Because the allegations that remain after Lead Plaintiff's dismissal state a securities fraud claim for Defendants' alleged misstatements and omissions related to K12's churn rates, Lead Plaintiff did not anticipate – nor has there been to date – a high degree of objection to the proposed Settlement on this basis.

approval of the Settlement. Lead Plaintiff accordingly submits that the Settlement is fair, reasonable, and adequate and should be approved.

II. THE COURT SHOULD APPROVE THE PLAN OF ALLOCATION

Approval of a plan of allocation is governed by the same standards by which a class action settlement is reviewed – namely, it must be fair, reasonable and adequate. *See Mills*, 265 F.R.D. at 258. The Plan of Allocation, developed with the assistance of Lead Plaintiff's consulting damages expert, provides a fair, reasonable and adequate method for distributing funds in connection with the Settlement.

The Plan of Allocation, which is fully described in the Notice, distributes the recovery according to when Class Members purchased, acquired and/or sold their shares of K12 common stock. Gardner Decl. ¶67. The Notice informed the Class that the deadline for objecting to the Plan of Allocation is June 10, 2013, and to date Lead Counsel is aware of no such objection. *Id*. ¶¶62-68. Pursuant to the Plan of Allocation, a claimant must have either purchased K12 common stock (a) during the Class Period prior to the close of trading on November 16, 2011 (the date of the first corrective disclosure) and held until at least until the close of trading on November 16, 2011, or (b) purchased on or after November 17, 2011 and held until at least the close of trading on December 12, 2011 (the day before the second and final corrective disclosure). *Id*. ¶67. Claimants cannot recover more than their out-of-pocket loss.

Accordingly, the Plan of Allocation is fair, adequate and reasonable, and warrants the Court's approval.

III. THE COURT SHOULD APPROVE THE FORM AND METHOD OF NOTICE PROVIDED

Before finally approving the Settlement, the Court should determine that the notice program satisfied the requirements of Rule 23 of the Federal Rules of Civil Procedure and due

process. The Notice must have constituted "the best notice . . . practicable under the circumstances," Fed. R. Civ. P. 23(c)(2)(B), and complied with the content requirements of Rule 23(c)(2) and the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), 15 U.S.C. § 78u-4(a)(7). These standards require only that the notice be "reasonably calculated to reach interested parties." *Mullane v. Cent. Hanover Bank & Trust Co.,* 339 U.S. 306, 318 (1950).

In accordance with the Preliminary Approval Order, the Claims Administrator caused 27,111 copies of the Notice and Proof of Claim to be mailed to potential Class Members who could be reasonably identified. *See* Ex.3 ¶¶3-6. In addition, the Court-approved Summary Notice was published in *Investor's Business Daily* and transmitted over *PR Newswire* within fourteen days of the Notice Date. *Id*. ¶7. GCG also established a settlement website, from which Class Members can access the Notice and Proof of Claim and other relevant information. *Id*. ¶8. This combination of individual and publication notice, disseminated in accordance with the Court's Preliminary Approval Order, was reasonably calculated to inform potential Class Members about the Settlement and constituted the best notice practicable under the circumstances.

CONCLUSION

Lead Plaintiff respectfully requests that the Court (i) grant its unopposed motion for final approval of the proposed Settlement; (ii) approve the proposed Plan of Allocation; and (iii) approve the Parties' Stipulation of Partial Voluntary Dismissal with Prejudice (ECF No. 135), so-ordered by the Court on March 11, 2013 (ECF No. 139).

Dated: May 17, 2013

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on the 17th day of May, 2013, I will electronically file the foregoing with the Clerk of Court using the CM/ECF system, which will then send a notification of such filing (NEF) to the following:

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