UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE FIFTH STREET FINANCE CORP. SECURITIES LITIGATION	:	**Case No. 15-cv-7759 (LAK)**
This Matter Relates To:	:	
All Actions	:	

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

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Court-appointed Lead Plaintiff Oklahoma Police Pension and Retirement System ("Lead Plaintiff"), through its court-approved counsel Labaton Sucharow LLP ("Lead Counsel"), respectfully submits this memorandum of law in support of its motion for approval of the proposed settlement (the "Settlement") of this securities fraud class action (the "Action") and Plan of Allocation. The terms of the Settlement are set forth in the Stipulation of Settlement, dated as of July 27, 2016 (the "Settlement Agreement"), which was previously filed with the Court. ECF No. 93-1.[1]

PRELIMINARY STATEMENT

Through the Settlement, Lead Plaintiff has obtained an excellent recovery for the Class in the amount of $14,050,000.00 in cash, thereby resolving all claims against defendants Fifth Street Finance Corp. ("FSC"), a business development corporation ("BDC"); Fifth Street Asset Management Inc. ("FSAM"), its investment adviser's parent company; Leonard M. Tannenbaum; Bernard D. Berman; Alexander C. Frank; Todd G. Owens; Ivelin M. Dimitrov; and Richard A. Petrocelli (together, the "Individual Defendants," and with Fifth Street and FSAM, "Defendants").

This very favorable result is the product of a unique and rigorous settlement process, which took a pragmatic approach to evaluating the benefits of continuing to litigate and the risks of non-recovery as the case progressed, including (i) uncertainty as to Defendants' ability to satisfy a judgment, in light of their exposure in both this and multiple other actions, a relatively small amount of aggregate insurance coverage provided by wasting policies, and the fact that the high-end of Lead Plaintiff's damages range (approximately $95 million) roughly equaled the total cash the corporate defendants had on hand as of December 31, 2015 ($99.8 million total, with FSC's share being $82.6 million and FSAM's share being $17.2 million) and (ii) Defendants' defenses based on the Supreme

[1] All capitalized terms not defined herein have the same meanings set forth in the Settlement Agreement.

Court's recent decision in *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318 (2015) ("*Omnicare*"). *Omnicare* provides a forceful means for the Defendants to challenge falsity, which was typically not difficult to plead or prove, by claiming that the alleged false statements were simply subjective opinions supported by reasonable bases, not false facts. In other words, Defendants were able to argue that even if the alleged misrepresentations were technically false under applicable accounting guidelines, they were not false under the securities laws unless the Class could meet the more stringent standards for statements of opinion set forth in *Omnicare*. In addition, Defendants also raised serious challenges to Lead Plaintiff's ability to establish scienter, loss causation, and damages, as discussed below.

The Settlement recovers a significant amount of the Class' estimated damages, approximately 15% to 20% of *Lead Plaintiff's* expert's best estimate of damages, and considerably more if certain of Defendants' counter-arguments were credited by a jury—assuming of course that the claims went to a jury and that any liability were established. Such recoveries are well above average securities class action recoveries of approximately 6%. *See* Section I.C.8., *infra*. This Settlement also presents a superior recovery when compared to the median reported settlement amounts in securities class actions, which was $6.1 million in 2015 and $8.2 million from 1996 to 2014. *See* Laarni T. Bulan, Ellen M. Ryan, and Laura E. Simmons, *Securities Class Action Settlements - 2015 Review and Analysis* at 1 (Cornerstone Research 2016).[2]

[2] *See* Exhibit 4 to the Declaration of Ira A. Schochet in Support of Lead Plaintiff's Motion for 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, dated January 12, 2017, ("Schochet Declaration" or "Schochet Decl."), submitted herewith.

The Court is respectfully referred to the Schochet Declaration for a full discussion of the factual background and procedural history of the Action, the efforts of Lead Counsel, the risks and obstacles faced if litigation continued, a discussion of the negotiations leading to the Settlement, and the reasons why the Settlement and Plan of Allocation are fair, reasonable, and adequate and should be approved by the Court. All exhibits referenced herein are annexed to the

The accompanying Schochet Declaration describes in detail the history of this litigation, including the strategy and significant effort that led to the Settlement, and the wealth of data, facts and analyses with which Lead Plaintiff and Lead Counsel were able to adequately determine the appropriate level at which to agree to resolve the claims. Among other things, Lead Plaintiff and Lead Counsel: (i) conducted a thorough pre-filing investigation into the claims of the Class, including identifying more than fifty potential witnesses (former employees of Fifth Street) and interviewing eleven of them; (ii) researched and filed a detailed Consolidated Amended Class Action Complaint (the "Complaint"), including working with a forensic accounting expert to identify potential allegations to include; (iii) closely consulted with damages/causation experts as well as the accounting expert; (iv) reviewed and analyzed more than 5,000 pages of internal FSC and FSAM documents submitted to Lead Plaintiff by Defendants before engaging in preliminary settlement discussions, which also included internal emails and a full set of all insurance policies potentially covering Lead Plaintiff's claims, as well as those of the plaintiffs in the related FSAM Class Action and Derivative Actions; (v) participated in a two-day "Pre-Mediation Presentation" by Defendants' Counsel to Lead Counsel, Lead Plaintiff's accounting expert, and counsel for plaintiffs in the related actions, as well as retired California Superior Court Judge Daniel Weinstein ("Judge Weinstein" or the "Mediator") and his staff, which was designed to enable plaintiffs and their counsel to determine whether mediated discussions concerning potential settlements would be appropriate and fruitful; (vi) participated in a three-day mediation session from June 15, 2016 to June 17, 2016 with Judge Weinstein, during which they forcefully argued the strengths of the Class' claims and tenaciously held out for a maximum recovery; (vii) pushed, in rigorous negotiations lasting for approximately

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Schochet Declaration. For clarity, citations to exhibits that themselves have attached exhibits, will be referenced as "Ex. ___ - ___." The first numerical reference is to the designation of the entire exhibit attached to the Schochet Declaration and the second reference is to the exhibit designation within the exhibit itself.

one month, to significantly expand the amount of material Defendants would provide to Lead Counsel to evaluate a settlement, notwithstanding the PSLRA stay; (viii) reviewed and analyzed more than 2.4 million pages of documents produced by Defendants during a subsequent additional discovery process, including (a) additional documents related to the Pre-Mediation Presentation and all documents referenced therein, (b) FSC credit files for the FSC investments Lead Plaintiff alleged were significantly impaired during the Class Period, which included documents relating to the origination, valuation, and management of those investments, and (c) the full set of documents that Defendants' Counsel had produced to the U.S. Securities and Exchange Commission ("SEC") on behalf of FSC and FSAM relating to the allegations raised in the Action, the FSAM Class Action and the Derivative Actions in connection with an ordinary-course examination of FSAM's investment adviser subsidiary, Fifth Street Management LLC, by the SEC's Office of Compliance Inspections and Examinations, as well as an investigation by the SEC Division of Enforcement; and (ix) conducted five separate day-long interviews of five senior executives and directors of FSC and FSAM during the additional discovery process to expand upon and test the assertions made by Defense counsel during the Pre-Meditation Presentation. Through this thorough and comprehensive effort, the Class was able to achieve a very favorable Settlement.

Lead Plaintiff, a sophisticated institutional investor that manages more than $2 billion in assets and was actively involved during the negotiations that lead to the Settlement, fully supports its approval. *See* Declaration of Oklahoma Police Pension and Retirement System in Support of Approval of Proposed Class Action Settlement and Request for Attorneys' Fees and Expenses, dated December 29, 2016, Ex. 1. Moreover, Judge Weinstein has endorsed the Settlement and believes that it constitutes an excellent result in light of the extensive efforts demonstrated in the arm's-length bargaining of counsel, the merits of the claims and defenses, the potential maximum damages, the

amount of available insurance coverage, and the possibility that Lead Plaintiff would recover nothing if the Court were to accept Defendants' factual or legal arguments. *See* Declaration of Hon. Daniel H. Weinstein (Ret.) in Support of Proposed Settlements of Fifth Street Securities Litigation, dated December 29, 2016 ("Weinstein Decl."), Ex. 2 ¶¶ 25-26.

Accordingly, for all the reasons discussed herein and in the Schochet Declaration, it is respectfully submitted that the amount provided by the Settlement – when measured by the efforts to achieve it, the risks of proceeding without it, and by the range of damages that Lead Plaintiff could have obtained through trial if it were successful – is not only fair, reasonable and adequate, but is an outstanding result for the Class that should be approved by the Court. Likewise, the Plan of Allocation, which was developed with the assistance of Lead Plaintiff's damages expert, provides a fair and equitable method for distribution among eligible Class Members and should also be approved by the Court.

ARGUMENT

I. THE SETTLEMENT IS FAIR, REASONABLE, AND ADEQUATE

A. The Standards for Evaluating Class Action Settlements

Pursuant to Rule 23(e) of the Federal Rules of Civil Procedure, this Court may approve a class action settlement where it finds the settlement to be "fair, reasonable, and adequate." Fed. R. Civ. P. 23(e)(2); *see also Wal-Mart Stores Inc. v. Visa U.S.A., Inc.,* 396 F.3d 96, 116 (2d Cir. 2005). The evaluation of a proposed settlement requires an assessment of both the procedural and substantive fairness of the settlement. *See McReynolds v. Richards-Cantave*, 588 F.3d 790, 804 (2d Cir. 2009).

While the decision to grant or deny approval of a settlement lies within the broad discretion of the trial court, a number of courts have observed a general policy in favor of settling class actions. *See Wal-Mart*, 396 F.3d at 116 ("We are mindful of the 'strong judicial policy in favor of

settlements, particularly in the class action context.'") (citation omitted); *see also Aponte v. Comprehensive Health Mgmt. Inc.*, No. 10 Civ. 4825 (JLC), 2013 WL 1364147, at *2 (S.D.N.Y. Apr. 2, 2013) (noting that "[c]ourts examine procedural and substantive fairness in light of the 'strong judicial policy in favor of settlement[]' of class action suits") (citation omitted); *In re WorldCom, Inc. ERISA Litig.*, No. 02 Civ. 4816 (DLC), 2004 WL 2338151, at *6 (S.D.N.Y. Oct. 18, 2004) (noting that "public policy favors settlement, especially in the case of class actions").

Because a settlement represents an exercise of judgment by the negotiating parties, the Second Circuit has cautioned that, while a court should not give "rubber stamp approval" to a proposed settlement, it must "stop short of the detailed and thorough investigation that it would undertake if it were actually trying the case." *City of Detroit v. Grinnell Corp.*, 495 F.2d 448, 462 (2d Cir. 1974); *see also In re EVCI Career Colls. Holding Corp. Sec. Litig.*, No. 05 Civ. 10240 (CM), 2007 WL 2230177, at *4 (S.D.N.Y. July 27, 2007) (in evaluating a settlement, "a court neither substitutes its judgment for that of the parties who negotiated the settlement nor conducts a mini-trial of the merits of the action") (citation omitted).

In addition to the presumption of fairness that attaches to a settlement reached as a result of arm's-length negotiations, the Second Circuit has identified nine factors that courts should consider in deciding the substantive fairness of a class action settlement:

> (1) the complexity, expense and likely duration of the litigation; (2) the reaction of the class to the settlement; (3) the stage of the proceedings and the amount of discovery completed; (4) the risks of establishing liability; (5) the risks of establishing damages; (6) the risks of maintaining the class action through the trial; (7) the ability of the defendants to withstand a greater judgment; (8) the range of reasonableness of the settlement fund in light of the best possible recovery; [and] (9) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation.

Grinnell, 495 F.2d at 463 (citations omitted); *see also In re Wachovia Equity Sec. Litig.*, No. 08 Civ. 6171 (RJS), 2012 WL 2774969, at *3-5 (S.D.N.Y. June 12, 2012). "[N]ot every factor must weigh

in favor of settlement, rather the court should consider the totality of these factors in light of the particular circumstances." *In re Global Crossing Sec. & ERISA Litig.*, 225 F.R.D. 436, 456 (S.D.N.Y. 2004) (citation omitted). As demonstrated below and in the Schochet Declaration, the Settlement amply satisfies the criteria for approval articulated by the Second Circuit.

B. The Settlement Is Procedurally Fair

A presumption of fairness attaches to a proposed settlement if it is reached by experienced counsel after arm's-length negotiations, and great weight is accorded to the recommendations of counsel, who are most closely acquainted with the facts of the underlying litigation. *See Shapiro v. JPMorgan Chase & Co.*, No. Civ. 8831(CM)(MHD), 2014 WL 1224666, at *7 (S.D.N.Y. Mar. 24, 2014). A court may find the negotiating process is fair where, as here, "the settlement resulted from 'arm's-length negotiations and that plaintiffs' counsel have possessed the experience and ability . . . necessary to effective representation of the class's interests.'" *D'Amato v. Deutsche Bank*, 236 F.3d 78, 85 (2d Cir. 2001) (citation omitted); *see also Wachovia Equity*, 2012 WL 2774969, at *3.

Here, the Settlement is the product of vigorous and informed arm's-length negotiations by highly experienced, fully-informed counsel with the assistance of an experienced mediator, Judge Weinstein, who has overseen negotiations in numerous complex, multi-party, high-stakes litigation. *See* Weinstein Decl. ¶¶ 6-7 (Ex. 2); Schochet Decl. ¶¶ 5-7, 32-52; *see also City of Providence v. Aeropostale Inc. et al.*, No. 11 Civ. 7132, 2014 WL 1883494, at *4 (S.D.N.Y. May 9, 2014), *aff'd, Arbuthnot v. Pierson*, 607 F. App'x. 73 (2d Cir. 2015) (describing Judge Weinstein "as one of the nation's premier mediators in complex, multi-party, high stakes litigation, and one in whom this court reposes considerable confidence as a result of past experience."); *In re Telik, Inc. Sec. Litig.*, 576 F. Supp. 2d 570, 576 (S.D.N.Y. 2008) (finding "Judge Weinstein's role in the settlement

negotiations strongly supports a finding that they were conducted at arm's-length and without collusion.").

As explained in the Schochet Declaration (*e.g.*, ¶¶ 5-7, 32-52) and the Weinstein Declaration (¶¶ 9-25), both the decision to engage in settlement discussions and the decision ultimately to settle were the products of protracted negotiations that proceeded in essentially three stages. First, there were preliminary negotiations to establish a structure and process for future discussions, including the production to Lead Plaintiff of approximately 5,000 pages of key internal FSC and FSAM documents in advance of a two-day Pre-Mediation Presentation by Defendants' Counsel, which took place on June 6 and 7, 2016. The Pre-Mediation Presentation was designed to enable Lead Plaintiff, and the plaintiffs in the related actions, to determine whether mediated discussions concerning a potential settlement of the claims in the respective cases would be appropriate and fruitful.

In advance of the Pre-Mediation Presentation, Lead Counsel raised with Defendants numerous detailed questions and potentially open issues concerning FSC's valuation and interest recognition procedures and processes generally and their application to the four key investments specifically, including the inputs used to value such investments, which Lead Counsel and its accounting expert believed remained unanswered by their analysis and review of the documents produced to date. Lead Plaintiff sought to have these questions addressed during the Pre-Mediation Presentation and by any subsequent confirmatory discovery. Schochet Decl. ¶ 34.

During the Pre-Mediation Presentation, Defendants' Counsel reported detailed factual information concerning events and circumstances relating to the principal allegations in the Complaint, as well as related litigation issues, including (i) an overview of the investment activities of FSC; (ii) a review of the unique features of BDCs, including dividend payouts based on accrued

payment-in-kind ("PIK") interest[3] and their incentives to work with troubled portfolio companies, including through restructuring loans to include a PIK interest component, to avoid having those companies default on their obligations and thus maximize long-term recovery value; (iii) scrutiny of FSC's assets by internal and external auditors and third-party valuation firms, including valuation firms required and selected by FSC's creditors as well as valuation firms selected by Defendants; (iv) the circumstances of the timing of FSC's write-downs of the four portfolio companies at issue in the Action; (v) FSC's investment valuation policy and the circumstances of valuation review by its valuation team and its auditor PricewaterhouseCoopers; (vi) the accounting standards applicable to BDCs, including the differing approaches to estimating fair value of debt instruments: the enterprise value and the market yield methods; and (vii) analyses of insurance coverage, indemnity and damages issues. Schochet Decl. ¶ 36. The Pre-Mediation Presentation addressed many of the questions that Lead Plaintiff posed to Defendants in advance of the presentation. Those that remained open were addressed after Lead Plaintiff posed additional questions for clarification following the Presentation and through the additional discovery, as addressed in the Schochet Declaration. *Id.* ¶¶ 38, 43-52.

Following the Pre-Mediation Presentation and the review of the documents that had been thus far produced, Lead Plaintiff and Lead Counsel agreed to move forward with a formal mediation—stage two of the process. Between June 15 and 17, 2016, Lead Counsel, Defendants'

[3] PIK is contractually deferred interest added to principal and generally due at the end of the loan term. ¶ 35 n. 6. When a borrower cannot pay normal interest terms, PIK provisions can be used in a refinanced loan to nominally increase loan income (and, thus, the fees paid to FSAM) while at the same time rendering that income more speculative as payment is deferred until the end of the loan term. *Id.* BDCs, such as FSC, may pay cash dividends on PIK income even though that interest has not yet been, and may never be, paid (in cash) and are required to do so to the extent that the PIK income exceeds 90% of their total taxable income, including interest income. *Id.* During the Class Period, FSC recorded, projected and paid cash dividends partly based on PIK income. *See id.*

Counsel, and others participated in a three-day mediation session before Judge Weinstein, a highly qualified mediator with more than 25 years of experience presiding over complex commercial disputes, including many complex multi-party securities class action lawsuits. Weinstein Decl. ¶ 6. Approximately 60 people attended the mediation sessions, including Lead Counsel, Defendants' Counsel, a representative of Lead Plaintiff (who attended the mediation sessions on June 16 and 17), plaintiffs' counsel in the related actions, representatives of all of Defendants' insurers in the applicable insurance towers, and a representative from Fifth Street. Each constituency met separately to caucus and to have discussions with Judge Weinstein. *See* Schochet Decl. ¶¶ 39-40.

During the mediation, Lead Counsel made a presentation to representatives of the corporate defendants and carriers in which Lead Counsel argued as to the continued strength of the Class's claims, even in light of the facts revealed by the Pre-Mediation Presentation, based in part on its accounting expert's analysis, thereby making it clear that Lead Plaintiff had a sufficient basis upon which to resist any settlement resolution that did not provide the Class with a material portion of both the available insurance proceeds and their aggregate damages. The representative of Lead Plaintiff actively participated in negotiations with a thorough understanding of the issues. During the mediation, Lead Counsel also consulted by telephone with its forensic accounting expert, who participated in a discussion with Lead Counsel and Defendants' Counsel during which the latter responded to the remaining unanswered substantive merits-related questions that Lead Counsel had posed to Defendants. *Id.* ¶ 40.

The settlement discussions required all three full days of the scheduled mediation session. At the conclusion of the mediation, however, the parties to this Action were unable to reach an agreement in principle, and Judge Weinstein thereafter made a mediator's proposal to settle this case for $14,050,000. Weinstein Decl. ¶ 19. Both sides considered the proposal over several days. Lead

Plaintiff ultimately agreed in principle to the proposed Settlement, subject to its ability to conduct further discovery, including the production of additional documents and interviews of key senior executives and directors of FSC and FSAM to verify the accuracy of information Defendants' Counsel presented during and after the Pre-Mediation Presentation and address issues and questions that Lead Counsel believed remained open following the mediation. After approximately one month of negotiation, Lead Plaintiff and Defendants executed the Settlement Agreement on July 27, 2016, subject to termination if additional discovery did not support continuing with the Settlement. *See* Schochet Decl. ¶¶ 41-42.

The parameters of the additional discovery, which made up the final stage of discussions, were negotiated for approximately one month. During these protracted discussions, Lead Counsel successfully pushed to significantly expand the scope of the discovery initially proposed by Defendants. The confirmatory discovery was ultimately conducted between July 29, 2016 and August 26, 2016. Pursuant to the agreement between the parties, Defendants produced more than 90,000 documents (numbering more than 2.4 million pages), involving, *inter alia*: (i) the Pre-Mediation Presentation and all documents referenced therein; (ii) additional documents utilized in creating the Pre-Mediation Presentation, including the list of search terms used while creating the presentation and in connection with Fifth Street's investigation into the Complaint's allegations; (iii) the credit files for the four FSC investments Lead Plaintiff alleged to be significantly over-valued and impaired during the Class Period, which consisted of documents relating to the origination, valuation, and management of those investments; and (iv) the full set of documents that the Defendants' counsel had produced to the SEC on behalf of FSC and FSAM in connection with its investigation. *See* Schochet Decl. ¶¶ 43-50.

After Lead Counsel's review and analysis of the documents produced by Defendants, Lead

Plaintiff also conducted five separate day-long interviews of senior executives and directors of FSC and FSAM during the week of August 22, 2016, including Individual Defendants Bernard D. Berman (FSC Director, President and former Chief Compliance Officer (CCO); FSAM Co-President and CCO), Alexander C. Frank (FSC's former CFO; FSAM's COO and CFO), and Ivelin M. Dimitrov (FSC Director, President, and Chief Investment Officer (CIO); FSAM CIO); the Chairman of FSC's Audit Committee, Richard P. Dutkiewicz; and Fifth Street's Head of Portfolio Management, Brian D. Finkelstein. *See* Schochet Decl. ¶ 51.

After review of all of this discovery, and in consultation with its accounting expert, Lead Plaintiff and Lead Counsel determined to proceed with the proposed Settlement. On August 31, 2016, Lead Counsel informed Defendants' Counsel that Lead Plaintiff would not terminate the Settlement, given that the additional discovery process reinforced and confirmed Lead Plaintiff's belief that the Settlement is fair, reasonable, and adequate, and represents an excellent result for the Class. *See* Schochet Decl. ¶ 52.

The recommendation of Lead Plaintiff, a sophisticated institutional investor that manages approximately $2 billion in retirement fund assets, also supports the fairness of the Settlement. A settlement reached "under the supervision and with the endorsement of a sophisticated institutional investor . . . is 'entitled to an even greater presumption of reasonableness.'" *In re Veeco Instruments Inc. Sec. Litig.*, No. 05 MDL 01695 (CM), 2007 WL 4115809, at *5 (S.D.N.Y. Nov. 7, 2007) (citation omitted). "'Absent fraud or collusion, the court should be hesitant to substitute its judgment for that of the parties who negotiated the settlement.'" *Id*. (citation omitted). In particular, Lead Plaintiff took a very active role in the negotiation of the Settlement, as envisioned by the PSLRA, including attending two days of the mediation session and directly engaging with Judge Weinstein. *See generally* Exs. 1, 2, Schochet Decl. ¶¶ 39-40, 139.

Furthermore, Lead Counsel has extensive experience prosecuting complex securities class actions and taking them to trial. Schochet Decl. ¶ 136. Counsel believes that the Settlement is not only fair, reasonable, and adequate, but is an excellent result for the Class and Lead Plaintiff. Its opinion is entitled to "great weight." *Aeropostale Inc.*, 2014 WL 1883494, at *5. *See also* Ex. 2 ¶ 25 ("these proposed settlements are the result of vigorous, arm's-length negotiations by experienced, competent counsel, who were well prepared and well versed in the strengths and weaknesses of their respective positions and on the applicable law.")

Each of these considerations confirms the reasonableness of the Settlement and that the Settlement is entitled to the presumption of procedural fairness.

C. The Settlement Satisfies the Second Circuit's Test of Substantive Fairness

1. The Complexity, Expense, and Likely Duration of the Action Support Approval of the Settlement

"This factor captures the probable costs, in both time and money, of continued litigation." *Shapiro*, 2014 WL 1224666, at *8. Securities class actions like this one are by their nature complicated, and district courts in this Circuit have long recognized that "[a]s a general rule, securities class actions are 'notably difficult and notoriously uncertain' to litigate." *In re Bear Stearns Co. Sec. Derivative and ERISA Litig.,* 909 F. Supp. 2d 259, 266 (S.D.N.Y. 2012) (citation omitted); *see also In re Alloy, Inc., Sec. Litig.*, No. 03 Civ. 1597 (WHP), 2004 WL 2750089, at *2 (S.D.N.Y. Dec. 2, 2004) (approving settlement, noting action involved complex securities fraud issues "that were likely to be litigated aggressively, at substantial expense to all parties"); *In re AOL Time Warner, Inc. Sec. & "ERISA" Litig.*, No. 02 Civ. 5575, 2006 WL 903236, at *8 (S.D.N.Y. Apr. 6, 2006) (due to their "notorious complexity," securities class actions often settle to "circumvent[] the difficulty and uncertainty inherent in long, costly trials") (citation omitted). This case is no exception.

The Class' claims here raise numerous factual issues concerning the complex practice of fair value determinations for illiquid, non-investment grade assets; interest income recognition for such assets; the appropriate application of accounting guidelines relevant to fair value and income recognition determinations; the appropriateness of granting, and the sustainability of, dividends; valuation and income recognition policies and procedures; as well as complicated legal issues concerning falsity, scienter, and loss causation, among other things, each of which would require extensive percipient and expert testimony at trial. Schochet Decl. ¶¶ 59-92. Accordingly, one of the factors considered in agreeing to settle was the difficulty of ensuring that a jury would be able to assess these complicated evaluation facts, rules, guidelines, and regulations. Lead Plaintiff had a heavy burden to successfully simplify the issues in order to prove its case in chief. Defendants could have very well convinced the jury that the complexity substantially undermined falsity and scienter.

The Class has also not been aided by any roadmap from a government investigation, or from any other case or proceeding. Although Lead Counsel became aware of an investigation by the SEC related to the allegations in the Action, the investigation has not materialized into claims against any of the Defendants and there are no pleadings, findings, or testimony to be used by Lead Plaintiff or Lead Counsel to further the Class's claims. Schochet Decl. ¶¶ 7 n. 6, 44.

Finally, absent this Settlement, Defendants' motion to dismiss would have been refiled and decided, and, assuming Lead Plaintiff prevailed, the Action would have proceeded through more fact discovery and depositions, expert discovery, summary judgment briefing and possibly to trial at considerable additional expense and investment of time, with no guarantee of success. Throughout this process, "motions would be filed raising every possible kind of pre-trial, trial and post-trial issue conceivable." *In re Initial Pub. Offering Sec. Litig.*, 260 F.R.D. 81, 117 (S.D.N.Y. 2009) (citation omitted). Even with a successful outcome at trial, the post-trial motions and appeals process would

have likely spanned years, during which time the Class would have received no distribution of any damage award. *See Strougo ex rel. Brazilian Equity Fund, Inc. v. Bassini*, 258 F. Supp. 2d 254, 261 (S.D.N.Y. 2003) ("[E]ven if a shareholder or class member was willing to assume all the risks of pursuing the actions through further litigation . . . the passage of time would introduce yet more risks . . . and would, in light of the time value of money, make future recoveries less valuable than this current recovery."). An appeal of a favorable verdict would carry the risk of reversal, in which case the Class would receive no recovery at all, even after having prevailed on the claims at trial. *See, e.g., Hubbard v. BankAtlantic Bancorp, Inc.,* 688 F.3d 713 (11th Cir. 2012) (affirmance of judgment as a matter of law for defendants, after Labaton Sucharow obtained jury verdict for plaintiffs); *Robbins v. Koger Props., Inc.*, 116 F.3d 1441 (11th Cir. 1997) (reversing $81 million jury verdict and dismissing case with prejudice in securities action); *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215 (10th Cir. 1996) (overturning plaintiffs' verdict obtained after two decades of litigation); *cf. In re Apollo Grp., Inc. Sec. Litig.*, No. CV-04-2147-PHX-JAT, 2008 WL 3072731 (D. Ariz. Aug. 4, 2008), *rev'd*, No. 08-16971, 2010 WL 5927988 (9th Cir. June 23, 2010) (trial court overturned unanimous verdict for plaintiffs, later reinstated by the Ninth Circuit Court of Appeals, and judgment re-entered after denial of *certiorari* by the U.S. Supreme Court).

Thus, this factor weighs heavily in favor of approval of the Settlement.

2. The Reaction of the Class to the Settlement

One court has noted that the reaction of a class to a settlement "is considered perhaps 'the most significant factor to be weighed in considering its adequacy.'" *Veeco Instruments,* 2007 WL 4115809, at *7 (citation omitted). "[T]he absence of objectants may itself be taken as evidencing the fairness of a settlement." *In re PaineWebber Ltd. P'ships Litig.*, 171 F.R.D. 104, 126 (S.D.N.Y. 1997), *aff'd*, 117 F.3d 721 (2d Cir. 1997) (citation omitted); *see also In re Luxottica Grp. S.p.A. Sec. Litig.*, 233 F.R.D. 306, 311-12 (E.D.N.Y. 2006).

While the deadline of January 26, 2017 for Class Members to object or seek exclusion has not passed, in response to a thorough notice program, in which 43,177 Notice Packets have been mailed, to date not a single Class Member has objected to any aspect of the Settlement and no requests for exclusion from the Class have been received. *See* Ex. 6 ¶¶ 9, 13.[4] A full discussion of the notice program is set forth below in Section II.

3. The Stage of the Proceedings and the Amount of Discovery Completed

In considering this factor, "'the question is whether the parties had adequate information about their claims such that their counsel can intelligently evaluate the merits of plaintiff's claims, the strengths of the defenses asserted by defendants, and the value of plaintiffs' causes of action for purposes of settlement.'" *Bear Stearns,* 909 F. Supp. 2d at 267 (quoting *In re IMAX Sec. Litig.*, 283 F.R.D. 178, 190 (S.D.N.Y. 2012)). To satisfy this factor, parties need not have even engaged in formal or extensive discovery. *See Maley v. Del Global Techs. Corp.*, 186 F. Supp. 2d 358, 363 (S.D.N.Y. 2002).

As summarized above, and as detailed in the Schochet Declaration, the Settlement follows a robust investigation conducted by Lead Counsel, one that included: (i) interviews of eleven witnesses (former employees of Fifth Street); (ii) consulting with forensic accounting and damages/ causation experts; (iii) participation in the two-day Pre-Mediation Presentation by Defendants' Counsel, after review of over 5,000 pages of internal FSC and FSAM documents (including all relevant insurance policies), and during which it sought particularized information identified with the assistance of experts; (iv) pushing to significantly expand the amount of additional discovery material Defendants would provide, notwithstanding the PSLRA stay, so that the settlement offer could be vetted; (v) the analysis of more than two million pages of internal Company and FSAM

[4] If any objections or additional requests for exclusion are received, Lead Counsel will report on them in its reply papers, which are due on February 9, 2017.

documents, going to the heart of the allegations;[5] and (vi) separate day-long interviews of five senior executives and directors of FSC and FSAM to expand upon and test the assertions made by Defense counsel during and after the Pre-Meditation Presentation. *See e.g.*, Schochet Decl. ¶ 7, 21, 33-52.

Armed with this substantial base of knowledge, which would otherwise have only been obtained after a motion to dismiss was decided and considerable formal discovery, Lead Plaintiff was in a position to balance the proposed settlement amount with a well-educated assessment of the likelihood of overcoming the significant risks of litigation that were apparent at the beginning of this case. Accordingly, Lead Plaintiff and Lead Counsel respectfully submit that they had "a clear view of the strengths and weaknesses of their case[]" and of the range of possible outcomes at trial. *Teachers Ret. Sys. of La. v. A.C.L.N., Ltd.*, No. 01-Civ-11814 (MP), 2004 WL 1087261, at *3 (S.D.N.Y. May 14, 2004) (quotation marks and citation omitted). The Court thus should find that this factor also supports approval of the Settlement.

4. The Risks of Establishing Liability

In assessing the Settlement, the Court should balance the benefits afforded to the Class, including the immediacy and certainty of a recovery, against the continuing risks of litigation. *See Grinnell*, 495 F.2d at 463. As this case amply demonstrates, securities class actions present hurdles to proving liability that are difficult for plaintiffs to meet. *See AOL Time Warner*, 2006 WL 903236, at *11 (noting that "[t]he difficulty of establishing liability is a common risk of securities litigation");

[5] The documents included: (a) those related to the Pre-Mediation Presentation and all documents referenced in the presentation, including internal emails, (b) FSC credit files for the four main FSC investments Lead Plaintiff alleged were significantly impaired during the Class Period, which included documents relating to the origination, valuation, and management of those investments, and (c) the full set of documents that Defendants' counsel had produced to the SEC on behalf of FSC and FSAM relating to the allegations raised in the Action, the FSAM Class Action and the Derivative Actions in connection with an ordinary-course examination of FSAM's investment adviser subsidiary, Fifth Street Management LLC, by the SEC's Office of Compliance Inspections and Examinations, as well as an investigation by the SEC Division of Enforcement.

Alloy, 2004 WL 2750089, at *1 (finding that issues present in securities action presented significant hurdles to proving liability). Indeed, an empirical report published by NERA Economic Consulting surveying cases in 2015 found that with respect to motions to dismiss filed in securities class action cases, 54% were granted in full and 20% were granted in part. *See* Svetlana Starykh and Stefan Boettrich, *Recent Trends in Securities Class Action Litigation: 2015 Full-Year Review*, at 19 (NERA Jan. 25, 2016), Ex. 5.

The principal claims in the Action are based on §10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 promulgated thereunder. "To establish a §10(b) claim, a plaintiff must prove: (1) the defendant made a material misrepresentation or omission; (2) with scienter; (3) in connection with the purchase or sale of a security; (4) reliance; (5) economic loss; and (6) loss causation." *IBEW Local Union No. 58 Pension Trust Fund & Annuity Fund v. Royal Bank of Scotland Grp. PLC*, 783 F.3d 383, 389 (2d Cir. 2015) (citing *Stoneridge Inv. Partners, LLC v. Scientific–Atlanta, Inc.*, 552 U.S. 148, 157 (2008)).

The central allegations in the Action are that Defendants misrepresented: (i) the fair value of FSC's investment portfolio generally and the fair value of its investments in four companies specifically;[6] (ii) the extent to which FSC had covered, and would be able to cover, its dividend projection, which it increased by a material amount, 10% to $.0917 per share, for September through November 2014 early in the Class Period; (iii) the financial health and delinquency (or non-accrual) status of FSC's investments; and (iv) related financial metrics, such as interest income, net interest income, net assets resulting from operations, and earnings per share. *E.g.*, Schochet Decl. ¶¶ 21-27. The core allegation is that FSC inflated its net assets resulting from operations by deferring write-

[6] Namely, FSC's investments in: (i) TransTrade Operators, Inc. ("TransTrade"), (ii) Phoenix Brands Merger Sub LLC ("Phoenix"), (iii) JTC Education, Inc. ("JTC") and (iv) CCCG, LLC ("CCCG"). *Id.* ¶¶ 61-96.

downs of the fair value of its investments in the afore-referenced four companies, as well as placing those investments on non-accrual status, until after the FSAM IPO. *Id.* ¶ 25. As a result, FSAM's reported revenues, which to a considerable extent were derivative of the value of the assets it managed, were artificially inflated, contributing to the success of the offering, to the substantial benefit of certain of the individual Defendants who had ownership stakes in FSAM. *Id.* ¶¶ 23-26. Had FSC written down and placed on non-accrual status those assets by the quarter ended September 30, 2014, before the completion of the FSAM IPO, it allegedly would have reported a $1.109 million loss in net assets resulting from operations, rather than the increase that it reported to investors. *Id.* ¶ 25.

As discussed below and in the Schochet Declaration (*e.g.*, ¶¶ 9-11, 29, 56-92) there is no question that the Class would have confronted a number of challenges in establishing liability at trial. Indeed, Defendants' arguments made it clear that the Parties held, in many cases, polar opposite views of the factual and legal issues presented, many of which would have been the subject of expert testimony.

a. Risks Concerning Falsity

In *Omnicare,* the Supreme Court held that to prove the falsity of statements of opinion, plaintiffs must plead and prove that the speaker did not truly hold the opinion or that the statements did not rest on some meaningful inquiry. *Omnicare*, 135 S.Ct. at 1325-28, 1332. Accordingly, Defendants argued in the motion to dismiss, and would have likely argued at summary judgment and trial, that because FSC's investment assets were illiquid non-investment-grade assets that lacked ascertainable market values, the alleged misstatements based on those values reflected subjective, good faith judgments, opinions, and estimates that were fundamentally incapable of being false or misleading. Therefore, according to Defendants, the Class would have had to satisfy *Omnicare* and prove that Defendants truly did not believe that FSC's disclosed valuations of its investment assets

were true, or show that Defendants had not conducted an adequate investigation. Lead Plaintiff would have had to battle this contention with respect to each of the alleged underlying misstatements. In further support of this argument, Defendants would proffer evidence demonstrating that FSC's valuation and income recognition policies and procedures were approved by its external auditors and vetted by external third-party valuation firms, and also contend that the reasonableness of FSC's valuations and accrual/interest income recognition determinations is demonstrated by the fact that it has not been required to issue an accounting restatement. Schochet Decl. ¶¶ 60-63.

Lead Plaintiff had many counter-arguments, including that, for example, fair value and non-accrual determinations are not just entirely discretionary opinions. Rather, there are accounting guidelines that establish procedures and parameters circumscribing the range of possible opinions. Lead Plaintiff would have argued that Defendants did not have a reasonable basis for their opinions because they had not conducted a meaningful inquiry, particularly in light of the troubled history of the relevant investments. For example, Lead Plaintiff would argue that key inputs used to value the four relevant investments, particularly the portfolio companies' financial forecasts for the next five years, were inappropriate as they failed to account for, and be adjusted following, company-specific developments, such as repeated projection misses due to competitive developments, macroeconomic developments or heightened regulatory scrutiny, indicating that the revenue forecasts for these companies were unlikely to be met. As such, Lead Plaintiff would argue, the valuations on which these inputs were based were not the result of a meaningful inquiry. *See, e.g.*, *In re Lehman Bros. Sec. & ERISA Litig.*, 131 F. Supp. 3d 241, 253–54 (S.D.N.Y. 2015). Lead Plaintiff would also argue that third party valuations reports disclosing valuations in line with those applied and disclosed by Defendants do not immunize them from liability given that they were based on the same problematic

inputs as FSC's valuations, which Defendants knew or recklessly disregarded lacked a reasonable basis. Schochet Decl. ¶¶ 64-67.

Nonetheless, despite these arguments, this Court's recent decision in *City of Westland Police & Fire Ret. Sys. v. MetLife, Inc.*, 129 F. Supp. 3d 48, 68–69 (S.D.N.Y. 2015), would have provided further support to Defendants in light of the similarities between that case and this one. *MetLife* concerned accounting reserves, and the Court in that case found, under *Omnicare,* it is "substantially more difficult for a securities plaintiff to allege adequately (or, ultimately, to prove) that such a statement [of opinion] is false than it is to allege adequately (or prove) that a statement of pure fact is false." *Id.*

As discussed in detail in the Schochet Declaration, Defendants would also likely pursue a "truth on the market" defense that the alleged misstatements could not have been false because FSC purportedly fully disclosed its valuation policies to investors by explaining the various methodologies, the inputs applied to each, the multiple levels of review, and the inherent subjectivity in making these valuation decisions. Class Members could thus draw their own conclusions about FSC's valuation judgments. Schochet Decl. ¶ 70.

Lead Plaintiff would respond by showing that the disclosed information was buried in FSC's voluminous SEC filings and that a substantial, time-consuming analysis by accounting experts was required to glean the truth, and therefore Defendants could not meet their burden of showing that the information was "conveyed to the public with a degree of intensity and credibility sufficient to counter-balance effectively any misleading information created by the alleged misstatements." *Ganino v. Citizens Utils. Co.,* 228 F. 3d 154, 167 (2d Cir. 2000) (quotation omitted); *see e.g.*, *In re Massey Energy Co. Sec. Litig.*, 883 F. Supp. 2d 597, 617 (S.D. W. Va. 2012). Further, the information disclosed did not disclose company-specific developments, projections or risks

necessary to provide investors with the true extent to which the investments' fair value should be written down. Schochet Decl. ¶ 71; *see, e.g.*, *Rombach v. Chang*, 355 F. 3d 164, 173 (2d Cir. 2004).

Despite these arguments, the Class faced a very real risk that the Action would be dismissed at the motion to dismiss stage and, even if it survived, at summary judgment or trial. This Court's recent decision in *MetLife* would have surely been heavily relied upon by Defendants and Lead Counsel would have had to convince this Court that the instant Action was distinguishable.

b. Risks in Proving Scienter

The Class faced a significant challenge in proving that Defendants acted with scienter as "[p]roving a defendant's state of mind is hard in any circumstances." *In re Telik, Inc. Sec. Litig.*, 576 F. Supp. 2d 570, 579 (S.D.N.Y. 2008); *see also Fishoff v. Coty Inc.*, No. 09 Civ. 628 (SAS), 2010 WL 305358, at *2 (S.D.N.Y. Jan. 25, 2010) ("The element of scienter is often the most difficult and controversial aspect of a securities fraud claim.") By a preponderance of the evidence, Lead Plaintiff would have to prove that Defendants knew or were reckless in not knowing that FSC's fair value determinations and financial statements and metrics implicated thereby were false when issued —a task that was not aided by the issuance of a restatement. *See Novak v. Kasaks*, 216 F.3d 300, 311-12 (2d Cir. 2000).

Here, as noted above and detailed in the Schochet Declaration, the complexity and arguably subjective nature of the fair value and non-accrual determinations on which Lead Plaintiff's allegations entirely depended was notable. The Class faced tremendous risks in overcoming Defendants' arguments that FSC's valuations and non-accrual determinations left considerable margins of error for individuals to reach differing, but reasonable, conclusions. *See e.g.*, Schochet Decl. ¶¶ 76-77. As each of the alleged misstatements involved judgment calls, estimates, opinions, and projections of the financial metrics, Defendants could successfully argue that they did not act with scienter, because, at the time of making the relevant statements, they actually believed that the

statements were true, their statements rested on a meaningfully inquiry, and they were unaware of information undermining the bases for their beliefs. *See S.E.C. v. Price Waterhouse*, 797 F. Supp. 1217, 1241 (S.D.N.Y. 1992) ("no finding of fraud or recklessness can rationally be made" where financial misstatements "involved complex issues of accounting as to which reasonable accountants could reach different conclusions").

Lead Plaintiff was confident that it would have been able to support its claims with persuasive testimony and documentary evidence that the valuation and credit quality of FSC's portfolio was critical to the business strategies and operations of FSC and FSAM and that the Individual Defendants were closely involved in valuing FSC's investments and reporting those valuations. Schochet Decl. ¶¶ 79. Defendants were thus presumably aware of any adverse facts concerning their investment portfolio, including in particular the four relevant portfolio companies' frequent need to refinance or restructure loans, lackluster financial results, including consistent revenue misses, and the continued, increasing challenges facing them that made a turnaround in their fortunes unlikely, making clear that delay in writing them down lacked any reasonable basis. Thus, Lead Plaintiff would endeavor to introduce documentary and witness evidence indicating that Defendants knew or were severely reckless in not knowing that FSC's financial statements were false when issued.

To further rebut scienter, Defendants would also likely argue that they had no motive to engage in the alleged fraud. Defendants would argue that FSC did not receive a material benefit from the initial public offering of FSAM, and that certain Individual Defendants similarly did not receive any personal benefit as a result. Schochet Decl. ¶¶ 78.

Lead Plaintiff would seek to counter these assertions by arguing that Defendants were motivated to participate in and conceal inflated fair value determinations in order to enrich

themselves through the FSAM IPO. Given that FSAM's future expected cash flows are tied directly to the long-term viability of FSC and its business, defendants allegedly sought to maintain the illusion of sustainable performance in FSC's investment portfolio until after the FSAM IPO. Many of the Defendants personally benefited from the FSAM IPO, which is strong evidence of motive. Schochet Decl. ¶ 80. In particular, Defendants Tannenbaum, Berman, Dimitrov and Frank collectively reaped nearly $100 million in proceeds from it, thus demonstrating their motive. *See, e.g.*, *ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co*., 553 F. 3d 187, 198 (2d Cir. 2009) ("the 'motive' showing is generally met when corporate insiders allegedly make a misrepresentation in order to sell their own shares at a profit"). FSAM possessed the same motive, along with the motivation to increase the base and incentive compensation it received from FSC.[7] Such motives are imputable to the individual defendants who acted on behalf of FSAM and FSC. *See, e.g., In re Time Warner Inc. Sec. Litig.*, 9 F. 3d 259, 269 (2d Cir. 1993).

However, jury reactions to such factually intricate financial testimony are inherently difficult to predict. Defendants would have presented counter-evidence, including expert testimony as well as different interpretations of the evidence offered by the Class to support their various defenses to liability. Continued litigation involved substantial risks in proving Defendants' liability and a finding in favor of the Class by the jury was never assured.[8]

5. The Risks of Establishing Loss Causation and Damages

Even if Defendants' liability were established, Lead Plaintiff would have had to prove the existence and the amount of damages. Loss causation requires proof of a "causal connection between the material misrepresentation and the [economic] loss" suffered. *Dura Pharms., Inc. v.*

[7] *See In re JPMorgan Chase & Co. Sec. Litig.*, No. 06 Civ. 4674, 2007 WL 4531794, at *8 (N.D. Ill. Dec. 18, 2007) (recognizing a motive to "increase [ ] incentive compensation … [as an] important consideration[]" in the scienter analysis).

[8] The Court is respectfully referred to paragraphs 59 to 82 of the Schochet Declaration for a more detailed discussion of the risks faced by Lead Plaintiff in establishing liability.

Broudo, 544 U.S. 336, 338 (2005). Once causation is established, damages estimation remains "a complicated and uncertain process, typically involving conflicting expert opinion about the difference between the purchase price and [share's] 'true' value absent the alleged fraud." *Global Crossing*, 225 F.R.D. at 459 (citation and quotation marks omitted).

Lead Plaintiff alleged a disclosure date of February 9, 2015, when FSC reported its financial disclosures for the quarter ended December 31, 2014, the same quarter in which Defendants conducted the initial public offering of FSAM. On this disclosure date, FSC announced that it would issue no dividends for February 2015, while decreasing future dividend payments by more than 30%, and that it had moved $106 million worth of investments to non-accrual status as of the end of the quarter during which FSAM was being taken public. On the news, the price of FSC common stock plummeted $1.27 (or by nearly 15%) per share on February 9, 2015 to close at $7.22 per share. Lead Plaintiff's expert estimated aggregate damages based on this alleged disclosure to be approximately $88 million. The upper-bound of potential damages (about $95 million) also factored in a price decline continuing to the next trading day on February 10, 2015. Schochet Decl. ¶ 84.

Defendants would have likely argued at summary judgment and trial that because no new information was revealed on February 10, 2015, the decline in the price of FSC stock on that day was caused by unrelated factors rather than by a continued reaction from the prior day's disclosures, and the Class bore the burden to disaggregate those issues to establish loss causation and damages. *See, e.g., In re Moody's Corp. Sec. Litig.*, 07 Civ. 8375 GBD, 2013 WL 4516788, at *12 (S.D.N.Y. Aug. 23, 2013) (holding that "plaintiffs must disaggregate at least some portion of the declines in share prices from losses resulting from other, non-fraud-related events"). Defendants would also likely argue that it is inappropriate to calculate damages based on a two-day window, where, as here,

the relevant stock allegedly trades in an efficient market. *See, e.g.*, *Erica P. John Fund, Inc. v. Halliburton Co*., 309 F.R.D. 251, 269 (N.D. Tex. 2015).[9] Schochet Decl. ¶ 84.

Defendants would also likely argue that Class members' gains based on their pre-Class Period purchases are required to be netted out, which Lead Plaintiff's expert calculates would reduce damages to approximately $74 million.[10] Schochet Decl. ¶ 86.

Defendants would likely further contend at trial that damages were significantly lower than this, arguing that the disclosure on February 9, 2015 could not have caused the alleged losses because the elements of the allegedly concealed risk were previously *revealed* to the market each quarter in FSC's public filings, long before the price drop. For instance, Defendants would attempt to establish that each cash infusion into the investments, each restructuring of payment-in-kind interest, and each alteration of loan terms was disclosed before the write-downs occurred. Defendants would thus attempt to establish that FSC's alleged financial condition was known by

[9] Lead Plaintiff would counter such arguments with case law and expert analysis. *See, e.g., United States v. Hatfield*, No. 06-CR-0550 JS AKT, 2014 WL 7271616, at *13 (E.D.N.Y. Dec. 18, 2014) (finding a two-day event window appropriate where the corrective press release was made late in the day); Mark L. Mitchell & Jeffry M. Netter, *The Role of Financial Economics in Securities Fraud Cases: Applications at the Securities and Exchange Commission*, 49 Bus. Law. 545, 549 (1994) ("The current academic standard is to extend the event period to the close of trading on the day after the release of the pertinent information….With respect to securities fraud cases, there is substantial variation in the complexity of determining the length of an event window….The main advice is to carefully identify the exact dates during which the information in question reached the market, and then restrict the window to a short period if possible, generally two or three days around each release of new information.") . However, it is far from clear how a trier-of-fact would resolve the ensuing expert battle and assess the evidence.

[10] *See Abrahamson v. Fleschner*, 568 F. 2d 862, 878-79 (2d Cir. 1977) (holding "a plaintiff may [not] recover for losses, but ignore his profits, where both result from a single wrong"). Lead Plaintiff would contest such an interpretation of the law, *see, e.g., In re Schering-Plough Corp. Sec. Litig*., No. 01-0829, 2003 WL 25547564, at *26 (D.N.J. Oct. 10, 2003) (recognizing that "[a]ny capital gains made with respect to the sale of shares purchased before the Class Period are irrelevant"). However, there was a very significant risk that this issue could be resolved as a matter of law in a manner unfavorable to the Class, given that Lead Plaintiff would essentially be arguing for a change in Second Circuit precedent, based on persuasive out of circuit authority premised on statutory analysis.

investors well before the alleged disclosure date of February 9, 2015. Defendants would likely have argued that the only arguably *new* information disclosed on February 9, 2015 related to the suspension and cut of FSC's dividend, in which case damages would likely be reduced significantly further, likely to materially less than half of Lead Plaintiff's expert's lowest estimate. Schochet Decl. ¶ 87.

Lead Plaintiff of course had counterarguments, many overlapping substantially with its arguments supporting falsity. Schochet Decl. ¶ 88. However, expert testimony rests on many subjective assumptions that a jury could reject as speculative or unreliable. Here, the Parties' and their respective damages experts would strongly disagree with each other's assumptions and their respective methodologies, including the method of disaggregating potentially confounding news from the alleged fraud-related cause of the stock drops and whether a single- or two-day disclosure window is appropriate. Therefore, the risk that the jury would credit Defendants' damages position over that of Lead Plaintiff had considerable consequences in terms of the amount of recovery for the Class, even assuming liability was proven and, again, the reaction of a jury to battling expert testimony is highly unpredictable. Lead Plaintiff and Lead Counsel thus recognized the possibility that a jury could be swayed by convincing testimony from Defendants' expert, and find little or no damages. *See, e.g.*, *Veeco Instruments,* 2007 WL 4115809, at *10 ("The jury's verdict with respect to damages would depend on its reaction to the complex testimony of experts, a reaction which at best is uncertain.").[11]

[11] The Court is respectfully referred to paragraphs 83 through 89 of the Schochet Declaration for a more detailed discussion of the risks faced by Lead Plaintiff in establishing loss causation and damages.

In sum, proving loss causation and damages would have been a serious risk at summary judgment or trial.[12] Accordingly, in the absence of a settlement, the Class could have recovered an amount significantly less than the total Settlement Amount – or even nothing at all. In contrast, the substantial and certain payment of $14,050,000 by Defendants, weighs heavily in favor of approving the Settlement.

6. The Risks of Maintaining the Class Action Through Trial

Class certification can be reviewed and modified at any time by the Court before final judgment. *See* Fed. R. Civ. P. 23(c)(1)(C) ("An order that grants or denies class certification may be altered or amended before final judgment."); *see also Annunziato v. Collecto, Inc*., 293 F.R.D. 329, 340 (E.D.N.Y. 2013) ("[u]nder rule 23, district courts have the power to amend class definitions or decertify classes as necessary") (citation omitted). Although Lead Plaintiff believes there are strong grounds for certifying a litigation class, discussed in Lead Plaintiff's Motion for Authorization to Notify Class of Proposed Settlement and to Schedule a Fairness Hearing (ECF Nos. 92-94), the Settlement avoids any uncertainty with respect to class certification.[13]

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[12] *See, e.g., Apollo Grp.,* 2008 WL 3072731 (on a motion for judgment as a matter of law, overturned a jury verdict in favor of shareholders based on insufficient evidence presented at trial to establish loss causation); *Phillips v. Scientific-Atlanta, Inc.*, 489 F. App'x. 339 (11th Cir. 2012) (upholding summary judgment in favor of defendants on loss causation grounds in a case litigated since 2001); *In re BankAtlantic Bancorp, Sec. Litig.*, No. 07-61542-CIV-UNGARD, 2011 WL 1585605 (S.D. Fla. Apr. 25, 2011) (court granted defendants' judgment as a matter of law on the basis of loss causation, overturning jury verdict and award in plaintiff's favor after four-week trial conducted by Labaton Sucharow), *aff'd*, 688 F.3d 713 (11th Cir. 2012); *Robbins,* 116 F. 3d at 1441 (finding no loss causation and overturning $81 million jury verdict).

[13] In the Notice Order (ECF No. 103), the Court provisionally certified the Class for settlement purposes. There have been no developments in the case that would undermine that determination and, for all the reasons stated in the Lead Plaintiff's Memorandum of Law in Support of Consented to Motion for Authorization to Notify Class of Proposed Settlement and to Schedule Fairness Hearing (ECF No. 94), incorporated herein by reference, Lead Plaintiff now requests that the Court reiterate its prior certification (i) of the Class pursuant to Fed. R. Civ. P. 23(a) and (b)(3), for settlement purposes; and (ii) of Lead Plaintiff as Class Representative, as well as its prior appointment of Labaton Sucharow as Lead Counsel.

7. Ability to Withstand a Greater Judgment

The ability of a defendant to pay a judgment greater than the amount offered in settlement is relevant to whether a settlement is fair. *Grinnell*, 495 F. 2d at 463. However, even if defendants could withstand a greater judgment, "this factor, standing alone, does not suggest the settlement is unfair," especially where, as here, the "other Grinnell factors weigh heavily in favor of settlement." *D'Amato*, 236 F.3d at 86; *see also Cavalieri v. General Elec. Co*., No. 06-315, 2009 WL 2426001, at *2 (N.D.N.Y. Aug. 6, 2009) ("The court also notes that although neither party contends that defendants are incapable of withstanding greater judgment, that does not 'indicate that the settlement is unreasonable or inadequate.'") (citation omitted); *In re Sony SXRD Rear Projection TV Class Action Litig.*, No. 06 Civ. 5173 (RPP), 2008 WL 1956267, at *8 (S.D.N.Y. May 1, 2008) ("a defendant is not required to 'empty its coffers' before a settlement can be found adequate") .

Here, even if a favorable judgment was obtained following trial and upheld on appeal, there was a limited pool of available insurance, which plaintiffs in each of the related cases were competing to obtain and which was fast dissipating as Defendants defended the various claims and addressed an SEC investigation. A bankruptcy risk also existed because (i) the high-end of Lead Plaintiff's damages range roughly equaled the total cash FSC and FSAM had on hand as of December 31, 2015, and (ii) FSC in general faced highly uncertain business prospects given its focus on speculative assets.

While it is unclear whether Defendants are capable of withstanding a judgment greater than the Settlement Amount, as a practical matter, the prospects of recovering a substantially greater sum would have been offset by the inevitable post-trial motions and appeals Defendants would likely pursue following any judgment—all of which would have dissipated available funds and insurance coverage—as well as the risk of collection. Defendants have paid the Settlement Amount into an escrow account pursuant to the Stipulation, which is already earning interest for the Class. *See*

Prasker v. Asia Five Eight LLC, No. 08 Civ. 5811(MGC), 2010 WL 476009, at *5 (S.D.N.Y. Jan. 6, 2010) (approving settlement and noting that "[t]he settlement eliminated the risk of collection by requiring Defendants to pay the Fund into escrow").

8. The Reasonableness of the Settlement in Light of the Best Possible Recovery and the Attendant Risks of Litigation

The last two substantive factors courts within the Second Circuit consider are the range of reasonableness of a settlement in light of (i) the best possible recovery and (ii) litigation risks. *Grinnell*, 495 F.2d at 463. In analyzing these last two factors, the issue for the Court is not whether the Settlement represents the best possible recovery, but how the Settlement relates to the strengths and weaknesses of the case. The court "'consider[s] and weigh[s] the nature of the claim, the possible defenses, the situation of the parties, and the exercise of business judgment in determining whether the proposed settlement is reasonable.'" *Id*. at 462 (citation omitted). Courts agree that the determination of a "reasonable" settlement "is not susceptible of a mathematical equation yielding a particularized sum[.]" *PaineWebber*, 171 F.R.D. at 130 (quotation marks and citations omitted). Instead, "in any case there is a range of reasonableness with respect to a settlement[.]" *Newman v. Stein*, 464 F.2d 689, 693 (2d Cir. 1972); *see also Global Crossing*, 225 F.R.D. at 461 (noting that "the certainty of [a] settlement amount has to be judged in [the] context of the legal and practical obstacles to obtaining a large recovery"); *In re Indep. Energy Holdings PLC Sec. Litig.*, No. 00 Civ. 6689 (SAS), 2003 WL 22244676, at *4 (S.D.N.Y. Sept. 29, 2003) (noting few cases tried before a jury result in full amount of damages claimed).

Here, according to analyses prepared by Lead Plaintiff's damages expert, the Settlement represents a recovery of approximately 15% to 20% of the maximum estimated damages of between approximately $74 million to about $95 million, under different scenarios where a jury finds damages associated with only one disclosure date (February 9, 2015) or a two-day window

(February 9-10, 2015), and/or the Court holds that gains made on pre-Class Period purchases needs to be netted out. Schochet Decl. ¶¶ 84, 87. If Defendants' truth on the market liability arguments were credited, maximum damages could fall much further bringing the Settlement recovery percentage to likely over 50% of that damages figure.

Such estimated recoveries fall squarely within the range of reasonableness and, even at the low end of the damages range, are more than double common recoveries. *See, e.g., In re Merrill Lynch & Co. Inc. Research Reports Sec. Litig.*, No. 02 MDL 1484 (JFK), 2007 WL 313474, at *10 (S.D.N.Y. Feb. 1, 2007) (court approved $40.3 million settlement representing approximately 6.25% of estimated damages and noting that this is at the "higher end of the range of reasonableness of recovery in class actions securities litigations"); *In re Merrill Lynch & Co. Research Reports Sec. Litig.*, 246 F.R.D. 156, 167 (S.D.N.Y. 2007) (approving $125 million settlement that was "between approximately 3% and 7% of estimated damages [and] within the range of reasonableness for recovery in the settlement of large securities class actions").[14]

Moreover, the Settlement compares very favorably to the median reported settlement amounts in securities class actions, which was $6.1 million in 2015 and $8.2 million from 1996 to 2014. *See* Laarni T. Bulan, Ellen M. Ryan, and Laura E. Simmons, *Securities Class Action Settlements - 2015 Review and Analysis*, at 1 (Cornerstone Research 2016) (Ex. 4).

Considering that the Class might not have been able to survive the motion to dismiss or prove liability at trial, and the possibility that damages awarded by a jury could have been significantly lower than those demanded by the Class (or none at all), the Settlement is an excellent recovery. *See*

[14] *See also In re Omnivision Techs., Inc. Sec. Litig.*, 559 F. Supp. 2d 1036, 1042 (N.D. Cal. 2008) (settlement yielding 6% of potential damages after deducting fees and costs was "higher than the median percentage of investor losses recovered in recent shareholder class action settlements"); *In re Rite Aid Corp. Sec. Litig.*, 146 F. Supp. 2d 706, 715 (E.D. Pa. 2001) (noting that class action settlements since 1995 typically recovered between 5.5% and 6.2% of estimated losses).

Indep. Energy, 2003 WL 22244676, at *4 (noting few cases tried before a jury result in full amount of damages claimed); *In re Citigroup Inc. Sec., Litig.*, 07 Civ. 9901, 2013 WL 3942951, at *11 (S.D.N.Y. Aug. 1, 2013) (noting that "the risk that the class would recover nothing or would recover a fraction of the maximum possible recovery must factor into the decision-making calculus").

II. THE NOTICE PROGRAM SATISFIED RULE 23 AND DUE PROCESS

In accordance with the Notice Order, to date the Claims Administrator, A.B. Data, Ltd. ("A.B. Data"), has mailed 43,177 copies of the Notice of (1) Pendency and Proposed Settlement of Class Action; (2) Motion for Attorneys' Fees and Expenses; and (3) Hearing on Proposed Settlement (the "Notice"), the FSC cover letter (which was printed on blue paper to easily distinguish it from the FSAM Class Action cover letter), and claim form ("Notice Packets") to potential Class Members and their nominees. *See* Declaration of Adam D. Walter Regarding: (A) Mailing of the Cover Letter, Individual Notice and Claim Form; (B) Issuance of the Publication Notice; and (C) Report on Requests for Exclusion and Objections Received to Date, dated January 10, 2017 ("Mailing Decl."), ¶¶ 2-9, Ex. 6. The Publication Notice was also published in *The Wall Street Journal* and *Investor's Business Daily* and disseminated over the *PR Newswire* on December 5, 2016 and December 7, 2016. *Id.* ¶ 10. The Notice, the Claim Form, the Settlement Agreement and its Exhibits, and the Notice Order were also posted on a case-specific website identified in the Notice. *Id.* ¶ 12. The website has online claim filing capability and also prominently featured a notification on the home page about the related FSAM Class Action and the Derivative Actions, with links to websites with further information about those settlements. *Id*.

The Notice contains a detailed description of the nature and procedural history of the Action, as well as the material terms of the Settlement, including, *inter alia*: (i) the recovery under the Settlement; (ii) the manner in which the Net Settlement Fund will be allocated among eligible Class Members; (iii) a description of the claims that will be released; (iv) the right and mechanism for

Class Members to exclude themselves; and (v) the right and mechanism for Class Members to object to the Settlement, the Plan of Allocation, and/or the Fee and Expense Application.

Accordingly, the notice program fully satisfied Rule 23(c)(2)(B), which requires "the best notice that is practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort." Fed. R. Civ. P. 23(c)(2)(B). The notice program also satisfied the specific requirements of PSLRA and Rule 23(e)(1), which requires that notice must be provided in a "reasonable manner"—*i.e.*, it must "'fairly apprise the prospective members of the class of the terms of the proposed settlement and of the options that are open to them in connection with the proceedings.'" *Wal-Mart,* 396 F.3d at 114 (quoting *Weinberger v. Kendrick*, 698 F.2d 61, 70 (2d Cir. 1982)).

Although the deadlines to object or seek exclusion are not until January 26, 2017, to date no objections to any aspect of the Settlement have been received. The Claims Administrator has received no requests for exclusion from the Class. Ex. 6 ¶ 13.

III. THE PLAN OF ALLOCATION IS FAIR AND REASONABLE

If the Court approves the proposed Settlement, upon completion of the claims filing process, the Net Settlement Fund will be distributed to Class Members according to the Plan of Allocation set forth in the Notice. "[T]he adequacy of an allocation plan turns on whether counsel has properly apprised itself of the merits of all claims, and whether the proposed apportionment is fair and reasonable in light of that information." *PaineWebber*, 171 F.R.D. at 133; *Luxottica Grp.*, 233 F.R.D. at 316-17. As with the Settlement, the opinion of experienced and informed counsel carries considerable weight. *Indep. Energy*, 2003 WL 22244676, at *5. "When formulated by competent and experienced class counsel, an allocation plan need have only a 'reasonable, rational basis.'" *Global Crossing*, 225 F.R.D. at 462 (citing *In re Am. Bank Note Holographics, Inc. Sec. Litig.*, 127 F. Supp. 2d 418, 429-30 (S.D.N.Y. 2001)).

The Plan of Allocation, which was fully described in the Notice, was prepared with the assistance of the Class' damages expert and provides for the distribution of the Net Settlement Fund among Authorized Claimants based upon each Class Member's "Recognized Loss," as calculated by the formulas described in the Notice. In developing the Plan of Allocation, the Class' damages expert considered the amount of artificial inflation present in FSC's common stock throughout the Class Period that was purportedly caused by the alleged fraud. This analysis entailed studying the price declines associated with FSC's allegedly corrective disclosures, adjusted to eliminate the effects attributable to general market or industry conditions. In this respect, an artificial inflation value was determined as part of the Plan. This inflation will be utilized in calculating Recognized Loss Amounts for Authorized Claimants. Schochet Decl. ¶¶ 100-104.

A.B. Data, as the Court-approved Claims Administrator, will determine each Authorized Claimant's *pro rata* share of the Net Settlement Fund based upon each Authorized Claimant's total Recognized Loss compared to the aggregate Recognized Losses of all Authorized Claimants, as calculated in accordance with the Plan of Allocation. The calculation will depend upon several factors, including when the Authorized Claimant's common stock was purchased, whether the stock was sold during the Class Period, and, if so, when. *Id*. ¶ 103. After the claims administration process is completed, and claimants have been given an opportunity to address any deficiencies in their claims and challenge the rejection of invalid claims, Lead Plaintiff will file a motion with the Court asking for authorization to distribute settlement checks. Ultimately, any balance that remains in the Net Settlement Fund after distribution(s) to eligible claimants, which is not feasible or economical to reallocate, will be contributed to a non-sectarian, not-for-profit charitable organization(s) designated by Lead Plaintiff and FSC, and approved by the Court. *See* Settlement Agreement at 32.

Accordingly, the proposed Plan of Allocation is designed to fairly and rationally allocate the Settlement proceeds among the Class. Notably, to date, no Class Member has objected to the Plan. Accordingly, Lead Counsel respectfully requests that this Court approve the Plan of Allocation.

CONCLUSION

The Settlement reached in this Action is an outstanding result that provides an immediate substantial and certain benefit for the Class. For the reasons set forth herein and in the Schochet Declaration, Lead Plaintiff and Lead Counsel respectfully submit that the Settlement and Plan of Allocation are fair, reasonable, and adequate, and request that the Court grant approval of the Settlement and Plan of Allocation.[15]

Dated: January 12, 2017

Respectfully submitted,

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Counsel for Court-Appointed Lead Plaintiff Oklahoma Police Pension and Retirement System

[15] A proposed form of Judgment and Final Order, negotiated by the Parties, and a proposed order approving the Plan of Allocation will be submitted to the Court with Lead Plaintiff's reply papers, after the deadlines for seeking exclusion and objecting have passed.

CERTIFICATE OF SERVICE

I hereby certify that on January 12, 2017 the foregoing was filed through the ECF system and will be sent electronically to the registered participants as identified on the Notice of Electronic Filing (NEF).

/s/ Ira A. Schochet
Ira A. Schochet