UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE PENN WEST PETROLEUM LTD. SECURITIES LITIGATION	Master File No. 14-cv-6046-JGK

MEMORANDUM OF LAW IN SUPPORT OF LEAD PLAINTIFFS' MOTION FOR FINAL APPROVAL OF CLASS ACTION SETTLEMENT AND PLAN OF ALLOCATION

Date: June 3, 2016

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Pursuant to Rule 23(e) of the Federal Rules of Civil Procedure, the Court-appointed Lead Plaintiffs, Miami Fire Fighters' and Police Officers' Retirement Trust ("Miami FIPO") and Avi Rojany (collectively, "Lead Plaintiffs"), on behalf of themselves and the Settlement Class, respectfully submit this memorandum of law in support of their motion for final approval of the proposed Settlement resolving all claims asserted in this securities class action (the "Action") and for approval of the proposed plan of allocation of the proceeds of the Settlement (the "Plan of Allocation").[1]

I. INTRODUCTION[2]

Subject to this Court's approval, Lead Plaintiffs have agreed to settle all claims in this Action in exchange for a cash payment of Can$26,500,000, or US$19,759,282 on the day it was deposited into the Escrow Account. This is an excellent result for the Settlement Class given the

[1] Unless otherwise defined, all capitalized terms used herein have the meanings ascribed to them in the Stipulation and Agreement of Settlement dated February 12, 2016 (the "Stipulation"). *See* ECF No. 121-1.

[2] The Joint Declaration of John Rizio-Hamilton and Lionel Z. Glancy in Support of: (I) Lead Plaintiffs' Motion for Final Approval of Class Action Settlement and Plan of Allocation, and (II) Co-Lead Counsel's Motion for an Award of Attorneys' Fees and Reimbursement of Litigation Expenses ("Joint Declaration" or "Joint Decl."), filed herewith, is an integral part of this submission. For the sake of brevity, the Court is respectfully referred to it for a detailed description of, among other things: the history of the Action; the nature of the claims asserted; the negotiations leading to the Settlement; the risks and uncertainties of continued litigation; and the terms of the Plan of Allocation for the Settlement proceeds. All citations to "¶ __" and "Ex. __" in this memorandum refer, respectively, to paragraphs in, and exhibits to, the Joint Declaration.

many risks inherent in this litigation and the dire financial condition of the Company, which created very real ability to pay issues. In fact, on May 16, 2016, Penn West issued a press release stating that the Company anticipated that it would not be in compliance with its financial covenants as of June 30, 2016, and therefore it was not certain as to its ability to continue as a going concern. The Settlement has, however, been fully funded since March 14, 2016.

The Settlement is the product of Lead Plaintiffs' extensive investigation concerning the claims asserted in the Action and vigorous prosecution of the litigation on behalf of the Settlement Class. By the time the agreement to settle had been reached, Co-Lead Counsel had, among other things: (i) conducted a thorough review of information concerning Penn West's business, including SEC filings, analyst reports, investor presentations, news articles and interviews of former Penn West employees; (ii) drafted the detailed 116-page Consolidated Amended Class Action Complaint ("Complaint"); (iii) researched and drafted an omnibus opposition to Defendants' motions to dismiss; (iv) consulted with valuation, accounting and damages experts; and (v) engaged in an extensive mediation process under the auspices of Judge Daniel Weinstein (Ret.) ("Weinstein"), addressing liability, damages, loss causation, and ability to pay, which entailed a full-day mediation followed by nearly a month of follow-up negotiations. ¶¶ 4, 12-27. As a result, Co-Lead Counsel had a thorough understanding of the defenses to the claims asserted and the risks to establishing liability, damages, and collecting an excess judgment in this case when they negotiated the Settlement. ¶¶ 34-47.

While Lead Plaintiffs and Co-Lead Counsel believe that the claims asserted are meritorious, they recognize the substantial challenges to establishing that Defendants acted with scienter, demonstrating loss causation, proving class-wide damages, and achieving a greater recovery. Defendants have vigorously contested scienter and would have argued that Lead

Plaintiffs had not alleged any motive for Defendants to commit fraud, and could not point to any witnesses or documents to support allegations that Defendants knowingly or recklessly committed fraud. Defendants also had credible damages and loss causation arguments that could have greatly reduced, or even eliminated, any potential recovery. Finally, even if Lead Plaintiffs could have succeeded at trial, there is a significant risk that Penn West could not pay any amount in excess of its insurance coverage, which was being utilized to defend this and several other actions, and would have continued depleting as the litigation progressed.

As a condition to the agreement to settle, Defendants agreed to provide Lead Plaintiffs with: (i) documents and information concerning Penn West's inability to pay any amount beyond its existing insurance coverage; (ii) certain documents and information regarding the Company's accounting and audit processes; and (iii) an interview with a Penn West employee knowledgeable about the documents and information produced. ¶ 30. Lead Plaintiffs subsequently reviewed approximately 20,000 pages of documents produced by Penn West, and interviewed Penn West's current Chief Financial Officer ("CFO"), David A. Dyck ("Dyck"), about Penn West's financial condition and the Company's accounting and audit processes. ¶ 31-33. Lead Plaintiffs also retained J.T. Atkins, an experienced valuation expert, who analyzed the discovery materials and the Company's financial statements, and concluded that Penn West lacked the ability to settle the class action for more than its insurance coverage. *See* Affidavit of J.T. Atkins (the "Atkins Aff.") (Ex. 3) ¶¶ 2, 28. All these discovery efforts confirmed Penn West's inability to pay any settlement amount beyond its insurance policy limits and confirmed Co-Lead Counsel's assessment of the Settlement as fair and reasonable. ¶ 33.

As explained herein, the Settlement is fair, adequate, and reasonable under the governing standards in this Circuit because it was reached after almost two years of hard-fought litigation,

lengthy settlement negotiations, and due diligence discovery. The Settlement Amount represents an extremely significant percentage of Defendants' remaining insurance coverage, and eliminates the significant costs and risks of continuing litigation through trial and appeals, particularly since the Court has not yet ruled on Defendants' motions to dismiss.

For these reasons, Lead Plaintiffs and Co-Lead Counsel believe that the Settlement is in the best interests of the Settlement Class. In addition, the Plan of Allocation, which ties each investor's recovery to when the securities were acquired and sold, is a fair and reasonable method for distributing the Net Settlement Fund to the Settlement Class and warrants approval.

II. THE PROPOSED SETTLEMENT MERITS FINAL APPROVAL

A court will approve a settlement if it is "fair, adequate, and reasonable, and not a product of collusion." *Wal-Mart Stores, Inc. v. Visa U.S.A. Inc.*, 396 F.3d 96, 116 (2d Cir. 2005).[3] Although "[t]he decision to grant or deny such approval lies squarely within the discretion of the trial court, … this discretion should be exercised in light of the general judicial policy favoring settlement." *In re PaineWebber Ltd. P'ships Litig.*, 171 F.R.D. 104, 124 (S.D.N.Y. 1997), *aff'd*, 117 F.3d 721 (2d Cir. 1997). Accordingly, public policy considerations strongly favor settlement, particularly in class actions. *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.'"). Furthermore, "[i]n evaluating the settlement of a securities class action, federal courts, including this [c]ourt, have long recognized that such litigation is notably difficult and notoriously uncertain." *In re IMAX Sec. Litig.*, 283 F.R.D. 178, 189 (S.D.N.Y. 2012); *In re Marsh & McLennan Cos., Sec. Litig.*, No. 04 CIV. 8144 (CM), 2009 WL 5178546, at *5 (S.D.N.Y. Dec. 23, 2009) (same).

[3] Unless otherwise noted, all emphasis is added and internal citations are omitted in quotations.

A. The Settlement is Entitled to a Presumption of Fairness Because it is the Product of Arm's-Length Negotiations Among Experienced Counsel

Courts may apply a presumption of fairness when a class settlement is the product of "arm's-length negotiations between experienced, capable counsel after meaningful discovery," *In re Citigroup Inc. Bond Litig.*, 296 F.R.D. 147, 155 (S.D.N.Y. 2013) (quoting *Wal-Mart*, 396 F.3d at 116). Because counsel are "most closely acquainted with the facts of the underlying litigation," courts give "great weight" to the recommendations of counsel regarding settlement, especially when negotiations are facilitated by an experienced, third-party mediator. *In re Telik, Inc. Sec. Litig.*, 576 F. Supp. 2d 570, 576 (S.D.N.Y. 2008); *see also D'Amato v. Deutsche Bank*, 236 F.3d 78, 85 (2d Cir. 2001) (finding that a mediator's involvement in settlement negotiations "helps to ensure that the proceedings were free of collusion and undue pressure").

Here, the Parties' negotiations did not commence until after Co-Lead Counsel engaged in an extensive investigation to understand the strengths and weaknesses of the case. Specifically, Co-Lead Counsel thoroughly reviewed publicly available information about the Company; interviewed former Penn West employees; consulted accounting and damages experts; prepared the detailed 116-page Complaint; and fully briefed Defendants' motions to dismiss. ¶¶ 4, 12-21. As part of the mediation process facilitated by Judge Weinstein, the Parties exchanged written statements and presentations concerning liability, damages, loss causation, and ability to pay. ¶ 25. The Parties also engaged in an all-day, in-person mediation in Toronto on December 8, 2015, but no settlement was reached at the mediation. *Id*. The Parties continued to negotiate for several weeks through Judge Weinstein, who ultimately made a mediator's recommendation that the Action be settled for Can$26,500,000, which the Parties accepted on January 4, 2016. ¶¶ 25-26.

The extensive and arm's-length nature of the settlement negotiations and the involvement of an experienced and respected mediator like Judge Weinstein support the conclusion that the

Settlement is presumptively fair, adequate, and reasonable. *See City of Providence v. Aeropostale, Inc.*, No. 11 Civ. 7132(CM)(GWG), 2014 WL 1883494, at *4 (S.D.N.Y. May 9, 2014), *aff'd sub nom., Arbuthnot v. Pierson*, 607 F. App'x 73 (2d Cir. 2015) ("[t]his initial presumption of fairness and adequacy applies here because the Settlement was reached by experienced, fully-informed counsel after arm's-length negotiations and, ultimately, with the assistance of Judge Daniel Weinstein, one of the nation's premier mediators in complex, multi-party, high stakes litigation") (collecting cases); *Marsh & McLennan*, 2009 WL 5178546, at *8 (finding "no reason to doubt that the Settlement is procedurally fair" when "negotiations were conducted with the assistance of Judge Weinstein, a highly regarded mediator with extensive experience in securities litigation").

On February 5, 2016, the Parties executed a Term Sheet containing the agreement in principle to settle. ¶ 26. One condition of the Term Sheet was that Lead Plaintiffs could conduct due diligence discovery and would have the right to withdraw from the Settlement if Judge Weinstein issued a written determination that the information produced by Penn West rendered the proposed Settlement unfair, unreasonable, or inadequate. ¶ 30. After reviewing the documents produced by Penn West, conducting an interview of its CFO, and receiving the opinion from their valuation expert noted above, Lead Plaintiffs and Co-Lead Counsel confirmed their belief that the Settlement is fair, adequate, and reasonable. ¶¶ 32-33.

The conclusion of Lead Plaintiffs and Co-Lead Counsel that the Settlement is fair, adequate, and reasonable and in the best interests of the Settlement Class further supports its approval. Lead Plaintiffs, including Miami FIPO, an institutional investor of the type favored by Congress when passing the PSLRA, are sophisticated investors who took an active role in supervising this litigation and recommended that the Settlement be approved. *See In re Veeco Instruments Inc. Sec. Litig.*, No. 05 MDL 01695 (CM), 2007 WL 4115809, at *5 (S.D.N.Y. Nov.

7, 2007) ("under the PSLRA, a settlement reached . . . under the supervision and with the endorsement of a sophisticated institutional investor . . . is 'entitled to an even greater presumption of reasonableness . . . .'"). *See also* Declaration of Dania L. Orta of Miami FIPO (Ex. 1) ¶¶ 4-6; Declaration of Avi Rojany (Ex. 2) ¶¶ 4-6. Co-Lead Counsel, which have extensive experience in prosecuting securities class actions, have also concluded that the Settlement is in the Settlement Class' best interests, and their judgment is entitled to "great weight." *Telik*, 576 F. Supp. 2d at 576.

These facts strongly weigh in favor of affording the Settlement the presumption of fairness and granting final approval.

B. The Settlement is Substantively Fair, Reasonable and Adequate Under the *Grinnell* Factors

The Settlement is also substantively fair, adequate, and reasonable. It is well-established that "in this Circuit, courts examine the fairness, adequacy, and reasonableness of a class settlement according to the *Grinnell* factors," which are:

> (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.

Wal-Mart, 396 F.3d at 117 (quoting *City of Detroit v. Grinnell Corp.*, 495 F.2d 448, 463 (2d Cir. 1974), *abrogated on other grounds by Goldberger v. Integrated Res., Inc.*, 209 F.3d 43 (2d Cir. 2000)); *Deutsche Bank*, 236 F.3d at 86.

In applying the *Grinnell* factors, a court "must give comprehensive consideration to all relevant factors," *Hayes v. Harmony Gold Mining Co.*, 509 F. App'x 21, 23 (2d Cir. 2013), but "not every factor must weigh in favor of settlement, rather [a] court should consider the totality of

these factors in light of the particular circumstances." *IMAX*, 283 F.R.D. at 189. "[W]hen evaluating a settlement agreement, the court is not to substitute its judgment for that of the parties, nor is it to turn consideration of the adequacy of the settlement into a trial or a rehearsal of the trial." *In re Sony Corp. SXRD*, 448 F. App'x 85, 87 (2d Cir. 2011).

As demonstrated below, the Settlement satisfies the criteria for approval under *Grinnell*.

1. Continued Litigation Would be Complex, Expensive, and Protracted

In general, "the more complex, expensive, and time consuming the future litigation, the more beneficial settlement becomes as a matter of efficiency to the parties and to the Court." *In re Citigroup Inc. Sec. Litig.*, 965 F. Supp. 2d 369, 381-82 (S.D.N.Y. 2013). This is particularly true here, as "securities class actions are by their very nature complicated and district courts in this Circuit have 'long recognized' that securities class actions are 'notably difficult and notoriously uncertain' to litigate." *City of Providence*, 2014 WL 1883494, at *5 (quoting *In re Bear Stearns Cos. Sec., Deriv. & ERISA Litig.*, 909 F. Supp. 2d 259, 266 (S.D.N.Y. 2012)).

Further litigation would have required substantial additional expenditures of time and money, involving complex issues of law and fact, with a significant risk of a lower recovery. *See In re AOL Time Warner, Inc. Sec. & ERISA Litig.*, No. 02 CIV. 5575 (SWK), 2006 WL 903236, at *9 (S.D.N.Y. Apr. 6, 2006) ("In addition to the complex issues of fact involved in this case, the legal requirements for recovery under the securities laws present considerable challenges, particularly with respect to loss causation and the calculation of damages."). The subject matter of the claims and nearly four and half-year Settlement Class Period increased the complexity and expense of litigation. Lead Plaintiffs allege that, throughout the Settlement Class Period, Defendants materially misstated Penn West's financial results, including its operating expenses and net income, primarily by reclassifying operating expenses as either capital expenses or royalties. The facts underlying these claims involve disputed accounting treatment under

International Financial Reporting Standards and Canadian Generally Accepted Accounting Principles, which would continue to require extensive assistance from accounting and industry experts to properly litigate.

In the absence of the Settlement, the Action would have required resolution of the three motions to dismiss, extensive fact and expert discovery, a litigated class certification motion, summary judgment motions, litigating *Daubert* motions, proving Lead Plaintiffs' claims at trial, and post-trial motion practice. Given the number of defendants and issues involved during the lengthy Settlement Class Period, the Parties anticipated extensive document and deposition discovery at considerable expense. Throughout each litigation phase, Lead Plaintiffs would undoubtedly have faced a robust defense from Defendants' experienced counsel. *See In re Alloy, Inc. Sec. Litig.*, No. 03 Civ. 1597, 2004 WL 2750089, at *2 (S.D.N.Y. Dec. 2, 2004) (securities fraud issues "likely to be litigated aggressively, at substantial expense to all parties"). As a result of such "notorious complexity, securities class action litigation is often resolved by settlement, which circumvents the difficulty and uncertainty inherent in long, costly trials." *AOL Time Warner*, 2006 WL 903236, at *8.

Even if Lead Plaintiffs could recover an equally large judgment after a trial *and* recover from Defendants – both of which are far from certain given the risks discussed herein – the additional delay through post-trial motions and the appellate process could deny the Settlement Class any recovery for years, further reducing its value. *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").

Significantly, as discussed more fully in §II.B.6, *infra*, due to Penn West's deteriorating financial condition and lack of cash, insurance coverage was the only practical source of recovery, and these funds would be reduced by defense costs if this and the Canadian actions had continued. Accordingly, there is a very significant risk that further litigation might yield a smaller recovery – or no recovery at all – several years in the future. *See, e.g.*, *Hicks v. Morgan Stanley & Co.*, No. 01 Civ. 10071 (RJH), 2005 WL 2757792, at *6 (S.D.N.Y. Oct. 24, 2005) ("Further litigation would necessarily involve further costs; justice may be best served with a fair settlement today as opposed to an uncertain future settlement or trial of the action."); *In re Am. Bank Note Holographics, Inc. Sec. Litig.*, 127 F. Supp. 2d 418, 425 (S.D.N.Y. 2001) (protracted litigation could force a company experiencing financial difficulties into bankruptcy and foreclose significant recovery for the class).

The Settlement eliminates the expense and delay of continued litigation, the depletion of existing insurance coverage, and the risk that the Settlement Class could receive no recovery.

2. The Lack of Objections and/or Opt-Outs Support Final Approval

The reaction of the class to a proposed settlement is a significant factor to weigh in considering its fairness and adequacy. *See Bear Stearns*, 909 F. Supp. 2d at 266-67. The absence of valid objections and low number of requests for exclusion provides evidence of Settlement Class members' approval of the terms of the Settlement. *See Wal-Mart*, 396 F.3d at 118 ("If only a small number of objections are received, that fact can be viewed as indicative of the adequacy of the settlement."); *Am. Bank Note*, 127 F. Supp. 2d at 425 (noting "the lack of objections may well evidence the fairness of the Settlement").

Pursuant to the Preliminary Approval Order (ECF No. 124), the Court-appointed Claims Administrator, Epiq Class Action & Claims Solutions, Inc. ("Epiq"), began mailing copies of the Notice and the Claim Form (together, the "Notice Packet") on March 29, 2016. *See* Declaration of Stephanie A. Thurin Regarding: (A) Mailing of the Notice and Proof of Claim Form; (B)

Publication of the Summary Notice; and (C) Report on Requests for Exclusion Received to Date ("Thurin Decl.") (Ex. 4) ¶¶ 3-5. As of June 2, 2016, Epiq had disseminated a total of 273,414 Notice Packets to potential members of the Settlement Class and nominees. *See id*. ¶ 8. In addition, the Summary Notice was published in *Investor's Business Daily* and *The National Post* in Canada, and transmitted over *PR Newswire* on April 12, 2016. *See id*. ¶ 9. The Notice contains a description of the Action, the Settlement, and information about Settlement Class Members' rights to participate in the Settlement by submitting a Claim Form; to object to the Settlement, the Plan of Allocation, or Lead Counsel's motion for attorneys' fees and expenses; or to request exclusion from the Settlement Class. While the Court's deadline for members of the Settlement Class to object or exclude themselves from the Settlement Class – June 20, 2016 – has not yet passed, to date, no objections and only 15 requests for exclusion have been received. ¶ 54; Thurin Decl. ¶ 15.

The Settlement Class' favorable reaction supports approving the Settlement. *See Bear Stearns*, 909 F. Supp. 2d at 267 ("Given the absence of significant exclusion or objection—the rate of exclusion is 5.1% and the rate of objection is less than 1%—this factor weighs strongly in favor of approval."); *In re Merrill Lynch & Co. Research Reports Sec. Litig.*, No. 02 MDL 1484(JFK), 2007 WL 313474, at *15 (S.D.N.Y. Feb. 1, 2007) (finding that 34 requests for exclusion in response to the mailing of nearly 400,000 notices was a "minimal" number that "militates in favor of approving the settlement as be fair, adequate, and reasonable.").

3. Lead Plaintiffs had Sufficient Information to Make Informed Decisions About Settling this Case

The third *Grinnell* factor, which looks to the "stage of the proceedings and the amount of discovery completed," *Wal-mart*, 396 F.3d at 117, examines "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. To satisfy this factor, the Parties "need not have engaged in extensive discovery as long as they have engaged in sufficient investigation of the facts to enable the Court to intelligently make . . . an appraisal of the settlement." *AOL Time Warner*, 2006 WL 903236, at *10; *IMAX*, 283 F.R.D. at 190 ("The threshold necessary to render the decisions of counsel sufficiently well informed, however, is not an overly burdensome one to achieve—indeed, formal discovery need not have necessarily been undertaken yet by the parties.").

By the time the Parties agreed to settle, Lead Plaintiffs and Co-Lead Counsel understood the strengths and weaknesses of the claims and defenses asserted, and could make informed appraisals regarding the chances of success. Lead Counsel expended significant time and resources analyzing and litigating the legal and factual issues in the Action. Among other things, Co-Lead Counsel: (i) thoroughly reviewed publicly available information concerning Penn West, including SEC filings, analyst reports, investor presentations, and financial press; (ii) interviewed former Penn West employees with knowledge of its accounting practices; (iii) prepared the detailed 116-page Complaint; (iv) researched and drafted the 72-page omnibus opposition to the three motions to dismiss filed by Defendants; and (v) consulted experts on accounting, loss causation and damages. ¶¶ 4, 12-20. Co-Lead Counsel also engaged in an extensive mediation process under the auspices of Judge Weinstein, including *inter alia*, the exchange of detailed statements and presentations addressing liability, expert damage analyses, loss causation, and ability to pay; a full-day mediation; and nearly a month of follow-up negotiations. ¶¶ 22-26.

Lead Plaintiffs also had the benefit of due diligence discovery, which was a condition of the agreement to settle. ¶ 30. In connection with this discovery, Co-Lead Counsel analyzed

approximately 20,000 pages of internal Penn West documents that were produced in response to their document requests. ¶ 32. Co-Lead Counsel also interviewed Penn West's CFO concerning the Company's financial condition and accounting practices. *Id.* Finally, as noted above, Co-Lead Counsel retained an expert to assess Penn West's ability to pay a settlement in excess of its insurance coverage. ¶ 33.

In light of these efforts, Lead Plaintiffs and Co-Lead Counsel had a strong understanding of the claims and defenses asserted and the significant risks to establishing liability, damages, and collecting an excess judgment in order to intelligently negotiate the Settlement. *See AOL Time Warner*, 2006 WL 903236, at *10; *see also In re Advanced Battery Techs., Inc. Sec. Litig.*, 298 F.R.D. 171, 177 (S.D.N.Y. 2014) (where "no merits discovery occurred," counsel that had conducted their own investigation, engaged in detailed briefing, and conducted targeted due diligence discovery were "knowledgeable with respect to possible outcomes and risks in this matter and, thus, able to recommend the Settlement"); *In re Sony SXRD Rear Projection Television Class Action Litig.*, No. 06 Civ. 5173 (RPP), 2008 WL 1956267, at *7 (S.D.N.Y. May 1, 2008) ("[a]lthough the parties did not engage in extensive formal discovery, such efforts are not required for the Settlement to be adequate, so long as the parties conducted sufficient discovery to understand their claims and negotiate settlement terms").

4. Lead Plaintiffs Faced Major Risks in Establishing Liability and Damages

In assessing the fairness, reasonableness and adequacy of a settlement, courts should consider the "risks of establishing liability [and] the risks of establishing damages." *Grinnell*, 495 F.2d at 463; *Wal-Mart*, 396 F.3d at 117. Analyzing these risks "does not require the Court to adjudicate the disputed issues or decide unsettled questions; rather, the Court need only assess the risks of litigation against the certainty of recovery under the proposed settlement." *In re Global*

Crossing Sec. & ERISA Litig., 225 F.R.D. 436, 459 (S.D.N.Y. Nov. 24, 2004); *AOL Time Warner*, 2006 WL 903236, at *11 (same). In other words, "the Court should balance the benefits afforded to members of the Class and the immediacy and certainty of a substantial recovery for them against the continuing risks of litigation." *Maley v. Del Global Techs. Corp.*, 186 F. Supp. 2d 358, 364 (S.D.N.Y. 2002). Courts should, therefore, "approve settlements where plaintiffs would have faced significant legal and factual obstacles to proving their case." *Global Crossing*, 225 F.R.D. at 459.

a. Risks of Establishing Liability

"The difficulty of establishing liability is a common risk of securities litigation," particularly where, as here, Defendants had credible defenses. *AOL Time Warner*, 2006 WL 903236, at *11. While Lead Plaintiffs believe they adequately alleged scienter, they recognize the difficulties of proving scienter at trial. *See id.* (recognizing that "avoiding dismissal at the pleading stage does not guarantee that scienter will be adequately proven at trial"). Indeed, scienter is often considered "the most difficult and controversial aspect of a securities fraud claim." *Fishoff v. Coty Inc.*, No. 09 Civ. 628 (SAS), 2010 WL 305358, at *2 (S.D.N.Y. Jan. 25, 2010), *aff'd*, 634 F.3d 647 (2d Cir. 2011).

Even though the Company has admitted to materially misstating Penn West's financial results, Defendants have vigorously argued that none of their alleged misstatements were made with sufficient knowledge or recklessness to prevail under the federal securities laws. Specifically, Defendants argued that Lead Plaintiffs had not alleged any concrete and personal benefits giving rise to a motive for Defendants to engage in fraud, and could not point to any witnesses or internal documents to support their allegations that Defendants knowingly or recklessly committed securities fraud. Defendants further argued that the nature of the accounting errors were not consistent with fraud, but rather were judgment calls; that the overall impact of the voluntary

Restatement was limited; and that Penn West received clean audit opinions throughout the Class Period. While Lead Plaintiffs would argue that the nature and magnitude of the accounting errors supported an inference of scienter, there is a substantial risk that the Court or a jury would accept Defendants' arguments.

b. Risks of Establishing Loss Causation and Damages

If the litigation had proceeded, Lead Plaintiffs could have encountered significant causation and damages defenses. Lead Plaintiffs must establish that it was the revelation of Defendants' misrepresentations or omissions which caused Lead Plaintiffs to incur a loss, and not non-fraud related business or macroeconomic factors. *See Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 345-46 (2005) (plaintiffs bear "the burden of proving that the defendant's misrepresentations caused the loss for which the plaintiff seeks to recover"). Disentangling the market's reaction to various pieces of news is a "complicated concept, both factually and legally." *Global Crossing*, 225 F.R.D. at 459. Accordingly, the "[c]alculation of damages is a 'complicated and uncertain process, typically involving conflicting expert opinion' about the difference between the purchase price and the stock's 'true' value absent the alleged fraud." *Id.*

The Parties held extremely disparate views with respect to damages, and Defendants' challenges to loss causation and damages could pose a serious risk to the Settlement Class at the pleading stage, summary judgment, trial, and on appeal. *See, e.g.*, *Hubbard v. BankAtlantic Bancorp, Inc.*, 688 F.3d 713, 716 (11th Cir. 2012) (reversing plaintiffs' jury verdict for failure to prove loss causation); *In re Scientific Atl., Inc. Sec. Litig.*, 754 F. Supp. 2d 1339, 1379-80 (N.D. Ga. 2010) (granting motion for summary judgment because plaintiffs did not disentangle fraud-related and non-fraud-related portions of stock decline). As to the first alleged corrective disclosure, Defendants had credible arguments that nothing in Penn West's November 6, 2013 disclosure corrected or revealed anything about the improper classification of expenses. *See* ECF

Nos. 86 at 34-35, 103 at 24. If Defendants were to prevail on this issue at any stage, it would significantly reduce potential damages. As to the second corrective disclosure on July 29, 2014, Defendants also argued that other factors unrelated to the alleged fraud affected Penn West's stock price, including, but not limited to, negative news about the Company's declining production, high debt levels, and dividend risk.

In complex securities cases, it is axiomatic that the Parties would rely on expert testimony to assist the jury in determining damages. *See Global Crossing*, 225 F.R.D. at 459 ("[P]roof of damages in securities cases is always difficult and invariably requires expert testimony which may, or may not be, accepted by a jury."). While Lead Plaintiffs would argue that the stock price declines were attributable to corrections of the alleged misstatements and omissions concerning Penn West's financial results and present expert testimony addressing loss causation and damages, there is little doubt that Defendants would proffer their own expert to offer contrary testimony with respect to all of the price declines. *See IMAX*, 283 F.R.D. at 193 ("[I]t is well established that damages calculations in securities class actions often descend into a battle of experts."). In such a "battle of experts, it is virtually impossible to predict with any certainty which testimony would be credited, and ultimately, which damages would be found" by the jury. *In re Telik*, 576 F. Supp. 2d at 579-80.

Therefore, even if liability were established at trial, "a jury could find that damages were only a fraction of the amount that plaintiffs contend" because "[a] jury could be swayed by experts for the Defendants, who would minimize the amount of Plaintiffs' losses." *Del Global*, 186 F. Supp. 2d at 365. If a jury were to accept Defendants' arguments, damages in this case could be greatly reduced or even eliminated. *Marsh & McLennan*, 2009 WL 5178546, at *6 ("[i]f there is anything in the world that is uncertain when a case like [a securities class action] is taken to trial,

it is what the jury will come up with as a number for damages."). As a result, "the risks faced by the securities plaintiffs in establishing damages are substantial, and this factor favors approving the settlement." *Global Crossing*, 225 F.R.D. at 459.

5. Risks of Maintaining Class Action Status Through Trial

Although class certification has not yet been briefed in this case, Defendants would undoubtedly have raised vigorous challenges to class certification, and such disputes "could well devolve into yet another battle of the experts." *Bear Stearns*, 909 F. Supp. 2d at 268. If a class were to be certified, Defendants could move to decertify the class at any time. *See* Fed. R. Civ. P. 23(c)(2); *Global Crossing*, 225 F.R.D. at 460 ("[E]ven if plaintiffs could obtain class certification, there could be a risk of decertification at a later stage."). Here, "the uncertainty surrounding class certification supports approval of the Settlement," *Marsh & McLennan*, 2009 WL 5178546, at *6, because "even the process of class certification would have subjected Plaintiffs to considerably more risk than the unopposed certification that was ordered for the sole purpose of the Settlement." *AOL Time Warner*, 2006 WL 903236, at *12.

6. The Ability of Defendants to Withstand Greater Judgment

Even if Lead Plaintiffs were able to overcome the significant risks described above and prevail at trial, they would still face the very real risk that Defendants would be unable to satisfy any judgment obtained due to Penn West's weak financial condition and the limited remaining insurance coverage. To assist Co-Lead Counsel's due diligence of the reasonableness of the Settlement, Co-Lead Counsel retained a valuation expert to review Penn West's financial condition, and he has confirmed that Penn West did not have the resources to pay a settlement in excess of its insurance coverage without seriously jeopardizing its ability to operate. *See* Atkins Aff. ¶¶ 2, 28. Penn West's financial condition has deteriorated significantly since this Action commenced on August 4, 2014. Penn West's financial results are heavily tied to crude oil prices,

which fell from over $100 per barrel in June 2014, to approximately $37 per barrel in 2015. *See id.* ¶¶ 11-12. Penn West's stock price has declined over 90% since August 4, 2014, and now trades at approximately $0.67 per share. ¶ 35. The NYSE also notified Penn West that it will be de-listed if its stock price does not recover to exceed an average of $1 for 30 trading days. *Id.*

Despite Penn West's efforts to strengthen its balance sheet by suspending its dividend in September 2015, laying off about half of its workforce in 2015, cutting its 2016 budget by 90%, and selling non-core assets to raise cash, the Company remains in financial distress. *See* Atkins Aff. ¶¶ 16, 21, 27. In its Annual Report filed on March 10, 2016, Penn West reported Can$2.646 billion in net losses for 2015. The Company reported a mere Can$2 million cash position on its balance sheet as of December 31, 2015.[4] As of March 31, 2016, the value of the Company's long term debt was a hefty Can$1.858 billion. On May 16, 2016, Penn West reported that "there is a risk that the Company will not be in compliance with its financial covenants at the end of the second quarter of 2016" and if negotiations with its lenders are unsuccessful "there is a risk of default" which "has resulted in uncertainty on the Company's ability to continue as a going concern." *Id.* ¶ 26. Penn West also previously announced in May 2015 that it had agreed to temporarily pledge all of its assets (or the proceeds from asset sales) to its lenders. *Id.* ¶ 27.

It is clear from both Penn West's public filings and Lead Plaintiffs' due diligence that Penn West's insurance coverage is the only practical source of recovery for both the U.S. and the three Canadian Actions. Significantly, these insurance funds would be heavily reduced by defense costs if the U.S. and Canadian litigations continued. Courts have recognized that "[t]his factor typically

[4] Due to the Company's revolving credit facility, any cash from revenues is transferred to lenders to reduce the Company's debt liabilities and is not considered excess free cash.

weighs in favor of settlement where a greater judgment would put the defendant at risk of bankruptcy or other severe economic hardship." *AOL Time Warner*, 2006 WL 903236, at *12; *see also Global Crossing*, 225 F.R.D. at 460 (since the companies had filed for bankruptcy, "without the proposed settlement, class members might well receive far less than the settlement would provide to them, even if they could prevail on their claims"); *Del Global*, 186 F. Supp. 2d at 365 (in light of the company's "dire financial condition, it is unlikely that the Company could withstand a substantial judgment," making a greater recovery than the settlement difficult); *Am. Bank Note*, 127 F. Supp. 2d at 427 (noting the "serious question as to the ability of the Defendants to withstand a greater judgment" because the company's financial condition had substantially weakened at the time of settlement discussions, and its likelihood of filing for bankruptcy increased with the passage of time). The very significant risk here that continued litigation would yield a smaller recovery – or no recovery at all – several years in the future weighs heavily in favor of the Settlement.

7. The Settlement Amount is in the Range of Reasonableness in Light of the Best Possible Recovery and All the Attendant Risks of Litigation

Courts typically analyze the last two *Grinnell* factors together. *See Grinnell*, 495 F.2d at 463. In so doing, courts "consider[] and weigh[] 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." *In re Flag Telecom Holdings, Ltd. Sec. Litig.*, No. 02-CV-3400 (CM) (PED), 2010 WL 4537550, at *20 (S.D.N.Y. Nov. 8, 2010) (quoting *Grinnell*, 495 F.2d at 462). A court's "determination of whether a given settlement amount is reasonable in light of the best possibl[e] recovery does not involve the use of a mathematical equation yielding a particularized sum." *Bear Stearns*, 909 F. Supp. 2d at 269. Instead, the Second Circuit has held "[t]here is a range of reasonableness with respect to a settlement—a range which recognizes the uncertainties

of law and fact in any particular case and the concomitant risks and costs necessarily inherent in taking any litigation to completion." *Wal-Mart*, 396 F.3d at 119.

Lead Plaintiffs submit that the Can$26.5 million settlement is well within the range of reasonableness in light of the best possible recovery and all the attendant risks of litigation, particularly Defendants' ability to pay. If Lead Plaintiffs overcame all the obstacles noted above to establishing liability, the realistic maximum recoverable damages at trial would be approximately $270 million. ¶ 47. Under that scenario, the Can$26.5 million, or USD $19,759,282, settlement represents approximately 7.3% of the maximum damages. However, Penn West's counsel stated at the preliminary approval hearing that Defendants would argue that damages were "close to zero or at zero." ECF No. 128, Tr. of Prelim. Approval Hr'g at 10:3-12. Even if Defendants were not successful in establishing that damages were zero, they had significant loss causation and damages arguments that, if accepted, would have reduced damages to $45 million to $60 million. Under that scenario, the Settlement represents 33% to 44% of damages. *Id*. Given these risks, the Settlement is an extremely favorable outcome.

Moreover, weighing "[t]he 'best possible' recovery necessarily assumes Plaintiffs' success on both liability and damages covering the full Class Period alleged in the Complaint *as well as the ability of Defendants to pay the judgment*." *Del Global*, 186 F. Supp. 2d at 365 (emphasis added). This case has been pending for almost two years, and could be expected to last several more years had the Settlement not been reached. "While additional years of litigation might well have resulted in a higher settlement or verdict at trial, continued litigation could also have reduced the amount of insurance coverage available and not necessarily resulted in a greater recovery." *In re Blech Sec. Litig.*, No. 94 CIV. 7696 (RWS), 2000 WL 661680, at *5 (S.D.N.Y. May 19, 2000). Insurance coverage would be swiftly depleted because five different defense firms have been

retained to represent the Company and the Individual Defendants in the U.S. and Canada. Any remaining insurance coverage would also have to be split between the U.S. and three separate Canadian Actions. Indeed, the Can$53 million global settlement, which represents approximately 90% of the remaining coverage, was split such that both the U.S. and joint Canadian Actions settled for Can$26.5 million.[5] Furthermore, because the insurance policy is denominated in Canadian dollars, the U.S. Action faced significant currency risk. In 2015, the Canadian dollar fell about 16% against the U.S. dollar. Given Penn West's inability to pay an excess judgment and the fact that the available insurance coverage would be further eroded as the cross-border litigations continued, the Court should consider that the Settlement provides for payment now without any further risk to the Settlement Class, rather than a speculative and likely lower payment years later.

In sum, the *Grinnell* factors – including Lead Plaintiffs' well-developed understanding of the strengths and weaknesses of the case, and the significant risks, expense, and delay of further litigation – support a finding that the Settlement is fair, adequate, and reasonable.

C. The Plan Of Allocation Should Be Approved

"When formulated by competent and experienced counsel, a plan for allocation of net settlement proceeds need have only a reasonable, rational basis." *IMAX*, 283 F.R.D. at 192; *Bear Stearns*, 909 F. Supp. 2d at 270 (same). In designing a fair and rational plan, counsel may take into account "the relative strength and values of different categories of claims." *Global Crossing*,

[5] With respect to the status of the three Canadian Actions, the Ontario Superior Court of Justice approved the settlement and attorneys' fees request on May 31, 2016. The Alberta and Quebec hearings are scheduled for later this month and Lead Counsel will provide the Court with a status report on those actions at the Settlement Fairness Hearing.

225 F.R.D. at 462; *see also Marsh & McLennan*, 2009 WL 5178546, at *13 ("In determining whether a plan of allocation is fair, courts look largely to the opinion of counsel.").

The proposed Plan of Allocation is set forth in the Notice disseminated to the Settlement Class. *See* Notice (Ex. 4-A) at 9-14, 17-25. Co-Lead Counsel developed the Plan of Allocation in consultation with Lead Plaintiffs' damages expert with the objective of equitably distributing the Net Settlement Fund. The Plan of Allocation was developed based on an event study, which calculated the estimated amount of artificial inflation in the per share or per unit closing prices of Penn West common stock, trust units and call options (and the amount of artificial deflation in the per share closing prices of Penn West put options) on each day of the Settlement Class Period as a result of Defendants' alleged materially false and misleading statements and omissions. In calculating this estimated alleged artificial inflation (or deflation), the damages expert considered price changes in Penn West common stock and options in reaction to the alleged corrective disclosures, adjusting for factors attributable to market or industry forces, the evidence developed, and the strength of the claims, as advised by Co-Lead Counsel. Under the Plan of Allocation, a "Recognized Loss Amount" will be calculated for each purchase of Penn West common stock, trust units and call options, and sale of put options (collectively, "Penn West Securities"), during the Settlement Class Period for which adequate documentation is provided. The calculation of Recognized Loss Amounts is explained in detail in the Notice and incorporates several factors, including when and for what price the Penn West Securities were purchased and sold, the estimated artificial inflation (or deflation for put options) in the Penn West Securities' respective prices at the time of purchase and sale, as determined by Lead Plaintiffs' damages expert, and the strength of the claims. *See In re Datatec Sys. Inc. Sec. Litig.*, No. 04-CV-525 (GEB), 2007 WL 4225828, at *5 (D.N.J. Nov. 28, 2007) ("plans that allocate money depending on the timing of purchases

and sales of the securities at issue are common"). The Net Settlement Fund will be allocated to Authorized Claimants on a *pro rata* basis based on the relative size of their total Recognized Loss Amounts.

Co-Lead Counsel believes that the proposed Plan of Allocation provides a fair and reasonable method to equitably allocate the Net Settlement Fund among Settlement Class Members who suffered losses as result of the conduct alleged in the Action, and their opinion as to allocation is entitled to "considerable weight" by the Court in deciding whether to approve the plan. *Am. Bank Note*, 127 F. Supp. 2d at 430. To date, no objections to the Plan of Allocation have been received, suggesting that the Settlement Class also finds the Plan of Allocation to be fair and reasonable. *See* ¶ 63; *In re Nasdaq Mkt.-Makers Antitrust Litig.*, No. 94 Civ. 3996 RWS, 2000 WL 37992, at *2 (S.D.N.Y. Jan. 18, 2000) (holding that the "small number of objections to the Proposed Plan" was entitled to "substantial weight" in approving the plan). Moreover, similar plans have repeatedly been approved by courts in this District. *See, e.g.*, *Global Crossing*, 225 F.R.D. at 462 ("Pro-rata distribution of settlement funds based on investment loss is clearly a reasonable approach.").

Since the Plan of Allocation represents a fair and equitable method for allocating the Net Settlement Amount among Settlement Class members, it merits final approval from the Court.

D. Notice to the Settlement Class Satisfied all the Requirements of Rule 23 and Due Process

"The adequacy of a settlement notice in a class action under either the Due Process Clause or the Federal Rules is measured by reasonableness." *Pierson*, 607 F. App'x at 73. The Notice satisfied Fed. R. Civ. P. 23(e)(1), which requires that notice of a settlement be "reasonable" – *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." *Pierson*, 607 F.

App'x at 73-74. The Notice also satisfies Fed. R. Civ. P. 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."

Both the substance of the Notice and the method of dissemination to potential members of the Settlement Class satisfies these standards. The Notice program was carried out by Epiq, a nationally-recognized claims administrator. The Notice contains the information required by Fed. R. Civ. P. 23(c)(2)(B) and the PSLRA, 15 U.S.C. § 78u-4(a)(7), including: (i) an explanation of the nature of the Action and claims asserted; (ii) the definition of the Settlement Class; (iii) a description of the key terms of the Settlement, including the consideration amount and the releases to be given; (iv) the Plan of Allocation; (v) the Parties' reasons for proposing the Settlement; (vi) a description of the attorneys' fees and expenses that will be sought; (vii) an explanation of Settlement Class Members' right to request exclusion from the Settlement Class and to object to the Settlement, the Plan of Allocation or the requested attorneys' fees or expenses; and (viii) notice of the binding effect of a judgment on Settlement Class Members. The Notice also provides instructions for submitting a Claim Form in order to be eligible to receive a distribution from the Net Settlement Fund, relevant deadlines, and contact information.

As discussed above, in accordance with the Preliminary Approval Order, as of June 2, 2016, Epiq had mailed 273,414 copies of the Notice Packet by first-class mail to potential members of the Settlement Class and nominees. *See* Thurin Decl. ¶ 8. Epiq also caused the Summary Notice to be published in *Investor's Business Daily* and *The National Post* in Canada and transmitted over the *PR Newswire* on April 12, 2016. *See id*. ¶ 9. The Notice Packet listed a telephone hotline and contact information for Co-Lead Counsel and Epiq. *See id*. ¶¶ 10-13 & Notice at 16. Epiq also established a website to provide members of the Settlement Class with information concerning the

Settlement, all applicable deadlines, and copies of the Notice containing the Plan of Allocation, the Claim Form, the Stipulation, the Complaint, and the Preliminary Approval Order. *See* Thurin Decl. ¶ 14.

Notice via first-class mail to all members of the Settlement Class who could be identified with reasonable effort, supplemented with notice in widely-circulated publications and over a newswire, and a dedicated website, was "the best notice . . . practicable under the circumstances." Fed. R. Civ. P. 23(c)(2)(B); *see, e.g.*, *Advanced Battery*, 298 F.R.D. at 182-83 (individually mailed postcards and publishing through *Investor's Business Daily* and *PR Newswire* met the notice standard); *City of Providence*, 2014 WL 1883494, at *2.

E. Final Certification of the Settlement Class

The Court's March 1, 2016 Preliminary Approval Order certified the Settlement Class for settlement purposes only under Fed. R. Civ. P. 23(a) and (b)(3). *See* ECF No. 124 at 2. There have been no changes to alter the propriety of class certification for settlement purposes. Thus, for the reasons stated in Lead Plaintiffs' Preliminary Approval Brief (*see* ECF No. 122 at 14-22), Lead Plaintiffs respectfully request that the Court affirm its determinations in the Preliminary Approval Order certifying the Settlement Class under Rules 23(a) and (b)(3).

III. CONCLUSION

For all the forgoing reasons, Lead Plaintiffs respectfully request that the Court grant their motion.

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BERNSTEIN LITOWITZ BERGER & GROSSMANN LLP

/s/ John Rizio-Hamilton
John Rizio-Hamilton
1251 Avenue of the Americas
New York, NY 10020
Telephone: (212) 554-1400
Facsimile: (212) 554-1444
Email: johnr@blbglaw.com

Counsel for The City of Miami Fire Fighters' and Police Officers' Retirement Trust and Co-Lead Counsel for the Settlement Class

GLANCY PRONGAY & MURRAY LLP

/s/ Lionel Z. Glancy
Lionel Z. Glancy
1925 Century Park East, Suite 2100
Los Angeles, California 90067
Telephone: (310) 201-9150
Facsimile: (310) 201-9160
Email: lglancy@glancylaw.com

Counsel for Avi Rojany and Co-Lead Counsel for the Settlement Class

#989164