

How They Won It: Cravath Thwarts \$3.5M Vivendi Investor Suit

By **Brian Mahoney**

Law360, New York (March 25, 2013, 7:51 PM ET) – Cravath, Swaine & Moore LLP successfully rebutted the so-called fraud-on-the-market presumption in defeating a \$3.5 million investor suit accusing Vivendi SA of alleged misstatements and stock price inflation, using rigorous direct examination of the plaintiffs' witnesses and an unconventionally academic closing argument.

In the ruling, which followed a two-day bench trial that ended Feb. 19, U.S. District Judge Shira A. Scheindlin tossed a suit by a group of mutual funds and investment advisory plaintiffs affiliated with brokerage Gamco Investors Inc., handing the win to Vivendi, which was represented by Cravath partners Timothy G. Cameron and Paul C. Saunders.

The plaintiffs had accused Vivendi of hiding its liquidity woes caused by its mergers and purchases in the late 1990s, including its merger with Montreal-based alcoholic beverage distiller The Seagram Co. Ltd. and French television channel Canal Plus SA.

A 2010 jury verdict in a similar case had precluded Vivendi from relitigating allegations that Vivendi made materially false statements to investors. So to escape the Gamco suit, the Cravath team had to make a rare try at rebutting the fraud-on-the-market presumption of reliance.

The fraud-on-the-market presumption, which has its origins in the U.S. Supreme Court's 1988 decision in *Basic Inc. v. Levinson*, is based on the idea that in an efficient market, all public information about a company is reflected in its stock price. Therefore, if a shareholder relied on a company's stock price as an accurate measure of its intrinsic value, then that could count as reliance on the company's statements.

"The principal issue that we had to try was to demonstrate to the judge as a matter of fact that these entities did not rely on the integrity of the market price as reflecting its intrinsic value when they made their purchases," Saunders told Law360.

Successfully rebutting the presumption is rare, Cameron and Saunders said, but Cravath had developed an extensive evidentiary record over the past several years that led Cameron to believe winning the case was possible.

“The challenging part was that this was an issue of first impression,” Cameron said. “We certainly felt from the outset that we were on the right side of this issue. The challenge was being able to build the evidentiary record.”

The record that Cravath had developed over years of lengthy discovery had shown that Gamco had used another metric besides Vivendi's market price to calculate the intrinsic value of Vivendi's American Depositary Shares, which were the subject of the suit.

That metric, which Gamco dubbed the "private market value," involved calculating the combined value of a company's assets and comparing it to the stock price of the company. If the PMV was higher than the stock price, Gamco would choose to buy the company's stock. Consequently, Cameron and Saunders argued that Gamco did not view the public market price of Vivendi shares as reflective of its intrinsic value.

To convince Judge Scheindlin that this was the case, Cameron and Saunders conducted direct examination of key Gamco witnesses, including Gamco chief investment officer Mario Gabelli. The examinations were particularly challenging because the witnesses were all affiliated with the adversary, Cameron said.

“Every witness at trial was a current or former employee of the plaintiffs,” he said. “We made our case entirely through direct examination. We had to make our evidentiary record at trial examining witnesses that were adverse to our client's position.”

Judge Scheindlin would later find Gabelli's testimony to be unreliable, and key direct examination of another Gamco executive showed that the company saw Vivendi as a great value investment even during the class period, once again damaging the plaintiffs' claim that they believed Vivendi's share price accurately reflected its value.

After the direct examination, Cameron embarked on a closing argument that Saunders says delved into the complex case history of securities class actions, which rarely go to trial and thus offer a scant record on which to base rulings.

“Tim and Judge Scheindlin were having this dialogue at a level of sophistication that you rarely see in a closing argument,” Saunders said.

“One of the things that I thought important was understanding the genesis of this concept of intrinsic value,” Cameron added. “And that was one of the points discussed in the closing argument. I was prepared for a lively discussion, which is exactly what followed.”

Cameron argued that prior case law required the market price of the Vivendi ADS' to be the “motivating driving force” of Gamco's investment decision, and that Gamco's investing strategy clearly showed that this was not the case.

Judge Scheindlin concurred with Cameron, finding that the investors did indeed use another metric besides Vivendi's market price to calculate the intrinsic value of the company's securities, and that Vivendi's liquidity troubles were not pertinent to their investment decisions.

“The plaintiffs did not materially rely on market price in making their investment decision,” Judge Scheindlin said in her opinion. “Adopting Vivendi's useful formulation of the transaction causation test, the market price of Vivendi ADS' was not the 'motivating driving force' behind plaintiffs' investment decision.”

The victory was one of the only instances in which a defendant successfully rebutted the fraud-on-the-market presumption and has already proved instructive to securities defense attorneys, despite Judge Scheindlin saying the precedential value of the case was limited.

Indeed, shortly after the decision, Mayer Brown LLP partner Joshua Yount penned a paper calling the case “a valuable example of how the presumption of reliance can be rebutted.”

“Notwithstanding the district court's suggestions that Gamco may have limited implications in other cases, defendants in securities class actions should view the decision as confirming that individual reliance challenges are plausible obstacles to liability and class certification in many circumstances,” Yount wrote.

The plaintiffs are represented by Vincent R. Cappucci, Arthur V. Nealon, Jordan A. Cortez and Evan T. Raciti of Entwistle & Cappucci LLP.

Vivendi is represented by Paul C. Saunders, Timothy G. Cameron, Margot A. Miller, Xiao Liu and Sarita Prabhu of Cravath, Swaine & Moore LLP.

The case is Gamco Global Series Funds Inc. et al. v. Vivendi SA, case number 1:09-cv-07962, in the U.S. District Court for the Southern District of New York.

--Additional reporting by Sindhu Sundar. Editing by Andrew Park.

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