

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES—GENERAL

Case No. CV-14-2910-MWF (MRWx) **Date: January 24, 2017**

Title: In re OSI Systems, Inc. Derivative Litigation

Present: The Honorable MICHAEL W. FITZGERALD, U.S. District Judge

Deputy Clerk:
Rita Sanchez

Court Reporter:
Not Reported

Attorneys Present for Plaintiff:
None Present

Attorneys Present for Defendant:
None Present

Proceedings (In Chambers): ORDER RE PLAINTIFFS’ MOTION FOR
PRELIMINARY APPROVAL OF SETTLEMENT
[90]

Before the Court is Plaintiffs’ unopposed Motion for Preliminary Approval of Settlement, filed on December 9, 2016. (“the Motion,” Docket No. 90).

The Court held a hearing on January 23, 2017. For the reasons given below, the Motion is **GRANTED**. The proposed settlement represents a fair result after extensive, arm’s length negotiations.

The Final Settlement Hearing is scheduled for May 1, 2017, at 9:00 a.m.

I. BACKGROUND

This shareholder derivative action was brought against members of the Board of Directors of Defendant OSI System, Inc. The Complaint alleged that the Board and several individual Defendants breached their fiduciary duties as directors and/or officers by causing OSI to disseminate false and misleading statements to investors and the government. Plaintiffs further allege that Defendants failed to implement adequate internal controls, resulting in the above conduct that may have violated federal regulations, government contracts, and the fiduciary duty owed to the shareholders.

OSI produces x-ray security systems used in airports. OSI’s largest customers are the Department of Homeland Security and the Transportation Services

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Administration. Plaintiff alleges that, due to the lack of internal controls, OSI failed to disclose defects in several of its x-ray systems. As a result, in May 2013 DHS issued a Notice of Debarment to OSI. In addition, OSI's practices also gave rise to a securities fraud class action in this Court.

This action was commenced in 2014 by several Plaintiffs. Beginning in June 2015, the parties engaged in extensive settlement negotiations and mediation sessions before the Honorable Layn R. Phillips. Plaintiffs further retained Professor Daniel Morrissey, a corporate governance expert, to review the allegations and form a set of reforms designed to remedy the breach of fiduciary duty. In July 2016, the parties were able to agree to settlement terms. The parties then filed this Motion for preliminary approval of the settlement.

II. LEGAL STANDARDS

Federal Rule of Civil Procedure 23.1 requires court approval of any settlement in a derivative action. Fed. R. Civ. P. 23.1. “[A]pproval of a derivative action appears to be a two-step process, similar to that employed for approving class action settlements, in which the Court first determines whether a proposed settlement deserves preliminary approval and then, after notice of the settlement is provided to class members, determines whether final approval is warranted.” *In re MRV Commc'ns, Inc. Derivative Litig.*, 2013 WL 2897874, at *2 (C.D. Cal. June 6, 2013).

The Court takes as instructive case law governing preliminary approval of class action settlements under Rule 23(e). Under that rule, proposed settlements must be fundamentally fair, adequate, and reasonable. *Hanlon v. Chrysler Corp.*, 150 F.3d 1011, 1026 (9th Cir. 1998) (approving class action settlement in suit concerning a defectively-designed minivan). The Ninth Circuit has expressed a “strong judicial policy that favors settlements, particularly where complex class action litigation is concerned.” *Allen v. Bedolla*, 787 F.3d 1218, 1223 (9th Cir. 2015) (finding objectors’ motion to intervene was untimely and that district court did not meet heightened procedural standard for final approval of a class action settlement and award of

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attorneys' fees in case without class certification) (quoting *In re Syncor ERISA Litig.*, 516 F.3d 1095, 1101 (9th Cir. 2008)).

At the preliminary stage, the Court must find only that the settlement is within the "range of possible approval." *Spann v. J.C. Penney Corp.*, 314 F.R.D. 312, 319 (C.D. Cal. 2016); *In re Tableware Antitrust Litig.*, 484 F. Supp. 2d 1078, 1079 (N.D. Cal. 2007). In addition, the settlement should be (1) the product of serious, non-collusive negotiations, (2) have no obvious deficiencies, and (3) not improperly grant preferential treatment to only some segments of the class. *Spann*, 314 F.R.D. at 319.

III. DISCUSSION

The Motion argues the settlement should be approved because it is within the range of possible approval, and provides substantial benefits to both OSI and its shareholders. The parties worked diligently to come to a fair settlement, and the settlement appropriately balances the risks of continued litigation for both sides. In addition, the parties have formulated a strategy to provide notice to shareholders that they argue meets all requirements.

A. Terms of the Settlement

The settlement requires OSI to update and improve its corporate governance. Among other things, OSI must appoint a new independent director with compliance-related experience; appoint a lead independent director to the Board; strengthen training in corporate governance for all directors and officers; enhance oversight of compliance; and amend compensation policies to include compliance as a factor in determining compensation. (Motion at 8).

The settlement calls for incentive payments of \$5,000 to named Plaintiffs. (*Id.*). As part of the settlement, Plaintiffs' counsel would be entitled to seek a Fee and Expense Award in an amount up to \$1.6 million.

B. Fair Negotiations

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The Motion describes the extensive efforts of counsel for the shareholder-Plaintiffs. (Motion at 12). Counsel reviewed OSI's public documents; researched applicable law; prepared multiple complaints; investigated damages; participated in several negotiation discussions and mediation sessions with Defendant; and negotiated the final settlement. Plaintiffs' counsel states that as a result of these actions it is well-informed of the risks of continued litigation. Plaintiffs' counsel has taken into account the possibility that Plaintiffs' claims may be defeated by several available defenses, such as an inability to establish demand futility. (Motion at 13). The settlement avoids the possibility of no recovery for Plaintiffs after years of litigation.

In addition, the settlement represents a fair outcome for OSI. (Motion at 15). OSI avoids the possibility of protracted litigation resulting in future relief. In addition, the corporate governance measures provide a valuable benefit for the corporation. *Mills v. Elec. Auto-Lite Co.*, 396 U.S. 375, 395 (1970) (“[A]n increasing number of lower courts have acknowledged that a corporation may receive a substantial benefit from a derivative suit, justifying an award of counsel fees, regardless of whether the benefit is pecuniary in nature.”). OSI's Board has approved the settlement, and agreed to adopt the corporate governance measures. In addition, Professor Morrissey has confirmed, in detail, the materiality of these benefits. (Opinion of Professor Morrissey (Docket No. 91-8)). The settlement also allows OSI to avoid costly future litigation in this matter. OSI, as well as Plaintiffs, recognizes that “serious questions” exist as to the law in this case. (Motion at 16).

The parties engaged in arm's length negotiations conducted by experienced counsel before a respected mediator. (Motion at 13). Plaintiffs sent OSI several demands, including the proposed set of reforms, and Defendant responded with counter-demands. Retired Judge Phillips is experienced in the field of derivative litigation, and oversaw all of the mediation. *See In re Atmel Corp. Derivative Litig.*, 2010 WL 9525643, at *13 (N.D. Cal. Mar. 31, 2010) (“Judge Phillips' participation weighs considerably against any inference of a collusive settlement.”). The Court agrees with counsel that both sides were fairly apprised of the risks of continuing the litigation. In addition, the parties did not discuss or negotiate the amount of the Fee

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and Expense award until after the substantive terms had been agreed upon. (Motion at 14).

The Court concludes that the settlement is a fair result for both Plaintiffs and OSI, and the result of sincere, arm's length negotiations before an experienced mediator. The corporate governance measures, along with the possibility of an attorney Fee and Expense award, constitute a fair settlement. *Sved v. Chadwick*, 783 F. Supp. 2d 851, 864 (N.D. Tex. 2009) ("The derivative settlement offers tangible, long-term remedial measures that are specifically designed to avoid the alleged missteps in Home Solutions' past and protect shareholders as the company moves forward."); *Mohammed v. Ells*, 2014 WL 4212687, at *3 (D. Colo. Aug. 26, 2014) (approving a settlement of corporate governance reforms and attorneys' fees).

C. The Proposed Notice to Shareholders Is Adequate

The Motion calls for notice to be provided to OSI shareholders in the fashion outlined in the Motion, as well as approval of the Notice of Proposed Settlement of Derivative Action, Final Settlement Hearing, and Right to Appear (Docket No. 91-5); and the Summary Notice (Docket No. 91-6). The Notice includes information about the nature and history of the litigation; the terms of the settlement; the reasons for settling; and the potential \$1.6 million Fee and Expense Award sought in connection with the settlement by Plaintiffs' counsel. The Notice sets forth the procedure for objecting to the settlement, as well as how to contact counsel to obtain more information.

Regarding the manner of notice, OSI shall cause the Notice to be published twice in the national edition of *Investors' Business Daily*, post the Notice and the settlement terms on OSI's Investor Relations website, and include a statement in each quarterly 10-Q filed with the SEC beginning now and continuing through the date the settlement becomes final. Plaintiffs' counsel will also post the settlement and Notice of their websites.

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The Court concludes that this notice procedure is robust and comports with Rule 23.1. In addition, the content of the Notice is adequate to inform shareholders of their rights and how they may participate in the proceedings in this Court.

III. CONCLUSION

The Motion is **GRANTED**. The Court **APPROVES** the Preliminary Approval and Scheduling Order, which is attached to this Order.

The Court will hold a Final Settlement Hearing on May, 1, 2017, at 9:00 a.m. in Courtroom 5A, United States District Court, 350 West 1st Street, Los Angeles, California 90012, at 11:00 a.m.

IT IS SO ORDERED.

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WESTERN DIVISION

IN RE: OSI SYSTEMS, INC.) Lead Case No. 14-cv-02910-MWF (MRWx)
DERIVATIVE LITIGATION)
) DERIVATIVE ACTION
This Document Relates To:)
)
ALL ACTIONS)

~~PROPOSED~~ PRELIMINARY APPROVAL AND SCHEDULING ORDER

Plaintiffs in the above-captioned consolidated shareholder derivative action (the “California Action”) are applying pursuant to F.R.C.P. 23.1 for an Order for preliminary approval of the proposed Settlement of the California Action and the related action pending in the Delaware Court of Chancery (the “Delaware Action”) in accordance with the Stipulation and Agreement of Settlement entered into by the Settling Parties, dated November 23, 2016 (the “Stipulation”). The Court has read and considered the Stipulation and accompanying documents, and all Settling Parties have consented to the entry of this Preliminary Approval and Scheduling Order (the “Preliminary Approval Order”).

NOW, THEREFORE, this _____ day of _____, 2017, upon application of the Settling Parties, IT IS HEREBY ORDERED as follows:

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1. Except as otherwise defined herein, the Court adopts and incorporates the definitions in the Stipulation for purposes of this Preliminary Approval Order.

2. The Court preliminarily finds that the Settlement is fair, reasonable, and adequate to the Company and the Current OSI Shareholders.

3. The Court has scheduled a Settlement Hearing, which will be held on _____, 2017, at _____.m., before the Honorable Michael W. Fitzgerald, United States District Courthouse, 350 West First Street, Los Angeles, California 90012, in order to:

(a) consider whether the proposed Settlement, as set forth in the Stipulation, should be approved by the Court as fair, reasonable, adequate to the Company and the Current OSI Shareholders;

(b) consider whether the Notice and Summary Notice fully satisfies the requirements of F.R.C.P. 23.1 and due process;

(c) consider whether the Judgment should be entered dismissing the California Action with prejudice, directing Delaware Plaintiff to file dismissal with prejudice of the Delaware Action as against the Defendants pursuant to the Stipulation, and releasing the Released Persons from the Released Claims;

(d) consider whether Plaintiffs' application for the Fee and Expense Award and Service Awards should be approved; and

(e) hear other such matters as the Court may deem necessary and appropriate.

4. The Court reserves the right to adjourn the Settlement Hearing or modify

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any of the dates set forth herein.

5. The Court reserves the right to approve the Settlement at or after the Settlement Hearing with such modifications as may be consented to by the Settling Parties to the Actions.

6. The Court approves, as to form and content, the Notice and Summary Notice and finds that they are reasonable, constitute the most practicable notice under the circumstances, constitute sufficient notice to Current OSI Shareholders, and comply with the requirements of federal law and due process.

7. Within twenty (20) days of the Court's entry of this Preliminary Approval Order, OSI shall: (1) cause a copy of the Summary Notice, substantially in the form attached hereto, to be published twice in the national edition of the *Investors' Business Daily*; (2) post the Notice, the Stipulation and Exhibit A to the Stipulation on the Investor Relations page of the OSI website, which posting shall be maintained through the date of the Settlement Hearing; and (3) include a statement in each quarterly report (10-Q) filed with the SEC beginning on the date the Court grants preliminary approval through the date the Settlement becomes Final which explains that these shareholder derivative actions have settled and received preliminary approval and directs stockholders to the Company's Investor Relations webpage for additional information, including the Notice and Stipulation of Settlement. OSI shall cause to be paid all costs of such publishing and posting.

8. Within fourteen (14) days of the Court's entry of this Preliminary

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Approval Order, Counsel for the California Plaintiffs shall cause copies of the Notice, substantially in the form attached hereto, to be posted on their respective websites. California Plaintiffs shall cause to be paid all costs of such posting.

9. Any Current OSI Shareholder who wishes to object to the Settlement and/or show cause why it should not be approved, why the Judgment should or should not be entered thereon, or why Plaintiffs' Counsel's Fee and Expense Award or the Service Awards should not be awarded shall file a written objection, which objection shall: (a) state the case name and number, *In re OSI Systems, Inc. Derivative Litigation*, Lead Case No. 14-cv-02910-MWF (MRWx), and state all reasons for the objection; (b) give proof of current ownership of OSI stock as well as documentary evidence of when such stock ownership was acquired; and (c) clearly identify and provide any and all evidence that would be presented at the Settlement Hearing in connection with such objection; and (d) identify any case, by name, court, and docket number, in which the objector or his attorney, if any, has objected to a settlement in the last three years.

10. Such objection shall, at least fourteen (14) days prior to the Settlement Hearing, be filed with the Clerk of the Court, United States District Court for the Central District of California, Western Division, and also shall be served by first class U.S. Mail at the same time on the following counsel:

Counsel for Plaintiffs:

Francis A. Bottini, Jr.

Counsel for Defendants:

Peter A. Wald

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11. Any Current OSI Shareholder wishing to be heard at the Settlement Hearing is required to include a notice of intention to appear at the Settlement Hearing together with his, her, or its written objection.

12. Any Current OSI Shareholder who does not make his, her, or its objection in the manner provided in the preceding paragraph of this Preliminary Approval Order

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shall be bound by the Judgment entered and the releases to be given, and deemed to have waived such objection and shall forever be foreclosed from: (a) making any objections to the fairness, adequacy, or reasonableness of the Settlement; or (b) making any objections to the fairness and reasonableness of the Fee and Expense Award or Service Awards.

13. Plaintiffs' Counsel shall serve and file all papers in support of the Settlement, including any application by Plaintiffs' Counsel for attorneys' fees and expenses, no later than twenty-one (21) days prior to the Settlement Hearing. Not later than seven (7) days prior to the Settlement Hearing, Plaintiffs' Counsel shall serve and file their reply papers, if any.

14. All proceedings in the Actions, other than such proceedings as may be necessary to carry out the terms and conditions of the Stipulation and the Settlement, are hereby stayed and suspended until further order of this Court. Pending final determination of whether the Stipulation should be approved, Plaintiffs, the Company, and all of the Company's shareholders, and any of them, are barred and enjoined from commencing, prosecuting, instigating, or in any way participating in the commencement or prosecution of any action asserting any Released Claims against any Released Persons.

15. The Court may, for good cause, extend any of the deadlines set forth in this Preliminary Approval Order without further notice to Current OSI Shareholders.

16. If the Stipulation is not approved by the Court, is terminated, or shall not

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become effective for any reason, the California Action shall proceed, completely without prejudice to any party as to any matter of law or fact, as if the Stipulation had not been made and had not been submitted to the Court, and neither the Stipulation, any provision contained in the Stipulation, any action undertaken pursuant thereto, nor the negotiation thereof by any Settling Party shall be deemed an admission or offered or received in evidence at any proceeding in the California Action, the Delaware Action, or any other action or proceeding. In the event the Stipulation is not approved by the Court, is terminated, or shall not become effective for any reason, the parties shall return to their respective positions as of July 7, 2016.

IT IS SO ORDERED.

DATED: JANUARY 24, 2017



HONORABLE MICHAEL W. FITZGERALD
UNITED STATES DISTRICT JUDGE