

**IN THE 20TH JUDICIAL DISTRICT
CHANCERY COURT FOR DAVIDSON COUNTY, TENNESSEE
PART IV**

IN RE: SMILEDIRECTCLUB, INC.
SECURITIES LITIGATION

Consolidated Case No. 19-1169-IV

CLASS ACTION

This Document Relates To:

ALL ACTIONS

**BRIEF OF THE SECURITIES INDUSTRY AND FINANCIAL MARKETS
ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF THE
UNDERWRITERS' LIMITED OPPOSITION TO PRELIMINARY APPROVAL
OF THE PROPOSED SETTLEMENT WITH THE INDIVIDUAL DEFENDANTS**

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STATEMENT OF INTEREST¹

The Securities Industry and Financial Markets Association (“SIFMA”) is the leading trade association for broker-dealers, investment banks, and asset managers operating in the United States and global capital markets. On behalf of industry members and their one million employees, SIFMA advocates on legislation, regulations, and business policies affecting retail and institutional investors, equity and fixed-income markets, and related products and services. SIFMA’s mission is to support a strong financial industry while promoting investor opportunity, capital formation, job creation, economic growth, and trust and confidence in the financial markets. SIFMA regularly files amicus briefs in actions arising under or implicating the federal securities laws.

Many SIFMA members serve as underwriters of securities offerings. Underwriters play a critical role in the capital-raising process by assuming market risk, pricing securities, purchasing them from issuers, and reselling them to investors. The framework for allocating liability and damages among participants in securities offerings directly affects how underwriters assess and manage risk in connection with their participation in public offerings.

SIFMA has a substantial interest in this action because Plaintiffs seek application of a *pro tanto* method of setoff that is inconsistent with the proportionate fault principles embodied in the Private Securities Litigation Reform Act of 1995 (“PSLRA”) and prevailing federal precedent. An adverse ruling on this issue could expose underwriters to disproportionate financial risk and disrupt the long-established framework for allocating risk in securities offerings. This, in turn, could have significant consequences for the underwriting industry and capital markets, ultimately increasing the cost of capital for American businesses. The structure of the settlement at issue here and its

¹ No party’s counsel authored this brief in whole or in part, and no party or party’s counsel made a monetary contribution intended to fund preparing or submitting this brief. No person other than SIFMA or its counsel made a monetary contribution to the preparation or submission of this brief.

potential implications are thus directly relevant to SIFMA’s goal of promoting fair and efficient markets.

INTRODUCTION

SIFMA respectfully submits this brief to assist the Court in considering the method of damages setoff that should accompany any contribution bar order entered in connection with the proposed partial settlement. The question before the Court—whether to apply proportionate or *pro tanto* setoff—is not merely a procedural detail of settlement administration. It determines whether the Underwriter Defendants will bear liability corresponding to their own purported degree of fault, or whether they may be forced to absorb liability that may be more properly attributable to defendants who settled for a fraction of their purported responsibility.

Federal law provides a clear answer. Congress has codified a capped-proportionate setoff rule for settling defendants in federal securities cases, requiring that any verdict or judgment be reduced by the greater of (i) the settling defendant’s proportionate share of responsibility or (ii) the amount paid in settlement. 15 U.S.C. § 78u-4(f)(7)(B). This statutory mandate was the culmination and formalization of the Supreme Court’s declaration of proportionate setoff as “superior” to *pro tanto* setoff. *McDermott, Inc. v. AmClyde*, 511 U.S. 202, 217 (1994). Every federal circuit court to address the question in the securities context has applied proportionate setoff.

The implications of this Court’s decision extend well beyond the parties in this case. If underwriters, who serve as financial intermediaries in virtually every public securities offering in the United States, cannot rely on proportionate setoff, the consequences will reverberate across the capital markets: higher costs for issuers, less favorable terms for offerings, and in extreme cases, the withdrawal of underwriting services from the companies that need them most.

BACKGROUND

I. The Role of Underwriters in Securities Offerings.

The role of an underwriter in a debt or equity offering is to assume certain market risk, *i.e.*, the risk the market will not buy the issuer's securities. *See* Thomas Lee Hazen, *THE LAW OF SECURITIES REGULATION 72–75* (8th ed. 2021). Underwriters act as financial intermediaries in debt and equity offerings, such as initial public offerings, by pricing securities, purchasing them from the issuer, and reselling them to buyers. *Id.* at 70–75. If, for example, the issuer's securities are priced too high or if interest rates change such that the market does not purchase those securities in the offering, the underwriters hold that risk. *Id.* at 73–75. Underwriters conduct reasonable due diligence into the issuer in connection with the offering; however, no underwriter is privy to all of the issuer's information and no underwriter has the ability to “guarantee the absolute accuracy of every statement” made by the issuer in the offering documents. H.R. Rep. No. 85, 73rd Cong., 1st Sess., 1933 WL 983, at *5 (May 4, 1933); *see also* SEC, “The Regulation of Securities Offerings,” Securities Act Release No. 7606A, 1998 WL 792508, at *92 (Nov. 17, 1998).

Despite these limitations, underwriters are exposed to significant potential liability under the securities laws. Specifically, “Sections 11 and 12(a)(2) of the Securities Act of 1933 impose ***strict liability*** for any ‘untrue statement of a material fact or [omission of] a material fact’ in a ‘registration statement’ or ‘prospectus’” on “every underwriter with respect to [that offering].” *Pirani v. Slack Techs., Inc.*, 127 F.4th 1183, 1186 (9th Cir. 2025) (quoting 15 U.S.C. §§ 77k(a), 77l(a)(2)) (emphasis added). Underwriters are thus frequent targets of securities class actions, making the framework for allocating liability and damages among offering participants, including the method by which settlements with some defendants reduce the claims against remaining defendants, a matter of critical importance to the underwriting industry.

II. The Risk-Allocation Framework: Indemnification, Contribution, and Setoff.

A. Contractual Risk Allocation in Underwriting Agreements.

The industry has developed a commercial solution to address the strict liability exposure described above. Underwriters require issuers to agree to express provisions in any underwriting services agreement that provide robust indemnification and contribution rights in the event of securities litigation. *See, e.g.*, 1C Harold S. Bloomenthal & Samuel Wolff, *GOING PUBLIC AND THE PUBLIC CORPORATION* § 14:135 (2024 ed.) (“It is also common for the underwriting agreement to provide that the issuer will agree to indemnify the underwriter for liabilities incurred by the underwriter in connection with the proposed financing including liabilities arising under the Securities Act.”). The issuer typically agrees to pay for *both* legal fees and expenses incurred in the defense of securities claims, as well as *all* settlement consideration required to resolve the litigation. *See, e.g.*, 17 J. William Hicks, *CIVIL LIABILITIES: ENFORCEMENT & LITIGATION UNDER THE 1933 ACT* § 4:143 (2024 ed.) (collecting cases). This indemnification and contribution language in underwriting agreements is standard and almost never negotiated. Bloomberg Law, *Capital Markets, Drafting Guide – Underwriting Agreements: Indemnification and Contribution* (2025) (“The underwriters tend to be inflexible because, although the underwriters can rarely control the issuer’s misstatements and omissions, the underwriters are typically the deep-pocket targets of investor lawsuits.”). These contractual provisions reflect a fundamental industry expectation: that liability in securities offerings will be allocated based on relative fault, not merely on the depth of a defendant’s pockets.

B. The *pro tanto* vs. proportionate setoff distinction.

Under Section 11(f)(1) of the Securities Act, all defendants in a Section 11 action are jointly and severally liable, but “every person who becomes liable to make any payment” under Section 11 “may recover contribution” from the other defendants based on their respective degree of fault.

15 U.S.C. § 77k(f)(1). It is this statutory right to contribution that gives rise to the setoff question presented here.

Partial settlements involving a subset of defendants have unique attributes. Settling defendants typically insist on a “bar order” prohibiting non-settling codefendants from seeking contribution from the settling defendants. But in exchange for eliminating the statutory right to contribution, courts “set off” the non-settling defendants’ potential liability to account for the loss of their contribution rights. There are two primary methods:

1. Under *pro tanto* setoff, any judgment against the non-settling defendants is reduced by the dollar amount of the partial settlement—nothing more, *regardless of the settling defendants’ share of fault*.
2. Under proportionate setoff, any judgment is reduced by the percentage of responsibility for the violation borne by the settling defendants—*which may be greater or less than the settlement amount*.

The practical difference can be enormous. In Securities Act cases, this has tremendous real-world implications particularly when some defendants may be highly culpable but the secondary actors like banks may have greater financial resources.

III. Procedural Posture.

This consolidated securities class action arises from the September 2019 initial public offering of SmileDirectClub, Inc. The Individual Defendants² have agreed to settle this action and a related federal action, *Franchi v. SmileDirectClub, Inc.*, No. 3:19-cv-00962 (M.D. Tenn.) (the “Federal Action”). See Stipulation of Settlement ¶ 1.26. The Underwriter Defendants have filed

² Capitalized terms not otherwise defined herein have the meanings assigned to them in the Stipulation of Settlement, Ex. 1 to Plaintiff’s Motion for an Order Preliminarily Approving Settlement with the Individual Defendants (filed May 7, 2026) (the “Stipulation of Settlement”).

their Limited Opposition to the proposed settlement because the proposed settlement includes a bar order extinguishing the Underwriter Defendants’ statutory right to seek contribution from the Individual Defendants but provides the Underwriter Defendants with only a *pro tanto* setoff—a dollar-for-dollar credit of \$48 million—rather than a credit reflecting the Individual Defendants’ proportionate share of fault for any proven violation. *See* Stipulation of Settlement ¶ 7.2; Underwriters’ Limited Opposition at 1–5.

ARGUMENT

I. Federal Law and Policy Require Proportionate Setoff in Securities Act Cases.

A. The Supreme Court has recognized the superiority of proportionate setoff.

The starting point for any analysis of setoff methodology is the Supreme Court’s decision in *McDermott, Inc. v. AmClyde*, 511 U.S. 202 (1994). In *McDermott*, the Court directly compared the *pro tanto* and proportionate approaches and declared the proportionate-share approach “superior” based on three interrelated considerations. *Id.* at 217. First, *pro tanto* setoff risks forcing non-settling defendants to pay more than their fair share of a judgment, because settlements typically reflect less than the settling defendant’s proportionate fault, and the shortfall is borne entirely by the remaining defendants. *Id.* at 212–15. Second, the *pro tanto* rule’s advantage in promoting settlement “comes at too high a price in unfairness,” because it pressures non-settling defendants to settle by threatening them with disproportionate liability. *Id.* at 215. Third, the *pro tanto* approach offers “no clear advantage with respect to judicial economy.” *Id.* at 217. The Court further observed that proportionate setoff eliminates the need for contribution actions against settling defendants, because “the nonsettling defendants pay no more than their share of the judgment.” *Id.* at 209.

Although *McDermott* arose in federal admiralty law, its reasoning applies with equal force to Securities Act cases, which share the same structural features of joint and several liability and a

statutory right to contribution. *Id.* at 203, 209–210; 15 U.S.C. § 77k(f)(1). As discussed immediately below, federal courts have recognized this parallel and have consistently applied *McDermott*'s proportionate-setoff framework to securities litigation.

B. Federal courts have consistently applied proportionate setoff to Securities Act cases.

The weight of circuit authority is substantial. Since the Supreme Court declared proportionate setoff ‘superior’ in *McDermott* and Congress codified that approach in the PSLRA, **no federal appellate court has applied *pro tanto* setoff to Securities Act claims.** Every circuit to address the question has held that federal law governs the method of setoff in Securities Act cases and that proportionate setoff applies. *See Gerber v. MTC Elec. Techs. Co.*, 329 F.3d 297, 302–05 (2d Cir. 2003) (Sotomayor, J.) (approving “capped proportionate” setoff—credit equal to the greater of the settlement amount or the settling defendants’ proportionate share of fault); *Eichenholtz v. Brennan*, 52 F.3d 478, 486–87 (3d Cir. 1995) (holding that federal common law, not state law, governs setoff in Securities Act cases and that contribution under Section 11(f)(1) is a federal right); *Franklin v. Kaypro Corp.*, 884 F.2d 1222, 1229–32 (9th Cir. 1989) (applying proportionate setoff to Securities Act and Exchange Act claims). Federal district courts have consistently followed this authority. *See, e.g., Rieckborn v. Velti PLC*, 2015 WL 468329, at *17–20 (N.D. Cal. Feb. 3, 2015) (approving proportionate setoff for Securities Act claim); *In re WorldCom, Inc. Sec. Litig.*, 2005 WL 613107, at *8–9 (S.D.N.Y. Mar. 15, 2005) (same).

C. The PSLRA confirms Congress’s commitment to proportionate fault.

In 1995, Congress codified a capped-proportionate setoff rule in the PSLRA, requiring that any judgment be reduced by the greater of (i) the settling defendant’s proportionate share of responsibility or (ii) the amount paid in settlement. 15 U.S.C. § 78u-4(f)(7)(B). The PSLRA thus confirmed as a matter of statutory law what *McDermott* and the circuit courts had already

established under federal common law. As the Underwriters explain in detail in the Limited Opposition, the Individual Defendants here are “covered persons” within the meaning of 15 U.S.C. § 78u-4(f)(10)(C), because they are defendants in a private action arising under the Exchange Act or an outside director subject to Section 11 claims. *See* Underwriters Limited Opposition at 7–10. The PSLRA’s proportionate-share setoff provision therefore applies as a matter of statutory mandate. SIFMA adopts and incorporates by reference the Underwriters’ analysis of the PSLRA’s application to the proposed settlement, including their demonstration that settling Individual Defendants satisfy the statute’s “covered person” definition and that the PSLRA requires a proportionate-share setoff. *See id.*

D. Applying state-law setoff rules to federal securities claims would encourage forum-shopping.

The need for a uniform federal rule on setoff is underscored by the unique jurisdictional structure of the Securities Act. Unlike Exchange Act claims, which are subject to exclusive federal jurisdiction, Securities Act claims may be brought in either federal or state court. 15 U.S.C. § 77v(a). Critically, Securities Act claims filed in state court *cannot be removed* to federal court. *Id.* If the setoff method in Securities Act cases is governed by state law rather than federal law, the applicable setoff rule will vary depending on which state court the plaintiff chooses, creating a patchwork of inconsistent rules governing the same federal cause of action. That patchwork will itself create a structural incentive for plaintiffs to file Securities Act cases in—or structure partial settlements through—state-court forums that apply *pro tanto* setoff. The result would be a regime in which the allocation of liability among defendants in a federal securities case turns not on the merits or on federal policy, but on the plaintiff’s choice of forum. This outcome would be directly at odds with the principle, recognized in *Eichenholtz*, that contribution under Section 11(f)(1) is a “substantive federal right” that must be governed by federal law. 52 F.3d at 486.

II. An Adverse Ruling Would Have Serious Consequences for the Underwriting Industry and Capital Markets.

A. *Pro tanto* setoff would expose underwriters to disproportionate liability.

The Supreme Court recognized in *McDermott* that *pro tanto* setoff risks forcing non-settling defendants to pay more than their fair share of a judgment and concluded that this potential advantage in promoting settlement “comes at too high a price in unfairness.” 511 U.S. at 215. In the securities context, this unfairness falls squarely and predictably on underwriters.

Underwriters are secondary actors in the offering process. They conduct due diligence, but they necessarily rely on issuers to provide accurate and complete information about the company’s business, financial condition, and prospects. Officers and directors—who prepare the registration statement, control the company’s disclosures, and are most likely to know whether those disclosures are accurate—typically bear the greatest share of responsibility for any material misstatement.

Pro tanto setoff exploits this asymmetry. If the most culpable defendants settle for a fraction of their proportionate fault (as they inevitably will when they lack the assets to pay more), the entire shortfall falls on the remaining defendants. This outcome is fundamentally at odds with the contribution right that Congress created in Section 11(f)(1) of the Securities Act, the proportionate-fault regime that Congress adopted in the PSLRA, and the Supreme Court’s holding in *McDermott*.

B. Disproportionate liability would disrupt the risk-allocation framework that underpins securities offerings.

Underwriters manage the risk of participating in securities offerings through a combination of contractual protections and statutory rights. On the contractual side, underwriters require issuers to agree to robust indemnification and contribution provisions in the underwriting agreement. On the statutory side, Section 11(f)(1) provides a right to contribution among co-defendants based on relative fault. Together, these mechanisms reflect a fundamental expectation that each defendant’s ultimate exposure will correspond to its own degree of responsibility. Proportionate setoff is the

judicial safeguard that preserves this expectation when a partial settlement and bar order eliminate the non-settling defendant's ability to seek contribution directly. If underwriters cannot rely on proportionate setoff to limit their exposure to their actual share of responsibility, both the statutory and contractual framework governing securities offerings will be undermined, resulting in predictable consequences.

First, underwriters will need to price increased litigation risk into the cost of their services (whether through higher underwriting fees, wider spreads, or other terms)—costs that are ultimately passed to issuers and increase the cost of capital for companies seeking to access the public markets. Second, underwriters will seek to shift the increased litigation risk back to issuers through more aggressive indemnification obligations, higher insurance requirements, or contribution provisions that attempt to contract around the *pro tanto* rule. This will make offerings more expensive and more difficult to structure, particularly for issuers that are already under financial pressure. Third, in the most extreme cases, underwriters seeking to mitigate their legal exposure may decline to participate in offerings altogether, or even choose to exit certain business lines entirely. This is more likely for companies with elevated litigation risk, such as those in financial distress or operating in sectors with significant regulatory exposure.

Each of these consequences harms not just underwriters, but the companies seeking to access the capital markets, and ultimately their investors and employees. The securities laws were designed to facilitate capital formation, not to create a regime in which liability is allocated based on the depth of a defendant's pockets rather than the degree of its fault.

C. A Decision in Plaintiffs' Favor Would Have National Consequences.

The impact of this Court's decision would not be limited to the Underwriter Defendants in this case. A ruling that *pro tanto* setoff applies to federal Securities Act claims in state court would create a roadmap for future securities plaintiffs to structure partial settlements in precisely the

manner described above, by entering into quick, smaller settlements with the most culpable defendants, and then pursuing the full balance of any judgment from deeper-pocketed underwriters. Every future securities class action in which some defendants settle before trial would present the same opportunity. And every underwriter participating in a public offering would face the knowledge that its statutory right to contribution can be effectively nullified through a settlement and a bar order that leaves only a *pro tanto* credit.

Because Securities Act claims cannot be removed to federal court, 15 U.S.C. § 77v(a), this Court's ruling would be particularly consequential. Unlike other areas of securities law where federal courts can correct divergent interpretations through appellate review, the non-removability of Securities Act claims means there is no federal appellate check on a state court's adoption of *pro tanto* setoff. A ruling in favor of *pro tanto* setoff here would thus create a template that plaintiffs nationwide could replicate in any state-court forum, and non-settling defendants would have no procedural mechanism to obtain federal review of that determination.

The ultimate cost would be borne by the companies and investors the securities laws are designed to protect. Increased litigation risk and uncertainty for underwriters raises the cost of capital for American businesses of all sizes. Companies facing financial challenges, which are often the most in need of affordable investor capital, will find it harder and more expensive to access the public markets if underwriters are deterred from participating in their offerings. The proportionate-setoff rule, which was recognized as "superior" by the Supreme Court more than thirty years ago (*McDermott*, 511 U.S. at 217) and applied by federal courts to securities litigation ever since, exists precisely to prevent this result. SIFMA respectfully urges this Court to preserve it.

CONCLUSION

For the foregoing reasons, SIFMA respectfully requests that the Court require that any bar order entered in connection with the proposed partial settlement provide the Underwriter Defendants with a setoff equal to the greater of (a) the settlement amount or (b) the Individual Defendants' proportionate share of fault for any proven violation.

Dated: June 9, 2026

Respectfully submitted,

/s/ Britt K. Latham

Britt K. Latham (BPR #023149)
Margaret V. Dodson (BPR #035115)
Grace E. Platt (DE #7487, *practicing pursuant to Tenn. Sup. Ct. R. 7, Sec. 10.07*)

BASS, BERRY & SIMS PLC
21 Platform Way South, Suite 3500
Nashville, TN 37201
Telephone: (615) 742-6200
Fax: (615) 742-6293
blatham@bassberry.com

*Counsel for Amicus Curiae Securities Industry
& Financial Markets Association*

CERTIFICATE OF SERVICE

I hereby certify that a true and exact copy of the foregoing was filed and served upon the parties as indicated below by electronic mail on June 9, 2026:

<p>ANDREW G. FIORELLA MICHAEL D. MEUTI ALLYSON R. CADY BENESCH FRIEDLANDER COPLAN & ARONOFF LLP 200 Public Square, Suite 2300 Cleveland, OH 44114 2378 afiorella@beneschlaw.com mmeuti@beneschlaw.com acady@beneschlaw.com</p> <p>LAURA SEFERIAN DAVID A. RAMMELT BENESCH FRIEDLANDER COPLAN & ARONOFF LLP 71 South Wacker Drive, Suite 1600 Chicago, IL 60606 lseferan@beneschlaw.com drammelt@beneschlaw.com</p> <p>STEVEN A. RILEY MILTON S. MCGEE, III ELIZABETH O. GONSER RILEY & JACOBSON, PLC 1906 West End Avenue Nashville, TN 37203 sriley@rwjplc.com tmcgee@rwjplc.com egonser@rwjplc.com</p> <p>SAMUEL P. FUNK ERIK R. LYBECK EVAN S. ROTHEY SIMS FUNK, PLC 3102 West End Avenue, Suite 1100 Nashville, TN 37203 sfunk@simsfunk.com elybeck@simsfunk.com erothey@simsfunk.com</p>	<p>CHRISTOPHER E. THORSEN BAKER, DONELSON, BEARMAN, CALDWELL & BERKOWITZ, PC 1600 West End Avenue, Suite 2000 Nashville, TN 37203 cthorsen@bakerdonelson.com</p> <p>SHARON L. NELLES ANDREW J. FINN MARC DE LEEUW ADAM R. BREBNER SULLIVAN & CROMWELL LLP 125 Broad Street New York, NY 10004 nelless@sullcrom.com finna@sullcrom.com deleeuwm@sullcrom.com brebnera@sullcrom.com</p> <p>ROBERT A. SACKS SULLIVAN & CROMWELL LLP 1888 Century Park East Los Angeles, CA 90067 sacksr@sullcrom.com</p> <p><i>Counsel for J.P. Morgan Securities LLC; Citigroup Global Markets Inc.; BofA Securities, Inc.; Jefferies LLC; UBS Securities LLC; Credit Suisse Securities (USA) LLC; Guggenheim Securities, LLC; Stifel, Nicolaus & Company, Incorporated; William Blair & Company, LLC; and Loop Capital Markets LLC</i></p>
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WILLIAM C. PRICE
MICHAEL T. LIFRAK
**QUINN EMANUEL URQUHART &
SULLIVAN, LLP**
865 S. Figueroa Street, 10th Floor
Los Angeles, CA 90017
williamprice@quinnemanuel.com
michaellifrak@quinnemanuel.com

MICHAEL CARLINSKY
JESSE BERNSTEIN
LEIGHA EMPSON
**QUINN EMANUEL URQUHART &
SULLIVAN, LLP**
295 Fifth Avenue
New York, NY 10016
michaelcarlinsky@quinnemanuel.com
jessebernstein@quinnemanuel.com
leighaempson@quinnemanuel.com

CHRISTOPHER D. PORTER
**QUINN EMANUEL URQUHART &
SULLIVAN, LLP**
700 Louisiana St., Suite 3900
Houston, TX 77002
chrisporter@quinnemanuel.com

*Counsel for David Katzman, Kyle
Wailles, Steve Katzman, Susan
Greenspon Rammelt, Richard Schnal,
and Camelot Venture Group*

JERRY E. MARTIN
SETH M. HYATT
MATTHEW E. MCGRAW
**BARRETT JOHNSTON MARTIN
& GARRISON, PLLC**
200 31st Avenue North
Nashville, TN 37203
Telephone: (615) 244-2202
Facsimile: (615) 252-3798
jmartin@barrettjohnston.com
shyatt@barrettjohnston.com
mmcgraw@barrettjohnston.com

MICHAEL B. SILVERSTEIN
**BENESCH FRIEDLANDER
COPLAN & ARONOFF LLP**
41 South High Street, Suite 2600
Columbus, OH 43215
msilverstein@beneschlaw.com

BRIAN M. LUTZ
MICHAEL J. KAHN
**GIBSON, DUNN & CRUTCHER
LLP**
One Embarcadero Center, Suite
2600 San Francisco, CA 94111-3715
blutz@gibsondunn.com
mjkahn@gibsondunn.com

*Attorneys for Defendants Alexander
Fenkell and Jordan Katzman*

CHRISTOPHER M. WOOD
**ROBBINS GELLER RUDMAN
& DOWD LLP**
200 31st Avenue North
Nashville, TN 37203
cwood@rgrdlaw.com

DARREN J. ROBBINS
SCOTT H. SAHAM
JEFFREY J. STEIN
ASHLEY M. KELLY
TING H. LIU
JACK K. SCOTT
**ROBBINS GELLER RUDMAN
& DOWD LLP**
655 West Broadway, Suite 1900
San Diego, CA 92101
darrenr@rgrdlaw.com
scotts@rgrdlaw.com
jstein@rgrdlaw.com
akelly@rgrdlaw.com
tliu@rgrdlaw.com
jscott@rgrdlaw.com

THOMAS L. LAUGHLIN (*pro hac vice*)
MAX R. SCHWARTZ (*pro hac vice*)
JONATHAN M. ZIMMERMAN (*pro hac vice*)
MANDEEP S. MINHAS (*pro hac vice*)
SCOTT+SCOTT
ATTORNEYS AT LAW LLP
The Helmsley Building
230 Park Ave., 24th Floor
New York, NY 10169
Telephone: (212) 223-6444
Facsimile: (212) 233-6334
tlaughlin@scott-scott.com
mschwartz@scott-scott.com
jzimmerman@scott-scott.com
mminhas@scott-scott.com

Co-Lead Counsel for Plaintiffs

PATRICK V. DAHLSTROM
POMERANTZ LLP
10 S. La Salle St., Suite 3505
Chicago, IL 60603
Telephone: (312) 377-1181
Facsimile: (312) 377-1184
pdahlstrom@pomlaw.com

Attorneys for Plaintiff Wei

PAUL KENT BRAMLETT
ROBERT PRESTON BRAMLETT
BRAMLETT LAW OFFICES
40 Burton Hills Blvd., Suite 200
P.O. Box 150734
Nashville, TN 37215
Telephone: (615) 248-2828
Facsimile: (866) 816-4116
pknashlaw@aol.com
robert@bramlettlawoffices.com

Attorneys for Plaintiff Wei

MATHEW S. ANDREWS
ROBBINS GELLER RUDMAN
& DOWD LLP
420 Lexington Avenue, Suite 1832
New York, NY 10170
mandrews@rgrdlaw.com

*Attorneys for Plaintiff Fernandez And
Attorney for 1199SEIU Health Care
Employees Pension Fund and Bucks
County Employees Retirement Fund*

DARREN J. ROBBINS
BRIAN COCHRAN
ROBBINS GELLER
RUDMAN & DOWD LLP
655 West Broadway, Suite 1900
San Diego, CA 92101
Telephone: (619) 231-1058
Facsimile: (619) 231-7424
darrenr@rgrdlaw.com
bcochran@rgrdlaw.com

Attorneys for Plaintiff Fernandez

SAMUEL H. RUDMAN
MARY K. BLASY
ROBBINS GELLER
RUDMAN & DOWD LLP
58 S. Service Rd., Suite 200
Melville, NY 11747
Telephone: (631) 367-7100
Facsimile: (631) 367-1173
srudman@rgrdlaw.com
mblasy@rgrdlaw.com

Attorneys for Plaintiff Fernandez

JOE P. LENISKI, JR.
BENJAMIN A. GASTEL
**HERZFELD, SUETHOLZ, GASTEL,
LENISKI & WALL PLLC**
1920 Adelia St., Suite 300
Nashville, TN 37212
Telephone: (615) 842-5247
joey@hsglawgroup.com
ben@hsglawgroup.com

Attorneys for Plaintiff Mancour

/s/ Britt K. Latham

Britt K. Latham