UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

EMPLOYEES RETIREMENT SYSTEM OF THE CITY OF ST. LOUIS, et al., Plaintiffs, v. CHARLES E. JONES, et al., Defendants, and FIRSTENERGY CORP., Nominal Defendant.	Case No. 2:20-cv-04813 Chief Judge Algenon L. Marbley Magistrate Judge Kimberly A. Jolson

TODD AUGENBAUM'S OBJECTION TO THE PROPOSED SETTLEMENT

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Todd Augenbaum,[1] by his undersigned counsel, respectfully submits this objection to the proposed settlement (the "Proposed Settlement") of this action brought derivatively on behalf of FirstEnergy Corporation ("FirstEnergy" or the "Company"), and in response to Plaintiffs' Motion for Final Approval of Settlement and other relief (the "Motion"), ECF No. 179.[2]

PRELIMINARY STATEMENT

The Proposed Settlement appears impressive at first glance. However, upon closer examination, it becomes apparent that Plaintiffs fail to satisfy their burden to establish that the Proposed Settlement will benefit FirstEnergy. The Company is sacrificing $40 million of insurance coverage that it would otherwise be able to use to offset liabilities, and effectively becoming self-insured for the blowback from its bribery scandal in other existing material claims being prosecuted against it, despite the fact that its insurance coverage would otherwise almost certainly be exhausted absent a settlement. The Proposed Settlement also does not resolve the

[1] Pursuant paragraph 112 of to the Notice of (I) Pendency and Proposed Settlement of Stockholder Derivative Actions; (II) Settlement Fairness Hearing; and (III) Motion for an Award of Attorneys' Fees and Litigation Expenses (the "Notice"), Augenbaum states: his home address is 136-87 71st Rd, Flushing, NY 11367, but he should only be contacted through his undersigned counsel at Abraham, Fruchter & Twersky, LLP ("AF&T"), and through their telephone number. Augenbaum and his counsel do not currently intend to appear at the Settlement Fairness Hearing but reserve their right to do so, in which case they do not intend to call witnesses. The grounds for Augenbaum's objections are set forth herein. Proof that Augenbaum owned shares of FirstEnergy common stock as of the close of business on March 11, 2022 is filed herewith as Exhibit A, which also avers that Augenbaum continues to hold shares of FirstEnergy common stock today and will continue to hold such shares as of the Settlement Fairness Hearing. Augenbaum objects to filing that information on the public record because he is represented by counsel and should only be contacted through his counsel, making it oppressive and non-beneficial to force him to file personal information publicly, especially where Plaintiffs have not done so. Augenbaum also objects to the notice purporting to require copies of this objection, which is being served pursuant to Fed. R. Civ. P. 5, to "also be delivered (by hand, first- class mail, or express service) to Co-Lead Counsel for the Southern District Plaintiffs, Representative Counsel for Defendants, and counsel for the SLC and FirstEnergy at the addresses set forth below such that the objection is received on or before July 21, 2022." (Notice ¶111 (emphasis removed)).

[2] Capitalized terms undefined herein are defined in the Motion.

cornerstone of the operative complaint, and, instead, could leave Charles Jones ("Jones"), Michael Dowling ("Dowling"), and Dennis Chack ("Chack" and with Jones and Dowling the "Terminated Executives") – each of whom was fired for violating FirstEnergy's policies and code of conduct – in a better position vis-à-vis the Company if approved while, at the same time, unnecessarily releasing potentially valuable claims against the Company's auditors. Finally, the Proposed Settlement stretches too far by releasing broad unknown claims. Thus, as the record currently stands, at a very minimum, further information is needed to find the Proposed Settlement fair, reasonable, and adequate.

SUMMARY OF ADDITIONAL RELEVANT FACTS

FirstEnergy is defending other actions arising out of the same facts as this Action (the "Direct Claims") which are likely to subject it to hundreds of millions of dollars (or more) in additional settlements or judgments. The Direct Claims in which FirstEnergy believes it will incur a loss in resolving include: a SEC investigation, a civil racketeering suit by the State of Ohio, a class action pursuant to federal securities laws (the "Securities Class Action"), a ratepayers class action, and an investigation by FERC. *See* 2/16/22 Form 10-K at pp.63-65.[3]

Clearsulting LLC ("Clearsulting"), an Ohio entity, is a management consulting firm specializing in financial systems and controls. *See FirstEnergy Corp. and Clearsulting, LLC v. Pircio*, Docket No. 1:20-cv-01966 (the "*Whistleblower* Action"), ECF No. 1, ¶6 (N.D. Ohio). Starting in June 2019, Clearsulting provided consulting services to FirstEnergy. *Id.* at ¶¶11-12.

On August 7, 2020, a former Clearsulting employee, acting as a whistleblower, provided the SEC with evidence of violations of federal law by FirstEnergy. *Whistleblower* Action, ECF No. 14 at ¶¶20, 34. The precise evidence provided to the SEC is undisclosed, but it appears to be

[3] *Available at* https://www.sec.gov/Archives/edgar/data/1031296/000103129622000013/fe-20211231.htm.

convincing. "[O]n August 10, 2020, the SEC, through its Division of Enforcement, issued an order directing an investigation of possible securities laws violations by FirstEnergy, and on September 1, 2020, issued subpoenas to FirstEnergy and certain of its officers." *See* 2/18/21 Form 10-K at 9.[4] FirstEnergy expects to incur a loss in resolving that matter. *See* 4/21/22 Form 10-Q at 8-9.[5]

After reviewing the *Whistleblower* Action, Augenbaum and another stockholder made litigation demands (the "Augenbaum Litigation Demand") on the Board to investigate and assert claims against Clearsulting and PricewaterhouseCoopers ("PwC" and with Clearsulting the "Auditors"), the Company's external auditor, and to institute certain related corporate governance reforms. *See* Exhibit B.

The Augenbaum Litigation Demand was referred to a demand review committee and then to the SLC, but Augenbaum has received no substantive response despite additional inquiries and the passage of more than a year. On June 8, 2022, after reviewing the Proposed Settlement, Augenbaum sent a letter to counsel for all of the Settling Parties seeking to ensure FirstEnergy's claims against the Auditors were preserved and, to the extent appropriate, prosecuted. *See* Ex. C. Six weeks later, after 10:00 pm on July 19, 2022, the SLC responded to Augenbaum's June 8, 2022, letter by stating that it did not believe that the claims against Auditors are released (see Ex. D), and the next morning Plaintiffs' counsel joined in the SLC's position.

ARGUMENT

The Settling Parties "bear the burden of persuasion that the proposed settlement is fair, reasonable, and adequate." MCL 4th §§21.61, 21.631 (2004); *see also In re Dry Max Pampers*

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[4] *Available at* https://www.sec.gov/Archives/edgar/data/1031296/000103129621000020/fe-20201231.htm.

[5] *Available at* https://www.sec.gov/ix?doc=/Archives/edgar/data/1031296/000103129622000013/fe-20211231.htm

Litig., 724 F.3d 713, 719 (6th Cir. 2013) ("The burden of proving the fairness of the settlement is on the proponents.") (quoting 4 Newberg on Class Actions § 11:42 (4th ed.)). Here, Plaintiffs – the only Settling Party moving for approval of the Proposed Settlement – have not carried their burden for three principal reasons: (1) the Proposed Settlement and unnecessarily releases potentially valuable claims against the Clearsulting and other third parties that should be preserved; (2) the Proposed Settlement does not resolve the allegations laying at the heart of the operative complaint, but instead appears to sacrifice future insurance coverage, making the Company self-insured for amounts likely to exceed available coverage, and potentially benefitting the Terminated Executives; and, (3) the broad release of unknown claims is improper. If the Proposed Settlement is not rejected, the Settling Parties should be compelled to clarify the record, and to further notify FirstEnergy's stockholders about the aspects of the Proposed Settlement discussed in this memorandum.

I. PLAINTIFFS FAIL TO DEMONSTRATE THAT THE POTENTIAL RELEASE OF CLAIMS PROVIDED FOR CLEARSULTING AND OTHER ADVISORS IS FAIR AND REASONABLE

The Federal Judicial Center counsels wariness with respect to "releasing claims against parties who did not contribute to the class settlement." MCL 4th §21.61 & n.957 (citing cases).[6] Nevertheless, the Proposed Settlement, if approved, could potentially release Defendants' "consultants, experts, and attorneys (provided, however, that consultants, experts and attorneys are only "Released Defendants' Persons" insofar as they were engaged by Defendants and are not released under this Stipulation if and to the extent that they were engaged by the Company)." Proposed Settlement §1(y) (emphasis added).

[6] While the quoted language uses the word "class[,]" Section 21 of the Manual for Complex Litigation clarifies that the MCL does not distinguish between different types of representative actions, including class actions and derivative actions. *See* MCL 4th §21 (2004) at p.244.

In addition to unnecessarily releasing parties who are not contributing to the Proposed Settlement, that definition is problematic. FirstEnergy's stockholders cannot understand the scope of "Released Defendants Persons" without knowing which consultants, experts, or attorneys were "engaged by the Company" and which were "engaged by Defendants[.]" *See Sauers v. United Water Restoration Grp.*, Inc., 2017 WL 3425789, at *1 (M.D. Fla. July 21, 2017) (explaining that the court previously rejected a settlement agreement because "ambiguous language in the parties' proposed settlement agreement made [the scope of the release] unclear"). Here, because that information is non-public and because FirstEnergy can only act through its agents (*Orum Stair, LLC v. GJJG Ents., LLC*, 2016-Ohio-7064, ¶ 32, 72 N.E.3d 190, 199 (10th Dist. 2016)), stockholders are forced to guess which consultants would be released by the Proposed Settlement, which is unworkable.

Concerned with a potential release of the Auditors, Augenbaum attempted to seek clarity from the Settling Parties (*see* Exhibit C) but received no substantive written response explaining their position for over six weeks. Thirty-six hours before the objection deadline, the SLC conveyed its position that the claims are not released. *See* Exhibit D. The next day, Plaintiffs' counsel joined the SLC's position.

While Augenbaum is somewhat comforted by the SLC's and Plaintiffs' intention, their positions alone are inadmissible parol evidence. *See Williams v. Spitzer Autoworld Canton, L.L.C.*, 2009-Ohio-3554, ¶21, 122 Ohio St. 3d 546, 552, 913 N.E.2d 410, 417. By contrast to the SLC's letter, which states that the Auditors were "engaged by the Company" (*see* Ex. D), page 3 of the Company's Audit Committee Charter[7] states that the Company's audit committee "shall be solely

[7] Available at https://www.firstenergycorp.com/content/dam/investor/files/policies-charters/board-charters/Audit-Charter.pdf.

responsible for the ***appointment***, compensation ***and retention of*** (subject to shareholder ratification, if such ratification is required)" of the Company's independent auditor. (Emphasis added) Because all members of the Audit Committee are Defendants being released from liability, PwC, for example, may be able to assert that claims against it were released while the SLC is still investigating the same. The SLC and FirstEnergy may have convincing arguments to the contrary, but there is no reason for the Company to face any risk of persuasion.

Here, the possibility of FirstEnergy releasing Clearsulting and other potentially liable consultants without receiving any compensation from those entities should be eliminated by amending the Proposed Settlement. Plaintiffs' basis for approval of the Proposed Settlement – a wasting insurance policy and individuals who cannot satisfy a judgment (Motion at 32) – cannot justify potentially releasing claims against profitable consultants. While Clearsulting appears to be privately owned and does not disclose its revenue,[8] PwC disclosed annual revenue exceeding $45 billion globally, with over $18 billion of that coming from the Americas.[9] Presenting the Proposed Settlement as essentially a limited fund thus depends upon either not releasing third parties or making a showing that is absent from the Motion. Otherwise, the Company is sacrificing (or at the very least handicapping its prosecution of) claims, which are corporate assets, without any benefit or justification. *See, e.g., Quadrant Structured Prod. Co. v. Vertin*, 102 A.3d 155, 181 (Del. Ch. 2014) ("A corporate claim is an asset of the corporation"). Amending the Proposed Settlement to eliminate such a reading (or alternatively not releasing any consultants unless there is a necessary reason to do so) would sufficiently protect the Company's assets.

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[8] *See* https://www.glassdoor.com/Overview/Working-at-Clearsulting-EI_IE1843048.11,23.htm.

[9] *See* https://www.pwc.com/gx/en/about-pwc/global-annual-review-2021/downloads/pwc-global-annual-review-2021.pdf at p.10; *see also* Complaint ¶153.

Finally, even if the SLC is correct that claims against Clearsulting and other third parties are preserved, the Proposed Settlement is unclear about what would happen if Auditors crossclaim against Defendants. Claims against the Auditors could be substantial, and the fact that a portion of the Company's recoveries might be released from the Proposed Settlement, and not be realizable by the Company as a result of the Proposed Settlement, must be explored before the Proposed Settlement can be found to be fair, reasonable, and adequate. For example, the Auditors may claim that they relied upon management representations, and that the Terminated Executives misled them.[10] What then? Would any damages attributable to management be unrecoverable, and FirstEnergy's rights to them waived by the Proposed Settlement? Those questions should be answered before the Proposed Settlement is approved, as they potentially represent another example of the Terminated Executives being further enriched at FirstEnergy's expense.

II. PLAINTIFFS FAIL TO DEMONSTRATE THAT THE SETTLEMENT OF CLAIMS AGAINST THE DIRECTORS AND OFFICERS IS REASONABLE

A. Plaintiffs Fail to Explain How Much Money Resolving the Direct Claims Is Likely to Cost FirstEnergy or What Other Insurance Coverage Is Available to the Company

The most important factor in evaluating the fairness of a settlement is how the compensation received weighs against the expected value of litigation. *Shy v. Navistar Int'l Corp.*, 2022 WL 2125574, at *6 (S.D. Ohio June 13, 2022). This factor augurs against granting the Motion as the Settling Parties concededly cannot "determine[] the total damages incurred by FirstEnergy" much of which "remain[s] speculative." Motion at 30-31 & n.12. That is a sufficient reason to reject the Proposed Settlement.

[10] *See* https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/au-00333.pdf.

It is almost certain that the defense and resolution of the Direct Claims will cost FirstEnergy more than $220 million. For example, a median recovery in the Securities Class Action, alone, would exhaust the vast majority of available insurance coverage absent the Proposed Settlement based upon the $10 billion drop in the Company's market capitalization.[11] FirstEnergy spent $230 million in connection with its Deferred Prosecution Agreement. The chance of it resolving all remaining Direct Claims within policy limits (or the monetary component of the Proposed Settlement) appears negligible considering the five Direct Claims for which the Company believes a loss is probable, including the Securities Class Action and an Ohio ratepayer class action.

Plaintiffs also make no showing of other insurance policies available to the Company to resolve the Direct Claims. Absent such a showing, the Court should assume that there is no other insurance coverage to prosecute or settle the Direct Claims except for that which would be released pursuant to the Proposed Settlement.

B. Plaintiffs Fail to Establish that the $180 Million in Insurance Proceeds Would Otherwise Be Unavailable to Pay for the Direct Claims

Here, while Plaintiffs point to the $180 million dollars that would be recovered by the Proposed Settlement, they do not explain what would happen absent the Proposed Settlement. It appears to Augenbaum that if the Proposed Settlement is approved, FirstEnergy would effectively become self-insured, responsible for defending and resolving the Direct Claims for which it believes that it is probable that it will incur a loss.

The Motion states that the insurance policies that could pay these claims had approximately $220 million in coverage remaining. Motion at 4, Proposed Settlement §1(y)). The Motion contends that the Proposed Settlement should be approved because those policies were subject to

[11] *See* NERA Economic Consulting, Recent Trends in Securities Class Action Litigation: 2021 Full-Year Review, at 24 (Jan. 25, 2022), *available at* https://www.nera.com/content/dam/nera/publications/2022/PUB_2021_Full-Year_Trends_012022.pdf

"erosion to pay … defense costs and potential settlements in other related actions" (Motion at 4) but that ignores that while these policies are "wasting" they are also "the primary source of any recovery on the scale of damages alleged." *Id.* at 14, 32.

In other words, Plaintiffs' description of the facts acknowledges that the insurance policies that would fund the Proposed Settlement would otherwise be available to defend or resolve the Direct Claims absent the Proposed Settlement. Given those facts, it is Plaintiffs' burden to establish that the $220 million ($180 million of which is to be paid under the Proposed Settlement) would not be utilized by the Company through the Direct Claims. Because resolving the Direct Claims is likely to exhaust the $220 million remaining on the policies, it is unclear why the Company would leave any – let alone 20% – of its insurance coverage on the table in any negotiation. Absent unexpectedly favorable resolutions of the Direct Claims, that coverage will almost certainly be exhausted.

Because the record does not reflect what other insurance coverage (if any) is available to FirstEnergy, the Court should require such a showing before approving the Proposed Settlement. *See Owner-Operator Indep. Drivers Ass'n, Inc. v. Arctic Express, Inc.*, 2016 WL 5122565, at *5 (S.D. Ohio Sept. 21, 2016) ("[p]arties to the settlement must proffer sufficient evidence to allow the district court to review the terms and legitimacy of the settlement." (quoting *UAW v. Gen. Motors Corp.*, 497 F.3d 615, 631 (6th Cir. 2007))). If, instead, FirstEnergy is exchanging $220 million dollars of insurance coverage that would otherwise almost certainly be exhausted in the near future in exchange for a payment of $180 million now, then the Proposed Settlement should

be rejected because, in those circumstances, Plaintiffs fail to explain how the monetary aspect confers any material benefit upon the Company.[12]

C. Plaintiffs Fail to Account for the Negative Impact of the Broad Release on Existing Litigation and Claims Involving the Terminated Executives

The Proposed Settlement carves out compensation-based claims between FirstEnergy, on the one hand, and the Terminated Executives, on the other hand (the "Compensation Claims"). Proposed Settlement §§1(x), 1(z). That is an extraordinary carve-out considering it is well-settled that the "[r]easonableness [of a settlement agreement] depends on an analysis of the Class allegations and claims and ***the responsiveness of the settlement to those claims***." MCL 4th §21.62 (2004) (emphasis added).[13]

The Compensation Claims are central to this Action, which alleges that FirstEnergy paid bribes "driven by the Officer Defendants' selfish interests in executive compensation tied to revenues, contrary to FirstEnergy's long-term interests, and expos[ing] the Company to enormous harm." ECF No. 75 (complaint) at ¶2; *see also id.* at ¶¶4, 9, 87, Prayer F (alleging how Defendants caused FirstEnergy to pay bribes to increase Defendants' compensation and seeking restitution for all compensation obtained by Defendants). That is the crux of this Action, as echoed when the parties briefed, and the Court denied, Defendants' motions to dismiss. *See* ECF No. 86 (motion

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[12] A failure to approve the Proposed Settlement does not appear likely to impact the governance reforms contemplated by the Proposed Settlement, most of which have already been implemented or are being implemented. *See* Motion at 17. The Motion states that "[i]f the Settlement is approved, FirstEnergy will also implement additional governance reforms ensuring that the Board takes ownership of political and lobbying activities" but reforms aimed at lobbying were part of the Company's Deferred Prosecution Agreement with the Department of Justice. *See* https://www.sec.gov/Archives/edgar/data/1031296/000103129621000071/ex101-8k7x22x21.htm at §5.F and Attachment B. Whether Plaintiffs' counsel conferred a benefit by causing these governance reforms is entirely independent of whether the Released Claims should be released.

[13] The use of the term "class" in the MCL 4th is a shorthand for representative actions. *See* n.6, *supra*.

to dismiss opposition) at 2, 5-10; *Emps. Ret. Sys. Of City of St. Louis v. Jones*, 2021 WL 1890490, at *2 (S.D. Ohio May 11, 2021) ("The Company's financial situation also impacted each of the Officer Defendants, since most of their compensation was based on the Company's annual financial performance."); *id.* at *14 ("Plaintiffs allege Defendants were motivated to engage in the Ohio bribery scheme because 'it increased the amount of their performance-based compensation tied to the achievement of certain FirstEnergy financial targets.'"); *see also* Motion at 20.

The Proposed Settlement leaves the Compensation Claims unresolved, undermining the assertion that the Proposed Settlement will allow "FirstEnergy and its newly refreshed and reformed Board to move past the bribery scandal and avoid the uncertainties and distractions of continued litigation that otherwise might have weighed on the Company for years to come." Motion at 4. Instead, the Proposed Settlement, if approved, will allow the Terminated Executives to seek further compensation or damages from FirstEnergy. *See* ECF No. 179-3 at 24 ("Released Defendants' Claims does not include any claims that [Jones, Dowling, and Chack] have or may assert against FirstEnergy, including but not limited to, claims for [various types of compensation] and further including any claims for wrongful termination and/or any and all claims relating thereto."). Moreover, it seems that the release of Released Claims will leave the Terminated Executives with claims against FirstEnergy while limiting FirstEnergy's claims against them. Proposed Settlement §§1(x), 1(z). Augenbaum does not believe that would be fair or reasonable.

Whatever compensation the Terminated Executives believe they may be owed, including any potential clawbacks to which the Company believes it is entitled, must be dwarfed by potential claims the Company would have from the fallout from the Terminated Executives' disloyal conduct. Moreover, it has been reported that "[t]he Board elected not to use the contracted claw back provisions which could have recouped compensation paid during the years investigated" for

"several executives (including the former President and CEO) [who] were terminated by FirstEnergy."[14] If that is correct, then the bilateral carve-outs can only harm FirstEnergy. If it is not correct, the record should be clarified.

At the very least, the Proposed Settlement should not be approved unless the Terminated Executives release claims they may have against the Company given the immense amount of actual and prospective damages caused by the bribery scandal that they spearheaded. Indeed, Plaintiffs identify "the more than $100 million in compensation FirstEnergy paid to the Individual Defendants while the scheme was on going" (Motion at 31 n.12) as a concrete potentially recoverable damage but seemingly ignore the possibility that that amount might *increase* if the Proposed Settlement is approved. The Court should not countenance that possibility as fair, reasonable, or adequate.

III. THE BROAD RELEASE OF UNKNOWN CLAIMS IS IMPROPER

The Proposed Settlement would release "any and all claims and causes of action of every nature and description, whether known claims or Unknown Claims … that Plaintiffs, the Company, or the SLC … could have asserted on behalf of the Company that in any way are based on, arise from or relate to the allegations, transactions, facts, matters, disclosures or nondisclosures set forth in the Complaints[.]" Proposed Settlement §1(z). That is extraordinarily broad.

Faced with a similar proposed release in *In re Hewlett-Packard Co. S'holder Derivative Litig.*, 2015 WL 1153864 (N.D. Cal. Mar. 13, 2015), Judge Breyer found that it might be reasonable to release claims relating to HP's acquisition of Autonomy, which laid "at the heart of th[at] litigation[,]" but that a second clause of that would release "all Known Claims arising from the allegations in the Complaints, that Settling Plaintiffs or any other Securities Holder asserted or

[14] *See* Pennsylvania Public Utility Comm'n, Bureau of Audits, FE-PA Companies Management and Operations Audit 2022 at 63, *available at* https://www.puc.pa.gov/pcdocs/1748700.pdf.

could have asserted derivatively on behalf of the Company" was too broad to be approved. *Id.* at *3. Judge Breyer reasoned that "it was impossible for the Court or parties to determine the scope and merits of the claims released by this second clause, and because it encompassed a universe of claims that strayed far beyond the Autonomy acquisition at the heart of the litigation, the Court could not say it was a fair and reasonable resolution of this action." *Id.*

Here, Judge Breyer's reasoning applies with considerably more force. The scope and merits of claims released is indeterminate because the Proposed Settlement would release Unknown Claims tangentially related to the claims pled. If approved, that would resolve not only every claim that would be barred by *res judicata* if this case proceeded to judgment, but also a panoply of other rights that are tangential to the Complaint. *See UniSuper Ltd. v. News Corp.*, 898 A.2d 344, 347 (Del. Ch. 2006) ("a release may be overbroad if it could be interpreted to 'encompass any claim that has some relationship—however remote or tangential— to any 'fact,' 'act' or conduct 'referred to' in the Action.' In other words, a release is overly broad if it releases claims based on a common set of tangential facts, as opposed to operative or core facts.") (footnote omitted). The Court should require that the release of claims be limited to those claims pled in the Complaint and, at most, to other claims that are specifically described and that were sufficiently investigated by counsel for Plaintiffs and the SLC.

CONCLUSION

For the foregoing reasons, the Court should reject the Proposed Settlement.

Dated: July 21, 2022

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CERTIFICATE OF SERVICE

This certifies that the foregoing Objection was filed on July 21, 2022 via the Court's electronic filing system, which automatically results in service upon counsel of record for the defendants.

/s/ W. B. Markovits, Esq.
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