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Inside the Courts

An Update From Skadden Securities Litigators

CONTENTS

May 2014 | Volume 6 | Issue 2

AUDITOR LIABILITY 2

Athale v. Sinotech Energy Ltd., No. 11 Civ. 05831(AJN) (S.D.N.Y. Feb. 21, 2014)

BYLAWS 2

ATP Tour, Inc. v. Deutscher Tennis Bund (German Tennis Federation), No. 534, 2013 (Del. May 8, 2014)

CLASS CERTIFICATION 3

In re BP p.l.c. Sec. Litig., MDL No. 10-md-2185, 2014 (S.D. Tex. May 20, 2014)
In re Kosmos Energy Ltd. Sec. Litig., No. 3:12-CV-373-B (N.D. Tex. Mar. 19, 2014)
N.J. Carpenters Health Fund v. DLJ Mortg. Capital Inc., No. 08 Civ. 5653 (PAC) (S.D.N.Y. Mar. 17, 2014)
Dodona I, LLC v. Goldman, Sachs & Co., 296 F.R.D. 261 (S.D.N.Y. 2014)

EXCHANGE ACT 5

In re L & L Energy, Inc. Sec. Litig., No. 11-1423 (W.D. Wash. Dec. 3, 2013)

FIDUCIARY DUTIES 5

Mergers and Acquisitions 5
Chen v. Howard-Anderson, No. 5878-VCL (Del. Ch. Apr. 8, 2014)
In re Rural Metro Corp. S'holders Litig., No. 6350-VCL (Del. Ch. Mar. 7, 2014)
In re Orchard Enters. Inc. S'holder Litig., No. 7840-VCL (Del. Ch. Feb. 28, 2014)

FINRA 7

Goldman, Sachs & Co. v. City of Reno, No. 13-15445 (9th Cir. Mar. 31, 2014)

FOREIGN CORPORATIONS 8

City of Pontiac Policemen's And Firemen's Ret. Sys. v. UBS AG, No. 12-4355-cv (2d Cir. 2014)
Atlantica Holdings, Inc. v. Sovereign Wealth Fund Samruk-Kazyna JSC, No. 12 Civ. 8852 (JMF) (S.D.N.Y. Mar. 10, 2014)

INSIDER TRADING 9

Roth v. The Goldman Sachs Grp., Inc., 740 F.3d 865 (2d Cir. 2014)
Steginsky v. Xcelera Inc., 741 F.3d 365 (2d Cir. 2014)

INTERLOCUTORY APPEALS 10

In re Facebook, Inc., IPO Sec. & Derivative Litig., No. 12-2389 (S.D.N.Y. Mar. 13, 2014)

INTERPRETING *JANUS* 10

Sec. & Exch. Comm'n. v. Monterosso, Nos. 13-10341, 13-10342, 13-10464 (11th Cir. Mar. 3, 2014)
Sec. & Exch. Comm'n. v. Geswein, No. 5:10-CV-1235 (CAB) (N.D. Ohio Mar. 5, 2014)

LOSS CAUSATION 11

Nakkhumpun v. Taylor, Nos. 12-cv-01038, 12-cv-01521 (D. Colo. Jan. 29, 2014)

PSLRA 12

Pleading Standards 12
Kuyat v. BioMimetic Therapeutics, Inc., No. 13-5602 (6th Cir. Mar. 28, 2014)
Espinoza v. Whiting, No. 4:12-cv-1711 (SNLJ) (E.D. Mo. Mar. 18, 2014)

Safe Harbor Provision 12
Pound v. Stereotaxis, Inc., No. 4:11-cv-1752 HEA (E.D. Mo. Mar. 18, 2014)

SARBANES-OXLEY ACT 13

Beckett v. Brinx Res., Ltd., No. 3:13-CV-000342-LRH-WCG (D. Nev. Mar. 21, 2014)

SCIENTER/SECURITIES ACT CLAIMS 13

Yates v. Mun. Mort. & Equity, LLC, 744 F.3d 874 (4th Cir. 2014)

SEC ENFORCEMENT ACTIONS 14

Sec. Exch. Comm'n v. Shields, 744 F. 3d 633 (10th Cir. 2014)

STANDING 15

Galope v. Deutsche Bank Nat'l Trust Co., No. 12-56892 (9th Cir. Mar. 27, 2014)

STATUTE OF REPOSE 15

In re Bear Stearns Cos., Inc. Sec., Derivative, & ERISA Litig., No. 13 Civ. 2692 (S.D.N.Y. Feb. 5, 2014)
Nat'l Credit Union Admin. Bd. v. Morgan Stanley & Co., No. 13 Civ. 6705(DLC) (S.D.N.Y. Jan. 22, 2014)

AUDITOR LIABILITY

Athale v. Sinotech Energy Ltd., No. 11 Civ. 05831 (AJN) (S.D.N.Y. Feb. 21, 2014)

Click here to view the opinion.

S.D.N.Y. Dismisses Section 10(b) Claims Against Auditor

Judge Alison J. Nathan of the U.S. District Court for the Southern District of New York dismissed claims that an auditor's opinion contained allegedly material misstatements and omissions concerning a company's financials in violation of Section 10(b) of the Securities Exchange Act. The unqualified opinion concluded that the consolidated financial statements fairly represented the company's consolidated financial position and were in conformity with GAAP. The plaintiffs' allegation that the auditor participated in the company's alleged fraud to generate lucrative fees was insufficient to plead scienter because the mere desire to maintain a profitable business relationship does not establish motive. In addition, the auditor had no duty to conduct third-party investigations about the company's customers, assets and undisclosed dealings, or to research the company's industry and competitors, and the plaintiffs did not allege that the auditor knew about purported red flags pointing to the company's fraud or how the auditor learned of those red flags. Therefore, the plaintiffs failed to sufficiently plead that the auditor recklessly failed to discover the company's purported fraud. The auditor's alleged violation of GAAS and GAAP also did not support an inference of scienter because the plaintiffs' allegations were conclusory and did not specify how and why the auditor allegedly violated the standards under GAAS or GAAP. Lastly, the auditor was not liable for any forward-looking statements because the plaintiffs failed to allege that the auditor had ultimate authority over the statements at issue, and thus it was not a "maker" of any statements as required after the Supreme Court's decision in *Janus Capital Group., Inc. v. First Derivative. Traders*, 131 S. Ct. 2296 (2011).

BYLAWS

ATP Tour, Inc. v. Deutscher Tennis Bund (German Tennis Federation), No. 534, 2013 (Del. May 8, 2014)

Click here to view the opinion.

Delaware Supreme Court Holds That Fee-Shifting Provisions in a Delaware Non-Stock Corporation's Bylaws Are Not Per Se Invalid

The Delaware Supreme Court, sitting *en banc*, answered four certified questions from the U.S. District Court for the District of Delaware concerning the validity of a fee-shifting provision in a Delaware non-stock corporation's bylaws. The bylaw at issue shifted all litigation expenses to an unsuccessful plaintiff in intra-corporate litigation who did "not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought."

Without directly addressing whether the bylaw at issue was adopted for a proper purpose or enforceable in the circumstances presented, the court held that "that fee-shifting provisions in a non-stock corporation's bylaws can be valid and enforceable under Delaware law." The court explained that "[n]either the DGCL nor any other Delaware statute forbids the enactment of fee-shifting bylaws." Answering the four certified questions, the court explained that (i) fee-shifting bylaws like the one at issue may be lawfully adopted under Delaware law, but whether a specific fee-shifting bylaw is enforceable "depends on the manner in which it was adopted and the circumstances under which it was invoked"; (ii) if otherwise valid and enforceable, the bylaw could shift fees if a plaintiff obtained no relief in the litigation; (iii) the bylaws would be unenforceable if adopted for an improper purpose, noting that the "intent to deter litigation, however, is not invariably an improper purpose"; and (iv) generally, a fee-shifting bylaw is enforceable against members who joined the corporation before its enactment.

The Corporate Law Section of the Delaware State Bar Association is considering proposed legislation that would make clear that corporations (excluding non-stock corporations) may not impose on their shareholders liabilities beyond the cost of their investment, and thereby precluding *ATP* type bylaws.

CLASS CERTIFICATION

In re BP p.l.c. Sec. Litig., MDL No. 10-md-2185, 2014 (S.D. Tex. May 20, 2014)

Click here to view the opinion.

Texas District Court Denies Class Certification to One Subclass and Grants Certification to Another Following Plaintiffs' Second Try at Certification in Deepwater Horizon Litigation

On May 20, 2014, Judge Keith P. Ellison of the U.S. District Court for the Southern District of Texas denied in part and granted in part the plaintiffs' motion for class certification, granting certification to one of two proposed subclasses. The plaintiffs alleged that British Petroleum misled investors through a series of misrepresentations and omissions over a three-year period spanning before and after the Deepwater Horizon Spill and explosion. On December 6, 2013, Judge Ellison denied the plaintiffs' prior motion for class certification, holding that the plaintiffs failed to show class-wide damages consistent with their theory of the case. Judge Ellison allowed the plaintiffs to modify their proposed subclasses and articulate differing damages methodologies for each. The plaintiffs' revised subclasses were (i) a pre-explosion subclass consisting of people and entities who acquired BP shares before the oil spill and who allegedly relied on BP statements about the company's process safety improvements, and (ii) a post-explosion subclass consisting of people and entities who acquired BP shares after the spill and who allegedly relied on BP statements about the extent of the company's liability and the status of the spill.

Judge Ellison denied certification as to the pre-explosion class. The court held that the plaintiffs' theory of proximate causation — that shareholders were deprived of the opportunity to divest their shares and thus avoid the increased risk of BP's failure to implementing its process safety improvements before the explosion — injected individualized inquiries into the class-wide model because it required BP's statements to induce particular transactions. The court held that the "fraud-on-the-market" theory did not apply because shareholders in the pre-explosion subclass would have relied on their own risk thresholds and not on the integrity of the market price.

Judge Ellison granted certification as to the post-explosion class. The court found that a "constant dollar" approach to measuring damages was appropriate because "[p]laintiffs' theory in the post-explosion time frame [was] that Defendants misrepresented their internal estimates of the oil spill; that the stock market price failed to fall to the level reflecting the magnitude of the crisis facing BP; that the market learned the truth; and that the stock market price corrected." The court held that this damages methodology attempted to quantify the injury caused by the alleged wrongful conduct and could be deployed on a class-wide basis.

In re Kosmos Energy Ltd. Sec. Litig., No. 3:12-CV-373-B (N.D. Tex. Mar. 19, 2014)

Click here to view the opinion.

Texas District Court Denies Class Certification, Ruling That Lead Plaintiff Was Inadequate Class Representative

On March 19, 2014, Judge Jane J. Boyle of the U.S. District Court for the Northern District of Texas denied plaintiffs' motion for class certification. Plaintiffs sought to certify a class of investors who acquired stock from Kosmos Energy Limited through its May 2011 initial public offering. Plaintiffs alleged that Kosmos's registration statement and prospectus contained false and misleading information regarding the performance and production of an oil field. Defendants objected to class certification based on the adequacy and predominance requirements of Rule 23 of the Federal Rules of Civil Procedure.

Following the Supreme Court's decisions in *Wal-Mart Stores, Inc., v. Dukes* and *Comcast v. Behrend*, as well as the Fifth Circuit's decision in *Berger v. Compaq Computer Corp.*, the court denied the motion to certify the class. The court held that the lead plaintiff failed to establish adequacy as a class representative because the board chair of the plaintiff organization had not read the registration statement and did not know if the price of Kosmos stock had dropped after the plaintiff bought the stock or what might have caused a drop in stock price. In holding that the proposed lead plaintiff would not be an adequate class representative, the court emphasized

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that plaintiff had an especially close relationship with the law firm seeking appointment as lead plaintiff's counsel, thereby giving rise to the "very tendencies toward lawyer-driven litigation that the PSLRA was designed to curtail."

The court also held that the proposed lead plaintiff failed to demonstrate that common issues of fact and law predominated over individual issues. In particular, the court found that the un-rebutted evidence established that there were at least 14 different times during the class period when investors could have varying degrees of knowledge about Kosmos. Accordingly, given the thousands of potential investors and the differing degrees of knowledge they may have had when purchasing Kosmos stock, plaintiff was unable to prove the predominance of common issues of fact and law.

N.J. Carpenters Health Fund v. DLJ Mortg. Capital Inc., No. 08 Civ. 5653 (PAC) (S.D.N.Y. Mar. 17, 2014)

Click here to view the opinion.

S.D.N.Y. Reinstates Claims and Expands Class of MBS Investors

Judge Paul A. Crotty of the U.S. District Court for the Southern District of New York expanded a class of investors that purchased mortgage-backed securities pursuant to an offering in 2007 to include purchasers in a 2006 offering that presented the "same set of concerns." The court previously dismissed claims arising from the 2006 offering because the lead plaintiff had not purchased securities in that offering and, therefore, lacked standing to assert claims on behalf of those purchasers. Following the U.S. Court of Appeals for the Second Circuit's decision in *NECA-IBEW Health & Welfare Fund v. Goldman Sachs & Co.*, 693 F.3d 145 (2012), which held that a lead plaintiff has standing so long as he "has suffered some actual injury as a result of the putatively illegal conduct of the defendant" and that "conduct implicates the same set of concerns as the conduct alleged to have caused injury to other members of the putative class," the court reinstated the claims and expanded the class. The claimants were sufficiently numerous and the question of whether the defendant misrepresented its underwriting standards was common to the class. In addition, the court previously had determined that the plaintiff's claims were typical and the addition of 2006 offering class members did not disturb the prior ruling. Further, individual issues were not likely to predominate over class-wide issues, even though purchasers in the 2007 offering likely had more knowledge of the condition of the housing market than purchasers in 2006, the class included sophisticated investors with special knowledge of the housing market, and consideration of the materiality of each alleged misstatement would vary between groups of class members because the prospecti were not identical. Finally, class treatment was superior because the amount at stake did not justify individual adjudication and there were no "particular difficult[ies]" in proceeding as a class.

Dodona I, LLC v. Goldman, Sachs & Co., 296 F.R.D. 261 (S.D.N.Y. 2014)

Click here to view the opinion.

S.D.N.Y. Certifies Class of RMBS Investors

Judge Victor Marrero of the U.S. District Court for the Southern District of New York certified a class of investors in residential mortgage-backed securities on claims that an underwriter concealed information regarding the creditworthiness of the underlying home loans. The court found that the lead plaintiff's claim was typical of the class, even though the lead plaintiff implemented a unique trading strategy that included taking short positions against the loans underlying the securities, and also may have profited from the purchase of the securities at issue. The court further determined that reliance could be determined on a class-wide basis because the plaintiffs were entitled to a presumption of reliance under *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972), and evidence presented by the defendants at this stage was insufficient to rebut that presumption. Thus, issues common to the class would predominate. In addition, the court held that the plaintiffs need not prove loss causation at the class certification stage under *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011), and the defendants failed to otherwise show that damages calculations would require individualized determinations that would overwhelm issues common to the class.

EXCHANGE ACT

In re L & L Energy, Inc. Sec. Litig., No. 11-1423 (W.D. Wash. Dec. 3, 2013)

Click here to view the opinion.

Washington District Court Denies, in Part, Motion to Dismiss Exchange Act Claims Where Plaintiff Alleged a 'Must Have Known' Theory of Scienter

Judge Robert S. Lasnik of the U.S. District Court for the Western District of Washington denied, in part, the defendants' motion to dismiss a claim brought under Rule 10b-5.

The plaintiff shareholder alleged that L & L Energy, a mining company, and certain of its officers and directors intentionally misled the investing public by falsely claiming that L & L owned certain mining interests, and by including revenue derived from those mining interests in the company's financial statements.

The only issues before the court were falsity and scienter. As to the falsity of the defendants' statements, the court concluded that the plaintiff alleged sufficient facts that L & L did not own the mines at issue, and therefore, the financial statements that included revenue from those mines were misleading.

As to scienter, the court noted that the plaintiff "relies in large part on a 'must have known' theory of scienter: that given their positions in the company and the importance of the business interests at stake, defendants must have known that L & L Energy" did not own the mines at issue. The court accepted this theory of scienter. The court explained that the plaintiff's particularized allegations "make it hard to imagine how the inclusion of the mines' revenue . . . could have been an innocent mistake or error on the part of anyone involved in the operations of the company." However, not all of the individual defendants were "involved in the operations of the company." The court therefore dismissed the claims against a certain director. As to the CEO, however, the court found that he was "involved in the day-to-day operations" of the company and "participated in the business deals related to the contested mines." Therefore, the plaintiff's "must have known" theory of scienter applied to the claims against the CEO, and the court denied the motion to dismiss the claims against him.

FIDUCIARY DUTIES

Mergers and Acquisitions

Chen v. Howard-Anderson, No. 5878-VCL (Del. Ch. Apr. 8, 2014)

Click here to view the opinion.

Delaware Court of Chancery Elaborates on Standard of Review in Cash/Stock Merger and Application of Exculpatory Charter Provision

Vice Chancellor J. Travis Laster of the Delaware Court of Chancery issued an opinion granting in part and denying in part a motion for summary judgment arising out of the acquisition of Occam Networks, Inc. (Occam) by Calix Inc. (Calix). The plaintiffs contended that the defendants breached their fiduciary duties by (i) making decisions during Occam's sale process that fell outside of the range of reasonableness and (ii) issuing a proxy statement that contained materially misleading disclosures and omissions.

First, the court held that the merger, which was a mix of approximately 49.6 percent cash and 50.4 percent stock consideration, would be subject to enhanced scrutiny under *Revlon*. The court remarked that the fact that the transaction had already closed did not alter this analysis, noting "[t]he specter that potential context-dependent or situationally specific conflicts may have undermined a board's decision does not dissipate just because a transaction has closed." Applying the enhanced scrutiny analysis, the court stated that "the record supports an inference that it fell outside the range of reasonableness for the Board to rely on [a] 24-hour, July 4th market check and, under the circumstances then existing, to deliver an ultimatum to [a bidder] to make an offer within 24 hours." The court noted that while there was competing

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evidence that the board acted reasonably, on summary judgment, the court was required to resolve evidentiary conflicts in favor of the non-movant plaintiffs. Thus, evaluating the record in favor of the plaintiffs, the court stated that "[w]hen evaluated as a whole, the record supports a reasonable inference that the Board favored Calix at the expense of generating greater value through a competitive bidding process or by remaining a stand-alone company and pursing acquisitions."

However, applying the facts before the court, the court determined that the factual record did not contain evidence sufficient to create a dispute of material fact about the outside directors' good faith pursuit of the best value reasonably available, and thus they were protected by the company's exculpatory charter provision. However, with respect to the officer defendants, the court stated that "Section 102(b)(7) does not authorize exculpation for officers," and that "[b]ecause the plaintiffs have assembled evidence sufficient to support claims against [two of the directors] in their capacity as officers, the Exculpatory Provision does not protect them."

The court also denied the defendants' motion for summary judgment concerning disclosure claims, holding that the plaintiffs had presented sufficient evidence that information in the proxy statement was intentionally omitted or materially misleading, and could not grant the defendants' motion for summary judgment on the disclosure claims, including based on the exculpatory charter provision.

In re Rural Metro Corp. S'holders Litig., No. 6350-VCL (Del. Ch. Mar. 7, 2014)

Click here to view the opinion.

Delaware Court of Chancery Holds Financial Advisor Liable for Aiding and Abetting Breaches of Fiduciary Duty

Vice Chancellor J. Travis Laster of the Delaware Court of Chancery issued a post-trial opinion in stockholder litigation arising from a merger between Rural Metro Corp. (Rural) and an affiliate of Warburg Pincus (WP). The court held that Rural's directors (who had settled before trial) breached their fiduciary duty because their conduct in selling the company fell outside the range of reasonableness required by Revlon, and that their financial advisor knowingly aided and abetted that breach by "fail[ing] to disclose the relevant information to further its own opportunity to close a deal, get paid its contingent fee, and receive additional and far greater fees for buy-side financing work." The court's factual findings were based primarily on the contemporaneous documentary record created during the sales process.

Earlier in the case, before the merger was consummated, the parties had agreed to a disclosure-only settlement. One stockholder objected, arguing that the evidence obtained in confirmatory discovery revealed various conflicts of interest. The court rejected the settlement and appointed the objector's counsel as lead counsel. Shortly before trial, the director defendants and the board's other financial advisor settled their claims for a total of $11.6 million. The remaining claim for trial was against the financial advisor for aiding and abetting breaches of fiduciary duty by the Rural board.

In analyzing the Rural board's conduct, the court held that several of the board's decisions fell outside of the range of reasonableness and constituted the predicate breach for an aiding and abetting claim against the financial advisor. These decisions included failing to (i) directly and actively oversee the financial advisor's activities, (ii) adequately inform themselves of and consider alternatives, (iii) learn about actual and potential conflicts of interest, and (iv) disclose material information to stockholders regarding the same issues. Further, the court held that the financial advisor "knowingly participated" in the board's breach of fiduciary duty by purposefully inducing the breach. Among other things, the court found that (i) the financial advisor knew the board was not fully informed about the value of Rural or the financial advisor's conflicts of interest, (ii) the financial advisor never disclosed its conflicts of interest to the board or stockholders and (iii) the financial advisor downwardly revised its valuation analyses to make the deal price look more attractive. Finally, the court stated the evidence at trial demonstrated persuasively that the fair value of Rural's stock at the time of the sale exceeded the price that

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WP paid. Although the court postponed judgment on damages pending supplemental expert reports, it adopted in principle the plaintiffs' expert's damages analysis.

In re Orchard Enters. Inc. S'holder Litig., No. 7840-VCL (Del. Ch. Feb. 28, 2014)

Click here to view the opinion.

Delaware Court of Chancery Applies Entire Fairness Standard to Take-Private Merger

Vice Chancellor J. Travis Laster of the Delaware Court of Chancery granted in part and denied in part cross motions for summary judgment in connection with a take-private merger in which Orchard Enterprises Inc.'s (Orchard) common stockholders were cashed out by Orchard's controlling shareholder, Dimensional Associates (Dimensional) which, at the time of the merger, owned 42 percent of Orchard's common stock and 99 percent of Orchard's Series A preferred stock, representing approximately 53 percent of Orchard's voting power. The preferred stock was functionally identical to the common stock except that it had a liquidation preference.

First, the court granted summary judgment to the plaintiffs on their claim that the proxy statement contained materially misleading disclosures regarding whether the merger triggered the liquidation preference.

Second, the court granted summary judgment to the plaintiffs that the entire fairness standard of review with the burden of persuasion on the defendants should apply at trial. The court stated that Dimensional's failure to agree at the outset to approval by both the special committee and a majority-of-the-minority stockholders precluded review under the business judgment rule. Further, the court held that the protective measures did not warrant shifting the burden of persuasion from defendants to plaintiffs because (i) the stockholder vote was not fully informed due to disclosure violations and (ii) the plaintiffs raised genuine issues of material fact regarding the special committee process, including the independence and disinterestedness of the special committee's chairman (who had past business and social connections with members of Dimensional and worked as a consultant for Dimensional after the transaction closed).

Third, the court rejected the special committee member's argument that they were shielded from liability pursuant to Orchard's DGCL 102(b)(7) exculpation clause at this stage because, among other things, the case involved a controlling stockholder with entire fairness as the standard of review.

Finally, the court held that rescissory damages and quasi-appraisal damages were available to stockholders as a remedy for disclosure violations in the proxy statement.

FINRA

Goldman, Sachs & Co. v. City of Reno, No. 13-15445 (9th Cir. Mar. 31, 2014)

Click here to view the opinion.

Ninth Circuit Holds That Forum Selection Clause Supersedes Right to FINRA Arbitration

The U.S. Court of Appeals for the Ninth Circuit held that the forum selection clause in a contract between the City of Reno and Goldman, Sachs & Co. superseded any right to Financial Industry Regulatory Authority (FINRA) arbitration.

The case arose out of a contractual relationship between Goldman Sachs and Reno in which Goldman Sachs underwrote more than $200 million in complex securities issued by Reno. After Reno's financing collapsed, Reno initiated an arbitration before FINRA to resolve its claims. Goldman Sachs filed this action to enjoin the arbitration, arguing that (i) Reno was not a "customer" entitled to arbitrate under FINRA and (ii) Reno had disclaimed any right to arbitrate when it agreed to the forum selection clause in the parties' contract. The district court denied Goldman's motion for injunctive relief, and Goldman appealed.

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In reversing the district court, the Ninth Circuit decided three issues. First, the panel held that a court, rather than FINRA, must determine the question of FINRA arbitrability. The panel noted that decisions regarding arbitrability are "for judicial determination unless the parties *clearly and unmistakably provide otherwise*." The relevant FINRA rule regarding arbitrability did not provide the necessary "clear and unmistakable" evidence. Second, the court held that the City of Reno was a "customer" under FINRA Rule 12200. Noting a circuit split on the definition of "customer" under FINRA, the panel found the analysis of the U.S. Courts of Appeal for the Second and Fourth Circuits persuasive. Based on those circuits' analyses, the panel defined "customer" as "a non-broker and non-dealer who purchases commodities or services from a FINRA member in the course of the member's FINRA-regulated business activities." Given that definition, the panel decided that "Reno easily qualifies as Goldman's 'customer.'" Third, the panel held that the forum selection clause in the parties' contract superseded the default obligation to arbitrate under the FINRA rules. The court explained that forum selection clauses can supersede the default FINRA rules if the clauses "sufficiently demonstrate the parties' intent to do so." Here, the panel held that the clauses demonstrated such an intent, where the clauses provided that "all actions and proceedings . . . shall be brought in the . . . District of Nevada (alterations in original)." Further, while the parties did not include in the contract an express waiver as to their right to arbitrate, the panel "kn[e]w of no requirement that they do so."

FOREIGN CORPORATIONS

City of Pontiac Policemen's And Firemen's Ret. Sys. v. UBS AG, No. 12-4355-cv (2d Cir. 2014)

Click here to view the opinion.

Second Circuit Applies Morrison to Dismiss Claims Against Dual-Listed Issuers

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of foreign and domestic investors' claims that a foreign bank violated Section 10(b) of the Securities Exchange Act by misrepresenting the value of mortgage-backed securities prior to a substantial write-down. Although the foreign bank listed its shares on both U.S. and foreign exchanges, all plaintiffs purchased foreign-issued shares on a foreign exchange. Under the Supreme Court's holding in *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010), the court held in a matter of first impression in the Second Circuit that the Securities Exchange Act focuses on purchases and sales within the United States, and purchases by the foreign investors of foreign securities on a foreign exchange were beyond the statute's reach, even though the shares also were cross-listed on a U.S. exchange. Likewise, Section 10(b) did not apply to purchases by a U.S. investor of the foreign shares on a foreign exchange. Although the investor placed its buy orders within the U.S., the test for determining the location of a transaction under *Morrison* is the place where the party incurred "irrevocable liability to carry out the transaction," and the investor's trades were ultimately executed outside the U.S. on a foreign exchange. In addition, the court affirmed the dismissal of Securities Act claims because the plaintiffs failed to allege a material misstatement or what they did allege constituted nothing more than non-actionable puffery.

Atlantica Holdings, Inc. v. Sovereign Wealth Fund Samruk-Kazyna JSC, No. 12 Civ. 8852 (JMF) (S.D.N.Y. Mar. 10, 2014)

Click here to view the opinion.

S.D.N.Y. Dismisses Section 10(b) Claims Against Sovereign Wealth Fund

Judge Jesse M. Furman of the U.S. District Court for the Southern District of New York dismissed in part claims that a sovereign wealth fund violated Section 10(b) of the Securities Exchange Act by allegedly making misleading statements about a nonparty foreign bank's restructuring. As a threshold matter, although the fund constituted a foreign state, the court determined that it had subject-matter jurisdiction pursuant to the Foreign Sovereign Immunities Act because the claims were based upon the fund's commercial activity and had a direct effect on investors in the United States. The plaintiffs sufficiently alleged that the securities transactions occurred in the U.S. because the plaintiffs incurred irrevocable liability by placing orders through brokers in the U.S. who then fulfilled the orders in the United States. The plaintiffs sufficiently pleaded reliance because it was not unreasonable as a matter of

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law that plaintiffs failed to discover certain complex derivative transactions not prominently disclosed in the restructuring memorandum. Further, the plaintiffs could reasonably rely on other statements or omissions in the memorandum related to the 2010 restructuring because the no-representation clause language could not have been a product of negotiation between sophisticated business entities. However, the court dismissed claims based on statements made after 2011 because the plaintiffs did not purchase any debt instruments after those statements were made and thus could not have reasonably relied on any allegedly false statements.

INSIDER TRADING

Roth v. The Goldman Sachs Grp., Inc., 740 F.3d 865 (2d Cir. 2014)

Click here to view the opinion.

Second Circuit Affirms Dismissal of 'Short-Swing' Claims Against Investment Bank

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims against an investment bank that was alleged to have violated Section 16(b) of the Securities Exchange Act by purportedly making "short-swing" trades of certain stock options while holding more than 10 percent of that company's stock. Although the investment bank was a statutory insider at the time the options were written because of its 10 percent ownership, the bank sold down its holdings to below 10 percent before the options expired, and the options were never executed. The court held that the bank was not required to disgorge profits earned on the sale of the options because liability under Section 16(b) requires a "purchase" and a "sale," and in the context of an options contract, the purchase and sale do not occur until the option's expiration date. At the option's expiration in this case, the bank had sold off its shares and was no longer an insider. The court rejected the plaintiff's theory that a purchase and sale for purposes of Section 16(b) occur at the time an option is written because the text of the statute contemplates two separate transactions and prior to the expiration date, the purchaser of the options could exercise the options at a price that would not create a profit for the option writer.

Steginsky v. Xcelera Inc., 741 F.3d 365 (2d Cir. 2014)

Click here to view the opinion.

Second Circuit Upholds Insider Trading Claims, Holding That Section 10(b) Applies to Unregistered Securities

The U.S. Court of Appeals for the Second Circuit upheld insider trading claims under Sections 10(b) and 20(a) of the Securities Exchange Act arising from an investor's sale of company stock in a tender offering by a shell allegedly controlled by company insiders. The stock subsequently fell to $0.25 per share and was delisted and deregistered. The investor alleged that the company insiders failed to disclose any information about the stock before the tender offering, and thus purchased company stock through the shell while in possession of material, nonpublic information. The court held that Section 10(b) applies to both registered and unregistered securities, thus the securities were governed by federal securities regulation — not the law of the Cayman Islands where the company was incorporated — even though they were deregistered. Further, although the company and insiders had no affirmative duty to disclose information about the company once its shares were deregistered, the duty to refrain from trading on material nonpublic information continues to apply. The court affirmed dismissal of the plaintiff's Section 14(e) claims, however, because the insiders were alleged to have purchased stock while in possession of material nonpublic information about the company, rather than the tender offer itself.

INTERLOCUTORY APPEALS

In re Facebook, Inc., IPO Sec. & Derivative Litig., No. 12-2389 (S.D.N.Y. Mar. 13, 2014)

Click here to view the opinion.

S.D.N.Y. Denies Facebook's Motion to Appeal Earlier Ruling Over Securities Act Claims

Judge Robert W. Sweet of the U.S. District Court for the Southern District of New York denied Facebook's motion for certification to immediately appeal the court's earlier ruling denying dismissal of a consolidated class action complaint alleging violations of Sections 11, 12(a)(2) and 15 of the Securities Act. The court had sustained certain claims based on alleged misstatements and omissions regarding how certain product decisions would affect Facebook's revenue. Appellate review would not materially advance the termination of the multidistrict litigation, because obtaining reversal of an opinion denying a motion to dismiss based on very fact-specific allegations would only compel a remand for repleading and delay the entire action. Even if certain misrepresentation claims were not dismissed on appeal, the litigation would continue to advance in the same manner as if the appeal had never occurred because the misrepresentation claims were predicated on the same factual allegations. In addition, the questions presented for appeal did not involve a controlling question of law because determination of whether the defendants allegedly violated the securities laws in connection with Facebook's IPO was a fact-specific inquiry. Because the opinion was narrow and very fact-specific, the precedential effect of the opinion and any potential impact on the capital markets did not warrant immediate appeal. Finally, the court rejected the defendants' contention that the court's opinion conflicted with other district court decisions that rejected a duty to disclose interim revenue information under Item 303 of an S-K, because the defendants alleged omission of certain product-decision data that affected revenue and did not allege omission or misstatements about quantified revenue information. Therefore, there were no grounds for a difference of opinion on the questions to be appealed.

INTERPRETING *JANUS*

Sec. & Exch. Comm'n. v. Monterosso, Nos. 13-10341, 13-10342, 13-10464 (11th Cir. Mar. 3, 2014)

Click here to view the opinion.

Eleventh Circuit Affirms Summary Judgment Against GlobeTel Executives in Fraud Scheme

The U.S. Court of Appeals for the Eleventh Circuit affirmed summary judgment against three executives of GlobeTel Communications Corporation arising out of a fraud scheme involving falsified revenue reports.

The SEC alleged that the executives violated various provisions of the Securities Act and the Securities Exchange Act during the course of their fraudulent scheme. The district court granted summary judgment, finding, in part, that the defendants violated Section 17(a)(1) of the Securities Act, Section 10(b) of the Securities Exchange Act, and Rule 10b-5(a) promulgated thereunder.

On appeal, the defendants argued, in part, that they did not "make" any of the false statements at issue, and therefore, under *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), which held that "the maker of a statement is the person or entity with ultimate authority over the statement," they cannot be held liable under the securities laws.

The Eleventh Circuit rejected the defendants' argument. According to the court, "Janus only discussed what it means to 'make' a statement for purposes of Rule 10b-5(b), and did not concern section 17(a)(1) or (3) or Rule 10b-5(a) or (c)." This distinction is crucial because the "operative language of section 17(a) does not require a defendant to 'make' a statement in order to be liable" and "subsections (a) and (c) of Rule 10b-5 'are not so restricted' as subsection (b)." Here, the case against the defendants did not involve their "making" false statements; it concerned "their commission of deceptive acts as part of a scheme to generate fictitious revenue for GlobeTel."

Sec. & Exch. Comm'n. v. Geswein, No. 5:10-CV-1235 (CAB) (N.D. Ohio Mar. 5, 2014)

Click here to view the opinion.

District Court Refuses to Dismiss SEC Action Against Diebold Officers Alleging Fraudulent Accounting Practices

Judge Christopher A. Boyko of the U.S. District Court for the Northern District of Ohio refused to dismiss an SEC enforcement action brought against two former CFOs and a former director of corporate accounting of Diebold, Inc. The SEC alleged that between 2002 and 2007 the officers had engaged in fraudulent accounting practices in violation of Securities Act Section 17(a), Securities Exchange Act Section 10(b), SEC Rule 10b-5 and other federal securities laws. The SEC claimed the improper practices inflated Diebold's reported earnings in securities filings and other publicly disseminated information.

The court rejected the argument that dismissal was proper because the officers were not "makers" of the allegedly false financial statements under *Janus*, noting that such a determination would require a fact-intensive inquiry and declining to extend the *Janus* analysis beyond the Rule 10b-5 context to alleged Section 17(a) violations. The court also held that the SEC had adequately alleged the requisite scienter for aiding and abetting a Securities Exchange Act violation. The court explained that under Sixth Circuit law, the necessary "general awareness" of overall improper activity "encompasses both knowledge and reckless failure to know."

The court further determined that scheme liability claims under Section 17(a)(3) brought against the defendants were plausible, as the SEC had alleged the officers' deceptive acts went beyond misrepresentations and omissions, including their knowing or reckless use of improper revenue "opportunities" that resulted in materially false financial reporting and their instructions to employees to manufacture products on a timeline designed to inflate Diebold's revenues.

LOSS CAUSATION

Nakkhumpun v. Taylor, Nos. 12-cv-01038, 12-cv-01521 (D. Colo. Jan. 29, 2014)

Click here to view the opinion.

District of Colorado Rejects Repled Loss Causation Allegations Against Energy Company Officer and Directors

Judge Christine M. Arguello of the U.S. District Court for the District of Colorado denied the plaintiffs' motion for leave to amend their consolidated complaint, which claimed that some of Delta Petroleum's officers and directors violated section 10(b) of the Securities Exchange Act by allegedly misrepresenting the reasons why negotiations to sell a portion of its assets failed, and by allegedly misrepresenting the company's liquidity and financial condition. The court previously determined that the plaintiffs adequately alleged fraudulent misstatements but failed to show loss causation. In analyzing the plaintiffs' repled loss causation allegations, the court rejected the plaintiffs' theory that the defendants' misstatement fraudulently concealed a risk that subsequently materialized to cause the plaintiffs' loss. The court first concluded that two out of the three risks identified by the plaintiffs and the resulting drop price in the company's stock were too attenuated to support such a theory. Although the plaintiffs adequately alleged that Delta Petroleum concealed the risk that the assets might not sell for a price at or near $400 million, they nevertheless failed to allege a strong inference that the company made this alleged misstatement with scienter. The plaintiffs failed to adequately plead scienter because company executives fulfilled their fiduciary duty to maximize shareholder value by crafting a statement that would minimize the risk of receiving lower bids for the assets. Even though company insiders may have been negligent in misleading investors about the failed negotiations, that was insufficient to infer knowledge or reckless indifference. Further, statements made by company executives regarding improved liquidity were immaterial because statements of corporate optimism are not actionable. In addition, the plaintiffs failed to allege the falsity of statements regarding improved cash flows resulting from cost control measures because their allegations about Delta Petroleum's inability to pay its debts and Delta Petroleum seeking strategic alternatives did not show that Delta Petroleum's cost control measures failed to improve cash flows.

PSLRA

Pleading Standards

Kuyat v. BioMimetic Therapeutics, Inc., No. 13-5602 (6th Cir. Mar. 28, 2014)

Click here to view the opinion.

Sixth Circuit Affirms Dismissal of Securities Fraud Class Action Under the PSLRA

The U.S. Court of Appeals for the Sixth Circuit affirmed dismissal of an investor class action for securities fraud alleging that BioMimetic, a company that developed and manufactured a product called Augment Bone Graft to help heal damaged bones and muscles, misled investors about the product's chance of approval by the FDA in violation of Sections 10(b) and 20(a) of the Securities Exchange Act and SEC Rule 10b-5. The plaintiffs alleged that while the company was aware of deficiencies in its clinical trials, it spoke overly optimistically to investors about the overall chance that the product would be approved by the FDA. The company's stock subsequently experienced declines on multiple occasions throughout the failed approval process. The district court held that the plaintiffs failed to plead a sufficiently strong inference of scienter to satisfy the requirements of the Private Securities Litigation Reform Act (PSLRA). The Sixth Circuit agreed, noting that an opposing inference that the company legitimately believed the product would obtain FDA approval was more probable.

Espinoza v. Whiting, No. 4:12-cv-1711 (SNLJ) (E.D. Mo. Mar. 18, 2014)

Click here to view the opinion.

District Court Dismisses Class Action Against Patriot Coal for Insufficient Scienter Pleading Under the PSLRA

Judge Stephen N. Limbaugh of the U.S. District Court for the Eastern District of Missouri dismissed a class action brought on behalf of certain purchasers of Patriot Coal Corporation securities, ruling that the plaintiffs had not sufficiently alleged the scienter required under the PSLRA. The plaintiffs claimed the company had improperly accounted for costs associated with court-ordered environmental remediation obligations and that Patriot's CEO and CFO had made false and misleading statements related to that accounting and the company's financial condition up until its eventual bankruptcy filing, in violation of Sections 10(b) and 20(a)-(b) of the Securities Exchange Act and SEC Rule 10b-5.

The plaintiffs claimed that the use of the accounting treatment at issue was reckless because it was a departure from the defendants' past practice and was highly scrutinized by the SEC, eventually leading the defendants to change the treatment. They also claimed that the defendants were motivated to account for the remediation obligation improperly and misrepresent Patriot's financial health because they wanted to protect their jobs. Nonetheless, after a fact-intensive analysis, the court ruled the plaintiffs' allegations did not collectively support the strong inference of scienter required under the PSLRA, concluding that the defendants had reasonable explanations for their accounting decisions, had fully and accurately disclosed the values underlying their financial statements, and had not benefitted financially from their alleged misrepresentations. Accordingly, the court granted the company's motion to dismiss.

Safe Harbor Provision

Pound v. Stereotaxis, Inc., No. 4:11-cv-1752 HEA (E.D. Mo. Mar. 18, 2014)

Click here to view the opinion.

Eastern District of Missouri Dismisses Suit Alleging Misstatements Under the PSLRA

Judge Henry E. Autrey of the U.S. District Court for the Eastern District of Missouri dismissed a case claiming that Stereotaxis, Inc., a health care technology company, violated Sections 10(b) and 20(a) of the Securities Exchange Act and SEC Rule 10b-5 by allegedly making misrepresentations about its flagship cardiac intervention product. The shareholder plaintiff alleged that Stereotaxis made misstatements about the anticipated clinical adoption of its Niobe system by the medical community, projecting future success based in part on a "back-

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log" of "outstanding purchase orders and other commitments." Despite the company's optimism and its development of a system upgrade designed to address potential shortcomings, thus mitigating the risk of negative changes to the backlog of outstanding orders, subsequent performance failed to meet forecasts.

The court analyzed the misrepresentation claims under the heightened pleading requirements of the PSLRA and Rule 9(b), determining that the claims were insufficiently pled. First, the court concluded that Stereotaxis's forward-looking statements were accompanied by meaningful risk disclosures and thus protected under the "safe harbor" provision of the PSLRA. Second, the claims fell short of Rule 9(b) requirements because the plaintiff failed to show that Stereotaxis actually knew its statements were false or that the alleged misstatements were material. Nor did the plaintiff demonstrate a strong inference of scienter. Further, the court did not credit the plaintiff's confidential witnesses because they were not in a position to know the information they claimed to know. Because the plaintiff failed to plead a primary violation adequately, the Section 20(a) control liability claim also was dismissed.

SARBANES-OXLEY ACT

Beckett v. Brinx Res., Ltd., No. 3:13-CV-000342-LRH-WCG (D. Nev. Mar. 21, 2014)

Click here to view the opinion.

District of Nevada Holds That SOX Does Not Create Private Right of Action

Judge Larry R. Hicks of the U.S. District Court for the District of Nevada, in a case of first impression, held that Section 409 of the Sarbanes-Oxley Act does not create a private right of action.

Section 409, titled "Real time issuer disclosures," requires issuers to "disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer . . . as the Commission determines, by rule, is necessary or useful for the protection of investors and in the public interest."

In determining that Section 409 does not create a private right of action, the court analyzed whether Congress intended to provide a private remedy. The court observed that Section 409 does not contain any "rights creating" language. In addition, the court noted that other sections of the Sarbanes-Oxley Act explicitly provide for a private right of action. Because Section 409 does not contain such language, "the natural inference . . . is that Congress did not intend to create a private right of action." The court dismissed the claim with prejudice.

SCIENTER/SECURITIES ACT CLAIMS

Yates v. Mun. Mort. & Equity, LLC, 744 F.3d 874 (4th Cir. 2014)

Click here to view the opinion.

Fourth Circuit Affirms Dismissal of Section 10(b), Section 11 and Section 12 Claims Against Real Estate Asset Management Company

On March 7, 2014, the U.S. Court of Appeals for the Fourth Circuit affirmed the dismissal of a securities class action asserting claims under Section 10(b) of the Securities Exchange Act and Sections 11 and 12 of the Securities Act. Over a period of several years, Municipal Mortgage & Equity attempted to implement new standards adopted by the Financial Accounting Standards Board (FASB) that dealt with consolidating financial statements. The company had difficulty understanding and adjusting to the new standards. As a result, the company repeatedly issued restated financial statements and spent millions of dollars doing so. The plaintiffs alleged that the defendants violated Section 10(b) of the Securities Exchange Act by falsely representing that the company was in full compliance with the new standards and concealing the cost of correcting accounting errors. The plaintiffs also alleged that the defendants violated Sections 11 and 12 of the Securities Act through a secondary offering that the company made during the period it was issuing the restated financial statements.

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With respect to the Section 10(b) claims, the court held that although there were facts that could support an inference of scienter, taken together the facts did not support a "powerful and compelling inference that these defendants acted with wrongful intent or severe recklessness" necessary to meet the heightened pleading standards of the PSLRA. The court held that it was more likely that the company was out of its depth, and pointed to many accounting meetings and internal disagreements about how to implement the new standards as evidence of a good faith attempt to properly implement challenging new procedures. The court rejected the plaintiffs' contention that intentionality or recklessness should be inferred merely from the individual defendant's positions as senior executives and the fact that the new FASB requirements pertained to a core business of the company.

With respect to the claims concerning the secondary offering, the court adopted the interpretation of a majority of courts that Section 11 of the Securities Act is violated when a registration statement containing misleading information becomes effective. The court also held that the lead plaintiff lacked standing to bring a claim under Section 12 of the Securities Act, which requires plaintiffs to allege that they purchased shares from any person who offered or sold a security by means of a prospectus. The plaintiffs alleged that the lead plaintiff purchased company stock "pursuant and/or traceable to" a secondary public offering registration statement and prospectus, but provided only a confirmation slip for the lead plaintiff's purchase of the shares. The court, agreeing with the U.S. Court of Appeals for the First Circuit, held that allegations that a plaintiff purchased "pursuant and/or traceable to" a registration statement and prospectus, coupled with sufficient supporting facts, could establish standing for a Section 12 claim. Here, however, the confirmation slip for the lead plaintiff's purchase lacked supporting factual allegations to make a plausible claim that he purchased directly in the offering.

SEC ENFORCEMENT ACTIONS

Sec. Exch. Comm'n v. Shields, 744 F.3d 633 (10th Cir. 2014)

Click here to view the opinion.

Tenth Circuit Reverses Dismissal of SEC Claims Against Oil and Gas Exploration Company

The U.S. Court of Appeals for the Tenth Circuit reversed the dismissal of the SEC's claims that an oil and gas exploration company violated the Securities Act and Securities Exchange Act by selling unregistered securities to fund its operations. The company allegedly raised $5 million but invested only $600,000 into oil and gas development. The district court ruled that the SEC failed to sufficiently allege that the joint venture interests sold to investors were "securities" under federal law. The Tenth Circuit held that the interests might be securities, despite the "strong presumption" that a partnership interest is not a security. Although the joint venture agreements were described as general partnerships, and the investors had voting rights and the ability to replace the managing partner, the SEC adequately alleged that the investors were relying on the efforts of others — the company and its founder — to "significantly affect" the venture's success. The company marketed the investment opportunity indiscriminately and sold interests to investors across the U.S. with no prior experience in oil and gas, and the investors were entirely dependent on the company for information regarding the company's operations. In addition, the investors were contractually bound to use the company as a contractor in certain drilling contracts, leaving the investors dependent on the company even if it was removed as the managing partner.

STANDING

Galope v. Deutsche Bank Nat'l Trust Co., No. 12-56892 (9th Cir. 2014)

Click here to view the opinion.

Ninth Circuit Reverses District Court, Says Plaintiff Has Standing to Pursue Claims That Banks Manipulated LIBOR Rate

A divided panel for the U.S. Court of Appeals for the Ninth Circuit revived, in part, a putative class action alleging that certain banks purportedly manipulated the London Interbank Offered Rate (LIBOR). The majority reversed the district court's ruling that the plaintiff failed to establish the "injury-in-fact necessary for Article III standing." According to the majority, the plaintiff's standing "does not turn on whether she actually made interest payments that were adjusted in response to the allegedly manipulated LIBOR rate." Rather, the majority concluded, the plaintiff's "cognizable injury occurred when she purchased the loan, not upon payment of LIBOR-affected interest."

The dissent disagreed with the majority's analysis on this point, noting that the plaintiff "does not allege that she suffered any loss due to the Barclays Defendants' purported deceptive conduct, nor does she allege that any loss is traceable to a misrepresentation related to the LIBOR-rate manipulation or to the LIBOR-rate manipulation itself." The dissent pointed out that the plaintiff's payments were never affected by the defendants' alleged conduct. Therefore, according to the dissent, the plaintiff's "alleged injury is far too attenuated to establish Article III standing."

STATUTE OF REPOSE

In re Bear Stearns Cos., Inc. Sec., Derivative, & ERISA Litig., No. 13 Civ. 2692 (S.D.N.Y. Feb. 5, 2014)

Click here to view the opinion.

S.D.N.Y. Dismisses Sections 10(b) and 18 Claims Against Bear Stearns

Judge Robert W. Sweet of the U.S. District Court for the Southern District of New York dismissed claims that Bear Stearns violated Sections 10(b) and 18 of the Securities Exchange Act by allegedly misrepresenting the value of certain derivative financial instruments, the adequacy of its liquidity and capital reserves and the quality of its risk management. The plaintiff also alleged that Bear Stearns' outside auditor, Deloitte, made false and misleading representations and omissions concerning Bear Stearns' value-at-risk models. The plaintiff's claim under Section 10(b) was untimely under the five-year statute of repose because the claims accrued on the date of the last alleged misstatement, which was more than five years before the plaintiff filed the complaint. The plaintiff's claim under Section 18 also was untimely under that section's three-year statute of repose because the claims accrued when the company filed its last allegedly misleading 10-K more than three years before the plaintiff brought this action. In addition, *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974) did not toll the period to file the Section 10(b) and 18 claims. Relying on the U.S. Court of Appeals for the Second Circuit's recent opinion in *Police & Fire Retirement System of Detroit v. IndyMac MBS, Inc.*, 721 F.3d 95 (2d Cir. 2013), the court held that the earlier-filed class action did not toll the statute of repose because statutes of repose create substantive rights that cannot be abrogated by judicial construction. In addition, *American Pipe* did not toll the statute of limitations period under Sections 10(b) and 18 because the plaintiff's claims based on transactions involving Bear Stearns' security-based swaps were different than those asserted in an earlier-filed class action complaint. The court further determined that Section 10(b) does not grant plaintiffs a private right of action for claims against an issuer or auditor that is not a party to security-based swap agreements. Although the plaintiff's Section 18 claim based on an auditor's 2007 audit opinion was timely, the plaintiff failed to adequately plead reliance because it failed to identify a particular transaction that it made in reliance on filings incorporating the audit opinion.

Nat'l Credit Union Admin. Bd. v. Morgan Stanley & Co., No. 13 Civ. 6705 (DLC) (S.D.N.Y. Jan. 22, 2014)

Click here to view the opinion.

S.D.N.Y. Dismisses Section 11 Claims Against MBS Underwriter

Judge Denise L. Cote of the U.S. District Court for the Southern District of New York dismissed claims by the National Credit Union Administration (NCUA) that an underwriter violated Section 11 of the Securities Act by making material misstatements about the quality of mortgages underlying mortgage-backed securities in offering documents. The court held that the plaintiff's claims were time-barred by the applicable three-year statute of repose because the plaintiff filed suit more than three years after the date of the offering. Although Congress passed an "extender statute" specifically for the NCUA, which preempts other time limitations in favor of a six-year statute of limitations, the extender statute did not apply here because the three-year statute of repose already had expired by the time the NCUA assumed responsibility for the claims. The court held that the extender statute may enlarge the limitation on the time to file, but does not revive previously expired claims. Further, tolling under *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974) did not apply to the three-year statute of repose for Securities Act claims, even though class action lawsuits were filed prior to the statute of limitations arising from the sale of the same securities at issue in this case.

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