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AUCTION RATE SECURITIES

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Click here to view the opinion.

Ashland, Inc. v. Oppenheimer & Co., No. 10-5305 (6th Cir. July 28, 2011)

Click here to view the opinion.

Second and Sixth Circuits Affirm Dismissals of Ashland ARS Suits Against Brokerages

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of Ashland Inc.'s claim that Morgan Stanley violated Section 10(b) of the Securities Exchange Act, for failure to adequately plead reliance. The company claimed that Morgan Stanley's representative misrepresented the liquidity of certain auction rate securities (ARS), but the court ruled that a sophisticated investor — like Ashland — could not reasonably rely on those statements because Morgan Stanley had posted a statement on its website disclosing the ARS' liquidity risks. Similarly, Ashland could not rely upon the representative's alleged statements that Morgan Stanley would place bids to prevent an auction from failing, because Morgan Stanley's website disclosure specifically disclaimed any obligation for it to do so.

Separately, the U.S. Court of Appeals for the Sixth Circuit affirmed the dismissal of Ashland's suit alleging that Oppenheimer & Co. Inc. misrepresented the risks of ARS, holding that Ashland's allegations did not meet the particularity requirement of the Private Securities Litigation Reform Act (PSLRA). Ashland alleged that Oppenheimer made false and misleading statements to persuade Ashland to buy and hold ARS at a time when Oppenheimer knew that the market for such securities was unstable. The Sixth Circuit determined that the district court correctly concluded that many of the purported misstatements and omissions were not actionable, either because they lacked materiality or because Oppenheimer had no duty to disclose. For example, Ashland alleged that Oppenheimer omitted information about the correlation between ARS' credit ratings and low penalty rates, but the court concluded that this consisted of public information to which Ashland had access. The appellate court further concluded that Ashland failed to satisfy the PSLRA's scienter requirement in connection with its central claim that Oppenheimer withheld this "crucial factor" about the market for ARS: that its continued viability depended on the intervention of underwriters, many of whom were abandoning auctions. Ashland's allegations were conclusory and failed to specify how Oppenheimer could have possessed advance, nonpublic knowledge that the market would collapse in February 2008. The Sixth Circuit also affirmed the dismissal of Ashland's claims under the Kentucky Blue Sky laws and for common-law fraud, promissory-estoppel and negligent misrepresentation.

CLASS ACTIONS

Bacon v. Stiefel Labs. Inc., No. 09-cv-21871-CIV (S.D. Fla. July 21, 2011)

Click here to view the opinion.

Southern District of Florida Denies Class Certification of Suit Against Stiefel Labs

Judge James Lawrence King of the U.S. District Court for the Southern District of Florida refused to certify a class action alleging that Stiefel Laboratories violated ERISA and SEC Rule 10b-5 of the Securities Exchange Act by persuading employees to resell their shares to the company before its acquisition by GlaxoSmithKline PLC. As a threshold matter, the district court determined that the plaintiffs did not qualify for a presumption of reliance because the claims arose from a combination of inextricably intertwined misrepresentations and omissions, not pure omissions. The court also rejected a presumption of reliance premised on a common scheme, where defendants take the same unlawful acts in the same method against an entire class, because plaintiffs' reliance upon the alleged misrepresentations could not be similarly uniform. The court observed that "[i]nvesting decisions, particularly in a volatile market as existed at the end of 2008 and during difficult corporate conditions as may have existed with Stiefel Laboratories, are personal and cannot be presumed." Because questions of individual reliance predominated, the court concluded the case was not suitable for class certification.

DEMAND FUTILITY

In re Johnson & Johnson Derivative Litig., No. 10-2033 (FLW) (D.N.J. Sept. 29, 2011)

Click here to view the opinion.

New Jersey Federal Court Dismisses Derivative Claims Against Johnson & Johnson Officers and Directors

Judge Freda L. Wolfson of the U.S. District Court for the District of New Jersey dismissed without prejudice shareholders' derivative claims that certain officers and directors of Johnson & Johnson breached their fiduciary duties, because the shareholders did not adequately plead demand futility. The shareholders alleged that the officers and directors ignored numerous red flags, allowing widespread legal violations throughout Johnson & Johnson's business segments. Applying New Jersey law, which incorporates the standard promulgated in *Rales v. Blasband*, 634 A.2d 927 (Del. 1993), and *In re Caremark International*, 698 A.2d 959 (Del. Ch. 1996), for analyzing board inaction, the court ruled that the shareholders did not sufficiently allege that a majority of the board faced a substantial likelihood of personal liability. Although various subsidiaries were subject to subpoenas, lawsuits and government investigations involving alleged kickbacks and product recalls, the shareholders did not meet Rule 23.1's heightened pleading standards because they did not show that the directors knew the substance of these investigations and, in bad faith, failed to act, or of Johnson & Johnson's continuing wrongdoing following the investigations. However, the court granted the plaintiffs leave to amend, because the plaintiffs could potentially bolster their allegations by filing a books and records action in New Jersey state courts.

DIRECTORS AND DIRECTORS' DUTIES

Attorneys' Fees

Frank v. Elgamal, C.A. No. 6120-VCN (Del. Ch. July 28, 2011)

Click here to view the opinion.

In re Novell, Inc. S'holder Litig., C.A. No. 6032-VCN (Del. Ch. Aug. 30, 2011)

Click here to view the opinion.

Court of Chancery Denies as Premature Interim Petitions for Attorneys' Fees

Vice Chancellor John W. Noble of the Delaware Court of Chancery denied as premature a shareholder plaintiff's request for an interim award of attorneys' fees and expenses of $450,000 to compensate his attorneys for bringing an action challenging a proposed merger between American Surgical and AH Holdings resulting in corrective disclosures in a definitive proxy statement. Price- and process-related claims remained to be addressed post-closing. The court began by noting that "[i]nterim fee awards are generally disfavored," and whether fees should be awarded on an interim basis is a question "committed to the Court's discretion." Because "judicial economy and the orderly conduct of litigation are usually better served if interim awards of attorneys' fees are avoided ... absent exigent circumstances, the Court generally will only consider an application for attorneys' fees when a lawsuit has concluded." The court found that no exigent circumstances had been shown here and chose to defer ruling on attorneys' fees until all remaining claims had been litigated, allowing the court to make "a single determination as to what, if any, benefits have been achieved by this action."

Vice Chancellor Noble also denied an interim petition for attorneys' fees and expenses as premature in *In re Novell, Inc. Shareholder Litigation*. Specifically, the court denied as premature the application for nearly $3 million in interim attorneys' fees and expenses for mooted disclosure claims. The court noted that such interim fee petitions present the "difficult or, perhaps, impossible" task of parsing out a counsel's efforts in prosecuting mooted disclosure claims from those devoted to remaining claims. These two decisions stand in contrast to recent awards of interim attorneys' fee by other members of the Delaware Court of Chancery. [See *Inside the Courts,* Vol. 3, Issue 3, for a discussion of *In re Del Monte Foods Company Shareholders Litigation*, Consol. C.A. No. 6027-VCL (Del. Ch. June 27, 2011)].

Derivative Litigation

In re S. Peru Copper Corp. S'holder Derivative Litig., C.A. No. 961-CS (Del. Ch. Oct. 14, 2011)

Click here to view the opinion.

Court of Chancery Issues Historic Damages Award

In a 105-page post-trial opinion in a shareholder derivative suit, Chancellor Leo E. Strine Jr. of the Delaware Court of Chancery issued what is perhaps the largest damages award in the history of the court. A controlling shareholder ("the stockholder") was ordered to pay $1.263 billion in damages, plus interest, for its role in a 2005 merger in which Southern Peru Copper bought Minera Mexico S.A. Prior to the transaction, the stockholder controlled both companies. In February 2004, the stockholder proposed that Southern Peru buy its 99.15 percent share stake in privately held Minera Mexico in exchange for 72.3 million shares of newly issued Southern Peru stock. Based on the then-current market price of Southern Peru's stock, the proposed deal was valued at approximately $3.05 billion.

The Southern Peru board promptly resolved to create a three-member special committee of independent directors to evaluate the stockholder's proposal. The court noted that the board resolution creating the committee "did not give the Special Committee express power to negotiate, nor did it authorize the Special Committee to explore other strategic alternatives." According to the court, it quickly became clear that the committee's financial advisor could not reconcile the value of Minera with the market value of the requested Southern Peru stock. To close the gap, the committee began to "devalue its own acquisition currency" in order to "justify paying more for Minera than they originally thought they should." As a result, the committee never derived a stand-alone value for Minera that equaled the stockholder's asking price. Instead, the special committee relied on a "relative" valuation analysis "that involved comparing the discounted cash flow ('DCF') values of Southern Peru and Minera, and a contribution analysis that improperly applied Southern Peru's own market EBITDA multiple (and even higher multiples) to Minera's EBITDA projections, to determine an appropriate exchange ratio to use in the Merger."

A deal was thus ultimately struck under which 67.2 million shares of Southern Peru stock were issued in exchange for the shareholder's 99.15 percent interest in Minera. The exchange ratio was fixed, and the special committee's requests for a collar around the purchase price and a majority of the minority vote were rejected. The shareholder entered voting agreements with Southern Peru's two second-largest shareholders to help ensure an agreed-upon two-thirds vote provision would be satisfied. The stock price of Southern Peru rose steadily between the date the parties entered the deal and its closing, thereby increasing the actual value of the transaction to approximately $3.75 billion. Although the special committee could have changed its favorable recommendation before the deal closed, it never requested an updated fairness opinion or altered its original recommendation, a fact the court criticized. Ultimately, Chancellor Strine concluded that "[a] focused, aggressive controller extracted a deal that was far better than market, and got real, market-tested value of over $3 billion for something that no member of the special committee, none of its advisors, and no trial expert was willing to say was worth that amount of actual cash. ... That non-adroit act of commercial charity toward the controller resulted in a manifestly unfair transaction." Because "the process by which the Merger was negotiated and approved was not fair and did not result in the payment of a fair price," the court ordered the $1.263 billion damages award in compensation.

NECA-IBEW Pension Fund v. Cox, No. 1:11-cv-00451 (S.D. Ohio Sept. 20, 2011)

Click here to view the opinion.

Southern District of Ohio Refuses to Dismiss Executive Pay Derivative Action

Judge Timothy S. Black of the U.S. District Court for the Southern District of Ohio upheld a derivative suit regarding allegedly excessive executive pay practices at Cincinnati Bell Inc. The plaintiffs alleged that the company's directors breached their fiduciary duties of loyalty and due care, and were unjustly enriched, in approving more than $8.5 million in additional management compensation in 2010 despite a $61.3 million decline in net income, a drop in earnings

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from $0.37 to $0.09 cents per share and a negative 18.8 percent annual shareholder return. Applying Ohio law, the court held that the plaintiffs adequately pled that the Cincinnati Bell board was not entitled to the protections of the business judgment rule because the plaintiffs raised a plausible claim that these pay hikes and bonuses were not in the best interests of the company's shareholders and therefore constituted an abuse of discretion and bad faith. The court further held that the plaintiffs adequately proved that demand on the board prior to instituting the lawsuit would have been futile, because the plaintiff had named as defendants the very same directors who had approved the executive pay increases.

Mergers and Acquisitions

In re Alloy, Inc. S'holder Litig.,
C.A. No. 5626-VCP
(Del. Ch. Oct. 13, 2011)

Click here to view the opinion.

Court of Chancery Dismisses Breach of Fiduciary Duty Claims for Money Damages Brought on Behalf of Former Shareholders

Vice Chancellor Donald F. Parsons Jr. of the Delaware Court of Chancery dismissed breach of fiduciary duty claims for money damages brought on behalf of former shareholders of Alloy, Inc., challenging a going-private transaction that cashed out the company's shareholders. Alloy had a nine-member board. Two of the nine directors held senior management positions at Alloy and collectively owned 15 percent of the company's shares. The plaintiffs claimed that these two insiders were disloyal because they retained their senior management positions and received an equity interest in the post-merger company. (The parties did not dispute for purposes of deciding the motion that these two inside directors were interested in the merger.) The plaintiffs also alleged that the other seven Alloy directors — all of whom ultimately served on the special committee that negotiated and approved the deal — breached their duty of loyalty and disclosure. The court rejected all of these claims based largely on the company's Section 102(b)(7) provision and the fact that a majority of disinterested and independent Alloy board members approved the transaction and disclosures issued to stockholders.

First, the court rejected a claim that the special committee did not "evaluate fully" alternative transactions, explaining that "[e]ven if supported by well-pleaded facts, such a criticism would state at best a claim for breach of the duty of care [and] Alloy's certificate exculpates directors from monetary liability for breaches of the duty of care. Therefore, this allegation does not support an inference that the Special Committee acted disloyally or in bad faith, nor does it provide Plaintiffs with any basis for nonmonetary relief under any reasonably conceivable set of circumstances." Next, the court found that the 15 percent ownership stake of the inside directors did not, "without specific allegations of domination, create an inference that they controlled the board." The court also rejected allegations that the personal interest of the two insiders in the deal "effectively blocked competing offers," finding that there was no well-pleaded allegations supporting such a claim.

In addition, the court rejected claims specifically targeting the special committee's financial advisor, which had represented both the special committee *and* the full board in the deal. The court also refused to infer bad faith on behalf of the entire Alloy board based on the benefits obtained by the two inside directors. The court found that dismissal would be proper based on the Section 102(b)(7) exculpatory provision in Alloy's certificate of incorporation.

Gaines v. Narachi,
C.A. No. 6784-VCN
(Del. Ch. Sept. 30, 2011,
& Oct. 6, 2011)

Click here to view the opinion.

Court of Chancery Grants Expedited Discovery Related to Cash Flow Disclosures

Vice Chancellor John W. Noble of the Delaware Court of Chancery granted a motion to expedite proceedings to facilitate a motion to enjoin preliminarily the proposed merger of AMAG Pharmaceuticals, Inc. and Allos Therapeutics, Inc. The plaintiff, a stockholder of the acquirer AMAG, asserted three challenges against the AMAG board of directors: (i) a failure to maximize shareholder value under *Revlon*; (ii) the use of entrenching deal protection measures in violation of *Unocal*; and (iii) inadequate disclosures primarily based on insufficient cash flow

(continued on next page)

information. The court rejected the plaintiff's *Revlon* claims, noting that "AMAG is the acquirer of Allos, or so the transaction anticipates. AMAG is not selling itself; there will be no change of control, even if the transaction is concluded. Whether the AMAG board acted reasonably in negotiating its deal with Allos is not an action for this Court to review with scrutiny, especially because a majority of the AMAG board is independent and disinterested." As to *Unocal* claims, the court found no colorable allegation that deal protection devices were in response to a takeover threat, noting that the devices were "relatively routine."

The court also initially found that the disclosure claims were not colorable. The plaintiff moved for re-argument, however, and the court revisited its decision and granted expedition on the plaintiff's disclosure challenge to the absence of free cash flow projections from the disclosure documents. In granting expedition on that issue, the court explained that AMAG's investment banker performed a discounted cash flow analysis (by discounting unlevered free cash flows) to calculate the estimated equity values of AMAG and Allos. The forecasted free cash flow analysis was not included in the disclosure materials. The court explained that while three Court of Chancery cases addressing this issue, *Maric Capital Master Fund v. Plato Learning Inc.*, *David P. Simonetti Rollover IRA v. Margolis* and *In re Netsmart Technologies, Inc. Shareholders Litigation*, required the disclosure of free cash flow numbers, these opinions "do not state a blanket rule that free cash flow estimates used in a DCF analysis must always be disclosed." The court noted that all three opinions "emphasized the fact that the shareholders plaintiffs would be cashed out in the proposed mergers. This is an important consideration in determining the level of disclosure required surrounding future cash flows because those shareholders were being asked to decide whether to take a sum certain at that time in exchange for their right to those future cash flows." Here, although AMAG shareholders would not be cashed out, the court found free cash flows could be of interest because "their stake in these cash flows will be diluted by the issuance of shares to acquire Allos." Because a fact question existed at this preliminary stage as to whether AMAG management, or its banker, had prepared the free cash flow numbers missing from the disclosure materials, expedited discovery was granted.

In re OPENLANE, Inc. S'holders Litig., C.A. No. 6849-VCN (Del. Ch. Sept. 30, 2011)

Click here to view the opinion.

Court of Chancery Denies Request to Enjoin Acquisition; Finds Board Possessed 'Impeccable Knowledge' of Company's Business

Vice Chancellor John W. Noble of the Delaware Court of Chancery denied two stockholder plaintiffs' requests to enjoin the consummation of KAR Auction Services, Inc.'s acquisition of OPENLANE, Inc. for $210 million in cash plus any excess cash over necessary working capital at closing. The plaintiffs alleged that the OPENLANE board engaged in a flawed sales process in violation of its *Revlon* duties, because it only contacted three potential buyers (including KAR), failed to perform an auction or an adequate market check, failed to obtain a fairness opinion, relied on its financial advisor's nine-month-old financial analysis and locked up the deal with a no-solicitation clause that lacked a "fiduciary out," coupled with the board's ownership of a majority of the voting power of the stock.

The court declined to enjoin the merger, even though it noted that "the Board's decision making process was not a model to be followed." The court held that "if a board fails to employ any traditional value maximization tool, such as an auction, a broad market check, or a go-shop provision, that board must possess an impeccable knowledge of the company's business for the Court to determine that it acted reasonably." The court then found that "the record supports the conclusion that this is one of those few boards that possess an impeccable knowledge of the company's business": two of the board members were co-founders of the company and the remainder of the board were either investors in the company or affiliated with a company that was an investor. The board also had held nine meetings in the preceding nine months. The court further noted that the board held over 59 percent of OPENLANE's outstanding stock. Thus, the

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court found the board's ownership interests suggested that the board was motivated to get the best price reasonably available.

The court held that the merger was not a *fait accompli* that violated the Delaware Supreme Court's controversial *Omnicare* decision. The court found that here, there was no voting agreement under which stockholders had promised to vote for the merger. Rather, the record "merely suggest[ed] that, after the Board approved the Merger Agreement, the holders of a majority of shares quickly provided consents." The court also addressed the lack of a fiduciary out and noted that the Supreme Court's *Omnicare* decision could be read to require a fiduciary out. Nevertheless, the court rejected the argument that the lack of a fiduciary out required the Court of Chancery to enjoin the transaction. Citing *Omnicare*, the court held that "hostile bidders are on notice that Delaware courts may not enforce a merger agreement that lacks a fiduciary out if they present a board with a superior offer." Thus, although the court noted that "it is not surprising that another suitor has not emerged," the lack of a fiduciary out does not prevent a topping offer from emerging. "Enjoining a merger when no superior offer has emerged is a perilous endeavor because there is always the possibility that the existing deal will vanish, denying shareholders the opportunity to accept any transaction."

N.J. Carpenters Pension Fund v. infoGROUP, Inc., C.A. No. 5334-VCN (Del. Ch. Sept. 30, 2011)

Click here to view the opinion.

Court of Chancery Refuses to Dismiss Former Shareholder's Loyalty Claims in Merger Suit

Vice Chancellor John W. Noble of the Delaware Court of Chancery granted in part and denied in part a motion to dismiss the claims of a former shareholder of infoGROUP, Inc. challenging the company's merger into a subsidiary of CCMP. Vinod Gupta was the founder and former CEO and board chairman of infoGROUP and owned 37 percent of its outstanding common stock. After the merger was announced, the plaintiff filed a complaint alleging that the merger was the product of an unfair process and that the directors were dominated and controlled by Gupta, who instigated the merger in order to satisfy his personal need for liquidity. The defendants moved to dismiss the complaint, arguing that the plaintiff's claims were derivative, not individual, and that a majority of disinterested and independent directors approved the merger.

In refusing to dismiss the plaintiff's loyalty claims, the court found that it sufficiently alleged that the merger was not approved by a majority of disinterested and independent directors. The court first found that the plaintiff adequately alleged that Gupta was materially interested in the merger "because it provided him with desperately needed liquidity" and that "[l]iquidity has been recognized as a benefit that may lead directors to breach their fiduciary duties." Moreover, the court found that the plaintiff adequately alleged Gupta dominated and controlled the other infoGROUP directors through "a pattern of threats aimed at other Board members and unpredictable, seemingly irrational actions that made managing the Company difficult and holding the position of director undesirable," such as threatening the other board members with lawsuits if they did not take action to sell the company. The court also determined that the plaintiff's claims were individual, not derivative, and that the plaintiff therefore had standing to assert its claims. The court dismissed the plaintiff's disclosure claim, which the plaintiff appeared to have dropped at oral argument, noting that the facts underlying the claim could still prove relevant to the remaining loyalty claims.

In re Ness Techs., Inc. S'holders Litig., C.A. No. 6569-VCN (Del. Ch. Aug. 3, 2011)

Click here to view the opinion.

Court of Chancery Grants in Part and Denies in Part Request for Expedited Discovery in Shareholder Class Action

Vice Chancellor John W. Noble of the Delaware Court of Chancery granted in part and denied in part shareholder plaintiffs' request for expedited discovery as to price, process and disclosure claims in an action challenging a transaction through which Ness Technologies, Inc.'s largest shareholder, Citi Venture Capital International (CVCI), would acquire Ness through a wholly owned subsidiary, Jersey Acquisition Corporation, for $7.75 in cash per Ness share.

(continued on next page)

First, the court decided to expedite discovery based on the plaintiffs' price and process claims, holding that "[t]here is little in the Plaintiffs' allegations to suggest that either the price of, or the process leading up to, the Proposed Transaction were unfair to Ness's shareholders." The court found, however, that the plaintiffs stated a colorable claim on one narrow issue — namely, potential conflicts of interest by the special committee's and the Ness board's financial advisors, which could give rise to related disclosure claims. The proxy disclosed that these advisors had "in the past provided financial advisory and financing services" to affiliates of CVCI, and "may receive fees" in the future for doing so. The court found that "[t]hese disclosures do not indicate how much business the financial advisors have done, are doing, or might expect to do in the future with CVCI or its affiliates; if the amount of business involved would be material to either of the advisors, the Plaintiffs might have a colorable claim." Thus, the court permitted the plaintiffs to engage in limited expedited discovery "to answer the narrow question of whether the Special Committee's or the Board's financial advisor's past, present, or expected future dealings with CVCI or its affiliates created a conflict of interest for one or both of the financial advisors." The court held that the plaintiffs' other disclosure claims were not colorable.

ERISA

In re Citigroup ERISA Litig.,
No. 09-3804-cv
(2d Cir. Oct. 19, 2011)

Click here to view the opinion.

Second Circuit Dismisses Class Action Against Citigroup's Employee Retirement Fund's Fiduciaries

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of a putative class action alleging that Citigroup's employee retirement fund's fiduciaries violated their fiduciary duties by offering Citigroup shares. The plaintiffs alleged that the plan fiduciaries violated ERISA by continuing to offer a fund consisting primarily of Citigroup stock after Citigroup stock purportedly became an imprudent investment. The court adopted the *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995), presumption (which also has been adopted by the Fifth, Sixth and Ninth Circuits) that an employee stock option plan fiduciary's decision to invest in the employer's stock does not violate ERISA unless the fiduciaries abused their discretion in making those investments. Although the fiduciaries may have known that Citigroup was exposed to the subprime market, the plaintiffs did not adequately allege that they knew Citigroup was in such a "dire situation" as to require them to override the plan's terms. In addition, the court determined that the fiduciaries had no duty to disclose nonpublic information relating to specific investment options, and the plaintiffs did not sufficiently allege that the plan's fiduciaries made any misstatements they knew to be false. Consequently, the court affirmed the dismissal of the putative class action.

FOREIGN CORPORATIONS

In re UBS Sec. Litig.,
No. 07 Civ. 11225 (RJS)
(S.D.N.Y. Sept. 13, 2011)

Click here to view the opinion.

S.D.N.Y. Dismisses Claims Brought by Purchasers of UBS Shares on Foreign Exchanges

Judge Richard J. Sullivan of the U.S. District Court for the Southern District of New York dismissed claims brought by domestic and foreign investors who had purchased UBS shares on foreign exchanges that UBS had violated Section 10(b) of the Securities Exchange Act. The court ruled that foreign-cubed claims, which involve (i) a foreign investor's purchase (ii) of a foreign company's shares (iii) on a foreign exchange, are outside the scope of Section 10(b) even if the shares are cross-listed on a U.S. exchange. The court also ruled that foreign-squared claims, which involve (i) a domestic investor's purchase (ii) of a foreign company's shares (iii) on a foreign exchange, are outside the scope of Section 10(b) because the location of the exchange or transaction determines whether a transaction in a foreign company's securities is within the scope of Section 10(b).

Basis Yield Alpha Fund (Master) v. Goldman Sachs Grp., Inc., No. 10 CV 4537 (BSJ) (DCF) (S.D.N.Y. July 20, 2011)

Click here to view the opinion.

S.D.N.Y. Dismisses Claims Involving Cayman Islands Mutual Fund's CDO Purchase

Judge Barbara S. Jones of the U.S. District Court for the Southern District of New York dismissed a Cayman Islands mutual fund's claim that Goldman Sachs violated Section 10(b) of the Securities Exchange Act in connection with the fund's collateralized debt obligation (CDO) purchase from Goldman Sachs. Although the fund alleged numerous instances of domestic conduct (*e.g.*, alleged misrepresentations by a New York-based Goldman Sachs managing director), it did not provide sufficient facts to determine where the sale actually occurred and therefore failed to allege that the purchase or sale occurred in the United States under *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010).

INSIDER TRADING

United States v. Gansman, No. 10-0731-cr (2d Cir. Sept. 9, 2011)

Click here to view the opinion.

Second Circuit Upholds Conviction of Accounting Firm Attorney

The U.S. Court of Appeals for the Second Circuit upheld the conviction of James Gansman for violating Section 10(b) of the Securities Exchange Act by engaging in insider trading. As an attorney at an accounting firm, Gansman had acquired nonpublic information, which he passed on to a woman with whom he was having an affair. The woman then traded on the nonpublic information. The court ruled that Gansman was entitled to argue that, under Rule 10b5-2, he did not have the requisite intent to commit insider trading because his relationship with the woman created a duty of confidence between them, and he did not intend that she use the information for insider trading. However, the trial court properly instructed the jury on this defense, and the government presented evidence that Gansman did intend that the woman trade on the nonpublic information; he therefore was not entitled to a new trial.

Chechele v. Scheetz, No. 10 Civ. 7992 (RJS) (S.D.N.Y. Aug. 29, 2011)

Click here to view the opinion.

S.D.N.Y. Dismisses Claims Against Investor Involving Alleged Short-Swing Trading

Judge Richard J. Sullivan of the U.S. District Court for the Southern District of New York dismissed claims that an investor violated Section 16(b) of the Securities Exchange Act by allegedly engaging in short-swing trading. Although the defendant never individually owned 10 percent of the shares of the company he traded in, the investor was allegedly part of a group of investors that collectively owned more than 10 percent of the company's shares, making him an insider. The plaintiffs relied on various agreements, but none of the agreements were between the defendant and the other members of the alleged group. Thus, those agreements did not create a reasonable inference of a shareholder group, and therefore there was no short-swing liability.

Gibbons v. Malone, No. 10 CV 8640 (BSJ) (S.D.N.Y. Aug. 8, 2011)

Click here to view the opinion.

S.D.N.Y. Dismisses Shareholder's Claim That Director Engaged in Short-Swing Trading

Judge Barbara S. Jones of the U.S. District Court for the Southern District of New York dismissed a shareholder's claim that a director allegedly engaged in short-swing trading purportedly in violation of Section 16(b) of the Securities Exchange Act. The director sold one type of the company's securities and purchased a different type over the course of 12 days, resulting in a profit. Because the shares had different voting rights and different dividend rights and were not convertible, they were different classes of shares, and thus the trades did not violate Section 16(b)'s prohibition on insiders' purchase and sale of equity securities within a six-month period.

PRIMARY LIABILITY

Haw. Ironworkers Annuity Trust Fund v. Cole,
No. 3:10-CV371
(N.D. Ohio Sept. 1, 2011)

Click here to view the opinion.

Northern District of Ohio Dismisses Claim Against Dana Corp. Execs in Reliance on *Janus*

Judge James G. Carr of the U.S. District Court for the Northern District of Ohio granted in part a motion for reconsideration, holding that the U.S. Supreme Court's recent decision in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), compelled dismissal of a SEC Rule 10b-5(b) claim against former Dana Corporation executives. In *Janus*, the Supreme Court held that a person or entity "makes" an untrue statement of material fact in connection with the purchase or sale of a security only if that person or entity has "ultimate authority" over the statement, including its content and whether and how to communicate it. Applying *Janus*, the district court determined that the plaintiffs' complaint did not state a claim for primary liability under Rule 10b-5(b) because it alleged that the defendants had manipulated accounting and inflated earnings in response to a mandatory directive from top company management. The complaint therefore alleged that the defendants only were implementing the instructions of those with ultimate control over the statements. The district court further rejected the plaintiffs' argument that the holding of *Janus* limited to legally separate entities and could not be applied to corporate insiders, noting that the Supreme Court in no way indicated such a limitation. The court did not dismiss the plaintiffs' claims of deceptive conduct under SEC Rules 10b-5(a) or 10b-5(c), which it held were unaffected by *Janus*.

SCIENTER

WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.,
No. 10-55401
(9th Cir. Aug. 23, 2011)

Click here to view the opinion.

Ninth Circuit Addresses Several Rule 10b-5 Claims

The U.S. Court of Appeal for the Ninth Circuit affirmed in part and reversed in part the district court's dismissal of the plaintiff's amended complaint with leave to amend. The plaintiff, WPP Luxembourg, brought suit against Spot Runner and its individual founders and investors. The plaintiffs alleged securities fraud claims for violations of Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5 based on material omissions and scheme liability against all the defendants, violations of Section 10(b) and Rule 10b-5 for insider trading against Spot Runner. The district court dismissed the Section 10(b) claims.

The Ninth Circuit reversed with respect to the Rule 10b-5(b) claim against the founders, finding that scienter and loss causation had been adequately alleged. With respect to scienter, the court found the allegations that (i) the defendants knew of the contractual duty to disclose and failed to do so while selling their own shares and (ii) failure to disclose the company's poor performance when combined with the questionable interpretation of the contractual notice provision sufficiently alleged fraudulent intent for the purposes of surviving a motion to dismiss when viewed holistically under *Tellabs*. In assessing the plaintiff's loss causation allegations, the court deemed sufficient for pleading purposes the plaintiff's allegation that the founders' concealment of their own stock sales caused the loss because the plaintiff would not have continued to invest if it had known about their sales. Declining to determine if Fed. R. Cir. P. 9(b)'s heightened pleading requirement applied to loss causation allegations, the court noted, "[a]lthough these allegations do not provide detailed share prices, the number of shares currently held, or whether attempts to sell the Spot Runner shares were made, the amended complaint includes a statement of loss causation sufficient to provide 'some assurance that the theory has a basis in fact.'"

The Ninth Circuit affirmed the dismissal of the Rule 10b-5(b) claims against Spot Runner general counsel Peter Huie and the company itself. In affirming the dismissal of the claims against

(continued on next page)

Spot Runner, the court noted that the company would be disadvantaged by the founders' secondary market sales. "Because Spot Runner is a corporate entity distinct from the Founders, the Founders' motivation to commit fraud cannot be automatically ascribed to the Company, particularly where the alleged behavior is at odds with the Company's financial interests."

Finally, in addressing scheme liability, the court held, "[a] defendant may only be liable as part of a fraudulent scheme based upon misrepresentations and omissions under Rules 10b-5(a) or (c) when the scheme also encompasses conduct beyond those misrepresentations or omissions." The court dismissed the claim, as no such additional conduct was alleged.

Sec. & Exch. Comm'n v. Shanahan, No. 10-1820 (8th Cir. July 19, 2011)

Click here to view the opinion.

Eighth Circuit Affirms Judgment as Matter of Law Where SEC Failed to Prove Scienter or Negligence to Support Securities Fraud Claims Against Outside Director

The U.S. Court of Appeals for the Eighth Circuit affirmed a decision concluding that the SEC failed to prove the requisite elements of scienter and negligence in its case against an outside director accused of violating Sections 10(b), 14(1) and 17(a) of the Securities Exchange Act, as well as SEC Rules 10b-5 and 14a-9, by granting backdated stock options to company officials. The SEC alleged that Engineered Support Systems, Inc. (ESSI) engaged in unlawful undisclosed backdating, and that this practice violated ESSI's unambiguous representation in its proxy and financial statements that all options had been and would continue to be granted at an exercise price equal to the market value on the date of the grant. The Eighth Circuit concluded that, although the SEC presented ample evidence that ESSI granted backdated options and that the outside director participated in the process, the SEC failed to demonstrate the requisite scienter or negligence to support securities fraud charges. The SEC had not presented any evidence that the outside director knew or should have known that the alleged omissions or misrepresentations presented a danger of misleading buyers or sellers. The appeals court further explained that ESSI's option dating practice was not clearly contrary to the plain language of the representation, and that accounting and finance professionals, not an outside director who had no personal expertise in these matters, bore the primary responsibility of avoiding ambiguous statements that *may* mislead investors.

As a matter of first impression, the Eighth Circuit determined that scienter is an element of a Section 14(a) claim, at least for claims against outside directors and accountants. The court concluded that the SEC failed to prove scienter and, in the alternative, failed to establish a negligent violation of Section 14(a) because the SEC failed to present any evidence that the outside director violated the applicable standard of care. The SEC did not counter the outside director's undisputed testimony that he did not draft the proxy statements, did not perceive that the statements might be misleading in light of the options dating and pricing practice, and had not been made aware of any reason to be concerned.

In re Bos. Scientific Corp. Sec. Litig., No. 10-10593-DPW (D. Mass. Sept. 19, 2011)

Click here to view the opinion.

Massachusetts Federal Court Dismisses Securities Exchange Act Claims

Judge Douglas P. Woodlock of the U.S. District Court for the District of Massachusetts dismissed claims that Boston Scientific violated Section 10(b) of the Securities Exchange Act because the plaintiffs did not adequately allege scienter. Boston Scientific's officers allegedly made misleading statements about the stability and quality of its sales force when they did not disclose that Boston Scientific had recently fired 10 sales agents following an internal investigation. Although the officers knew at the time of the allegedly misleading statements that the sales agents had been fired, the plaintiffs did not adequately allege that the officers knew this would have a material impact on the company as a whole. In addition, Boston Scientific's public offering during that period was not evidence of scienter, because the plaintiffs did not allege that Boston Scientific's officers personally benefited from the offering, and Boston Scientific's offering materials disclosed that its ability to retain key members of its sales force could affect its future performance.

SEC ENFORCEMENT

Sec. & Exch. Comm'n v. Gabelli, No. 10-3581-cv (L) (2d Cir. Aug. 1, 2011)

Click here to view the opinion.

Second Circuits Reverses Dismissal of SEC Claims Relating to Disclosure of Market Timing in Investment Fund

The U.S. Court of Appeals for the Second Circuit reversed the dismissal of the SEC's claims that officers of an investment fund and the fund's investment adviser violated Section 10(b) of the Securities Exchange Act and Section 17(a) of the Securities Act by allegedly failing to disclose that it allowed one preferential investor to market time in the fund. While allowing the preferential investor to time the market, the investment adviser issued a memorandum stating that it had been identifying and banning investors engaged in market timing, but had not completely eliminated them. Although "literally true," the statement violated Sections 10(b) and 17(a) because it created a materially misleading impression. In addition, the SEC's claims that the officers violated Section 206 of the Investment Advisers Act were not barred by the relevant five-year statute of limitations because the claims did not accrue until the SEC first discovered the officers' alleged fraud.

Gupta v. Sec. & Exch. Comm'n, No. 11 Civ. 1900 (JSR) (S.D.N.Y. July 11, 2011)

Click here to view the opinion.

S.D.N.Y. Upholds Equal Protection Claim in Connection With Galleon Insider Trading Prosecutions

In connection with the Galleon Group insider trading prosecutions, Judge Jed S. Rakoff of the U.S. District Court for the Southern District of New York upheld Rajat Gupta's claim that the SEC was allegedly violating his constitutional due process rights by bringing an administrative action against him, rather than filing an enforcement action in federal court. Gupta alleged that the SEC's administrative action against him, in light of the federal court proceedings alleging similar facts against 28 others, treated Gupta differently than the other Galleon-related defendants, in violation of the Equal Protection Clause. Applying *Free Enterprise Fund v. Public Company Accounting Oversight Board*, 130 S. Ct. 3138 (2010), the court determined it could decide the Equal Protection claim because (i) there would be no meaningful judicial review otherwise; (ii) the claim was collateral to the Securities Exchange Act's review provisions; and (iii) it was outside the SEC's expertise.

SECONDARY ACTORS

Reese v. BP Exploration (Alaska) Inc., No. 10-35128 (9th Cir. June 29, 2011)

Click here to view the opinion.

Ninth Circuit Applies *Janus* to Reject Securities Fraud Claim

The U.S. Court of Appeals for the Ninth Circuit applied the U.S. Supreme Court's recent ruling in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), when finding that plaintiffs failed to state a claim for securities fraud under Section 10(b), Rule 10b-5 promulgated thereunder, and Section 20(a) of the Securities Exchange Act. *Janus* held that liability under Rule 10b-5 is limited to the actor who actually "made" an allegedly false or misleading statement in connection with the sale of securities.

Shareholders of BP, p.l.c. sued defendant BP Exploration (Alaska) Inc. (BPXA), a separate entity from BP that was contractually obligated to operate a BP pipeline. The contract had been repeatedly filed with the SEC by another BP entity, and required BPXA to act as a "prudent operator." After BPXA allegedly breached the prudent operator contract by mismanaging the pipeline, shares in BP p.l.c. dropped, and the plaintiffs, through lead plaintiff Claude A. Reese, sued. The district court denied the defendants' motion to dismiss the securities fraud claims but certified an interlocutory appeal. Judge Ronald A. Gould of the Ninth Circuit held for a unanimous panel that, even before *Janus*, the "breach of a contractual promise of future

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conduct, even though the contract is filed in conjunction with [SEC] reporting requirements, was not a sufficient foundation for a securities fraud action."

In a footnote, Judge Gould further explained that even if periodic filings of the contract were an implicit statement that the contract would not be breached, under *Janus*, BP "made" that statement, not defendant BPXA: "[plaintiff] does not allege that BPXA had ultimate authority over the ... SEC filings." The court concluded that Reese could not amend his complaint to comply with *Janus* because, "[a]s was fatal to plaintiffs' claims in *Janus Capital Group*, here only the [BP entity] — not BPXA — bore a statutory obligation to file with the SEC, and there is no allegation that BPXA made the filings[.]"

Sec. & Exch. Comm'n v. Kelly, No. 08 Civ. 4612 (CM) (S.D.N.Y. Sept. 22, 2011)

Click here to view the opinion.

S.D.N.Y. Dismisses Claims Related to Alleged Misstatements of Advertising Revenue

In an SEC enforcement action, Judge Colleen McMahon of the U.S. District Court for the Southern District of New York dismissed claims that former officers of AOL violated Section 10(b) of the Securities Exchange Act and Section 17(a) of the Securities Act by allegedly misstating AOL's advertising revenue. Applying *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), the court ruled that the officers could not be liable under Section 10(b) because they did not make the allegedly misleading statements themselves. The court also ruled that subsections (a) and (c) of SEC Rule 10b-5, which address "scheme liability," were not applicable because the only allegations involved a public misrepresentation or omission, rather than an inherently deceptive act. In addition, the court ruled that *Janus* barred the SEC's Section 17(a) claims because the elements of that claim are the same as the elements of a Section 10(b) claim.

Sec. & Exch. Comm'n v. Daifotis, No. C 11-00137 WHA (N.D. Cal. Aug. 1, 2011)

Click here to view the opinion.

California Federal Court Applies *Janus* to Action Brought by SEC

Judge William Alsup of the U.S. District Court for the Northern District of California reconsidered a previous order on the defendants' motion to dismiss in light of the U.S. Supreme Court's holding in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), that the only "maker" of a statement is "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it."

The SEC brought an enforcement action against two individual defendants for several alleged securities law violations in connection with their management of the Schwab YieldPlus Fund. After the court denied the defendants' motion to dismiss several of the claims, the Supreme Court ruled in *Janus*. The court granted the defendants' motion for reconsideration and re-evaluated several alleged fraudulent statements. The court dismissed some of the claims because the alleged misstatements were not "made" by the defendant, but refused to dismiss others.

In particular, the court ruled that the plaintiffs properly alleged that misstatements were "made" by one defendant fund manager because the statements were contained in a document titled "Manager's Discussion" that was reviewed by him before it was issued to the public under his title. However, misstatements in an advertisement were not "made" by that manager solely on the allegation that the advertisement included a picture of him.

Further, the court clarified that *Janus*' interpretation of "to make," which addressed a case brought under Section 10(b), does not apply to other securities laws, especially where those sections do not have implied rights of action, such as Sections 17(a) and 34(b). "*Janus* was not a touchstone to change myriad laws that happen to use the word "make" — it was a decision interpreting primary liability under Rule 10b-5," the court said.

SECURITIES ACT CLAIMS

Katz v. Gerardi, No. 10-1407 (10th Cir. Aug. 25, 2011)

Click here to view the opinion.

Tenth Circuit Affirms Dismissal of Securities Act Claims

The U.S. Court of Appeals for the Tenth Circuit affirmed the district court's dismissal of the plaintiffs' claims for violations of Sections 11 and 12(a)(2) of the Securities Act. The plaintiffs were minority shareholders in a real estate investment trust owned by defendant Archstone Smith Trust, a public company. As part of a merger, the plaintiffs were squeezed out of the REIT and had the option of receiving either cash or stock in the newly formed entity in exchange for their shares. Plaintiff Jack P. Katz elected to receive cash. The Tenth Circuit affirmed the dismissal of Katz's Securities Act claims, holding that he lacked standing to bring claims under Sections 11 and 12(a)(2) of the act because "both sections provide relief *only* for purchasers — and not sellers — of securities." In connection with the merger, Katz sold each of his units when he elected to receive cash. Therefore, he is plainly a seller and not a purchaser. In dismissing the claims on this ground, the court held that the fundamental change doctrine — also known as the forced seller doctrine — applies only to claims under the Securities Exchange Act and not Securities Act claims. The fundamental change doctrine "enables a shareholder, whose investment has been fundamentally changed, to meet the causation and reliance requirements of the securities laws even though the shareholder has not made an actual purchase or sale of securities." The court noted that, even if applicable to Securities Act claims, the doctrine would not have changed Katz's status from seller to purchaser because he sold his units for cash and never purchased the "new" units resulting from the merger.

Fait v. Regions Fin. Corp., No. 10-2311-cv (2d Cir. Aug. 23, 2011)

Click here to view the opinion.

Second Circuit Affirms Dismissal of Claims Involving the Misstatement of Goodwill Associated With an Acquisition

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims that Regions Financial violated Sections 11 and 12 of the Securities Act by allegedly misstating the goodwill associated with an acquisition and failing to sufficiently increase its loan loss reserves. Statements regarding a company's goodwill are opinions because there is no objective standard for measuring goodwill, and opinion statements are only actionable if the opinion is incorrect and the defendant does not believe the opinion. Because the plaintiffs did not plausibly allege that Regions Financial did not believe its statements regarding its goodwill, the trial court correctly dismissed their claims. Further, the plaintiffs' claims on loan loss reserves also failed because the plaintiffs did not point to any objective standard for measuring loss reserves and could not plausibly allege that the defendants knew the statements were false when made.

SECURITIES FRAUD PLEADING STANDARDS

MLSMK Inv. Co. v. JP Morgan Chase & Co., No. 10-3040-cv (2d Cir. July 7, 2011)

Click here to view the opinion.

In Madoff-Related Case, Second Circuit Concludes That PSLRA Precludes RICO Claims Predicated Upon an Alleged Securities Fraud

In a case of first impression, the U.S. Court of Appeals for the Second Circuit concluded that Section 107 of the Private Securities Litigation Reform Act precludes all Racketeer Influenced and Corrupt Organizations Act (RICO) claims predicated upon an alleged securities fraud, regardless of whether the plaintiff could bring a securities fraud claim. In doing so, the court affirmed the district court's dismissal of an investment company's RICO claim, which alleged that JP Morgan Chase conspired with Bernard Madoff to defraud investors by providing him with banking services. The court determined that there is no exception to Section 107's bar where a plaintiff has no private right of action. Thus, although the plaintiff's claim only alleged

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aiding and abetting Madoff's securities fraud, and therefore could not serve as a basis for a private securities claim, it was still barred.

Henning v. Orient Paper, Inc., No. 10-5887-VBF (AJWx) (C.D. Cal. July 20, 2011)

Click here to view the opinion.

California Federal Court Denies Motion to Dismiss; Finds the PSLRA's Pleading Standards Are Satisfied

Judge Valerie Baker Fairbank of the U.S. District Court for the Central District of California denied the defendants' motion to dismiss the plaintiffs' amended complaint alleging securities fraud under Section 10(b) of the Securities Exchange Act. The plaintiffs had purchased common stock of defendant Orient Paper, Inc. (ONP), a holding company listed on the NYSE Amex that conducts business through an operating entity in China. Various ONP officers are also included as defendants in the suit. The plaintiffs based their allegations on various frauds originally alleged in reports by Muddy Waters, an independent industry analyst and research firm. The complaint alleged that the defendants did not disclose material related-party transactions, included false and misleading financial statements in their Form 10-Ks, materially misstated profits, and failed to disclose unusual or infrequent events that reduced ONP's general expenses.

The court found that the plaintiffs had met their burden under the Private Securities Litigation Reform Act, rejecting the defendants' arguments that the plaintiffs had not pleaded material misstatements or omissions with particularity and failed to adequately plead scienter and loss causation. The court noted that the defendants improperly argued the allegedly false statements were true — a factual dispute improper for this stage of the proceedings. With respect to the scienter allegations, the court found that even though the defendants did not sell their stock during the period, the plaintiffs' allegations of related-party transactions created an indirect benefit to the defendants. Moreover, the independent investigation commenced by the defendants after the Muddy Waters reports broke did not negate an inference of scienter insofar as the plaintiffs alleged the investigation was an attempt to whitewash their participation in the fraud. Further, the defendants' outside counsel and adviser failed to publish any statement setting forth independent conclusions at the end of the investigation. Finally, with respect to loss causation, the court rejected the defendants' argument that the loss was caused by Muddy Waters' publication of unsubstantiated rumors, rather than any action by the defendants.

Urman v. Novelos Therapeutics, Inc., No. 10-10394-NMG (D. Mass. June 23, 2011)

Click here to view the opinion.

Massachusetts Federal Court Dismisses Claims Related to Alleged Misrepresentations in Magazine Interview

Judge Nathaniel M. Gorton of the U.S. District Court for the District of Massachusetts dismissed claims that a pharmaceutical manufacturer and its CEO violated Section 10(b) of the Securities Exchange Act by misrepresenting in a magazine interview that patients in a test group were living longer than expected and citing positive results from other trials. Although the magazine published the allegedly misleading statements and the CEO's qualifications on separate days, they came from a single interview. Because the magazine clearly stated that the full interview would be published on a later day, the court found the statements not misleading because a reasonable investor would read them in conjunction with the CEO's qualifications. Further, the plaintiff's general allegations that the CEO must have known that the trial conducted on this particular test group was different from previous trials because of his position in the company were insufficient to establish scienter.

Prime Mover Capital Partners L.P. v. Elixir Gaming Techs., Inc., No. 10 Civ. 2737 (LAK) (S.D.N.Y. June 22, 2011)

Click here to view the opinion.

S.D.N.Y. Dismisses Claims Related to Alleged False Statements

Judge Lewis A. Kaplan of the U.S. District Court for the Southern District of New York dismissed claims that a gaming machine operator violated Section 10(b) of the Securities Exchange Act by making allegedly false statements concerning its contracts and expected

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earnings, artificially inflating its share price. The court dismissed one plaintiff's claims because that plaintiff did not allege that it purchased or sold any of the defendant's stock while the stock was artificially inflated. It dismissed another plaintiff's claims for failure to allege loss causation because the alleged corrective disclosures came out after the gaming machine operator's share price reached its low point. The remaining claims were dismissed under the Private Securities Litigation Reform Act (PSLRA) safe harbor for forward-looking statements because the plaintiff did not allege facts showing that the statements were false when made.

SETTLEMENTS

In re Cadence Design Sys., Inc. Sec. Litig., No. 08-4966 SC (N.D. Cal. Aug. 26, 2011)

Click here to view the opinion.

Northern District of California Rejects Proposed Settlement Based on Insufficient Proposed Notice Procedure

Judge Samuel Conti of the U.S. District Court for the Northern District of California rejected without prejudice an unopposed motion for settlement approval, holding that the proposed notice to absent class members was deficient. The plaintiffs, Alaska Electrical Pension Fund (Alaska) and various additional shareholders, sued Cadence Design System, Inc. (Cadence), a publicly traded company, and several of its officers, alleging misstatements regarding Cadence's revenues. Alaska was appointed lead plaintiff, and after Cadence's motion to dismiss was denied, the parties reached a settlement. Alaska moved for judicial approval of the settlement under Rule 23(e).

Because the class had not been certified, the court was required to review not only the fairness of the settlement, but also whether class treatment was proper, including whether the proposed notice to absent class members was the best practicable under the circumstances. Alaska had proposed to disseminate notice by using names and addresses gleaned from Cadence's transfer records, and by printing the notice in the publication *Investor's Business Daily*. The additional shareholder plaintiffs also proposed giving notice via a Form 8-K filed with the SEC. The court ruled that these procedures were inadequate under Rule 23. The plaintiffs failed to specify how the notice would be delivered or estimate how many of the names and addresses could be reliably harvested from Cadence's transfer records. Additionally, because some securities are held in "street name," for the benefit of the true owner, the plaintiffs would need to reach out to various entities that hold street name securities for the benefit of others. However, the plaintiffs failed to explain to the court how they would identify and contact those street name owners. These deficiencies in the proposed notice precluded approval of the settlement, and the parties were invited to file amended motions addressing the problems.

SLUSA

Atkinson v. Morgan Asset Mgmt., Inc., No. 09-6265 (6th Cir. Sept. 8, 2011)

Click here to view the opinion.

Sixth Circuit Affirms Dismissal of Purported State Law Fraud Class Action Preempted by SLUSA

The U.S. Court of Appeals for the Sixth Circuit upheld the dismissal of a purported fraud class action on the basis that the Securities Litigation Uniform Standard Act (SLUSA) preempted investors' state law claims of fraud related to mutual funds that lost value in the 2007 credit crunch. The plaintiffs alleged that Morgan Asset Management took unjustified risks in allocating the funds' assets and concealed these risks from shareholders. After Morgan removed the state action to federal court under SLUSA, the plaintiffs moved for remand. Concluding that SLUSA preempted the action, the district court denied the plaintiffs' motion for remand and dismissed their claims with prejudice.

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On appeal, the plaintiffs argued that their action fell into the "first Delaware carve-out" (which involves the purchase or sale of securities by the issuer or an affiliate of the issuer exclusively from or to holders of equity securities of the issuer) and that nine of the 13 claims merited remand to state court because they lacked fraud-based allegations. The Sixth Circuit held that the plaintiffs' proposed exemption from SLUSA preemption — the first Delaware carve-out — did not apply because the plaintiffs alleged that Morgan had deceived them into holding the shares too long, not that Morgan duped them into the purchase or sale of securities. As mere holders of shares, the plaintiffs could not invoke the exception to SLUSA preemption. The Sixth Circuit also rejected the argument that some of the claims evaded SLUSA preemption because the claims did not require fraud as an element. The court concluded that "because all of Plaintiffs' claims include allegations of fraud, SLUSA damns each one." The court further noted that the district court correctly analyzed the allegations in the complaint, not the state-law label placed on a claim, in concluding that allegations of fraud pervaded each claim. Moreover, because fraud pervaded each claim, the Sixth Circuit affirmed dismissal of all claims with prejudice, as any efforts of artful amendment would be futile.

STATUTES OF REPOSE

Goldenson v. Steffens, No. 2:10-cv-00440-JAW (D. Me. Aug. 4, 2011)

Click here to view the opinion.

Maine Federal Court Upholds Claims Against Hedge Fund Involving Madoff Ponzi Scheme

In a case arising out of the Madoff Ponzi scheme, Judge John A. Woodcock Jr. of the U.S. District Court for the District of Maine upheld investors' claims that a hedge fund violated Section 10(b) of the Securities Exchange Act by allegedly misrepresenting that the fund used a complex investment strategy when it was actually a feeder fund for Bernard Madoff. Although often more than five years old, the defendants' allegedly fraudulent statements were not barred by the five-year statute of repose applicable to Section 10(b) because the statements were allegedly part of a common scheme, and some of the statements occurred outside the temporal confines of the statute of repose. In addition, although the defendants did not personally invest the investors' money, the court determined that the plaintiffs alleged primary claims, as required by Section 10(b), because they alleged that the defendants themselves made fraudulent statements.

SUCCESSOR OBLIGOR CLAUSES

Bank of N.Y. Mellon Trust Co., N.A. v. Liberty Media Corp., No. 284, 2011 (Del. Sept. 21, 2011)

Click here to view the opinion.

Delaware Supreme Court Affirms Decision Determining What Constitutes 'Substantially All' of a Company's Assets

The Delaware Supreme Court, sitting *en banc*, affirmed the Court of Chancery decision described below regarding a question of New York law not previously addressed by any New York state court involving the construction of a "boilerplate successor obligor provision in an indenture."

The Court of Chancery decision held that four separate spin-offs by Liberty Media could not be aggregated for the purpose of finding that they constituted a disposition of "substantially all" of Liberty Media's assets in violation of the successor obligor provision. The Delaware Supreme Court determined that, "[i]n the context of the 'substantially all' analysis under a boilerplate successor obligor provision in an indenture ... we conclude that the principles articulated [by the Second Circuit in *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*] are the proper basis for determining, under New York law, the nature and degree of interrelationship that will warrant aggregation of otherwise separate and individual transactions as part of a 'series.'" Under

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Sharon Steel, aggregation is appropriate "only when a series of transactions are part of a 'plan of piecemeal liquidation' and 'an overall scheme to liquidate' and not where each transaction stands on its own merits without reference to the others." The Delaware Supreme Court determined that, in this instance, aggregation of the transactions was not appropriate because "each transaction was the result of a discrete, context-based decision and not as part of an overall plan to deplete Liberty's asset base over time." The court concluded that, "[h]ad the parties to the Indenture intended to create an asset disposition covenant with a broader scope than the standard, boilerplate successor obligor covenant, it was incumbent upon them to include it in a separate, negotiated covenant."

VENUE

Sec. & Exch. Comm'n v. Johnson, No. 09-5399 (D.C. Cir. June 28, 2011)

Click here to view the opinion.

District of Columbia Circuit Reverses Jury Verdict

In an SEC enforcement action, the U.S. Court of Appeals for the District of Columbia Circuit reversed a jury verdict finding a former software company executive guilty of aiding and abetting securities fraud because venue in the District of Columbia was improper. The court rejected the SEC's theory that venue was proper because the defendant's former employer, and alleged co-conspirator, had filed a fraudulent Form 10-Q in the District of Columbia, as the Securities Exchange Act's venue provision requires the individual's charged conduct to actually have occurred in the venue. Because all of the allegedly fraudulent actions committed by the defendant had occurred in Nevada, venue was not proper in the District of Columbia.

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