Skadden

Inside the Courts

An Update From Skadden Securities Litigators

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CLASS CERTIFICATION

Fort Worth Emps. Ret. Fund v. J.P. Morgan Chase & Co., No. 09-cv-3701 (JPO) (S.D.N.Y. Sept. 30, 2014)

Click here to view the opinion.

SDNY Certifies Class of Shareholders in Securities Action Against Investment Bank

Judge J. Paul Oetken of the U.S. District Court for the Southern District of New York certified a class of shareholders in a securities action that alleged that an investment bank violated Sections 11, 12(a)(2) and 15 of the Securities Act of 1933 by making misleading statements in a registration statement and prospectus concerning the sale of certain mortgage-backed securities. First, the court denied the defendants' motion to exclude the plaintiffs' expert on class certification and found that the plaintiffs' expert's opinion regarding the common effects of defendants' alleged false statements and the method to calculate damages was reliable. Second, the court held that the plaintiffs' Section 11 liability claim could be maintained on a class-wide basis because there was substantial factual and legal overlap between the security offerings, the alleged false statements made in the security offering documents, and the entities and mortgage originators involved in the transactions. The court further determined that whether plaintiffs received notice of the alleged fraud by way of certain publicly available news articles, and thus were barred from asserting claims by the applicable one-year statute of limitations, could also be determined on a class-wide basis. The court could not determine, however, that damages could be calculated on a class-wide basis, as required by the Supreme Court's decision in *Comcast Corp. v. Behrend*, 133 S. Ct. 1426 (2013), because the plaintiffs' expert on damages merely stated that such calculations were possible but did not state with precision the methodology that he would use to value the complex mortgage-backed securities at issue. The court therefore certified the class for liability purposes only and denied the plaintiffs' motion for class certification as to damages without prejudice.

DISCOVERY

Freedman v. Weatherford Int'l Ltd., No. 12 Civ. 2121 (LAK) (JCF) (S.D.N.Y. July 25, 2014)

Click here to view the opinion.

SDNY Rejects Motion to Compel Production of E-Discovery Reports

Magistrate Judge James C. Francis IV of the U.S. District Court for the Southern District of New York denied plaintiffs' motion to compel the production of certain electronic discovery reports in a federal securities fraud class action. The plaintiffs requested reports comparing the defendants' document production with the documents (1) collected in connection with two prior internal investigations and (2) that would have been collected using the plaintiffs' proposed search terms. A "sample report" using a limited number of custodians "took several weeks, over 250 hours of vendor time, and 750 hours of computer processing time," indicating that creating the full reports would be "extremely burdensome and technically infeasible." The court denied the motion because the plaintiffs did not demonstrate that the defendants' production was deficient or that the reports were relevant to test the production's reasonableness and adequacy. In addition, plaintiffs were not entitled to documents collected in the course of an internal investigation. The documents were entitled to work-product protection, even though plaintiffs argued that the company had waived privilege by purportedly raising an affirmative defense of good faith reliance on advice of counsel. The court held that it was "unclear" whether the defendant had raised a defense based on its state of mind, and thus the evidence did not support a waiver of privilege.

EXCHANGE ACT

Brado v. Vocera Commc'ns, Inc.,
No. C-13-3567-EMC
(N.D. Cal. July 30, 2014)

Click here to view the opinion.

District Court Allows Plaintiffs to Use Internal Documents Obtained From a Former Employee Before Discovery in Securities Action

Judge Edward M. Chen of the United States District Court for the Northern District of California ruled that plaintiffs in a putative federal securities class action could cite and rely on allegedly confidential company documents in their opposition to defendants' motion to dismiss.

Plaintiffs, investors in Vocera Communications, Inc., alleged that Vocera "misrepresented its profitability and that plaintiffs consequently suffered losses when Vocera stock prices fell." During the preliminary fact-finding process, an investigator for the plaintiffs' attorney met with and interviewed a former Vocera employee who provided internal company documents and other information relevant to the alleged wrongdoing. Claiming that the documents were wrongfully taken from Vocera and wrongfully acquired by plaintiffs, defendants sought the return of the documents and to bar plaintiffs from using the documents at the motion-to-dismiss stage.

The district court rejected defendants' request, granting plaintiffs "permission to use the documents, subject to claims of privilege and a protective order." In arriving at this conclusion, Judge Chen analyzed prior cases in which courts considered whether to allow a party to use internal documents wrongfully obtained from a defendant. The court distilled certain factors to consider, such as (i) whether opposing counsel is forthcoming about the source of the documents; (ii) if there are "incentives and disincentives" for employees to wrongfully disclose documents; (iii) whether there is prejudice to the opposing party in disallowing the use; (iv) whether the use or non-use of the documents will interfere with "the court's imperative to pursue the truth in resolving a dispute"; and (v) Sarbanes-Oxley's public policy favoring corporate whistleblowers. After weighing these factors, the court found no reason to preclude plaintiffs' use of the wrongfully disclosed documents at the motion-to-dismiss stage of the case. Nonetheless, the court imposed a protective order regarding the use of the documents and explained that the documents could still be subject to claims of privilege.

Petrie v. Electronic Game Card, Inc.,
No. 12-55620
(9th Cir. July 30, 2014)

Click here to view the opinion.

Ninth Circuit Holds That Materials Requested Before PSLRA Discovery Stay May Properly Support Fraud Allegations

The United States Court of Appeal for the Ninth Circuit reversed the dismissal of an action brought under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 against directors and officers of an online game developer, holding that the district court improperly struck allegations and exhibits that relied on discovery materials provided by a third party that were sought prior to when the discovery stay under the PSLRA went into effect.

A year before filing for bankruptcy in late 2010, Electronic Game Card, Inc. reported millions of dollars in assets from producing electronic "scratch off" devices for casinos and other gaming establishments. After the company reported its dismal financial state, a group of investors filed suit, alleging that the company's former CEO and CFO made false and misleading statements in violation of the Securities Exchange Act.

The district court struck allegations and exhibits from the third amended complaint, reasoning that they were based on discovery materials procured in violation of the PSLRA discovery stay. After striking these portions of the complaint, the district court concluded that the investors failed to adequately plead false statements and scienter.

The Ninth Circuit reversed. According to the panel, the stricken allegations were not a product of discovery that violated the PSLRA, which provides that "all discovery ... shall be stayed during the pendency of any motion to dismiss" in a private securities litigation suit. Rather, the

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investors relied on materials provided by a third-party auditor subpoenaed before the defendant former CEO gave notice of his intent to file a motion for judgment on the pleadings. Because no PSLRA discovery stay was in effect at the time of the subpoena, and because the investors did not pursue discovery after the notice of intent to file a motion, the Ninth Circuit concluded that the district court improperly struck those portions of the amended complaint. The panel remanded the case to the district court.

U.S. v. McGee,
No. 13-3183
(3d Cir. Aug. 14, 2014)
Click here to view the opinion.

Third Circuit Upholds Insider Trading Conviction Under Misappropriation Theory

The United States Court of Appeals for the Third Circuit held that the SEC did not exceed its authority when it enacted Rule 10b5-2, which does not require the existence of a fiduciary duty in order for liability to attach.

At trial, a jury convicted a former Alcoholics Anonymous mentor, Timothy McGee, of insider trading under a misappropriation theory. McGee traded on material non-public information that he received from his former AA mentee, Christopher Maguire, regarding the then-pending 2008 sale of Philadelphia Consolidated Holding Corporation (PHLY). Maguire had missed several AA meetings and when McGee inquired, Maguire disclosed information regarding the sale negotiations. McGee made a profit of $292,128 after the announcement of the sale.

On appeal, McGee challenged Rule 10b5-2 as exceeding SEC authority, arguing that a fiduciary duty must exist for him to be found liable for insider trading and that he did not owe such a duty. For liability to attach under Section 10(b), there must be a predicate deceptive act, which in insider trading cases generally arises from corporate insiders who breach their duty of confidence and trust by trading on material non-public information for their own benefit. While that is the ordinary scenario, the Third Circuit noted that an insider trading claim can also be brought under a misappropriation theory, where an outsider trades on material non-public information by breaching a duty of confidence or trust in the holder of that information. The Securities Exchange Act of 1934 speaks of a relationship of trust and confidence, which encompasses broader relationships than where fiduciary duties are involved.

SEC Rule 10b5-2 defines three instances in which a duty of trust and confidence exists: (i) when "a person agrees to maintain information in confidence"; (ii) when "the person communicating material nonpublic information and the person to whom it is communicated have a history, pattern, or practice of sharing confidences," which gives rise to an expectation of confidence; and (iii) when "a person receives or obtains material nonpublic information from his or her spouse, parent, child, or sibling."

The Third Circuit held that "Rule 10b5-2(2) is based on a permissible reading of 'deceptive device[s]'" under Section 10(b), and therefore the SEC did not exceed its authority in enacting the rule. While the panel expressed concern regarding the potential scope of misappropriation liability under Rule 10b5-2(2), it reasoned that "it is for Congress to limit its delegation of authority to the SEC or to limit misappropriation by statute."

Reinschmidt v. Zillow, Inc., et. al,
No. C12-2084 RSM
(W.D. Wash. Oct. 20, 2014)
Click here to view the opinion.

District Court Dismisses 10b-5 Claims Calling Corporate Optimism Non-Actionable

Judge Ricardo S. Martinez of the U.S. District Court for the Western District of Washington dismissed a putative class action brought against the online real estate database Zillow, Inc., alleging violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.

Plaintiffs alleged that Zillow and certain of its officers and directors made false and misleading statements about Zillow's business practices and financial results. According to the allegations, Zillow in early 2012 implemented a then-new, three-tier pricing model for the subscriptions local real estate professionals purchased. According to plaintiffs, defendants made numerous false and misleading statements about the new pricing model, including the average revenue

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per subscriber. Specifically, plaintiffs alleged that Zillow's CEO told the market that some of Zillow's existing subscribers began paying higher prices under the new pricing model, even though Zillow had difficulty implementing the new pricing model, and later stated in an SEC filing that Zillow received a lower average revenue per subscriber than anticipated.

In dismissing plaintiffs' suit, Judge Martinez found that plaintiffs "merely speculate[d]" that a lower average revenue per subscriber meant that Zillow was not actually charging or receiving higher subscription prices in its new three-tier model. Indeed, it was "entirely possible" that Zillow increased certain subscription prices even while its average revenue per subscriber remained decreased because the company started selling lower-tier subscriptions.

The court also found that Zillow had no duty to disclose the average revenue per subscriber because such a disclosure was not required to correct previously disclosed information. The court further concluded that the alleged false and misleading statements were mere corporate puffery, and that the optimistic statements were made in conjunction with risk disclosures that subscribers may react adversely to a new subscription plan.

Because the court concluded plaintiffs would be unable to address the deficiencies in an amended complaint, the court dismissed the claims with prejudice.

FIDUCIARY DUTIES

Books and Records

Wolst v. Monster Beverage Corp., C.A. No. 9154-VCN, 2014 WL 4966139, opinion (Del. Ch. Oct. 3, 2014)

Click here to view the opinion.

Delaware Court of Chancery Denies Request for Books and Records in Pursuit of Time-Barred Claim

Vice Chancellor John W. Noble of the Delaware Court of Chancery issued an opinion denying plaintiff's request for books and records pursuant to Section 220 of the Delaware General Corporation Law, finding that plaintiff had stated no proper purpose for the books and records she sought, but rather sought documents in pursuit of a time-barred derivative claim.

In 2008, shareholders of Monster Beverage, including plaintiff, filed a derivative action arising out of alleged insider trading that had occurred two years prior, in 2006 and 2007. When that derivative action was dismissed for failure to plead demand futility, plaintiff made a litigation demand on the board, which was subsequently rejected. Plaintiff then brought a Section 220 books and records demand seeking to evaluate the board's refusal of her litigation demand. Plaintiff conceded that her goal in pursuing the books and records request was to "determine whether there is a basis to bring a derivative suit" based on the insider trading that allegedly occurred in 2006 and 2007.

The court found that plaintiff lacked a proper purpose for the inspection because the derivative claims she sought to pursue were presumptively time-barred. While the court recognized that "[a] potentially viable affirmative defense to an anticipated derivative claim will not necessarily defeat a books and records effort," it ultimately determined that in this "specific factual setting," "the burden of producing books and records that Section 220 imposes upon the corporation should be avoided in this instance." The court found that plaintiff's seven-year delay was unreasonable and "presumptively prejudicial under the circumstances because of fading memories and the protracted distractions diverting management's attention from the needs of the corporation."

The court also rejected plaintiff's argument that, under *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974), the pendency of a related federal securities class action through 2014 tolled the running of the statute of limitations for the derivative claim, observing that "[i]t does not appear that the class action concept of tolling has been extended to derivative suits," and emphasizing that plaintiff "was not a member of the class in the federal securities litigation and

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thus is not entitled to the benefits accruing to that class." The court summarized: "In short, the Court declines to extend the rationale of *American Pipe*, which protects stockholders' direct claims, to derivative claims that stockholders might assert on behalf of the corporation."

Bylaws

City of Providence v. First Citizens BancShares, Inc., et al., C.A. No. 9795-CB (consol.), opinion (Del. Ch. Sept. 8, 2014)

Click here to view the opinion.

Delaware Court of Chancery Upholds Facial Validity of Forum Selection Bylaw

Chancellor Andre Bouchard of the Delaware Court of Chancery recently upheld the facial validity of a forum selection bylaw adopted by a controlled company's board of directors on the same day it announced the company's entry into a merger agreement. The court also dismissed challenges to the bylaw's adoption and application.

The text of the bylaw at issue was "functionally identical" to the bylaws challenged in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, "[i]n all but two respects. ... " According to the court, the two distinctions were as follows: "first, whereas the boards of Chevron and FedEx selected Delaware courts as their exclusive forums, the board of FC North selected North Carolina courts [(where its principal operations reside) as its exclusive forum]; and second, FC North's Forum Selection Bylaw, unlike that of Chevron or FedEx, is applicable only 'to the fullest extent permitted by law.'" In upholding the facial validity of the bylaw, the court explained that the inclusion of the "to the fullest extent permitted by law" qualifier "appears to carve out from the ambit of the Forum Selection Bylaw a claim for relief, if any, that may be asserted only in the Court of Chancery." The court expressed no opinion on the "wisdom of selecting" a non-Delaware forum for the litigation of Delaware law claims.

In dismissing breach of fiduciary duty challenges to the board's adoption of the forum selection bylaw, the court explained that the stockholder plaintiff's allegations were "wholly conclusory" and provided "no basis to infer" that the forum selection bylaw was "the product of a breach of fiduciary duty." The court explained that, absent well-pled facts supporting an inference of self-interest, the stockholder plaintiff had "failed to rebut the presumption of the business judgment standard of review that attaches to the Board's adoption of the Forum Selection Bylaw or to show that the Board's selection of North Carolina as the exclusive forum was irrational."

Finally, applying the United States Supreme Court's analysis in *The Bremen v. Zapata Off-Shore Company*, the court enforced the forum selection bylaw and dismissed the pending complaint challenging the proposed merger. The court explained that the timing of the adoption of the forum selection bylaw (on the same day the merger was announced) did not render the bylaw unenforceable, stating "[t]hat the Board adopted it on an allegedly 'cloudy' day when it entered into the merger agreement ... rather than on a 'clear' day is immaterial given the lack of any well-pled allegations ... demonstrating any impropriety in this timing."

Mergers and Acquisitions

In re KKR Fin. Holdings LLC S'holder Litig., C.A. No. 9210-CB, 2014 WL 5151285 (consol.), opinion (Del. Ch. Oct. 14, 2014)

Click here to view the opinion.

Delaware Court of Chancery Dismisses Fiduciary Duty Claims Against Non-Controller

Chancellor Andre G. Bouchard of the Delaware Court of Chancery issued an opinion dismissing plaintiffs' claims for breach of fiduciary duty and aiding and abetting, and rejecting plaintiffs' contention that KKR's stock-for-stock acquisition of KKR Financial Holdings LLC (KFN) should be evaluated for entire fairness despite KKR's less-than 1 percent equity interest in KFN.

Plaintiffs argued that KKR exercised control over KFN's business through an affiliate, KKR Financial Corp., a Maryland REIT that managed and advised KFN pursuant to a terminable management agreement. According to plaintiffs, KFN admitted in certain public filings that it was

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"highly dependent on [KKR Financial's management] and may not find a suitable replacement if [KKR Financial] terminates the Management Agreement." Despite that alleged dependence, the court found that KKR Financial did not control KFN, noting that "although the allegations of the complaint demonstrate that [KKR Financial] managed the day-to-day operations of KFN, they do not support a reasonable inference that KKR controlled the *board* of KFN when it approved the merger." The court emphasized that while KKR Financial managed KFN's daily operations, the ultimate authority for managing KFN's business always remained in the hands of the KFN board, over which KKR Financial had no control. As a result, the court declined to accept plaintiffs' invitation "to impose fiduciary obligations on a relatively nominal stockholder, not because of any coercive power that stockholder could wield over the board's ability to independently decide whether or not to approve the merger."

The court further found that KKR's acquisition of KFN was subject to business judgment review for two additional reasons: first, because the transaction was approved by a majority of disinterested and independent KFN directors, and second, because the transaction had been ratified by a fully informed vote of the stockholders unaffiliated with KKR. In its analysis of stockholder ratification, the court considered the Delaware Supreme Court's decision in *Gantler v. Stephens*, 965 A.2d 695 (Del. 1995), which brought into question the effectiveness of stockholder ratification "when the stockholder vote is statutorily required as opposed to a purely voluntary stockholder vote." The court interpreted *Gantler* "simply [as] clarify[ing] that the term 'ratification' applies only to a voluntary stockholder vote." As a result, the effect of the required stockholder vote here was to ratify the transaction, such that the business judgment rule controlled.

INTERPRETING *JANUS*

Town N. Bank, N.A. v. Shay Fin. Servs., Inc., No. 3:11-CV-3125-L, 2014 WL 4851558 (N.D. Tex. Sept. 30, 2014)

Click here to view the opinion.

Texas District Court Holds That Defendants Are Not 'Makers' of Statements by Affiliates

On September 30, 2014, the United States District Court for the Northern District of Texas dismissed *sua sponte* a securities complaint alleging that securities brokers violated Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 and state law by failing to disclose risks in the mortgage-backed securities they sold to plaintiff. The court held that plaintiff was improperly attempting to "attribute or bootstrap the motives of and the benefits to the unidentified affiliates of Defendants that structured the securities to the broker Bank Defendants based on nothing more than general allegations of company affiliation."

The plaintiff alleged that offering documents prepared by the broker defendants' affiliates contained false or misleading information, and that defendants had a duty to disclose that the securities were subject to greater risk. Relying on J*anus Capital Group v. First Derivative Traders*, 131 S.Ct. 2296 (2011), defendants argued that they were not the "makers" of the securities offering documents because they did not issue or author any of the documents listed in plaintiff's complaint, and thus they had no duty to disclose. Defendants also contended that plaintiff failed to allege with particularity facts concerning the identity of the speakers, the locations where the statements or omissions were made, or the dates when the alleged statements or omissions occurred.

The court agreed and held that the complaint did not contain any allegations "from which the court could reasonably infer that defendants, as brokers-sellers of the securities, had 'ultimate authority' over the statements in the offering documents and whether and how to communicate such information." The court stated that *Janus* makes clear that "'[o]ne who prepares or publishes a statement on behalf of another is not its maker.'" The court also held that "Rule 10b-5 liability [cannot] be imposed on a party that merely publishes or delivers a misleading statement made by another when a 'close relationship' or affiliation exists between the two entities." In dismissing the complaint, the court noted that the pleading did not include any "allegations from which the court could infer that defendants and their affiliates are not legally

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separate entities or that corporate formalities were not observed here." Similarly, the court noted that the mere existence of an affiliate relationship is insufficient to impute knowledge necessary for scienter from one company to another.

The court also rejected plaintiff's argument that defendants had a duty to act based on a fiduciary relationship, finding that plaintiff's allegations were "conclusory and insufficient to transform an arms-length securities [transaction] between a broker and seller into a fiduciary relationship based on trust and confidence."

INVESTMENT COMPANY ACT

Laborers' Local 265 Pension Fund v. iShares Trust, No. 13-6486 (6th Cir. Sept. 30, 2014)

Click here to view the opinion.

Sixth Circuit Affirms the Dismissal of Claims Alleging Excessive Securities Lending Fees in Violation of the Investment Company Act

The U.S. Court of Appeals for the Sixth Circuit affirmed the dismissal of claims brought by two pension funds against subsidiaries of BlackRock, Inc. for violations of Sections 36(a) and 36(b) of the Investment Company Act (ICA) in connection with lending of iShares securities. The plaintiffs alleged that iShares' lending agent and its investment advisor, both BlackRock subsidiaries, collected, in the aggregate, an excessive fee in violation of the ICA. The defendants contended that (1) the Section 36(b) claim was barred by the terms of a 2002 exemptive order issued by the Securities and Exchange Commission (SEC) in which the SEC permitted the fees to the lending agent at issue in the complaint, and (2) Section 36(a) of the ICA does not provide an implied right of action.

In affirming the district court's dismissal of the claims, the Sixth Circuit concluded that the 2002 SEC exemptive order triggered the Section 36(b)(4) carve-out provision and barred the plaintiffs' Section 36(b) claim against both the lending agent and the investment advisor. In so holding, the court rejected the plaintiffs' argument that the lending-fee and investment-advisory fee should be aggregated in determining whether the investment advisor had violated Section 36(b), reasoning that the fees were for different services and there was no logical basis for aggregating the two. The court further held that dismissal of the plaintiff's Section 36(a) claim was warranted because Section 36(a) does not provide a private right of action. Acknowledging that the circuits were divided on the issue, the Sixth Circuit concluded that neither the text nor the structure of the ICA indicated congressional intent to create an implied private right of action under Section 36(a).

LOSS CAUSATION

Pub. Employees Ret. Sys. of Mississippi, Puerto Rico Teachers Ret. Sys. v. Amedisys, Inc., No. 13-30580, 2014 WL 4931411 (5th Cir. Oct. 2, 2014)

Click here to view the opinion.

Fifth Circuit Holds That the 'Whole Is Greater Than the Sum of Its Parts' in Loss Causation Pleading

On October 2, 2014, the U.S. Court of Appeals for the Fifth Circuit overturned a dismissal of a putative securities class action, holding that five partial disclosures collectively constituted and culminated in a "corrective disclosure" that adequately pled loss causation.

In *Amedisys*, plaintiffs alleged that defendants, a home health service corporation and its directors, violated Section 10(b) of the Securities Exchange Act of 1934 by issuing materially false and misleading public statements, causing Amedisys securities to be traded at materially inflated prices. The plaintiffs pointed to five separate partial disclosures of the truth of the company's misrepresentations: an online report that raised questions about the company's billing practices, the resignations of the company's CEO and CIO, an article published by the *Wall Street Journal* regarding the company's Medicare data, three government investigations into the company's billing practices and the announcement of disappointing second-quarter

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operating results. The district court held that plaintiffs failed to adequately plead loss causation because none of the partial disclosures was sufficient on its own to constitute a corrective disclosure.

The Fifth Circuit disagreed, and held that the five disclosures could and should be reviewed together. The Fifth Circuit held that to plead loss causation, a plaintiff must allege that when the "'relevant truth' about the fraud began to leak out or otherwise make its way into the marketplace, it caused the price of the stock to depreciate and, thereby, proximately caused the plaintiff's economic harm." The Fifth Circuit joined the Second, Tenth and Eleventh Circuits and the Southern District of California in holding that the "test for relevant truth simply means that the truth disclosed must make the existence of the actionable fraud more probable than it would be without that alleged fact, taken as true."

The Fifth Circuit also held that relevant truth can be gradually perceived through several partial disclosures and explained that "[t]his holding can best be understood by simply observing that the whole is greater than the sum of its parts." To conclude otherwise would "effectively reward defendants who are able to successfully conceal their fraudulent activities by shielding them from civil suit." The Fifth Circuit held that when the five partial disclosures were "viewed together and in the context of Amedisys's poor second quarter 2010 earnings, it is plausible that the market, which was once unaware of Amedisys's alleged Medicare fraud, had become aware of the fraud and incorporated that information into the price of Amedisys's stock."

The Fifth Circuit rejected the district court's finding that the *Wall Street Journal* article on its own did not constitute a corrective disclosure simply because its analysis was based on publicly available Medicare records. While noting that generally any information that is released to an efficient market is presumed to be immediately incorporated into the price of a security, the Fifth Circuit held that it was "plausible that complex economic data understandable only through expert analysis may not be readily digestible by the marketplace ... especially where the data itself is only available to a narrow segment of the public and not the public at large."

The Fifth Circuit remanded the case for the district court to conduct the "highly fact intensive inquiry" necessary to determine if the misleading statements and the alleged corrective disclosures were connected to plaintiff's loss.

PSLRA

Lead Plaintiff

Sklar v. Amarin Corp. PLC, No. 13-cv-06663 (FLW) (TJB) (D.N.J. July 29, 2014)

Click here to view the opinion.

New Jersey District Court Appoints Alleged Day-Trader as Lead Plaintiff in Securities Fraud Class Action

Judge Freda L. Wolfson of the U.S. District Court for the District of New Jersey appointed an alleged day-trader as lead plaintiff in a federal securities fraud class action against a pharmaceutical company. A different proposed lead plaintiff argued that the alleged day-trader, although having the largest financial interest in the action, was atypical of the class and subject to unique defenses because he executed 4,565 purchases and sales of company stock over the course of the class period, averaging 18.2 transactions per trading day. Although some courts have refused to appoint day-traders as lead plaintiffs because such investors have been subject to the unique defense that they would have purchased and sold company stock whether or not the price was inflated, the alleged day-trader's declaration that the company was a "core" holding, that he closely followed publically available information about the company, and that he did not trade on small price movements showed that he relied on the company's public statements. In addition, the alleged day-trader averred that his larger stock purchases were often broken up into smaller trades as a result of his broker's trading techniques, inflating his total trades during the class period.

Scienter

In re Omnicare, Inc. Securities Litigation, No. 13-5597 (6th Cir. Oct. 10, 2014)

Click here to view the opinion.

Sixth Circuit Clarifies Standard for Imputing Scienter in Securities Litigation

The U.S. Court of Appeals for the Sixth Circuit affirmed the dismissal of claims brought against Omnicare, Inc., and several of its current and former officers, under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. The plaintiffs alleged that the defendants made various material misrepresentations and omissions about Omnicare's compliance with Medicare and Medicaid regulations. Determining that the complaint did not sufficiently allege that defendants acted with the requisite scienter, the Sixth Circuit ruled that plaintiffs failed to meet the heightened pleading standards for securities fraud under the Private Securities Litigation Reform Act (PSLRA).

The opinion interpreted and narrowed the court's previous decision in *City of Monroe Emp. Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651 (6th Cir. 2005). *City of Monroe* held that the knowledge of a "corporate officer or agent" could generally be imputed to the corporation. In *Omnicare*, the court offered a narrower articulation of the rule for evaluating whether an agent's knowledge of a material misrepresentation or omission can be imputed to the entire corporation to establish corporate scienter. Under this new approach, the knowledge of only three categories of individuals may be imputed to a corporation: "(a) the individual agent who uttered or issued the misrepresentation; (b) any individual agent who authorized, requested, commanded, furnished information for, prepared … reviewed, or approved the statement in which the misrepresentation was made before its utterance or issuance; (c) any high managerial agent or member of the board of directors who ratified, recklessly disregarded, or tolerated the misrepresentation after its utterance of issuance."

Applying this rule, the court determined that the complaint did not allege specific facts to show that the individual defendants had actual knowledge of any material misrepresentation or omission. The court also noted that, although the knowledge of the former vice president of Internal Audit regarding potential material misrepresentations or omissions could be imputed to Omnicare, the complaint failed to establish a strong inference of fraudulent intent on the part of Omnicare as required under the PSLRA. Thus, the complaint failed to state a claim on which relief could be granted as to both the individual defendants and the corporation.

The Supreme Court heard arguments on November 3, 2014, in a related appeal on whether a plaintiff may plead that a statement of opinion or belief was "untrue" under Section 11 of the Securities Act of 1933 by alleging the statement was objectively false, or if the plaintiff also must allege that the speaker knew the statement was false at the time it was made.

RELIANCE

Salvani v. ADVFN PLC, No. 13 Civ. 7082 (ER) (S.D.N.Y. Sept. 23, 2014)

Click here to view the opinion.

SDNY Dismisses Section 10(b) Claims Regarding Statements on Online Message Board

Judge Edgardo Ramos of the U.S. District Court for the Southern District of New York dismissed *sua sponte* claims that an Internet-based company and a John Doe defendant violated Section 10(b) of the Securities Exchange Act by falsely stating on an online message board that the plaintiffs, a broker and associated entity, were orchestrating a "pump and dump" stock scheme. First, the plaintiffs' fraud-on-the-market theory of reliance failed because the plaintiffs knew that the message board statements were false and thus could not have relied on the integrity of the allegedly inflated market price. Second, the plaintiffs failed to allege that the stock — which traded on an electronic exchange for over-the-counter stocks — traded in an open and efficient market. In addition, the plaintiffs failed to sufficiently allege loss causation, as the decline in stock price caused by the allegedly false statement was not accompanied by an increase in stock price when the truth was revealed. Further, the plaintiffs could not invoke a materialization of risk theory of loss causation — which requires a discreet connection between the risk that is hidden from investors and the subsequent loss suffered by those investors — because plaintiffs claimed that the false statement itself (not a previously concealed or subsequently revealed risk) caused the stock price decline.

SCIENTER

Weinstein v. McClendon, No. 13-6121 (10th Cir. July 8, 2014)

Click here to view the opinion.

Tenth Circuit Affirms Dismissal of 10(b) Claims, Finding Complaint's Conclusory Allegations Insufficient to Demonstrate Inference of Scienter

The U.S. Court of Appeals for the Tenth Circuit affirmed the dismissal of claims that an oil and natural gas company violated Section 10(b) of the Securities Exchange Act by concealing material information about the company's financial condition from investors. Plaintiffs were required to plead with particularity facts giving rise to a strong inference of scienter and, as to any allegedly fraudulent omissions, facts demonstrating that the defendant knew of the material fact allegedly concealed and knew that the omission was likely to mislead investors. The plaintiffs alleged that the company misled investors as to its efforts to reduce debt and reconcile certain conflicts of interest between the company and the CEO, including that the company (i) failed to disclose certain future production costs associated with its obligations to deliver gas, (ii) made false statements about its interest in a well program; and (iii) failed to disclose details of the CEO's interest in a natural gas exploration program. The court affirmed dismissal of the plaintiffs' case and held that the complaint's conclusory allegations showed at most that the company had knowledge of arguably material facts, which was insufficient to demonstrate a cogent and compelling inference of scienter. The court distinguished the plaintiffs' allegations from the facts alleged in *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309 (2011), because the defendants in that case "took affirmative steps to discredit specific, objective public allegations regarding the possible health risks of their leading product," while the plaintiffs here alleged "much more vague and subjective" statements.

SECURITIES ACT CLAIMS

MHC Mut. Conversion Fund, L.P. v. Sandler O'Neill & Partners, L.P., No. 13-1016 (10th Cir. Aug. 1, 2014)

Click here to view the opinion.

Tenth Circuit Upholds Dismissal of Section 10(b) and 11 Claims

The U.S. Court of Appeals for the Tenth Circuit affirmed the dismissal of claims that a bank holding company violated Section 11 of the Securities Act of 1933 by misrepresenting its exposure to further deterioration in the mortgage-backed securities market in a registration statement. The court held that the statements were opinions and that they were supported by information that a reasonable issuer of securities could rely upon (*e.g.*, the company had conducted an internal analysis and had retained multiple experts to conduct independent analyses of market prospects). In addition, the company disclosed the assumptions underlying its opinions, including that it expected the housing market to improve in the near future, and if it did not, that the company would be required to take additional write-downs. The court further affirmed dismissal of the plaintiffs' claims under Section 10(b) of the Securities Exchange Act of 1934 because the complaint did not give rise to a strong inference of scienter. The company's interest in raising capital, alone, did not demonstrate a motive to commit fraud, and plaintiffs failed to allege any other particularized facts indicating that the company intended to deceive investors.

Firefighters Pension & Relief Fund of the City of New Orleans v. Bulmahn, CIV.A. 13-3935, 2014 WL 5040696 (E.D. La. Sept. 26, 2014)

Click here to view the opinion.

Eastern District of Louisiana Holds Issuer Is Not Required to Predict With Mathematical Certainty Extent to Which Known Trend Will Affect Revenues or Liquidity

On September 26, 2014, the United States District Court for the Eastern District of Louisiana dismissed a consolidated securities class action brought against the directors and officers of the bankrupt ATP Oil & Gas Corporation. The plaintiff alleged that in a 2010 registration statement issued in connection with a $1.5 billion notes exchange following drilling moratoriums enacted after the Deepwater Horizon Spill, defendants made false and misleading statements regarding the company's liquidity and business prospects in violation of the Securities Act of 1933.

In its Section 11 claims, plaintiff alleged, among other things, that defendants failed to disclose that ATP reasonably expected the moratoria to affect liquidity and revenues in a material way. Plaintiff pointed to testimony in ATP's bankruptcy proceedings that took place in 2012, two years after the 2010 offering, as evidence "that ATP knew in 2010 that it could not survive the moratoria." The district court rejected this contention, pointing to the detailed discussion in the prospectus of the "moratoria's impact on ATP's operations as well as their possible future effects."

Relying on caselaw from the Second Circuit, the district court held that although an issuer is required to disclose the reasons that an event or trend will be material, an issuer is not required to "predict in mathematical terms the *extent* to which a known trend ultimately will affect revenues or liquidity." The district court noted that plaintiff's contention "would require defendants, at a time when the end date of the *de facto* moratorium was still unknown, to both foresee and publicly declare the inevitability of their bankruptcy some two years down the road, despite the fact that such prognosticating would most assuredly operate as a self-fulfilling prophecy."

The district court dismissed the majority of the plaintiff's Section 11 claim without prejudice, stating that plaintiff's allegations "amount[ed] to an attempt to plead fraud by hindsight," were "incompatible" with plaintiff's statements in the complaint disclaiming any allegations of fraud, and "fail[ed] to plead defendants' knowledge with the requisite particularity."

SLUSA

Goodman v. AssetMark, Inc., No. 09-CV-5603 (E.D.N.Y. Oct. 17, 2014)

Click here to view the opinion.

EDNY Denies Motion to Reconsider Claims Dismissed Pursuant to SLUSA

Judge Joseph Bianco of the U.S. District Court for the Eastern District of New York denied plaintiffs' motion for reconsideration of the dismissal of state-law breach of fiduciary duty claims previously dismissed pursuant to the Securities Litigation Uniform Standards Act of 1998 (SLUSA), which bars certain state-law class action claims based on the purchase or sale of nationally traded securities. The plaintiffs argued that their claims should be reinstated in light of the Supreme Court's decision in *Chadbourne & Parke LLP v. Troice*, 134 S. Ct. 1058 (2014), which held that SLUSA applies when an alleged fraudulent misrepresentation is material to the recipient's decision to buy or sell covered securities. The court determined that *Chadbourne* did not alter SLUSA's application to the plaintiffs' claims because the plaintiffs intended to purchase interests in a mutual fund that was managed by a particular investment advisor but were induced to purchase and hold a different mutual fund by defendants' misrepresentations. Although the plaintiffs argued that they intended to purchase only investment advisory services, the court determined that they made the decision to purchase the mutual fund — a covered security — and that SLUSA properly applied.

SLUSA PRECLUSION

Campbell v. Am. Int'l Grp., Inc., 760 F.3d 62 (D.C. Cir. 2014)

Click here to view the opinion.

DC Circuit Court Holds That SLUSA Does Not Independently Confer Federal Subject Matter Jurisdiction

On September 10, 2014, the U.S. Court of Appeals for the D.C. Circuit dismissed a putative securities class action suit, holding that the Securities Litigation Uniform Standards Act of 1998 (SLUSA) does not confer federal subject matter jurisdiction over state-law claims. In *Campbell*, a shareholder alleged that AIG and its directors depleted the investment value of the equity units issued by the company. Rather than alleging that the district court had diversity jurisdiction, plaintiffs alleged that SLUSA conferred independent federal jurisdiction over the state law claims through Subsection (d)(1)(A) of the statute (codified at 15 U.S.C. § 77p(d)(1)(A)). The district court disagreed and granted defendants' motion to dismiss.

The Court of Appeals affirmed the dismissal, holding that plaintiffs' "reading of [SLUSA] is untenable." The court explained that SLUSA's preclusion provision bars plaintiffs from bringing certain state-law securities fraud claims as class actions, either in state or federal court, and that Subsection (d)(1)(A) serves as an exception to the statute's preclusive reach. The Court of Appeals held that the "carve-out" provision in Subsection (d)(1)(A) "does not embark on a wholly independent mission to confer federal-court jurisdiction on state-law actions." Rather than create new rights in federal courts, the Court of Appeals stated that Congress intended SLUSA to preserve certain "state-law claims falling within the Delaware carve-out in their pre-SLUSA state — not to inject those claims into federal court for the first time."

STANDING

Cartica Mgmt., LLC v. Corpbanca, S.A., No. 14-cv-2258 (PKC) (S.D.N.Y. Sept. 25, 2014)

Click here to view the opinion.

SDNY Dismisses Claims Against Chilean Bank for Lack of Standing

Judge P. Kevin Castel of the U.S. District Court for the Southern District of New York dismissed claims that a Chilean bank violated Sections 10(b) and 13(d) of the Securities Exchange Act of 1934 by making allegedly false and misleading statements concerning a proposed merger. The plaintiffs — who held the bank's American Depositary Receipts (ADRs) and foreign-issued shares — sought to enjoin the merger under Sections 10(b) and 13(d). Relying on *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), but noting the absence of clear Second Circuit authority on whether claims for injunctive relief pursuant to Section 10(b) and Rule 10b-5 may be brought where the plaintiff is neither a purchaser nor seller of securities on a domestic market, the court ruled that the plaintiffs lacked standing under Section 10(b) to seek injunctive relief because the plaintiffs' purchases of ADRs — which were made about a year before the merger was disclosed — could not have been made in connection with false statements about the merger. In addition, the plaintiffs' purchases of the bank's securities on foreign exchanges were not actionable under *Morrison v. National Australia Bank*, 561 U.S. 247 (2010). The court also dismissed the plaintiffs' injunctive relief claim under Section 13(d) because the defendants made adequate corrective disclosures in post-announcement filings well before the scheduled shareholder vote. Specifically, the defendants put investors on notice that the merger parties would form a group after the merger is completed and also adequately disclaimed any beneficial owner status of the bank's securities.

STATUTES OF LIMITATIONS

Schmidt v. Skolas, et. al,
No. 4:12-cv-00603-JEG,
No. 13-3750
(3d Cir. Oct. 17, 2014)

Click here to view the opinion.

Third Circuit Reverses Dismissal of Breach of Fiduciary Claims

The United States Court of Appeal for the Third Circuit reversed the dismissal of a suit brought by a former shareholder of the now-defunct biotech firm Genaera Corporation against Genaera's liquidating trustee, asset purchasers, majority shareholders, and former directors and officers, which alleged that they breached their fiduciary duties to the company. The "essence" of the complaint was that the defendants "dispos[ed] of promising drug technologies in tainted insider deals for far less than their true value." The complaint further alleged that two majority shareholders "aided and abetted" these breaches "so that the companies they controlled could acquire Genaera's assets at fire sale prices."

The district court dismissed the complaint with prejudice, rejecting the former shareholder's argument that Pennsylvania's two-year statute of limitations should be tolled because the shareholder was unaware of the identity of the buyer until after the statute ran. The shareholder argued that the discovery rule, a judicially created device that "tolls the running of the applicable statute of limitations until the point where the complaining party knows or reasonably should know that he has been injured and that his injury has been caused by another party's conduct," should apply. In concluding that the discovery rule did not apply, the district court considered several documents attached to defendants' motion.

On appeal, the Third Circuit held that the district court erred in in considering documents outside the record and that it incorrectly refused to toll the statute of limitations under the discovery rule. The Third Circuit pointed to its earlier decision, *In re Mushroom Transportation Co.*, 382 F.3d 325, 343 (3d Cir. 2004), as "provid[ing] standards for applying the discovery rule in cases involving the statute of limitations applicable to fiduciary defendants." It reiterated that "the existence of a fiduciary relationship is relevant to a discovery rule analysis precisely because it entails such a presumptive level of trust in the fiduciary ... that it may take a 'smoking gun' to excite [a] searching inquiry ... into [wrongful] behavior."

In dissent, Judge Marjorie Rendell maintained that the district court properly dismissed the former shareholder's claims, echoing the district court's opinion that "to toll the statute of limitations on every plaintiff's mere assertion that he needed time to put together all the facts and circumstances would eviscerate the very concept of a limitations period."

STATUTES OF REPOSE

Bensinger v. Denbury Resources Inc.,
No. 10-cv-1917
(E.D.N.Y. July 14, 2014)

Click here to view the opinion.

EDNY Holds That Statute of Repose Bars Claims Added Through Amended Complaint

Judge John Gleeson of the U.S. District Court for the Eastern District of New York dismissed claims that a company violated Section 14(a) of the Securities Exchange Act of 1934 by making allegedly false statements in a merger proxy. The applicable three-year statute of repose barred the plaintiffs' claims because they were added through an amended complaint filed outside of the statutory period. The court ruled that the new claims could not be construed to have commenced when the plaintiffs sent a letter requesting a court conference to discuss amendment. Further, the claims could not relate back to the date of the filing of the original complaint under the Second Circuit's opinion in *Police & Fire Ret. Sys. of City of Detroit v. IndyMac MBS, Inc.*, 721 F.3d 95 (2d Cir. 2013), which held that a subsequently filed claim may relate back to a prior pleading to avoid being barred by a statute of limitations, but not by a statute of repose. Likewise, the court determined that the plaintiffs' initial class-action complaint did not toll the statute of repose under the Supreme Court's decision in *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974), because that holding also applies only to statutes of limitation.

Kaplan v. S.A.C. Capital Advisors, L.P., Nos. 12-cv-9350 (VM), 13-cv-2459 (VM) (S.D.N.Y. Aug. 14, 2014)

Click here to view the opinion.

SDNY Rules Section 20A Claims Not Barred by Statute of Repose

Judge Victor Marrero of the U.S. District Court for the Southern District of New York granted in part and denied in part claims that an investment company violated Sections 10(b) and 20A of the Securities Exchange Act of 1934 by allegedly trading on inside information concerning an Alzheimer's drug at the same time as the plaintiffs. The court rejected the defendant's argument that its disgorgement payment in an SEC settlement extinguished certain claims because Section 20A provides for an offset. Although the plaintiffs' alleged losses were lower than the amount disgorged in the settlement, the plaintiffs were entitled to discovery to determine if the settlement was sufficient. The court also refused to dismiss disgorgement claims for losses unrelated to the defendant's insider information because an insider trader "assume[s] the risk" that independent factors could increase the amount they must disgorge. In addition, none of the plaintiffs' Section 20A claims were barred by the statute of repose, even though some trades were made outside the five-year period, because the defendant's scheme constituted a single violation that occurred both before and after the pertinent time period. Importantly, the court determined that "a plaintiff need only allege conduct that violates the Exchange Act; whether such action would itself be time-barred is irrelevant." But the court dismissed claims based on Section 10(b) that were outside the five-year period because a Section 10(b) violation "occurs at each transaction" for the purposes of calculating the repose date.

Fed. Deposit Ins. Corp. v. Chase Mortg. Fin. Corp., No. 12 Civ. 6166 (LLS) (S.D.N.Y. Sept. 2, 2014)

Click here to view the opinion.

SDNY Rules Agency's Extender Statute Does Not Override the Securities Act's Statute of Repose, Distinguishing Case From *CTS Corp. v. Waldburger*

Judge Louis L. Stanton of the U.S. District Court for the Southern District of New York dismissed claims that an underwriter violated the Securities Act of 1933 because the claims were barred by the applicable statute of repose. Although the securities at issue were purchased outside of the Securities Act's three-year statute of repose, the FDIC argued that the claims were timely because a provision of the Financial Institutions Reform, Recovery, and Enforcement Act extending statutes of limitations for the FDIC also purportedly extended the statute of repose. The defendants had previously filed a motion to dismiss the claims as barred by the statute of repose, but they withdrew the argument after the U.S. Court of Appeals for the Second Circuit held in *Federal Housing Finance Agency v. UBS Americas, Inc.*, 712 F.3d 136 (2d Cir. 2013) (*FHFA*), that a similar extender statute in the Housing and Economic Recovery Act altered both the statute of limitations and the statute of repose (affirming Judge Denise Cote's decision to that effect as reported at 858 F. Supp. 2d 306 (S.D.N.Y. 2012)).

The defendants renewed their argument that the claims were untimely after the Supreme Court issued its opinion in *CTS Corp. v. Waldburger*, 134 S. Ct. 2175 (2014) (decided after *FHFA*), which holds that a federal environmental statute preempting state statutes of limitations did not apply to statutes of repose. (The Tenth Circuit, in *Nomura Home Equity Loan, Inc. v. National Credit Union Administration Board*, 764 F.3d 1199 (10th Cir. 2014), reconsidered, post-*CTS*, upon remand from the Supreme Court, yet affirmed its prior decision holding that the National Credit Union Administration's extender statute applied to enlarge the statutes of limitations and repose applicable to claims within its purview. A petition for *certiorari* remains pending.) Relying heavily on *CTS*, the statutory text and legislative history (and without any consideration of *Nomura*), Judge Stanton ruled that the FDIC's extender statute did not extend statutes of repose because the extender statute focused on claim accrual, which was not applicable to the statute of repose. The court reasoned that its interpretation did not contradict the extender statute's purpose of allowing the FDIC to recover additional funds because the extender statute still enlarged the Securities Act's statute of limitations from one year to three.

Nomura Home Equity Loan, Inc. v. Nat'l Credit Union Admin. Bd., Nos. 12-3295 & 3298 (10th Cir. Aug. 19, 2014)

Click here to view the opinion.

After Reconsideration in Light of *CTS Corp. v. Waldburger,* Tenth Circuit Holds That Agency's Extender Statute Overrides the Securities Act's Statute of Repose

The U.S. Court of Appeals for the Tenth Circuit affirmed a district court's ruling that the Securities Act's statute of repose did not bar claims by the National Credit Union Administration (NCUA) against the issuers and underwriters of certain residential mortgage-backed securities. The Tenth Circuit had previously held that the claims were not time-barred, but the U.S. Supreme Court vacated that judgment and remanded the case to the Tenth Circuit to consider the Supreme Court's intervening decision, *CTS Corp. v. Waldburger*, 134 S. Ct. 2175 (2014). In *CTS*, the Supreme Court held that a federal environmental statute preempting state statutes of limitations did not apply to statutes of repose. On remand, the Tenth Circuit determined that *CTS* did not change its analysis because the statute at issue in *CTS* had "a completely different structure." Unlike the statute in *CTS*, the NCUA's extender statute created an exclusive time framework. It contained its own time limits that applied only to the NCUA. In addition, the NCUA's extender statute included concepts of repose because the limitations period could run from the NCUA's appointment as conservator, regardless of whether the plaintiff was aware of the injury. The NCUA's extender statute also did not mention equitable tolling, a statute of limitations concept, unlike the statute in *CTS*. Finally, the court reasoned that extending both the statute of limitations and the statute of repose would further Congress' intent to "maximize potential recoveries" for the NCUA. The defendants have again requested *certiorari* review by the Supreme Court.

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