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Inside the

Courts

An Update From Skadden Securities Litigators

CONTENTS

December 2013 | Volume 5 | Issue 4

U.S. SUPREME COURT 3

Halliburton Co. v. Erica P. John Fund, Inc., No. 13-317 (U.S. Nov. 15, 2013)
Lawson v. FMR LLC, No. 12-3 (U.S. Nov. 12, 2013)
Chadbourne & Parke LLP v. Troice, No. 12-79, *Willis of Colorado Inc. v. Troice*, No. 12-86 and *Proskauer Rose LLP v. Troice*, No. 12-88 (U.S., Oct. 7, 2013)

AUDITOR LIABILITY 4

In re OSG Sec. Litig., No. 12 Civ. 7948 (SAS) (S.D.N.Y. Sept. 10, 2013)

CLASS ACTIONS 4

Severing Claims 4
In re Facebook, Inc. IPO Sec. and Derivative Litig., No. 12-2389 (S.D.N.Y. Aug. 13, 2013)

Certification. 5
Hall v. Variable Annuity Life Ins. Co., No. 12-20440 (5th Cir. Aug. 15, 2013)
Smilovits v. First Solar, Inc., No. 12-00555 (D. Ariz. Oct. 8, 2013)
Haw. Ironworkers Annuity Trust Fund v. Cole, No. 10-cv-371 (N.D. Ohio Sept. 4, 2013)

DODD-FRANK ACT 6

Dennis v. Hart, Nos. 12-55241, 12-55266, 12-55282, 12-55291 (9th Cir. July 31, 2013)

DUTY TO DISCLOSE 7

Sec. & Exch. Comm'n v. EagleEye Asset Mgmt., LLC, No. 11-11576-WGY (D. Mass. Oct. 4, 2013)

FIDUCIARY DUTIES 7

Derivative Litigation. 7
Ark. Teacher Ret. Sys. v. Countrywide Fin. Corp., No. 14, 2013 (Del. Sept. 10, 2013)
Marvin H. Maurras Revocable Trust v. Bronfman, No. 1:12-cv-03395 (N.D. Ill. Sept. 24, 2013)

Mergers and Acquisitions 8
In re BioClinica, Inc. S'holder Litig., No. 8272-VCG (Del. Ch. Oct. 16, 2013)
In re Sirius XM S'holder Litig., No. 7800-CS (Del. Ch. Sept. 27, 2013)
Se. Pa. Transp. Auth. v. Volgenau, No. 6354-VCN (Del. Ch. Aug. 5, 2013)

FOREIGN CORPORATIONS 9

Stream SICAV v. Wang, No. 12 Civ. 6682 (PAE) (S.D.N.Y. Oct. 7, 2013)

LOSS CAUSATION 10

Nuveen Mun. High Income Opportunity Fund v. City of Alameda, Cal., No. 11-17391 (9th Cir. Sept. 19, 2013)
In re Moody's Corp. Sec. Litig., No. 07 Civ. 08375 (GBD) (S.D.N.Y. Aug. 23, 2013)

MISREPRESENTATIONS 11

In re ProShares Trust Sec. Litig., No. 12-3981 (2d. Cir. July 22, 2013)

PONZI SCHEMES 11

United States v. McKye, No. 12-6108 (10th Cir. Aug. 20, 2013)

Skadden

Inside the Courts

An Update From Skadden Securities Litigators

CONTENTS

December 2013 | Volume 5 | Issue 4

PSLRA 11

Kaplan v. S.A.C. Capital Advisors L.P., No. 12 Civ. 9350 (VM) (S.D.N.Y. Oct. 22, 2013)

SCIENTER 12

Rahman v. Kid Brands, Inc., No. 12-4257 (3d Cir. Nov. 15, 2013)
Ross v. Lloyds Banking Grp., PLC, No. 12-4600-cv(L) (2d Cir. Sept. 19, 2013)
Ricker v. Zoo Entm't, Inc., No. 12-3951 (6th Cir. Aug. 27, 2013)

SEC ENFORCEMENT ACTIONS 13

Sec. & Exch. Comm'n v. Thompson, No. 11-4182 (10th Cir. Oct. 4, 2013)
Sec. & Exch. Comm'n v. CMKM Diamonds, Inc., Nos. 11-17021, 11-17025 (9th Cir. Sept. 10, 2013)

SECURITIES ACT CLAIMS 14

Pension Trust Fund for Operating Eng'rs. v. Mortg. Asset Securitization Transactions, Inc., No. 12-3454 (3d Cir. Sept. 17, 2013)
Salameh v. Tarsadia Hotel, No. 11-55479 (9th Cir. Aug. 13, 2013)
In re OSG Sec. Litig., No. 12 Civ. 7948 (SAS) (S.D.N.Y. Sept. 10, 2013)

SECURITIES FRAUD PLEADING STANDARDS 15

In re Barclays Bank PLC Sec., No. 11-2665-cv (2d Cir. Aug. 19, 2013)
Coyne v. Metabolix, Inc., No. 12-10318-DPW (D. Mass. Sept. 20, 2013)
City of Taylor Gen. Emps. Ret. Sys. v. Magna Int'l Inc., No. 12 Civ. 3553 (NRB) (S.D.N.Y. Aug. 23, 2013)

STANDING 17

In re Bernard L. Madoff Inv. Sec. LLC, Nos. 11-5044, 11-5051, 11-5175, 11-5207 (2d Cir. June 20, 2013)

STATUTES OF LIMITATIONS 17

Matana v. Merkin, No. 13 Civ. 1534 (PAE) (S.D.N.Y. July 30, 2013)

STATUTES OF REPOSE 18

In re Countrywide Fin. Corp. Mortg.-Backed Sec. Litig., Nos. 2:11-ML-02265-MRP (MANx), 2:12-CV-08558-MRP (MANx) (C.D. Cal. Aug. 26, 2013)

U.S. SUPREME COURT

Halliburton Co. v. Erica P. John Fund, Inc., No. 13-317 (U.S. Nov. 15, 2013)

Click here to view the Fifth Circuit opinion.

Supreme Court to Hear Class Action Certification Appeal in *Halliburton*

In a case that could have significant implications for putative federal securities class actions, the Supreme Court granted *certiorari* in *Halliburton Co. v. Erica P. John Fund, Inc.* In its petition for *certiorari*, Halliburton asked the Court to consider two issues. First, it asked the Court to "overrule or substantially modify" the holding of *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), at least to the extent *Basic* establishes a presumption of classwide reliance based on a fraud-on-the-market theory. Second, even if the Court is not inclined to revisit its holding in *Basic*, Halliburton urged the Court to nonetheless hold that a defendant may rebut — at the class certification stage — the presumption of classwide reliance by introducing evidence that any alleged misrepresentations did not distort the market price. The Supreme Court did not limit its consideration to either question.

The claims arise out of alleged misrepresentations made by Halliburton and some of its directors. In the opinion below, the U.S. Court of Appeals for the Fifth Circuit affirmed the district court's certification of the plaintiff class. The panel refused to allow Halliburton to present "market price impact" evidence at the class certification stage as a means to rebut the fraud-on-the-market presumption of reliance.

Arguments in the case are set for March 5.

Lawson v. FMR LLC, No. 12-3 (U.S. Nov. 12, 2013)

Click here to view the oral argument transcript.

Supreme Court Hears Arguments Regarding SOX Whistleblower Provision

Oral argument was held on November 12, 2013, in *Lawson v. FMR LLC*, No. 12-3. The question presented by the Supreme Court's grant of *certiorari* is whether an employee of a private company that is a contractor for a public company is protected from retaliation under Sarbanes Oxley. The employees seeking protection under Sarbanes Oxley were employed by private investment advisors to a public mutual fund. They were allegedly terminated by their private employers for reporting potential securities violations. The U.S. Court of Appeals for the First Circuit, in a case of first impression among all circuits, ruled that Sarbanes Oxley's protections only applied to employees of public companies, and so it did not protect employees of private contractors. The Department of Labor subsequently determined that the whistleblower protections did extend to employees of private companies that were acting as the agents or contractors of public companies, and this interpretation has been followed in subsequent administrative proceedings, creating an inconsistency in the way the law is being applied.

Chadbourne & Parke LLP v. Troice, No. 12-79, *Willis of Colorado Inc. v. Troice*, No. 12-86 and *Proskauer Rose LLP v. Troice*, No. 12-88 (U.S., Oct. 7, 2013)

Click here to view the oral argument transcript.

Supreme Court Hears Argument in Cases Questioning the Preemptive Scope of Federal Securities Laws

On October 7, 2013, the Supreme Court heard oral argument in a trilogy of cases (*Chadbourne & Parke LLP v. Troice*, No. 12-79, *Willis of Colorado Inc. v. Troice*, No. 12-86 and *Proskauer Rose LLP v. Troice*, No. 12-88) to resolve a circuit court split as to the meaning and scope of the "in connection with" requirement of the Securities Litigation Uniform Standards Act (SLUSA). The principal question presented by the Supreme Court's grant of *certiorari* is whether SLUSA precludes a state-law class action alleging a scheme of fraud that involves misrepresentations about transactions in SLUSA-covered securities.

All three cases originate from a multibillion-dollar Ponzi scheme perpetuated by Robert Allen Stanford, who induced investment in certificates of deposit (CDs) by promising above-market returns and assuring investors that the CDs were backed by safe, liquid investments when, in fact, the claimed investments did not exist. Groups of investors filed suits in Louisiana and Texas, alleging that Stanford's investment company, as well as its lawyers

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and insurance brokers, should be held responsible under state law for participating in the scheme. The U.S. District Court for the Northern District of Texas held that the suits were precluded by SLUSA because, though the CDs themselves were not covered securities, the plaintiffs' allegations connected the fraud to transactions in covered securities.

The U.S. Court of Appeals for the Fifth Circuit consolidated the cases and overturned the district court's ruling, holding that SLUSA did not preclude the claims because the alleged fraudulent statements were "only tangentially related" to transactions in covered securities. With this holding, the Fifth Circuit rejected conflicting circuit standards for construing the "in connection requirement" of SLUSA. In 2006, the Supreme Court visited a related issue in *Merrill Lynch v. Dabit*, in which the Court held that SLUSA preempts state law securities class actions brought by investors who allegedly would have sold their shares but instead held them due to purported misstatements or omissions.

AUDITOR LIABILITY

In re OSG Sec. Litig.,
No. 12 Civ. 7948 (SAS)
(S.D.N.Y. Sept. 10, 2013)

Click here to view the opinion.

SDNY Upholds Claims That Company's Auditors Issued Opinions That Were Incorporated Into a Registration and Failed to Disclose Significant Tax Liabilities

Judge Shira A. Scheindlin of the U.S. District Court for the Southern District of New York upheld claims that a company's auditors violated Section 11 of the Securities Act by issuing audit opinions that were incorporated into a registration and failed to disclose significant tax liabilities. Following a board member's resignation, the company filed a Form 8-K stating that three years of financial statements "should no longer be relied upon." The company entered bankruptcy shortly thereafter, and the IRS filed a claim for more than $35 million of unpaid taxes. The auditors were subject to strict liability for the allegedly false statements regarding the company's tax liabilities, even though the audit opinion contained the word "opinion" in its title, because statements regarding the company's tax liabilities were not inherently subjective and, thus, did not require the plaintiffs to show that the auditors actually believed they were false. In addition, the plaintiffs sufficiently alleged a claim against an auditor performing services only in 2007 and 2008, even though the company did not owe back taxes from those years, because the 2007 and 2008 financial statements were required to disclose all liabilities including those that would have accrued in 2004 and 2005.

CLASS ACTIONS

Severing Claims

In re Facebook, Inc. IPO Sec. and Derivative Litig.,
No. 12-2389
(S.D.N.Y. Aug. 13, 2013)

Click here to view the opinion.

SDNY Denies Motions to Sever Certain Class Members Asserting Securities Exchange Act Claims in Consolidated Action Against Facebook

In a consolidated securities class action against Facebook, Judge Robert W. Sweet of the U.S. District Court for the Southern District of New York denied motions to sever certain class members asserting Securities Exchange Act claims. The court had previously consolidated all class actions asserting federal securities law claims, despite opposition by the same class members, and the lead plaintiff in the consolidated action subsequently chose not to advance Securities Exchange Act claims. The court determined that the lead plaintiff had discretion to exercise control over the litigation and was not required to bring all available claims. In addition, severing the Securities Exchange Act claims would be improper because those claims and the claims asserted by the class sought the same relief on behalf of a similar class, named the same defendants and arose out of the same events. Allowing both sets of claims to proceed as class actions would result in the type of duplicative litigation that the Private Securities Litigation Reform Act was intended to prevent. Further, the Exchange Act plaintiffs would not be prejudiced because they remained free to bring Securities Exchange Act claims individually.

Certification

Hall v. Variable Annuity Life Ins. Co., No. 12-20440 (5th Cir. Aug. 15, 2013)

Click here to view the opinion.

Fifth Circuit Holds That Vacatur of Class Certification Order Ceases Tolling of Statute of Repose

The U.S. Court of Appeals for the Fifth Circuit unanimously affirmed the dismissal of a proposed class action filed against Variable Annuity Life Insurance Company (VALIC) holding that the vacatur of class certification in an identical prior suit restarted the five-year statute of repose applicable to securities fraud actions.

In 2001, plaintiff James Drnek filed a class action complaint against VALIC alleging that it had committed securities fraud by misrepresenting the prospective tax benefits of its annuities (the *Drnek* action). The district court certified a nationwide class of purchasers of VALIC annuities. Following class certification, class counsel failed to comply with the district court's expert and fact witness disclosure schedule. Accordingly, in 2004, the district court vacated its prior order granting class certification, reasoning that without any expert or other witness testimony, the plaintiffs would be unable to prove a classwide measure of damages. In 2009, plaintiff John Hall filed an identical class action against VALIC reciting the same claims as Drnek (the *Hall* action). VALIC filed a motion to dismiss the *Hall* complaint, arguing that the statute of repose resumed running when the *Drnek* court vacated its class certification order; thus, because the *Hall* action was filed after the five-year statute of repose expired, the *Hall* claim had been extinguished. The district court agreed and granted the motion to dismiss, holding that the *Drnek* court's vacatur was the functional equivalent of a denial of class certification.

On appeal, the Fifth Circuit affirmed. The Fifth Circuit rejected Hall's argument that the statute of repose continued to be tolled because the *Drnek* court vacated certification without finding that the class should not have been certified and that the *Drnek* class' original motion for certification therefore remained pending. The Fifth Circuit held that although the vacatur of a certification order has the effect of nullifying that order, it does not necessarily reinstate the parties' preexisting procedural and temporal status. The Fifth Circuit noted the unfairness of holding that a vacatur of class certification implicitly reactivates a pending motion for certification because doing so would silently perpetuate tolling for putative class members, leaving VALIC indefinitely exposed to the stale claims of an uncertified class. The Fifth Circuit also agreed with the district court that the vacatur of class certification was the functional equivalent of a denial of certification because the *Drnek* court vacated certification, concluding that the plaintiffs could not prove a classwide measure of damages, a classic issue of common question predominance under Rule 23(b)(3). The court said that the plaintiffs whose class certification has been vacated have no reason to think that the ex-class representative would continue to protect their interests.

Smilovits v. First Solar, Inc., No. 12-00555 (D. Ariz. Oct. 8, 2013)

Click here to view the opinion.

District of Arizona Certifies Class in Shareholder Action Under Fraud-on-the-Market Theory

Judge David G. Campbell of the U.S. District Court for the District of Arizona certified a class of shareholders in a securities action that alleges First Solar, Inc. made misrepresentations to investors to inflate its stock price. In one of the first district court orders from within the Ninth Circuit to apply the Supreme Court's holding in *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, 133 S. Ct. 1184 (2013), the U.S. District Court for the District of Arizona rejected the argument that merely invoking the fraud-on-the-market theory causes common issues to predominate for purposes of class certification, regardless of whether the subject securities traded on an efficient market.

The crux of the court's analysis centered on the predominance inquiry of Rule 23(b)(3). To satisfy Rule 23(b)(3), the plaintiffs pleaded a fraud-on-the-market theory of reliance. This theory embodies the principle that "the market price of a security traded in an efficient market reflects all public information and therefore that a buyer of the security is presumed

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to have relied on the truthfulness of the information in purchasing the security." Fraud on the market generally entitles plaintiffs to a rebuttable presumption of reliance, and may obviate the need to prove individual reliance. Here, the plaintiffs posited that "[b]ecause fraud on the market (and therefore reliance) will either be proved or fail for the class as a whole, common issues necessarily will predominate." Thus, the plaintiffs argued, the court did not need to inquire as to the efficiency of the market for First Solar stock. While the court acknowledged the "logical force" of the plaintiffs' position, it rejected the entreaty. Instead, the court conducted its own market efficiency analysis. Nonetheless, the court ultimately concluded, under a preponderance of the evidence standard, that First Solar did trade in an efficient market, pointing to the fact that its stock was traded on the NASDAQ exchange, and that the five factors articulated in *Cammer v. Bloom*, 711 F. Supp. 1264 (D.N.J. 1989), slightly favored a finding of market efficiency.

Haw. Ironworkers Annuity Trust Fund v. Cole,
No. 10-cv-371
(N.D. Ohio Sept. 4, 2013)

Click here to view the opinion.

Class Certification Denied Where Reliance Not Established by Fraud-on-the-Market Presumption Because Information Not Disclosed to Public

Judge James G. Carr of the U.S. District Court for the Northern District of Ohio refused to certify a purported class action alleging that former officers of Dana Holding Corporation violated Section 10(b) of the Securities Exchange Act as part of a scheme to defraud the investing public by artificially inflating the value of securities via a massive accounting fraud. To establish classwide reliance, the fund sought to invoke the fraud-on-the-market presumption of reliance. And, as required to establish a fraud-on-the-market presumption of reliance, the fund maintained that the alleged misrepresentations were publicly known because the deceptive conduct at issue — the defendants' falsification of Dana's financial results — was communicated to the public through Dana's quarterly press releases and financial reports. While the court had previously found that the defendant's scheme was communicated to the investing public in ruling on the motion to dismiss, it reached a different conclusion at class certification, explaining that on a motion for class certification the court could no longer accept at face value the fund's claim that Dana's press release conveyed the defendants' deceptive conduct to the public. The court determined that, when subjected to the more rigorous analysis required at class certification, the deceptive conduct alleged in the complaint was not communicated to the public. Because the alleged accounting fabrications remained hidden from the public, the plaintiffs were unable to establish classwide reliance premised on the fraud-on-the-market theory. Accordingly, the court concluded that the class did not meet the predominance requirement of Rule 23 and denied certification.

DODD-FRANK ACT

Dennis v. Hart,
Nos. 12-55241, 12-55266,
12-55282, 12-55291
(9th Cir. July 31, 2013)

Click here to view the opinion.

Ninth Circuit Vacates District Court Orders, Citing Lack of Federal Jurisdiction

In four related shareholder derivative suits, the U.S. Court of Appeals for the Ninth Circuit held that the plaintiffs' state law claims regarding corporate action following shareholders' "say-on-pay" votes, conducted pursuant to the federal Dodd-Frank Wall Street Reform and Consumer Protection Act, did not establish federal question jurisdiction that would permit the defendants to remove the cases. The panel vacated the district court's orders, with instructions to remand the cases to state court.

The Dodd-Frank Act provides that, at least every three years, public companies must conduct a shareholder vote "to approve the compensation of executives." The defendants' federal question argument in support of removal was premised on the say-on-pay vote, which the board ignored, and which precipitated the suits, such that the complaints were "suffused with references to the vote." While the Ninth Circuit agreed with the defendants' factual premise, the panel held it insufficient to support federal jurisdiction. The causes of action, the panel pointed

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out, arose under state law, rather than federal. The Ninth Circuit further held that Section 27 of the Securities Exchange Act did not confer federal jurisdiction because the shareholders' suit did not seek to enforce any liability or duty created by the Securities Exchange Act. To the contrary, the defendant corporation did what the act requires: it held a vote. Any alleged mismanagement or breach of fiduciary duty involved state claims only. The Ninth Circuit therefore held that the removed claims must be remanded to state court.

DUTY TO DISCLOSE

Sec. & Exch. Comm'n v. EagleEye Asset Mgmt., LLC, No. 11-11576-WGY (D. Mass. Oct. 4, 2013)

Click here to view the opinion.

District of Massachusetts Issues Opinion Explaining Why Court Denied Summary Judgment on Claims That Investment Adviser Misappropriated Client Funds

Judge William G. Young of the U.S. District Court for the District of Massachusetts issued an opinion explaining why the court denied summary judgment on claims that an investment adviser violated Section 10(b) of the Securities Exchange Act and his fiduciary duties under the Investment Advisors Act by misappropriating client funds despite overwhelming evidence against the defendant. After a trial, the jury found that the defendant impermissibly transferred client funds into an options trading account and lost millions of dollars using a high-risk trading strategy. The court expressed the view that courts often overuse summary judgment, and by doing so encroach upon a jury's right to make the finding itself and the parties' constitutional rights to the same. Although evidence on summary judgment (including that the defendant altered documents with correction fluid to effect transfers of client funds) strongly indicated a fraudulent intent, the possibility remained that a jury could have disagreed (for example, by finding that the defendant was merely sloppy), and a trial was warranted. In addition, although whether an adviser owes a fiduciary duty to a client is a matter of law, the court explained that the scope of that duty is a matter for the jury. Moreover, he warned investment advisers that a jury will determine the scope of the duty by considering the standard of care applied by a reasonable adviser, which may or may not comport with common industry standards or practices. In fact, the jury determined in this case that the defendant violated his fiduciary duty by failing to disclose a prior history of options trading losses, despite evidence that he had been trained not to discuss past results, not discussing past results was industry practice and no SEC rule affirmatively requires advisers to disclose their track records.

FIDUCIARY DUTIES

Derivative Litigation

Ark. Teacher Ret. Sys. v. Countrywide Fin. Corp., No. 14, 2013 (Del. Sept. 10, 2013)

Click here to view the opinion.

Delaware Supreme Court Reaffirms Core Derivative Standing Principles

The Delaware Supreme Court issued an opinion addressing the continuous ownership requirement for stockholders in derivative lawsuits, derivative standing and the fraud exception to the continuous ownership requirement. The opinion — in which the Delaware Supreme Court ratified and reaffirmed the continuous ownership rule and the fraud exception recognized in *Lewis v. Anderson*, 477 A.2d 1040 (Del. 1984) — answers a question certified from the U.S. Court of Appeals for the Ninth Circuit to the Delaware Supreme Court in connection with an appeal of dismissed derivative claims filed against directors and officers following a merger.

In the opinion, the court explains that the "fraud" exception to the continuous ownership rule only applies in the "limited circumstances" where the "merger itself is being perpetrated merely to deprive shareholders of their standing to bring the derivative action." The court further explains that its *dicta* in an earlier opinion, *Arkansas Teacher Retirement Systems v. Caiafa*, 996 A.2d 321 (Del. 2010), which upheld the approval of a settlement of a related litigation, did not "change the scope of the fraud exception," or "'clarify,' 'expand,'

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or constitute 'a new material change' in *Lewis v. Anderson*'s continuous ownership rule or the fraud exception." Thus, answering the Ninth Circuit's certified question in the negative, the Delaware Supreme Court held that shareholder plaintiffs may not maintain a derivative suit after a merger that divests them of their ownership interest in the corporation on whose behalf they sue by alleging that the merger at issue was necessitated by, and is inseparable from, the alleged fraud that is the subject of their derivative claims.

Marvin H. Maurras Revocable Trust v. Bronfman, No. 1:12-cv-03395 (N.D. Ill. Sept. 24, 2013)

Click here to view the opinion.

Northern District of Illinois Nixes Derivative Suit Against Accretive Health

Judge Gary Feinerman of the U.S. District Court for the Northern District of Illinois dismissed without prejudice a consolidated shareholder derivative suit against Accretive Health, Inc., alleging that the company's board of directors (1) breached their duties of loyalty and good faith by causing or permitting the company to violate state and federal laws; (2) breached their fiduciary duty to maintain internal controls; (3) made untrue statements or omissions of material fact in violation of Section 10(b) of the Securities Exchange Act; and (4) breached Section 29(b) of the Securities Exchange Act. The complaint accused Accretive's board of directors of knowing about the company's violations of debt collection and health privacy laws, but deciding to forego costly compliance measures. The court dismissed the complaint because, although the plaintiffs "adequately alleged that Accretive broke the law," they did not adequately allege that a majority of the board had sufficient knowledge of the illegal actions and yet consciously refrained from taking steps to remedy the situation. For this reason, the plaintiffs failed to establish that making a demand on the board would have been futile. The court further held that the plaintiffs' allegations that the board members owned company stock were insufficient to render them "interested" in the context of demand futility. Finally, the court held that the plaintiffs failed to satisfy the pleading standards of the Private Securities Litigation Reform Act (PSLRA), because the more compelling inference was that most of the directors were not aware of Accretive's various legal violations, rather than that they acted with scienter.

Mergers and Acquisitions

In re BioClinica, Inc. S'holder Litig., No. 8272-VCG (Del. Ch. Oct. 16, 2013)

Click here to view the opinion.

Court of Chancery Dismisses Claims Arising Out of Acquisition of BioClinica

Vice Chancellor Sam Glasscock III of the Delaware Court of Chancery dismissed breach of fiduciary duty and aiding and abetting claims arising out of the acquisition of BioClinica, Inc. by JLL Partners, Inc., BioCore Holdings, Inc. and BC Acquisition Corp. The court explained that, in light of an exculpatory provision protecting directors from liability for breaches of the duty of care, and "because the Plaintiffs fail to adequate[ly] allege any director interest in the transaction, the Plaintiffs' remaining claims against the directors must be based on a breach of the duty of good faith to survive." The court rejected the stockholder plaintiffs' allegations that the BioClinica board acted in bad faith by "'inflating' the capital expenditure estimates provided by management and used in [its investment banker's] fairness opinion in order to knowingly depress the implied values in those valuations," explaining that "without a story of *why* the directors would artificially inflate the capital expenditures, there is no basis to conclude that they acted in bad faith ... ."

In re Sirius XM S'holder Litig., No. 7800-CS (Del. Ch. Sept. 27, 2013)

Click here to view the opinion.

Court of Chancery Applies Three-Year Statute of Limitations and Dismisses Breach of Fiduciary Duty Claims

Chancellor Leo E. Strine Jr. of the Delaware Court of Chancery applied Delaware's three-year statute of limitations and dismissed breach of fiduciary duty claims. The court explained that, when struggling financially in 2009, Sirius XM Radio, Inc. negotiated an investment agreement with Liberty Media that provided a needed capital infusion. The investment agreement included a standstill provision that, among other things, limited

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Liberty Media's ability to take majority control of Sirius for three years. Once the standstill period expired, however, the investment agreement specifically prevented the Sirius board from using a poison pill or any other charter or bylaw provision to interfere with Liberty Media's ability to purchase additional Sirius stock. When the standstill period expired on March 6, 2012, Liberty Media announced that it intended to acquire majority control of Sirius if it could obtain regulatory approval from the FCC and began purchasing additional stock on the open market. The plaintiffs sued, alleging that the Sirius board permitted Liberty Media Corporation to obtain control of Sirius without paying a control premium in breach of its fiduciary duties. The plaintiffs also alleged that Liberty Media had breached its fiduciary duties as a controlling stockholder by purchasing shares on the open market to acquire majority control of Sirius without paying a premium.

In dismissing the plaintiffs' claims, the court explained that they had filed their claims more than three years after the investment agreement was signed and publicly disclosed. The court further explained that Liberty Media's open market purchases that increased its level of ownership to more than 50 percent did not "support a claim for breach of fiduciary duty because those purchases did not involve any use of fiduciary power by Liberty Media at all."

Se. Pa. Transp. Auth. v. Volgenau, No. 6354-VCN (Del. Ch. Aug. 5, 2013)

Click here to view the opinion.

Court of Chancery Grants Defendants' Motion for Summary Judgment, Applying Business Judgment Rule to Leveraged Buyout

Vice Chancellor John W. Noble of the Delaware Court of Chancery granted the defendants' motion for summary judgment and applied the business judgment rule to a leveraged buyout involving a controlling stockholder and a third party. In the transaction, the controlling stockholder was able to roll over a portion of his equity while minority stockholders were cashed out. A plaintiff stockholder brought a class action suit alleging that the directors, and the controlling stockholder, breached their fiduciary duties in approving the sale of the corporation to a private equity firm.

The court distinguished its decision in *In re MFW Shareholders Litigation*, 67 A.3d 496 (Del. Ch. 2013), which applied the business judgment rule to a going-private transaction initiated by a controlling stockholder, because "[u]nlike *MFW*, which involved a controlling stockholder on both sides of the transaction, this case involves a merger between a third-party and a company with a controlling stockholder." Relying on *In re John Q. Hammons Hotels Inc. Shareholder Litigation*, No. 758-CC (Del. Ch. Oct. 2, 2009), the court held that such a third-party transaction involving a controlling stockholder will be reviewed under the business judgment rule where "(1) the transaction [is] recommended by a disinterested and independent special committee, (2) which has 'sufficient authority and opportunity to bargain on behalf of minority stockholders,' including the 'ability to hire independent legal and financial advisors[;]' (3) the transaction [is] approved by stockholders in a non-waivable majority of the minority vote; and (4) the stockholders [are] fully informed and free of any coercion.

FOREIGN CORPORATIONS

Stream SICAV v. Wang, No. 12 Civ. 6682 (PAE) (S.D.N.Y. Oct. 7, 2013)

Click here to view the opinion.

SDNY Authorizes Service of an International Employee By Serving the Registered Agent of His Former US Employer

In a securities fraud action, Judge Paul A. Engelmayer of the U.S. District Court for the Southern District of New York authorized service on an international employee by serving the registered agent of his former U.S. employer. The employee was the founder and CEO of SmartHeat, a Nevada corporation, but moved to China and became the CEO of one of the company's Chinese subsidiaries. Service on a high-level employee's corporate employer is reasonably calculated to apprise the employee of the pending action and therefore satisfied due process requirements. Although the employee worked for the employer's subsidiary, the

(continued on next page)

court determined that he remained involved in the business of the parent and all subsidiaries, and that it was "all but inconceivable" that the company would not inform the employee of the lawsuit. In addition, the substitute service was not prohibited by the Hague Convention or other international treaty or agreement. Further, a court may order service by a method other than the Hague Convention where appropriate, and doing so in this case was justified by the complicated procedure for achieving service in China under the Hague Convention and the undue delay that would result.

LOSS CAUSATION

Nuveen Mun. High Income Opportunity Fund v. City of Alameda, Cal., No. 11-17391 (9th Cir. Sept. 19, 2013)

Click here to view the opinion.

Ninth Circuit Affirms Summary Judgment in Favor Of Bond-Issuing Municipality for Lack of Loss Causation

The U.S. Court of Appeals for the Ninth Circuit affirmed the district court's grant of summary judgment in favor of the city of Alameda in a securities fraud action brought by purchasers of municipal bonds. Plaintiff Nuveen bought over $20 million worth of bonds, which were used to finance the development of a cable and Internet system. When the system performed poorly, the city was forced to sell the telecom at a substantial loss. Nuveen lost almost half of its investment. Nuveen subsequently brought federal and state securities claims, alleging the city made material misrepresentations regarding the system's projections and anticipated performance, and that those misrepresentations induced Nuveen to purchase the notes.

In affirming the district court's summary judgment decision, the Ninth Circuit held that there was no triable issue as to loss causation. Even accepting that Alameda misrepresented the risks and projections associated with the system, Nuveen failed to "demonstrate a causal connection between the alleged misrepresented risks in the Official Statement and the economic loss Nuveen suffered." Nuveen argued that the court should apply a different loss causation standard where, as here, the market for the notes was inefficient. In such a case, Nuveen contended, the loss causation element is satisfied if the notes "could never have been sold *but for* the City's fraud." While the panel appeared to concede that the market for the notes was inefficient because the notes were traded only sporadically, it declined Nuveen's invitation to employ this "novel" loss causation standard. To use Nuveen's "but for" standard, the Ninth Circuit explained, "collapses transaction causation with loss causation."

The panel further held that the city had immunity under California statute from Nuveen's state law claims, affirming the district court in that regard as well. Finally, the Ninth Circuit denied the city's cross-appeal for defense costs, holding that Nuveen had reasonable cause to maintain its claims.

In re Moody's Corp. Sec. Litig., No. 07 Civ. 08375 (GBD) (S.D.N.Y. Aug. 23, 2013)

Click here to view the opinion.

SDNY Claims That Rating Agency Misrepresented the Independence and Objectivity of Ratings Model Used to Analyze Residential Mortgage-Backed Securities

Judge George B. Daniels of the U.S. District Court for the Southern District of New York dismissed claims that a rating agency violated Section 10(b) of the Securities Exchange Act by misrepresenting the independence and objectivity of its ratings model used to analyze residential mortgage-backed securities. Although the plaintiffs adequately alleged that the agency's representations regarding its independence could have been material to a reasonable investor, the plaintiffs failed to show that the alleged misrepresentations had an inflationary effect on the agency's stock price. Because the fraud-on-the-market presumption of reliance applies only where a material misstatement causes artificial inflation of the market price, the plaintiffs were not entitled to the presumption. Moreover, the plaintiffs did not attempt to show reliance on the agency's statements on an individualized basis and, thus, failed to satisfy the reliance element. Further, the plaintiffs failed to adequately prove that the subsequent decline in the agency's stock price was caused by corrective disclosures related to the agency's allegedly

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fraudulent mortgage-backed securities ratings rather than market forces and other factors unrelated to fraud. The plaintiffs' expert report authored by Chad Coffman failed to sufficiently disaggregate the effect of general market forces and provided no factual support for assumptions that the stock price decline was related to three factors related to the alleged fraud.

MISREPRESENTATIONS

In re ProShares Trust Sec. Litig.,
No. 12-3981
(2d. Cir. July 22, 2013)

Click here to view the opinion.

Second Circuit Affirms Dismissal of Claims That Company Misrepresented the Risk Of Loss in ETFs Designed to Replicate or Provide the Inverse Result of Stock Indices

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims that a company offering exchange-traded funds (ETFs) violated Sections 11 and 15 of the Securities Act by misrepresenting the risk of loss in ETFs designed to either replicate or provide the inverse result of certain stock indices. The investors alleged that the value of the ETFs diverged significantly from the ETFs' underlying index over long periods, which could result in losses even if the investor correctly predicted the movement of the underlying index. The Second Circuit, however, held that this risk was adequately disclosed in both the registration statement and the prospectus, and that the ETFs were not designed to be held as long-term investments. The company also adequately disclosed the risk that market volatility may distort the ETFs' performance, and the company was not required to specifically disclose all possible negative results across any market scenario. In addition, the company's illustration of the ETF's costs over a 10-year period was intended only for comparison with other funds and would not have led a reasonable investor to conclude that the ETFs should be held as long-term investments, and other performance projection illustrations were not misleading in light of the adequate risk disclosures in the registration statement and prospectus.

PONZI SCHEMES

United States v. McKye,
No. 12-6108
(10th Cir. Aug. 20, 2013)

Click here to view the opinion.

Tenth Circuit Reverses Criminal Conviction of Alleged Ponzi Schemer Because of Improper Jury Instruction

The U.S. Court of Appeals for the Tenth Circuit reversed the criminal conviction of an alleged Ponzi schemer because one jury instruction given during the trial was improper. The district judge instructed the jury that the definition of a "security" under federal law "includes a note," but the Tenth Circuit agreed with the defendant that not all notes are securities and whether the notes at issue were securities was a question of fact for the jury. The instruction improperly swayed the jury's determination because it implied that the notes at issue were securities, even though the instruction did not say so conclusively. In addition, the government failed to show that the error was harmless because the issue was contested by the parties at trial and the defendant presented evidence supporting a finding that the notes were not securities.

PSLRA

Kaplan v. S.A.C. Capital Advisors L.P.,
No. 12 Civ. 9350 (VM)
(S.D.N.Y. Oct. 22, 2013)

Click here to view the opinion.

SDNY Approves Appointment of Lead Plaintiff in Class Action Even Though Firm Had Served as a Lead Plaintiff in Five Securities Class Actions in Three Years

Judge Victor Marrero of the U.S. District Court for the Southern District of New York approved the appointment of a lead plaintiff in a securities class action even though the firm had served as lead plaintiff in five securities class actions within the past three years and potentially had only a small financial stake in the litigation. The court determined that the PSLRA's limitation on a person serving as lead plaintiff in more than five actions within a three-year period was focused on

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individuals and did not apply to institutional investors like the purported lead plaintiff. In addition, the court declined to determine whether some of the plaintiff's claims were time-barred, which would leave it with a small financial stake in the litigation, because a determination on that issue would not be dispositive. Even if the plaintiff's financial interest was smaller than it alleged, that would not bar it from serving as lead plaintiff because there were no competing applicants.

SCIENTER

Rahman v. Kid Brands, Inc., No. 12-4257 (3d Cir. Nov. 15, 2013)

Click here to view the opinion.

Third Circuit Court of Appeals Affirms Dismissal of Exchange Act Claims Against Kid Brands, Inc. and Its Officers

The U.S. Court of Appeals for the Third Circuit affirmed the dismissal of a putative class action accusing Kid Brands, Inc. and certain of its officers of violating Sections 10(b) and 20(a) of the Securities Exchange Act. The complaint alleged that Kid Brands misled investors and artificially inflated the Kid Brands stock price by issuing deceptive financial reports and press releases relating to the company's compliance with customs laws. The purported issues with customs law compliance occurred at a company's subsidiary.

The Third Circuit concurred that the plaintiff failed to adequately allege scienter against either the individual defendants or the company. As to the individual defendants, the panel agreed with the district court's decision to discount the allegations of the plaintiff's confidential witnesses. The panel explained that those allegations failed to provide any particularized facts that could support a strong inference of scienter. Further, the complaint failed to plead facts that demonstrated any of the individual defendants had a motive to engage in wrongful conduct.

As to the company, the Third Circuit acknowledged the "corporate scienter" doctrine to which some circuits adhere. While the Third Circuit has neither accepted nor rejected that doctrine, and the panel here declined to endorse it, the court nonetheless noted that, "even if we recognize the doctrine of corporate scienter, this case would not come within the doctrine" because "there is no credible evidence to suggest that Kid Brands covered up the customs violations at its subsidiaries." The panel also dispatched with the plaintiff's scienter argument based on the "core operations doctrine," reasoning that "in spite of customs violations at three of the four Kid Brands subsidiaries, the $10 million in anticipated liabilities covering wrongful conduct over a nearly five-year span cannot be regarded as affecting the 'core operations' of a company that had hundreds of millions of dollars in annual net sales."

Ross v. Lloyds Banking Grp., PLC, No. 12-4600-cv(L) (2d Cir. Sept. 19, 2013)

Click here to view the opinion.

Second Circuit Affirms Dismissal of Claims That a Bank Misrepresented the Financial Condition of a Target Bank

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims that a bank violated Section 10(b) of the Securities Exchange Act by allegedly misrepresenting the financial condition of a target bank. The plaintiff failed to adequately allege scienter because the bank had no cognizable economic interest in consummating a deal that it knew at the time would be detrimental, and allegations that executives hoped to create a "superbank" were too generalized to demonstrate bad faith intent. Further, statements made during an earnings call regarding certain "highly liquid near cash" assets that the target would contribute were not false because those descriptions referred only to the portion of the assets that consisted of government debt, and the plaintiff failed to sufficiently allege that the bank knew, at the time the statements were made, that the assets included certain residential mortgages and personal and commercial loans that should not have been characterized as "liquid" or "near cash." In addition, the target's ultimate decision not to participate in a government liquidity program did not create an inference that the target's prior statements that it had assets of sufficient quality to submit to the assistance program were false when made. A subsequent report by a British governmental agency indicating that a number of the target's

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assets did not qualify for the assistance program also did not demonstrate the statements' falsity because the report's scope was specifically limited to a single division of the target. Finally, subsequent downward adjustments to the target's assets did not demonstrate that the acquiring bank did not believe its estimates, where the acquiring bank disclosed that the target's assets might require significant downward revisions.

Ricker v. Zoo Entm't, Inc., No. 12-3951 (6th Cir. Aug. 27, 2013)

Click here to view the opinion.

Sixth Circuit Affirms Dismissal of Action Against Zoo Entertainment

The U.S. Court of Appeals for the Sixth Circuit affirmed the dismissal of a complaint accusing Zoo Entertainment, Inc. of violating Sections 10(b) and 20(a) of the Securities Exchange Act by publishing material financial statements with reckless disregard to their falsity. The court affirmed the dismissal because the plaintiff's allegations did not support a strong inference that Zoo acted with scienter, as required by the Private Securities Litigation Reform Act (PSLRA). In support of scienter, the plaintiff pointed to revenue recognition problems caused by late payments from one of Zoo's largest customers, litigation with another client offered to corroborate these alleged revenue recognition problems, weak internal controls due to the lack of adequate finance staff, the magnitude of the restatement and the departure of Zoo executives. In affirming the dismissal, the Sixth Circuit reasoned that the inference that Zoo recklessly disregarded internal revenue recognition problems was not as strong as at least one opposing inference: Zoo, a small company with acknowledged deficiencies in its accounting department, miscalculated revenue that precipitated litigation as well as the restatement of the financials and the departure of executives from Zoo.

SEC ENFORCEMENT ACTIONS

Sec. & Exch. Comm'n v. Thompson, No. 11-4182 (10th Cir. Oct. 4, 2013)

Click here to view the opinion.

Tenth Circuit Affirms Determination That Unsecured Promissory Notes, the Proceeds of Which Were Unknowingly Invested in a Ponzi Scheme, Constituted Securities

The U.S. Court of Appeals for the Tenth Circuit affirmed summary judgment determining that certain unsecured promissory notes, the proceeds of which were unknowingly invested in a Ponzi scheme, constituted securities under the Securities Exchange Act and the Securities Act. The court held that whether a financial instrument meets the definition of a security is a question of law and not for a jury. The notes promised to return the principal amount plus interest of between 3 and 5 percent after six months, but provided that the borrower could opt for a six-month extension to the note so long as the borrower made timely interest payments. The court applied the "family resemblance" test adopted by the U.S. Supreme Court in *Reves v. Ernst & Young*, 494 U.S. 56 (1990). The defendant failed to raise a genuine issue of fact as to whether the notes were issued to raise funds for investment purposes, rather than for other commercial or consumer purposes, which weighed in favor of finding that the notes were securities. In addition, evidence that the defendant offered the notes to any person interested, the investing public's reasonable expectation that the notes were for investment purposes, and the lack of any alternative regulatory scheme or other risk-reducing factor all weighed in favor of finding that the notes were securities.

Sec. & Exch. Comm'n v. CMKM Diamonds, Inc., Nos. 11-17021, 11-17025 (9th Cir. Sept. 10, 2013)

Click here to view the opinion.

Ninth Circuit Reverses Grant of Summary Judgment Against Defendant Transfer Agent in Alleged Scheme to Sell Unregistered Securities

The U.S. Court of Appeals for the Ninth Circuit reversed, in part, a district court's grant of summary judgment in favor of the SEC in a civil enforcement action against defendants allegedly involved in a scheme to sell unregistered securities in violation of Section 5 of the Securities Act.

The SEC alleged that defendants 1st Global Stock Transfer, LLC, a transfer agent, and its owner, Helen Bagley, participated in a scheme to sell billions of shares of unregistered stock in CMKM Diamonds, Inc. Applying the "necessary participant and substantial factor" test, the

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district court granted summary judgment in favor of the SEC, holding that Global and Bagley had played more than a de minimis role in the scheme, and that, but for their participation, there would not have been a sale of unregistered securities. As such, Global and Bagley were each a necessary participant and a substantial factor in the distribution of unregistered securities, according to the district court.

In reversing the district court's judgment as to Global and Bagley, the Ninth Circuit explained that the necessary participant and substantial factor test requires more than "but for" causation; a defendant's role in the transaction must be "significant." In addition, the test must be applied on a case-by-case basis, and cannot be applied categorically to transfer agents merely because their role is "central to the distribution" of securities: "A participant's title, standing alone, cannot determine liability under Section 5 ... ." Here, because Global and Bagley relied on multiple legal opinions before issuing the shares, it could not be said as a matter of law that they were substantial participants in the scheme. The Ninth Circuit remanded the case for further proceedings.

SECURITIES ACT CLAIMS

Pension Trust Fund for Operating Eng'rs. v. Mortg. Asset Securitization Transactions, Inc., No. 12-3454 (3d Cir. Sept. 17, 2013)

Click here to view the opinion.

Third Circuit Affirms Dismissal of Securities Act Claims Despite District Court Applying Incorrect Pleading Requirements and Timeliness Standard

The U.S. Court of Appeals for the Third Circuit held that a Securities Act plaintiff does not need to affirmatively plead compliance with the one-year statute of limitations set forth in Section 13 of the act. In addition, the Third Circuit held that Section 13 establishes a discovery standard, as opposed to an inquiry notice standard, for evaluating the timeliness of Securities Act claims. Here, however, because the plaintiffs' claims, which concerned misrepresentations related to mortgage-backed securities, were untimely even under the more lenient discovery standard, the panel affirmed the district court's dismissal of the action.

In holding that a Securities Act plaintiff need not affirmatively plead compliance with the statute of limitations, the Third Circuit explained that requiring such a pleading would have the effect of "shifting the burden to the plaintiff to negate the applicability of the affirmative defense." The panel recognized an existing circuit split on the issue, noting that the First, Eighth and Tenth Circuits require a plaintiff to plead compliance with the statute of limitations. The Third Circuit joins the Seventh, Ninth and Eleventh Circuits in dispensing with the compliance pleading requirement.

On the notice issue, the panel explained the difference between the inquiry notice and discovery standards. Under inquiry notice, the statute of limitations begins to run once a plaintiff "had sufficient information of possible wrongdoing to place them on 'inquiry notice' or to excite 'storm warnings' of culpable activity." In contrast, under the discovery standard, a claim accrues "(1) when the plaintiff did in fact discover, or (2) when a reasonably diligent plaintiff would have discovered, 'the facts constituting the violation' — whichever comes first." Thus, the difference between the standards comes down to, on the one hand, when a diligent plaintiff would have begun investigating wrongdoing versus, on the other hand, when a diligent plaintiff "would have sufficient information about that fact to adequately plead it in a complaint." The Third Circuit based its decision on its reading of the recent Supreme Court case *Merck & Co., Inc. v. Reynolds*, 559 U.S. 633 (2010).

Salameh v. Tarsadia Hotel, No. 11-55479 (9th Cir. Aug. 13, 2013)

Click here to view the opinion.

Ninth Circuit Affirms Dismissal of Securities Action for Failure to Allege Sale of a Security

In this securities action based on federal and California law, the U.S. Court of Appeals for the Ninth Circuit affirmed the dismissal of a putative class action, holding that the plaintiffs' claims based on their purchase of condominiums in the Hard Rock Hotel San Diego failed to allege the sale of a "security."

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The plaintiffs each bought a condo in the hotel, a 12-story, mixed-use development with commercial space and 420 condominium units. They alleged that the purchase contract to buy the condo unit obligated them to enter into a rental management agreement with the hotel operator and that, taken together, those two contracts constituted the sale of a security. The Ninth Circuit rejected that argument. The panel acknowledged that the term "security" includes any "investment contract," even "[n]ovel, uncommon or irregular devices." The court further explained that a rental agreement signed in conjunction with a purchase contract can be considered a security where the rental agreement induced the purchase and promised investment-like profits. Here, however, the plaintiffs failed to allege that the purchase contract and rental management agreement were offered as a package, nor was there any allegation that the rental management agreement "would result in investment-like profits."

In re OSG Sec. Litig., No. 12 Civ. 7948 (SAS) (S.D.N.Y. Sept. 10, 2013)

Click here to view the opinion.

SDNY Upholds in Part and Dismisses in Part Claims That Executives of A Shipping Company Allegedly Misreported the Company's Tax Liabilities

Judge Shira A. Scheindlin of the U.S. District Court for the Southern District of New York upheld in part and dismissed in part claims that executives of a shipping company violated Sections 11 and 12(a)(2) of the Securities Act and Section 10(b) of the Securities Exchange Act by allegedly misreporting the company's tax liabilities. At the end of 2012, the company released a statement disclaiming the past three years of financial statements and entered bankruptcy, and the IRS filed a claim for more than $35 million of unpaid taxes. The court upheld claims under Section 11 because the defendant-executives assisted in preparing a prospectus for a public stock offering that contained misstatements and participated in marketing efforts for that offering, and the offering resulted in financial gain to the company, even though the executives did not receive any personal compensation linked to the offering. Further, the plaintiffs' claims under Sections 11 and 12 were not based on allegations "classically associated with fraud," but rather only on misstatements in the registration statement and prospectus, and so the plaintiffs were not required to meet a heightened pleading standard. However, the plaintiffs failed to adequately allege fraudulent intent necessary to support a claim under Section 10(b). An executives' interest in helping a company to acquire capital is not, as a matter of law, a motive to commit fraud. Other circumstantial evidence was also insufficient to support an inference of fraud. An executives' general understanding of tax provisions did not necessarily indicate knowledge of particular tax misstatements and the "core operations doctrine" did not apply to impute knowledge to the executives because the company's business was shipping, not tax policy, even though tax treatment was important to the company's profit margin. Further, an executive's resignation just prior to the company's bankruptcy was not indicative of the executive's knowledge at the time the tax misstatements were made, and the size and duration of the company's tax error were also insufficient to support an inference of fraud.

SECURITIES FRAUD PLEADING STANDARDS

In re Barclays Bank PLC Sec., No. 11-2665-cv (2d Cir. Aug. 19, 2013)

Click here to view the opinion.

Second Circuit Affirms and Reverses Dismissal of Claims That International Bank Concealed the Magnitude of Its Losses in Mortgage-Backed Securities

The U.S. Court of Appeals for the Second Circuit affirmed in part and reversed in part the dismissal of claims that an international bank violated Sections 11 and 12(a)(2) of the Securities Act by concealing the magnitude of its losses in mortgage-backed securities prior to four public stock offerings. The plaintiffs' claims relating to three of the four offerings were time-barred by the one-year statute of limitations because the plaintiffs could have reasonably discovered the alleged violations through corrective disclosures issued by the bank more than one year prior to the action. However, claims relating to the fourth offering were not time-barred, and the district court erred in ruling that the plaintiffs' allegations were insufficient and also denying leave

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to amend. Allegations that the bank failed to adequately disclose its expected losses due to mortgage-backed securities were plausible because the bank took no write-downs prior to the relevant offerings, took its first write-down shortly after the final offering and shortly thereafter sold a third of its assets. Although the plaintiffs' initial complaint failed to allege that the bank did not believe its own valuation of the mortgage-backed securities holdings at the time of the alleged misstatements, the plaintiffs proposed an amended complaint containing those allegations, which the district court incorrectly rejected as being futile.

Coyne v. Metabolix, Inc.,
No. 12-10318-DPW
(D. Mass. Sept. 20, 2013)

Click here to view the opinion.

District of Massachusetts Dismisses Claims That a Manufacturer Allegedly Misrepresented Its Ability to Meet Milestones in the Development of a New Product

Judge Douglas P. Woodlock of the U.S. District Court for the District of Massachusetts dismissed claims that a manufacturer of biopolymer plastics violated Section 10(b) of the Securities Exchange Act by allegedly misrepresenting the company's ability to meet certain milestones in the development of a new product as part of a joint venture with technology contributed by Metabolix and funding contributed by Archer Daniel Midland Company. The company's performance predictions were forward-looking and contained meaningful cautionary language and, thus, were protected by the PSLRA's safe-harbor, even though each necessarily reflected the company's present ability to meet its goals. Further, the plaintiff did not sufficiently allege that the company knew its predictions were false when made, or that the predictions were, in fact, false. In addition, statements discussing demand for the company's product and product delays were neither false nor misleading, and the company was not required to cast descriptions of its business in the most negative light possible. Although statements regarding discrepancies in the quality of the company's product between two factories were materially misleading, the court determined that the plaintiff failed to allege any facts specific enough for the court to infer fraudulent intent. The plaintiff also failed to sufficiently allege that the decrease in the company's stock price after the company announced it was ceasing development of the product was, in fact, connected to statements the court determined were false or misleading.

City of Taylor Gen. Emps. Ret. Sys. v. Magna Int'l Inc.,
No. 12 Civ. 3553 (NRB)
(S.D.N.Y. Aug. 23, 2013)

Click here to view the opinion.

SDNY Dismisses Claims That a Manufacturer Downplayed Problems Faced by Its European Operations

Judge Naomi R. Buchwald of the U.S. District Court for the Southern District of New York dismissed claims that an equipment manufacturer violated Section 10(b) of the Securities Exchange Act by downplaying problems faced by its European operations. Stating that the complaint's allegations "border[ed] on the absurd" and were "fanciful on its face," the court ruled that the plaintiffs failed to adequately allege any statement that was false when made. Although some statements by company executives arguably expressed optimism as to the worsening condition of the company's European operations, other disclosures fairly warned investors of those risks, and federal securities laws do not require pessimism or highly granular disclosures. In addition, the plaintiffs failed to adequately plead scienter. Stock sales by company insiders during the class period were not suspicious or unusual because the sales were explained by an executive's retirement from the company in one case and by the natural expiration of stock options in the other. Further, company executives were not reckless because the plaintiffs failed to allege any facts or circumstances disregarded by the executives when making the allegedly misleading public statements.

STANDING

In re Bernard L. Madoff Inv. Sec. LLC,
Nos. 11-5044, 11-5051, 11-5175, 11-5207
(2d Cir. June 20, 2013)

Click here to view the opinion.

Second Circuit Dismisses Claims by the Trustee of The Liquidation of Bernard L. Madoff Investment Securities

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims brought by the trustee in the liquidation of Bernard L. Madoff Investment Securities (BLMS) alleging that several financial institutions committed fraud by directing investments to Bernie Madoff despite certain alleged warning signs. The trustee's claim for contribution was properly dismissed because the financial institutions' obligation arose from a federal law that did not provide a right to contribution. In addition, the trustee lacked standing to assert claims on behalf of investors who lost money in the Madoff fraud because federal bankruptcy law permits a trustee to recover from third parties only on behalf of the estate itself — not the estate's creditors. Further, the Securities Investors Protection Act, which applies to the liquidation of a failed brokerage firm, does not grant a trustee standing to assert claims on behalf of investors because that law generally grants the same powers to trustees as provided by federal bankruptcy law. Moreover, the trustee was not a "bailee" and did not owe customers a duty to recover and return money entrusted with BLMS because those funds were received by fraud — not as a bailment — and any potential bailment was destroyed when BLMS held the investors' money in a comingled account.

STATUTES OF LIMITATIONS

Matana v. Merkin,
No. 13 Civ. 1534 (PAE)
(S.D.N.Y. July 30, 2013)

Click here to view the opinion.

SDNY Dismisses Claims That 'Fund of Funds' Misrepresented Its Investment Strategy and Failed to Recognize Warning Signs of Madoff's Fraud

Judge Paul A. Engelmayer of the U.S. District Court for the Southern District of New York dismissed claims that a "fund-of-funds" investing substantially all of its assets with Bernard L. Madoff Investment Securities misrepresented its investment strategy and failed to recognize the warning signs of Madoff's fraud. Claims that the defendants' offering materials included misrepresentations about the fund's strategy were untimely under the applicable six-year statute of limitations because the claims accrued on the dates the plaintiff invested in the funds (which was more than six years ago). Further, the time to bring suit was not tolled, under *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974), by the filling of a putative class action involving related funds because that suit did not include the named defendant in this action. Claims based on alleged misrepresentations in the defendant's quarterly letters to investors, however, were timely but did not adequately allege that any statements were false and misleading. In addition, the New York attorney general's suit against the defendants under the Martin Act did not toll the statute of limitations because actions under the Martin Act are not intended to replace private litigation. Further, the alleged misrepresentations in marketing letters sent by the defendants after the plaintiff-investor's initial investment were immaterial and could not reasonably have been relied upon. Leave to amend was granted as to the plaintiff's fraud claims that were timely (but insufficiently alleged) and as to the plaintiff's implied contractual duty claim because the plaintiff may be able to identify (but failed to do so previously) contracts giving rise to such a duty.

STATUTES OF REPOSE

In re Countrywide Fin. Corp. Mortg.-Backed Sec. Litig., Nos. 2:11-ML-02265-MRP (MANx), 2:12-CV-08558-MRP (MANx) (C.D. Cal. Aug. 26, 2013)

Click here to view the opinion.

Central District of California Dismisses Securities Action, Finding All Claims Untimely

Judge Mariana R. Pfaelzer of the U.S. District Court for the Central District of California dismissed with prejudice all claims, state and federal, in this securities action based on the sale of mortgage-backed securities. The court found the federal claims, brought under Sections 11 and 12(a)(2) of the Securities Act, time-barred because they did not satisfy the three-year statute of repose in Section 13 of the act. As for the state claims, the plaintiff asserted causes of action under the Texas Securities Act (TSA), which contains a five-year statute of repose. The sale of the securities at issue, however, occurred more than five years before the suit was filed. Thus, it appeared those claims would be similarly time-barred. In order to escape dismissal, the plaintiff argued that the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), a federal statute, extended the Texas statute of repose by at least three years. Under FIRREA, where, as here, an action is brought by a receiver, any statute of limitations, even under a state law, is extended by three years. The plaintiff contended that this "extender provision" also applies to statutes of repose.

The district court disagreed, explaining that while statutes of limitation are procedural in nature, statutes of repose actually provide a substantive right to the potential defendant. Thus, the FIRREA extender provision could only alter the substantive rights under the TSA if FIRREA preempts the TSA. The court then performed a comprehensive preemption analysis. First, the court ruled there was no express preemption because the court found no "clear and manifest" evidence to overcome the presumption that Congress does not intend to preempt areas of traditional state regulation. Second, there was no field preemption because "FIRREA's extender provision clearly leaves room for the operation of state law." Finally, the court considered conflict preemption. In holding that FIRREA did not preempt the TSA under conflict preemption, the court reasoned that the Texas statute of repose did not stand "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress ... ." While acknowledging that there was "a degree of tension between the TSA and FIRREA," there was not "the kind of sharp conflict needed to preempt state law." Therefore, the TSA's statute of repose remained unaltered, and the plaintiff's claims were untimely.

ATTORNEY CONTACTS

Editors

Matthew J. Matule
617.573.4887
matthew.matule@skadden.com
Boston

Amy Park
650.470.4511
amy.park@skadden.com
Palo Alto

Edward B. Micheletti
302.651.3220
edward.micheletti@skadden.com
Wilmington

Charles F. Smith
312.407.0516
charles.smith@skadden.com
Chicago

Peter B. Morrison
213.687.5304
peter.morrison@skadden.com
Los Angeles

New York

John K. Carroll
212.735.2280
john.carroll@skadden.com

Jonathan L. Frank
212.735.3386
jonathan.frank@skadden.com

William P. Frank
212.735.2400
william.frank@skadden.com

Robert A. Fumerton
212.735.3902
robert.fumerton@skadden.com

Jay B. Kasner
212.735.2628
jay.kasner@skadden.com

Jonathan J. Lerner
212.735.2550
jonathan.lerner@skadden.com

Scott D. Musoff
212.735.7852
scott.musoff@skadden.com

Joseph N. Sacca
212.735.2358
joseph.sacca@skadden.com

Susan L. Saltzstein
212.735.4132
susan.saltzstein@skadden.com

Seth M. Schwartz
212.735.2710
seth.schwartz@skadden.com

Robert E. Zimet
212.735.2520
robert.zimet@skadden.com

George A. Zimmerman
212.735.2047
george.zimmerman@skadden.com

Boston

James R. Carroll
617.573.4801
james.carroll@skadden.com

David S. Clancy
617.573.4889
david.clancy@skadden.com

Thomas J. Dougherty
617.573.4820
dougherty@skadden.com

Matthew J. Matule
617.573.4887
matthew.matule@skadden.com

Chicago

Matthew R. Kipp
312.407.0728
matthew.kipp@skadden.com

Michael Y. Scudder
312.407.0877
michael.scudder@skadden.com

Charles F. Smith
312.407.0516
charles.smith@skadden.com

Houston

Noelle M. Reed
713.655.5122
noelle.reed@skadden.com

Charles W. Schwartz
713.655.5160
charles.schwartz@skadden.com

Los Angeles

Peter B. Morrison
213.687.5304
peter.morrison@skadden.com

Eric S. Waxman
213.687.5251
eric.waxman@skadden.com

Palo Alto

Timothy A. Miller
650.470.4620
timothy.miller@skadden.com

Amy Park
650.470.4511
amy.park@skadden.com

Washington, D.C.

Charles F. Walker
202.371.7862
charles.walker@skadden.com

Jennifer L. Spaziano
202.371.7872
jen.spaziano@skadden.com

Wilmington

Thomas J. Allingham II
302.651.3070
thomas.allingham@skadden.com

Paul J. Lockwood
302.651.3210
paul.lockwood@skadden.com

Edward B. Micheletti
302.651.3220
edward.micheletti@skadden.com

Robert S. Saunders
302.651.3170
rob.saunders@skadden.com

Karen L. Valihura
302.651.3140
karen.valihura@skadden.com

Jennifer C. Voss
302.651.3230
jennifer.voss@skadden.com

Edward P. Welch
302.651.3060
edward.welch@skadden.com