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Inside the Courts
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Appraisal

Delaware Court of Chancery Dismisses Appraisal Action for Failure to Satisfy Continuous Ownership Rule

In re Appraisal of Dell Inc., Consol. C.A. No. 9322-VCL (Del. Ch. July 13, 2015)
Click here to view the opinion.

Vice Chancellor J. Travis Laster of the Delaware Court of Chancery dismissed an appraisal action on a motion for summary judgment where the plaintiff stockholders failed to satisfy the continuous record holder requirement imposed by 8 Del. C. § 262.

Delaware's appraisal statute provides appraisal rights only for stockholders who "hold[] shares of stock on the date of the making of a demand [for appraisal] … who continuously hold[] such shares through the effective date of the merger or consolidation …" Moreover, under the statute, "stockholder" is defined as "a holder of record of stock in a corporation."

The plaintiffs in this action were beneficial owners of Dell stock from the date of their appraisal petition through the effective date of the merger. Cede & Co. was the record holder of the plaintiffs' shares until they petitioned for appraisal, at which time the Depository Trust Company transferred the plaintiffs' physical stock certificates to the plaintiffs' custodial banks and retitled those shares from Cede's to the banks' names pursuant to bank procedures.

The court granted the defendant company's motion for summary judgment and dismissed the appraisal action, finding that Cede, as the record holder of Dell stock at the time the appraisal petition was submitted, did not continuously hold stock through the effective date of the merger, but rather transferred title to the banks before the merger was consummated. Although the plaintiffs argued that "they did not know about or approve" the bank transfers, the court explained that "[o]ur law currently treats ownership changes driven by the depository system as voluntary transfers, making this a risk that the [plaintiffs] accepted." The court expressed some sympathy with the plaintiffs' plight, however, and indicated he personally might have considered a different conclusion, "[but] that is not how our cases have interpreted the [appraisal statute], and this court is bound by those precedents."

Class Certification

EDNY Conditionally Certifies Class of Shareholders in Securities Fraud Action Against Mobile Technology Company

In re Symbol Techs. Inc. Sec. Litig., No. 05-cv-3923 (DRH) (AKT) (E.D.N.Y. June 25, 2015)
Click here to view the opinion.

Judge Denis R. Hurley of the U.S. District Court for the Eastern District of New York conditionally certified a class of shareholders in an action that alleged that a mobile technology company violated Section 10(b) of the Securities Exchange Act by allegedly making false and misleading statements about its revenue projections and internal controls. The plaintiff's claim was typical of the class, even though it had purchased the company's stock after some of the purported misrepresentations about internal controls and earnings were made, because those statements were not distinct from the other alleged misrepresentations made before the plaintiff purchased stock. In addition, the plaintiff was not subject to a unique loss causation defense because its attempt to prove that it suffered an economic loss, even though it purchased the company's stock after the alleged disclosure, would be the same as the rest of the putative class. Further, the court held that possible intraclass conflicts relating to the motivations of different class members to dispute when the stock was most and least inflated related only to damages and did not warrant the denial of class certification. The court also noted that the plaintiff was aware of its role in the litigation and nothing suggested that it would be unable to protect the interests of the class.

Definition of a Security

Southern District of Florida Grants Summary Judgment, Finding No Evidence of 'Investment Contract'

Creative Am. Educ., LLC v. The Learning Experience Sys., LLC, No. 9:14-cv-80900 (S.D. Fla. May 11, 2015)
Click here to view the opinion.

Judge Robin L. Rosenberg of the U.S. District Court for the Southern District of Florida granted summary judgment in favor of the defendants on claims brought under the Securities Act, finding that the plaintiff failed to show that the agreement at issue constituted a sale of a security under the Securities Act.

The plaintiff is a business entity created by foreign investors from Singapore who were seeking to immigrate to the United States. The investors sought to start a child care business in the U.S. through a franchise, The Learning Experience (TLE), which

is owned by the defendant Learning Systems Experience, LLC. The plaintiff executed several agreements with TLE, including a franchise agreement to establish two child care franchises in Colorado. Although it was their intent to actively participate in the franchises, the investors were unable to arrive in the United States prior to the completion of the build-outs for their franchise locations. The plaintiff therefore executed a management agreement with TLE that authorized TLE to manage the franchises for a certain period of time. The agreement contemplated that the investors eventually would co-manage the businesses with TLE and, after additional time, would exclusively manage the businesses, at which point TLE would no longer be involved with any management responsibilities.

The investors soon encountered staffing and regulatory issues and sought to close down the franchises. TLE, citing its rights under the franchise and management agreements, took control of the franchises.

The plaintiff filed suit, asserting numerous causes of action. As relevant here, the plaintiff alleged that TLE's sale of a franchise under the franchise agreement, combined with the later-executed management agreement, effectively gave total control of the franchise to TLE, thereby transforming the sale of the franchise into an investment with profits to come solely from the efforts of TLE. As such, the plaintiff argued that this sale constituted the sale of a security and violated the Securities Act and the Florida Securities and Investor Protection Act.

In analyzing whether the circumstances at issue constituted the sale of a security, the court noted that the Securities Act broadly defines securities to include the term "investment contract," but the act itself does not define investment contracts. Rather, the Supreme Court has created a three-part test to determine whether a contract comprises a security. The test requires (1) an investment of money (2) in a common enterprise (3) with an expectation of profits to come solely from the efforts of others. The dispute here arose under the third element of the test, as the plaintiff argued that TLE usurped all control over the franchises.

The court found that the two agreements together did not constitute a security. First, the court stated that the execution of the franchise and management agreements were separated by several months' worth of time and that the agreements were executed under different circumstances. Thus, it was not necessarily appropriate to consider the two agreements together as potentially comprising a single security. The court further observed the utter lack of evidence that TLE simultaneously marketed its franchise agreement and management agreement to the plaintiff.

The court also noted that it was the original intention of the investors to manage their franchises themselves. Consistent with that intention, the management agreement clearly contemplated a transition in management from TLE to the plaintiff. Indeed, the management agreement was effectively just a "gap filler" measure to help the investors while they obtained their work visas. Thus, the legal standard — which states that an agreement is only an investment contract when it generates profits solely from the efforts of others — cannot be satisfied where the investors intended to manage the franchises and ultimately participated in the management of the franchises. In fact, under the terms of the various agreements, the court found that the plaintiff — not the defendants — retained ultimate control over the franchises.

Derivative Litigation

Court of Chancery Dismisses Stockholder's Class and Derivative Complaint

Teamsters Union 25 Health Servs. & Ins. Plan v. Baiera,
C.A. No. 9503-CB (Del. Ch. July 13, 2015)
Click here to view the opinion.

Chancellor Andre G. Bouchard of the Delaware Court of Chancery dismissed a class and derivative complaint brought by a stockholder of Orbitz Worldwide, Inc. (Orbitz) challenging the fairness of a services agreement with an allegedly controlling stockholder, and also found that the plaintiff did not have standing to assert breach of fiduciary duty claims against the Orbitz directors for alleged violations of the rules of the New York Stock Exchange (NYSE).

In granting the motion to dismiss, the court rejected the plaintiff's assertion that demand should be excused simply because an alleged controlling stockholder stood on both sides of the services agreement, finding "this theory is inconsistent with Delaware Supreme Court authority that focuses the test for demand futility exclusively on the ability of a corporation's board of directors to impartially consider a demand to institute litigation on behalf of the corporation — including litigation implicating the interests of a controlling stockholder." The court also rejected the contention that "demand would be excused as a matter of law whenever a transaction between a corporation and its putative controlling stockholder implicates the entire fairness standard." Because the members of the audit committee that approved the services agreement were disinterested and independent, the court found that demand was not excused under the test elaborated in *Rales v. Blasband*, 634 A.2d 927 (Del. 1993). The

court also dismissed the claim that the Orbitz board breached its fiduciary duties by violating the NYSE rules. The complaint did not allege that "NYSE, as a self-regulatory organization, has indicated that Orbitz violated the NYSE Rules and Plaintiff has not standing to assert or prove that Orbitz violated the NYSE Rules." The court held that "to prove its breach of fiduciary duty claim, Plaintiff would be prosecuting the functional equivalent of a claim to enforce the NYSE Rules. In my view, Plaintiff has no standing to do so."

Court of Chancery Dismisses Challenge to Compensation Paid to Members of Controlling Stockholder Family

Friedman v. Dolan, C.A. No. 9425-VCN (Del. Ch. June 30, 2015)
Click here to view the opinion.

Vice Chancellor John W. Noble of the Delaware Court of Chancery dismissed a stockholder challenge to allegedly excessive compensation paid to members of the Dolan family, which was alleged to collectively control the company. The stockholder plaintiff argued that the compensation was subject to entire fairness review, despite having been approved by Cablevision's compensation committee, because the controlling Dolan family was "on both sides" of the awards. The court disagreed, explaining that generally a board's decision to award executive compensation to others is initially protected by the business judgment rule. Despite feeling "troubled" by some of the alleged facts, the court stated that the plaintiff had not alleged facts demonstrating that the Dolan family had "*leverag[ed]* control over the compensation committee" and was hesitant "to endorse the principle that every controlled company, regardless of use of an independent committee, must demonstrate the entire fairness of its executive compensation in court whenever questioned by a shareholder." The court found it "especially undesirable to make such a pronouncement here, where annual compensation is not a 'transformative' or major decision."

The court found that the plaintiff had failed to allege that a majority of the compensation committee members either lacked independence or acted in bad faith, rejecting the assertion that merely being appointed by a controlling stockholder is sufficient to show a lack of independence. Noting that "[i]t is the essence of business judgment for a board to determine if a particular individual warrant[s] large amounts of money," the court dismissed the plaintiff's challenge with prejudice. In dismissing, the court reminded that "[a]lthough there might be concerns about the extent to which negotiations are truly at arm's-length, our law … respects the judgment of independent directors. Moreover, reflexively reviewing decisions of independent directors who serve in the often difficult environment of controlled corporations would offer little benefit to those corporations or their shareholders."

The court also rejected claims for breach of fiduciary duty (loyalty and good faith) against five members of the Dolan family, including three described as the "Dolan Daughters" who had been chastised as having engaged in "minimal participation" at board meetings and for "lack of qualifications." On these latter claims, the court held that it "does not have a bright line rule, but the complaint does not offer a reasonably conceivable set of facts to support disloyalty or bad faith through non-participation." The court further held that "judges are not equipped to evaluate whether an individual is qualified to serve on a board," and that without additional facts, "[t]here is no obligation to draw the conclusion that family ties and experience at non-profits are inadequate qualifications to serve as a director of a public company."

Delaware Court of Chancery Dismisses Derivative Action for Failure to Plead Demand Futility

In re Gen. Motors Co. Derivative Litig.,
Consol. C.A. No. 9627-VCG (Del. Ch. June 26, 2015)
Click here to view the opinion.

Vice Chancellor Sam Glasscock III of the Delaware Court of Chancery dismissed a derivative action brought on behalf of GM stockholders based on the company's manufacture and use of faulty ignition switches in GM automobiles, finding that the plaintiff stockholders failed to adequately plead that making demand on the company's board of directors would have been futile.

In 2014, GM issued 45 recalls of 28 million vehicles, largely due to issues with the ignition switches in these vehicles, which caused a vehicle to slip from "run" mode to "accessory" mode and resulted in a number of injuries and deaths. According to the plaintiffs, "information relating to the defect had been known to certain engineers and other employees within the company for a number of years," but the board failed to uncover the problems until 2014. After the defects were uncovered and government investigations ensued, the plaintiffs brought a derivative action seeking to hold GM's board liable, "not because the Board was complicit in the defect, but because it did not know about it until February 2014."

The court found that the stockholder plaintiffs failed to adequately plead demand futility, explaining that "[t]o survive a challenge under [Court of Chancery] Rule 23.1 [governing derivative actions], the complaint must make sufficient non-conclusory allegations to raise a reasonable doubt in the mind of the Court that a majority of the directors can exercise its business

judgment on behalf of the corporation, in light of the directors' alleged conflicted interests." Rejecting the plaintiffs' claims that the board acted in bad faith by failing to exercise oversight, and thus demand was excused, the court explained that "there is no sufficiently pled allegation that the Board was aware that its risk management system was not functioning as it should — *i.e.*, there were no 'red flags' or other bases from which I can infer knowledge on the part of the Board that its system was inadequate."

Delaware Court of Chancery Dismisses Derivative Action for Failure to Plead Demand Was Wrongfully Refused

Ironworkers Dist. Council of Philadelphia & Vicinity Ret. & Pension Plan v. Andreotti, C.A. No. 9714-VCG (Del. Ch. May 8, 2015)
Click here to view the opinion.

Vice Chancellor Sam Glasscock III of the Delaware Court of Chancery dismissed a derivative action brought on behalf of DuPont stockholders for failure to adequately plead that the DuPont board of directors wrongfully refused the stockholders' demand.

Between 2009 and 2013, DuPont was a defendant in patent litigation that resulted in a settlement whereby DuPont agreed to pay a competitor, Monsanto Company, $1.75 billion over a 10-year period. DuPont stockholders made a demand on the DuPont board to bring fiduciary duty litigation. A committee of the board considered the demand and, after an extensive investigation that generated a 179-page written report, ultimately refused. The plaintiff then brought suit in the Court of Chancery, alleging that its demand had been wrongfully refused.

The court explained that by making demand on the board, the plaintiff conceded the board's independence, and could successfully plead that the board's refusal of its demand was wrongful only if it could rebut the presumption that the board's consideration of the demand was a valid exercise of business judgment. The plaintiff failed to plead that the board was grossly negligent in considering demand — in fact, the committee spent more than nine months investigating the demand, interviewing 23 witnesses and reviewing hundreds of documents, and produced a comprehensive report of its findings. The plaintiff also did not adequately allege that the board acted in bad faith by forgoing fiduciary duty litigation. The court explained that "[f]or me to find that [the board's] decision was in bad faith, I would have to find that a viable fiduciary duty action exist[ed] as a corporate asset" "with such clarity … that a reasonable doubt exists about the good faith of the Board's refusal to bring the litigation."

Disclosures in Offering Documents

Second Circuit Upholds Dismissal of Claims Against Automobile Manufacturer, Finding 'Quintessential Commercial Puffery'

Scott v. Gen. Motors Co., No. 14-3770-cv (2d Cir. May 28, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Second Circuit, in a summary order, affirmed the dismissal of claims that an automobile manufacturer allegedly violated Sections 11 and 15 of the Securities Act by concealing inventory issues during a 2010 initial public offering. The plaintiffs alleged that the company made misstatements regarding its monitoring of dealer inventory levels and inventory management. The district court previously had found that the company's alleged misstatements that it "aimed" to increase profitability by monitoring dealer inventory levels was mere puffery and that the company had complied with its disclosure obligations under Item 303 of Regulation S-K, which requires the disclosure of known trends and uncertainties reasonably expected to materially affect financial results. The Second Circuit held that the company's alleged misstatement was "explicitly aspirational" and therefore was "quintessential commercial puffery." The court also found the company's statement about improved inventory management was mere "corporate optimism" upon which a reasonable investor would not rely. In addition, the Second Circuit held that the company's statement that an increase in inventory was primarily due to higher demand was accurate because demand did increase in the relevant year, and the plaintiff failed to otherwise show an inaccuracy. Finally, the plaintiff failed to allege that the inventory management practices at issue in the case qualified as "known trends or uncertainties" that were "reasonable expected" to materially impact financial results under Item 303 of Regulation S-K.

Fraud-on-the-Market Theory

SDNY Holds That Defendant Successfully Rebutted Presumption of Reliance as to Value Investor

In re Vivendi Universal, S.A. Sec. Litig., No. 02-cv-5571 (SAS) (S.D.N.Y. Aug. 11, 2015)
Click here to view the opinion.

Judge Shira A. Scheindlin of the U.S. District Court for the Southern District of New York granted summary judgment on an asset manager's claim that a media company violated Section 10(b) of the Securities Exchange Act by misrepresent-

ing the company's cash position prior to a liquidity crunch and asset write-down. A jury previously had found in favor of a class of investors in a trial on liability, and the court established a procedure for the parties to conduct discovery specific to, and to litigate, individual issues of reliance and damages. The court determined that the asset manager, a "value investor" which used a proprietary "price-value ratio" to identify underpriced stocks, began purchasing a large block of shares after four of the allegedly nine corrective statements were made, and admitted that "*none* of the nine corrective disclosures identified by class plaintiffs' expert 'corrected' any misunderstanding by [the asset manager] concerning the value of Vivendi." The court held that the asset manager had not relied on the market price of the company's stock because price was not important to the asset manager's calculation of the stock's intrinsic value, and the trader that made the investment testified that he "was not misled" by the allegedly fraudulent statements and described the alleged liquidity crisis as "overblown." Further, the court determined that the Supreme Court's recent statement in *Halliburton Co. v. Erica P. John Fund, Inc.* (*Halliburton II*), 134 S. Ct. 2398 (2014), that a "value investor" may rely on the price of a stock if he "trad[ed] stock based on the belief that the market price will incorporate public information within a reasonable period," did not preclude the defendants' post-liability phase challenge to reliance because *Halliburton II* addressed reliance in the context of class certification, where the Court has held that investors are entitled to a presumption of reliance on the integrity of the market under certain circumstances. The district court noted that there is a "key difference" between relying on stock price in a price analysis, like "price-value" ratio, and relying on the "*integrity* of the market price." Although investors may be entitled to a presumption of the latter at the class certification stage, the court determined that defendants nevertheless are entitled to challenge that presumption with evidence at trial or thereafter. The Court in *Halliburton II* did not intend to "jettison" the presumption of reliance at class certification for an "iron-clad" rule that investors always rely on market price and, indeed, the Court noted that not all investors "rely on the security's market price as an unbiased assessment of [its] value."

Northern District of Texas Provides Roadmap for Rebutting Fraud-on-the-Market Presumption at Class Certification Stage

Erica P. John Fund, Inc. v. Halliburton Co., No. 3:02-cv-1152-M (N.D. Tex. July 25, 2015)
Click here to view the opinion.

In *Halliburton, Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398 (2014), the Supreme Court upheld the fraud-on-the-market presumption of reliance first recognized by the Court in *Basic Inc. v. Levinson,* 485 U.S. 224 (1988) but held that defendants may introduce evidence of lack of price impact at the class certification stage to rebut the presumption of market efficiency. On remand, the U.S. District Court for the Northern District of Texas gave concrete guidance on how to evaluate such evidence. After a thorough review of expert testimony and an evidentiary hearing, the district court denied class certification with respect to all but one of the plaintiffs' claims relating to alleged corrective disclosures Halliburton made.

The plaintiffs brought a putative class action against Halliburton and its chief executive officer, David Lesar, alleging violations of Section 10(b) of the Securities Exchange Act and Rule 10b-5. The plaintiffs claimed that Halliburton, in an attempt to inflate its stock price, made a series of misrepresentations regarding its potential liability in asbestos litigation, its expected revenue from certain construction contracts and the anticipated benefits of its merger with another company. Halliburton subsequently made a number of corrective disclosures, which the plaintiffs contend caused the company's stock price to drop.

Before weighing competing economic expert testimony, the district court addressed two threshold legal issues: (1) which party has the burden of production and persuasion with respect to price impact at the class certification stage, and (2) whether, during the price-impact inquiry, the court should rule as a matter of law that particular disclosures were corrective or not corrective. First, the district court joined the Southern District of Florida and the Southern District of New York in holding that defendants bear the burden of persuasion and production to show an absence of price impact at the class certification stage. The court concluded that to rebut the presumption of reliance on an alleged misrepresentation, "Halliburton must ultimately persuade the Court that its expert's event studies are more probative of price impact than the Fund's expert's event studies." Second, the district court held that it could not determine at the class certification stage whether a disclosure was "corrective." The question of whether a disclosure is "corrective" relates to materiality and loss causation, neither of which may be decided at the class certification stage. Thus, the district court assumed the disclosures in the complaint were corrective statements made to rectify misrepresentations.

Next, the court evaluated the evidence presented by the parties regarding the price impact of the corrective disclosures. Both Halliburton and the plaintiffs submitted expert reports, including event studies, to show the impact (or lack thereof) of the alleged misrepresentations on Halliburton's stock price. In weighing the evidence offered by the experts regarding price impact, the

district court established three specific guidelines. First, the court held that evidence of price impact (or lack thereof) must be shown with a 95 percent confidence standard, meaning that to show that a corrective disclosure caused a company's share price to decline, an expert would need to be able to "reject with 95% confidence the null hypothesis that the corrective disclosure had no impact on price." Second, the court held that applying a "multiple comparison adjustment" to the economic evaluation is appropriate where there are large numbers of dates tested for price impact. Third, the court held that for efficient markets, evidence of price impact must appear within one day of the alleged corrective disclosure in order to serve as proof that the disclosure caused the stock price decline.

For all but one of the six corrective disclosures, the district court found that Halliburton met the burden of proving the corrective disclosures did not have a price impact on the company stock and thus found that the presumption of reliance did not apply. Accordingly, the court refused to certify a class with respect to claims arising from those disclosures. However, the court did certify a class of investors to proceed with claims arising from the December 7, 2001, disclosure of a $30 million jury verdict against a Halliburton subsidiary, which was followed by a 40 percent decline in stock price. For this disclosure, the court held that Halliburton failed to prove that the uncertainty of the asbestos environment "caused the entirety of Halliburton's substantial price decline."

Interpreting *Janus*

SDNY Finds *Janus* Does Not Abrogate the Group Pleading Doctrine in Case Against Mining Company

In re Barrick Gold Sec. Litig., No. 13 Civ. 3851 (SAS) (S.D.N.Y. June 2, 2015)
Click here to view the opinion.

Judge Shira A. Scheindlin of the U.S. District Court for the Southern District of New York declined to dismiss, on a motion for reconsideration, claims that officers of a mining company violated Sections 10(b) and 20(a) of the Securities Exchange Act in April 2015. The amended complaint alleged that the company made certain false statements about the operation of its mines, and the court's prior order dismissed claims related to alleged statements by certain officer defendants. In light of that dismissal, the officer defendants argued that *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011) precluded liability for the other alleged statements which they were not alleged to have personally made. In *Janus*, the Supreme Court declared that only the person or entity with "ultimate authority" over a statement could be liable for making it. The officer defendants contended that *Janus* had abrogated the group pleading doctrine, which creates a presumption that group-published documents (*e.g.*, statements in prospectuses and press releases) are attributable to individuals charged with running the company. The court disagreed and held that the group pleading doctrine survived *Janus*, finding that *Janus* dealt with a "separate corporate entity" without ultimate authority over the statement, whereas this case involved a single entity within which "more than one person will have ultimate authority over a statement." Because the officer defendants were directly involved in the "everyday business" of the company, the plaintiffs adequately alleged that the officers were the "makers" of the statements at the pleading stage. However, the court noted that "at trial or summary judgment, plaintiffs will need to provide proof that the individual defendants did in fact have ultimate authority over the statements in order to hold them liable." Further, the court rejected the plaintiffs' alternative argument that a nonspeaking defendant may be liable merely because his alleged conduct is at the "heart of the fraudulent scheme," finding that *Janus* plainly held that only defendants with ultimate authority over a statement can be held liable.

Loss Causation

Seventh Circuit Reverses $2.5 Billion Jury Verdict for Alleged Section 10(b) and Rule 10b-5 Violations

Glickenhaus & Co. v. Household Int'l, Inc., No. 13-3532 (7th Cir. May 21, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Seventh Circuit reversed a $2.5 billion jury verdict awarded against Household International, Inc. and three of its former executives for alleged violations of Section 10(b) of the Securities Exchange Act and Rule 10b-5. In May 2009, a jury found the defendants liable for making false and misleading statements relating to (1) predatory lending, (2) the delinquency rate of Household's loans, and (3) revenue from particular credit card agreements. The Seventh Circuit determined that at trial the plaintiffs failed to prove loss causation and the jury was improperly instructed on the meaning of making a false statement under *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011).

On appeal, Household argued that the plaintiffs failed to prove loss causation, in part because the plaintiffs' expert used a "leakage model" for damages that incorporated both fraud and firm-specific, nonfraud price declines. Although the Seventh Circuit expressly endorsed the leakage model, it concluded

that the expert's failure to fully address firm-specific, nonfraud factors that may have contributed to the stock price decline was problematic. The court held that to opine that firm-specific, nonfraud factors had no stock price impact in a leakage model, an expert must testify that no firm-specific, nonfraud related information caused the stock price declines at issue and explain "in nonconclusory terms the basis for this opinion." The court held that the burden then shifts to the defendants to identify firm-specific, nonfraud related information that could have affected the stock price. Accordingly, the court ordered a new trial on the loss causation issue.

Household also argued that the jury was incorrectly instructed on what it means to "make" a false statement under the U.S. Supreme Court's ruling in *Janus*. The district court instructed the jury that the plaintiffs needed to prove that the "defendant made, approved, or furnished information to be included in a false statement of fact." The Seventh Circuit held that the "approved or furnished information" instruction was error under *Janus*. Therefore, the Seventh Circuit also ordered a new trial for the three individual defendants on this issue.

PSLRA — Safe Harbor Provision

Eighth Circuit Affirms Dismissal of Complaint Under PSLRA Safe Harbor Provision

Julianello v. K-V Pharm. Co., No. 14-2592 (8th Cir. July 2, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Eighth Circuit affirmed the dismissal of a class action securities fraud complaint against a pharmaceutical company and three of its officers, holding that the alleged materially false or misleading statements or omissions were protected by the PSLRA's safe harbor provision for forward-looking statements accompanied by cautionary language.

The plaintiffs alleged that certain statements made by the company and its officers during the period in which the company launched and marketed a new prescription drug were false or misleading because the defendants failed to disclose that the price point at which they were planning to market the drug was too high and that there was a risk the Food and Drug Administration would not enforce the company's exclusive sales rights to the drug. The district court dismissed the complaint, finding that the relevant statements were protected by the PSLRA's safe harbor provision for forward-looking statements and that the plaintiffs had failed to adequately plead facts supporting a strong inference of scienter.

The Eighth Circuit upheld the district court's ruling, holding that the defendants' statements fell within the safe harbor provision because they were sufficiently forward-looking, as their veracity could not be determined at the time they were made, and that the statements were accompanied by specific cautionary language. As the panel decided the case on safe harbor grounds, it did not reach the issue of scienter.

DC Circuit Holds That Safe Harbor Protection Requires Cautionary Language to Be Tailored to Forward-Looking Statement

In re Harman Int'l Indus., Inc. Sec. Litig., No. 14-7017 (D.C. Cir. June 23, 2015)
Click here to view the opinion.

On June 23, 2015, the U.S. Court of Appeals for the District of Columbia Circuit reversed and remanded the dismissal of a securities fraud class action against a manufacturing company and its executives. The Court of Appeals held that the district court erred in finding that company and officer statements were protected by the PSLRA's safe harbor provision for forward-looking statements.

The plaintiffs alleged that Harman International Industries and three of its officers violated Sections 10(b) and 20(a) of the Securities Exchange Act by making materially false and misleading forward-looking statements about the company's financial condition. Among other things, the plaintiffs argued that forward-looking statements made on conference calls related to the company's personal navigation device products (PNDs) were fraudulent. The defendants countered that the statements made on the conference calls were accompanied by meaningful cautionary statements and thus fell within the Securities Exchange Act's safe harbor rule. The defendants pointed to the moderator's statement on the calls that "certain statements made by the Company during this call are forward-looking statements … includ[ing] the Company's beliefs and expectations as to future events and trends affecting the Company's business and are subject to risks and uncertainties." In addition, analysts on the calls were "advised to review the reports filed by Harman International with the [SEC] regarding these risks and uncertainties." The district court held that the statements made on the conference calls fell within the statutory safe harbor.

The Court of Appeals disagreed and reversed, holding that forward-looking statements must be accompanied by "meaningful cautionary statements." Relying on reasoning from the Third and Fifth circuits, the D.C. Circuit held that a cautionary statement is "meaningful" only if it is "tailored to the forward-looking statement that it accompanies." The court held that the cautionary

statements made on the conference calls were not tailored to the PND business because they were "misleading in light of historical facts" and did not address certain unique risks to the company that could cause actual results to differ from the forward-looking statements. Thus, the forward-looking statements were not entitled to safe harbor protection.

Sixth Circuit Affirms Dismissal of Securities Fraud Class Action

Pension Fund Grp. v. Tempur-Pedic Int'l, Inc., No. 14-5696 (6th Cir. June 4, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Sixth Circuit affirmed the dismissal of a putative class action brought by investors for alleged violations of Section 10(b) of the Securities Exchange Act. The plaintiffs alleged that the company misled investors by touting the company's recent successes and issuing positive financial projections while failing to disclose the company's deteriorating financial position as a result of a competitor's new product.

The Sixth Circuit agreed with the district court that none of the alleged statements or omissions constituted securities fraud. The court reasoned that the company's statements concerning future financial performance and expected growth were forward-looking statements that were protected under the PSLRA's safe harbor provision because the statements were accompanied by meaningful cautionary language. The court rejected the plaintiffs' argument that the company should have specifically disclosed the risks posed by a competitor's new product, concluding that having disclosed generally the risks of competition, the company was not required to disclose how a specific competitor affected its sales. The court further held that the company's statements regarding its "competitiveness" and "consumer preferred product line" were mere puffery and immaterial as a matter of law. The court affirmed both the dismissal of the complaint and the denial of plaintiffs' motion to amend, reasoning that amendment would be futile.

Scienter

Second Circuit Reinstates Claims Against Coffee Company

Emps.' Ret. Sys. of Gov't. of Virgin Islands v. Blanford, No. 14-199-cv (2d Cir. July 24, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Second Circuit vacated the dismissal of claims that a coffee company violated Section 10(b) of the Securities Exchange Act by misleading investors with respect to the company's inventory and demand for its product. The court held that the plaintiffs had sufficiently alleged that the company had falsely stated that its sales exceeded supply and that it was not building excess inventory in light of the company's alleged $50 million revenue gap and inventory spike during the same period. Confidential witness testimony supported the plaintiff's allegations that the company had built substantial inventory, and that it had allegedly taken steps to conceal this excess inventory during audits by temporarily loading products onto trucks or hiding them within the facility. In addition, confidential witnesses who held management-level positions corroborated allegations that company executives ignored or discouraged employee questions and complaints about inventory build-up. Although the defendants argued that the confidential witness testimony failed because it was not linked to any particular quarter, the court held that "allegations concerning activity in one period can support an inference of similar circumstances in a subsequent period." Further, the court found that allegations that the company actively hid excess inventory from auditors, which one confidential witness described as "unheard of in the food industry," supported a strong inference of scienter. Further, the court found that certain trades by two executives pursuant to Rule 10b5-1 trading plans were suspicious in size and timing. Although the trades were predetermined, the plan supported an inference of scienter because it was created after the alleged fraud began and some sales followed allegedly false public statements by the company and executives.

Second Circuit Affirms Dismissal of Claims Against Energy Company

Lucas v. Icahn, No. 14-1906-cv (2d Cir. June 25, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims that an energy company allegedly violated Section 10(b) of the Securities Exchange Act by making false statements about the value of an agreement to pay debt held by a related entity in exchange for certain assets it had acquired from the entity as part of a restructuring plan. The plaintiffs alleged that the company accurately disclosed the mechanics of the deal but misrepresented the value of the agreement to pay the entity's debt over time, which was substantially less than the alleged $1.25 billion price of the asset acquired when discounted for present value. The court did not decide whether the alleged disclosures were misleading and reasoned that, even if they were, the plaintiffs failed to adequately allege scienter. The court determined that the company's disclosures about the mechanics of the deal and the information needed for an investor to perform an independent valuation suggested that the company did not intend to misstate the value of the arrangement.

Second Circuit Affirms Dismissal of Claims Against Oil and Gas Exploration Company

In re Magnum Hunter Res. Corp. Sec. Litig., No. 14-2581-cv (2d Cir. June 23, 2015) (summary order)
Click here to view the opinion.

The U.S. Court of Appeals for the Second Circuit in a summary order affirmed the dismissal of claims that an oil and gas exploration company violated Sections 10(b) of the Securities Exchange Act and Section 11 of the Securities Act by allegedly misrepresenting that it had effective internal controls and accounting practices. The plaintiffs alleged that the company knew it had delinquent accounting controls because later financial restatements showed it previously had published inaccurate financial results. The court determined that allegations that accounting irregularities and faulty internal controls existed did not create a strong inference of scienter, and the company had repeatedly disclosed during the relevant time period that it had material accounting weaknesses in its financial reporting. Further, confidential witness testimony that the company's finance personnel were inexperienced or incompetent suggested at most that the company had inadequate internal controls, not that the statements were made with fraudulent intent. In addition, statements that the company altered production numbers were insufficient because the confidential witness did not identify any particular numbers that were altered and did not tie any alleged alteration to a particular misstatement. In addition, the court held that the plaintiff's Securities Act claims were untimely under the one-year statute of limitations applying either the inquiry notice rule or the less onerous discovery rule, as pronounced in *Merck & Co. v. Reynolds*, 559 U.S. 633, 653 (2010). The court determined that under either rule, the statute of limitations had expired because the company's disclosures more than a year before the complaint would have led a reasonably diligent investor to discover the facts underlying the plaintiff's claims, and the plaintiffs were not entitled to tolling "until a company's disclosures touch on every specific allegation that a plaintiff chooses to put in his complaint."

Eighth Circuit Upholds Dismissal of Claims Against Corporate Officers

Podraza v. Whiting, No. 14-1947 (8th Cir. June 22, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Eighth Circuit affirmed the dismissal of a class action securities fraud complaint against certain corporate officers of Patriot Coal Corporation (Patriot), holding that the plaintiffs failed to plead facts to support a strong inference of scienter under the PSLRA.

The plaintiffs alleged that Patriot's former CEO and chief financial officer knowingly made deceptively false statements in the company's financial filings in violation of Sections 10(b), 20(a) and 20(b) of the Securities Exchange Act and Rule 10b-5 by fraudulently capitalizing the costs of certain environmental remediation obligations in order to avoid the effect expensing the costs would have had on Patriot's bottom line. The plaintiffs argued that the magnitude of the violation of generally accepted accounting principles (GAAP), as well as several other factors including the company's precarious financial position, supported a strong inference of scienter.

The Eighth Circuit affirmed the district court's dismissal of the complaint, holding that the plaintiffs failed to support their claims with particularized allegations that the defendants knew they should have expensed the costs of the remediation or were reckless in initially failing to do so. The panel further noted that several facts contradicted the inference of scienter, including (1) Patriot's independent auditor had reviewed the relevant financial statements and stated the documents complied with GAAP, (2) Patriot offered a thorough, if ultimately incorrect, explanation to the SEC on why they initially chose to capitalize the installation costs, and (3) Patriot disclosed that it was corresponding with the SEC about its accounting treatment.

Securities Fraud Pleading Standards

The Tenth Circuit Reverses, in Part, Dismissal of Claims Against Former Officers of Petroleum Company

Nakkhumpun v. Taylor, No. 14-1060 (10th Cir. Apr. 7, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Tenth Circuit affirmed in part and reversed in part the dismissal of claims that former officers of a petroleum company violated Section 10(b) of the Securities Exchange Act by making false statements about (1) a potential real estate sale that did not come to fruition, and (2) the company's financial condition. As to the real estate deal, the plaintiff alleged that the defendants falsely stated that the deal fell through because of a lack of financing. The court determined that the alleged statements were false in light of allegations that the purchaser had rescinded its offer after revaluing the property at a lower price, and the company's statements did not sufficiently disclose that alleged fact. Further, the plaintiff alleged a strong inference of scienter because the company allegedly knew that the offer had been retracted because of the purchaser's valuation, but allegedly "conditioned the market" to believe otherwise in an effort to attract additional purchasers. Although the defendants may have sought only to maximize shareholder value, scienter does not require defendants "to act with the primary purpose

of deceiving shareholders" and the defendants here "recklessly" disregarded the risk of misleading investors. In addition, the plaintiffs adequately alleged loss causation under a "materialization of a concealed risk" theory because the allegedly false statements concealed the risk that the company might not find another buyer at the current price, and that risk materialized when the company announced its inability to do so. The court rejected the defendants' argument that the company's 10-K had sufficiently disclosed the risk, because those disclosures were made before the allegedly false statements, and therefore would not have corrected any misunderstanding by the market after the statements were made. One defendant has petitioned the U.S. Supreme Court to accept his appeal of the decision.

However, the court affirmed the dismissal of claims that the defendants had made certain false statements about improvements in the company's financial performance while its financial condition was allegedly "deteriorating." The plaintiff failed to allege that the defendants intended to mislead investors, because the statements were limited to certain public financial data, even if the statements were "overly rosey" in light of the company's condition. Further, the court held that certain statements of opinion were not false, under *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318 (2015), because the plaintiff failed to allege "any facts that would cast doubt on the sincerity or reasonableness" of the statements.

District Court Dismisses in Part Putative Class Action Alleging Securities and Securities Exchange Act Violations

Constr. Workers Pension Fund v. Navistar Int'l Corp.,
No. 13-2111 (N.D. Ill. July 10, 2015)
Click here to view the opinion.

Judge Sara L. Ellis of the U.S. District Court for the Northern District of Illinois dismissed in part a putative class action alleging that Navistar International Corporation and certain officers and directors violated Sections 10(b) and 20(a) of the Securities Exchange Act and Rule 10b-5. The shareholder plaintiffs alleged that the defendants perpetrated a fraud on the market by making false and misleading statements in news articles and during analyst calls concerning Navistar's progress in developing new technology to meet the Environmental Protection Agency's requirements.

The court determined that the plaintiffs' complaint failed to comply with the strictures of the Private Securities Litigation Reform Act (PSLRA) because it contained bare, sweeping allegations that were backed with little factual support. The court further ruled that many of the challenged statements were protected by the PSLRA's safe harbor provision for forward-looking statements, rejecting the plaintiffs' argument that statements omitting material information could not be forward-looking. The court also held that the lead plaintiff lacked standing to assert certain claims based on statements made after it purchased Navistar stock, rejecting the argument that the lead plaintiff could bring those claims as a representative of class members who actually had bought stock in the statements' wake. However, the court did determine that the plaintiffs had adequately pleaded causes of action with respect to two statements made by Navistar's president and CEO, including his statement during an analyst call that certain Navistar "technology [was] already proven." The court declined to dismiss the claims based on these statements but dismissed the remaining claims with prejudice.

Eastern District of Pennsylvania Refuses to Dismiss Exchange Act Claims Against Payday Lender

West Palm Beach Police Pension Fund v. DFC Global Corp.,
No. 13-6731 (E.D. Pa. June 16, 2015)
Click here to view the opinion.

Judge Berle M. Schiller of the U.S. District Court for the Eastern District of Pennsylvania refused to dismiss claims under Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder brought against payday loan industry leader DFC Global Corp. and certain of its officers.

According to the plaintiff's allegations, the defendant, which operates under various names, including The Money Shop, Dollar Financial, Month End Money and Payday Express Limited, touted its "conservative approach to extending consumer credit," its "very effective credit analytics function" and its superior ability to "underwrite a customer's ability to repay." In contrast to those assurances, the plaintiff claims that (1) the defendant's underwriting and risk management practices were not "conservative" or "responsible," (2) the company misled investors about critical metrics, including its loan loss reserves and net income, (3) the defendant extended loans to those who could not repay them, and (4) the company repeatedly rolled over loans to borrowers for a fee in order to avoid reporting defaults without any additional credit assessment.

The court's analysis focused on the falsity and scienter elements of a securities fraud claim. As regards falsity, the court made several key findings. First, the court rejected the defendant's argument that the statements at issue were opinions. On this point, the court stated that it "is unwilling to afford immunity to purported lies that defrauded investors because DFC Global executives carefully added 'I think' or 'we believe' to their statements." Moreover, even if some of the statements were opinions, they remain actionable here because if a defendant "represents that its lending practices are 'conservative' and that its collateralization is 'adequate,' the securities laws are clearly implicated

if it nevertheless intentionally or recklessly omits certain facts contradicting these representations." Second, the court rejected the defendant's arguments that its statements about the conservative nature of its underwriting or its responsible lending practices were mere puffery, finding that "fraudulent comments regarding such a fundamental aspect of DFC Global's business are of vital importance to investors." Third, the court rejected the defendant's arguments that the plaintiff was attempting to plead fraud-by-hindsight. The court found that, accepting the plaintiff's allegations as true, the defendant's practices were not "what a reasonable person would deem conservative lending practices" — even at the time the statements were made.

Regarding scienter, the court relied on three additional findings. First, the allegations of fraud relate to the defendant's core business, and that tends to support an inference of scienter. Second, the allegations supplied by confidential witnesses further supported an inference of scienter. As one example, the court cited a confidential witness who served as the head of compliance for DFC Global's online business in the United Kingdom. That witness claimed that DFC Global "never got in compliance" with industry regulations, "despite the Company's purported assurance to the contrary." This same witness also claimed that DFC Global did not adhere to various rules regarding limitations on rolling over a consumer's debt. Third, the court noted the resignation of certain key executives at the defendant. While the court acknowledged that the resignation of key officers is, as a standalone matter, insufficient to show scienter, "when considering the totality of plaintiffs' scienter allegations, the Court concludes that the resignation of key executives, including the President and COO responsible for implementing new regulations, bolsters the evidence of conscious or reckless behavior."

District Court Allows Securities Fraud Action Against Urban Outfitters to Proceed

In re Urban Outfitters, Inc. Sec. Litig., No. 13-5978 (E.D. Pa. May 4, 2015)
Click here to view the opinion.

Judge L. Felipe Restrepo of the U.S. District Court for the Eastern District of Pennsylvania denied a motion to dismiss filed by the defendants Urban Outfitters, Inc. (Urban) and certain of their officers in a securities fraud putative class action.

The plaintiff, an Urban shareholder, asserted claims for violations of Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder, as well as for control person liability under Section 20(a) of the Securities Exchange Act. The plaintiff alleged that the defendants misrepresented information related to failed product assortments and the resulting deceleration in sales growth during the first half of fiscal year 2014. Specifically, the plaintiff alleged that the defendants concealed and/or failed to disclose that one of Urban's five brands — Urban Outfitters — was experiencing declining sales while at the same time implementing more frequent and significant product markdowns.

In denying the defendants' motion to dismiss, the court found that the plaintiff adequately alleged both falsity and scienter. Regarding falsity, the defendants throughout the class period stated that Urban's sales continued to grow and that there had been no change of philosophy or strategy relating to average selling price. The court noted that such statements ran contrary to the plaintiffs' allegations. The court also found that many of the defendants' statements did not fall within the PSLRA's safe harbor provision because many of those statements concerned past or present financial conditions, as opposed to purely forward-looking projections. In response to the defendants' argument that they were under no duty to disclose Urban's product markdowns, the court found that because the defendants specifically discussed "the issues of sales trends and promotional activity" by Urban Outfitters, "defendants put these topics 'in play' and triggered a duty to disclose and correct any inaccurate or misleading prior disclosure."

The court cited several factors in finding that the plaintiff adequately alleged scienter. First, the plaintiff alleged that the defendants issued statements throughout the class period denying that there were any unusual or special circumstances affecting either the sales trends or price points. Given the plaintiff's allegations to the contrary, the defendants' statements themselves are indicative of scienter. Second, the court found that the plaintiff adequately alleged that the misrepresentations and omission were made on "core matters of central importance" to the company and its high-level executives, which gives rise to an inference of scienter when taken together with additional allegations connecting the executives' positions to their knowledge. Third, the court cited the plaintiff's allegations regarding the defendants' stock sales, including that one executive sold 99 percent of his stock holdings just a week before the company's announcement concerning its third-quarter sales growth, which was the alleged corrective disclosure that disappointed the market and resulted in a price drop in Urban stock.

SLUSA

Northern District of California Remands Securities Act Claims Under SLUSA

Liu v. Xoom Corp., Nos. 15-cv-00602 and 15-cv-01319 (N.D. Cal. June 25, 2015)
Click here to view the opinion.

Judge Lucy H. Koh of the U.S. District Court for the Northern District of California granted the plaintiff's motion to remand an action brought under Sections 11 and 15 of the Securities Act, finding that the Securities Litigation Uniform Standards Act (SLUSA), which amended both the jurisdictional and anti-removal provisions of the Securities Act, did not permit removal of the action to federal court.

The court began by analyzing the relevant statutory provisions, including SLUSA. Under SLUSA, which Congress enacted in 1998, no case arising under the relevant subchapter of the Securities Act can be removed to federal court, except "as provided in section 77p(c)." Section 77p(c) refers to Subsection 77p(b), which in turn refers to class actions "based upon the statutory or common law of any State or subdivision thereof."

The parties here disagreed over whether the plaintiff's action, which asserted claims under federal law only, properly fit within the anti-removal exception of Section 77p(b).

The court found that "[p]laintiff has the better of the argument." Under the plain language of the statute, the anti-removal exception does not apply because "[p]laintiff asserts only federal Securities Act claims, and no claims under state law." This result, the court noted, is consistent with "what appears to be emerging as the dominant view around the country." In fact, "[a]lthough district courts had previously been split on the question, not a single district court in any district has denied remand since August 2012." The court then noted that, although appellate courts have not directly addressed this issue, both the Ninth Circuit and the Supreme Court have endorsed this view in *dicta* in multiple cases.

Statute of Limitations

Second Circuit Holds Claims Against Financial Institution Are Untimely

NECA-IBEW Pension Trust Fund v. Lewis, No. 14-402-cv
(2d Cir. June 15, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Second Circuit affirmed the denial of a motion for leave to file amended claims that a bank violated Sections 11 and 12 of the Securities Act by allegedly concealing (1) an asset write-down, (2) changes to its "Value-at-Risk" model, and (3) certain loan origination practices prior to public stock offerings. The Second Circuit determined — as to each category of allegations — that the plaintiffs' claims were untimely under the Securities Act's one year statute of limitations. The court did not decide whether the plaintiffs' claims accrued under the inquiry notice rule or the "less-burdensome" discovery rule, as pronounced in *Merck & Co. v. Reynolds*, because the court found the claims to be untimely under either rule. The court determined that the bank had disclosed the alleged write-down, the changes to its VAR model and thealleged loan origination practices throughout 2007 and 2008, but the plaintiffs had not filed their complaint until January 2010.

Contacts

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

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

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

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

*Editors

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Skadden, Arps, Slate, Meagher & Flom LLP
Four Times Square
New York, NY 10036
212.735.3000