Securities Litigation Update

Securities Class Actions Continue to Decline as Percentage of All Securities Litigation: Using different statistical methods, year-end studies published by both Advisen and Cornerstone Research found that, despite a strong surge in filings in the latter part of 2010, the number of securities class actions filed in 2010 was below the historical average. The reports noted that class actions have dropped from approximately 33 percent of all securities litigation prior to 2006 to just 16 percent in 2010, although the number of securities class actions filed in 2010 increased slightly from 2009. The decrease in class action filings as a percentage is significant given that both Advisen and Cornerstone found a significant drop in credit-crisis-related filings. Cornerstone indeed reported a 76 percent drop from 2009. With heightened pleading standards and other obstacles to prosecuting securities actions, derivative and single-/joint-party suits have become more common.

Nonetheless, the reports noted that securities class actions are still one of "the most commonly filed types of security suits," and "typically produce most of the largest settlements." For example, Advisen termed "eye-popping" the tentative $600 million class action settlement agreed to by Countrywide Financial in 2010. Cornerstone also noted that many analysts expect a higher number of M&A transactions in 2011, which may translate into sustained, if not increased, securities class action filings this year.

Supreme Court Rules That Facts Can Be Material, Even if Not "Statistically Significant": In a much-anticipated decision clarifying materiality standards for pleading a claim under the federal securities laws, the Supreme Court ruled unanimously on March 22, 2011 that a company cannot withhold information from shareholders simply because it doesn't meet the scientific standard of statistical significance. In *Matrixx Initiatives, Inc. v. Siracusano*, No. 09-1156, the Court resolved a split in the circuit courts concerning the need to plead "statistical significance" to establish materiality for purposes of a securities fraud claim. The First, Second, and Third Circuits had held that a pharmaceutical company's failure to disclose complaints concerning a drug is not materially misleading unless the company is alleged to have had knowledge that the drug caused "a statistically significant number of" medical problems. *See N.J. Carpenters Pension and Annuity Funds v. Biogen IDEC Inc.*, 537 F.3d 35 (1st Cir. 2008); *In re Carter-Wallace, Inc. Sec. Litig.*, 150 F.3d 153 (2d Cir. 1998); *Oran v. Stafford*, 226 F.3d 275 (3d Cir. 2000). In *Siracusano*, however, the Ninth Circuit had held that a bright-line rule to determine materiality is inappropriate and that questions of materiality should generally be left to the trier of fact. *Siracusano v. Matrixx Initiatives, Inc.*, 585 F.3d 1167 (9th Cir. 2009), *cert. granted*, __U.S.__, 130 S. Ct. 3411 (2010). In a decision by Justice Sonia Sotomayor, the Court agreed with the Ninth Circuit that there is no "bright-line rule" governing when companies must disclose information to shareholders; "[g]iven that medical professionals and regulators act on the basis of evidence of causation that is not statistically significant, it stands to reason that in certain cases reasonable investors would as well." Unfortunately for companies making disclosure decisions, the Court did not specify what a "reasonable investor" would consider material. The Court, however, did not "create an affirmative duty to disclose any and all material information," but instead required disclosure "only when failure to disclose would render other statements misleading."

Supreme Court to Consider Expansive View of "Primary Violator" Liability: Also currently under consideration by the Supreme Court is *Janus Capital Group, Inc. v. First Derivative Traders*, No. 09-525, a case involving a Fourth Circuit decision that potentially expands the definition of "primary violator" under the federal securities laws. In *Janus Capital*, investors in mutual funds sued the funds' holding company (Janus Capital Group) and investment advisor (Janus Capital Management), alleging that the mutual funds were mismanaged, resulting in a loss to investors. The Fourth Circuit found that investors had asserted a viable Section 10b-5 claim because the Janus entities had helped to draft and disseminate the funds' prospectuses. The funds argued that they could not be liable for assisting in preparation of the prospectuses, given the Supreme Court's rulings in *Cent. Bank of Denver v. First Interstate Bank*, 511 U.S. 164 (1994), and *Stonebridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, __U.S.__, 128 S. Ct. 761 (2008), which eliminated aiding and abetting liability in private Rule 10b-5 actions and confirmed that only "primary violators" are liable for securities fraud.

The questioning at the December oral argument suggested that the justices might be divided as to whether a fund's investment manager can be subject to liability as a "primary violator" under the federal securities laws based on alleged misstatements in the fund's prospectuses. Several justices asked about the relationship between an investment advisor and a fund, including whether an investment advisor should be viewed as the equivalent of a corporate manager liable for a corporation's misstatements. A decision upholding the Fourth Circuit's decision might represent a significant expansion of the current scope of "primary violator" liability under the securities laws.

Speculators Bet on Madoff Claims: The latest securities to attract the attention of distressed-investment Wall Street traders are claims in the notorious Bernard L. Madoff bankruptcy case, in which total losses are estimated at roughly $20 billion. As the *New York Times* has reported, hedge funds and other investment firms have quietly been contacting Madoff victims whose loss claims have been approved by the Madoff trustee, Irving Picard. See http://dealbook.nytimes.com/2010/12/13/speculators-are-eager-to-bet-on-madoff-claims/. The funds offer to buy approved Madoff claims immediately for cash, but at a sharp discount from their face value, ranging from 20 to 34.5 cents on the dollar. With the trustee already having collected more than $2 billion and the estate continuing to commence big-ticket actions, the Madoff bankruptcy process is viewed by some as creating an opportunity to earn big returns. Recent filings have included lawsuits against deep-pocketed banks such as JPMorgan Chase, UBS and HSBC, among others.

Bankruptcy lawyers expect the legal fights will take years to resolve, with no guarantee of recovering any of the billions being sought. But for small investors caught in the Madoff fraud who cannot afford to wait years to recover, getting some cash now might be more attractive than waiting for a future litigation payoff.

SEC to Implement Whistleblower Reward Program by Mid-April: The Wall Street Reform and Consumer Protection Act, signed into law by President Barack Obama on July 21, 2010, sets a deadline of April 15, 2011, for the SEC to implement its so-called “reward” program, codified in Section 21F of the Securities Exchange Act of 1934. The objective of the program is to reward whistleblowers who offer information about securities law violations.

The commentary accompanying proposed Regulation 21 F, issued in November 3, 2010, offered insights into the SEC’s intentions. Among other things, the SEC has attempted to strike a balance between encouraging whistleblower reporting directly to the SEC and preserving the incentive for employees to report violations internally. Proposed Regulation 21F thus allows a whistleblower to wait up to 90 days between reporting violations internally and providing information to the SEC without compromising eligibility for a cash reward. The SEC hopes that this “grace period” will give corporations a sufficient amount of time to conduct internal investigations and respond appropriately to a whistleblower’s information. In addition, the SEC will consider a whistleblower’s cooperation with his or her company’s internal compliance program as a favorable factor in determining the percentage of any recovery that the whistleblower receives as reward.