Skadden

Inside the Courts

An Update From Skadden Securities Litigators

CONTENTS

April 2011 | Volume 3 | Issue 2

Skadden

Inside the Courts

An Update From Skadden Securities Litigators

CONTENTS

April 2011 | Volume 3 | Issue 2

U.S. SUPREME COURT

MATERIALITY

Matrixx Initiatives, Inc. v. Siracusano, No. 09-1156 (U.S. Mar. 22, 2011)

Click here to view the opinion.

Supreme Court Rejects Bright-Line Test for Materiality and Scienter Allegations in Securities Fraud Case

A unanimous U.S. Supreme Court held that a securities fraud complaint, based on a pharmaceutical company's alleged failure to disclose reports of adverse events associated with a product, may state a claim, even if the complaint does not allege that the company knew of a statistically significant number of adverse events. In an opinion by Justice Sonia Sotomayor, the Court rejected a bright-line test that would require an allegation of statistical significance in order to satisfy the materiality and scienter requirements under Section 10(b) of the Securities Exchange Act and Rule 10b-5. In finding that the plaintiffs had adequately alleged material omissions, the Court noted that neither drug regulators nor medical professionals limit the evidence considered for purposes of assessing whether a product causes harm to statistically significant data. "Given that medical professionals and regulators act on the basis of evidence of causation that is not statistically significant, it stands to reason that investors would as well." The Court cautioned that its ruling would not require disclosure of all adverse events, but only those that would significantly alter the total mix of information. Further, in addressing the scienter issue, the Court first noted that it was assuming (but not deciding) that "deliberate recklessness" would satisfy the scienter element. This leaves for another day the question of whether recklessness constitutes scienter. The Court rejected the drug company's argument that, because the plaintiffs did not allege that the company knew of statistically significant evidence that the drug at issue caused harm, there is no basis to infer scienter. The Court held that "Matrixx's proposed bright-line rule requiring an allegation of statistical significance to establish a strong inference of scienter is just as flawed as its approach to materiality."

AUDITOR LIABILITY CLAIMS

Amorosa v. AOL Time Warner Inc., No. 09-5270-cv (L) (2d Cir. Feb. 2, 2011)

Click here to view the opinion.

Second Circuit Affirms Dismissal of Claims Against AOL Auditor

In a *per curiam* summary order signed by the clerk, the U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims that AOL's auditor, Ernst & Young, violated Section 11 of the Securities Act and Sections 10(b) and 14(a) of the Securities Exchange Act by making alleged misrepresentations in a "clean" audit opinion on AOL. As to the Section 10(b) and 14(a) claims, the plaintiff failed to plead loss causation because he did not identify any purported corrective disclosures that implicated Ernst & Young's challenged audit opinions and, further, did not connect AOL's alleged fraud to Ernst & Young itself. Put differently, because the alleged corrective disclosure did not reveal any alleged misstatements or omissions about Ernst & Young's audit opinion (*i.e.*, that the audit did not comply with GAAS), the complaint did not plead securities fraud against Ernst & Young. As to the untimeliness of the Section 11 claim, the complaint alleged that the first disclosures relating to Ernst & Young's alleged misrepresentations were more than a year before the plaintiff filed suit. Further, although the plaintiff claimed that corrective disclosure occurred less than one year before he filed suit, AOL's stock price had actually increased after that purported corrective disclosure, making his Section 11 claim fail for lack of loss causation.

CLASS ACTION FAIRNESS ACT

Rubin v. Mercer Ins. Grp., Inc., No. 10-6816 (MLC) (D.N.J. Feb. 15, 2011)

Click here to view the opinion.

New Jersey Federal Court Remands Action Removed Under CAFA

In an opinion marked "not for publication," Judge Mary L. Cooper of the U.S. District Court for the District of New Jersey remanded an action asserting claims for breach of fiduciary duty in connection with a merger agreement. The plaintiffs alleged, *inter alia*, that the individual defendants — who were executives at the target entity — breached their fiduciary duties by entering into agreements to vote in favor of the merger. The defendants had removed the action based on the Class Action Fairness Act (CAFA); however, actions with claims that solely relate to covered securities or that solely relate to rights or duties created by a security cannot be removed under that act. Because the claims were based on a publicly traded security, the court determined that the case could not have been removed under CAFA. Further, the claims related to the rights, duties and obligations created by ownership of the target's stock, thereby precluding CAFA removal as well.

CLASS CERTIFICATION

Barber v. Am. Airlines Inc., No. 110092 (Ill. Mar. 24, 2011)

Click here to view the opinion.

Lucero v. Bureau of Collection Recovery, Inc., No. 10-2122 (10th Cir. Mar. 31, 2011)

Click here to view the opinion.

Illinois Supreme Court Dismisses Potential Class Action Where Defendant Tenders Requested Relief

The Illinois Supreme Court dismissed a potential class action against American Airlines and held that the tender of requested relief to the named plaintiff prior to a motion for class certification mooted her claim. The plaintiff filed a breach of contract claim after an American Airlines counter agent refused to refund her baggage fee and advised the plaintiff that American Airlines did not refund baggage fees where a person rejected an alternative flight after cancellation of the original flight. The plaintiff filed the complaint four days after the cancellation of her flight, and the record provided no indication that she made any effort to contact American Airlines and seek a refund or investigate the accuracy of the explanation offered by the counter agent. American Airlines subsequently determined that the plaintiff was entitled to a refund and offered to refund the $40 fee and court costs incurred to date. The plaintiff rejected this offer, but the airline refunded the fee to her credit card.

The Illinois Supreme Court ruled that the refund mooted the plaintiff's claim and thereby made her an unfit class representative. The plaintiff's claim was moot because she had not filed a motion for class certification prior to the time when the defendant made its tender of relief. In so ruling, the court explicitly rejected the "pick off" exception, whereby a putative class action can survive a settlement with a lead plaintiff, and overruled cases suggesting that a class action should not be dismissed where the defendant tendered full relief until the plaintiff had a "reasonable opportunity" to move for class certification. The court concluded that the lower court correctly dismissed the claim because it was undisputed that no motion for class certification was pending when American Airlines tendered the baggage fee refund.

The Illinois Supreme Court opinion stands in sharp contrast to the recent decision by the U.S. Court of Appeals for the Tenth Circuit in *Lucero v. Bureau of Collection Recovery, Inc.*, No. 10-2122 (10th Cir. March 31, 2011), where the court held that "a named plaintiff in a proposed class action for monetary relief may proceed to seek timely class certification where an unaccepted offer of judgment is tendered in satisfaction of the plaintiff's individual claim before the court can reasonably be expected to rule on the class certification motion." In analyzing this matter of first impression, the Tenth Circuit engaged in a robust analysis of Supreme Court and federal circuit court authority and noted that "uncertainty prevails among the lower courts regarding the jurisdictional effect of offers of judgment made prior to class certification." The Tenth Circuit concluded that "a nascent interest attaches to the proposed class upon the filing

(continued on next page)

of a class complaint such that a rejected offer of judgment for statutory damages and costs made to a named plaintiff does not render the case moot under Article III." For this reason, the defendant's tender of a Rule 68 offer for the full amount of the named plaintiff's claim did not moot the class action complaint.

In re DVI, Inc. Sec. Litig.,
Nos. 08-8033 & 08-8045
(3d Cir. Mar. 29, 2011)

Click here to view the opinion.

Third Circuit Affirms Certification Order in Interlocutory Appeal of Securities Fraud Action

In an interlocutory appeal of a securities fraud action, the U.S. Court of Appeals for the Third Circuit affirmed the district court's class certification order. The district court had certified a class of investors in DVI in claims under Section 10(b) of the Securities Exchange Act against DVI, its officers and directors, its underwriter and its auditor, but it had declined to certify claims against DVI's outside corporate counsel (Clifford Chance) because the outside counsel's conduct was not publicly disclosed and it owed no duty of disclosure to DVI's investors. The auditor appealed the certification of a class against it, and the plaintiffs appealed the denial of certification of a class against the outside counsel. On appeal, the court determined that the district court did not abuse its discretion in either ruling. The auditor's appeal was limited to whether the plaintiffs had satisfied the Rule 23(b)(3) predominance requirement, particularly with regard to the reliance element of the plaintiffs' claims. The auditor argued that the plaintiffs — who were relying on a market-efficiency and fraud-on-the-market presumption of reliance — must prove loss causation at the class certification stage in order to invoke that presumption. (This issue is presently before the U.S. Supreme Court in *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 856 (2011).) Although the court held that the plaintiffs need not establish loss causation as a prerequisite to invoking the presumption of reliance, it also held that rebuttal of that presumption falls within the ambit of issues that should be addressed at the class certification stage. Although the court held that the auditor did not do so, it did confirm that a defendant's successful rebuttal demonstrating that purported misrepresentations or purported corrective disclosures did not affect the stock price would defeat the presumption of reliance. As to the plaintiffs' appeal, the court applied *Pacific Investment Management Co. v. Mayer Brown LLP* (*Refco*), 603 F.3d 144 (2d Cir. 2010) — "a case with facts analogous to those presented here" — and determined that DVI filed the allegedly false Form 10-Q, and that, as a secondary actor, the outside counsel was not liable because no statements were attributed to it.

N.J. Carpenters Health Fund v. Residential Capital, LLC,
No. 08 CV 8781 (HB)
(S.D.N.Y. Jan. 18, 2011)

Click here to view the opinion.

S.D.N.Y. Denies Class Certification in Two Suits Involving MBS Issuers

Judge Harold Baer Jr. of the U.S. District Court for the Southern District of New York denied class certification in two related lawsuits alleging that issuers of mortgage-backed securities violated Sections 11 and 12(a)(2) of the Securities Act through the use of offering documents that allegedly misrepresented whether the underlying residential mortgages were formed in conformity with disclosed underwriting guidelines. Although the putative classes satisfied Rule 23's numerosity, commonality, typicality and adequacy requirements, the court determined that the proposed class failed to satisfy Rule 23(b)(3)'s predominance requirement. Section 11 provides a cause of action for purchasers who did not know of the alleged misrepresentations at the time of purchase, and the court recognized that putative class members had different levels of knowledge about the purported loosening of underwriting standards at the time of purchase. The putative class included entities such as JPMorgan, which allegedly knew about systemic deficiencies in underwriting guidelines in a separate lawsuit, and Blackrock Management, which touts its expertise in mortgage-backed securities. Further, those entities purchased the mortgage-backed securities at different times, as information became available that cast increasing doubt on whether mortgage originators were complying with their underwriting standards. The court noted that these issues would require individualized hearings as to each putative class member, defeating Rule 23(b)(3)'s superiority requirement.

CONFIDENTIAL WITNESSES

City of Livonia Employees' Ret. Sys. v. Boeing Co., No. 09-7143 (N.D. Ill. Mar. 7, 2011)

Click here to view the opinion.

Illinois Federal Court Grants Motion to Reconsider and Dismisses Complaint After Discovery of New Facts About Confidential Source

Judge Suzanne B. Conlon of the U.S. District Court for the Northern District of Illinois granted a motion for reconsideration and dismissed with prejudice claims that Boeing violated Section 10(b) of the Securities Exchange Act on the basis that the plaintiffs misrepresented facts concerning a confidential source. The plaintiffs accused Boeing of intentionally deceiving investors about the testing and delivery schedule of the 787 Dreamliner commercial aircraft. The court initially denied Boeing's motion to dismiss for failure to plead scienter, relying on the plaintiffs' allegations that their confidential source, who held an inside position at Boeing, had firsthand knowledge of 787 test results. The court also denied Boeing's subsequent motion to dismiss for fraud on the court. Although Boeing contended that the confidential witness did not hold the position or have the personal knowledge attributed to him, the court found a good faith basis for the allegations based on notes from the plaintiffs' investigators and representations by plaintiffs' counsel.

The court reversed course, however, after Boeing filed a motion to reconsider dismissal in light of new facts about the confidential source. At deposition, the confidential source denied that he was employed by Boeing or knew about the distribution of test results. The confidential source also stated that he had not seen the allegations attributed to him prior to meeting with defense counsel and had not met plaintiffs' counsel until after the filing of the amended complaint. As an initial matter, the court rejected the plaintiffs' argument that the court could not reconsider whether to dismiss the complaint based on facts outside the complaint. The court explained that it could consider evidence developed in discovery in deciding whether the court's previous decision was premised on factual errors. In dismissing the complaint, the court concluded that the plaintiffs misrepresented material facts regarding the position and personal knowledge of the confidential witness. And, in addressing the plaintiffs' contention that the confidential source now was lying, the court observed that the entire issue could have been avoided had plaintiffs' counsel conducted a reasonable inquiry before filing the amended complaint and making flawed representations to the court. Because the amended complaint failed to adequately plead scienter with the particularity required by PSLRA without the allegations from the confidential source, the court dismissed the complaint with prejudice.

DIRECTORS AND DIRECTORS' DUTIES

BOOKS AND RECORDS

Louisiana Mun. Police Employees Ret. Sys. v. Morgan Stanley & Co., Inc., C.A. No. 5682-VCL (Del. Ch. Mar. 4, 2011)

Click here to view the opinion.

Lambrecht v. Bank of Am. Corp., No. 650182/09E (N.Y. Sup. Ct. Oct. 1, 2010)

Click here to view the opinion.

Court of Chancery Limits Scope of Information Request

Vice Chancellor J. Travis Laster of the Delaware Court of Chancery granted in part and denied in part a motion to dismiss a shareholder plaintiff's request to inspect Morgan Stanley & Co.'s books and records pursuant to Del. Code tit. 8, § 220. The plaintiff made its books and records demand for the purpose of investigating whether the Morgan Stanley board wrongfully refused the plaintiff's earlier demand that Morgan Stanley initiate litigation against certain of its officers and directors for alleged wrongs arising out of the company's involvement with auction rate securities. The court found that the plaintiff had stated a proper purpose, explaining that "[e]xploring whether a litigation demand was wrongfully refused is a proper purpose for using Section 220." In so holding, the court noted that a board's decision to refuse a litigation demand is reviewed under the business-judgment rule, and the "highly deferential standard for reviewing a demand-refusal decision makes it critical that an accountability mechanism exist in the form of a limited right to information under Section 220."

(continued on next page)

The court, however, limited the scope of the plaintiff's request, finding that certain requests were not reasonably required to investigate whether the litigation demand was wrongfully refused. The court permitted the plaintiff to examine, among other things, certain minutes of audit committee meetings (in which the prior litigation demand was discussed) and the audit committee's report and presentation to the board. The court also permitted inspection of a report prepared by a law firm retained for the purpose of considering the plaintiff's prior litigation demand, as well as a report created by a second law firm concerning Morgan Stanley's auction rate securities practices. According to the court, these materials were relied upon by the audit committee and the board in refusing the prior litigation demand. The court also allowed the inspection of the engagement letters of both law firms, so that the plaintiff could "evaluate the scope of the firm's engagement and its economic incentives." The plaintiff was not entitled, however, to certain other categories of requested information, including documents and notes relied upon by the second law firm in investigating Morgan Stanley's auction rate securities practices and creating its report. The court held that to obtain this information, the plaintiff "must make a greater showing of need by articulating in more specific and convincing fashion why the incremental information is reasonably required to evaluate the Board's demand-refusal decision."

In *Lambrecht v. Bank of Am. Corp.*, the Supreme Court of New York reached a different result. The court refused to allow a plaintiff stockholder to inspect the books and records of Bank of America Corporation (BofA) regarding the BofA board's consideration of the plaintiff's pre-suit demands to institute litigation. In *Lambrecht*, the plaintiff, who was a former stockholder of Merrill Lynch, made written demands on the boards of directors of Merrill Lynch and BofA demanding that they commence litigation against former officers and directors of Merrill Lynch in connection with Merrill's aggressive subprime mortgage investments. The BofA board informed the plaintiff that it would not cause Merrill Lynch to pursue litigation against its former officers and directors. In response, the plaintiff filed a double-derivative action in the U.S. District for the Southern District of New York and then filed a Section 220 action in the New York state court seeking books and records to investigate the rejection of the plaintiff's demands. In granting summary judgment dismissing the plaintiff's claims, Justice Paul G. Feinman found that the plaintiff had "no credible basis from which the court can infer that [BofA's] decision not to pursue claims against Merrill's former directors and officers was the product of wrongdoing." Justice Feinman reached that conclusion based in part on the plaintiff's admission under oath that "she did not have a basis for believing that the [BofA] Board was involved in any wrongdoing." As a result, the court concluded that the plaintiff was not entitled to inspect the books and records of BofA and dismissed the Section 220 action.

CORPORATE RESTRUCTURING

CDX Liquidating Trust v. Venrock Assocs., No. 10-1953 (7th Cir. Mar. 29, 2011)

Click here to view the opinion.

Seventh Circuit Reverses Judgment as a Matter of Law in Case Regarding Breach of Fiduciary Duty

The U.S. Court of Appeals for the Seventh Circuit reversed a judgment as a matter of law in favor of J.P. Morgan Partners LLC and Venrock Associates, two venture capital groups accused of aiding and abetting a board of directors' breach of fiduciary duty. The Seventh Circuit decided that the burden of proving causation was on the defendant because, where the plaintiff rebuts the business-judgment rule, the burden shifts to the defendants to prove the entire fairness of the transaction. Cadant agreed to provide lenders J.P. Morgan and Venrock with twice the outstanding principal of the loans plus any unpaid interest in the event that Cadant was liquidated. The board member who negotiated the deal was the principal of Venrock, and three other board members who championed the deal were employed by Venrock or J.P. Morgan, though one resigned from J.P. Morgan before the loan issued. In granting judgment as a matter of law, the district court concluded that the defendants were protected by the business-judgment rule and that the bursting of the dot-com bubble, not the unfavorable loans, led to Cadant's downfall.

(continued on next page)

The Seventh Circuit disagreed with both the district court's conclusions, reversing the judgment and remanding for a new trial. The Seventh Circuit decided that the burden of proving causation was on the defendant — because, where the plaintiff rebuts the business-judgment rule, the burden shifts to the defendants to prove the entire fairness of the transaction. For a transaction involving the sale of a company, the defendants must essentially prove that "the disloyal acts had no effect on the shareholders — no causal relation to their loss." The court also concluded that, regardless of who bore the burden of proof, a fact issue remained about the cause of Cadant's loss, and thus the district court erred in granting judgment as a matter of law.

DERIVATIVE LITIGATION

In re Merrill Lynch & Co., Inc., Sec., Derivative & ERISA Litig., No. 07 Civ. 9696 (JSR) (S.D.N.Y. Mar. 28, 2011)

Click here to view the opinion.

S.D.N.Y. Dismisses Two Actions Styled as Double-Derivative Stockholder Class Actions

Judge Jed S. Rakoff of the U.S. District Court for the Southern District of New York dismissed two actions styled as double-derivative stockholder class actions seeking to compel the board of directors of Bank of America Corporation (BofA) to force its Merrill Lynch subsidiary to bring various claims against Merrill Lynch's officers and directors in connection with Merrill's allegedly risky investments in collateralized debt obligations. In the first action, the plaintiff stockholder argued that any demand upon the BofA board to pursue these claims would be futile because the BofA board was conflicted and could not impartially decide whether to bring these claims against Merrill Lynch's officers and directors. The court disagreed, holding that there was no reason why the BofA board would be incapable of performing a disinterested assessment of a demand to sue Merrill Lynch's officers and directors for pre-merger conduct in which the BofA board had no connection and faced no personal liability whatsoever with respect to these claims.

In the second related action, the plaintiff stockholder had made several demands upon the boards of BofA and Merrill Lynch to initiate litigation against present and former officers and directors of Merrill who she alleged mismanaged Merrill and should be held responsible for the unprecedented losses experienced by the company as a result of its investments in mortgage-backed securities. After BofA informed the plaintiff that it would not cause Merrill to pursue these claims, she asserted that the BofA board wrongfully refused her litigation demands by not giving serious consideration to her demands, only holding a single meeting to discuss her demands and responding with a boilerplate rejection letter that did not describe any investigation that the board undertook. Judge Rakoff found that the plaintiff's contentions were meritless. Following settled Delaware law, the court held that the decision whether to commit the corporation to litigation lied solely in the discretion of the BofA board, that such decision is protected by the business judgment rule, and that conclusory allegations challenging the board's investigation and response letter will not suffice. The court made clear that "there is no prescribed procedure or form a board must follow when responding to a demand letter," but rather a board's response is dependant on the nature and complexity of the issues at hand and should be tailored accordingly. Further, the court held that there was no specific time period by which the BofA board was required to expend evaluating and investigating these claims, especially given that the BofA board was "already quite familiar" with the allegations in the plaintiff's demand letters. The court found that BofA's response letter belied the plaintiff's assertions and evidenced the BofA board's appropriate conduct under the circumstances. In particular, the court viewed favorably that both the audit committee and the full BofA board engaged in a cost-benefit analysis to consider the negative consequences of pursuing the claims against present and former Merrill Lynch officers and directors, including weighing the potential adverse effects the pursuit of such claims would have on a number of then-pending litigations and governmental inquiries. As a result, the court ruled that the plaintiff stockholder would be unable to overcome the considerable burden of showing that the decision not to bring the lawsuit was made in bad faith or was based on an unreasonable investigation, even if discovery later confirmed that the BofA board rejected the demand after only one meeting. Ultimately, the court dismissed the two double-derivative actions in their entirety with prejudice.

In re Bear Stearns Cos., Inc. Sec., Derivative, & ERISA Litig., No. 08 MDL 1963 (S.D.N.Y. Jan. 19, 2011)

Click here to view the opinion.

S.D.N.Y. Allows Class Action to Proceed While Dismissing Certain Derivative Claims

Judge Robert W. Sweet of the U.S. District Court for the Southern District of New York allowed purported class claims for violation of Sections 10(b) and 20A of the Securities Exchange Act against Bear Stearns Cos. Inc. and its auditor to proceed, while dismissing certain derivative claims. A number of proposed class actions related to the March 2008 collapse of Bear Stearns were consolidated into a single case and assigned to the Southern District of New York by a multidistrict litigation panel in 2008. Various defendants moved to dismiss the claims. In the securities suit, the plaintiffs allege that Bear Stearns and numerous former executives made materially false and misleading statements about the bank's financial condition and its exposure to the subprime mortgage market. In addition, Bear Stearns is alleged to have suffered from a "pervasive weakness" in its internal controls, and to have "repeatedly and systematically violated Generally Accepted Accounting Principles." As to Bear Stearns' auditor, the plaintiffs alleged, among other things, that in issuing its audit opinion on Bear Stearns' financial statements, the accounting firm failed to comply with GAAP and GAAS, recklessly disregarding "red flags" that would have alerted the auditor to the falsity of the financial statements. The court found that the plaintiffs sufficiently alleged that Bear Stearns and the auditor made false statements and acted with scienter to allow the federal securities claims to proceed.

As to the derivative claims, the derivative plaintiff alleged that certain officers and directors of Bear Stearns, among other things, knew that adverse facts about Bear Stearns were being concealed from the public and that the positive representations being made about the company were then materially false and misleading. The court found that the derivative plaintiff did not adequately allege that the purpose of the merger was to deprive him of a derivative action in order to fall within the fraud exception to the continuous ownership rule. Nevertheless, because the derivative plaintiff also held JPMorgan stock (the buyer of Bear Stearns, post-collapse) at the time of filing the derivative complaint, a double-derivative action might have been proper. However, the court found that the derivative plaintiff's double-derivative suit failed because he did not sufficiently allege that JPMorgan was harmed by the defendants' misconduct. The court explained that "[i]t is a fundamental requirement of a double-derivative suit that the injury to the subsidiary must also cause injury to the parent." The court additionally found that the derivative plaintiff's claims were "dismissed on the independent ground that the plaintiff did not make a demand on JPMorgan's board of directors and has failed to plead particularized facts demonstrating that the demand is excused."

MERGERS AND ACQUISITIONS

S. Muoio & Co. LLC v. Hallmark Entm't Invs. Co., C.A. No. 4729-CC (Del. Ch. Mar. 9, 2011)

Click here to view the opinion.

Court of Chancery Holds That Recapitalization Was Entirely Fair

Chancellor William B. Chandler III of the Delaware Court of Chancery in a post-trial opinion, held that a recapitalization of Crown Media Holdings, Inc., "orchestrated" by its controlling stockholder and primary debt holder, Hallmark Cards, Inc., was entirely fair. The court began by explaining that "[a] transaction between a majority stockholder and the company in which it owns a majority stake is generally reviewed under the entire fairness standard and the controlling stockholder (or the party standing on both sides of the transaction) bears the burden of proof." If the defendant can show that the challenged transaction was negotiated and approved by an independent committee of directors or an informed majority of the minority, however, the burden of proof shifts to the challenging shareholder plaintiff. The court also noted that, had the controlling stockholder here permitted the use of both an independent special committee and an informed majority of the minority approval condition, the transaction could have avoided entire fairness review. Applying entire fairness review, the court found that the evidence at trial "easily met" the exacting standard, and demonstrated, from a process standpoint, that the special committee was independent and fully informed and that it had negotiated with Hallmark at arm's length. In finding that the special committee was independent, the court explained that "[t]he mere nomina-

(continued on next page)

tion of a director by a majority stockholder ... is insufficient to demonstrate lack of independence." The court further found that the special committee was provided a sufficient mandate by the board, retained expert advice and met frequently during the process.

As for price, the court explained that "[a] strong record of fair dealing can influence the fair price inquiry, reinforcing the unitary nature of the entire fairness test." The court found the evidence at trial demonstrated that, "without a recapitalization, Crown was facing insolvency and its equity was worthless." The court discussed the various expert testimony proffered by both the plaintiffs and the defendants, concluding that, "[i]n sum, because Crown's outstanding debt exceeded the value of its equity before the Recapitalization, and because defendants' proffered expert testimony persuasively and thoroughly supported their valuation conclusions (and plaintiff's experts failed to convince me otherwise) ... the Recapitalization was entirely fair."

In re Atheros Commc'ns, Inc. S'holder Litig., C.A. No. 6124-VCN (Del. Ch. Mar. 4, 2011)

Click here to view the opinion.

Court of Chancery Enjoins Transaction Pending Issuance of Curative Disclosures

Vice Chancellor John W. Noble of the Delaware Court of Chancery preliminarily enjoined, pending final judgment, Atheros Communications, Inc. and its board of directors from conducting a stockholder meeting or stockholder vote on a proposed $3.1 billion all-cash transaction with Qualcomm Inc. pending the issuance of curative disclosures. The court found certain disclosure claims relating to Atheros' financial advisor's compensation in connection with the transaction were likely to succeed on the merits. Specifically, the court focused on the fact that the proxy materials failed to disclose the overall amount of compensation and the percentage that was contingent on the deal closing. The court explained that "contingent fees are undoubtedly routine; they reduce the target's expense if a deal is not completed; perhaps, they properly incentivize the financial advisor to focus on the appropriate outcome. Here, however, the differential between compensation scenarios may fairly raise questions about the financial advisor's objectivity and self-interest." The court found that "[s]tockholders should know that their financial advisor, upon whom they are being asked to rely, stands to reap a large reward only if the transaction closes and, as a practical matter, only if the financial advisor renders a fairness opinion in favor of the transaction."

The court, however, rejected the plaintiffs' *Revlon* claims, finding there was nothing in the record to indicate that the board acted unreasonably. The court explained that the independence and disinterestedness of seven of the board's eight directors was unchallenged. The court found no indication that the board favored one bidder over another, and noted that the board's decision to pursue an offer with Qualcomm, which was conditioned on exclusivity, was unlikely to be found unreasonable on the merits. The court concluded that, "[o]n the whole, there is nothing in the record to indicate that the Board acted unreasonably. It was an independent board with deep knowledge of the Company's industry and it employed a robust and sophisticated process. As a result, the Court will not second-guess the Board's conduct, and the Plaintiffs have failed to demonstrate any reasonable probability of success on the merits of their price and process claims."

Olson v. ev3, Inc., C.A. No. 5583-VCL (Del. Ch. Feb. 21, 2011)

Click here to view the opinion.

Court of Chancery Discusses Viability of Claims Challenging Top-Up Option Provisions

Vice Chancellor Travis Laster of the Delaware Court of Chancery discussed the viability of claims challenging top-up option provisions in connection with a contested fee application following the settlement of "the first meaningful full-scale challenge to the use of a top-up option." The underlying settlement resolved "appraisal dilution" and statutory violation claims stemming from the use of a top-up option in a two-step merger agreement with a front-end tender offer. The court explained that so-called "appraisal dilution" claims "threaten[] stockholders who might seek appraisal with the issuance of a significant number of shares at less than what the dissenting stockholder believes is fair value. Because the top-up shares will be

(continued on next page)

outstanding at the time of the short-form merger, any remaining stockholders who might otherwise have sought appraisal would find their proportionate interest in the firm diluted by the issuance of what they regard as underpriced shares." The top-up option thus allegedly coerces stockholders into tendering their shares. The settlement alleviated any threat of "appraisal dilution" by ensuring that any shares issued under the top-up option and any related consideration would not be considered for purposes of appraisal. The court described this benefit to be "ephemeral at best" because, among other reasons, Delaware's appraisal statute appears to call for the exclusion of shares issued under a top-up option.

Second, the court highlighted the risk that shares issued under a top-up option in exchange for a promissory note may be considered void if the merger agreement fails to define the "material terms" of that note. The merger agreement in the underlying litigation originally "authorized the consideration for the Top-Up Shares to be paid with a promissory note, but failed to set forth the material terms of the note, including the terms of repayment, provisions for interest, whether the note will be secured, negotiable or transferable, or other material terms." The court explained that Del. Code tit. 8, § 157(b) governs the terms upon which shares may be acquired from the corporation upon the exercise of an option, and "requires that the option terms, including the consideration to be provided for the shares, be set forth in the certificate of incorporation or in a resolution adopted by the board of directors providing for the creation and issue of such rights or options, and, in every case, shall be set forth or incorporated by reference in the instrument or instruments evidencing such rights or options." According to the court, "[b]y requiring that the Merger Agreement spell out the terms of the promissory note, the settlement ensured that the instrument ... evidencing the Top-Up Option set forth the consideration to be paid for the shares as required by Section 157(b)." The settlement also required the ev3 board to meet and approve the amended merger agreement and adopt an implementing resolution. The court explained that "[t]his term ensured that the board would determine the consideration to be received for the Top-Up Option Shares, as required by Sections 152, 153(a), and 157(d), and that a board resolution would exist that provided for the creation and issuance of the Top-Up Option, as required by Section 157(b)." The court also noted that, while Del. Code tit. 8, § 152 provides that consideration for shares may consist of "cash, any tangible or intangible property or any benefit to the corporation, or any combination thereof," providing for payment of the par value in cash eliminated "any conceivable debate over whether the value of the consideration received for the Top-Up Option Shares might be less than the par value of those shares, as required by Section 153(a)."

VENUE

Galaviz v. Berg, Nos. C 10-3392 RS, C 10-4233 RS, 2011 WL 135215 (N.D. Cal. Jan. 3, 2011)

Click here to view the opinion.

California Federal Court Refuses to Enforce Forum Selection Clause Added to Corporate Bylaws

Judge Richard Seeborg of the U.S. District Court for the Northern District of California refused to enforce a forum selection bylaw against shareholders of Oracle Corporation, where the bylaw was added by the directors named as defendants after the alleged wrongdoing occurred. According to the court, "the enforceability of a venue provision for derivative actions contained in corporate bylaws" presented "a question of first impression." The court further noted that "[s]uch bylaws are reportedly a recent phenomenon" spurred by a statement in *In re Revlon, Inc., Shareholder Litig.*, 990 A.2d 940 (Del. Ch. 2010), that, "if boards of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes."

In the action, Oracle shareholders sued individual directors in the Northern District of California, alleging breach of fiduciary duty and abuse of control. Before the plaintiffs sued, but after the alleged wrongdoing, the directors had unilaterally adopted a bylaw requiring all derivative suits

(continued on next page)

brought on behalf of Oracle to be brought in the Delaware Court of Chancery. Nominal defendant Oracle and the individual directors moved to dismiss the California action on the basis of the forum selection bylaw. The defendants argued that corporate bylaws operate as contracts between shareholders and directors, and that the forum selection provision in Oracle's bylaws should be enforced just as any other contractual forum selection clause would be.

Applying federal common law, Judge Seeborg rejected that argument because the defendants amended the corporate bylaws unilaterally. According to the court, just as a contract cannot generally be amended unilaterally, a unilateral corporate bylaw cannot be enforced against shareholders without shareholder approval. The court stated that "the venue provision was unilaterally adopted by the directors who are defendants in this action, after the majority of the purported wrongdoing is alleged to have occurred, and without the consent of existing shareholders who acquired their shares when no such bylaw was in effect." With respect to a charter amendment, as opposed to adoption of a bylaw, however, the court added, "Certainly were a majority of shareholders to approve such a charter amendment, the arguments for treating the venue provision like those in commercial contracts would be much stronger, even in the case of a plaintiff shareholder who had personally voted against the amendment." Because the court ruled the forum selection bylaw unenforceable, Judge Seeborg did not need to address whether Delaware law permitted the directors to add such a bylaw in the first place.

FOREIGN CORPORATIONS

In re Infineon Techs. AG Sec. Litig., No. C 04-04156 JW (N.D. Cal. Mar. 17, 2011)

Click here to view the opinion.

California Federal Court Rejects Argument That Section 10(b) Covers Securities Purchased Abroad When Shares Are Listed and Traded Domestically

Applying the U.S. Supreme Court's holding in *Morrison v. National Australia Bank*, 130 S. Ct. 2869 (2010), Judge James Ware of the U.S. District Court for the Northern District of California dismissed foreign purchasers from a securities fraud and control person liability class action under Section 10(b) of the Securities Exchange Act brought against Infineon Technologies AG and its senior officers and directors. The putative class of plaintiffs alleged that the defendants conspired to fix prices of dynamic random access memory and then misrepresented that conspiracy's effect on Infineon's share price in connection with the sale of securities. The district court initially certified a class that included investors who purchased Infineon securities on the Frankfurt bourse, where plaintiffs alleged that common shares were actively traded. While the class certification order was on appeal to the U.S. Court of Appeals for the Ninth Circuit, the Supreme Court decided *Morrison* and the Ninth Circuit vacated the class certification order and remanded for further proceedings in light of *Morrison*. On remand, the plaintiffs argued that, under *Morrison*, the Securities Exchange Act still applies to "transactions in securities listed on domestic exchanges," and that the Infineon shares were listed and traded on the New York Stock Exchange, even if the shares at issue here were purchased in Frankfurt. Judge Ware rejected that argument, reasoning that a transaction occurring on a foreign exchange is not covered by the Securities Exchange Act, even if the defendant lists and trades other securities domestically. The court further noted that its ruling was consistent with every other federal district court to apply *Morrison* to allegations concerning foreign transactions. The court granted the defendants' motion to dismiss with prejudice with respect to all claims asserted on behalf of individuals who purchased Infineon ordinary shares on the Frankfurt bourse.

In re Vivendi Universal, S.A. Sec. Litig., No. 02 Civ. 05571 (RJH) (HBP) (S.D.N.Y. Feb. 17, 2011)

Click here to view the opinion.

S.D.N.Y. Applies *Morrison* to Dismissal of Stockholders

Following a jury verdict that Vivendi was liable to its stockholders for violations of Section 10(b) of the Securities Exchange Act, Judge Richard J. Holwell of the U.S. District Court for the Southern District of New York applied *Morrison v. National Australia Bank, Ltd.*, 130 S. Ct. 2869 (2010), to dismiss those Vivendi stockholders who had purchased Vivendi's stock that

(continued on next page)

traded on a French bourse but had not purchased its U.S.-traded American depositary receipts (ADRs). In doing so, the court explained that the spirit of *Morrison* requires that a stock be traded on an American exchange to be subject to Securities Exchange Act liability, and that Vivendi's listing some of its common stock on the NYSE and registering that stock with the SEC in connection with its public offering of ADRs was not sufficient to subject it to liability for violations of U.S. securities laws in connection with its common stock that traded only on a French bourse. Further, the court denied the plaintiffs' request to conform their pleadings to instead assert fraud claims against Vivendi under New York common law, because the burden of proof for securities fraud (preponderance) is lower than the burden of proof for common-law fraud (clear and convincing). Consequently, the court dismissed the claims of class members who had purchased foreign-traded Vivendi stock instead of its U.S.-traded ADRs.

In re Royal Bank of Scot. Grp. plc Sec. Litig., No. 09 Civ. 300 (DAB) (S.D.N.Y. Jan. 11, 2011)

Click here to view the opinion.

S.D.N.Y. Dismisses Claims Related to Exposure to ADRs

Judge Deborah A. Batts of the U.S. District Court for the Southern District of New York dismissed claims that the Royal Bank of Scotland (RBS) violated Section 10(b) of the Securities Exchange Act and Sections 11 and 12(a)(2) of the Securities Act in connection with RBS's alleged misstatements about its exposure to American subprime mortgages. The court dismissed the lead plaintiffs' Section 10(b) claims under *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010), because they had purchased RBS's common stock, which was listed on only European bourses, even though RBS had listed American depository shares on the NYSE. Further, because the lead plaintiffs had not purchased RBS's ADRs on the NYSE, they lacked standing to assert Section 10(b) claims on behalf of putative class members who did. The court also dismissed the Securities Act claims pursuant to *Morrison* to the extent that they related to RBS's rights offerings on foreign bourses because the Securities Act does not apply to those listings.

INVESTMENT COMPANY ACT/SLUSA

Smit v. Charles Schwab & Co., Inc., No. 10-CV-03971-LHK (N.D. Cal. Mar. 8, 2011)

Click here to view the opinion.

California Federal Court Dismisses Claims Pursuant to SLUSA, But Rejects Argument That Investment Company Act Violations Cannot Serve as the Predicate for State Unfair Competition Claims

In this putative class action, investors in the Schwab Total Bond Market Fund (the Fund) alleged that the defendants deviated from the Fund's investment objective by investing in high-risk, non-U.S. agency collateralized mortgage obligations (CMOs) and by investing more than 25 percent of its total assets in U.S. agency and non-U.S. agency mortgage-backed securities and CMOs. The plaintiffs alleged that the defendants made these changes without first holding a shareholder vote, in violation of Section 13(a) of the Investment Company Act (ICA). The plaintiffs also alleged claims under California's Unfair Competition Law (UCL), and based their California state law UCL claim on the alleged ICA violation. The defendants moved to dismiss, *inter alia*, on the grounds that the ICA cannot serve as a predicate offense for a UCL claim because there is no private right of action under the ICA and that the Securities Litigation Uniform Standards Act (SLUSA) preempted the plaintiffs' claims.

Judge Lucy H. Koh of the U.S. District Court for the Northern District of California held that concluding that the absence of a private right under the ICA serves as a bar to a UCL claim "would be inconsistent with case law holding that even statutes with no private right of action can serve as the basis for a UCL claim." The court observed that, although the Ninth Circuit recently found that "enforcement of the ICA was exclusively granted to the SEC," "this finding was not based on any express language in the ICA itself or its legislative history. Without an express bar prohibiting private enforcement of the ICA § 13(a), ... a UCL claim can proceed on the basis of an alleged violation of this statute."

(continued on next page)

The court, however, granted the defendants' motion to dismiss on the ground that the plaintiffs' claims were preempted by SLUSA, which prohibits class actions brought on behalf of more than 50 people if the action is based on state law and alleges, *inter alia*, a misrepresentation of material fact in connection with the purchase or sale of a covered security. As to the misrepresentation element, the court concluded that the plaintiffs' complaint alleged misrepresentations even though the plaintiffs "avoided using the word 'misrepresentation.'" As to the "in connection with" element, the court, relying on the Supreme Court's decision in *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71 (2006), held that "there is no question that Plaintiff's allegations arise 'in connection with' the purchase or sale of covered securities, as required by SLUSA" because, among other reasons, the named plaintiff defined the class as anyone who, during the class period, purchased shares of, or continued to invest in, the Fund based on the allegedly false or misleading statements.

LOSS CAUSATION

Katyle v. Penn Nat'l Gaming, Inc., No. 09-2272 (4th Cir. Mar. 14, 2011)

Click here to view the opinion.

Fourth Circuit Affirms Denial of Motion to Amend Complaint for Failure to Allege Loss Causation

The U.S. Court of Appeals for the Fourth Circuit affirmed the denial of a motion for leave to file an amended complaint because the proposed complaint failed to adequately allege loss causation. The plaintiffs brought claims under Section 10(b) of the Securities Exchange Act, alleging that Penn National Gaming misled the market into continuing to believe that an announced cash-out merger/leveraged buyout would close even though Penn knew that the deal was doomed. The plaintiffs claimed that the truth "leaked out to the market through a variety of leaks," including skeptical analyst reports, news of regulatory delays and Penn's failure to issue a press release regarding regulatory approval. The district court held that none of these events constituted a "corrective disclosure" or caused a significant decline in Penn's stock price.

The Fourth Circuit affirmed the decision and held that the series of partial disclosures identified by the plaintiffs did not inform the market of Penn's alleged ongoing fraudulent omission. The court noted that the plaintiffs failed to allege that there was a connection between the partial disclosures and any misrepresentation made by Penn. The court stated that even a series of disclosures must "reveal to the market in some sense the fraudulent nature of the practices about which a plaintiff complains," and "relate back to the misrepresentation and not to some other negative information about the company." In this case, the alleged disclosures did not "relate back" because they did not inferentially suggest that Penn's prior press releases were fraudulent and that the LBO would not close. As regards Penn's failure to issue a press release regarding regulatory approval, the court observed that the plaintiffs were unable to identify a single decision that suggested a defendant's silence might constitute a corrective disclosure. Because none of the alleged partial disclosures was "corrective" or related back to the alleged misrepresentations, the plaintiffs failed to allege facts showing that their losses were caused by fraud.

PSLRA DISCOVERY STAY

In re Heckmann Corp. Sec. Litig., C.A. No. 10-378-LPS-MPT (D. Del. Feb. 28, 2011)

Click here to view the opinion.

Delaware Federal Court Denies Third-Party Motion Relating to Merger

In a purported class action asserting claims under Sections 10(b) and 14(a) of the Securities Exchange Act in connection with Heckmann Corp.'s merger with another company, Magistrate Judge Mary Thynge of the U.S. District Court for the District of Delaware denied the lead plaintiff's motion for leave to serve interrogatories on Heckmann and preservation subpoenas on third parties involved with the merger. As to the preservation subpoenas, the lead plaintiff

(continued on next page)

had not shown undue prejudice through the potential loss or destruction of relevant documents from the third parties. Further, the subpoenas were not sufficiently particularized; it was irrelevant that they sought only document preservation, and not document production. In addition, because the lead plaintiff failed to submit copies of the proposed interrogatory to Heckmann with its motion, the court denied the request because it could not determine if the discovery was sufficiently particularized.

RETROACTIVITY

Sacks v. Sec. & Exch. Comm'n, No. 07-74647 (9th Cir. Feb. 22, 2011)

Click here to view the opinion.

Ninth Circuit Holds That FINRA Rule Does Not Apply Retroactively

The U.S. Court of Appeals for the Ninth Circuit granted a petition for review of a rule, proposed by the Financial Industry Regulatory Authority (FINRA) and adopted by the SEC, that prohibits non-attorneys who have been banned from the securities industry from representing parties in securities-related arbitration. Under the rule, the petitioner, a non-attorney, was banned from representing parties in securities-related arbitration. He claimed that, since 1991, he has represented parties in over 1,300 arbitration claims, tried 300 or so cases to a decision, and mediated another 250 or so claims to a settlement. The rule would have prevented him from continuing to represent parties in securities-related arbitration. Relying on its decision in *Koch v. SEC*, 177 F.3d 784 (9th Cir. 1999), and the "deeply rooted" presumption against retroactivity, the court held that the SEC rule at issue was impermissibly retroactive as applied to the petitioner.

RICO CLAIMS

Rennel v. Rowe, No. 10-1388 (7th Cir. Mar. 25, 2011)

Click here to view the opinion.

Seventh Circuit Affirms Dismissal of RICO Suit Premised on Hard Bargaining

The U.S. Court of Appeals for the Seventh Circuit affirmed the dismissal of a RICO suit and concluded that the defendant's heavy-handed purchase technique in buying out a joint venture amounted to hard bargaining, not the predicate act of extortion needed to bring a RICO claim. The plaintiff argued that the amount offered to buy him out — 8 percent or nothing — was so deficient as to be extortionate, especially in light of the defendant's threats to run the plaintiff out of business. The Seventh Circuit noted that, while the use of fear of economic loss to obtain property could amount to extortion, in this case the conduct did not rise to the level of extortion because the defendant had a claim of right to the plaintiff's interest in the joint venture and merely engaged in unpleasant hard dealing. Because the plaintiff failed to establish the predicate act of extortion to support the RICO claim, the Seventh Circuit upheld its dismissal.

SCIENTER

City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Waters Corp., No. 10-1514 (1st Cir. Jan. 20, 2011)

Click here to view the opinion.

First Circuit Affirms Dismissal of Claims Relating to Change in Japanese Regulations

The U.S. Court of Appeals for the First Circuit affirmed the dismissal of claims that Waters Corp. and two of its senior executives violated Section 10(b) of the Securities Exchange Act because the complaint failed to plead a strong inference that the defendants acted with scienter in failing to disclose a change in Japanese regulations that would have an impact on Waters' sales. The inference of a nonculpable reason for not disclosing the change was stronger than the inference of scienter. Although the Japanese market was 10 percent of Waters' sales, Waters' total sales were above projections in the two quarters before the defendants disclosed the change in Japanese regulations (and a decline in sales in Japan) and sales in Japan subsequently rebounded. Further, Waters missed its earnings expectations because of higher costs and expenses and not lower sales.

Sec. & Exch. Comm'n v. Fuhlendorf, No. C09-1292 (W.D. Wash. Mar. 17, 2011)

Click here to view the opinion.

Washington Federal Court Refuses to Grant Summary Judgment on Questions of Scienter and Materiality

Judge Marsha J. Pecham of the U.S. District Court for the Western District of Washington refused to grant summary judgment in favor of Stuart Fuhlendorf, the former CFO of Isilon Systems, Inc., a data systems company, on claims that Fuhlendorf committed securities fraud in violation of Section 10(b) of the Securities Exchange Act. The SEC alleged that Fuhlendorf knew that Isilon would not meet analysts' expectations and, thus, took actions designed to inflate Isilon's reported revenue. In particular, the SEC alleged that Fuhlendorf booked revenue from a number of transactions with its customers in violation of Generally Accepted Accounting Principles because the transactions were subject to certain contingencies under which the customer was not obligated to pay Isilon until the contingency was met.

Fuhlendorf moved for summary judgment on the ground that there was insufficient evidence of scienter. Fuhlendorf also moved for summary judgment on four of the five allegedly improper transactions on the ground that such transactions were not material because they did not exceed five percent of Isilon's quarterly revenues. The court denied the motion for summary judgment on the question of scienter, holding that a factual dispute existed as to whether Fuhlendorf knew that the transactions were subject to contingencies and, therefore, acted with scienter when recognizing revenue for the transactions. The court further denied the motion for summary judgment on the question of materiality, holding that, although the transactions were small, there is "no bright-line rule" regarding materiality.

SECURITIES ACT CLAIMS

Plumbers' Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp., No. 09-2596 (1st Cir. Jan. 20, 2011)

Click here to view the opinion.

First Circuit Vacates Dismissal of Claims Relating to Mortgage Originators' Underwriting Standards

In a suit relating to mortgage-backed certificates issued by eight different trusts, the U.S. Court of Appeals for the First Circuit vacated the dismissal of claims that the mortgage originators and the securitizing bank violated Sections 11 and 12(a)(2) of the Securities Act in connection with statements about the originators' underwriting standards. The court determined that plaintiffs' allegation that the offering documents misrepresented that the originators disregarded their underwriting guidelines stated a claim because "a wholesale abandonment" of underwriting standards is different than the cautionary language in the offering documents that the originators would apply exceptions to the underwriting guidelines in certain circumstances. However, the court otherwise affirmed the dismissal of the claims. First, the three named plaintiffs only purchased certificates issued by two of those trusts and therefore lacked standing to assert claims based upon the other six trusts' certificates. Second, the complaint did not plead that the originators actually improperly influenced appraisals, only that some banks had done so. Similarly, the complaint did not plead that the ratings agencies believed the ratings they gave to the certificates were false, and so failed to state a claim based upon those alleged misrepresentations.

SECURITIES FRAUD PLEADING STANDARDS

Plymouth County Ret. Sys. v. Carter's Inc., No. 1:08-cv-02940-JOF (N.D. Ga. Mar. 16, 2011)

Click here to view the opinion.

Georgia Federal Court Dismisses Claims Relating to Purported Payment Manipulations

Judge J. Owen Forrester of the U.S. District Court for the Northern District of Georgia dismissed claims that Carter's and its officers violated Section 10(b) of the Securities Exchange Act by (i) purportedly manipulating when Carter's booked certain payments to retailers to smooth its

(continued on next page)

earnings and (ii) allegedly misrepresenting the growth opportunities of a company it acquired. The plaintiff's reliance on confidential witnesses did not provide statements creating the strong inference of scienter that Carter's knew that the purported manipulations of when the payments were booked were false, and similarly those purported manipulations were not core to Carter's operations and therefore could not be attributed to its senior officer defendants. Further, the court dismissed claims against Carter's outside auditor (PricewaterhouseCoopers) because the complaint did not sufficiently plead that the auditor had too close a relationship to Carter's or fail to exercise professional skepticism in approving Carter's filings.

Barnard v. Verizon Commc'ns, Inc., No. 10-1304 (E.D. Pa. Jan. 31, 2011)

Click here to view the opinion.

Pennsylvania Federal Court Dismisses Claims Relating to Spin-Off

Judge Gene E.K. Pratter of the U.S. District Court for the Eastern District of Pennsylvania dismissed claims that Verizon and JP Morgan violated Section 10(b) of the Securities Exchange Act through the 2006 spin-off of Verizon's Yellow Pages publishing subsidiary as Idearc. The plaintiffs were shareholders in Idearc prior to its bankruptcy (which extinguished their holdings in Idearc) who asserted that Verizon allegedly committed fraud by loading up Idearc with Verizon's debt prior to the Idearc spin-off, and that JP Morgan allegedly facilitated that purported fraud. The complaint did not plead what specific statement was a material misrepresentation or omission and failed to identify any statements allegedly omitting material facts about Idearc's financial health. The plaintiffs also failed to allege when and at what price they acquired shares of Idearc stock, which precluded the court from determining what statements may have been relied upon, and where there is any alleged causal link between the challenged conduct and the purported injury.

Patel v. Patel, No. 1:09-CV-3684-CAP (N.D. Ga. Jan. 14, 2011)

Click here to view the opinion.

Georgia Federal Court Dismisses Claims Relating to FDIC Bank Takeover

In a lawsuit filed following the FDIC's appointment as receiver of Haven Trust Bank, Judge Charles A. Pannell Jr. of the U.S. District Court for the Northern District of Georgia dismissed claims that the bank's directors and officers violated Section 10(b) of the Securities Exchange Act by purportedly failing to disclose in private placement memoranda (i) the bank's true financial condition, (ii) the defendants' alleged self-dealing transactions, and (iii) the defendants' alleged failure to address "numerous known improprieties that had been repeatedly identified by federal and state regulators." The court determined that the complaint did not plead scienter or loss causation. As to scienter, the complaint did not plead any insider stock sales by the three defendants alleged to have acted with scienter and could not merely rely upon the defendants' positions as directors and officers, or attendance at meetings and access to documents to establish a strong inference of scienter. As to loss causation, the plaintiffs' losses allegedly were caused by the FDIC's takeover of the bank, but the complaint did not explain why the defendants' alleged misrepresentations caused the FDIC to take over the bank, rather than the effect of subprime mortgage and financial crises on the bank's loan portfolio and its real estate collateral.

STANDING/INVESTMENT ADVISORS ACT

Thomas v. Metro. Life Ins. Co., No. 09-6207 (10th Cir. Feb. 2, 2011)

Click here to view the opinion.

Tenth Circuit Holds That Named Plaintiffs Lack Standing to Appeal Order Denying Permission to Add Additional Named Plaintiffs

The U.S. Court of Appeals for the Tenth Circuit addressed two issues arising from an order granting summary judgment to defendants Metropolitan Life Insurance Companies, Inc. and Metlife Securities, Inc. First, the court held that individual plaintiffs who lack standing to bring a securities fraud claim also lack standing to appeal an order that denies them leave to amend the complaint to add plaintiffs who could state a securities fraud claim. Second, concerning

(continued on next page)

an issue of first impression among the federal appellate courts under the Investment Advisors Act (IAA), the court clarified a provision that creates an exception to liability under the IAA for broker-dealers who offer investment advice that is solely incidental to their conduct as broker-dealers.

In the lawsuit, the plaintiffs challenged under several legal theories the practices of Metlife financial services representatives, who allegedly advised customers to buy Metlife investment products without disclosing their financial interest in commission compensation derived from those sales. The plaintiffs claimed the failure to disclose the incentives and consequent failure to give unbiased investment advice amounted to securities fraud and a violation of the Investment Advisors Act. Discovery revealed, however, that each named plaintiff purchased only life insurance during the class period, not mutual funds or securities. When the district court dismissed the securities fraud claims because no named plaintiff had purchased mutual funds or securities, the plaintiffs sought leave to amend the complaint to add named plaintiffs. The district court denied leave to amend, and only named plaintiffs Robert and Amanda Thomas appealed. The Tenth Circuit affirmed, noting that parties lack Article III standing to vindicate the rights of third parties on appeal, and that the putative class had not been certified. Because the only parties purportedly aggrieved by the lower court's order were unnamed, absent individuals who may have purchased mutual funds or securities from Metlife, the Thomases lacked standing to enforce those rights on appeal.

As opposed to securities fraud claims, the named plaintiffs did have standing to assert claims under the IAA, however, because they purchased life insurance from Metlife financial services representatives. On this issue, the Tenth Circuit affirmed the district court's grant of summary judgment on the IAA claims. The IAA assigns fiduciary duties to "investment advisors," including any person who engages in the business of advising others with respect to securities transactions for compensation. The IAA contains a broker-dealer exception, however, for any broker or dealer who gives investment advice that is "solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor." Addressing a matter of first impression among appellate courts (according to the opinion) the court held that financial services representatives fall under the broker-dealer exception even when they allegedly give frequent and substantial investment advice. The exception applies whenever the investment advice is given in connection with conduct as a broker, and so long as no distinct or additional compensation is paid for the advice. The court rejected the plaintiffs' reading of the broker-dealer exception, which asserted that the quantity and importance of the advice should render the broker-dealer exception inapplicable.

STATUTES OF LIMITATIONS

FirstBank P.R., Inc. v. La Vida Merger Sub, Inc., No. 10-1585 (1st Cir. Mar. 16, 2011)

Click here to view the opinion.

First Circuit Affirms Dismissal of Claims Relating to Bank Merger

The U.S. Court of Appeals for the First Circuit affirmed the dismissal of claims that Instituto de Banca y Comerico (IBC), IBC's principal shareholder, Leeds Equity Partners IV, and Leeds' general partner violated Section 10(b) of the Securities Exchange Act by allegedly fraudulently depriving the plaintiff, FirstBank Puerto Rico, of its right to acquire 15 percent of IBC by Leeds' purchase of all of the outstanding shares of IBC. The district court had dismissed FirstBank's claims on statute of limitations grounds, and the First Circuit affirmed. The First Circuit panel, which included Associate Justice David Souter, affirmed because FirstBank knew of the Leeds-IBC merger more than two years before filing suit, thereby barring its claims under the two-year limitations period applicable to Securities Exchange Act claims. The court also distinguished *Merck & Co., Inc. v. Reynolds*, 130 S. Ct. 1784 (2010), because, unlike in *Merck*, FirstBank had actual notice of the facts and the alleged fraud (including scienter) for more than two years before it filed suit against IBC and Leeds.

Joseph v. Elan Motorsports Techs. Racing Corp., No. 10-1420 (7th Cir. Mar. 14, 2011)

Click here to view the opinion.

Seventh Circuit Reverses Denial of Motion to Amend Complaint Where Plaintiff Sued Wrong Corporate Defendant

The U.S. Court of Appeals for the Seventh Circuit reversed a decision denying a plaintiff's motion for leave to amend the complaint to name the correct corporate subsidiary as a defendant more than seven years after filing suit. The plaintiff brought a breach of contract suit against Elan Motorsports Technologies Corp., rather than against Elan Motorsports Technologies Inc., a subsidiary of the former and the party to the contract. When the plaintiff recognized his mistake, he sought leave to amend his complaint to name the correct defendant. The district court denied leave to amend and held that the complaint did not "relate back" to the date of the initial complaint because it was the plaintiff's fault that he named the wrong party. The plaintiffs' claim was thus barred by the statute of limitations.

The Seventh Circuit reversed, relying on the U.S. Supreme Court's recent decision in *Krupski v. Costa Crociere S.p.A.*, 130 S. Ct. 2485 (2010). That case established that in determining whether a complaint relates back, a court must inquire only (1) whether the defendant who is sought to be added by the amendment knew or should have known that the plaintiff, had it not been for a mistake, would have sued him instead of or in addition to suing the named defendant; and (2) whether, even if so, the delay in the plaintiff's discovering his mistake impaired the new defendant's ability to defend himself. Although the court described the plaintiff's six-year delay in identifying the correct defendant as "inexcusable," it held that the correct defendant was not placed at a disadvantage by the delay. Because Elan Motorsports Technologies Inc. knew that the plaintiff intended to sue it and suffered no harm from the delay, the amended complaint related back to the previous complaint and was not time barred.

City of Pontiac Gen. Employees' Ret. Sys. v. MBIA, Inc., No. 09-4609-cv (2d Cir. Feb. 28, 2011)

Click here to view the opinion.

Second Circuit Vacates Dismissal of Claims Against MBIA

The U.S. Court of Appeals for the Second Circuit vacated the dismissal of purported class claims that MBIA violated Section 10(b) of the Securities Exchange Act in light of the U.S. Supreme Court's decision in *Merck & Co., Inc. v. Reynolds*, 130 S. Ct. 1784 (2010). Applying *Merck* — which holds that the statute of limitations does not begin to run on Securities Exchange Act claims until a reasonably diligent plaintiff would discover the facts constituting the violation — the court decided that a fact is not discovered until a reasonably diligent plaintiff knew enough about the fact to plead it with sufficient detail and particularity to survive a motion to dismiss. Consequently, the court ordered the district court on remand to consider — in addition to the defendants' additional arguments on Rule 9(b) and statute of repose hurdles — when the lead plaintiffs had enough information about MBIA's purported scienter to survive a motion to dismiss; only at that point could the statute of limitation have begun to run.

Footbridge Ltd. Trust v. Countrywide Fin. Corp., No. 10 Civ. 367 (PKC) (S.D.N.Y. Mar. 15, 2011)

Click here to view the opinion.

S.D.N.Y. Dismisses Claims Relating to MBS Purchases

Judge P. Kevin Castel of the U.S. District Court for the Southern District of New York dismissed claims that Countrywide violated Sections 11 and 12(a)(2) of the Securities Act in connection with mortgage-backed securities purchased by the plaintiffs. Sections 11 and 12(a)(2) are subject to a three-year statute of repose — for Section 11, three years from the effective date of the registration statement and, for Section 12(a)(2), three years from the sale of the security. Because the complaint was filed more than three years after both of those dates, the plaintiffs' claims were extinguished. Further, the statute of repose for Securities Act claims is not subject to equitable tolling. In addition, *American Pipe* tolling — which tolls the running of a statute of limitations for putative and actual class members — does not apply to statutes of repose.

ATTORNEY CONTACTS

Editors

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

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

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

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

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

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

Douglas M. Kraus
212.735.2510
douglas.kraus@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
212.735.413
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

Garrett J. Waltzer
650.470.4540
garrett.waltzer@skadden.com

San Francisco

James E. Lyons
415.984.6470
james.lyons@skadden.com

Timothy A. Miller
415.984.2647
timothy.miller@skadden.com

Washington, D.C.

Richard L. Brusca
202.371.7140
richard.brusca@skadden.com

Charles F. Walker
202.371.7862
charles.walker@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