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Inside the Courts

An Update From Skadden Securities Litigators

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UNITED STATES SUPREME COURT

Class Certification

Amgen Inc. v. Conn. Ret. Plans and Trust Funds,
No. 11-1085
(U.S. Feb. 27, 2013)

Click here to view the opinion.

Supreme Court Holds Securities Fraud Plaintiffs Are Not Required To Prove Materiality of Allegedly False Statements to Certify a Class

In a 6-3 decision, the Supreme Court of the United States held that a securities fraud plaintiff alleging fraud on the market need not establish the materiality of an alleged fraudulent statement in order to obtain class certification. Justice Ginsburg delivered the opinion of the Court, and Justices Scalia, Thomas and Kennedy dissented.

The particular questions presented by the Supreme Court's grant of *certiorari* were whether, in a misrepresentation case under SEC Rule 10b-5, a securities fraud plaintiff alleging fraud on the market must establish materiality of the misstatements in order to obtain class certification and whether, in such a case, the district court must allow the defendant to present evidence rebutting the applicability of the fraud-on-the-market theory before certifying a plaintiff class based on that theory.

The Supreme Court held that establishing the materiality of the alleged fraudulent statement is not necessary; it is enough to show that the security in question was traded in an efficient market and that the alleged fraudulent statement became public. Having made that showing, the plaintiff could invoke the fraud-on-the-market presumption of reliance and thus represent a class of shareholders. The Court explained that "Rule 23(b)(3) requires a showing that *questions* common to the class predominate, not that those questions will be answered, on the merits, in favor of the class. ... The alleged misrepresentations and omissions, whether material or immaterial, would be so equally for all investors composing the class." The Supreme Court further held that rebuttal of the fraud-on-the-market presumption of reliance is appropriate at the class certification stage if it would disprove commonality of the class members' reliance; rebuttal evidence on materiality does not disprove commonality.

The Supreme Court's holding affirmed the U.S. Court of Appeals for the Ninth Circuit, resolving an existing split between the First, Second and Fifth Circuit Courts of Appeals and the Third, Seventh and Ninth Circuit Courts of Appeals.

Statutes of Limitations

Gabelli v. Sec. & Exch. Comm'n,
No. 11-1274
(U.S. Feb. 27, 2013)

Click here to view the opinion.

Supreme Court Rejects Discovery Rule on Statute of Limitations for SEC Civil Penalty Enforcement Actions

In a unanimous opinion authored by Chief Justice Roberts, the U.S. Supreme Court held that the five-year limitations period that governs SEC enforcement actions begins to run when the alleged fraud is complete. The Court reversed the Second Circuit on the issue, which had held that the discovery rule applied in cases where the defendant allegedly committed fraud. The SEC alleged that two mutual fund managers allowed one of the fund's investors to engage in market timing in the fund in exchange for an investment in a separate hedge fund, but the SEC filed the action more than five years after the conduct was alleged to have taken place. The Court explained that limitations periods ordinarily begin to run upon a party's injury, but in cases of fraud — when the injury itself is concealed — courts have developed the discovery rule to protect individuals, who are after all not required to be in a constant state of investigation. That rationale, however, does not apply to the SEC, whose mission is to investigate (and prevent) fraud and which has statutory authority to demand detailed records, including through extrajudicial subpoenas. Therefore, the Court concluded the discovery rule does not apply to the SEC.

CLASS CERTIFICATION

In re Computer Scis. Corp. Sec. Litig., No. 1:11-cv-610 (E.D. Va. Dec. 19, 2012)

Click here to view the opinion.

Virginia Court Certifies Class in Federal Securities Fraud Action

Judge Thomas Ellis of the U.S. District Court for the Eastern District of Virginia certified a stockholder class in a case brought pursuant to Section 10(b) of the Securities Exchange Act. The action dated to June 3, 2011, when City of Roseville Employee's Retirement System filed a complaint alleging that defendant Computer Sciences Corporation (CSC) had violated the federal securities laws by making false and misleading statements about a major contract and CSC's internal controls. Subsequently, the court consolidated that action with three similar cases, naming Ontario Teachers' Pension Plan the lead plaintiff.

In certifying the class, the court rejected arguments that defendants have brought in a number of recent cases in an effort to defeat the presumption of reliance due to market efficiency for widely traded common stocks. The court held that Ontario Teachers had adequately demonstrated the existence of an efficient market for the defendant's stock. Notably, CSC shares traded on the New York Stock Exchange, a fact that — although not itself dispositive — weighed heavily in favor of a finding of market efficiency. Moreover, during the relevant time, the company had more than 155 million shares outstanding, an average weekly trading volume of 4 percent, and the attention of some 39 Wall Street analysts, who authored more than 300 class-period reports on the company. The court rejected the defendant's argument that the plaintiffs were obliged to present an event study to show a causal relationship between the alleged misstatements and movements in the defendant's stock price.

In the opinion, the court also granted a motion to appoint Ontario Teachers as lead plaintiff — again rejecting arguments that defendants often try to develop in opposing certain institutional lead plaintiffs. The court reasoned that — although Ontario Teachers employed somewhat notable trading strategies, including trading on perceived market "inefficiencies"; purchased shares in the defendant's stock following the close of the class period; and owed duties to its own investors — it nevertheless shared the interests and injuries of other class members. Moreover, held the court, any unique defenses to the claims of Ontario Teachers were not likely to become the focus of the litigation. Thus, the court held that Ontario Teachers satisfied the typicality and adequacy requirements of Federal Rules of Civil Procedure 23(a)(3) and (4).

DIRECTORS AND DIRECTORS' DUTIES

Derivative Litigation

Ark. Teacher Ret. Sys. v. Mozilo, No. 10-56340 (9th Cir. Jan. 10, 2013)

Click here to view the opinion.

Ninth Circuit Certifies Dispositive Question of Delaware Law to the Supreme Court of Delaware

In this shareholder derivative action, five investors sued on behalf of former Countrywide Financial Corporation, asserting claims for breach of fiduciary duty and securities law violations against former Countrywide officers and directors. While the suit was pending, Countrywide merged into a wholly owned subsidiary of Bank of America Corporation in a transaction that divested the plaintiffs of their Countrywide shares. Countrywide moved for judgment on the pleadings, arguing the plaintiffs no longer had standing to pursue derivative claims because the shareholders did not continuously hold Countrywide shares. The district court granted the motion, holding the plaintiffs could not satisfy the "continuous ownership" requirement for shareholder derivative standing under Federal Rule of Civil Procedure 23.1 and Delaware law. The plaintiffs argued that under *Arkansas Teacher Retirement Systems v. Caiafa*, 996 A.2d 321 (Del. 2010), they maintain post-merger derivative standing under the fraud exception to the continuous ownership requirement. Countrywide argued that under *Lewis v. Anderson*, 477 A.2d 1040 (Del. 1984), reaffirmed by *Arkansas Teacher*, the fraud exception to the continuous

(continued on next page)

ownership requirement applies only when the plaintiffs allege that the merger was executed merely to destroy derivative standing, and the plaintiffs do not so allege. The U.S. Court of Appeals for the Ninth Circuit, reviewing the district court's order granting the defendant's motion for judgment on the pleadings and denying the plaintiffs' motion for reconsideration, certified the following question to the Supreme Court of Delaware:

> Whether, under the "fraud exception" to Delaware's continuous ownership rule, shareholder plaintiffs may maintain a derivative suit after a merger that divests them of their ownership interest in the corporation on whose behalf they sue by alleging that the merger at issue was necessitated by, and is inseparable from, the alleged fraud that is the subject of their derivative claims.

Mergers and Acquisitions

In re Celera Corp. S'holder Litig., No. 212, 2012 (Del. Dec. 27, 2012, revised Jan. 2, 2013)

Click here to view the opinion.

Delaware Supreme Court Affirms in Part and Reverses in Part Decision Approving Settlement of Litigation Regarding Celera Sale

The Delaware Supreme Court affirmed in part and reversed in part the Delaware Court of Chancery's decision approving a settlement in *In re Celera Corp. Shareholder Litigation*, C.A. No. 6304-VCP (Del. Ch. Mar. 23, 2012). Vice Chancellor Donald F. Parsons Jr. of the Delaware Court of Chancery had previously overruled an objection and approved the settlement of litigation challenging a two-step merger transaction (covered in *Volume 4, Issue 2* of *Inside the Courts*). During briefing on a motion for a preliminary injunction, Celera Corporation entered into a memorandum of understanding with the lead plaintiff, New Orleans Employees' Retirement System (NOERS), that contemplated a settlement of class claims for therapeutic benefits, including the modification of deal protection devices and additional disclosures, but no increase in the merger price. Celera's largest shareholder objected to the settlement because it believed the merger price was too low, and that NOERS — which had sold its Celera shares for a slight premium shortly after executing the memorandum of understanding, but before the deal closed through the second-step short-form merger — was an inadequate class representative. The Court of Chancery found, however, that NOERS satisfied the adequacy of representation requirements of Rule 23, "albeit barely," calling NOERS's decision to sell its shares before the merger closed "careless and cavalier."

The objector appealed the Court of Chancery's decision, challenging three aspects of the lower court's ruling: (i) the certification of NOERS as lead plaintiff; (ii) the approval of the settlement without an opt-out right; and (iii) the fairness of the settlement itself, arguing that the settlement unfairly forced the objector to forego a valuable claim for scant consideration. The Delaware Supreme Court affirmed the Court of Chancery's ruling that the plaintiff was an adequate representative. The Delaware Supreme Court, however, found that the Court of Chancery erred in denying the objector a discretionary opt-out right, based on the facts that the representative was "'barely' adequate," the objector was a significant shareholder (holding an approximately 24.5 percent stake at the time the merger closed) and was prepared to prosecute a "supportable claim for substantial money damages, and the only claims realistically being settled at the time of the certification hearing nearly a year after the merger were for money damages." Accordingly, '[u]nder these particular facts and circumstances, the Court of Chancery had to provide an opt-out right." The Delaware Supreme Court did not reach the objector's challenge to settlement approval because of its holding that the objector should have been permitted to opt out.

In re Novell, Inc. S'holder Litig., No. 6032-VCN (Del. Ch. Jan. 3, 2013)

Click here to view the opinion.

Court of Chancery Dismisses Allegations Arising Out of Attachmate Acquisition by Merger of Novell

Vice Chancellor John W. Noble of the Delaware Court of Chancery dismissed nearly all of the allegations asserted against the Novell board arising out of Attachmate Corporation's 2011 acquisition by merger of Novell, Inc. The court dismissed allegations that (i) the included deal protections were a violation of fiduciary duty, (ii) the CEO's severance agreements constituted an improper interest, (iii) a banker used artificially low projections and was conflicted, (iv) a minority shareholder dominated and controlled the board process, (v) proxy disclosures were misleading, (vi) a related sale of Novell's patent portfolio at an allegedly too-low price was a breach of fiduciary duty, and (vii) the board violated Del. Code tit. 8, § 251(b) in approving the merger. The court also found that the plaintiffs had failed to allege that any member of the nine-member board was improperly interested or lacked independence (the plaintiffs had challenged only two of the nine members), and that the board was exculpated from monetary liability for any breach of the care by operation of Del. Code tit. 8, § 102(b)(7). The court also found that the eight-month process leading to the all-cash premium merger — a process that included contacting dozens of potential buyers — "far exceeded" the standard articulated in *Lyondell Chemical Co. v. Ryan* for stating a bad-faith claim in the *Revlon* context.

Nevertheless, the court permitted a small subset of the plaintiffs' bad-faith allegations to survive. According to the court, the plaintiffs had alleged, among other things, that the board never permitted a potential bidder (Party C) to partner with other buyers, even though Attachmate had been permitted to do so, and that the board never followed up with Party C following the negotiated sale of the company's patent portfolio. The plaintiffs alleged that if the board had done so, Party C might have increased its bid. The court held that these facts were unexplained on the current record, and if left unexplained could constitute bad faith, because bad faith can be found where a fiduciary's actions are "so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith." In so holding, the court noted that at the pleading stage the board had not had a chance to "prove its case," and that a number of valid reasons could exist for the board's decisions during the sales process.

DISCOVERY

In re Merck & Co., Inc. Sec., Derivative & "ERISA" Litig., MDL No. 05-1658 (SRC) (D.N.J. Dec. 12, 2012)

Click here to view the opinion.

New Jersey Court Affirms Decision That Voluntarily Producing Documents to Justice Department Waived Attorney-Client Privilege in Unrelated Private Action

In an opinion labeled "Not for Publication," Judge Stanley R. Chesler of the U.S. District Court for the District of New Jersey affirmed a magistrate judge's decision that voluntarily producing documents to the Department of Justice in connection with an investigation waived the attorney-client privilege and work product protection in an unrelated private action. Merck had voluntarily produced the documents to the Department of Justice under an agreement that its limited waiver of any protection offered by the attorney-client privilege or work product doctrine would not extend to any third party and requiring the Government to maintain the documents confidentiality. Applying *Westinghouse v. Republic of the Philippines*, 951 F.2d 1414 (3d Cir. 1991), the court held that the waiver was ineffective because selective waivers do not promote the public policy interests traditionally attributed to privilege.

EXCHANGE ACT

Kleinman v. Elan Corp.,
No. 11-3706-cv
(2d Cir. Feb. 1, 2013)

Click here to view the opinion.

Second Circuit Affirms Dismissal, Finds Pharmaceutical Company Had No Duty to Disclose Contradictory Details in Press Release About Drug in Testing Stage

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims that a pharmaceutical company violated Section 10(b) of the Securities Exchange Act by allegedly issuing a press release about a drug in the testing stage without disclosing certain contradictory details, because the company had no duty to disclose the information. Although the company released a subsequent press release that allegedly contradicted the initial report's positive statements, the alleged representations about the drug's efficacy were subjective rather than definitive and therefore were intentional puffery, and the alleged omissions regarding the company's testing procedure were not necessary for investors to understand the testing methods implemented. In addition, the court held that the decline in the company's stock price following the second press release was insufficient to show that the second press release was a corrective disclosure of a prior misrepresentation, because other factors may have influenced investors' decisions.

EXPERT WITNESSES

Fed. Hous. Fin. Agency v. JP Morgan Chase & Co.,
No. 11 Civ. 6188 (DLC)
(S.D.N.Y. Dec. 3, 2012)

Click here to view the opinion.

SDNY Denies Challenge to Methodology for Testing Whether Underwriting Standards Were Correctly Applied in Loans Underlying Mortgage-Backed Securities

Judge Denise Cote of the U.S. District Court for the Southern District of New York denied a *Daubert* challenge to a report tendered by the Federal Housing Finance Agency on behalf of Fannie Mae and Freddie Mac. To avoid testing whether underwriting standards were correctly applied in all 1.1 million loans underlying the mortgage-backed securities at issue, a statistical expert tested a small sample of loans from each securitization for compliance with the disclosed underwriting standards using statistical techniques to ensure that loans with high and low credit scores were equally likely to be selected. In finding that the statistical analysis satisfied the standard for scientific evidence under *Daubert*, the court held that the expert's methodology was reliable and that the objections — in large part, the difficulty of consistently replicating the results and the higher margin of error within samplings of certain securitizations — properly go to the weight of the expert's testimony (an issue for the jury) rather than to its admissibility.

FRAUD-ON-THE-MARKET THEORY

State v. Marsh & McLennan Cos., Inc.,
No. SC S059386
(Or. Dec. 13, 2012)

Click here to view the opinion.

Oregon Supreme Court Determines Stock Purchaser Who Purchases Stock on Efficient, Open Market May Establish Reliance by Means of Fraud-on-the-Market Presumption

The Supreme Court of Oregon, in reversing the summary judgment decision of the trial court and the Oregon Court of Appeals, concluded that under Or. Rev. Stat. § 59.137, a stock purchaser who purchases stock on an efficient, open market may establish reliance by means of the fraud-on-the-market presumption.

The state of Oregon, on behalf of the Oregon Public Employee Retirement Fund, asserted claims against Marsh & McLennan Companies, Inc. and Marsh, Inc. (collectively, Marsh), alleging that a scheme perpetrated by false and misleading statements, in violation of Or. Rev. Stat. §§ 59.135 and 59.137, caused the state to lose $10 million on investments. The state alleged that the Marsh shares are traded on an efficient securities market (the New York Stock

(continued on next page)

Exchange), that the prices of the Marsh shares during the time at issue reflected the material information that Marsh disclosed to the market, and that the prices of the Marsh shares were artificially inflated because of Marsh's misrepresentations. The state also alleged that Marsh's alleged misrepresentations were brought to light through an investigation by the New York Attorney General, and once the misrepresentations were disclosed, the price of Marsh stock declined 37 percent, causing the state to lose approximately $10 million.

The trial court determined, and the Oregon Court of Appeals affirmed, that Or. Rev. Stat. §§ 59.135 and 59.137 require proof of reliance, the state had not established proof of actual reliance and the state could not establish reliance based on the fraud-on-the-market presumption. The Supreme Court of Oregon determined that the U.S. Supreme Court's consistent line of decisions reaffirming the fraud-on-the-market doctrine numerous times was compelling. The Supreme Court of Oregon reasoned that Or. Rev. Stat. § 59.137 was intended to create consistency between Oregon and federal securities laws and was enacted by the Oregon Legislative Assembly after the fraud-on-the-market doctrine had been a part of the federal law landscape for 15 years. Thus, the Oregon Legislative Assembly intended that reliance could be established through the use of the fraud-on-the-market presumption.

FOREIGN CORPORATIONS

In re Satyam Computer Servs. Ltd. Sec. Litig.,
No. 09 MD 2027 (BSJ)
(S.D.N.Y. Jan. 2, 2013)

Click here to view the opinion.

SDNY Dismisses Claims Arising From Purchase of Stock on Indian Exchanges Under *Morrison*

Judge Barbara S. Jones of the U.S. District Court for the Southern District of New York dismissed claims that certain Satyam Computer Services directors and officers violated Section 10(b) of the Securities Exchange Act and Sections 11 and 12(a)(2) of the Securities Act by allegedly overstating the income and assets of the company and borrowing heavily against the company's allegedly inflated stock. The court dismissed claims arising from the purchase of Satyam stock on Indian exchanges under *Morrison v. National Australian Bank Ltd.*, 130 S. Ct. 2869 (2010), because the transactions did not occur in the United States. The court also dismissed claims arising from alleged misrepresentations in SEC filings because the directors' failure to notice several purported signs of ongoing fraud were not enough to show scienter. In addition, the court dismissed claims against two companies operated by Satyam insiders because the plaintiffs failed to show sufficient connection between the defendants and transactions occurring in the U.S. to satisfy personal jurisdiction in U.S. courts, even though the insiders were involved in the fraud in India.

FORWARD-LOOKING STATEMENTS

In re WebMD Health Corp. Sec. Litig.,
No. 11 Civ. 5382 (JFK)
(S.D.N.Y. Jan. 2, 2013)

Click here to view the opinion.

SDNY Dismisses Claims Related to Allegedly Overly Optimistic Revenue Forecasts Issued by WedMD

Judge John F. Keenan of the U.S. District Court for the Southern District of New York dismissed claims that WebMD violated Section 10(b) of the Securities Exchange Act by issuing allegedly overly optimistic revenue forecasts, even though it allegedly knew of adverse business developments relating to WebMD and the pharmaceutical industry as a whole. The court determined that the challenged statements were forward looking and subject to the Private Securities Litigation Reform Act's safe harbor provisions because those statements were accompanied by meaningful cautionary language and the plaintiffs failed to show that WebMD actually knew the statements were false. In addition, the complaint did not adequately allege that the challenged statements that were not forward looking were false or misleading. Further, even if the safe harbor provisions did not apply, the plaintiffs failed to adequately allege materiality and scienter.

INSIDER TRADING CLAIMS

Gibbons v. Malone,
No. 11-3620-cv
(2d. Cir. Jan. 7, 2013)

Click here to view the opinion.

Second Circuit Finds Section 16(b) Does Not Apply to Purchase of One Series Of Stock and Sale of Another Series That Could Not Be Converted Into the First

The U.S. Court of Appeals for the Second Circuit affirmed dismissal of an action brought under Section 16(b) of the Securities Exchange Act because its limitations on short-term trading do not apply to the purchase of one series of a stock and the sale of another series that could not be converted into the first. The district court dismissed a claim for disgorgement against a company insider after he purchased Series A company stock and sold Series B company stock within a six-month period. Because the Series A and B company stock were separately traded and nonconvertible, the stocks were not the same for Section 16(b) purposes. The court also declined to extend Section 16(b) to stocks that are "substantially similar," finding that such a standard departs from the language of the statute and would be unworkable.

INVESTMENT COMPANY ACT

Kasilag v. Hartford Inv. Fin. Servs., LLC,
No. 11-1083 (RMB/KMW)
(D.N.J. Dec. 17, 2012)

Click here to view the opinion

New Jersey Court Upholds Claims That Investment Manager Violated Fiduciary Duty With High Fees

In an opinion labeled "Not for Publication," Judge Renee Marie Bumb of the U.S. District Court for the District of New Jersey upheld claims that an investment manager violated Section 36(b) of the Investment Company Act, but dismissed claims alleging that an investment manager violated SEC Rule 12b-1. As to the Section 36(b) claims, the complaint adequately alleged that the investment manager violated its fiduciary duty by charging investment management fees significantly higher than the fees it paid to subadvisers for similar work and the fees charged by one of its competitors. However, the court dismissed claims alleging that the defendant's distribution fees were excessively high under Rule 12b-1, even though they were charged in addition to "front-end sales" fees, because charging both fees is customary and the plaintiff failed to cite authority to the contrary.

LOSS CAUSATION

Solow v. Citigroup, Inc.,
No. 12-2499-cv
(2d Cir. Jan. 15, 2013)

Click here to view the opinion.

Second Circuit Affirms Dismissal of Claims That Citigroup Allegedly Made Misleading Statements About Its Capitalization and Liquidity During the 2008 Financial Crisis

In a summary order, the U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims that Citigroup violated Section 10(b) of the Securities Exchange Act by allegedly making misleading statements about its capitalization and liquidity during the 2008 financial crisis. Citigroup's statements that it was "well capitalized" were not misleading because they tracked the regulatory definition of that phrase, and it had no duty to disclose actions that only had the potential to negatively affect capitalization in the future. Further, the plaintiff failed to sufficiently allege loss causation as to Citigroup's statements about liquidity. The plaintiff failed to adequately allege that the statements were, in fact, disclosures of a previously concealed risk, and were responsible for the decreases in price (rather than general market conditions), even though the price of Citigroup's stock declined after the alleged corrective statements were made.

MATERIALITY

Filing v. Phipps,
No. 11-4157
(6th Cir. Oct. 23, 2012)
Click here to view the opinion.

Sixth Circuit Affirms Summary Judgment, Holding That Closely Held Corporation's Failure to Disclose Merger Discussions During Stock Buyback Was Not Material

In an unpublished opinion, the U.S. Court of Appeals for the Sixth Circuit affirmed a grant of summary judgment for the defendants, fiduciaries of White Rubber Company, holding that the closely held corporation's failure to disclose merger discussions during a stock buyback was not material under Section 10(b) of the Securities Exchange Act. Although White Rubber Company initiated the buyback the month before the discussions began, the transaction did not occur until two years after the buyback. Moreover, in contrast to cases in which courts declined to hold that merger discussions were not material — *e.g.*, *Basic Inc. v. Levinson*, 485 U.S. 224 (1988) — during the period in question, White Rubber had not hired consultants to examine the transaction. Finally, although the representatives of the constituent corporations had discussed a merger, at the time of the stock buyback, these conversations were merely "preliminary." By contrast, the negotiations in cases like *Basic* involved the exchange of "vastly more confidential information."

SCIENTER

In re VeriFone Holdings, Inc. Sec. Litig.,
No. 11-15860
(9th Cir. Dec. 21, 2012)
Click here to view the opinion.

Ninth Circuit Reviews a Class Action Plaintiff's Allegations Holistically to Determine Whether Plaintiff Sufficiently Pled Scienter

The U.S. Court of Appeals for the Ninth Circuit held that while any one allegation may not compel an inference of scienter when viewed in isolation, when considered holistically "the inference [that defendants] were deliberately reckless as to the truth of their financial reports and related public statements is at least as compelling as any opposing inference" and thus sufficient to plead scienter.

The plaintiff, individually and on behalf of investors who purchased VeriFone Holdings, Inc. stock between August 31, 2006, and April 1, 2008, alleged that VeriFone, the company's CEO and former chairman, and the company's former CFO violated Sections 10(b), 20(a) and 20A of the Securities Exchange Act in connection with a December 2007 restatement of financial results. In November 2006, VeriFone acquired Lipman Electronic Engineering Ltd. and began integrating the two companies. VeriFone publicized that the merger was likely to improve its financial condition, increasing its pro forma gross margin expectations from 41-44 percent to 42-47 percent. The plaintiff alleged, however, that the defendants were aware that VeriFone's own gross margins never exceeded 45.6 percent in the five prior quarters and Lipman's had just dropped to 41.9 percent after five years of declines, and thus a representation of increasing gross margins up to 48 percent during the class period had no reasonable basis.

In the three quarters following the merger, VeriFone reported gross margins of 47.1 percent, 48.1 percent and 48.2 percent, so that the company could claim the merger was a success. On December 3, 2007, VeriFone announced that its consolidated financial statements for those three quarters should not be relied upon due to errors in accounting, and the gross margins were accordingly reduced to 41.4 percent, 42.3 percent and 41.2 percent respectively. On the day of the statement, VeriFone shares fell from $48.03 to $26.03, dropping more than 45 percent.

The district court dismissed the third amended complaint for failure to plead a strong inference of scienter with respect to any of the defendants, and the Ninth Circuit reversed in part and affirmed in part. The Ninth Circuit recognized that the Supreme Court in *Matrixx* did not mandate a specific approach to reviewing the allegations of scienter. Thus, according to the court, some courts first discuss the sufficiency of specific allegations and then conduct a holistic

(continued on next page)

review, as the district court did here, while others only conduct a holistic analysis. The Ninth Circuit, in approaching the case through a holistic review only, clarified that the district court did not err as a matter of law by first engaging in an individualized discussion of each of the allegations, but instead erred in its undue discounting of the claims as a whole and the conclusion that an inference of deliberate recklessness was not warranted under a holistic review.

The Ninth Circuit held that the plaintiff's allegations, reviewed together, gave rise to a strong, cogent inference that VeriFone and the individual defendants were deliberately reckless to the truth or falsity of their statements regarding VeriFone's financial results, an inference equally as compelling as the competing inference that VeriFone "was simply overwhelmed with integrating a large new division into its existing business," as defendants contended. In so holding, the Ninth Circuit concluded, "[a]lthough [the defendants] attack individual allegations in isolation, they cannot overcome the overwhelming inference drawn from a holistic view."

Iowa Pub. Emp.'s Ret. Sys. v. Deloitte & Touche LLP, No. 12 Civ. 2136 (JPO) (S.D.N.Y. Jan. 23, 2013)

Click here to view the opinion.

SDNY Dismisses Claims Regarding Auditor's Issuance of Allegedly Deficient Audit Opinions for Investment Company That Purportedly Was Part of a Ponzi Scheme

Judge J. Paul Oetken of the U.S. District Court for the Southern District of New York dismissed claims that an auditor violated Section 10(b) of the Securities Exchange Act by issuing allegedly deficient audit opinions for an investment company that allegedly was part of a Ponzi scheme. The plaintiff did not adequately allege that the auditor failed to recognize "red flags" in the suspicious movement of money between company and employee accounts because it did not allege that the auditor actually had access to the transfer records or that the auditor failed to take particular steps to identify the fraud. Further, evidence that the SEC discovered the fraud independently was not enough to show recklessness because the SEC's investigation included multiple entities involved in the scheme.

Sarafin v. BioMimetic Therapeutics, Inc., No. 3:11-0653 (M.D. Tenn. Jan. 10, 2013)

Click here to view the opinion.

Tennessee Court Dismisses Securities Fraud Class Action Where Statements Regarding Clinical Trial Did Not Support Inference of Scienter

Judge Kevin H. Sharp of the U.S. District Court for the Middle District of Tennessee dismissed a purported class action alleging that BioMimetic Therapeutics, Inc. violated Section 10(b) of the Securities Exchange Act by allegedly hiding information about the integrity and statistically insignificant results of a clinical trial for a recombinant bone and tissue growth factor technology. The plaintiffs alleged that the company told the public it was using a primary study population approved by the Food and Drug Administration but then secretly switched the group. The switch in the population skewed the clinical trial results, making the results more favorable than they would have been under the originally proposed protocol. When the FDA's Orthopedic and Rehabilitation Devices Panel issued a report citing concerns about the trial, the stock price dropped.

The court found that, under the PSLRA's heightened pleading requirements, the investors failed to adequately support their claims with allegations of scienter. The company's press releases and earnings calls did not suggest a deliberate intention to deceive investors because the company had disclosed the existence of the two study groups and made statements about positive results based on the FDA-approved group. Even though the company made a pitch for why it believed the second population study was more accurate, the company acknowledged that the FDA would be looking at everything, including the primary study population. Further, the court found that the company did not commit fraud by making forward-looking statements about its earning potential or the FDA approval of the bone treatment, as the statements were protected by the PSLRA's safe harbor provisions.

SECONDARY ACTOR LIABILITY

In re DVI Inc. Sec. Litig.,
No. 03-5336
(E.D. Pa. Jan. 4, 2013)

Click here to view the opinion.

Pennsylvania Court Grants Summary Judgment in Favor of Law Firm on Claims Related to Allegedly Fraudulent Financial Disclosures

Judge Legrome D. Davis of the U.S. District Court for the Eastern District of Pennsylvania granted summary judgment in favor of law firm Clifford Chance on claims that it violated Section 10 of the Securities Exchange Act by allegedly drafting fraudulent financial disclosures in an attempt to hide certain financial information about the client's financial condition from investors and the SEC. The court held that the plaintiffs failed to show reliance because Clifford Chance owed no duty to investors to make, and did not make, any public statements regarding its client on which plaintiffs could have relied. In addition, Clifford Chance was not liable, despite playing a substantial role in the creation of public statements made by its client, because liability cannot be based solely on an advisory relationship under *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), and none of its client's public statements were publicly attributed to Clifford Chance.

Meridian Horizon Fund, L.P. v. Tremont Grp. Holdings, Inc.,
No. 09 Civ. 3708
(S.D.N.Y. Dec. 11, 2012)

Click here to view the opinion.

SDNY Finds That Oppenheimer Acquisition Corp. Was Not Liable For Alleged Securities Law Violations of Wholly Owned Subsidiary

Judge Thomas P. Griesa of the U.S. District Court for the Southern District of New York dismissed claims that Oppenheimer Acquisition Corp. was subject to control person liability under Section 20(a) of the Securities Exchange Act for the alleged securities law violations of its wholly owned subsidiary because the complaint did not plead any culpable participation by Oppenheimer. On an issue that has divided the Southern District of New York, the court held that Section 20(a) requires plaintiffs to show that a control person was in some meaningful sense a culpable participant in the primary violation. The court found that the weight of Second Circuit precedent required dismissal because the complaint failed to allege culpable participation on the part of Oppenheimer.

SECURITIES ACT CLAIMS

N.J. Carpenters Health Fund v. Royal Bank of Scotland Grp., PLC,
No. 12-1707-cv
(2d Cir. Mar. 1, 2013)

Click here to view the opinion.

Second Circuit Reverses Dismissal of Suit Alleging Misrepresentations Concerning Underwriting Standards Applied to Home Loans Underlying Mortgage-Backed Securities

The U.S. Court of Appeals for the Second Circuit reversed the dismissal of claims alleging violations of Sections 11 and 12(a)(2) of the Securities Act. RBS was sued for alleged misrepresentations concerning the underwriting standards applied to home loans underlying certain mortgage-backed securities. The panel held that, at this early stage of the proceedings, and crediting recollections attributed to certain former employees regarding purported systematic disregard for the stated underwriting standards, the plaintiffs raised a possible inference that the company misrepresented its underwriting standards by alleging that (i) a disproportionate number of the home loans included in the securities ultimately defaulted, and (ii) a rating agency downgraded the securities because of the bank's lax underwriting standards. The nationwide housing market collapse — a risk disclosed in the registration statement — did not constitute an "obvious alternative explanation" for the high default rate. Further, the alleged misrepresentations were material because a reasonable investor would want to know whether the company complied with its reported underwriting standards, and the company's general disclosure of the risks in the housing market would not necessarily alert investors to the company's alleged abandonment of the underwriting standards. (The court also vacated and remanded the district court's determination that the plaintiffs lacked class-standing in light of *NECA-IBEW Health & Welfare Fund v. Goldman Sachs & Co.*, 693 F.3d 145 (2d Cir. 2012).)

Silverstrand Invs. v. AMAG Pharm., Inc., No. 11-2063 (1st Cir. Feb. 4, 2013)

Click here to view the opinion.

First Circuit Reverses Dismissal of Claims Related to Pharmaceutical Company's Alleged Failure to Disclose Reports of More Than 20 Serious Adverse Events With Drug

The U.S. Court of Appeals for the First Circuit reversed the dismissal of claims that AMAG Pharmaceuticals violated Sections 11 and 12 of the Securities Act by allegedly failing to disclose in securities offering documents that AMAG had reported to the FDA that at least 23 serious adverse events had been reported to the FDA in connection with AMAG's Feraheme drug. The court determined that the complaint's allegations about AMAG's alleged omission of the serious adverse events in its offering documents plausibly pled a violation of Items 303 and 503 of Regulation S-K. Items 303 and 503 require a company to disclose known uncertainties that are reasonably likely to have material effects on the company and the most significant factors that may adversely affect the company, respectively — including that, in AMAG's case, Feraheme (i) had been on the market for six months, (ii) was approved on the third attempt (the FDA had twice declined to approve it due to safety concerns), (iii) was sold in a market dominated by alternatives with proven safety records, and (iv) was the entire basis for AMAG's profitability. However, the court upheld the dismissal of Sections 11 and 12 claims premised on AMAG's alleged failure to disclose that a material portion of revenue was derived from Internet practices highlighted in an FDA warning letter issued nine months after the offering, because the complaint did not plead that AMAG derived a significant amount of revenue from Internet sales at the time of the securities offering.

SLUSA PRECLUSION

Freeman Investments, L.P. v. Pacific Life Ins. Co., No. 09-55513 (9th Cir. Jan. 2, 2013)

Click here to view the opinion.

Ninth Circuit Revives Breach of Contract and Fiduciary Duty Claims Related to Variable Universal Life Insurance Contracts

The U.S. Court of Appeals for the Ninth Circuit revived plaintiffs' breach of contract and breach of the duty of good faith and fair dealings claims, previously dismissed by the district court, holding that the claims are not precluded by SLUSA. The plaintiffs, individuals who purchased variable life insurance policies from defendant Pacific Life Insurance Company, brought a putative class action against the defendant alleging breach of contract, breach of the duty of good faith and fair dealing, and unfair competition under Cal. Bus. & Prof. Code § 17200. The plaintiffs also claimed the statute of limitations should toll because the defendant concealed the actions giving rise to the plaintiffs' claims. The defendant moved to dismiss the complaint, arguing that the class action was precluded by SLUSA, which bars class actions brought under state law, whether styled in tort, contract or breach of fiduciary duty, that in essence claim misrepresentation or omission in connection with certain securities transactions. The district court granted the defendants' motion to dismiss in its entirety.

On appeal, the Ninth Circuit reasoned the plaintiffs need not show that the defendant fraudulently misrepresented the cost of insurance or omitted critical details in order to prevail on the breach claims; they need only persuade the court that theirs is the better reading of the contract. The Ninth Circuit further determined that the plaintiffs did not make a stealth allegation of fraudulent omission with their tolling argument and the allegation that the defendant hid its breach of contract does not turn the breach claims into claims of fraudulent omission. The Ninth Circuit held the breach of contract and breach of the duty of good faith and fair dealings claims were not precluded by SLUSA and directed the district court to grant the plaintiffs leave to amend their complaint to eliminate references to hidden loads, knowing concealment and wrongful conduct, as these concepts are irrelevant to the plaintiffs' breach claims and tolling claims. The Ninth Circuit concluded the district court correctly dismissed the plaintiffs' unfair competition claim, as that claim was precluded by SLUSA.

STANDING

In re Century Aluminum Co. Sec. Litig., No. 11-15599 (9th Cir. Jan. 2, 2013)

Click here to view the opinion.

Ninth Circuit Requires Aftermarket Plaintiffs Adequately Allege That Shares Are Traceable to Stock Offering Made in Connection With the False or Misleading Statement

The U.S. Court of Appeals for the Ninth Circuit affirmed the dismissal of plaintiffs' claims under Section 11 of the Securities Act for lack of statutory standing, strictly applying the pleading requirements set forth in *Iqbal* and *Twombly* and holding that aftermarket plaintiffs must allege specific facts sufficient for a court to reasonably infer that their shares can be traced back to the relevant offering. The plaintiffs purchased aftermarket shares in defendant Century Aluminum Company at the end of January 2009. In their Section 11 claims, the plaintiffs alleged the shares they purchased were issued under a materially false and misleading prospectus supplement, dated January 28, 2009, issued in connection with a secondary offering of 24.5 million shares of the company's stock. When the secondary offering commenced, more than 49 million shares of the company's common stock were already in the market.

The plaintiffs argued it was enough for them to allege that they "purchased Century Aluminum common stock directly traceable to the Company's Secondary Offering" in order to establish standing. The Ninth Circuit, however, disagreed and determined that under the pleading requirements established in *Iqbal* and *Twombly*, plaintiffs must allege "factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." Specifically, the Ninth Circuit found that when a company has issued shares in multiple offerings, a greater level of factual specificity is needed before a court can reasonably infer that shares purchased in the aftermarket are traceable to a particular offering and particular alleged false or misleading statement. The Ninth Circuit held that the plaintiffs' conclusory allegation that they "purchased Century Aluminum common stock directly traceable to the Company's Secondary Offering" was devoid of factual content and fell short of what *Iqbal* and *Twombly* require in order to establish statutory standing under Section 11 of the Securities Act.

In re Am. Int. Grp., Inc. Sec. Litig., No. 04 Civ. 8141 (DAB) (S.D.N.Y. Jan. 7, 2013)

Click here to view the opinion.

SDNY Denies State Attorney General's Motion To Intervene in Proposed Class Action Settlement

Judge Deborah A. Batts of the U.S. District Court for the Southern District of New York denied the New York Attorney General's motion to intervene in a proposed class action settlement of alleged violations of the Securities Exchange Act, because the New York Attorney General lacked standing. The New York Attorney General, which is pursuing a parallel state action against the defendants, objected to the proposed settlement because purported errors in an expert's testimony regarding loss causation allegedly undervalued damages in the case. But the court held that the New York Attorney General did not have standing to object under Rule 23 because it was not a class member, and similarly did not have standing under CAFA because the suit was filed before CAFA was enacted and does not give a state attorney general standing to intervene in any suit where state residents are members of a settling class. The court also rejected standing based on the New York Attorney General's claim the proposed settlement would cause actual, imminent injury to the ongoing state case. Finally, the New York Attorney General's motion to intervene under Rule 24 was denied because the Attorney General failed to show a sufficient legal interest at stake to intervene as of right and intervention would unduly delay the action.

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