Skadden

Inside the Courts

An Update From Skadden Securities Litigators

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Skadden

# Inside the Courts

*An Update From Skadden Securities Litigators*

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## AUDITOR LIABILITY

*Sec. & Exch. Comm'n v. Deloitte Touche Tohmatsu CPA Ltd.*, No. 11-mc-512 (D.D.C. Apr. 22, 2013)

Click here to view the opinion.

### District of Columbia Lifts Stay on SEC Action Seeking to Enforce Subpoena for Audit Work-Papers Regarding US-listed Chinese Foreign Issuer

Judge Gladys Kessler of the U.S. District Court for the District of Columbia granted the SEC's motion to lift the stay on an action seeking to enforce a subpoena for Deloitte's audit work-papers in connection with an ongoing SEC investigation into a U.S.-listed Chinese company. The action was previously stayed in light of a SEC administrative proceeding occurring in parallel and seeking to bar five accounting firms — including a China-based member audit firm of Deloitte — from practicing in front of the SEC. At issue in both proceedings is a refusal to produce audit work-papers to the SEC on the grounds that, under Chinese law, doing so would expose the firm to criminal liability in China. However, the Court held that Deloitte was unable to show that lifting the stay would cause substantial hardship or inequity — even though the subject of both proceedings overlapped to a certain extent — because (1) the proceedings sought different remedies, (2) the SEC's purported statutory basis for the two actions were different, and (3) both the administrative decision and the court's ruling on the subpoena would be appealable to the U.S. Court of Appeals for the District of Columbia Circuit, eliminating the risk of inconsistent rulings.

## CONFIDENTIAL WITNESSES

*Fort Worth Emps. Ret. Fund v. J.P. Morgan Chase & Co.*, No. 09 Civ. 3701 (JPO)(JCF) (S.D.N.Y. May 7, 2013)

Click here to view the opinion.

### S.D.N.Y. Grants Defendants' Request for Identities of Confidential Witnesses, Ruling the Names Are Not Protected by the Work Product Doctrine

In a securities class action, Judge James C. Francis of the U.S. District Court for the Southern District of New York granted the defendants' request for the identities of confidential witnesses relied upon in the complaint. Although the plaintiffs disclosed a list of 44 potential witnesses with information relevant to the case, they refused to identify the confidential witnesses. The court ruled that the names of confidential witnesses are not protected by the work product doctrine, even though some disagreement exists within the Southern District of New York. Further, the plaintiffs failed to show any concerns — such as employment retaliation — in disclosing the confidential witnesses, but the court allowed the plaintiffs to submit a supplementary affidavit identifying any such concerns. The court also granted the defendants' request for the dates on which the lead plaintiffs retained counsel because those dates were relevant to the defendants' statute of limitations argument. The court denied, however, requests for retainer agreements and agreements with counsel to monitor the status of the lead plaintiffs' investments because the defendants could not show that those documents were relevant to any claims or defenses, and the information contained by the documents could be elicited during depositions.

## DERIVATIVE LITIGATION/BOOKS AND RECORDS

*City of Roseville Emps.' Ret. Sys. v. Kid Brands*, No. 11-2919 (JLL) (D.N.J. Nov. 8, 2012)

Click here to view the opinion.

### District of New Jersey Orders Production of Corporate Books and Records Following Dismissal Without Prejudice of Underlying Derivative Suit

Magistrate Judge Michael A. Hammer of the U.S. District Court for the District of New Jersey ordered production of corporate books and records following the dismissal without prejudice of an underlying derivative suit for failure to adequately plead demand futility.

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In so ruling, the court first determined that it had supplemental jurisdiction over the plaintiff's books and records made under New Jersey law despite the dismissal of the underlying derivative complaint because a without-prejudice dismissal "is not final for purposes of jurisdiction." Because jurisdiction was supplemental, the court found, in what it described as a "unique" procedural posture, that the plaintiff's inspection right must be "strictly limited" to the allegations made in the underlying dismissed complaint. The court also noted that a books and records request made pursuant to New Jersey Statute 14A: 5-28(4) — a statute modeled after the Model Business Corporation Act — must be "circumscribed with rifle precision" to a plaintiff's proper purpose. Recognizing that the company had already produced certain board and executive committee minutes, the court explained that a stockholder's inspection rights under New Jersey law are "broad" if properly connected to a proper purpose. Thus, the court ordered the further production of documents that "directly related" to certain allegations that were made in the dismissed complaint and that were "necessary" to address the plaintiff's demand futility deficiencies as discussed in the dismissal opinion.

## DIRECTORS AND DIRECTORS' DUTIES

### Bylaws

*Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, Nos. 7220-CS, 7238-CS (Del. Ch. June 25, 2013)

Click here to view the opinion.

#### Delaware Court of Chancery Upholds Director-Enacted Forum Selection Bylaws

Chancellor Leo E. Strine Jr. of the Delaware Court of Chancery held that director-enacted bylaws containing an exclusive forum provision are valid and enforceable as a matter of Delaware law. The forum selection bylaws at issue specified the Delaware courts as the exclusive forum in which stockholder derivative suits, fiduciary duty claims and other intra-corporate actions must be brought, unless otherwise consented to by the company. The court explained that the Delaware General Corporation Law "allows the corporation, through the certificate of incorporation, to grant the directors the power to adopt and amend the bylaws unilaterally. The certificates of incorporation of [the defendant corporations] authorize their boards to amend the bylaws. ... In other words, an essential part of the contract stockholders assent to when they buy stock in [the defendant corporations] is one that presupposes the board's authority to adopt binding bylaws consistent with 8 *Del. C.* § 109. ... Therefore, this court will enforce the forum selection bylaws in the same way it enforces any other forum selection clause ... ." The court noted, however, that "as-applied challenges to the reasonableness of a forum selection clause should be made by a real plaintiff whose real case is affected by the operation of the forum selection clause." The plaintiffs are pursuing an appeal of the decision.

### Mergers and Acquisitions

*In re Morton's Rest. Grp., Inc. S'holders Litig.*, No. 7122-CS (Del. Ch. July 23, 2013)

Click here to view the opinion.

#### Delaware Court of Chancery Dismisses Stockholders Complaint Challenging Acquisition, Applying the Enhanced Scrutiny of *Revlon*

Chancellor Leo E. Strine Jr. of the Delaware Court of Chancery granted the defendants' motion to dismiss a complaint by stockholders challenging the purchase of Morton's Restaurant Group by affiliates of Landry's, Inc. The court applied the enhanced scrutiny of *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), not the entire fairness standard of review, to the plaintiffs' fiduciary duty claims. In so doing, the court rejected the plaintiffs' argument that a large private equity stockholder's alleged need for liquidity required entire fairness review. The court explained that the plaintiffs "point to no authority under Delaware law that a stockholder with only a 27.7% block and whose employees comprise only two out of ten board seats creates a rational inference that it was a

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controlling stockholder," and even if they had, the plaintiffs "have failed to make any well-pled allegations indicating that [the private equity stockholder] had a conflict of interest with the other stockholders of Morton's."

In applying *Revlon*, the court explained that "[w]hen in the course of the pleading stage, the plaintiffs concede that the board reaches out to over 100 buyers, signs up over 50 confidentiality agreements, treats all bidders evenhandedly, and employs two qualified investment banks to help test the market, they provide no basis for the court to infer that there was any *Revlon* breach, much less a non-exculpated one, under our Supreme Court precedent in cases like *Lyondell Chemical Co. v. Ryan*." The court concluded by remarking that "[i]t is an example of a now too common invocation of the iconic *Revlon* case in a circumstance where the key problem in *Revlon* — board resistance to the highest bidder based on a bias against that bidder — is entirely absent."

*In re MFW S'holders Litig.*,
No. 6566-CS
(Del. Ch. May 29, 2013)

Click here to view the opinion.

## Delaware Court of Chancery Applies Business Judgment Rule to Controlling Stockholder Going-Private Transaction

Chancellor Leo E. Strine Jr. of the Delaware Court of Chancery granted summary judgment in favor of the defendants in litigation following a controlling stockholder going-private transaction. The court held that the business judgment rule will apply to a merger proposed by a controlling stockholder where, from the outset, the offer is conditioned upon the "(i) negotiation and approval by a special committee of independent directors fully empowered to say no, and (ii) approval by an uncoerced, fully informed vote of a majority of the minority investors." The court emphasized that for the business judgment rule to apply, it must "be clear that the procedural protections employed qualify to be given cleansing credit ... ." The plaintiffs have appealed the decision.

*Koehler v. NetSpend Holdings Inc.*,
No. 8373-VCG
(Del. Ch. May 21, 2013)

Click here to view the opinion.

## Delaware Court of Chancery Explicates a Board's Duties in a Single-Bidder Change-of-Control Transaction

Vice Chancellor Sam Glasscock III of the Delaware Court of Chancery denied a stockholder plaintiff's motion for preliminary injunction, and in the process explicated a board's duties in a single-bidder change-of-control transaction. The court explained that "[u]nder *Revlon* ... a board may dispense with a market check where 'the directors possess a body of reliable evidence with which to evaluate the fairness of a transaction.'" Nevertheless, "[w]here a board decides to forgo a market check and focus on a single bidder, that decision must inform its actions regarding the sale going forward, which in toto must produce a process reasonably designed to maximize price."

The court explained that "[t]he combination" of a lack of market check, reliance on a "weak" fairness opinion, acquiescence to strong deal protection provisions, including the failure to waive certain "don't ask don't waive" standstill provisions, and an anticipated "short period" between signing and closing "resulted in the Board's approving the merger consideration without adequately informing itself of whether $16.00 per share was the highest price it could reasonably attain for the stockholders." The court, however, refused to enjoin the transaction because an injunction "presents a possibility that the stockholders will lose their chance to receive a substantial premium over market for their shares ... and because no other potential bidders have appeared."

## DODD-FRANK/WHISTLEBLOWER PROTECTION

*Asadi v. G.E. Energy (USA), L.L.C.*, No. 12-20522 (5th Cir. July 17, 2013)

Click here to view the opinion.

### Fifth Circuit Limits Dodd-Frank Whistleblower Protection to Those Who Report Possible Securities Law Violations to the SEC

The U.S. Court of Appeals for the Fifth Circuit affirmed the dismissal of a former executive's Dodd-Frank whistleblower-retaliation claim, holding that he was not a "whistleblower" within the plain meaning of the statute. The plaintiff, a former GE Energy executive located in Jordan, was allegedly fired for reporting a possible Foreign Corrupt Practices Act violation to his superior at GE Energy, even though he did not report it to the SEC. The district court held that the statute did not apply extraterritorially and thus dismissed on that basis. On appeal, the Fifth Circuit did not address the extraterritorial reach of the statute, but instead considered whether the plaintiff qualified as a "whistleblower." The Fifth Circuit rejected the view taken by district courts in the Second and Sixth Circuits that the statute may extend to protect certain individuals who do not make disclosures to the SEC, and concluded that the Dodd-Frank whistleblower-protection provision unambiguously requires individuals to provide information relating to a violation of the securities laws to the SEC to qualify for protection from retaliation.

## DUTY TO DISCLOSE

*Rescue Mission of El Paso, Inc. v. K-Sea Transp. Partners L.P.*, No. 12-cv-00509 (WHW) (D.N.J. June 14, 2013)

Click here to view the opinion.

### District of New Jersey Dismisses Claims That Company Allegedly Misrepresented Its Tenuous Financial Position Amid the Recession

Judge William H. Walls of the U.S. District Court for the District of New Jersey dismissed claims that a marine transporter violated Section 10(b) of the Securities Exchange Act by allegedly misrepresenting its tenuous financial position amid the recession. The company's officers were not required to disclose certain financial information, even though the information may have been material, because the company had no affirmative duty beyond its general reporting requirements to disclose fiscal results. Additionally, the challenged statements discussing the company's health were measured and qualified and the company adequately warned plaintiffs that conditions going forward may be choppy due to the changing economic landscape and decreased demand for ships. Further, the plaintiffs failed to adequately show that the challenged statements were reckless, and there was no indication that executives benefited as a result.

## ERISA

*Harris v. Amgen, Inc.*, No. 10-56014 (9th Cir. June 4, 2013)

Click here to view the opinion.

### Ninth Circuit Holds Plaintiffs Can Use Federal Securities Law Violations to Allege ERISA Breach of Duty Claims Because the Presumption of Prudence Does Not Apply

The U.S. Court of Appeals for the Ninth Circuit, in reversing the dismissal of an ERISA class action, held that the plaintiffs sufficiently alleged the defendants violated the duty of care they owe as fiduciaries under ERISA.

The case arises from the same underlying facts as the Supreme Court's recent decision in *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, 133 S. Ct. 1184 (2013), which held that plaintiffs need not establish the materiality of alleged fraudulent statements to obtain class certification based on a fraud-on-the-market theory. In addition to those securities fraud claims, a putative class of Amgen, Inc.'s employees brought ERISA-based claims against Amgen and the plan administrators of Amgen's retirement plans, which held Amgen stock.

The defendants won dismissal below, arguing that they were entitled to a presumption of prudence under *Quan v. Computer Sciences Corp.*, 623 F.3d 870 (9th Cir. 2010), in determining

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whether their decisions constituted breaches of duty under ERISA because their plans encourage the fiduciary to invest primarily in employer stock. The Ninth Circuit disagreed and held that the explicit statement in the defendants' plan that fiduciaries *may* offer a company stock fund as an investment to participants does not suggest that they were *encouraged* to do so, and thus the *Quan* presumption of prudence did not apply. Instead, the Ninth Circuit held the normal, more stringent, prudent man standard applied to the defendants' investment decisions as fiduciaries under the plans.

Under this standard, the Ninth Circuit determined that the alleged misrepresentations and omissions, scienter and resulting decline in share price in *Amgen* were sufficient to state a claim that the defendants violated their duty of care under ERISA in this case. The Ninth Circuit reasoned that the fiduciaries knew or should have known that the Amgen common stock fund was purchasing stock at an artificially inflated price due to material misrepresentations and omissions by company officers, as well as by allegedly improper off-label marketing, but they nevertheless continued to allow plan participants to invest in the fund.

The Ninth Circuit also held that the plaintiffs sufficiently alleged that the defendants violated their duties by failing to provide material information to plan participants about investment in the Amgen common stock fund. Rejecting the defendants' argument that plaintiffs failed to allege reliance, the Ninth Circuit held that ERISA plan participants who invest in a company stock fund, whose assets consist solely of publicly traded common stock, can rely on the fraud-on-the-market theory, just as any other investor in publicly traded stock would.

Finally, Amgen argued that it should be dismissed because it was not a fiduciary under the plan and had delegated its discretionary authority. Because the Amgen plan provided that Amgen was the named fiduciary and plan sponsor, and because the plan did not mention delegating exclusive authority to trustees and investment managers, the Ninth Circuit held that Amgen was a fiduciary. The Ninth Circuit reversed the district court's dismissal of Amgen and the plan administrators and remanded for further proceedings.

## INSIDER TRADING CLAIMS

*McDaniel v. Wells Fargo Invs., LLC*, Nos. 11-17017, 11-55859, 11-55943, 11-55958 (9th Cir. Apr. 9, 2013)

Click here to view the opinion.

### Ninth Circuit, Affirming Lower Courts, Holds That Federal Securities Law Preempts Enforcement of California's Forced-Patronage Statute

The U.S. Court of Appeals for the Ninth Circuit affirmed four district court decisions granting motions to dismiss. In each of the four cases, former employees of the defendants in the field of financial advising filed four separate class actions. The plaintiffs alleged that because the defendants' trading policies allowed employees to open self-directed trading accounts only in-house, they forced each employee to patronize his or her employer in the purchase of a thing of value. The plaintiffs alleged this amounted to "forced patronage" in violation of Section 450(a) of the California Labor Code.

To meet the federal requirement that broker firms take reasonably designed measures to prevent their employees from misusing material, nonpublic information, the defendants enacted policies prohibiting their financial advisers from opening self-directed trading accounts outside the firm.

The Ninth Circuit concluded that federal securities law preempts a challenge to such a policy based on the forced patronage provision of the California Labor Code because the state law is a significant obstacle to the congressional goal of preventing insider trading. While the plaintiffs argued that there were less stringent ways in which the defendants could guard against insider trading, the Ninth Circuit emphasized that the SEC has noted favorably that almost all firms require employees to maintain accounts with the firm and that NYSE Rule 407(b) codifies the no-outside-account policy as a default rule. Because the state law claims were preempted, the Ninth Circuit affirmed the dismissals.

## LOSS CAUSATION

*Mass. Ret. Sys. v. CVS Caremark Corp.*, No. 12-1900 (1st Cir. May 24, 2013)

Click here to view the opinion.

### First Circuit Vacates Dismissal of Claims That CVS Allegedly Misrepresented The Success of Its Computer System Integration Following Caremark Merger

The U.S. Court of Appeals for the First Circuit vacated dismissal and remanded for further consideration of claims that CVS violated Section 10(b) of the Securities Exchange Act by allegedly misrepresenting the success of the company's computer system integration following its merger with Caremark. The district court previously determined that the plaintiffs failed to sufficiently allege loss causation. The First Circuit, however, held those allegations sufficient: CVS allegedly falsely reported that the companies' systems were working together correctly, problems with integration caused the loss of two Caremark clients, and the market price fell when the system problems were revealed by analysts. Although the analyst reports were not based on a direct disclosure, a prior earnings call discussing certain "service issues" and the loss of two Caremark clients was sufficient for analysts to infer problems with integration and, therefore, the reports constituted corrective disclosures. In addition, the size of the accounts lost, alleged changes in the way the company described the operational success of its prescription management business, and the retirement of the executive responsible for implementing the integration would have tipped analysts to the alleged integration problems.

*Meyer v. Greene*, No. 12-11488 (11th Cir. Feb. 25, 2013)

Click here to view the opinion.

### Eleventh Circuit Affirms Dismissal of Class Action, Holding None of the Alleged 'Corrective Disclosures' Described by the Plaintiff Established Loss Causation

The U.S. Court of Appeals for the Eleventh Circuit affirmed the dismissal of a consolidated class action securities fraud complaint for failure to adequately plead loss causation, determining that when a plaintiff invokes the fraud-on-the-market theory to prove reliance, a "corrective disclosure" used to allege loss causation must present facts to the market that are publicly revealed for the first time and that reveal to the market that previous statements were false or fraudulent.

The City of Southfield Fire & Police Retirement System brought a consolidated class action securities fraud complaint against the St. Joe Company and its current and former officers for failing to write down the value of certain real estate assets in St. Joe's quarterly and annual reports to the SEC, thus overstating the value of its holdings and performance during the class period. The plaintiffs claimed three purported "corrective disclosures" alleging loss causation: (1) a presentation given by hedge fund investor David Einhorn suggesting St. Joe's assets were significantly overvalued, (2) St. Joe's disclosure of an informal SEC investigation, and (3) St. Joe's announcement that the SEC's informal investigation had ripened into a "private order of investigation."

Determining that plaintiffs had failed to allege loss causation, the district court granted the defendants' motion to dismiss, with prejudice, and the Eleventh Circuit affirmed. The Eleventh Circuit determined that none of the alleged "corrective disclosures" described by the plaintiffs were in fact corrective disclosures sufficient to establish loss causation. With regard to the Einhorn presentation, the Eleventh Circuit noted that the presentation contained a disclaimer on the second slide stating that all of the information in the presentation was "obtained from publicly available sources." As such, the presentation did not contain facts that were newly presented to the market. The Eleventh Circuit reasoned that because an efficient market theory assumes that all publicly available information is digested and incorporated into a price of a security, a corollary of the efficient market theory is that disclosure of information already known by the market will not cause a change in the stock price — such a disclosure cannot show loss causation. With regard to St. Joe's two disclosures related to the SEC investigation, the Eleventh Circuit held these also were not "corrective disclosures" because they did not reveal to the market the falsity of a prior misstatement. The announcement of an investigation does not reveal to the market that a company's previous statements were false or fraudulent, it

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merely reveals an investigation is underway. The Eleventh Circuit held that because neither the Einhorn presentation nor the announcements regarding the SEC investigations were corrective disclosures, the plaintiffs' complaint failed to adequately allege a causal connection between the alleged misrepresentation and the investment's subsequent decline in value.

## MISREPRESENTATIONS

*In re Anadarko Petroleum Corp. Class Action Litig.*, No. 4:12-cv-0900 (S.D. Tex. July 15, 2013)

Click here to view the opinion.

### Texas District Court Dismisses Vast Majority of Securities Claims Against Anadarko

Judge Keith P. Ellison of the U.S. District Court for the Southern District of Texas dismissed the vast majority of securities claims against Anadarko Petroleum Corporation and its key executives. Anadarko was a passive, non-operating investor in the Macondo well that BP was drilling when the Gulf of Mexico oil spill and explosion occurred in April 2010. After the spill, a putative class of Anadarko shareholders sued, alleging that the defendants misled investors about the company's involvement in the Macondo project, as well as its safety practices, risk management, and insurance reserves and coverage. The court said that the majority of the allegedly misleading statements attributed to the defendants were "too squishy, too untethered to anything measurable, to communicate anything that a reasonable person would deem to be important to a securities investment decision." The court further held that the Supreme Court's decision in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), barred the plaintiffs' claim that Anadarko should be liable for BP's pre- and post-spill statements related to the accident. The court allowed only one claim to survive, related to a response to a question on a post-spill earnings call, but suggested that the plaintiffs will face an uphill battle to prove the claim. According to the court, the fact that the statement was an isolated occurrence and the executive did not try to sell stock at the time "suggests that [the executive] simply misspoke on the conference call, and that the statement was not part of a coordinated scheme to blunt the effect of the oil spill on Anadarko's share price."

## MORTGAGE-BACKED SECURITIES

*Shailja Gandhi, Revocable Trust v. Sitara Capital Mgmt., LLC*, No. 12-3105 (7th Cir. July 9, 2013)

Click here to view the opinion.

### Seventh Circuit Ends Legal Battle Over Hedge Fund's Ill-Fated Investment in Freddie Mac Securities

The U.S. Court of Appeals for the Seventh Circuit affirmed summary judgment for Sitara Capital Management, holding that the Northern District of Illinois properly rejected a motion by investors to file a third amended complaint based on the hedge fund's ill-fated investments in Freddie Mac. The case proceeded to discovery on only a handful of counts, including breach of fiduciary duty under the Employee Retirement Income Security Act (ERISA) and the failure to register investment advisers and securities.

On the day dispositive motions were due, Sitara moved for summary judgment. The plaintiffs, meanwhile, requested leave to file their third amended complaint, this time alleging securities fraud related to facts discovered during a recent deposition. The court granted Sitara's motion and denied the plaintiffs' request. On appeal, the Seventh Circuit affirmed, holding that the new allegations of fraud would be futile because the plaintiffs could not establish the falsity of the statements on which they allegedly relied. Moreover, the court held that the plaintiffs failed to allege fraud with the requisite degree of particularity despite conducting extensive discovery. Accordingly, the Seventh Circuit granted the defendants' motion for summary judgment and denied the plaintiffs' leave to file an amended complaint.

## SCIENTER

*Pub. Pension Fund Grp. v. KV Pharm. Co.*, No. 4:08-CV-1859 (CEJ) (E.D. Mo. Apr. 30, 2013)

Click here to view the opinion.

### District Court Refuses to Dismiss Claims That KV Pharmaceutical Failed to Disclose FDA Compliance Problems

Judge Carol Jackson of the U.S. District Court for the Eastern District of Missouri refused to dismiss an action against KV Pharmaceutical relating to statements made about the company's compliance with FDA regulations between 2003 and 2009. The court initially had dismissed the complaint for failure to state a claim, but was reversed in part by the U.S. Court of Appeals for the Eighth Circuit, which determined that the complaint adequately pleaded that relevant statements by KV and its former CEO about the company's FDA compliance were false and misleading. The Eighth Circuit remanded for consideration of whether the complaint also properly pleaded scienter and loss causation.

On remand, the district court held that the plaintiffs had established that KV's CEO acted with the requisite state of mind by alleging the following facts: that he knew of and had discussed the violations with the FDA; that he signed a consent decree with the government that reflected his knowledge of the issues; that he was terminated for cause, "with full knowledge of all pertinent facts"; and that the ongoing fraudulent scheme could not have been perpetrated without the knowledge and involvement of company executives at the highest level. The court further determined that the plaintiffs adequately alleged a causal connection between the misstatements and their losses by pleading that the monetary losses were foreseeable and caused by the corrective disclosure of the concealed risk.

## SEC ENFORCEMENT

*Sec. & Exch. Comm'n v. Wyly*, No. 10 Civ. 5760(SAS) (S.D.N.Y. June 6, 2013)

Click here to view the opinion.

### S.D.N.Y. Grants Summary Judgment, in Part, on Claims That Defendants Allegedly Evaded Federal Securities Laws by Hiding Their Ownership of Four Public Companies

In an SEC enforcement action, Judge Shira A. Scheindlin of the U.S. District Court for the Southern District of New York granted, in part, summary judgment on claims that the defendants evaded federal securities laws by allegedly hiding their ownership of, and trading activity in, four public companies through various offshore trusts and subsidiary entities in the Isle of Man and the Cayman Islands. Some of the SEC's claims were time-barred by the five-year statute of limitations, and the limitations period was not equitably tolled because the SEC failed to sufficiently show acts of concealment. However, the court denied summary judgment motions, in part, as to other claims because the SEC adequately demonstrated that the nonpublic information transmitted by the defendants pertaining to the sale of one defendant's company was material. Further, the insider controlled the potential sale, personally transacted with the stocks of that company, and knew the transaction was likely to be "bullish and massive" and acted on that knowledge.

*Sec. & Exch. Comm'n v. Tourre*, No. 10 Civ. 3229(KBF) (S.D.N.Y. June 4, 2013)

Click here to view the opinion.

### S.D.N.Y. Denies Summary Judgment on Claims That Marketing and Sale of Interests in CDO Allegedly Misrepresented Its Status and Performance

Judge Katherine B. Forrest of the U.S. District Court for the Southern District of New York denied summary judgment on claims that the marketing and sale of interests in a synthetic collateralized debt obligation (CDO) violated Section 10(b) of the Securities Exchange Act by misrepresenting the status and performance of the CDO. The offers were "domestic" under *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010), because the offeror was in the United States at the time of the offer. In addition, evidence was sufficient to show that the defendant had personally sold the securities because the defendant was a "necessary participant" in the sale. The defendant

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also had a central role in the development of a fraudulent term sheet and flip-book and participated in email and other marketing. Furthermore, the defendant engaged in interstate commerce by use of the telephone and Internet to accomplish the alleged fraud.

*Sec. & Exch. Comm'n v. Schooler*, No. 3:12-cv-2164-GPC-JMA (S.D. Cal. July 1, 2013)

Click here to view the opinion.

## Southern District of California Holds That the SEC Sufficiently Alleged That General Partnership Interests Were Securities Under the Agency's Statutory Authority

Judge Gonzalo P. Curiel of the U.S. District Court for the Southern District of California denied a motion to dismiss, rejecting the defendants' argument that the SEC did not have statutory authority to bring its claims. The SEC alleged that since 2007, the defendants defrauded thousands of investors by offering and selling $50 million worth of general partnerships without disclosing the true value of land underlying the investments, mortgages encumbering those properties and when exactly the land was transferred from the defendants to the general partnerships.

On the defendants' motion to dismiss, the court determined that the general partnerships, as alleged, were securities because they were "investment contracts" under the definitions in the Securities Act and the Securities Exchange Act. To determine whether the general partnerships are investment contracts, the court applied the three-part test from *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981), which recognizes an investment contract if at least one of the following factors is present: (1) the general partnership agreement leaves so little in the hands of the partners that the arrangement is, in fact, a limited partnership, (2) the partners are so inexperienced and unknowledgeable in the general partnership business affairs that they are incapable of intelligently exercising their partnership powers, or (3) the partners are so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that they cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.

The court held that the SEC had sufficiently alleged the second and third factors. Under the first factor — the distribution of power — the court noted that the partnership agreements themselves left significant control in the general partners' hands, defeating the SEC's allegation that the investments really operated as limited partnerships. However, under the second factor, the SEC sufficiently alleged that the partners were unsophisticated in business affairs enough to show that the "partnerships" were really investment contracts. Relatedly, under the third factor, the SEC had alleged that the unsophisticated partners were dependent on the promoter based on the promoter's representations to investors that his expertise was crucial to the success of the investments. Because the SEC adequately pleaded at least one of the *Williamson* factors, the court denied the motion to dismiss.

*Saad v. Sec. & Exch. Comm'n*, No. 10-1195 (D.C. Cir. June 11, 2013)

Click here to view the opinion.

## District of Columbia Circuit Vacates SEC Lifetime Bar Order for Failure to Address Potentially Mitigating Factors

The U.S. Court of Appeals for the District of Columbia vacated a SEC lifetime bar order against the petitioner and remanded the matter for further consideration because the commission failed to adequately address all of the potentially mitigating factors when determining the appropriate sanction against the petitioner. The petitioner, a former registered general securities representative and principal, violated FINRA rules by submitting false expense reports to his employer and subsequently trying to conceal his misconduct. He was discharged by his employer. After his termination, the petitioner was sanctioned by the FINRA Hearing Panel, which imposed a permanent bar against the petitioner's association with a member firm in any capacity — "the securities industry equivalent of capital punishment." The SEC affirmed. On review, the D.C. Court of Appeals vacated the commission's lifetime bar order and remanded the matter for further consideration. The court determined that the SEC abused its discretion by ignoring several potentially mitigating factors asserted by the petitioner that were supported by evidence in the record. In particular, the commission and FINRA decisions did not

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address the fact that the petitioner's former firm had already disciplined him by terminating his employment prior to FINRA's institution of regulatory proceedings, or the fact that the petitioner was under extreme personal and professional stress at the time of the misconduct because he had received a production warning from his employer while his infant child was being hospitalized for a serious stomach disorder. The SEC claimed that it had "implicitly" considered but rejected these facts, which the court said was insufficient. The D.C. Court of Appeals took no position on the proper outcome of the case. Rather, the court remanded the matter for the commission to "carefully and thoughtfully address each potentially mitigating factor supported by the record."

## SECURITIES ACT CLAIMS

*Ind. State Dist. Council of Laborers & Hod Carriers Pension & Welfare Fund v. Omnicare, Inc.*, No. 12-5287 (6th Cir. May 23, 2013)

Click here to view the opinion.

### Sixth Circuit Finds No Obligation to Allege 'Knowledge of Falsity' Under Section 11

The U.S. Court of Appeals for the Sixth Circuit partly reversed the dismissal of a putative securities class action against Omnicare and its fiduciaries, holding that the plaintiffs were not required to plead knowledge of falsity in actions under Section 11 of the Securities Act. The opinion marked a departure from the reasoning of the U.S. Courts of Appeals for the Second and Ninth Circuits, which required plaintiffs to allege subjective falsity in Section 11 claims that are based on statements of opinion or belief. See *Fait v. Regions Financial Corp.*, 655 F.3d 105, 113 (2d Cir. 2011); *Rubke v. Capitol Bancorp Ltd.*, 551 F.3d 1156, 1162 (9th Cir. 2009).

The plaintiffs were Omnicare investors who alleged the company's public statements of legal compliance were materially false because Omnicare was engaged in a variety of illegal activities. The district court dismissed the action on two grounds: (1) the plaintiffs failed to allege the defendants knew their statements were false, and (2) the plaintiffs failed the heightened pleading standard of Rule 9(b), which applied despite the plaintiffs' brief disclaimer that their complaint did not sound in fraud. On appeal, the Sixth Circuit partly reversed, holding that the plaintiffs were subject to Rule 9(b) but were not required to plead knowledge of falsity for their claims under Section 11. Distinguishing precedent that imposed a requirement of subjective falsity for limited numbers of claims under Section 10(b) of the Securities Exchange Act, the court held that a defendant's mental state was irrelevant to an action under Section 11, which imposes strict liability. Nor was the court persuaded by the reasoning of the Second and Ninth Circuits, which argued for a "subjective falsity" requirement by analogizing to cases interpreting Section 14(a) of the Securities Act. Although objective falsity — and not mere disbelief—was necessary to plead a violation of Section 14(a), the Sixth Circuit held that the reasoning did not extend to an action under Section 11. Accordingly, the court partly reversed the dismissal of the action, holding that knowledge of falsity was not a requirement under Section 11.

## SECURITIES EXCHANGE ACT DISCLOSURES

*Cucinotta v. Deloitte & Touche, LLP*, No. 58727 (Nev. May 30, 2013)

Click here to view the opinion.

### Nevada Supreme Court Holds Communications About Alleged Illegal Acts Are Subject to an Absolute Privilege in a Defamation Action

In a matter of first impression, the Supreme Court of Nevada held that an individual who is required by law to communicate allegedly defamatory matter, including information divulged in compliance with the Securities Exchange Act, is absolutely privileged in making such statements.

While performing a financial audit for Global Cash Access Holdings, Inc. (GCA), Deloitte & Touche, LLP obtained an intelligence bulletin authored by the FBI that contained information about alleged illegal acts committed by GCA and two members of its board of directors. Deloitte discharged its duty under federal securities law to disclose the allegations to GCA's audit committee. After an internal investigation revealed no evidence of misconduct on the

*(continued on next page)*

part of GCA or the two members of its board of directors, the two members of GCA's board of directors brought a defamation and tortious interference action against Deloitte and the Deloitte accountant who disclosed the information to GCA's audit committee.

The district court granted Deloitte's motion for summary judgment, concluding that Deloitte's communications were protected by a conditional privilege because the plaintiffs did not present evidence that Deloitte acted with actual malice. On appeal, the Supreme Court of Nevada affirmed the district court's summary judgment, but held that Deloitte's communications were protected by an absolute privilege, rather than a conditional one. The court reasoned that those who are required by law to publish allegedly defamatory statements should not incur any liability for doing so. The court held that one who is required by law to publish allegedly defamatory matter is absolutely privileged to publish it when (1) the communications are made pursuant to a lawful process, and (2) the communications are made to a qualified person. The court said Deloitte was subject to an absolute privilege and affirmed summary judgment because Deloitte (1) discharged its duty pursuant to the lawful process set forth in 15 U.S.C. § 78j-1 and (2) made the communication to GCA's audit committee — a qualified person.

## SECURITIES FRAUD PLEADING STANDARDS

*In re Fannie Mae 2008 Sec. Litig.*, No. 12-3859 (2d Cir. May 15, 2013)

Click here to view the opinion.

### Second Circuit Affirms Dismissal of Claims Related to Fannie Mae's Capital Reserves and Write-Downs Relating to Subprime Mortgage Holdings

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims that Fannie Mae violated Section 10(b) of the Securities Exchange Act by allegedly misrepresenting the organization's capital reserves and concealing the inadequacy of write-downs relating to sub-prime mortgage holdings. The claims constituted fraud by hindsight because the plaintiffs alleged only that Fannie Mae's initial write-down should have been larger because Fannie Mae decided to make additional write-downs as a result of further deterioration of the subprime mortgage market. Although evidence of subsequent write-downs may, in some circumstances, indicate fraud, the facts as alleged indicated that the need for additional write-downs was a product of imperfect business judgment during tumultuous economic conditions and not fraud.

*Gusinsky v. Barclays PLC*, No. 12 Civ. 5329(SAS) (S.D.N.Y. May 13, 2013)

Click here to view the opinion.

### S.D.N.Y. Dismisses Claims That Bank Allegedly Participated in LIBOR Rate Manipulation Scheme

Judge Shira A. Scheindlin of the U.S. District Court for the Southern District of New York dismissed claims that a bank violated Section 10(b) of the Securities Exchange Act by allegedly participating in a LIBOR rate manipulation scheme. The court held that statements about the bank's business practices were not false and misleading because its business ethics representations constituted inactionable puffery and statements regarding risk management and compliance procedures were not sufficiently connected to the bank's alleged involvement in the LIBOR scheme. In addition, the bank did not conceal any alleged contingent liabilities arising from the LIBOR scheme because possible liabilities need not be disclosed when the violation happens, but rather at the point during a company's investigation when the possibility of liability becomes more than remote, and the bank disclosed the possibility of regulatory penalties during its internal investigation. The court also dismissed claims that the bank's allegedly false LIBOR submissions themselves (allegedly submitted to manipulate the LIBOR rate) were false and misleading because the plaintiffs failed to show loss causation. Even if the false LIBOR submissions caused the price of the bank's stock to rise at the time, disclosure of the bank's conduct was preceded by a three-year gap during which no fraudulent activity was alleged, so any inflation in the bank's stock would have dissipated prior to the first corrective disclosure.

*Sec. Police & Fire Prof'l of Am. Ret. Fund v. Pfizer, Inc.*, No. 10-cv-3105 (SDW)(MCA) (D.N.J. Apr. 22, 2013)

Click here to view the opinion.

### District of New Jersey Dismisses Claims That Pfizer Allegedly Misrepresented the Effectiveness of Drug Meant to Treat Alzheimer's

Judge Susan D. Wigenton of the U.S. District Court for the District of New Jersey dismissed claims that Pfizer violated Section 10(b) of the Securities Exchange Act by allegedly misrepresenting the effectiveness of a drug meant to treat Alzheimer's disease. The plaintiff challenged statements in two press releases. In the first press release, the challenged statement read in context was not misleading. As to the statement in the second press release, Pfizer had no independent duty of disclosure as to "Phase II" results. Further, Pfizer did not make an affirmative statement about "Phase II," and therefore did not put the issue "in play," requiring additional statements to prevent the press releases from being allegedly misleading.

## SLUSA PREEMPTION

*Holtz v. J.P. Morgan Sec. LLC*, No. 12-cv-7080 (N.D. Ill. June 26, 2013)

Click here to view the opinion.

### District Court Dismisses Contractual and Fiduciary Duty Claims Against JP Morgan as Precluded by SLUSA

Judge John W. Darrah of the U.S. District Court for the Northern District of Illinois dismissed a putative class action brought on behalf of JP Morgan's financial advisory clients as precluded by the U.S. Securities and Litigation Uniform Standards Act (SLUSA). The plaintiffs brought claims for breach of contract, breach of fiduciary duty and unjust enrichment in connection with an alleged scheme that required JP Morgan financial advisers to push the defendants' own proprietary mutual funds and investments, as opposed to funds and investments managed by third parties, even where doing so was contrary to clients' interests. The plaintiffs attempted to limit their pleadings to their stated claims and specifically disclaimed that their allegations were to be construed as allegations of fraud, misrepresentation or material omission. The court nonetheless dismissed the complaint as precluded by SLUSA, holding that, despite the plaintiffs' artful pleading, the substance of the allegations amounted to a claim of fraudulent concealment in connection with the sale of securities. The court reasoned that it would be "difficult and maybe impossible to disentangle" the allegations of fraud from the plaintiffs' other claims, and dismissed the complaint with prejudice.

## STATUTES OF REPOSE

*Police & Fire Ret. Sys. of the City of Detroit v. IndyMac MBS, Inc.*, Nos. 11-2998-cv(L), 11-3036-cv(CON) (2d Cir. June 27, 2013)

Click here to view the opinion.

### Second Circuit Affirms Partial Denial of Motion To Intervene by Absent Class Members in Action Against IndyMac

The U.S. Court of Appeals for the Second Circuit affirmed the partial denial of motions to intervene by five absent class members in a putative class action alleging that IndyMac violated Sections 11, 12(a) and 15 of the Securities Act by allegedly misrepresenting the underwriting standards, real estate appraisal practices, and the processes used to rate mortgage-backed securities that it issued. The proposed intervenors filed their motions after the district court had dismissed the claims related to MBSs that the lead plaintiffs had not purchased. The motions were untimely because they were filed after Section 13's three-year repose period had expired, and that period was not tolled by *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974). Equitable tolling principles do not apply to statutes of repose, like Section 13, and even if tolling under *American Pipe* is considered to be a legal doctrine, the Rules Enabling Act bars the courts from changing substantive rights of the parties. In addition, under Rule 15(c) of the Federal Rules of Civil Procedure, the proposed amended complaint does not relate back to a prior, timely complaint because lack of jurisdiction cannot be aided by intervention.

*Arco Capital Corps. Ltd. v. Deutsche Bank AG*,
No. 12 Civ. 7270
(S.D.N.Y. June 6, 2013)

Click here to view the opinion.

## S.D.N.Y. Dismisses Claims That Deutsche Bank Allegedly Misrepresented The Quality of Collateralized Loan Obligations in Credit Default Swap Agreements

Judge Robert W. Sweet of the U.S. District Court for the Southern District of New York dismissed claims that Deutsche Bank violated Section 10(b) of the Securities Exchange Act by allegedly misrepresenting the quality of collateralized loan obligations, and the underlying loans, in certain credit default swap agreements. The claims were untimely under the five-year statute of repose, which begins to run on the date of the transaction rather than on the date of the last misrepresentation in cases (such as here) where the alleged representations occurred post-purchase. Additionally, the claims were barred by 28 U.S.C. § 1658(b), which requires that Section 10(b) claims be brought within two years of the date upon which a reasonable plaintiff would have sufficient information to adequately allege a violation. However, the court did determine that the transaction was domestic under *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010), even though the transaction was executed by a foreign issuer and purchaser, because the notes at issue were expressly nonbinding until payment was received by the trustee in New York.

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