Skadden

Inside the Courts

An Update From Skadden Securities Litigators

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CLASS CERTIFICATION

Goodman v. Genworth Fin. Wealth Mgmt. Inc., No. 09-CV-5603, 2014 WL 1452048 (JFB) (GRB) (E.D.N.Y. Apr. 15, 2014)

Click here to view the opinion.

E.D.N.Y. Denies Class Certification in Investment Marketing Materials Dispute

Judge Joseph F. Bianco of the U.S. District Court for the Eastern District of New York denied class certification of claims that a financial services company violated Section 10(b) of the Securities Exchange Act by allegedly misrepresenting the company's investment approach in its marketing materials. The plaintiffs alleged that Genworth misrepresented that its investment approach would be guided by a particular investment manager's recommendations concerning mutual fund and asset allocation selections. The court determined that the plaintiffs failed to allege a common theory of reliance as required under Federal Rules of Civil Procedure 23(b)(3). The plaintiffs did not identify an efficient market for the securities at issue, so they were not entitled to a presumption of reliance under the fraud-on-the-market theory. The plaintiffs also were not entitled to a presumption of reliance under *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972), which applies to material omissions, because the plaintiffs' claims actually were based on Genworth's affirmative representations concerning an investment manager's role in mutual fund selection and asset allocation, not any alleged omissions. In addition, the court rejected the plaintiffs' purported expert on class-wide reliance because plaintiffs cannot prove class-wide reliance by showing that the representations and omissions at issue were uniform and material.

DEMAND FUTILITY

Rosenbloom v. Pyott, No. 12-55516 (9th Cir. Sept. 2, 2014)

Click here to view the opinion.

Ninth Circuit Reverses District Court's Dismissal, Holds Plaintiffs Adequately Alleged Demand Futility in Shareholder Derivative Action

The U.S. Court of Appeals for the Ninth Circuit reversed the dismissal of a derivative action brought by shareholders of Allergan, Inc., concluding that the plaintiffs had adequately alleged demand futility.

Allergan makes Botox, a cosmetic and therapeutic drug. Botox has been prescribed for both on-label and off-label uses. While a doctor may prescribe an approved drug for an off-label use, federal law imposes limits on whether and how a drug manufacturer can promote off-label uses. In 2010, Allergan faced allegations it had acted illegally in marketing and labeling Botox. The company settled several *qui tam* suits and pleaded guilty in a criminal case. Allergan ultimately paid over $600 million in fines.

Shortly thereafter, plaintiff shareholders filed a derivative action alleging that Allergan's directors were liable to the company for violations of various state and federal laws, and for breaches of their fiduciary duties. The plaintiffs, however, did not make a demand on Allergan's board requesting that Allergan bring the claims in its own name. The plaintiffs argued that demand was excused for two reasons. First, the board decided to pursue a business plan premised on unlawful conduct. Second, the board remained consciously inactive despite actual or constructive knowledge of wrongdoing at the company. The district court dismissed the action, concluding that the plaintiffs failed to allege particularized facts that demand was excused.

On review, the Ninth Circuit first explained the different standards under which demand may be excused. For the plaintiffs' claim that the board pursued a business plan premised on unlawful conduct, the two-part, disjunctive *Aronson* test applies. See *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984). Under that standard, demand is excused if, under the particularized facts alleged, *either* a reasonable doubt is created that the directors are disinterested and independent, *or* there is a reasonable doubt that the challenged transaction was otherwise the product of a valid exercise of business judgment. Under that standard, the court noted, a director has a "disabling interest for pre-suit demand purposes when the potential for liability ... may rise to a substantial likelihood."

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For the plaintiffs' claim that the board remained consciously inactive when it knew (or should have known) about illegal conduct, the court acknowledged that the demand standard is "less settled." Some courts have employed the *Aronson* test for this claim. Other courts classify the claim as a theory of oversight liability, as set forth in *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959, 971 (Del. Ch. 1996). Demand futility for *Caremark* claims is tested under the *Rales* standard, which requires a plaintiff to allege facts that create a reason to doubt that the board "could have properly exercised its independent and disinterested business judgment in responding to a demand." *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993). Despite the uncertainty regarding the appropriate demand standard, the court explained that demand is excused under either approach if a plaintiff alleges particularized facts that create a reasonable doubt as to whether a majority of a board faces a substantial likelihood of personal liability for breaching the duty of loyalty. The court also noted that, "[w]hen appropriate, courts may evaluate demand futility by looking to the whole board of directors rather than by going one by one through its ranks."

The panel first analyzed the plaintiffs' claim that the board remained consciously inactive despite actual or constructive knowledge of wrongdoing at the company. The court recognized, as Allergan argued, that it was entirely possible for off-label sales to increase on their own, without any illegal promotion by a drug manufacturer. Here, however, the plaintiffs provided "a battery of particularized factual allegations that strongly support an inference" that the board knew of illegal activity and yet did nothing. First, the plaintiffs alleged that the board closely and regularly monitored off-label Botox sales. Second, the board received data directly linking Allergan's sales programs to fluctuations in off-label sales. Third, the board received repeated FDA warnings about illegal promotion of Botox. Fourth, Botox was one of Allergan's most important drugs. Fifth, the conduct "was unquestionably of significant magnitude and duration."

The court concluded that, taking these allegations together, the district court abused its discretion in determining that they did not create a reasonable inference of conscious inaction. The panel highlighted three specific errors by the district court. First, the district court considered the allegations in isolation rather than in combination, "even though in cases like this one an inference of Board involvement or knowledge may depend on a combination of factual allegations." Second, the district court drew inferences in the board's favor, rather than in the plaintiffs' favor. Third, the district court "essentially insisted on a smoking gun of Board knowledge, even though precedent holds that plaintiffs can show demand futility by alleging particular facts that support an *inference* of conscious inaction."

Having already determined that demand was excused, the panel still proceeded to briefly analyze demand futility under the plaintiffs' claim that the board pursued a business plan premised on unlawful conduct. Taking the same factual allegations, the court concluded that it was a reasonable inference that the "red flags of illegal conduct" were not "signs that the marketing team had gone off the rails." Rather, as the plaintiffs alleged, it was reasonable to infer that "they were welcome indicators that a massive, Board-approved push for off-label sales of Botox was going according to plan." The court reasoned that an inference that the board decided to break the law can be drawn even without a "Board-approved document stating, 'we're all going to go promote Botox off-label now and do so in a way that violate[s] the FDA's regulations.'" Rather, it is sufficient if the allegations create a reasonable doubt that the board adopted a plan premised on illegal, off-label marketing of Botox, and therefore faces a substantial likelihood of liability for breaching the duty of loyalty.

In re MGM Mirage Derivative Litig., No. 2:09-cv-01815-KJD-RJJ, 2014 WL 2960449 (D. Nev. June 30, 2014)

Click here to view the opinion.

District of Nevada Dismisses MGM Mirage Shareholder Derivative Action, Citing Issue Preclusion

Judge Kent J. Dawson of the U.S. District Court for the District of Nevada granted defendant MGM Resorts International's (MGM) motion to dismiss a shareholder derivative action.

The plaintiff alleged that MGM officers and directors made false representations regarding MGM's "construction of CityCenter, a massive, multi-billion dollar high rise on the Las Vegas strip." The plaintiff failed to make a demand of MGM's board, but alleged that demand was not required because it would have been futile.

Meanwhile, two other MGM shareholders filed a derivative suit in Nevada state court in 2011, alleging the same misleading conduct on the part of MGM directors and officers, and alleging the same issues of demand futility. The Nevada state court granted MGM's motion to dismiss that action, and the Nevada Supreme Court affirmed the judgment in December 2013.

Given the state court ruling, MGM argued here that the plaintiff was precluded from relitigating the same issue. Judge Dawson first explained that, in applying Nevada issue preclusion law, four elements must be satisfied: (i) the issue decided in the prior litigation must be identical to the issue presented here; (ii) the initial ruling must have been on the merits and final; (iii) the party against whom the judgment is asserted must have been a party in privity with a party in the prior litigation; and (iv) the issue was actually and necessarily litigated. The plaintiffs here based their arguments on elements (i) and (iii).

As to whether the issues here and in the prior state court action were identical, the plaintiff argued that the facts supporting the demand futility issue were different because the plaintiff here had access to internal MGM documents and the benefit of a court order in a related securities action. The court disagreed, reasoning that "[d]emand futility is the 'common issue' in both proceedings." Thus, "additional facts supporting demand futility are irrelevant."

As to whether the party here was the same as, or in privity with, the parties in the prior action, the plaintiff argued that the actions were brought by different shareholders. The court acknowledged a "dearth of Nevada state law" on this point. However, the court noted that a derivative action allows a shareholder to "'step into the corporation's shoes,'" and found persuasive a recent District of Nevada opinion that concluded "'plaintiffs in a shareholder derivative action represent the corporation, and therefore the question of whether demand on the board of directors would have been futile is an issue that is the same no matter which shareholder serves as plaintiff.'" The court allowed for the possibility that the plaintiff may have merely been in privity with the state court shareholder plaintiffs, but "it is clear that Plaintiff is one or the other." Therefore, element (iii) was satisfied. Accordingly, because all four elements of Nevada's issue preclusion law were met, the court dismissed the complaint.

Gordon v. Bindra, No. 2:14-cv-01058-ODW (ASx), 2014 U.S. Dist. LEXIS 77620 (C.D. Cal. June 5, 2014)

Click here to view the opinion.

District Court Dismisses Derivative Claims Over Parent Company's Actions Regarding Struggling Subsidiary

Judge Otis D. Wright II of the U.S. District Court for the Central District of California dismissed, for failure to allege demand futility, a shareholder derivative action alleging that board members of Edison International (EIX), in violation of their fiduciary duties, caused subsidiary Energy Mission Energy (EME) to pay $924 million in dividends and $183 million under a tax-sharing agreement while EME was insolvent. According to the complaint, these actions forced EME into bankruptcy.

The plaintiff attempted to demonstrate that the directors were not disinterested by alleging that they faced a serious threat of liability based on the allegations. The court concluded that the plaintiff failed to make that showing.

First, the court noted that, under California law, "there is no indication" of a duty owed by directors of a parent corporation to a subsidiary. Moreover, California courts have held that there is "'no broad, paramount fiduciary duty of care or loyalty that directors of an insolvent

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corporation owe the corporation's creditors solely because of a state of insolvency.'" Given that, the parent company directors would also not owe a fiduciary duty to the subsidiary's creditors because "the parent's directors … are even further removed." Therefore, the plaintiff cannot establish demand futility based on a likelihood of director liability.

Second, EIX's articles of incorporation include an exculpation clause that relieves directors of liability to the extent allowed under California law. Thus, the plaintiff would have to allege that the directors acted intentionally, knowingly, or in bad faith.

Third, even if the court were to find that the EIX board owed EME some fiduciary duty on the basis that EME was insolvent, the plaintiff still failed to adequately plead that EME was, in fact, insolvent. The complaint contains numerous statements regarding EME's "financial crisis" or "'looming debt problems,'" but those descriptive phrases, the court ruled, could not substitute for well-pleaded allegations regarding EME's insolvency.

Fourth, the plaintiff failed to allege on a "'director-by-director'" basis why each did not meet the test of independence or disinterest. Rather, "'she lumps all Individual Defendants together or simply references the 'EIX Board.'" Such "generalized allegations preclude the Court from making findings" regarding each director.

Finally, the plaintiff failed to allege that the transactions in question were not a valid exercise of business judgment. The plaintiff based her argument on the claim that the directors acted in bad faith by forcing EME to violate a provision of the U.S. Bankruptcy Code. However, the allegedly fraudulent transfer occurred before EME was insolvent, even under the plaintiff's allegations. Further, as noted above, the plaintiff failed to plead sufficient facts that EME was, in fact, insolvent.

ERISA

Fish v. Greatbanc Trust Co., 749 F.3d. 671 (7th Cir. 2014)

Click here to view the opinion.

Seventh Circuit Reverses District Court Decision Granting Defendant Summary Judgment in ERISA Action for Breach of Fiduciary Duty

The U.S. Court of Appeals for the Seventh Circuit reversed the district court's grant of summary judgment in favor of the defendants in an action brought under the Employee Retirement Income Security Act of 1974 (ERISA). The plaintiffs, participants in The Antioch Company's employee stock ownership plan, alleged that the plan trustee breached its fiduciary duties in connection with a leveraged buyout of Antioch stock that ultimately left the company bankrupt. The defendants contended that the plaintiffs' claims were time-barred under ERISA's three-year statute of limitations because the plaintiffs gained actual knowledge of the alleged ERISA violations from proxy statements describing the transaction and the company's subsequent financial decline more than three years before they filed suit.

In reversing the district court's decision, the Seventh Circuit held that a plaintiff does not have "actual knowledge" of a breach of fiduciary duty, for purposes of triggering ERISA's three-year statute of limitations, until the plaintiff has knowledge of "all material facts." However, the court explained that this standard does not require that plaintiffs have knowledge of every detail of a transaction or knowledge of illegality. The court further ruled that where a plaintiff alleges a "process-based" fiduciary duty claim, knowledge of the transaction terms alone is not enough to trigger the three-year statute of limitations. Rather, the court explained, the plaintiff must have actual knowledge of the procedures the fiduciary used or failed to use.

Applying this standard, the Seventh Circuit concluded that neither the proxy materials nor plaintiffs' knowledge of Antioch's financial problems gave them actual knowledge of the inadequate processes the fiduciaries used to evaluate the buyout transaction more than three years before filing suit. Thus, the court ruled the plaintiffs' claims were not time-barred under ERISA's three-year statute of limitations.

EXCHANGE ACT

Police Ret. Sys. of St. Louis v. Intuitive Surgical, Inc., No. 12-16430, 2014 WL 3451566 (9th Cir. July 16, 2014)

Click here to view the opinion.

Ninth Circuit Holds Company's Alleged False and Misleading Statements Were Nonactionable Puffery and That Plaintiffs Failed to Adequately Plead Scienter

The U.S. Court of Appeals for the Ninth Circuit affirmed the dismissal of a federal securities action brought under Section 10(b) of the Exchange Act and SEC Rule 10b-5. In affirming the district court, the panel held that the company's purportedly false and misleading statements were actually nonactionable puffery. In addition, the plaintiffs failed to adequately allege that executives made false statements with knowing or reckless disregard for the truth.

The plaintiffs alleged that Intuitive executives, in the company's 2007 annual report and in four analyst calls in 2008, painted an overly optimistic picture of the company's prospects for continued growth despite internal data showing Intuitive was headed for a slowdown.

The Ninth Circuit disagreed, holding that the plaintiffs failed to adequately plead falsity or scienter. As to falsity, the panel concluded that the alleged misstatements — which the court characterized as "classic growth and revenue projections" — either were forward-looking statements covered by the safe harbor provision of the PSLRA or mere corporate puffery. For the statements concerning future economic performance or "assumptions underlying those projections," Intuitive provided disclaimers accompanying each purported misstatement. Those disclaimers contained cautionary language that was "virtually identical to the cautionary language approved in *Cutera*," referring to *In re Cutera Sec. Litig.*, 610 F.3d 1103 (9th Cir. 2010), the preeminent Ninth Circuit case on statements protected by the PSLRA's safe harbor provision.

As to scienter, the plaintiffs attempted to establish scienter through three different avenues: (i) the core operations theory, (ii) witness accounts and (iii) evidence of insider trading. Under the core operations theory, the plaintiffs failed to allege specific facts showing the individual defendants' involvement in day-to-day operations, or that the individual defendants accessed reports that purportedly showed a grim financial outlook for the company. The witness account consisted of the impressions of a single low-level employee, amounting to "an unsubstantiated statement without substance or context." Finally, as to insider trading, "the complaint contains no allegations regarding the defendants' prior trading history, which are necessary to determine whether the sales during the Class Period were 'out of line with' historical practices."

City of Edinburgh Council v. Pfizer, Inc., 754 F.3d. 159 (3rd Cir. 2014)

Click here to view the opinion.

Third Circuit Affirms Dismissal of 10b-5 Claims Against Pfizer Over Alzheimer's Drug

The U.S. Court of Appeals for the Third Circuit affirmed the dismissal of claims brought against Pfizer, as successor-in-interest to Wyeth, under Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5.

The plaintiff investors alleged that Wyeth made false and misleading statements regarding interim Phase 2 clinical trial data for its Alzheimer's drug, including that the company's decision to initiate a Phase 3 trial was based, in part, on the "'encouraging'" Phase 2 interim data. In addition, the plaintiffs alleged that Wyeth's statements and actions triggered a duty to disclose full and complete material information about the Phase 2 interim results.

In denying the plaintiffs' appeal and affirming the district court's dismissal, the Third Circuit first explained that the plaintiffs' "own pleading demonstrates the accuracy of defendants' statement." Indeed, the plaintiffs' allegations of falsity were "based on a selective reading" of Wyeth's purportedly misleading press release. A complete reading of the press release revealed no false or misleading statements. Second, the allegedly misleading statements "explicitly cautioned investors that '[n]o conclusion' could be drawn about the Phase 2 interim results until the completion of Phase 2." (Alteration in original.) Third, the affirmative statements the company made regarding the Phase 2 interim results referred to them in ways such as "encouraging." Such expressions, the court held, were mere inactionable puffery.

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The panel next addressed the allegations supplied by two confidential witnesses, described as "former Wyeth executives" who were involved in the development of the Alzheimer's drug. According to the confidential witnesses, there was internal disagreement regarding how to interpret the Phase 2 interim results, and whether they supported the decision to proceed to Phase 3. The Third Circuit held that these allegations were also insufficient to state a claim. "Interpretations of clinical data are considered opinions. … Opinions are only actionable under the securities laws if they are not honestly believed and lack a reasonable basis. … [Plaintiffs] have failed to adequately allege defendants did not honestly believe their interpretation of the interim results or that it lacked a reasonable basis."

Finally, the court held that the company was under no duty to disclose the full Phase 2 interim results. According to the court, because Wyeth did not "place the strength or nature of the Phase 2 interim results 'in play,' … it was under *no* duty to provide additional details about those results."

Retail Wholesale & Dep't Store Union Local 338 Ret. Fund v. Hewlett-Packard Co., No. 12-cv-04115-JST, 2014 WL 2905387 (N.D. Cal. June 25, 2014)

Click here to view the opinion.

Northern District of California Dismisses With Prejudice Claims Against Hewlett-Packard Arising Out of Allegations Regarding Former CEO's Relationship With Ex-Adult Film Actress

Judge Jon S. Tigar of the U.S. District Court for the Northern District of California dismissed with prejudice claims brought by Hewlett-Packard shareholders alleging that the company and its former chairman, president and CEO, Mark Hurd, made false and misleading statements and omissions regarding Hurd's compliance with HP's Standards of Business Conduct (SBC) policy. The plaintiffs alleged that HP and Hurd made statements regarding the importance of the SBC policy and, in so doing, implied that Hurd "was in fact in compliance with them."

Instead, according to the Second Amended Complaint (SAC), Hurd hired ex-adult film actress Jodie Fisher, with whom he had a personal relationship, as an independent consultant to host executive events and introduce Hurd to important HP customers. A later investigation by HP's board revealed that Fisher received compensation or expense reimbursement where there was not a legitimate business purpose, and that Hurd submitted inaccurate expense reports that were intended to or had the effect of concealing his relationship with Fisher. Thus, the plaintiffs alleged, statements implying Hurd's compliance with the SBC policy were materially misleading, and Hurd's failure to disclose his conduct was a material omission.

The district court disagreed, concluding that "[b]oth claims fail because they do not adequately plead materiality or falsity." While the SAC adequately alleged that Hurd violated the SBC, plaintiffs failed to plead that any of HP or Hurd's representations amounted to a warranty of ethical compliance with the SBC. The court explained "a code of ethics is inherently aspirational; it simply cannot be that every time a violation of that code occurs, a company is liable under federal law for having chosen to adopt the code at all, particularly when the adoption of such a code is effectively mandatory." Judge Tigar distinguished cases in which courts found actionable various companies' misrepresentations about their compliance with corporate policy because those cases "related either to compliance with the law (as opposed to a purely company policy) or to a company's core product or service."

Finally, the court found that Hurd's concealment of his noncompliance with the SBC was not a materially false omission. As an initial matter, the plaintiffs' theory effectively would create an actionable omission any time an executive is "involved in misconduct that might lead to his or her resignation or termination." More to the point, however, for an omission to be actionable, there must be a duty to disclose the underlying non-compliance or misconduct. Here, because the representations about corporate ethics did not constitute a warranty of compliance, Hurd had no duty to disclose his misconduct to make those representations not misleading.

Norfolk Cnty. Ret. Sys. v. Tempur-Pedic Int'l, Inc., No. 5:12-CV-195-KKC, 2014 U.S. Dist. LEXIS 70859 (E.D. Ky. May 23, 2014)

Click here to view the opinion.

District Court Dismisses Section 10(b) and 20(a) Claims Against Tempur-Pedic For Failure to Adequately Plead a Material Misrepresentation or Omission

Judge Karen K. Caldwell of the U.S. District Court for the Eastern District of Kentucky dismissed an investor class action for securities fraud alleging that Tempur-Pedic, a company that manufactures premium mattresses, and two of its officers misled investors about the financial impact of a competitor's new product line in violation of Sections 10(b) and 20(a) of the Securities Exchange Act and SEC Rule 10b-5. The court ruled that the plaintiffs had not adequately pled a material misrepresentation or omission and that many of the statements at issue also fell within PSLRA's "safe harbor" provision.

The plaintiffs claimed that while Tempur-Pedic's CEO and CFO were aware the introduction and expansion of the competing line had encroached on its market share, they overstated Tempur-Pedic's performance after its debut and made overly optimistic statements about the company's future growth opportunities. The complaint also alleged that the officers exercised thousands of stock options for a gain of over $5.7 million before releasing a series of press releases lowering projections and expectations, after which Tempur-Pedic's share price dropped dramatically.

The court determined that most of the statements at issue were immaterial because they were so vague and generally optimistic that they communicated nothing at all and that the officers' representations about past performance were not misleading because they were accurate statements of historical fact. The court also concluded that the officers were not liable for any material omissions because disclosures about the competing product were not necessary to correct any otherwise misleading prior statements. Finally, the court explained that if any of the officers' forward-looking statements did constitute material misrepresentations or involve material omissions, they were accompanied by meaningful cautionary language and thus protected under the "safe harbor" provision of the PSLRA. Accordingly, the court dismissed the plaintiffs' complaint and denied as futile the plaintiffs' request for leave to amend.

EXPERT WITNESSES

In re Pfizer Inc. Sec. Litig., No. 04 Civ. 9866, 2014 WL 2136053 (LTS) (HBP) (S.D.N.Y. May 21, 2014)

Click here to view the opinion.

S.D.N.Y. Excludes Plaintiffs' Expert Testimony in Pfizer Stock Price Litigation

Judge Laura Taylor Swain of the U.S. District Court for the Southern District of New York excluded the expert testimony of Daniel R. Fischel proffered in support of the plaintiffs' claims concerning the effect of a pharmaceutical company's alleged misrepresentations on its stock price. Fischel's report utilized an event study to purportedly demonstrate that the company's stock price was inflated by the allegedly false public statements. The court previously had granted summary judgment to the defendant with respect to two of the alleged misstatements and statements by a nonparty, and in response, Fischel reduced his overall stock price inflation findings by 9.7 percent. However, Fischel provided little analysis or explanation as to how he reached the new amount of stock price inflation, and failed to disaggregate his computations to identify inflation caused by the dismissed misstatements. The court determined that "Fischel's failure to account in any way for the impact of the excluded [] statements render[ed] his opinions unhelpful to the jury," and excluded his testimony.

FIDUCIARY DUTIES

Books and Records

Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Trust Fund IBEW, No. 614, 2013, 2014 WL 3638848 (Del. July 23, 2014)

Click here to view the opinion.

Delaware Supreme Court Finds *Garner v. Wolfinbarger* Exception to Privilege Applies In Stockholder/Corporation Plenary Proceedings and Section 220 Actions

Defendant Wal-Mart Stores, Inc. appealed from a Court of Chancery judgment that identified specific steps Wal-Mart had to take in searching for documents and categories of documents that had to be produced in response to a books and records demand pursuant to 8 *Del. C.* § 220. Plaintiff IBEW made a books and records demand seeking information regarding alleged bribery of Mexican officials and Wal-Mart's internal investigation of such bribery. After a trial to determine whether Wal-Mart had produced all responsive documents in response to the demand, the Court of Chancery entered an order requiring production of a wide variety of additional documents, including, among others, officer-level documents, documents spanning a seven-year period and documents from recovery tapes. The Court of Chancery also ordered the production of documents ordinarily would be protected by the attorney-client and work product privileges, applying the privilege exceptions elaborated by the U.S. Court of Appeals for the Fifth Circuit in *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970).

The Delaware Supreme Court affirmed the Court of Chancery's judgment with respect to the scope of document production, the range of dates of documents and the requirement that documents be collected from backup tapes, finding the Court of Chancery properly exercised its discretion. As for the production of privileged documents, the Delaware Supreme Court determined that the doctrine elaborated in *Garner v. Wolfinbarger* should be applied in plenary stockholder/corporation proceedings, as well as in a Section 220 action. In *Garner*, the Fifth Circuit recognized a fiduciary exception to the attorney-client privilege, permitting stockholders of a corporation to "invade the corporation's attorney-client privilege in order to prove fiduciary breaches by those in control of the corporation upon showing good cause." The Supreme Court held that, in a Section 220 proceeding, the inquiry into whether documents are "necessary and essential" to the stockholder's proper purpose in making a demand should precede any privilege inquiry, "because the necessary and essential inquiry is dispositive of the threshold question — the scope of document production to which the plaintiff is entitled under Section 220." After holding that the *Garner* standard applies in plenary stockholder proceedings and in Section 220 actions, the Supreme Court found that the Court of Chancery properly applied the *Garner* exception in ordering the production of documents protected by the attorney-client and work-product privileges.

Bylaws

ATP Tour, Inc. v. Deutscher Tennis Bund (German Tennis Fed'n), 91 A.3d 554 (Del. 2014)

Click here to view the opinion.

Delaware Supreme Court Upholds the Facial Validity of Fee-Shifting Bylaw in Nonstock Corporation

Justice Carolyn Berger of the Delaware Supreme Court issued an opinion holding that fee-shifting provisions in a Delaware nonstock corporation's bylaws are not *per se* invalid. The bylaw at issue shifted all litigation expenses to an unsuccessful plaintiff in intracorporate litigation who did "not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought."

The Supreme Court answered four certified questions from the U.S. District Court for the District of Delaware: (i) Fee-shifting bylaws may be lawfully adopted under Delaware law; (ii) If otherwise valid and enforceable, the bylaw could shift fees if a plaintiff obtained no relief in the litigation (given the difficulty in applying a "substantially achieves" standard); (iii) The bylaws would be unenforceable if adopted for an improper purpose (notably, the court remarked

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that the "intent to deter litigation would not necessarily render the bylaw unenforceable"); and (iv) The bylaw generally would be enforceable against members who joined the corporation before the provision's enactment.

The court also noted it was not deciding whether the specific bylaw at issue was adopted for a proper purpose or enforceable under the circumstances.

The Corporation Law Section of the Delaware Bar is actively considering legislation that might limit *ATP*'s holding in some fashion.

Rights Plans

Third Point LLC v. Ruprecht, Nos. 9469-VCP *et al.*, 2014 WL 1922029 (Del. Ch. May 2, 2014)

Click here to view the opinion.

Delaware Court of Chancery Upholds Discriminatory Rights Plan

Vice Chancellor Donald F. Parsons, Jr. of the Delaware Court of Chancery issued an opinion denying a preliminary injunction and allowing Sotheby's annual meeting to proceed and refused to enjoin the use of its rights plan. In response to an apparent threat posed by increasing activity in Sotheby's stock by hedge funds, including plaintiff Third Point, Sotheby's adopted a rights plan that would be triggered at a lower percentage of ownership for those stockholders who filed a Schedule 13D (10 percent trigger threshold) than those filing a Schedule 13G (20 percent trigger threshold). Third Point, an activist hedge fund, claimed that the Sotheby's board violated its fiduciary duties by adopting the rights plan and refusing to provide Third Point with a waiver from the 10 percent trigger, allegedly to give the board an impermissible advantage in an ongoing proxy contest.

The court refused to issue a preliminary injunction, noting "[t]he substantive issue on the plaintiffs' motion is not whether the defendants have breached their fiduciary duties or whether the corporation's rights plan is invalid. Rather, the question is whether plaintiffs have made a sufficient showing to warrant my granting a preliminary injunction." The court found that the plaintiffs had not stated a reasonable likelihood of success on the merits and that *Unocal* was the appropriate standard of review, and it was "possible, but unlikely, that [the] *Blasius* [standard of review] may be implicated within the *Unocal* framework in this case."

First, applying *Unocal*, the court found that Third Point presented an objectively reasonable and legally cognizable threat to the corporation by its "creeping control." The court also held that the plaintiffs did not demonstrate a reasonable probability of success on their *Blasius* claim that the board adopted the rights plan for the primary purpose of interfering with the franchise of any stockholder, including Third Point, several months later. Second, the court found that the plaintiffs had not shown a reasonable likelihood that they would be able to demonstrate that the rights plan was either coercive or preclusive. Third, the court found that the board would likely be able to show that the rights plan was a reasonable and proportionate response to the threat of creeping control.

With respect to the board's refusal to grant Third Point a waiver from the 10 percent trigger in March 2014 to allow it to acquire up to 20 percent of the corporation's stock, the court noted, "[t]his presents a much closer question than the Board's original decision to adopt the Rights Plan in October 2013." The court held it was not clear that the board "did or should have had the exact same concerns in March 2014 that it did in October 2013 when it adopted the Rights Plan. As a result, I am skeptical that there is a reasonable probability that the Board could establish that when it rejected the request for a waiver, it had an objectively reasonable belief that Third Point continued to pose a 'creeping control' risk to the Company, either individually or as part of a 'wolf pack.'" Nevertheless, the court held that the Sotheby's board "made a sufficient showing as to at least one objectively reasonable and legally cognizable threat: negative control."

On the other elements of injunctive relief, the court found that "[a]lthough it is a close question, I find that Third Point's reduced odds of winning the proxy contest due to the Rights

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Plan likely would have qualified as a threat of irreparable harm, if Third Point had established a likelihood of success on the merits." Also, the balance of the equities weighed "slightly in favor" of plaintiffs, but since there was not a showing of likelihood of success on the merits, an injunction was not warranted.

For further details, please see Skadden's May 12, 2014, memorandum titled "[Delaware Court of Chancery Recognizes Potential Benefits of Shareholder Rights Plans in Addressing Shareholder Activism]."

FOREIGN CORPORATIONS

Loginovskaya v. Batratchenko, No. 13-1624-cv (2d Cir. Sept. 4, 2014)

Click here to view the opinion.

Second Circuit Affirms Dismissal of Claims That Financial Services Firm Violated the Commodities Exchange Act Because the Plaintiff Did Not Allege A Domestic Transaction

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims that a financial services company allegedly violated the Commodities Exchange Act because the plaintiff did not allege a domestic transaction. The court held that the transactional test of *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010), applied to the Commodities Exchange Act's private right of action because the act did not contain a clear statement that it had extraterritorial effect. In addition, because the act limits private rights of action to suits over four specific types of transactions, those transactions must occur in the United States. Although the company that the plaintiff invested in was incorporated in New York, the plaintiff resided in Russia and negotiated and signed her investment contracts in Russia, and so the transactions were deemed to have occurred outside the United States. In sum, the court held that the Commodities Exchange Act "creates a private right of action for persons anywhere in the world who transact business in the United States," but it does provide a right of action for those "who choose to do business elsewhere."

Parkcentral Global Hub Ltd. v. Porsche Automobile Holdings SE, No. 11-447-cv (2d Cir. Aug. 15, 2014)

Click here to view the opinion.

Second Circuit Affirms Dismissal, Holding Plaintiffs Failed to Allege Facts to Overcome *Morrison*'s Presumption Against Extraterritoriality

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims that Porsche violated Section 10(b) of the Securities Exchange Act by allegedly claiming that it did not intend to acquire a controlling interest in Volkswagen and concealing its accumulation of Volkswagen's stock. The plaintiffs (international hedge funds with U.S.-based investment managers) purchased in the United States securities-based swap agreements tied to Volkswagen's stock trading only on foreign exchanges. These synthetic swap agreements were an "unusual security" according to the court, and those transactions were argued by the plaintiffs to be economically equivalent to short sales of Volkswagen's stock sufficient to invoke Section 10(b). Relying on *Morrison v. National Australia Bank, Ltd.*, 561 U.S. 247 (2010), and *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60 (2d Cir. 2012), the court held that, while a domestic securities transaction is necessary to invoke Section 10(b), it is not always sufficient to state a claim. The court reasoned that the plaintiffs' domestic purchase of the swap agreements at issue in this case was predominately foreign under *Absolute* because Porsche's alleged false statements were made primarily in Germany with respect to a German company traded only on a foreign exchange. The court thus held that the plaintiffs failed to allege facts to overcome *Morrison*'s presumption against extraterritoriality. According to the court, "the imposition of liability under § 10(b) on these foreign defendants with no alleged involvement in plaintiffs' transactions, on the basis of defendants' largely foreign conduct, for loss incurred by the plaintiffs in securities-based swap agreements based on the price movements of foreign securities would constitute an impermissibly extraterritorial extension of the statute." It remanded the case to allow the district court to entertain motions to amend the complaints, if any, in light of the opinion.

INTERPRETING *JANUS*

Prousalis v. Moore, 751 F.3d 272 (4th Cir. 2014)

Click here to view the opinion.

Fourth Circuit Holds That Janus Does Not Apply in Criminal Actions

On May 7, 2014, the U.S. Court of Appeals for the Fourth Circuit addressed the applicability of the U.S. Supreme Court's decision in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), to the criminal context, holding that *Janus* applies only to private suits; it does not extend to the criminal context. Thomas Prousalis, a securities lawyer, was convicted after pleading guilty under Rule 10b-5 to knowingly including false and misleading information in IPO registration materials that he prepared and which his client signed and filed. Prousalis appealed his conviction and lost. Thereafter, the Supreme Court issued its decision in *Janus*, holding that "the maker of a statement" for purposes of Rule 10b-5 is "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." Prousalis filed a *habeas* petition, arguing that the conduct for which he was convicted — merely preparing the registration materials that were signed and filed by others — no longer was illegal after the Supreme Court's decision in *Janus*. The Fourth Circuit rejected Prousalis' argument and affirmed the district court's dismissal of his petition. The Fourth Circuit held that *Janus* was rooted in the implied private right of action of Rule 10b-5 and that the decision is therefore "inapplicable outside the context of the 10b-5 implied private right of action." The Fourth Circuit noted that "the *Janus* Court gave no indication that it intended to curtail the government's criminal enforcement, nor did the opinion suggest that it even contemplated the issue." The Fourth Circuit thus declined to broaden *Janus*' holding beyond the domain of implied private rights.

LOSS CAUSATION

Loos v. Immersion Corp., No. 12-15100, __ F. 3d __ (9th Cir. Aug. 7, 2014)

Click here to view the opinion.

Ninth Circuit Holds Announcement of Investigation Insufficient to Plead Loss Causation

The U.S. Court of Appeals for the Ninth Circuit affirmed the dismissal of claims brought under Section 10(b) of the Exchange Act and SEC Rule 10b-5, holding that "the announcement of an investigation, standing alone, is insufficient to establish loss causation."

The plaintiff, purporting to represent a class of Immersion shareholders, alleged that Immersion "'cooked the books'" in response to mounting pressure from investors to become profitable. Specifically, the plaintiff claimed that Immersion violated GAAP principles by recognizing revenue earlier than permitted under the guidelines. The plaintiff alleged that this fraud was revealed to the market through a series of "'partial disclosures'" consisting of (i) disappointing earnings results for four out of five quarters and (ii) the subsequent announcement of an internal investigation into prior revenue transactions.

The district court dismissed the complaint, concluding that the plaintiff failed to adequately allege scienter or loss causation. The Ninth Circuit affirmed on loss causation grounds, without reaching the issue of scienter.

As to the quarterly results, the court held that disappointing earnings reports "are merely indicative of poor financial health; they do not tend to suggest that the company had engaged in fraudulent accounting practices. At bottom, these disclosures simply reveal that Immersion failed to meet its revenue goals."

On the issue of the investigation, the panel first noted that the Ninth Circuit has "never squarely addressed whether the disclosure of an internal investigation can satisfy the loss causation element of a § 10(b) and Rule 10b-5 claim." The court then proceeded to analyze a recent U.S. Court of Appeals for the Eleventh Circuit decision, *Meyer v. Greene*, 710 F.3d 1189

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(11th Cir. 2013). In that case, the Eleventh Circuit held that "the commencement of an SEC investigation, without more, is insufficient to constitute a corrective disclosure for purposes of § 10(b). The announcement of an investigation reveals just that — an investigation — and nothing more." *Meyer*, 710 F.3d at 1201. The Ninth Circuit agreed with the Eleventh Circuit's reasoning. The panel explained that the "announcement of an investigation does not 'reveal' fraudulent practices to the market. Indeed, at the moment an investigation is announced, the market cannot possibly know what the investigation will ultimately reveal. … Consequently, any decline in a corporation's share price following the announcement of an investigation can only be attributed to market speculation about whether fraud has occurred. This type of speculation cannot form the basis of a viable loss causation theory."

Bricklayers & Trowel Trades Int'l Pension Fund v. Credit Suisse Sec. (USA) LLC, 752 F.3d 82 (1st Cir. 2014)

Click here to view the opinion.

First Circuit Upholds Decision in Favor of Investment Bank in AOL Shareholder Dispute

The U.S. Court of Appeals for the First Circuit affirmed summary judgment to an investment bank in an action brought by a class of AOL shareholders claiming that the investment bank violated Section 10(b) of the Securities Exchange Act by allegedly misrepresenting information about AOL in its analysts' research reports. To attempt to satisfy their burden regarding loss causation, the plaintiffs introduced event studies and expert testimony allegedly showing that the investment bank's purported alleged misstatements or omissions concerning AOL's financial strength, the severity of AOL's layoffs and AOL's unconventional accounting caused AOL's stock price to artificially inflate. The court held that the plaintiffs' expert's event study was methodologically flawed, and consequently determined that there was no triable issue on loss causation. The event study contained several problems, including the selection of event dates based on unreliable data and the failure to properly consider previously disclosed information and other confounding factors. As a result, the court concluded that the district court did not abuse its discretion in excluding the plaintiff's expert testimony on loss causation. Because the plaintiffs failed to introduce admissible evidence on loss causation, summary judgment in favor of the investment bank was appropriate.

MISREPRESENTATIONS

La. Pac. Corp. v. Merrill Lynch & Co., No. 13-1980-cv, 2014 WL 2870146 (2d Cir. June 25, 2014)

Click here to view the opinion.

Second Circuit Affirms Dismissal of ARS-Related Claims Against Investment Bank

The U.S. Court of Appeals for the Second Circuit affirmed in a summary order the dismissal of claims that an investment bank violated Section 10(b) of the Securities Exchange Act by allegedly manipulating and misrepresenting the market for auction rate securities (ARS). The plaintiffs alleged that the investment bank's bidding affected the clearing rate of the auctions and that the investment bank's ARS activities inflated the market prices of ARS. The Second Circuit held that the liquidity risks inherent in ARS auctions and the investment bank's bidding were adequately disclosed in both an SEC cease-and-desist order and the investment bank's online disclosure of its ARS practices and procedures. In addition, the investment bank's disclosure that it routinely placed support bids was not misleading, even though it allegedly placed support bids in every single auction and knew that each auction would fail if it did not place these bids. Lastly, the Second Circuit compared the plaintiffs' allegations to two previously dismissed complaints against the same investment bank alleging similar claims and concluded that, like the insufficient allegations in those cases, the plaintiffs' allegations were too generalized and conclusory to support a claim.

PSLRA

Safe Harbor Provision

Spitzberg v. Houston Am. Energy Corp., No. 13-20519, 2014 WL 3442515 (5th Cir. July 15, 2014)

Click here to view the opinion.

Fifth Circuit Denies Safe Harbor Protection to Mixed Present/Future Statements

The U.S. Court of Appeals for the Fifth Circuit joined the First, Third and Seventh Circuits in holding that a "'mixed present/future statement is not entitled to the safe harbor with respect to the part of the statement that refers to the present.'" In *Spitzberg*, investors brought a securities fraud class action against an oil and gas exploration company and certain of its employees and directors, alleging that the defendants made material misrepresentations regarding the amount of oil in an oil-and-gas concession. The plaintiffs alleged that, based on the definition of "reserves" commonly used in the industry and in SEC regulations, the defendants' use of the word "reserves" in communications with investors suggested that certain production or geological testing had been completed when, in fact, no such production or testing had been done. The district court granted the defendants' motion to dismiss the complaint. On appeal, the plaintiffs argued, among other things, that one of their challenged statements regarding "reserves" was entitled to safe harbor protection. Examining the statement in context, the Fifth Circuit concluded that although the defendants' use of the term "reserves" communicated a forward-looking thought in one part of the statement, their use of the term elsewhere in the statement was undoubtedly backward-looking. Noting the absence of any authority to the contrary, the Fifth Circuit followed the decisions of its sister circuits in holding that a statement that contains both forward- and backward-looking aspects is not entitled to safe harbor protection with respect to that part of the statement that concerns the present.

RULE 10B-5 OMISSION LIABILITY

In re Genzyme Corp. Sec. Litig., 754 F.3d 31 (1st Cir. 2014)

Click here to view the opinion.

First Circuit Affirms Dismissal of Claims in Drug Development Dispute

The U.S. Court of Appeals for the First Circuit affirmed the dismissal of claims that a pharmaceutical company allegedly violated Section 10(b) of the Securities Exchange Act by concealing manufacturing difficulties that purportedly delayed the company's efforts to obtain FDA approval for a drug. The court held that the plaintiffs' complaint was an "ill organized and convoluted collection of 364 paragraphs" and failed to plead a strong inference of scienter as required by the Private Securities Litigation Reform Act. The company's decision not to disclose the FDA's preliminary findings after a factory inspection was not fraudulent because the findings were merely observational in nature and did not bear an explicit relation to whether the drug would receive FDA approval. The company's delay in disclosing certain difficulties with contamination in one of its factories also was not fraudulent because the company did not immediately know the cause of the problems and thereafter disclosed its investigation in due course. In addition, statements made to investors about the prospects of receiving FDA approval were inactionable forward-looking projections, and the company appropriately disclosed information about the negative developments in manufacturing the drug as it became available.

Wu v. Stomber, 750 F.3d 944 (D.C. Cir. 2014)

Click here to view the opinion.

D.C. Circuit Holds That Accurate, 'Snapshot' Disclosures Made During Volatile Market Cycles Are Not Actionable Under Federal Securities Law

The U.S. Court of Appeals for the D.C. Circuit dismissed the plaintiffs' Section 10(b) and Rule 10b-5 claims challenging snapshot disclosures made by an investment fund. The court held that no fraud had occurred because the disclosures, which were issued during a period of unusual market volatility, accurately reflected the portfolio's performance as of the date they purported

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to represent. Carlyle Capital Corporation was an investment fund heavily exposed to residential mortgage-backed securities (RMBS). Beginning in 2007, as the real estate and financial sectors took a sharp downturn, Carlyle's RMBS assets experienced substantial losses and increased volatility. When Carlyle conducted a private offering with accredited investors in June 2007, it disclosed a "snapshot" of "the latest, updated figure[s]" reflecting its RMBS losses and warned investors that the real estate securities market was "'highly volatile'" and "'difficult to predict.'" Carlyle's losses grew following the financing, and investors brought class action suits alleging material misstatements and omissions in the June 2007 offering memorandum. The district court dismissed the complaints. On appeal, the plaintiffs alleged that Carlyle's financials as of June 13, 2007, were inaccurate, relying on an email from a Carlyle director regarding the portfolio's much lower market valuation as of June 11. The D.C. Circuit rejected the plaintiffs' argument, noting that the initial offering memorandum purported to reflect Carlyle's balance sheet as of June 13, 2007, and had warned investors against relying on the stability of RMBS valuations due to volatile market conditions. Further, Carlyle postponed the pricing of its shares and issued a supplemental memorandum nine days later, which further updated the market regarding its portfolio's poor performance through June 26, 2007. Because Carlyle's disclosures in the offering memorandum and supplemental memorandum were accurate and "did not suggest [in either document] that the snapshot … was anything other than just that — a snapshot," the D.C. Circuit held that dismissal of the plaintiffs' securities fraud claims was proper.

SCIENTER

Shemian v. Research In Motion Ltd., No. 13-1602-cv, 2014 WL 2766173 (2d Cir. June 19, 2014)

Click here to view the opinion.

Second Circuit Upholds Dismissal of 10(b) Claims Against Telecommunications Company

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims that a telecommunication and wireless equipment company violated Section 10(b) of the Securities Exchange Act by allegedly issuing false and misleading statements about its projected financial results, sales of its existing product line, and the introduction of both a new operating system and new tablet. The Second Circuit held that the plaintiffs' claims did not adequately allege scienter. The plaintiffs failed to plead any cognizable motive to commit securities fraud because the plaintiffs did not allege specific facts supporting an inference that defendants "knew, when speaking, that their statements regarding product quality and release deadlines were false." Although the company's projections may have been unduly optimistic based on its history of product setbacks, such allegations were insufficient to show recklessness. The Second Circuit further held that the plaintiffs failed to adequately allege materiality. The court determined that the statements made by the company were at most puffery and any alleged omissions were not material in light of the total mix of information available. The court also dismissed arguments that the company failed to disclose information about its products as a "'known trends or uncertainties'" within the management discussion and analysis section of its SEC filings. The plaintiffs failed to allege any trend that was either not disclosed or not already known to the market. In addition, the court affirmed the trial court's denial of leave to amend.

Lee v. Active Power, Inc., No. A-13-CA-797-SS, 2014 WL 3010679 (W.D. Tex. July 2, 2014)

Click here to view the opinion.

Scienter May Be Imputed to Corporation From Employee Who Does Not 'Make' A Statement Within the Meaning of *Janus*

Judge Sam Sparks of the U.S. District Court for the Western District of Texas denied a motion to dismiss a securities fraud complaint, holding that the plaintiffs adequately alleged corporate scienter by pleading knowledge of an employee that could be imputed to the corporation. The plaintiffs sued Active Power, Inc., its CEO and CFO for alleged violations of Section 10(b) of the Securities Exchange Act and Rule 10b-5. The plaintiffs alleged that, based on false information provided by another employee, Active Power made false public statements regarding its China operations. The defendants moved to dismiss, arguing that the employee's scienter (which was

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undisputed) could not be imputed to the corporation because, under the U.S. Supreme Court's definition of "make" as articulated in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), the employee never actually made the statements on which the suit was based. The defendants argued that *Janus* overruled the Fifth Circuit's decision in *Southland Securities Corp. v. INSpire Insurance Solutions, Inc.*, 365 F.3d 353 (5th Cir. 2004), which held that corporate scienter may be imputed from an employee who "makes" a false statement or one who "furnish[es]" information used in a false statement. The court rejected the defendants' argument, holding that while *Janus* excludes from the definition of the "maker" of a false statement someone who merely furnishes information, *Janus* did not overrule the Fifth Circuit's controlling precedent in *Southland*. The court reasoned that *Janus* "defined who 'makes' a statement; the 'furnished information' language from *Southland* defined from whom scienter may be imputed for the purposes of corporate liability."

SEC ENFORCEMENT ACTIONS

S.E.C. v. Ginder,
752 F.3d 569 (2d Cir. 2014)

Click here to view the opinion.

Second Circuit Reverses Jury Verdict in Favor of SEC in Section 17 Claims Against Financial Broker

The U.S. Court of Appeals for the Second Circuit reversed a jury verdict in favor of the SEC in a civil enforcement action claiming that a financial broker violated Section 17 of the Securities Act by allegedly engaging in marking timing despite directives from certain mutual funds and the broker's employer to cease those activities. The jury found that the broker did not intentionally or recklessly violate Section 17, but that he had acted negligently. The district court ruled that the jury's verdict was supported by evidence that the broker did not read and heed emails from his supervisors directing him not to engage in market timing. The Second Circuit held that the broker was entitled to judgment as a matter of law based on insufficiency of evidence. The court determined that the SEC failed to present any evidence of the appropriate standard of care from which a jury could determine whether the broker acted negligently towards the mutual funds. In addition, the record evidence established that the mutual funds' prohibition on market timing was unclear and contradictory and that the broker's employer condoned the broker's market timing activities.

The dissent disagreed with the majority's analysis on this point, noting that the plaintiff "does not allege that she suffered any loss due to the Barclays Defendants' purported deceptive conduct, nor does she allege that any loss is traceable to a misrepresentation related to the LIBOR-rate manipulation or to the LIBOR-rate manipulation itself." The dissent pointed out that the plaintiff's payments were never affected by the defendants' alleged conduct. Therefore, according to the dissent, the plaintiff's "alleged injury is far too attenuated to establish Article III standing."

SECURITIES FRAUD PLEADING STANDARDS/STANDING

Aviva Life & Annuity Co. v. Davis,
No. 4:12-cv-00603-JEG,
2014 WL 2069640
(S.D. Iowa May 19, 2014)

Click here to view the opinion.

District Court Denies Motions to Dismiss Securities Action Against Former Dewey & LeBoeuf Managers

Judge James E. Gritzner of the U.S. District Court for the Southern District of Iowa refused to dismiss claims brought against three former Dewey & LeBoeuf LLP managers for alleged violations of Sections 10(b) and 20(a) of the Securities Exchange Act, SEC Rule 10b-5, and state securities laws. The plaintiffs claimed that the defendants used materials containing misrepresentations and omissions to convince institutional investors to purchase Dewey-issued notes. In denying the motion to dismiss, the court rejected the argument that the plaintiffs, who had sold their notes and some of their related rights, lacked standing to bring the securities claims.

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The court reasoned that even though the plaintiffs had expressly assigned their rights to bring claims against the defendants, the U.S. Supreme Court's holding in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) rendered such assignment inoperable as a matter of law. Accordingly, the assignee's release of all claims against Dewey during bankruptcy proceedings did not bar the plaintiffs' claims because their assignment never had been valid.

The court further held that the plaintiffs sufficiently pled a claim under Section 10(b), even though the complaint did not identify which defendant made which statement, where a state court indictment and SEC complaint set forth specific statements made by each individual defendant tying them to a conspiracy to commit a fraudulent act. Moreover, the court clarified that the group pleading doctrine, an exception to the heightened pleading requirement, survived both the passage of the PSLRA and the U.S. Supreme Court's decision in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011). The plaintiffs also sufficiently pled their Section 20(a) claim, even though Dewey, the primary violator, was not a named defendant. The court determined that a primary violator is not a required party to a Section 20(a) action. Rather, the primary violator's liability is merely a required element of the claim.

SETTLEMENTS

S.E.C. v. Citigroup Global Mkts., Inc., 752 F.3d 285 (2d Cir. 2014)

Click here to view the opinion.

Second Circuit Reverses District Court's Order Refusing to Approve MBS-Related Settlement Between SEC and Bank

The U.S. Court of Appeals for the Second Circuit reversed an order of a district court judge refusing to approve a settlement agreement between the SEC and a large bank arising from the bank's alleged short positions against mortgage-backed securities that it participated in selling. The district court ruled that it lacked sufficient information about the alleged conduct to determine if the consent agreement was not only fair and reasonable, but also adequate and in the public interest. The Second Circuit clarified that the proper standard for review of a proposed consent agreement is only whether the agreement is fair and reasonable. Applying that standard, the Second Circuit held that the district court abused its discretion in refusing to approve the agreement because the court needed only to establish some factual basis "supported by factual averments by the SEC, neither admitted nor denied by the wrongdoer," not "'cold, hard, solid facts established either by admissions or by trials.'" The record below supported such a finding. In addition, the district court's invocation of the public interest was error. The SEC is squarely responsible for determining if a proposed agreement serves the public interest, and a district court may only consider whether the agreement would disserve the public in some way, such as by barring potential litigations from receiving separate relief. Likewise, the SEC has the exclusive right to determine which claims to assert against a particular defendant, and the district court erred in questioning the SEC's decision not to assert fraud claims.

SLUSA

Hidalgo-Vélez v. San Juan Asset Mgmt., Inc., No. 13-1574, 2014 WL 3360698 (1st Cir. July 9, 2014)

Click here to view the opinion.

First Circuit Vacates District Court's Dismissal of State Law Claims Against Investment Fund

The U.S. Court of Appeals for the First Circuit vacated a district court's dismissal of state law claims pursuant to the Securities Litigation Uniform Standards Act (SLUSA) and reversed the denial of the plaintiffs' motion to remand the case to state court. The plaintiffs alleged that an investment fund did not comply with the investment policies it promised in the prospectus, and that its investment strategy was contrary to Puerto Rico law. The district court ruled that SLUSA barred the plaintiffs' state law class action claims against the investment fund and its

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adviser because, although the securities held by the plaintiffs were not "covered securities," the fund's anticipated investments included several covered securities. Relying on the U.S. Supreme Court's recent opinion in *Chadbourne & Parke LLP v. Troice*, 134 S. Ct. 1058 (2014), which limited SLUSA's reach, the First Circuit held that SLUSA did not preclude the plaintiffs' claims. Although the fund's prospectus "suggested" that the fund might hold covered securities, the main investment allocation — at least 75 percent of the fund's assets — contained offerings of uncovered securities, the alleged misrepresentations concerned uncovered securities (shares in the fund), and the plaintiffs primarily sought ownership of uncovered securities. Thus, unlike other cases where the investors' intent was to own covered securities, the alleged misrepresentations and any connection to covered securities in the fund's portfolio were too attenuated to support SLUSA preclusion.

In re Herald, Primeo, and Thema, 753 F.3d 110 (2d Cir. 2014)

Click here to view the opinion.

Second Circuit Denies Petition Seeking Rehearing of Dismissal of SLUSA Claims Against Madoff Securities

The U.S. Court of Appeals for the Second Circuit denied a petition seeking rehearing of an opinion affirming the dismissal of state law claims pursuant to the Securities Litigation Uniform Standards Act (SLUSA). The district court previously had determined that SLUSA barred the plaintiffs' state law class action claims against Madoff Securities because they were predicated on fraudulent transactions in nationally traded securities. After reviewing the U.S. Supreme Court's recent opinion in *Chadbourne & Park LLP v. Troice*, 134 S. Ct. 1058 (2014), the Second Circuit determined that SLUSA applied and denied rehearing, even though the *Chadbourne* opinion arguably limited the scope of SLUSA. The court held that in the case at hand, Madoff Securities had fraudulently induced the plaintiffs' investment in nationally traded securities, "albeit through feeder funds (not alleged in the instant complaints as anything other than intermediaries)," and thus SLUSA barred those claims in the class action format.

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