Skadden

Inside the
Courts

An Update From Skadden Securities Litigators

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U.S. SUPREME COURT

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Supreme Court Holds That Claims Dismissed in Their Entirety in Consolidated Action Are Appealable

The U.S. Supreme Court reversed the judgment of the U.S. Court of Appeals for the Second Circuit dismissing as unripe for appellate review the dismissal of a single-claim antitrust complaint in a consolidated MDL proceeding. The Second Circuit had held that because other claims in the proceeding remained active, the order was not a final decision and thus not appealable. The Supreme Court held that the district court's order dismissing the only claim asserted for failure to demonstrate injury had all "the hallmarks of a final decision" because it precluded the plaintiffs from further participation in the consolidated proceeding. Holding otherwise, the Court determined, would create a "quandary" with respect to the timing of appeals because a consolidated proceeding may end long after individual plaintiffs' claims have been dismissed. The "sensible solution" to this appeal-clock triggering event was held to be "[w]hen the transferee court overseeing pretrial proceedings in multidistrict litigation grants a defendant's dispositive motion on all issues in some transferred cases, those cases become immediately appealable." The Court held that Federal Rule of Civil Procedure 54(b) is designed to "permit acceleration of appeals in multiple-claim cases, not to retard appeals in single-claim cases."

DEMAND FUTILITY

Arduini v. Hart, No. 12-15750 (9th Cir. Dec. 17, 2014)

Click here to view the opinion.

Ninth Circuit Affirms Dismissal of Shareholder Derivative Action, Holding Issue Preclusion Bars Relitigating Whether Plaintiff Made Sufficient Demand on Corporation's Board

The U.S. Court of Appeals for the Ninth Circuit affirmed the dismissal of a shareholder derivative action, holding that, under Nevada law, a shareholder is precluded from relitigating the issue of demand futility where that issue was fully litigated in a prior consolidated derivative action.

In this action, asserted derivatively on behalf of International Game Technology (IGT), plaintiff Arduini, an IGT shareholder, alleged that certain IGT senior officers made intentionally misleading statements about the bright financial prospects of IGT when, in fact, IGT's prospects were dim, and that IGT's board of directors failed to adequately oversee the officers and the company.

Prior to Arduini filing this suit, however, four shareholders filed separate derivative suits, making similar allegations to the ones at issue here. Those four suits were subsequently consolidated. The district court dismissed the consolidated suit for failure to make a demand on the corporation's board or sufficiently allege demand futility. On appeal, the Ninth Circuit affirmed that dismissal.

In dismissing this action, the district court first held that "demand futility was squarely at issue [in the prior consolidated action] and [Arduini's] reasons for failing to make a demand on the board are essentially the same in this action, or any additional reasons could have been raised in the previous action." The district court rejected Arduini's argument that his new factual allegations precluded a finding of identity of issues. The district further held that Arduini was in privity with the plaintiffs in the prior consolidated action, as "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 Ninth Circuit affirmed. The panel explained that "[u]nder Nevada law, the underlying demand futility allegations need not be identical before issue preclusion applies. The question is, rather, whether the 'same ultimate issue' was decided in the prior case." Here, "the matter

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in dispute in both cases is simply whether demand should be excused because the shareholders have sufficiently alleged that making a demand on the current IGT board would be futile." Moreover, even assuming that under Nevada law a court may look to the underlying allegations to determine whether issue preclusion applies to demand futility, Arduini's additional allegations were irrelevant to the ultimate demand futility analysis because they do not show that the current board would be held liable and would thus be incapable of considering Arduini's demand, since only two of the eight current board members were on the board at the time of the allegedly wrongful behavior.

The court then addressed Arduini's arguments that he was not in privity with the plaintiffs in the consolidated suit. While the panel did not find any Nevada case addressing whether shareholders in derivative suits are in privity for the purposes of issue preclusion, it noted that the majority of courts that have addressed this issue have held that shareholders asserting derivative allegations are in privity. After analyzing the body of case law on the issue, the court was persuaded by the majority view and held that shareholders bringing derivative suits are in privity for the purposes of issue preclusion under Nevada law. The panel further concluded that there was no inequity in applying issue preclusion because the prior plaintiffs fully litigated their demand futility claim.

EXCHANGE ACT

Manning v. Merrill Lynch Pierce Fenner & Smith, Inc., No. 13-3693 (3d Cir. Nov. 10, 2014)

Click here to view the opinion.

Third Circuit Holds State Law Claims Predicated on Purported 'Naked' Short Sales Do Not 'Arise Under' Federal Law

The U.S. Court of Appeals for the Third Circuit held that state law claims, which allege that the defendants manipulated the price of a stock via "naked" short sales, do not "necessarily" depend on the contents of federal law, even though short sales are subject to detailed federal regulation under Regulation SHO, promulgated under the Securities Exchange Act. Accordingly, the panel held that such claims do not "arise under" federal law, and there was no federal-question jurisdiction in this case.

The plaintiffs, shareholders in Escala Group, Inc., sued certain financial institutions that engage in equity trading, alleging that the defendant institutions participated in "naked" short selling of Escala stock. According to the plaintiffs, such "naked" short selling had the effect of increasing the pool of tradable Escala shares, which diluted the plaintiffs' voting rights and caused the plaintiffs' shares to decline in value. The plaintiffs asserted various common-law causes of action and brought claims under New Jersey's RICO Act. The plaintiffs filed the action in New Jersey state court, and the defendants removed to the U.S. District Court for the District of New Jersey. The district court denied the plaintiffs' motion to remand, concluding that "the case at bar is premised upon and its resolution depends on the alleged violation of a regulation promulgated under the [Exchange] Act."

The plaintiffs appealed the district court's denial of their motion to remand. The defendants, in their opposition, cited two principal statutory provisions they believe confer jurisdiction: 28 U.S.C. § 1331 and 15 U.S.C. § 78aa (Section 27 of the Exchange Act). Section 1331, the "general federal-question statute," gives district courts original jurisdiction over "all civil actions arising under the Constitution, laws, or treaties of the United States." Section 27, meanwhile, gives district courts "exclusive jurisdiction ... of all suits in equity and actions at law brought to enforce any liability or duty created by [the Exchange Act] or the rules and regulations thereunder."

Regarding jurisdiction under Section 1331, the panel noted that "[a]lthough Plaintiffs' causes of action are all brought under state law, the Amended Complaint repeatedly mentions the requirements of Regulation SHO." Further, "[t]here is no question that Plaintiffs assert in their Amended Complaint, both expressly and by implication, that Defendants repeatedly violated federal law. Moreover, there is no New Jersey analogue to Regulation SHO." Still, notwith-

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standing that language in the plaintiffs' complaint, "Regulation SHO is not an element of any of Plaintiffs' claims." Therefore, the panel "conclude[d] it was improper for the District Court to foreclose the possibility that particular state causes of action could permit recovery solely under state law." The court explained that "even where there may be some basis to agree with defendants that plaintiffs' view of the state law is incorrect and will be so found, it is for the state court to make the determination as to the applicability of its state law." The panel provided an example, noting that "it is difficult to imagine why naked short selling cannot ... result in a violation of state general antifraud provisions independently of Regulation SHO."

Having concluded that Section 1331 did not confer federal-question jurisdiction, the panel proceeded to analyze whether "the exclusive jurisdiction provision in § 27 of the Exchange Act might nonetheless provide a more expansive basis for federal-question jurisdiction." The panel answered that question in the negative, holding that Section 27 does not expand federal courts' jurisdiction. The court reasoned that "[e]xclusiveness is a consequence of having jurisdiction, not the generator of jurisdiction because of which state courts are excluded." Thus, "§ 27 is coextensive with § 1331 for purposes of establishing subject-matter jurisdiction — the exclusive jurisdiction provision merely serves to divest state courts of jurisdiction." Accordingly, the Third Circuit held, "§ 27 does not provide an independent basis to exercise jurisdiction over Plaintiffs' claims." The panel remanded with instructions that the district remand the case to the Superior Court of New Jersey.

Mauss v. NuVasive, Inc.,
No. 13-2005
(S.D. Cal. Dec. 9, 2014)

Click here to view the opinion.

Southern District of California Dismisses 10b-5 Claims for Failure to Plead Falsity, Loss Causation

Judge Jeffrey T. Miller of the U.S. District Court for the Southern District of California dismissed claims brought on behalf of a putative class of NuVasive shareholders alleging that the company and three of its current and former executives misled the market regarding the company's "questionable sales and marketing practices." According to the complaint, the truth regarding the defendants' improper practices was revealed to the market when NuVasive, a company that develops and markets products relating to the surgical treatment of spine disorders, announced that it had been subpoenaed in an investigation concerning possible improper claims submitted to Medicare and Medicaid.

The panel first explained that, under recent Ninth Circuit precedent, the plaintiff failed to adequately plead loss causation. In *Loos v. Immersion Corp.*, 762 F.3d 880 (9th Cir. 2014), the Ninth Circuit held that "the announcement of an investigation, without more, is insufficient to establish loss causation." Indeed, such an announcement merely "puts investors on notice of a *potential* future disclosure of fraudulent conduct" but does not "reveal fraudulent practices to the market." Therefore, "[t]his type of speculation cannot form the basis of a viable loss causation theory." Here, "the only 'truth' that the [complaint] alleges was revealed to the market was that NuVasive had received a subpoena from the OIG." While the investigation apparently remains ongoing, the complaint "does not allege any further disclosure of fraud to the market." Accordingly, "[b]ecause the entire revelation to the market, thus far, is that NuVasive is under investigation, Plaintiff has not adequately alleged loss causation."

As a second, independent basis for dismissal, the court concluded that the plaintiff failed to adequately plead falsity. While the plaintiff's "entire case is based on Defendants' misrepresenting NuVasive's compliance with federal healthcare laws," the complaint does not allege particularized facts to show that NuVasive violated any laws. The court explained, "[w]ithout the 'who, what, when, where, and how' of at least some of the purportedly illegal conduct, and without some indication of how those facts constitute violations of healthcare laws and regulations, the court cannot meaningfully evaluate the plausibility of Plaintiff's claims."

The court granted the plaintiff leave to amend so he could address the loss causation and specificity issues identified in the order.

In re Tesla Motors, Inc. Sec. Litig., No. 13-05216 (N.D. Cal. Dec. 5, 2014)

Click here to view the opinion.

Northern District of California Dismisses Putative Class Claims Sparked by Battery Fires in Tesla Vehicles

Judge Charles R. Breyer of the U.S. District Court for the Northern District of California dismissed a putative class action brought against the much-lauded electric vehicle company Tesla Motors, Inc., alleging violations of Sections 10(b) and 20(a) of the Securities Exchange Act and SEC Rule 10b-5.

The plaintiffs alleged that Tesla and CEO Elon Musk made false and misleading statements regarding the risk of fire in the batteries powering the Model S when they touted the safety of that Tesla model. The plaintiffs claimed that the Model S battery had "significant vulnerabilities to road debris impact, puncture, and catastrophic fire," despite the fact that (1) there were no personal injuries associated with the three 2013 battery fires that sparked the controversy, and (2) the U.S. National Highway Traffic Safety Administration (NHTSA) closed its investigation into the fires because it identified no "defect trend."

The plaintiffs' chief allegation in this regard was that Tesla falsely stated in a press release that no batteries had ever caught fire, even though three prototype batteries had previously caught fire. The court rejected this claim, noting that the press release stated only that no *production* batteries had ever caught fire, and the plaintiffs failed to plead that this more narrow statement was false or misleading. The court also rejected the plaintiffs' allegations regarding statements on Tesla's website that Tesla made the "safest car in America" and that Tesla received the NHTSA's five-star safety rating in every category.

Alpha Capital Anstalt v. New Generation Biofuels, Inc., No. 13-CV-5586 (VEC) (S.D.N.Y. Nov. 18, 2014)

Click here to view the opinion.

S.D.N.Y. Dismisses, in Part, Fraud Claims Against Biofuel Startup

Judge Valerie Caproni of the U.S. District Court for the Southern District of New York dismissed, in part, claims that a biofuel company violated Section 10(b) of the Securities Exchange Act by overstating the value of its primary asset — a license agreement — and concealing certain negative feedback about its pending patents, all of which were ultimately withdrawn or rejected. Although the allegedly negative information was contained in Foreign Patent Reports that were publicly available, the court determined that a company may have a duty to disclose publicly available information in some circumstances, and that to hold otherwise would be an "oversimplification of the law." The plaintiff also sufficiently alleged loss causation as to the company's alleged misstatements about its intellectual property because the undisclosed deficiencies in the pending patents were a "significant cause" of the company's failure and the plaintiff's investment loss. However, the plaintiff failed to allege loss causation as to allegations that the company's founder concealed his ownership and sales of company stock. The court determined that "loss causation does not exist when the connection between the content of the alleged misstatements and the harm suffered is attenuated," and the company's collapse was ultimately caused by negative developments in its pending patents, not the CEO's stock sales. Although the founder may have secretly relied on the plaintiff's investment to liquidate his own holdings in the company, the "loss-causation requirement cabins a person's responsibility, even for fraudulent acts," and the alleged fraud did not cause the plaintiff's loss.

FIDUCIARY DUTIES

Books and Records

United Techs. Corp. v. Treppel, No. 127, 2014 (Del. Dec. 23, 2014)

Click here to view the opinion.

Delaware Supreme Court Reverses Ruling Preventing Corporation From Conditioning Access to Books and Records on Agreement Not to Sue Outside of Delaware

The Delaware Supreme Court reversed the Court of Chancery's determination that, under Section 220 of the Delaware General Corporation Law, a corporation could not condition a

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stockholder's access to books and records on an agreement to bring any lawsuit arising out of the books and records request only in a Delaware court.

A stockholder made a litigation demand on United Technologies related to the company's entrance into a Deferred Prosecution Agreement with the U.S. Department of Justice. The United Technologies board rejected the demand. The plaintiff then made an inspection demand under Section 220 in order to evaluate the board's decision to reject his litigation demand. The board agreed to the plaintiff's books and records request, but conditioned his inspection on signing a confidentiality agreement requiring "any claim, dispute, controversy or causes of action … arising out of, relating to, involving or in connection with" the inspection to be brought only in Delaware.

The Court of Chancery held that such a condition was "not the type of restriction that 220(c) seeks to impose." The Delaware Supreme Court reversed, emphasizing that the Court of Chancery has "wide discretion to shape the breadth and use of inspections under § 220 to protect the legitimate interests of Delaware corporations." The Supreme Court remanded so that the Court of Chancery could "consider how to exercise its discretion in the first instance," noting that the court should weigh various case-specific factors, including that derivative litigation involving the facts underlying the plaintiff's request had already been dismissed; that United Technologies had a legitimate interest in consistent rulings on issues of Delaware law; United Technologies' recent adoption of a forum-selection bylaw requiring certain litigation proceed only in Delaware; and United Technologies' significant investment in defending against prior derivative litigation.

Mergers and Acquisitions

C&J Energy Servs., Inc. v. City of Miami Gen. Emps.' & Sanitation Emps.' Ret. Trust, No. 655/657, 2014 (Del. Dec. 19, 2014)

Click here to view the opinion.

Delaware Supreme Court Reverses Entry of Preliminary Mandatory Injunction Affirmatively Requiring Company to Conduct Market Check

The Delaware Supreme Court reversed the Court of Chancery's entry of a preliminary mandatory injunction requiring a target company to shop itself to other potential acquirers, determining that the Court of Chancery misapplied the standard of review for evaluating a request for preliminary injunctive relief and finding that the Court of Chancery did not have a basis to order such relief.

The plaintiffs — stockholders of C&J Energy — brought suit seeking to preliminarily enjoin a transaction whereby Nabors would acquire a majority equity interest in C&J. Finding that the board had plausibly violated its fiduciary duties under *Revlon* by failing to affirmatively shop the company, the Court of Chancery entered an injunction requiring the C&J board to conduct an active market check.

The Delaware Supreme Court reversed, determining that the Court of Chancery misapplied the standard of review because the plaintiffs had made no more than a "plausible" showing that the C&J board breached its fiduciary duties. Moreover, the Supreme Court found that the Court of Chancery's "ruling rested on an erroneous understanding of what *Revlon* requires," explaining that "a market check does not have to involve an active solicitation so long as interested bidders have a fair opportunity to present a higher-value alternative, and the board has the flexibility to eschew the original transaction and accept the higher-value deal." Where "there were no material barriers that would have prevented a rival bidder from making a superior offer," C&J's passive market check was sufficient to satisfy the board's *Revlon* duties.

The Delaware Supreme Court further explained that "[t]o issue a mandatory injunction requiring a party to take affirmative action — such as to engage in the go-shop process the Court of Chancery required — the Court of Chancery must either hold a trial and make findings of fact, or base an injunction solely on undisputed facts."

In re Family Dollar Stores, Inc. S'holder Litig., No. 9985-CB (Del. Ch. Dec. 19, 2014)

Click here to view the opinion.

Court Declines to Second-Guess Board's Decision That Competing Offer Did Not Constitute Superior Proposal

Chancellor Andre G. Bouchard of the Delaware Court of Chancery denied stockholder plaintiffs' request to preliminarily enjoin the acquisition of Family Dollar by Dollar Tree, rejecting claims that the Family Dollar board had acted unreasonably in declining to negotiate with a competing bidder, Dollar General.

Throughout 2013 and early 2014, Family Dollar met with representatives of both Dollar General and Dollar Tree about a potential transaction. In May 2014, Dollar Tree made a nonbinding proposal to acquire Family Dollar for a mix of cash and stock. After determining that a transaction with Dollar General involved significant antitrust risk, Family Dollar approved a merger agreement with Dollar Tree under which stockholders would receive Dollar Tree stock and $59.60 in cash. In August and September 2014, Dollar General sent unsolicited proposals to acquire Family Dollar for $78.50 and $80 per share in cash, and offered to divest between 700 and 1,500 stores to reduce antitrust risk. Family Dollar nevertheless declined to negotiate with Dollar General.

The court deferred to the judgment of the Family Dollar board, which was comprised of a supermajority of independent and disinterested directors. In declining to issue a preliminary injunction, the court explained that, "when the record reveals no basis to question a board's motivations, the Court understandably will be more likely to defer to the board's judgment in determining how to conduct a corporate sale process." Notably, the court rejected the plaintiffs' challenge to the board's decision not to negotiate with Dollar General in response to its higher competing offers after the Dollar Tree merger agreement was signed, finding that "the Board's decision not to engage in discussions with General in response to its Revised Offer was a reasonable exercise of judgment consistent with the directors' obligations under Revlon to maximize value for Family's stockholders." Because the board had reasonably concluded that Dollar General would be unwilling to divest more than 1,500 stores, and that a transaction with Dollar General would create significant antitrust risk, the court "[saw] no basis to second guess the Board's judgment," which was based upon the advice of its advisers, regarding the magnitude of the regulatory risk.

INSIDER TRADING CLAIMS

U.S. v. Newman, Nos. 13-1837-cr (L), 13-1917-cr (con) (2d Cir. Dec. 10, 2014)

Click here to view the opinion.

Second Circuit Overturns Convictions of Insider Traders

The U.S. Court of Appeals for the Second Circuit vacated the convictions for insider trading of two portfolio managers. The government alleged that the portfolio managers traded on nonpublic information that two public-company employees passed to various analysts, who then gave the information to the portfolio managers. Although the public-company employees were never charged, and the defendant portfolio managers "knew next to nothing about" those employees, a jury convicted the portfolio managers of insider trading. The Second Circuit vacated the convictions and dismissed the indictment against them. As an initial matter, the court held that the government was required to prove that the portfolio managers knew both that company insiders disclosed nonpublic information and that the insiders received a personal benefit. The court then ruled that the government did not prove either that the company insiders received a personal benefit or that the portfolio managers knew the nature of the relationships between the employees and the analysts who passed the nonpublic information to the portfolio managers.

LEAD PLAINTIFF

In re Dynegy, Inc., No. 13-2581 (2d Cir. Oct. 31, 2014)

Click here to view the opinion.

Second Circuit Holds That Securities Plaintiff Lacked Standing in Bankruptcy Action

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of a bankruptcy appeal brought by the lead plaintiff in a securities action purportedly on behalf of the class of shareholders in the securities action. The company had entered into Chapter 11 reorganization after the lead plaintiff had filed his securities action and agreed to a reorganization plan that included a binding release of nondebtor third parties, including three individual defendants in the securities action. In the bankruptcy action, the lead plaintiff opted out of and objected to the release, purportedly on behalf of himself and the purported securities action class members, but the district court held that the lead plaintiff lacked standing to represent any class in the bankruptcy proceeding. The Second Circuit affirmed, holding that, although the lead plaintiff was appointed to represent the proposed class with respect to the securities action, he failed to seek class action status in the bankruptcy action (applicable in contested matters pursuant to Federal Rule of Bankruptcy Procedure 9014). Moreover, because the lead plaintiff had opted out of the release personally, his interest in the bankruptcy matter became moot, and he could no longer represent the interests of any purported class. The court rejected the lead plaintiff's assertion that a "special exception" should apply to protect the rights of the class because notice was given to the appropriate class members, and evidence suggested that any class members that wanted to opt out had done so.

PSLRA

Oregon Pub. Emps. Ret. Fund v. Apollo Grp. Inc., No. 12-16624 (9th Cir. Dec. 16, 2014)

Click here to view the opinion.

Ninth Circuit Holds Heightened Pleading Standard of Rule 9(b) Applies to Loss Causation Element of Section 10(b) Claims

The U.S. Court of Appeals for the Ninth Circuit held that the heightened pleading standards of Federal Rule of Civil Procedure 9(b) and the Private Securities Litigation Reform Act (PSLRA) apply to all elements of a federal securities fraud action brought under Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5, including loss causation.

In holding that a plaintiff must plead loss causation with the particularity required by Rule 9(b), the panel acknowledged that the law on this point has been "less clear." Indeed, since the landmark Supreme Court decision in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), the Ninth Circuit has at times "applied a plausibility standard to loss causation, which avoids the question of whether the Rule 8(a) or Rule 9(b) pleading standard applies," and at other times "applied both Rule 8(a) and 9(b) standards to allegations of loss causation, finding that plaintiffs meet both standards." The panel further noted that, while "[s]ome of our sister circuits have suggested that heightened pleading standards apply to loss causation[,]" "[o]ther circuits have suggested that heightened pleading standards do not apply to loss causation."

The panel concluded that Rule 9(b) applies to all elements of a securities fraud action, calling the decision "appropriate for at least three reasons." First, the law on securities fraud is derived from common-law fraud. Since Rule 9(b) applies to all circumstances of common-law fraud, it therefore "makes sense to apply the same pleading standard to all circumstances of securities fraud." Second, Rule 9(b) requires that, "[i]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake." In a federal securities action, loss causation is part of the "circumstances" constituting fraud because, "without it, a claim of securities fraud does not exist." Third, "our approach creates a consistent standard through which to assess pleadings in 10(b) actions, rather than the piecemeal standard adopted by some courts."

Wong v. Accretive Health, Inc., No. 14-2191 (7th Cir. Dec. 9, 2014)

Click here to view the opinion.

Seventh Circuit Affirms Approval of Class Action Settlement and Holds the PSLRA Does Not Bar Low Recoveries

The U.S. Court of Appeals for the Seventh Circuit affirmed the approval of a class action settlement that resolves claims brought against Accretive Health, Inc. and two of its officers for alleged violations of Sections 10(b) and 20(a) of the Securities Exchange Act. The plaintiffs alleged that the company engaged in overly aggressive collection practices and failed to adequately comply with certain regulations, in violation of the law and the company's contracts with a key client. They further alleged that Accretive concealed these practices and represented that it complied with the law and its contractual obligations in order to artificially inflate the price of its stock.

After mediation, the parties agreed to settle the claims for $14 million, or $0.20 per share. The district court granted final approval to the settlement over the objection of one class member, who subsequently appealed. The objector argued that the PSLRA barred the settlement because the act was intended to limit frivolous securities class actions. The court rejected this argument, ruling that "the PSLRA is not a *per se* bar to low settlements," and explaining that the objector "mistakenly equate[d] frivolous lawsuits with those that recover a low percentage of potential damages." The court also determined that the district court had not abused its discretion by approving the settlement without quantifying the net expected value of the litigation, reasoning that the settlement was reached through an extensive arm's-length mediation and that hiring an expert to quantify and testify as to damages would have been expensive to the class.

Finally, the court rejected the objector's argument that the district court abused its discretion by approving a distribution plan that allegedly included payments to shareholders who had sold their shares before the first corrective disclosure and therefore could not show damages. The court explained that a closer examination of the formula revealed that only those shareholders who could show loss causation would recover. Because the district court's approval of the settlement was not an abuse of discretion, the Seventh Circuit affirmed.

RULE 10B-5 OMISSION LIABILITY

Stratte-McClure v. Morgan Stanley, No. 13-0627-cv (2d Cir. Jan. 12, 2015)

Click here to view the opinion.

Second Circuit Affirms Dismissal of Section 10(b) Claims for Alleged Regulation S-K Omissions

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims that an investment bank violated Section 10(b) of the Securities Exchange Act by allegedly misrepresenting its exposure to and losses from the subprime mortgage market. The plaintiffs alleged that the investment bank violated Item 303 of Regulation S-K by failing to disclose "known trends or uncertainties" in its trading positions in certain credit default swaps tied to the subprime mortgage industry. In a matter of first impression, the Second Circuit held that a failure to make a required disclosure in a 10-Q under Item 303 of Regulation S-K is an omission that can serve as the basis for a Section 10(b) securities fraud claim. The court, however, determined that any such omission must still satisfy the materiality requirements outlined in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). Although the plaintiffs adequately alleged that the investment bank breached its duty to disclose its exposure to the deteriorating subprime mortgage market and resulting trading losses, the court determined that the plaintiffs failed to adequately allege scienter. Specifically, the plaintiffs failed to allege when the bank's employees learned that the deteriorating outlook on the market was likely to materialize and that the bank would be unable to reduce its trading position. Further, the bank's allegedly misleading 10-Q statements about its internal deliberation were insufficient to demonstrate a strong inference of scienter, especially considering that the bank was profiting from the declining market in other trading positions.

SCIENTER

In re Gold Res. Corp. Sec. Litig.,
No. 13-1323
(10th Cir. Jan. 16, 2015)

Click here to view the opinion.

Tenth Circuit Affirms Dismissal of 10(b) Claims, Finding Allegations Insufficient to Demonstrate Strong Inference of Scienter

The U.S. Court of Appeals for the Tenth Circuit affirmed the dismissal of claims that a gold mining company violated Section 10(b) of the Securities Exchange Act by allegedly concealing severe production problems leading to lower quality metal grades and by committing fraudulent earnings management. The plaintiffs alleged that the mining company had a duty to disclose the mounting complications with production at certain mining sites and that the company improperly recognized revenue from an alleged overbilling scheme. The court held that the plaintiffs failed to adequately allege scienter because the issues identified concerning the purported overbilling scheme effectively amounted to GAAP violations, which are insufficient to state a securities fraud claim absent other "particularized facts showing fraudulent intent." In addition, company executives were not reckless because they immediately conducted an investigation when they learned of the billing discrepancies, and it would have been imprudent to publicly disclose the discrepancies without first conducting this investigation. The court further determined that the plaintiffs failed to allege a strong inference of scienter as to the identified mining production problems because the company fully disclosed during various investor conference calls and press releases during the class period the risks inherent in the mining business and issues with production.

SEC PROSPECTUS REGULATIONS

Campbell v. Am. Int'l. Grp., Inc.,
No. 1:14cv1320
(E.D. Va. Jan. 20, 2015)

Click here to view the opinion.

Eastern District of Virginia Holds There Is No Private Right of Action Under SEC's 'Plain English' Regulations

Judge Leonie M. Brinkema of the U.S. District Court for the Eastern District of Virginia dismissed a putative class action alleging that American Insurance Group (AIG) deliberately misled investors about publicly traded securities. The plaintiff alleged that AIG's prospectus was confusing and violated the Securities and Exchange Commission's "plain English" regulations (17 C.F.R. § 230.421(d)(1)(2014)).

The court dismissed the plaintiff's claims for two reasons. First, the court ruled that the plaintiff did "not have standing to pursue an action stemming from the allegedly confusing nature of the Prospectus because ... [she] had not read the Prospectus before purchasing the Equity Units." The plaintiff was therefore unable to establish injury-in-fact, causation and redressability — necessary predicates for standing.

Second, the court held there is no private right of action for a violation of the SEC's "plain English" regulations. Relying on Supreme Court precedent (*Alexander v. Sandoval*, 532 U.S. 275, 288–91 (2001)) that requires clear congressional intent to create a private right of action, the district court ruled that the plaintiff in *Campbell* failed to identify language in any statute evidencing Congress' intent to create a private right of action for a violation of the SEC's "plain English" regulations.

SECURITIES ACT CLAIMS

United Food & Commercial Workers Union Local 880 Pension Fund v. Chesapeake Energy Corp., No. 13-6165 (10th Cir. Aug. 8, 2014)

Click here to view the opinion.

Tenth Circuit Upholds Dismissal of Section 11 and 12 Claims

The U.S. Court of Appeals for the Tenth Circuit affirmed the dismissal of claims that a natural gas company violated Sections 11 and 12(a)(2) of the Securities Act by allegedly concealing from investors prior to a public offering certain changes to the company's hedging strategy and that the company's CEO had pledged substantially all of his company stock as security for margin loans. Though the company had disclosed its general hedging strategy in its previous 10-Q and a pre-offering 8-K, the plaintiffs alleged that the company failed to disclose in its offering documents that it had increased its exposure to certain volatile swaps. The court held that the registration statement was not misleading because the company sufficiently disclosed the direction in which its hedging strategy was evolving, even though the company did not disclose the specific number of new swaps purchased after its 10-Q, and a reasonable investor could have discovered the way in which the company was changing its strategy by reviewing prior public filings. In addition, the company was not required to disclose the percentage of the CEO's stock held in margin accounts that was pledged as collateral, nor that the CEO lacked the financial resources to always cover his margin calls, and a reasonable investor would have understood the risks inherent in the company's disclosure that the CEO's stock was held in a margin account.

STANDING

Ret. Board of the Policemen's Annuity & Benefit Fund v. Bank of N.Y. Mellon, Nos. 13-1776-cv, 13-1777-cv (2d Cir. Dec. 23, 2014)

Click here to view the opinion.

Second Circuit Holds That Lead Plaintiff Lacks Standing to Represent Certain RMBS Investors

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims that a bank violated its fiduciary duties owed to trusts holding investments in residential mortgage-backed securities because the lead plaintiff lacked standing to assert claims related to certificates issued by trusts in which no plaintiff invested. The lead plaintiff alleged that the bank knew that the originator of the home loans systematically failed to adhere to the applicable underwriting standards, but that the bank failed to demand that the originator repurchase the defective loans. The Second Circuit held that the lead plaintiff lacked standing to bring claims on behalf of investors in trusts that the lead plaintiff had not invested in, despite the court's decision in *NECA-IBEW Health & Welfare Fund v. Goldman Sachs & Co.*, 693 F.3d 145 (2d Cir. 2012), which held that a lead plaintiff may bring Securities Act claims on behalf of investors in mortgage-backed securities that it had not purchased so long as the lead plaintiff alleged that it (1) "personally has suffered some actual injury as a result of the putatively illegal conduct of the defendant" and (2) "that such conduct implicates the same set of concerns as the conduct alleged to have caused injury to other members of the putative class by the same defendants." The court concluded that the breach-of-duty claims at issue — breaches of fiduciary duties and statutory duties applicable to trustees — differed significantly from the Securities Act claims in *NECA*, which were based on the same misrepresentations. The court determined that the investors' claims against the bank "must be proved loan-by-loan and trust-by-trust," and that the lead plaintiff did not have the same "real interest" in proving violations with respect to trusts in which it had not invested.

TENDER OFFERS

Sodhi v. Gentium S.P.A., No. 1:14-cv-00287-JPO (S.D.N.Y. Jan. 22, 2015)

Click here to view the opinion.

S.D.N.Y. Dismisses Claims That Board Concealed Information in Tender Offer

Judge J. Paul Oetken dismissed claims that a director and executive officer of a pharmaceutical company violated Section 14(e) of the Securities Exchange Act by failing to fully disclose in connection with a tender offer the basis on which the target's board (and their advisor) valued the company. The board recommended that shareholders participate in the tender offer and the company was ultimately acquired by another pharmaceutical company. The court dismissed the misstatement and omission claims because the board sufficiently disclosed why it believed that the sale price was fair, and the merger agreement allowed the board to consider other competing offers. Likewise, the company sufficiently disclosed the analysis underlying the company's adviser's fairness opinion, and the court characterized the plaintiff's allegations as "quibbles." Although the plaintiff alleged a number of metrics that were not disclosed, a disclosure statement need only include a "fair summary" of the basis of a valuation, and investors are "not entitled to disclosures sufficient to make their own independent assessment of the stock." In addition, the plaintiff failed to allege scienter because the individual defendant — who was also a large shareholder — did not have a motive to intentionally depress the price of the company's stock, even though he may have had an interest in selling his otherwise illiquid shares sooner rather than later. Moreover, the plaintiff failed to allege that the defendant acted recklessly by declining to make further disclosures after the plaintiff filed his complaint because the court determined that an equally compelling inference was that the defendant had determined that the company did not omit to disclose material information related to the tender offer.

WHISTLEBLOWER PROTECTIONS

Berman v. Neo@Ogilvy LLC, No. 1:14-cv-523-GHW-SN (S.D.N.Y. Dec. 5, 2014)

Click here to view the opinion.

S.D.N.Y. Dismisses Whistleblower Claim That Was Not Reported to SEC

Judge Gregory H. Woods of the U.S. District Court for the Southern District of New York dismissed claims by an employee that his former employer violated the whistleblower provisions of the Dodd-Frank Act because the employee did not qualify for protection under the act. The employee asserted that he had been terminated by his employer after identifying certain allegedly illegal financial transactions, but filed suit without first reporting the alleged misconduct to the SEC. The court determined that the claims must be dismissed because the act "unambiguously provides that, in order to qualify as a whistleblower, an individual must report information to the Commission." Although other courts (including in the S.D.N.Y.) have recognized a "narrow exception" to protect employees who only report alleged misconduct internally, the court adopted the view of the U.S. Court of Appeals for the Fifth Circuit in *Asadi v. G.E. Energy (USA), L.L.C.*, 720 F.3d 620 (5th Cir. 2013), and determined that such an exception is unsupported by the "plain language" of the act. Moreover, such an interpretation is consistent with other federal laws providing similar protections, including the Sarbanes-Oxley Act, which requires that employees first file a complaint with the Department of Labor before bringing a private retaliation action.

ATTORNEY CONTACTS

Editors

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

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

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

Amy S. Park
650.470.4511
amy.park@skadden.com
Palo Alto

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

New York

John K. Carroll
212.735.2280
john.carroll@skadden.com

Jonathan L. Frank
212.735.3386
jonathan.frank@skadden.com

William P. Frank
212.735.2400
william.frank@skadden.com

Robert A. Fumerton
212.735.3902
robert.fumerton@skadden.com

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

Jonathan J. Lerner
212.735.2550
jonathan.lerner@skadden.com

Scott D. Musoff
212.735.7852
scott.musoff@skadden.com

Joseph N. Sacca
212.735.2358
joseph.sacca@skadden.com

Susan L. Saltzstein
212.735.4132
susan.saltzstein@skadden.com

Seth M. Schwartz
212.735.2710
seth.schwartz@skadden.com

Robert E. Zimet
212.735.2520
robert.zimet@skadden.com

George A. Zimmerman
212.735.2047
george.zimmerman@skadden.com

Boston

James R. Carroll
617.573.4801
james.carroll@skadden.com

David S. Clancy
617.573.4889
david.clancy@skadden.com

Thomas J. Dougherty
617.573.4820
dougherty@skadden.com

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

Chicago

Matthew R. Kipp
312.407.0728
matthew.kipp@skadden.com

Michael Y. Scudder
312.407.0877
michael.scudder@skadden.com

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

Houston

Noelle M. Reed
713.655.5122
noelle.reed@skadden.com

Charles W. Schwartz
713.655.5160
charles.schwartz@skadden.com

Los Angeles

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

Eric S. Waxman
213.687.5251
eric.waxman@skadden.com

Palo Alto

Timothy A. Miller
650.470.4620
timothy.miller@skadden.com

Amy S. Park
650.470.4511
amy.park@skadden.com

Washington, D.C.

Charles F. Walker
202.371.7862
charles.walker@skadden.com

Jennifer L. Spaziano
202.371.7872
jen.spaziano@skadden.com

Wilmington

Thomas J. Allingham II
302.651.3070
thomas.allingham@skadden.com

Paul J. Lockwood
302.651.3210
paul.lockwood@skadden.com

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

Robert S. Saunders
302.651.3170
rob.saunders@skadden.com

Jennifer C. Voss
302.651.3230
jennifer.voss@skadden.com

Edward P. Welch
302.651.3060
edward.welch@skadden.com