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Skadden

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An Update From Skadden Securities Litigators

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U.S. Supreme Court

Supreme Court Decision Rejects Sixth Circuit Holding and Clarifies Pleading Standard for Section 11 Claims

Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund, 135 S. Ct. 1318 (2015)
Click here to view the opinion.

On March 24, 2015, the U.S. Supreme Court held that an issuer may be held liable under Section 11 of the Securities Act for statements of opinion made in a registration statement if the issuer failed to hold the belief professed or failed to disclose material facts about the basis for the opinion. In so doing, the Court vacated the Sixth Circuit's decision, which had held that a Section 11 plaintiff need only allege that an opinion in a registration statement was "objectively false." The Court held that, with respect to potential misstatement liability under Section 11, "a sincere statement of pure opinion is not an 'untrue statement of material fact,' regardless whether an investor can ultimately prove the belief wrong." As to the omissions prong of Section 11, the Court further held that an issuer may be liable under Section 11 for omitting material facts about the inquiry into or knowledge concerning a statement of opinion if those facts "conflict" with what a reasonable investor would "understand an opinion statement to convey" with respect to "how the speaker has formed the opinion" or "the speaker's basis for holding that view."

The issue presented in *Omnicare* has been raised in at least two other petitions for *certiorari*. In *Freidus v. ING Groep N.V.*, 135 S. Ct. 1698 (2015), the Supreme Court summarily vacated and remanded the case to the Second Circuit for further consideration in light of *Omnicare*. The Second Circuit subsequently vacated part of the judgment of the district court and remanded for further proceedings consistent with the Supreme Court's opinion. The petition for *certiorari* in *Belmont Holdings Corp. v. Deutsche Bank AG,* No. 14-1052 (U.S. Feb. 13, 2015) is still pending.

After the Supreme Court announced its decision in *Omnicare*, at least one court has engaged in a thorough analysis of the decision's implications on liability for statements of belief. *See In re BioScrip, Inc. Sec. Litig.*, No. 1:13-cv-06922-AJN (S.D.N.Y. Mar. 31, 2015) (stating that *Omnicare* increased the scope of liability for statements of belief beyond current Second Circuit precedent by holding that such a statement may be misleading "if, although sincerely held, it is formed on the basis of an omitted fact … that would likely conflict with a reasonable investor's own understanding of the facts conveyed by that statement."). For a full description of the *BioScrip* decision, please see page 7 of this publication. Other courts have applied *Omnicare*'s Section 11 misstatement and omission analysis to claims brought under Section 10(b) of the Securities Exchange Act. *See In re Merck & Co., Inc. Sec., Derivative & "ERISA" Litig*. Nos. 05-1151 (SRC), 05-2367 (SRC) (D.N.J. May 13, 2015), *In re Genworth Fin. Inc. Sec. Litig.*, No. 3:14-CV-682 (E.D. Va. May 1, 2015). Several other opinions have cited *Omnicare*, though it has not been central to their analysis. *See, e.g., Fed. Hous. Fin. Agency v. Nomura Holding Am., Inc.*, No. 11cv6201 (DLC) (S.D.N.Y. May 11, 2015).

Auditor Liability

Second Circuit Affirms Dismissal of Claims Against Independent Auditors

In re Advanced Battery Techs., Inc., No. 14-1410-cv (2d Cir. Mar. 25, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Second Circuit affirmed the denial of leave to file a second amended complaint alleging that independent auditors violated Section 10(b) of the Securities Exchange Act by falsely representing that their audits of a battery manufacturer conformed with generally accepted auditing standards (GAAS) and accurately reflected the company's financial condition. The plaintiffs alleged that the auditors failed to uncover and disclose numerous red flags in the company's financial statements, including contradictory filings in China and the United States, and the inclusion of a purportedly wholly owned subsidiary that the company did not own. The court held that the plaintiffs failed to adequately allege scienter. The court noted that an independent auditor generally is not required to review a company's foreign regulatory filings and the plaintiffs' allegations that the auditor should have in this case were merely conclusory. In addition, the auditors' review took place between 2007 and 2010, well before mid-2011, when regulators began to focus more heavily upon Chinese reverse mergers. Lastly, allegations that the auditors failed to discover that the manufacturer did not own the purported wholly owned subsidiary amounted to at most negligence, which is not sufficient to support a claim under Section 10(b).

SDNY Dismisses Section 10(b) Claims, Finding Allegations Insufficient to Demonstrate Auditor Scienter

Athale v. SinoTech Energy Ltd., No. 11-cv-5831 (AJN) (S.D.N.Y. Jan. 23, 2015)
Click here to view the opinion.

Judge Alison J. Nathan of the U.S. District Court for the Southern District of New York dismissed claims that an independent auditor violated Section 10(b) of the Securities Exchange Act by allegedly issuing a fraudulent audit opinion that failed to identify nonexistent earnings from certain alleged shell companies. The court held that the plaintiffs merely alleged violations of generally accepted accounting principles (GAAP), which do not state a claim in the absence of corresponding allegations demonstrating fraudulent intent. The court determined that the allegations about material weaknesses in the company's internal controls had an insufficient connection to the alleged fraud involving the shell companies. The plaintiffs also failed to allege that a reasonable auditor under similar circumstances would have expanded its audit in light of an allegedly suspicious increase in the company's expenditures on production equipment, which were paid to the shell companies. Likewise, the court found that the auditor was not reckless in deciding not to confirm accounts receivable from the third-party arrangements, even though the plaintiff alleged that not doing so violated GAAP, because GAAP violations alone are insufficient to demonstrate recklessness. The court determined that the allegations did not give rise to a strong inference of scienter because other equally plausible nonculpable explanations applied to the defendants' conduct, and the plaintiffs' allegations amounted only to fraud by hindsight.

Class Actions

Class Action Fairness Act

CAFA Securities Exception Deprives Ninth Circuit of Jurisdiction

Eminence Investors, L.L.L.P. v. Bank of N.Y. Mellon, No. 15-15237 (9th Cir. Apr. 2, 2015)
Click here to view the opinion.

In a case of first impression, the U.S. Court of Appeals for the Ninth Circuit held that the securities exception to the Class Action Fairness Act (CAFA) deprived the court of jurisdiction where plaintiff-bondholders' claims stemmed from the defendant's fiduciary duties arising from an indenture trustee agreement.

The plaintiffs asserted causes of action against the defendant bank for breach of fiduciary duty and gross negligence. The bank, the successor to the indenture trustee, removed the putative class action from California state court to federal court pursuant to CAFA. The district court remanded the case based on the defendant's untimely filing but did not consider whether the securities exception to CAFA removal applied. The bank appealed.

Even though the district court did not address the securities exception, the Ninth Circuit noted at the outset that the court lacked jurisdiction if the CAFA securities exception applied, as the bank solely predicated removal on CAFA and the court found no other source of jurisdiction applicable. The CAFA securities exception applies if each claim in a class action is related to certain rights, duties or obligations which must be "related to or created by or pursuant to" a security as defined under the Securities Act Section 2(a)(1) and the regulations issued thereunder.

The Ninth Circuit held that the CAFA securities exception applied. In so holding, the panel concluded that all of the causes of action in the complaint "relate[d] to the rights, duties … and obligations relating to or created by or pursuant to" the bonds at issue, which the parties agreed were "securities" under the Securities Act. The panel reasoned that the causes of action in the complaint were based on alleged duties (*i.e.*, the fiduciary duties of the bank), and thus the alleged duties arose from the bonds and the associated indenture. Acknowledging that the Ninth Circuit had yet to construe the language of the securities exception, the panel looked to the Second Circuit, which has interpreted the CAFA securities exception in three recent cases. The Ninth Circuit summarized the Second Circuit's case law as standing for the proposition that the securities exception applies where the rights or duties at issue are defined by the security instrument itself, even if there are "collateral issues of state law" involved, or there are additional "duties superimposed by state law as a result of the relationship created by or underlying the security." Based on this interpretation, the panel reasoned that even the gross negligence cause of action was based on the "duties superimposed by state law as a result of the relationship created by or underlying" the bonds at issue. Therefore, because the CAFA securities exception "must apply" in such a suit, the Ninth Circuit dismissed the appeal for lack of jurisdiction.

Class Certification

SDNY Finds Two Proposed Class Representatives to Be Inadequate

Gordon v. Sonar Capital Mgmt. LLC, No. 11-cv-9665 (JSR) (S.D.N.Y. Mar. 19, 2015)
Click here to view the opinion.

Judge Jed S. Rakoff of the U.S. District Court for the Southern District of New York denied a motion to certify a class of shareholders in a securities action alleging that a hedge fund violated Section 10(b) of the Securities Exchange Act by engaging in insider trading. The plaintiffs alleged that the hedge fund managers traded a company's stock based on material, nonpublic information that it received from a former employee about an undisclosed contract that was expected to generate substantial revenues. The court held that neither of the two proposed class representatives were appropriate to represent the putative class. First, one proposed representative had significant veracity issues and also failed to disclose his close relationship with his personal attorney — who had a financial incentive in the outcome of the case — and the court determined that the conflict could compromise the representative's ability to protect the interests of the class. The court also reasoned that the proposed representative lacked independent judgment, evidenced by prior testimony indicating that the representative did not know basic facts about the litigation. Second, as to the other proposed representative, the court determined that by netting gains and losses during the class period, the representative had not suffered any economic loss and thus was subject to unique defenses that made him an inadequate class representative. The plaintiffs have filed a petition to appeal the decision.

Settlements

District Court Holds That Nonsettling Defendants Are Entitled to Securities Class Action Judgment Reductions

Rieckborn v. Velti plc, No. 13-cv-03889-WHO
N.D. Cal. Feb. 3, 2015)
Click here to view the opinion.

Judge William H. Orrick of the U.S. District Court for the Northern District of California held that nonsettling class action defendants are entitled to a judgment reduction measured by the settling defendants' liability on Securities Act claims not explicitly covered under the Private Securities Litigation Reform Act of 1995 (the PSLRA). In so holding, the court clarified the appropriate terms of securities class action bar orders. In addition, the court's order provides class action settlement agreement drafters with guidance by clarifying that bar orders do not preclude "independent claims" and that such orders must be "mutual."

The plaintiffs, investors in Velti plc (Velti), asserted claims under the Securities Exchange Act and the Securities Act against Velti, several of Velti's officers and directors, its accounting firm, and the underwriters of the securities the plaintiffs purchased. Velti and four of the individual defendants subsequently agreed to a settlement with the plaintiffs. However, Velti's accounting firm and the underwriters declined to participate in the settlement. Under the partial settlement, Velti's insurance policies would finance the settlement fund exclusively.

The nonsettling defendants objected to the settlement on several grounds. As an initial matter, they argued that the proposed formula for calculating any judgment reduction they would receive was unacceptably vague. The plaintiffs responded that the calculation was not vague because any future judgment reduction would be "in accordance with applicable law." Agreeing with the nonsettling defendants, the court held that the judgment reduction provision in the settlement agreement had to state more clearly how settled Securities Act claims would reduce any judgment against the nonsettling defendants in the future. The court reasoned that it was not clear which "applicable law" would apply to the judgment reduction because the settlement involved claims under both the Securities Exchange Act and the Securities Act.

The nonsettling defendants further objected to the settlement, arguing that the settlement failed to make clear that they would be entitled to a judgment reduction measured by the proportionate liability attributable to other defendants on all Securities Act claims as opposed to only Securities Act claims that outside directors settled. Again, the court agreed with the nonsettling defendants and held that they were entitled to a judgment reduction measured by the proportionate liability attributable to other defendants under the PSLRA. The court rejected the plaintiffs' contention that nonsettling defendants were only entitled to a dollar-for-dollar judgment reduction on the Securities Act claims that the PSLRA did not explicitly cover. The plaintiffs argued that the plain language of the PSLRA limited judgment reduction measured by the proportionate liability attributable to other defendants to settled Securities Act claims against outside directors and excluded settled Securities Act claims against other defendants. The court reasoned that it was fair to limit nonsettling defendants' future liability based on the liability attributable to other defendants because settling plaintiffs should bear that risk as they have a "financial incentive to make sure that each defendant pays his respective share of damages." The court stated that the court would revise the settlement to make clear that the nonsettling defendants would be entitled to a judgment reduction based on all Securities Act claims against nonsettling defendants, measured by the proportionate liability attributable to other defendants.

As to the proposed bar order — that is, an order that in general bars categories of claims made by or against the settling parties relating to or arising from the settled securities fraud claims — the court concluded that the bar order had to be revised to clarify that it would prohibit claims both by and against released parties. The court held that, under Section 78u-4(f)(7)(A) of the PSLRA, any bar order must be "mutual" — meaning that "any party … protected against claims of contribution and indemnification [would] also be prohibited from asserting such claims." The court reasoned that the proposed securities class action bar order was not mutual because it did not prohibit contribution and indemnification claims *by* the released parties, but merely prohibited such claims *against* them.

Finally, the court dispelled the nonsettling defendants' fear that the bar order precluded their independent claims to recover amounts other than those any released party was required to pay under the settlement. The court made clear that bar orders must be limited to "claims for contribution and indemnity and claims where the injury is the nonsettling defendant's liability to the plaintiff," and cannot preclude independent claims.

Fiduciary Duties

Books and Records

Delaware Court of Chancery Permits Stockholders to Inspect Privileged Documents

In re Lululemon Athletica Inc. 220 Litig., Consol. C.A. No. 9039-VCP (Del. Ch. Apr. 30, 2015)
Click here to view the opinion.

Vice Chancellor Donald F. Parsons, Jr. of the Delaware Court of Chancery, in the context of Section 220 proceeding, ordered Lululemon to produce certain privileged communications under the *Garner* exception to the attorney-client privilege but denied stockholder plaintiffs' request for documents from the personal email accounts of its nonemployee directors.

The court previously ordered the company to produce documents relating to a 10b-5 trading plan under which the company's founder and former chairman sold a significant number of shares immediately prior to a 22 percent drop in the company's stock price.

The court subsequently considered whether certain documents fell within the scope of its earlier post-trial order. With respect to two emails that were protected by the attorney-client privilege, the court held that the plaintiffs had established "good cause" to set aside the privilege under *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970), because the plaintiffs' claims of wrongdoing were "obviously colorable," the documents sought did not involve legal advice regarding the books and records request, and the two emails at issue were unavailable from another source.

With respect to the plaintiffs' request for documents from the email accounts of its nondirector employees, the court found that its previous order required only the company, and not its directors, to produce documents. The court stated that "it [was] not clear that the Court could require that Plaintiffs receive access to those documents under Section 220," and that the emails were not necessary and essential to the plaintiffs' essential purpose.

Delaware Court of Chancery Permits Stockholder to Investigate Company's Oversight of Subsidiaries

Okla. Firefighters Pension & Ret. Sys. v. Citigroup Inc., C.A. No. 9587-ML (VCN) (Del. Ch. Apr. 24, 2015)
Click here to view the opinion.

Vice Chancellor John W. Noble of the Delaware Court of Chancery granted a company stockholder's request to inspect books and records, pursuant to 8 Del. C. § 220. The stockholder alleged that the company (the Company) failed to exercise appropriate oversight over two subsidiaries after the Company disclosed that its Mexican Banamex subsidiary had engaged in fraudulent transactions and its Banamex USA subsidiary had received grand jury subpoenas relating to compliance with banking regulations.

The court found that the plaintiff stated a proper purpose for requesting books and records by presenting "some credible basis" from which the court could infer wrongdoing. The court explained that "the 'credible basis' standard sets the lowest possible burden of proof," and emphasized that "[t]he Court ... encourages stockholders to pursue a Section 220 demand instead of bringing a premature complaint." While "the record would not likely support fiduciary duty claims capable of surviving a motion to dismiss," the court explained that the standard for entitlement to books and records is lower than that governing a motion to dismiss, and that the plaintiff sufficiently demonstrated "red flags" suggesting the Company may not have exercised sufficient oversight over its subsidiaries. However, the court narrowly tailored the scope of inspection solely to those documents "reasonably required to satisfy the purpose of the demand."

Delaware Court of Chancery Denies Books and Records to Investigate Exculpated Wrongdoing

Se. Pa. Transp. Auth. v. AbbVie, Inc., C.A. No. 10374-VCG (Del. Ch. Apr. 15, 2015)
Click here to view the opinion.

Vice Chancellor Sam Glasscock III of the Delaware Court of Chancery denied requests brought by stockholders of AbbVie, Inc. to inspect the company's books and records after the AbbVie board of directors changed its recommendation in favor of a transaction with Shire plc, a Jersey entity. The transaction was intended to be structured as a corporate inversion, but subsequent to signing the merger agreement, the U.S. Treasury Department and the IRS announced their intent to issue regulatory guidance eliminating certain tax advantages of inversions.

As a result of withdrawing its recommendation in support of the deal, AbbVie was required to pay to Shire a $1.635 billion termination fee.

The court denied the plaintiffs' requests for books and records, holding that "[a] stockholder seeking to use Section 220 to investigate corporate wrongdoing solely to evaluate whether to bring derivative litigation has stated a proper purpose only insofar as the investigation targets non-exculpated corporate wrongdoing." Because the plaintiffs did not allege a basis to establish bad faith or waste based on the board's conduct in evaluating the deal or changing its recommendation, and therefore stated no exculpated claim, the plaintiffs were not entitled to the books and records sought.

Derivative Litigation

Court Enters $171 Million Damages Award for Board's Failure to Evaluate Transaction in Good Faith

In re El Paso Pipeline Partners, L.P. Derivative Litig., C.A. No. 7141-VCL (Del. Ch. Apr. 20, 2015)
Click here to view the opinion.

Vice Chancellor J. Travis Laster of the Delaware Court of Chancery awarded $171 million in damages against the general partner of El Paso Partners, L.P. (Partnership) for failing to comply with the contractual standards expressed in a partnership agreement governing interested "dropdown" transactions.

In 2010, the Partnership purchased interests in two subsidiaries from El Paso Corporation, which controlled the general partner of the Partnership. In the following months, the Partnership purchased additional ownership of the subsidiaries in transactions whereby El Paso's ownership "dropped down" from El Paso to the Partnership. The partnership agreement required a good faith belief by the general partner's board that such dropdowns were in the best interests of the Partnership.

After trial, the court determined that the general partner's board "failed to form a subjective belief that the [dropdown] was in the best interests of [the Partnership]," explaining that "[t]he evidence at trial ultimately convinced [the court] that when approving the [dropdown], the Committee members went against their better judgment and did what [El Paso] wanted, assisted by a financial advisor that presented each dropdown in the best possible light, regardless of whether the depictions conflicted with the advisor's work on similar transactions or made sense as a matter of valuation theory." The court awarded damages to the plaintiff calculated as the difference between the purchase price and the actual value of assets received in the dropdowns.

District Court Dismisses Data Breach Litigation Framed as Derivative Lawsuit

Palkon v. Holmes, No. 2:14-cv-01234 (SRC) (D.N.J. Oct. 20, 2014)
Click here to view the opinion.

Judge Stanley R. Chesler of the U.S. District Court for the District of New Jersey dismissed a shareholder derivate lawsuit against directors of Wyndham Worldwide Corporation arising from three data breaches between April 2008 and January 2010 affecting the company's customers' financial and personal data.

During the data breaches, hackers stole over 600,000 customers' credit card information through "memory-scraping malware" after breaching Wyndham's main network and those of its hotels by guessing an administrator's user ID and password information. Palkon, a Wyndham shareholder during these cyberattacks, demanded in mid-2013 that the board pursue litigation over the attacks. The board refused Palkon's demands. Palkon then filed a derivative suit claiming that the board failed to (1) implement an adequate system of internal controls to protect customers' financial and personal information, and (2) timely disclose the data breaches to shareholders after they occurred.

In dismissing the claims with prejudice, the court concluded that the business judgment rule applied, and, under the circumstances, shielded the directors from liability. Under Delaware substantive law, where a board of directors refuses to pursue a shareholder's demand, that decision is subject to the business judgment rule, and a shareholder or order to defeat a motion to dismiss must raise a reasonable doubt that the refusal was a business judgment. A shareholder can do this by pleading with particularity that the decision was either (1) made in bad faith or (2) based on an unreasonable investigation.

First, the court rejected the plaintiff's allegation that the board acted in bad faith. On this point, the plaintiff argued that the board's refusal was influenced by conflicted legal counsel, an argument the court rejected. The court explained that counsel never had multiple, conflicting duties. To the contrary, "counsel was duty-bound at all times to advocate for WWC, and for no one else." Notwithstanding the plaintiff's allegation, there were no well-pleaded facts that counsel to the board faced any prospect of personal liability stemming from the cyberattacks.

Second, the court rejected the allegation that the board's refusal was based on an unreasonable investigation. The court reasoned that the board had "ample" information at its disposal when it rejected the plaintiff's demand. The board originally had become familiar with the subject matter based on a prior Federal Trade Commission (FTC) investigation into cybersecurity and data protection measures. In fact, the court noted, the board discussed cyberattacks and data security generally during 14 different meetings between October 2008 and August 2012. As the court concluded, by the time the plaintiff submitted his letter, the board's review of the letter did not occur in a vacuum. Moreover, the board "specifically consider[ed]" the demand and even met to discuss it. Accordingly, because "WWC's Board had a firm grasp of Plaintiff's demand when it determined that pursuing it was not in the corporation's best interest," the plaintiff failed to raise a reasonable doubt that the refusal was a business judgment.

Section 205

Court Approves Settlement in Contested Action Under Newly Enacted Section 205

In re Cheniere Energy, Inc. Stockholders Litig., C.A. No. 9710-VCL (Del. Ch. Mar. 16, 2015)
Click here to view the opinion.

Vice Chancellor J. Travis Laster approved a settlement of stockholder litigation and of one of the first contested actions brought under 8 Del. C. § 205, and validated over 25 million shares of Cheniere Energy, Inc. The newly enacted Section 205 provides the Delaware Court of Chancery with a statutory mechanism to validate defective corporate acts.

Stockholder plaintiffs filed derivative and class actions in the Court of Chancery alleging that the Cheniere stockholder vote on Amendment No. 1 to Cheniere's 2011 Incentive Plan was invalid. The plaintiffs alleged that Cheniere improperly failed to count abstentions applying a "votes cast" standard, when abstentions should have been counted as "no" votes using a "present and entitled to vote" standard. Had abstentions been counted as votes against, Amendment No. 1 would not have passed. The plaintiffs therefore claimed that the 17 million shares already issued as compensation to directors, officers and employees pursuant to Amendment No. 1, as well as the additional 7.8 million shares available under the plan, were void. The plaintiffs sought expedition and an injunction of Cheniere's 2014 annual meeting, at which stockholders were to be asked to vote on a new long-term incentive plan for Cheniere officers, directors and employees. Cheniere then filed a petition in the Court of Chancery under newly enacted Section 205 seeking a declaration as a matter of law that the vote on Amendment No. 1 was properly counted and the shares were valid; or, in the alternative, if the court determined that the vote on Amendment No. 1 was not counted properly, to use its authority under Section 205 to validate the shares authorized by Amendment No 1. Ultimately, the parties entered into a settlement of both the stockholder litigation and the Section 205 action. Among other things, the settlement provided that the parties would seek an order from the court under Section 205 validating all shares that had been previously issued under the 2011 Incentive Plan. The settlement also contemplated that the 7.8 million shares available for issuance under Amendment No. 1 would not be used for compensation purposes absent a new shareholder vote.

The court approved the settlement. It remarked that many of the shares being validated were issued to line-item employees, and that "[p]art of what this settlement will do is validate those shares so that there's no question about their validity." The court also noted that the settlement "will remove uncertainty about the validity of these shares in Cheniere's capital structure and also avoid potential problems down the road figuring out who can vote, who can't vote, giving opinions as to due authorization, and all kinds of nasty consequences that would flow if these shares are not validated." Thus, the Court of Chancery approved the settlement, and declared valid under Section 205 approximately 25 million shares of Cheniere stock. The court also rejected the plaintiffs' counsel's request for $43.1 million in attorneys' fees and instead awarded $5.5 million in fees.

Secondary Actor Liability

Second Circuit Denies Petition Seeking Rehearing of Dismissal of Securities Fraud Claims Against Clearing Broker

Fezzani v. Bear, Stearns & Co. Inc., Nos. 14-3983, 09-4414 (2d Cir. Jan. 30, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Second Circuit denied a petition seeking rehearing of an opinion affirming the dismissal of claims that a clearing broker violated Section 10(b) of the Securities Exchange Act by allegedly failing to disclose certain price misrepresentations made by a broker-dealer. The Second Circuit previously determined that the plaintiffs failed to adequately allege facts showing that a clearing broker participated in alleged price manipulation by a broker-dealer. The court denied rehearing because it again determined that the plaintiffs' allegations did not demonstrate that the clearing broker controlled the broker-dealer or directed it to execute the sham transactions at issue. The plaintiffs failed to allege any specific conduct tying the clearing broker to the manipulation of securities prices or communication of those prices to customers, and allegations that the clearing broker merely knew of the fraudulent scheme were insufficient. The court additionally clarified that, counter to the SEC's assertion in an *amicus* brief, the court's previous decision did not limit liability in market manipulation cases only to those defendants that communicated directly with investors. Rather, a person may well be held liable under Section 10(b) for "sending a false pricing signal to the market, upon which victims of the manipulation rely." However, such a theory did not apply in this case because the plaintiffs did not allege that they relied on or even knew about the clearing broker's alleged conduct, and they were not entitled to a presumption of reliance because the securities in question did not trade in a well-developed and efficient market.

Securities Fraud Pleading Standards

Item 303 Disclosure

District of Minnesota Partially Dismisses Securities Class Action

Beaver Cnty. Emps.' Ret. Fund v. Tile Shop Holdings Inc., No. 14-786 ADM/TNL (D. Minn. Mar. 4, 2015)
Click here to view the opinion.

Judge Ann D. Montgomery of the U.S. District Court for the District of Minnesota granted in part and denied in part motions to dismiss a securities class action brought on behalf of purchasers of Tile Shop Holdings, Inc. for alleged violations of the Securities Exchange Act and the Securities Act. The plaintiffs alleged that the defendants' failure to disclose Tile Shop's business dealings with companies owned by family members of the CEO violated Sections 10(b) and 20(a) of the Securities Exchange Act and Sections 11, 12(a)(2) and 15 of the Securities Act.

The plaintiffs asserted four theories of liability under Section 10(b) and Rule 10b-5, and the court concluded that three of those theories were sufficiently pleaded under the PSLRA as to the company and its CEO. First, the court held that the defendants' alleged failure to comply with Item 303 of Regulation S-K — requiring the disclosure of trends or uncertainties that would have a material impact on its net sales, revenues or income — could give rise to a violation of Rule 10b-5. Second, the court concluded that because the defendants did not disclose the close relationships between the company and its suppliers, statements regarding the strength of its supplier relationships could be misleading. Third, statements linking the company's high gross margins to its direct sourcing model could be misleading because the defendants did not disclose the nature of the supplier relationships. Although the court upheld the Section 10(b) claims against the company and its CEO, it dismissed the claim against the CFO due to the plaintiffs' failure to adequately allege scienter. The court also dismissed claims under Section 20(a) of the Securities Exchange Act and Section 15 of the Securities Act, concluding that the plaintiffs failed to allege particular facts that established certain defendants exerted control over the actions of the company.

The court also dismissed the plaintiffs' claims under Sections 11 and 12(a)(2) of the Securities Act relating to the company's June 2013 public offering. The court reasoned that the plaintiffs lacked standing to assert the claims because they did not purchase shares in the June 2013 public offering, nor did they plead facts to establish that their stock purchases were traceable to that offering. The court, however, allowed the Securities Act claims relating to the company's December 2012 public offering to proceed because (1) the plaintiffs pleaded that they purchased shares in that public offering, and (2) the plaintiffs adequately pleaded recoverable damages as required by Section 12(a).

Misrepresentations

SDNY Applies *Omnicare* and Denies, in Part, Motion to Dismiss Claims Against Pharmacy Services Company

In re BioScrip Inc. Sec. Litig., No. 1:13-cv-06922-AJN (S.D.N.Y. Mar. 31, 2015)
Click here to view the opinion.

Judge Alison J. Nathan of the U.S. District Court for the Southern District of New York refused to dismiss claims that a health care services company violated Section 10(b) of the Securities Exchange Act by misleading investors as to certain allegedly fraudulent Medicare and Medicaid reimbursement practices. The plaintiffs alleged that the company stated that it was in compliance with relevant health care regulations even though it knew, at the time the statements were made, about the government's ongoing investigation into alleged wrongdoing. The court held that the plaintiff adequately alleged that the company's opinions were not honestly held in light of the ongoing investigation. Further, applying the Supreme Court's recent decision in *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund,* 135 S. Ct. 1318 (2015), the court held that the company's failure to disclose the ongoing investigation was actionable because the legal compliance opinions might have led a reasonable investor to believe that there were no pending investigations of wrongdoing. The court dismissed, however, claims that the company exaggerated the success of its pharmacy benefits management segment despite allegedly losing a major client. The plaintiffs failed to adequately allege scienter because although the segment constituted significant business for the company, that fact alone was insufficient to demonstrate that the company knew it had lost the client when the statements were made. Further, although the plaintiffs' confidential witnesses testified that management would receive reports on the business segment, the testimony did not identify the content of particular reports, the date the reports were allegedly made available, or whether the defendants reviewed them.

Omissions

SDNY Dismisses Section 11 Claims Against an Online Video Advertisement Company on Materiality Grounds

Medina v. Tremor Video, Inc., No. 13-cv-8364 (PAC) (S.D.N.Y. Mar. 5, 2015)
Click here to view the opinion.

Judge Paul A. Crotty of the U.S. District Court for the Southern District of New York dismissed claims that an online video advertisement company violated Section 11 of the Securities Act by allegedly failing to disclose in a registration statement for the company's initial public offering material trends concerning lost revenue resulting from a two-week delay in advertisement purchases from two customers and increasing resistance among customers to performance-based pricing. The court held that the plaintiffs failed to allege that the two-week delay constituted an actionable trend under Item 303 because the timing of customers' purchases commonly varied, and the allegations did not demonstrate that, at the time the registration statement was filed, the delay was likely to negatively affect the company's business. Indeed, because of, and not despite, the "inherently fact-specific" nature of materiality, the court found the plaintiffs' "speculation" about the delay did not support a claim. Likewise, the court determined that the plaintiff failed to allege that the company could have disclosed an alleged trend toward less profitable demographic-based pricing because that trend did not become apparent until four months after the offering. In addition, the court determined that even if the alleged misstatements and omissions were material, each was accompanied by appropriate qualifying.

Reliance

SDNY Declines to Dismiss Investors' Claims That Beauty Company CEO Violated Securities Laws

Le Metier Beauty Inv. Partners LLC v. Metier Tribeca, LLC, No. 1:13-cv-04650 JFK (S.D.N.Y. Feb. 24, 2015)
Click here to view the opinion.

Judge John F. Keenan of the U.S. District Court for the Southern District of New York denied a motion to dismiss claims that a beauty company's CEO violated Section 10(b) of the Securities Exchange Act. Litigation against the company had been automatically stayed after the company filed for bankruptcy. Investors alleged that the CEO misrepresented how the company would use the proceeds from a sale of equity and used over 80 percent of the funds for prohibited purposes. The court determined that a provision of the purchase agreement providing that the purchaser did not rely upon representations outside of the agreement — disclaiming reliance on materials outside of the transactional documents — did not bar the claims. The "mere existence" of such a provision does not "automatically" mean that reliance was unreasonable, especially in the case of a general disclaimer, and the court noted that in this case the disclaimer did not specifically address any of the plaintiffs' allegations. In addition, the court determined that, at this stage of the proceeding, the plaintiffs' alleged reliance on representations outside of the purchase agreement was not unreasonable as a matter of law, even though the plaintiffs received a detailed business plan and had the ability to request other specific information from management at the time of the sale, because reliance is generally a fact question and the plaintiffs alleged that some of the additionally provided information was false.

Scienter

Fourth Circuit Overturns District Court's Order Dismissing a Securities Class Action for Failure to Plead Scienter

Zak v. Chelsea Therapeutics Int'l, Ltd., No. 13-2370 (4th Cir. Mar. 16, 2015)
Click here to view the opinion.

A split panel of the U.S. Court of Appeals for the Fourth Circuit reversed and remanded a securities class action against a pharmaceutical company and its executives, holding that the district court erred in dismissing the complaint for failure to plead facts supporting a strong inference of scienter.

The plaintiffs alleged that Chelsea Therapeutics and several of its officers violated Section 10(b) of the Securities Exchange Act by failing to disclose to investors that "the FDA expected Chelsea to produce two successful studies showing evidence of durability of effect" and that the "FDA briefing document included a recommendation against approval" of the new drug. The plaintiffs asserted that omitting this information from company press releases supported a strong inference of wrongful intent. In support of their motion to dismiss, the defendants asked the district court to take judicial notice of certain SEC documents showing a lack of scienter. The district court took judicial notice of the SEC filings and held that the plaintiffs failed to state a Section 10(b) claim.

The court of appeals reversed. First, the court held that it was not appropriate for the district court to take judicial notice of the SEC filings because they were not explicitly referenced in or an integral part of the complaint. Second, while emphasizing that its decision did "not stand for the proposition that a strong inference of scienter can arise merely based on a defendant's failure to disclose information," the court explained that "the scienter inquiry necessarily involves consideration of the facts and of the nature of the alleged omissions or misleading statements within the context of the statements that a defendant affirmatively made." The court considered several positive press releases issued by the defendants that made no mention of the FDA's reservations about the new drug. The court held that the plaintiffs' allegations permitted a strong inference that the defendants acted with wrongful intent "by failing to disclose critical information received from the FDA during the new drug application process, while releasing less damaging information that they knew was incomplete."

In a strongly worded dissent, Judge Stephanie D. Thacker rejected the majority's reasoning, noting that "[s]ince the enactment of the PSLRA, [the Fourth Circuit has] published eight decisions reviewing the dismissal of a securities fraud suit for failure to plead facts supporting a strong inference of scienter; in all of them, [the Fourth Circuit] concluded that the inference was lacking." Notwithstanding her agreement with the majority that the district court improperly relied on the SEC filings, Judge Thacker wrote that the allegations in the complaint did not "strongly imply either fraudulent intent or severe recklessness."

Second Circuit Affirms Dismissal of Section 10(b) Claims Because Company Lacked Motive to Mislead Investors or Disbelieve Its Risk Representations

Westchester Teamsters Pension Fund v. UBS AG, No. 14-165-cv (2d Cir. Feb. 27, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Second Circuit affirmed in a summary order the dismissal of claims that a financial services company violated Section 10(b) of the Securities Exchange Act by allegedly making misrepresentations about the company's risk management systems and internal controls. The plaintiffs failed to adequately allege scienter, either through a showing of "motive and opportunity" or of "conscious misbehavior or recklessness." The court determined that the company had no motive to mislead investors about its risk management systems, and it did not benefit in any way from alleged unauthorized actions of a rogue trader that exposed the company to large financial losses. The court further determined that the plaintiffs failed to allege that the company was reckless because the complaint did not allege with particularity any facts indicating that the company was warned about, or could have known about, the kind of unauthorized trading that occurred. Rather, the company had no reason to disbelieve its representations to investors that its risk controls were effective.

First Circuit Upholds Dismissal of Section 10(b) Claim Against Medical Device Company for Failing to Demonstrate Scienter

Simon v. Abiomed, Inc., No. 14-1502 (1st Cir. Feb. 6, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the First Circuit affirmed the dismissal of claims that a medical device company violated Section 10(b) of the Securities Exchange Act by concealing from investors that the company was promoting its heart pump product for off-label purposes. The plaintiffs alleged that the company knew about the alleged misconduct by way of certain nonpublic letters from the FDA concerning the activity, but concealed from investors that a source of its growth was from allegedly off-label sales. The plaintiffs relied on confidential witnesses who asserted that the company ignored the FDA's warnings. The court dismissed the claims because the plaintiffs failed to sufficiently allege scienter. The company had repeatedly disclosed the risk that the FDA might disagree with the company as to the legality of its marketing strategies, and it was not required to disclose any wrongdoing while negotiations with the FDA were pending and had not yet resulted in adverse action. In addition, the confidential witnesses' assertions were insufficient to support an inference of scienter because none of the witnesses had direct contact with senior management, and their assertions lacked specificity as to the time period and extent of the alleged wrongdoing. The court further determined that allegations that certain executives sold stock based on inside information were insufficiently suspicious to give rise to an inference of scienter. One executive actually increased his holdings during the class period, and another's trades corresponded with his first opportunity to sell shares after joining the company.

Tenth Circuit Upholds Dismissal of Section 10(b) Claims Against Biopharmaceutical Company

Wolfe v. Aspenbio Pharma, Inc., No. 12-1406 (10th Cir. Oct. 17, 2014)
Click here to view the opinion.

The U.S. Court of Appeals for the Tenth Circuit affirmed the dismissal of claims that a biopharmaceutical company violated Section 10(b) of the Securities Exchange Act by allegedly misrepresenting the efficacy of a proprietary screening test for appendicitis. The plaintiffs failed to allege that the current CEO of the company knew that the alleged statements were false at the time they were made. The court rejected the plaintiffs' assertion that the CEO's knowledge could be imputed solely from the CEO's executive position within a company. In addition, allegations that the CEO was informed about problems with the screening test were too "vague" to give rise to an inference of scienter under the PSLRA's heightened pleading standards. Further, the statements allegedly informing the CEO of the problems were made more than a year earlier and, even if true, did not plausibly demonstrate that the CEO knew his statements were false at the time they were made.

Western District of Louisiana Declines to Apply Group Pleading Doctrine to a Company That Is Not 'Extremely Small'

In re CenturyLink, Inc., No. 3:13-CV-02318 (W.D. La. Feb. 3, 2015) (recommendation adopted by the district court at Docket Nos. 70 and 71 on Apr. 21, 2015)
Click here to view the opinion.

The U.S. District Court for the Western District of Louisiana adopted the recommendation of Magistrate Judge James D. Kirk to grant a motion to dismiss a federal securities class action for failure to plead facts supporting a strong inference of scienter and denied the plaintiffs' request for leave to amend their complaint. The plaintiffs alleged that CenturyLink and its senior executives violated Sections 10(b) and 20(a) of the Securities Exchange Act by falsely representing, in press releases, conference calls, analyst conferences and SEC filings, that the company was financially capable of maintaining its credit rating and dividend payment.

As to the Section 10(b) claim, the magistrate judge held that the plaintiffs had failed to adequately plead scienter. The plaintiffs attempted to rely on the defendants' positions as senior executives to demonstrate a strong inference of scienter. The plaintiffs cited to *Spitzberg v. Houston Am. Energy Corp.*, 758 F.3d 676 (5th Cir. 2014), which allowed plaintiffs to use "group pleading" to establish scienter in a securities fraud action. However, the magistrate judge stated that the holding in *Spitzberg* was "limited to that defendant 'due to the extremely small size of the company at issue.'" The magistrate judge held that because CenturyLink was a large corporation, the plaintiffs were required to "plead facts sufficient to show [an] individual defendant acted with the 'intent to deceive, manipulate or defraud' or that he acted in a manner that was so reckless that it constituted an extreme departure from ordinary care which presented a danger of misleading buyers or sellers." Because the plaintiffs failed to do so, the magistrate judge held that a strong inference of scienter could not be found. The magistrate judge also recommended that because there was no primary violation of the Securities Exchange Act, there could be no control person liability under Section 20(a).

Northern District of California Dismisses Securities Fraud Action for Failure to Plead Scienter

Taormina v. Annie's, Inc., No. 14-02711 (N.D. Cal. April 16, 2015)
Click here to view the opinion.

Judge Beth Labson Freeman of the U.S. District Court for the Northern District of California dismissed without prejudice a putative class action complaint for securities fraud against organic food manufacturer Annie's, Inc., and certain officers of the company. The plaintiffs asserted claims for securities fraud under Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5, as well as a claim for control person liability under Section 20(a) of the Securities Exchange Act. The court found that while the consolidated complaint sufficiently alleged a material misrepresentation or omission by the defendants, it failed to adequately plead scienter.

The plaintiffs alleged that, during the class period, the defendants made material misrepresentations regarding (1) the company's accounting practices for customer incentives programs and (2) the adequacy of the company's internal controls over its accounting practices. According to the allegations, the defendants misstated the company's true net income by failing to capture all trade promotion costs. In addition, the company's public filings allegedly misrepresented internal controls over financial reporting because the company's accounting practices for trade promotion costs violated GAAP. During the class period, the company issued a series of press releases regarding its statements on the accounting practices and noted that it would be revising its methodology. However, in making the revision, the company stated that it did not consider the financial impact of the change to be "material," but stated that "material weaknesses" existed in its internal control over financial reporting.

In concluding that the plaintiffs adequately pleaded falsity, the court rejected the defendants' arguments that the statements regarding accounting practices were immaterial simply because the resulting changes in net income were relatively small. On that point, the court stated that it could not "conclude as a matter of law that a reasonable investor would not have viewed the alleged [accounting] discrepancies to be material." With respect to the alleged misstatements regarding the company's internal control over financial reporting, the defendants argued that the statements were couched as opinions and thus must be analyzed in light of the U.S. Supreme Court's recent holding in *Omnicare, Inc. v. Laborers Dist. Council Const. Indust. Pension Fund*, 135 S. Ct. 1318 (2015). In that case, the Supreme Court, reviewing Section 11 of the Securities Act, clarified the circumstances under which a company can be liable for statements of opinion contained in a registration statement. The Supreme Court held that "a statement of opinion is not misleading just because external facts show the opinion to be incorrect," so long as the opinion is honestly believed. The court noted, however, that the discussion of materiality in *Omnicare* "was limited to the second prong of § 11 regarding omissions." Thus, even though the court here agreed with the defendants that some of the statements regarding internal controls were, indeed, couched as opinions, the court "cannot conclude at this stage in the proceedings that the statements were not materially misleading."

Regarding scienter, the court found that statements from confidential witnesses were not themselves indicative of scienter because they were "too vague and general" to demonstrate that defendants made statements with intent or with deliberate recklessness. Indeed, plaintiffs failed to plead "any contemporaneous facts" suggesting that the individual defendants believed at the time that the statements about accounting methods for promotional costs were "inappropriate" and the company's internal controls were "insufficient."

Because Section 20(a) claims are predicated on an underlying violation of the securities laws, the court likewise dismissed that claim.

D. Mass Dismisses Section 10(b) Claims Against a British Columbia Power Company

In Re: Atl. Power Corp. Sec. Litig., No. 1:13-cv-10537-IT
(D. Mass. Mar. 13, 2015)
Click here to view the opinion.

Judge Indira Talwani of the U.S. District Court for the District of Massachusetts dismissed claims that a power company and certain of its officers violated Section 10(b) of the Securities Exchange Act by falsely stating that the company would be able to maintain or increase dividends despite the company's allegedly high debt. The court determined that allegations that the company knew its "crippling" level of debt would negatively affect dividends were too generalized to support a strong inference of scienter, and in any event the company had sufficiently disclosed all pertinent financial information to the market. Further, the court determined that the company's allegedly "labyrinthine" financial disclosures were not alone enough to support an inference of scienter, and the plaintiff failed to allege that the company intended to confuse investors. The court likewise rejected the plaintiffs' argument that the company's bonus structure incentivized officers to delay a reduction in dividends because the plaintiffs failed to plead any "additional or unusual" facts concerning the compensation scheme.

District Court Dismisses Section 10(b) Claim Against Intercloud Systems

Muncy v. Intercloud Sys., Inc., No. 14-111-DBL
(E.D. Ky. Mar. 10, 2015)
Click here to view the opinion.

Judge David L. Bunning of the U.S. District Court for the Eastern District of Kentucky granted in part and denied in part a motion to dismiss claims alleging violations of Section 10(b) of the Securities Exchange Act, Kentucky's Blue Sky Laws and state common law. The plaintiff claimed that the defendant's agents induced him to purchase stock in the company by making false statements and omitting material facts regarding a future initial public offering. In dismissing the Section 10(b) claim, the court held that certain statements concerned "predictions and matters of opinion" and were not actionable because (1) the plaintiff failed to plead facts showing that the defendant made the statement with knowledge of its falsity, and (2) predictions of profit and growth are not actionable unless backed by a guarantee or linked to a misleading statement. The court further concluded that, although a reasonable jury could find that at least one of the statements was misleading, the misstatement was not material because accurate information was publicly available in the defendant's SEC filings.

In addressing the alleged omissions, the court held that the defendant had a duty to disclose that the shares were not registered and the plaintiff would not be able to trade on them because a reasonable investor would consider this information important. The court concluded, however, that there was no liability under Section 10(b) for the alleged omissions because the complaint did not raise a strong inference that the defendant acted with scienter. Accordingly, the plaintiff's claim under Section 10(b) was dismissed. Because Rule 9(b) and the PSLRA do not apply to Kentucky's Blue Sky Laws, and the defendant failed to raise specific arguments as to why those claims should be dismissed, the court denied the defendant's motion to dismiss as to the Blue Sky Law claims.

SDNY Upholds Claims That a Pharmaceutical Company Acted With Scienter in Partially Disclosing Study Results

In Re Intercept Pharm., Inc. Sec. Litig., No. 1:14-cv-01123-NRB
(S.D.N.Y. Mar. 4, 2015)
Click here to view the opinion.

Judge Naomi Reice Buchwald of the U.S. District Court for the Southern District of New York refused to dismiss claims by a putative shareholder class that a pharmaceutical company violated Section 10(b) of the Securities Exchange Act by concealing negative developments in a drug study. The plaintiffs alleged that the company publicly disclosed that it was ending a drug trial after certain positive results, but concealed other allegedly negative findings until the following day. The company's stock price rose on news of the former disclosure and fell on the subsequent disclosure. The court upheld the claims on one of the plaintiffs' two theories of scienter. Although the plaintiffs alleged that the company wanted to increase and maintain its stock price prior to a proposed secondary offering, that offering was four months away, and thus that theory was "too generalized" to support an inference of scienter. However, certain alleged internal emails demonstrated that management knew of the related negative information at the time of the first disclosure and consciously decided not to disclose it. The court further determined that the "selective disclosure" of only the positive information created a "real possibility of misleading investors," and supported a strong inference of knowing misconduct. The court declined to hold at this stage of the proceeding that the information was immaterial because the plaintiffs had sufficiently alleged that it was at least a "significant" part of the company's decision to end the drug trial.

Statutes of Repose/Statutes of Limitations

Tenth Circuit Holds That Tolling Agreement Cannot Toll Time Limit Under Federal Extender Statute, Yet Equitable Estoppel Principles Preclude Use of a Limitations Defense

Nat'l Credit Union Admin. Bd. v. Barclays Capital Inc.,
No. 13-3183 (10th Cir. Mar. 3, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Tenth Circuit reversed a district court's ruling that the Securities Act's statute of repose barred claims by the National Credit Union Administration (NCUA) against the issuers and underwriters of certain residential mortgage-backed securities. The district court had previously held that the NCUA's federal extender statute pre-empted the Securities Act's statute of repose but that the NCUA's claims were still untimely because the three-year period in the extender statute could not be tolled by agreement. The Tenth Circuit, citing its recent decision in *Nat'l Credit Union Admin. Bd. v. Nomura Home Equity Loan, Inc.*, 764 F.3d 1199 (10th Cir. 2014), reaffirmed its holding that the federal extender statue is a statute of limitations that supplants the Securities Act's three-year statute of repose for suits brought by the NCUA as a conservator or receiver. The court further held that the NCUA's claims were untimely because they were brought outside the federal extender statute's three-year limitation, and the tolling agreement in the case could not toll the limitations period in contravention of the express language of the extender provision that its "limitations period cannot be tolled by agreement." However, the court determined that, although the claims were untimely, the defendant was equitably estopped from asserting the defense because it had expressly agreed not to do so during settlement negotiations, and the NCUA had relied on that promise. The court determined that the extender statute, in this context, operates like a statute of limitation rather than a statute of repose, and thus equitable estoppel may apply where an express promise was made not to assert the limitations period as a defense. In a recent decision by the U.S. District Court for the District of Kansas, the court adopted the Tenth Circuit's reasoning in Barclays and reconsidered its prior dismissal of claims against two defendants as time-barred. *Nat'l Credit Union Admin. Bd. v. UBS Securities, LLC*, No. 12-2591-JWL (D. Kan. May 27, 2015). As in *Barclays*, the court determined that the tolling agreements at issue were not enforceable with respect to the extender statute, but that two of the defendants also had agreed not to raise the limitations period as a defense and thus were equitably estopped from doing so. However, as to a third defendant that entered into a tolling agreement without making a "separate express promise" about raising the defense, the court refused to apply equitable estoppel, even though the NCUA argued that such a promise was "implied" in the tolling agreement.

SDNY Finds That FDIC Extender Provision Does Not Pre-Empt the Securities Act's Statute of Repose

F.D.I.C. v. Bear Stearns Asset Backed Sec. I LLC,
No. 1:12-cv-04000-LTS (S.D.N.Y. Mar. 24, 2015)
Click here to view the opinion.

Judge Laura Taylor Swain of the U.S. District Court for the Southern District of New York dismissed claims brought under Section 11 of the Securities Act by the Federal Deposit Insurance Corporation (FDIC) as receiver for two banks because the claims were time-barred by the Securities Act's statute of repose. The court rejected the FDIC's argument that the statute of repose was pre-empted by the FDIC Extender Provision of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which provides a six-year statute of limitations for contract claims brought by the FDIC as a receiver. The court determined that the Supreme Court's recent decision in *CTS Corp. v. Waldburger*, 134 S. Ct. 2175 (2014), which held that a similar extender provision did not pre-empt a state statute of repose, implicitly overturned prior law in the Second Circuit that held that such extender provisions may pre-empt a statute of repose. Applying *Waldburger*, the court determined that the text of the FDIC Extender Provision did not include any "reference to any statute of repose," indicating that Congress intended only to displace otherwise applicable statutes of limitations, and not statutes of repose. The court noted the Tenth Circuit's potentially conflicting decision in *Nat'l Credit Union Admin. Bd. v. Nomura Home Equity Loan, Inc.*, 727 F.3d 1246 (2013), and explicitly disagreed, noting that the "concepts of claim accrual, and measurement from events distinct from the actions of the defendant, are entirely inconsistent with the conceptual and practical framework of statutes of repose." The FDIC has appealed this decision to the U.S. Court of Appeals for the Second Circuit. The FDIC also has appealed a prior decision, issued in the Southern District of New York in September 2014, dismissing the FDIC's claims as time-barred on the same grounds. *FDIC v. Chase Mortg. Fin. Corp.*, No. 12-cv-6166, 2014 WL 4354671 (S.D.N.Y. Sept. 2, 2014). That appeal now is awaiting oral argument.

Northern District of Ohio Dismisses, in Part, Claims Against Brokerage Firms for Distributing Unregistered Securities

In re Biozoom, Inc. Sec. Litig., No. 1:14-CV-01087-JSG
(N.D. Ohio Feb. 26, 2015)
Click here to view the opinion.

Judge James S. Gwin of the U.S. District Court for the Northern District of Ohio dismissed, in part, claims brought against several brokerage firms for allegedly selling unregistered securities in violation of Section 12(a)(1) of the Securities Act. The defendants argued that many of the plaintiffs' claims were time-barred because a Section 12(a)(1) action must be brought within one year of the alleged violation, and the plaintiffs had filed most of their claims more than a year after purchasing the securities at issue. The plaintiffs countered that because Section 12(a)(1) prohibits both selling and offering unregistered securities, the one-year limitations period did not begin to run until the defendants stopped *offering* the stock. Citing Supreme Court precedent interpreting Section 12(a)(1) to require "some nexus with an actual sale" (*Pinter v. Dahl*, 486 U.S. 622, 644 (1988)), the court ruled that a violation occurs when an unregistered security is sold, even if the defendant subsequently continues to promote the security. Accordingly, the court dismissed many of the plaintiffs' claims as untimely.

The defendants argued that the remaining claims should be dismissed because the defendants were not "sellers" within the meaning of Section 12(a)(1), and because the Securities Act's dealer and broker transaction exemptions shielded them from liability. The court disagreed, determining that (1) the plaintiffs had plausibly alleged that the defendants sold the at-issue securities directly to them and (2) the defendants had not met their burden of establishing their entitlement to either exemption from the registration requirement. Consequently, the court declined to dismiss the plaintiffs' remaining claims.

Whistleblower Protections

SDNY Dismisses Whistleblower Claim Under CFPA as Matter of First Impression

Murray v. UBS Sec., LLC, No. 1:14-cv-00927 KPF
(S.D.N.Y. Feb. 24, 2015)
Click here to view the opinion.

Judge Katherine P. Failla of the U.S. District Court for the Southern District of New York dismissed a claim that an employer violated the anti-retaliation provisions of the Consumer Financial Protection Act (CFPA) by allegedly terminating an employee because of his refusal to publish misleadingly optimistic research about commercial mortgage-backed securities (CMBS). The court determined as a "matter of first impression" that the plaintiff's CFPA claim was only viable if the Consumer Financial Protection Bureau had designated CMBS as covered financial products under the statute's catch-all provision. Because the agency had not done so, the court dismissed the claim. The court did not dismiss, however, the plaintiff's claim pursuant to the Sarbanes-Oxley Act, even though the plaintiff had previously filed a claim under the Dodd-Frank Act based on the same facts, because the plaintiff's subsequently filed claim had not yet accrued at the time of his first lawsuit. In addition, the court also declined to stay the Sarbanes-Oxley claim pending resolution of the employee's Dodd-Frank claims, which had been ordered to arbitration. The court reasoned that, in light of the anti-arbitration provision in Sarbanes-Oxley, it would be "curious to stay litigation of such a statutory claim so that arbitration might proceed unimpeded on a different claim."

Inside the Courts
An Update From Skadden Securities Litigators

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