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Skadden

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Auction Rate Securities

D. Mass. Enters Summary Judgment Dismissing Claims That Financial Institutions Provided Misleading Information Regarding Auction Rate Securities

Tutor Perini Corp. v. Banc of Am. Sec. Litig., No. 11-10895-NMG (D. Mass. Aug. 12, 2015)
Click here to view the opinion.

Judge Nathaniel M. Gorton of the U.S. District Court for the District of Massachusetts granted summary judgment for the defendants on an investor's claim that a bank and an affiliated broker-dealer violated Section 10(b) of the Securities Exchange Act by concealing material information in connection with certain auction rate securities, which were allegedly unsuitable to the plaintiff. The plaintiff allegedly sustained losses when the market for certain student loan auction rate securities collapsed. The court dismissed all claims against the bank because the plaintiff "failed to identify any misconduct" on the part of that party. Further, although the plaintiff asserted in its briefing papers that the bank was "liable as a controlling person," the plaintiff had "not made that claim in its pleadings." As to the broker-dealer, the court held that the allegedly concealed information about the securities had, in fact, been disclosed to the plaintiff or was available in public documents. In addition, the plaintiff failed to demonstrate the element of reliance. A presumption of reliance was not available because the court found that the defendant had not concealed material information, and the plaintiff could not demonstrate actual reliance because it was a sophisticated investor which "received numerous written disclosures about the risks of auction failure." Regarding the plaintiff's unsuitability claim, the court noted that sophisticated investors like the plaintiff "have difficulty establishing" such a claim and dismissed the claim because the court had already concluded that the defendant did not make any material misstatements. The plaintiff was provided with a prospectus that provided disclosures with respect to suitability. The plaintiff has filed a notice of appeal to the U.S. Court of Appeals for the First Circuit.

Class Actions — Class Action Fairness Act

District Court Denies Remand Without Prejudice, Finds Plaintiffs Failed to Meet Their Evidentiary Burden to Show CAFA Exception Applied, Permits Jurisdictional Discovery

Calderon v. Total Wealth Mgmt., Inc., No. 15CV1632 BEN (NLS) (S.D. Cal. Oct. 8, 2015)
Click here to view the opinion.

Judge Roger T. Benitez of the U.S. District Court for the Southern District of California denied the plaintiffs' motion to remand a putative class action to California state court, finding that the plaintiffs failed to show by a preponderance of the evidence that one of the exceptions to the Class Action Fairness Act (CAFA) applied.

Twenty-seven named plaintiffs seeking to represent a class of investment advisory clients asserted 14 state law claims against the defendants — purported investment advisers — alleging that the defendants were routing the plaintiffs' funds to investment companies that were paying the defendants a percentage of the money they generated from the funds.

The defendants removed the case to federal court pursuant to CAFA. Under CAFA, federal courts have jurisdiction over certain class actions if the class has more than 100 members, the parties are minimally diverse and the amount in controversy exceeds $5 million. Both parties agreed that those elements were satisfied. The plaintiffs moved to remand, however, arguing that two exceptions to CAFA jurisdiction applied — the local controversy and home-state controversy exceptions.

For the local controversy and home-state controversy exceptions to apply, more than two-thirds of the proposed class must be citizens of the state in which the action is brought. Here, the 27 named plaintiffs were all citizens of California. However, the class was estimated to contain between 400 and 800 members. The only other evidence the plaintiffs submitted regarding the citizenship of class members was a declaration asserting that the plaintiffs' counsel had received inquiries about the case by other plaintiffs that would fit into the class, and every potential class member was a California resident.

The court first noted that, while the two concepts are related, citizenship is not the same as residency. Moreover, the court reasoned that although the court is permitted to make reasonable inferences from facts in evidence, concluding that more than two-thirds of a class of hundreds are California citizens based on the assertion that inquiries have been received and some unknown number of people calling are California residents is not a reasonable inference. The court emphasized that jurisdictional findings of fact should be based on more than guesswork, and the evidence in the record did not support a conclusion that two-thirds of class members were California citizens.

The court allowed plaintiffs to conduct limited jurisdictional discovery tailored to the two-thirds issue and granted leave to file a renewed motion to remand within 90 days.

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ERISA

District Court Refuses to Dismiss Putative Class Action Brought Under ERISA

Murray v. Invacare Corp., No. 1:13 CV 1882
(N.D. Ohio Aug. 28, 2015)
Click here to view the opinion.

Judge Donald C. Nugent of the U.S. District Court for the Northern District of Ohio refused to dismiss a putative class action complaint brought under the Employee Retirement Income Security Act (ERISA). The plaintiff, a participant in her employer's retirement plan, alleged that plan fiduciaries breached their duties of prudence and loyalty under ERISA when they allowed participants to acquire more shares of the employer's stock though they knew the stock was an imprudent investment. According to the plaintiff, the defendants held material, nonpublic, negative information about the company's compliance with Food and Drug Administration safety and compliance standards.

The defendants first argued that the plaintiff failed to state a claim for breach of the fiduciary duties of prudence and loyalty under the pleading standards set forth by the U.S. Supreme Court in *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459 (2014). The court rejected this argument, reasoning that *Dudenhoeffer* requires the court to consider "whether the complaint has plausibly alleged that a prudent fiduciary in the defendant's position could not have concluded that stopping purchases ... would do more harm than good to the fund by causing a drop in the stock price and a concomitant drop in the value of the stock already held by the fund." 134 S. Ct. at 2473. Because the plaintiff alleged that a prudent fiduciary in the defendants' position could have concluded that stopping plan participants from further investing in the company stock would not have caused the plan more harm than good, the court concluded that the plaintiff met her pleading burden.

The defendants further argued that the plaintiff failed to allege loss causation under *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005). The court also rejected this argument, concluding that the plaintiff identified three stock price drops that occurred in reaction to revelations of the truth by the company, which was sufficient to state an artificial inflation claim under *Dura Pharmaceuticals*. Accordingly, the court denied the defendants' motion to dismiss and allowed the putative class action to proceed.

Fiduciary Duties — Mergers and Acquisitions

Delaware Supreme Court Applies Business Judgment Rule to Merger Transaction Approved by Disinterested, Fully Informed Stockholders

Corwin v. KKR Fin. Holdings LLC, No. 629, 2014 (Del. Oct. 2, 2015)
Click here to view the opinion.

The Delaware Supreme Court affirmed a prior ruling by the Court of Chancery dismissing a complaint challenging a merger that was approved by a vote of fully informed, disinterested stockholders.

In the opinion below, the Court of Chancery held that a stock-for-stock merger between KKR & Co. L.P. (KKR) and KKR Financial Holdings LLC (Financial Holdings) was subject to business judgment review. The plaintiffs had argued that KKR was a controlling stockholder of Financial Holdings because, even though KKR owned less than 1 percent of Financial Holdings, KKR managed Financial Holdings through an affiliate under a contractual management agreement that could only be terminated by Financial Holdings if it paid a termination fee. The Court of Chancery found KKR was not a controlling stockholder and entire fairness did not apply. The Court of Chancery also found that enhanced scrutiny under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), did not apply because "the transaction was approved by an independent board majority and by a fully informed, uncoerced stockholder vote" and dismissed the case under the business judgment rule.

Affirming the Court of Chancery's decision, the Supreme Court explained that the business judgment rule, and not enhanced scrutiny under *Revlon*, is the appropriate standard of review for a disinterested merger transaction approved by an uncoerced, informed vote of stockholders. In so holding, the Supreme Court clarified its prior decision in *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009), explaining that *Gantler* dealt with the narrow issue of ratification and did not address the applicable standard of review governing merger transactions approved by fully informed stockholders.

Delaware Supreme Court Finds Allegations Challenging Director Independence Sufficient to Plead Demand Futility

Delaware Cnty. Emps. Ret. Fund v. Sanchez, No. 702, 2014
(Del. Oct. 2, 2015)
Click here to view the opinion.

The Delaware Supreme Court reversed the Court of Chancery's dismissal of a complaint for failure to plead demand futility.

The transaction at issue involved a multimillion dollar payment to a private company, Sanchez Resources, LLC, wholly owned by the family of A.R. Sanchez, Jr., from a public company, Sanchez Energy Corporation, in which the Sanchez family owned a 16 percent interest.

The appeal focused on whether plaintiffs had raised a pleading-stage doubt about the independence of one of the public company directors from another interested director. According to the complaint, the two directors had been close friends for more than five decades, and the otherwise disinterested director's personal wealth was largely attributable to business interests over which the interested director had substantial influence. The Supreme Court explained that these allegations did not amount to the kind of "thin social-circle friendship" the court typically rejects as demonstrating a director's lack of independence, and found that these allegations were instead sufficient to plead demand futility.

Delaware Court of Chancery Dismisses Aiding and Abetting Claim Against Financial Advisor

In re Zale Corp. Stockholders Litig., No. 9388-VCP
(Del. Ch. Oct. 1, 2015)
Click here to view the opinion.

Vice Chancellor Donald F. Parsons, Jr. of the Delaware Court of Chancery denied a motion to dismiss aiding and abetting breach of fiduciary duty claims asserted against a financial advisor that had advised a target company in connection with a merger transaction, but later granted reargument and dismissed the claims.

The case concerns Signet Jewelers Ltd.'s acquisition of Zale Corporation, which merger the court found was approved by a disinterested majority of Zale's stockholders in a fully informed vote. With respect to breach of the fiduciary duty claim asserted against Zale's directors, the court held that: (1) duty of care claims against the directors were barred by Zale's exculpatory charter provision, (2) no duty of loyalty violation was alleged because plaintiffs only claimed that up to four of the nine directors were conflicted — meaning a majority were independent and disinterested, and (3) none of the alleged "flaws" in the sale process rose to the level of bad faith. The court accordingly dismissed those claims.

However, the court found that plaintiffs stated a claim for aiding and abetting against Merrill Lynch, Zale's financial advisor in the transaction, based on the Zale board members' alleged breaches of the duty of care. Before the financial advisor was engaged by Zale, the financial advisor made a presentation to Signet regarding a possible acquisition of Zale. While Merrill Lynch was not hired for that work, a managing member of the financial advisor was on both the team that made the presentation to Signet and the team that advised the Zale board during the merger process. The court found that the board's failure to uncover this potential conflict "arguably" constituted gross negligence sufficient to state a claim for breach of the duty of care, and that the financial advisor knowingly participated in such breach because it knew of the alleged conflict and failed to disclose it.

On October 30, 2015, Vice Chancellor Parsons granted Merrill Lynch's motion for reargument and dismissed the case in its entirety. The court reversed its earlier decision based on the Delaware Supreme Court's decision in *Corwin v. KKR Financial Holdings*, which was issued one day after the original *Zale* opinion. Vice Chancellor Parsons held that under *KKR*, the operative standard of review was not enhanced scrutiny under *Revlon*, as he had previously held, but instead reverted to the business judgment rule based on the fully informed vote of Zale stockholders. Under the business judgment standard, the court held that the conduct of the directors did not violate the business judgment rule, and therefore no breach of fiduciary duty was pleaded. Because there was no primary breach of fiduciary duty, there could be no aiding and abetting claim against Merrill Lynch. Therefore, the court dismissed the remaining claim against Merrill Lynch, which disposed of the case in its entirety.

Fraud-on-the-Market Theory

SDNY Holds, for Purposes of Certification, That Plaintiffs Do Not Have to Demonstrate Price Impact to Prove Market Efficiency

Carpenters Pension Trust Fund of St. Louis v. Barclays PLC,
No. 12-cv-5329 (SAS) (S.D.N.Y. Aug. 20, 2015)
Click here to view the opinion.

Judge Shira A. Scheindlin of the U.S. District Court for the Southern District of New York certified a class of shareholders in an action that alleged that an investment bank violated Section 10(b) of the Securities Exchange Act by allegedly understating its borrowing costs through public statements and false London Interbank Offered Rate (Libor) submissions. The court held that the plaintiffs were entitled to a presumption of reliance at the class certification stage because the plaintiffs' expert established that the alleged misstatements were public and material, and that the stock was traded in an efficient market. In determining whether the market for the stock was efficient, the court examined the factors set forth in *Cammer v. Bloom*, 711 F. Supp. 1264, 1283-87 (D.N.J. 1989). The court rejected the defendants' argument that failure to satisfy the fifth factor — evidence of price changes after disclosure of material information, which the plaintiffs did not attempt to prove — was dispositive. At least in cases involving a "high-volume stock followed by a large number of analysts and traded on a national exchange," the court held that no single factor is dispositive and that the plaintiffs were not required to prove the fifth factor through an event study, although the defendants could have utilized price impact evidence themselves to attack the presumption of reliance under the U.S. Supreme Court's decision in *Halliburton Co. v. Erica P. John Fund Inc.*, 134 S. Ct. 2398 (2014). Considering the other *Cammer* factors, the court determined that the market for the bank's shares was efficient because the bank's shares were listed on the New York Stock Exchange, the bank was covered by a large number of analysts, its shares were traded at a high volume, there were a sufficient number of market makers, the bank's market capitalization was high, the market was liquid and the bank was eligible to file SEC Form S-3. However, as to the alleged omission claims, the court concluded that the plaintiffs were not entitled to a presumption of reliance because their claims were not truly based on omissions, and in any event, the defendants had no duty to disclose the allegedly concealed information. In addition, the court held that the plaintiffs' damages model matched its theory of liability and "survive[d] the minimal scrutiny required" at the class certification stage, despite noting that "significant obstacles" may remain at the merits stage.

Loss Causation

SDNY Enters Summary Judgment and Reaffirms Loss Causation Requirement in Fraudulent Inducement Claim

In re Lehman Bros. Sec. & ERISA Litig., No. 09-md-2017 (LAK) (S.D.N.Y. Sept. 10, 2015)
Click here to view the opinion.

Judge Lewis A. Kaplan of the U.S. District Court for the Southern District of New York granted summary judgment on claims that a former auditor of Lehman Brothers violated Section 10(b) of the Securities Exchange Act in connection with certain cash settled call warrants that tracked the performance of a particular investment fund. The warrants became worthless when Lehman filed for bankruptcy during the financial crisis. The plaintiff's claims against the auditor were based on certain alleged misstatements in audited financial documents filed by Lehman with the SEC and incorporated by reference into the offering memorandum of the warrants. The court held that the plaintiff failed to sufficiently allege loss causation, even though the plaintiff sought only rescissory damages and the securities were not publicly traded and were illiquid even before Lehman's bankruptcy. The plaintiff "relie[d] heavily on two dated Second Circuit precedents" — *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167 (2d Cir. 1970) and *Clark v. John Lamula Investors, Inc.*, 583 F.2d 594 (2d Cir. 1978) — which held that rescissory damages were appropriate for instances where an investor is fraudulently induced into purchasing a security. The court, however, found that those cases were inconsistent with the "current doctrine on loss causation, not to mention the Private Securities Litigation Reform Act (the 'PSLRA')," and observed that loss causation is an explicit requirement under the PSLRA. The court also took note of the law in other circuits, which likewise holds that proof of loss causation is required even for fraudulent inducement claims, and therefore the plaintiff had "a theory of causation that simply is not tenable." The plaintiff has filed a notice of appeal to the U.S. Court of Appeals for the Second Circuit.

Manipulative Scheme

SDNY Dismisses Claims in Connection With Alleged High-Frequency Trading

In re Barclays Liquidity Cross & High Frequency Trading Litig., No. 14-MD-2589 (JMF) (S.D.N.Y. Aug. 26, 2015)
Click here to view the opinion.

Judge Jesse Furman of the U.S. District Court for the Southern District of New York dismissed claims that certain stock exchanges and a financial institution violated Section 10(b) of the Securities Exchange Act by participating in certain alleged high-frequency trading (HFT) practices. Specifically, the complaint alleged that the defendants allowed subscribing HFT firms to obtain proprietary information about trading activity directly from the exchanges, allowed "co-location" (*i.e.*, allowing high-frequency traders to install "servers at, or extremely close to, the servers used to operate the Exchanges") and allowed HFT traders to use complex order types that were unavailable to ordinary investors. The plaintiffs further alleged that the exchanges favored the HFT firms over other investors because the exchanges profited from trading volume, and HFT firms drive up trading volume. The court dismissed the complaint for two reasons. First, it noted that in the securities context, "manipulation" is a term of art that requires an artificial effect on the price of a security, and the plaintiffs did not allege any artificial effect. Further, the exchange defendants had not concealed the "availability of proprietary data feeds and co-location services, and both were publicly approved by the SEC." In addition, the court noted that manipulative-scheme claims implicate only primary violations, and "the most that the Complaints can be said to allege is that the Exchanges aided and abetted the HFT firms' manipulation of the market price." With respect to claims against the financial institution, the court further held that the plaintiffs had failed to plead reliance because the plaintiffs did "not point to any statements by [the financial institution] that could have affected the price at which they decided to trade." Similarly, the plaintiffs were not entitled to a presumption of reliance under *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972), because the gravamen of the claims was based on alleged false statements — that the defendant promoted a private exchange called a "dark pool" as a safe place to trade — and not on an omission. Finally, the court declined to accept the plaintiffs' invitation "to apply a novel presumption of reliance based on the fairness and integrity of the market" because such a theory of reliance "would effectively excuse" plaintiffs from proving the element of reliance "for any market-manipulation claim." The plaintiffs have filed a notice of appeal to the U.S. Court of Appeals for the Second Circuit.

Misrepresentations

SDNY Dismisses Claims Against Oil and Gas Company Because Alleged Misrepresentations Were Not Pleaded With Particularity

In re PetroChina Co. Sec. Litig., No. 13-cv-6180 (ER) (S.D.N.Y. Aug. 3, 2015)
Click here to view the opinion.

Judge Edgardo Ramos of the U.S. District Court for the Southern District of New York dismissed claims that an oil and gas company violated Section 10(b) of the Securities Exchange Act by falsely representing in annual reports that it had adequate internal controls, complied with applicable laws and maintained high standards of governance and ethics. The plaintiffs alleged that the representations were false because the company and certain of its officers and directors became subject to corruption investigations and disciplinary action in China, and certain of the company's suppliers were under similar investigations. The court determined that the complaint failed to allege a false statement because "rather than precisely identifying the statements" that were purportedly false, the complaint "simply contains large block quotations" from two annual reports, the company's ethics policy and its website, and alleges in conclusory fashion that several paragraphs in those materials were false. Further, the complaint "relie[d] on allegations of bribery and corruption that postdate the time period covered by the 2011 and 2012 annual reports," from which the plaintiffs purported to identify false statements. The court further determined that although the scienter of employees, if any, could be imputed to the company, the plaintiffs failed to adequately plead scienter because the plaintiffs had not alleged facts that showed that any defendant had the motive and opportunity to commit the alleged fraud. The court noted that the complaint failed to allege that any of the individuals "were engaged in corruption of any kind at the time or prior to when the false statements were made and therefore possessed a motive to commit securities fraud." The plaintiffs have filed a notice of appeal to the U.S. Court of Appeals for the Second Circuit.

Scienter

Ninth Circuit Reverses Dismissal of Securities Fraud Claims, Holds Intent of CEO Can Be Imputed to Corporation, Even Where CEO Was Embezzling Funds From Company

Costa Brava Partnership III LP v. ChinaCast Educ. Corp., No. 12-57232 (9th Cir. Oct. 23, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Ninth Circuit reversed the dismissal of claims brought under Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder against an online for-profit education service, holding that a CEO's scienter could be imputed to the defendant corporation even though the CEO acted against the corporation's interest.

The plaintiff shareholders brought suit after it was discovered that the defendant's CEO had intentionally falsified numerous public filings while looting the company of a sizable chunk of its assets. The plaintiffs claimed that the CEO's scienter could be imputed to the corporation because its board of directors failed to take corrective action after a 2011 external audit disclosed that the company suffered from "serious internal control weaknesses." The district court dismissed the suit with prejudice, ruling that under the common law's "adverse interest exception" to the doctrine of *respondeat superior,* scienter could not be imputed to a principal from the fraud of a rogue agent who acted against the interests of the principal.

In reversing the district court, the Ninth Circuit held that the adverse interest exception itself contains an exception: A principal is still liable for the fraud of a rogue agent when an innocent third party relies in good faith on the agent's apparent authority. Thus, because the CEO was authorized to speak on the defendant's behalf, and shareholders had innocently relied on the CEO's fraudulent misrepresentations, the CEO's scienter could still be imputed to the defendant corporation.

The court recognized that this rule may eliminate the adverse interest exception for clean hands plaintiffs. Citing the Third Circuit's analysis in a similar case, however, the court argued that its approach best advances the public policy goals of both securities and agency law. Namely, holding corporations liable for the fraud of rogue executives fairly allocates risk away from innocent investors and encourages corporate boards to closely monitor high-level officials to detect securities fraud. Here, because the corporation's board had failed to institute effective internal controls despite outside warnings, the corporation was not immune from liability under the securities laws.

Second Circuit Vacates Dismissal of Claims Against Chinese Oil Exploration Company and Its Former CEO but Affirms Dismissal as to Directors and Certain Other Officers

Acticon AG v. China Ne. Petroleum Holdings Ltd., No. 15-172-cv (2d Cir. Aug. 28, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Second Circuit vacated in part the dismissal of claims against a Chinese oil exploration company for allegedly violating Section 10(b) of the Securities Exchange Act by making material misrepresentations concerning the company's internal controls. The plaintiffs alleged that the company's former CEO misrepresented the adequacy of the company's internal controls while at the same time engaging in unauthorized transfers of company funds. The Second Circuit determined that the plaintiffs adequately alleged scienter because the CEO had motive and opportunity to commit fraud and personally benefited from the alleged fraud. Likewise, the plaintiffs adequately alleged scienter as to the company because, as the company's CEO, the individual defendant's fraudulent intent could be imputed to the company. However, the Second Circuit found that the plaintiffs failed to adequately allege scienter as to other directors and officers of the company. The plaintiffs' general allegations that the directors and officers were reckless in failing to identify errors in the company's internal controls and accounting statements were insufficient in and of themselves to show scienter. In addition, as to at least one of the individual defendants, allegations that the individual made efforts to uncover the alleged fraud undermined any inference of scienter.

Eighth Circuit Upholds Summary Judgment Against Limited Liability Company for Violations of the Securities Exchange Act

Doud v. Toy Box Dev. Co., 798 F.3d 709 (8th Cir. Aug. 18, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Eighth Circuit upheld summary judgment against a limited liability company (LLC) for violations of Section 10(b) of the Securities Exchange Act and Rules 10b-9 and 10b-5 thereunder, as well as state and common law claims. The plaintiff alleged that the LLC violated federal securities law when it released escrow funds to itself before securing the necessary capital required by the offering. The district court concluded that the LLC's conduct violated Rules 10b-9 and 10b-5 and specifically determined that the plaintiff had established the scienter required to find violations of the Securities and Exchange Commission's rules.

The Eighth Circuit agreed with the district court that the LLC violated Rule 10b-9 and acted with the necessary scienter by breaking escrow before reaching the minimum capital required by the offering and by misrepresenting to investors that it had reached the minimum capital required by the offering. The court rejected the LLC's argument that it had the minimum capital amount in subscriptions at the time it broke escrow, reasoning that it is not enough for the seller merely to have commitments to buy the security being sold. The court further held that the facts were sufficient to show that the LLC employed a manipulative or deceptive device or contrivance in connection with a sale of security in violation of Rule 10b-5.

Securities Fraud Pleading Standards — Omissions

Sixth Circuit Affirms Dismissal of Section 10(b) Claim Against Yum! Brands

Bondali v. Yum! Brands, Inc., No. 15-5064 (6th Cir. Aug. 20, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Sixth Circuit affirmed the dismissal of a securities class action on the grounds that the plaintiffs failed to state a claim upon which relief could be granted. The plaintiffs brought Securities Exchange Act claims under Sections 10(b), 20(a) and Rule 10b-5 against Yum! Brands and certain corporate officers, alleging that the defendants made false or misleading statements by failing to disclose (1) that chicken being supplied to Yum's KFC China subsidiary had tested positive for drug and antibiotic residues, and (2) that Yum's food standards and safety protocols were inadequate.

The Sixth Circuit rejected the plaintiffs' arguments, agreeing with the district court that the plaintiffs failed to allege a material misrepresentation or omission because they did not assert facts demonstrating the defendants' statements were "objectively false or misleading in light of the information now known," *In re Omnicare, Inc., Sec. Litig.*, 769 F.3d 455, 478 (6th Cir. 2014). The panel further rejected the plaintiffs' contention that courts should consider the overall impression created by the statements at issue when determining whether the defendants' omissions rendered the statements false or misleading, remarking that Sixth Circuit precedent mandated that such an analysis be conducted on a statement-by-statement basis.

The Sixth Circuit also held, in the alternative, that the plaintiffs failed to adequately plead a strong inference of scienter, noting that mere allegations of motive and opportunity are not enough to give rise to the necessary inference.

SDNY Applies *Omnicare* to Dismiss Claims That Insurer's Opinions About Financial Reserves Were False

City of Westland Police & Fire Ret. Sys. v. Metlife, Inc., No. 12-cv-0256 (S.D.N.Y. Sept. 11, 2015)
Click here to view the opinion.

Judge Lewis A. Kaplan of the U.S. District Court for the Southern District of New York, applying the U.S. Supreme Court's recent decision in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, dismissed claims that an insurer violated Section 10(b) of the Securities Exchange Act by failing to disclose, in connection with the company's reserves, certain death benefits that had been incurred but not yet reported by insureds. Applying *Omnicare*, the court held that the company's statements of opinions were not false or misleading because the plaintiff failed to allege that the company disbelieved its opinions or that it concealed facts that "call[ed] into question the [company's] basis for offering the opinion." Although the company's 2007 "cross-check" of its life insurance records against a government database had revealed certain unpaid death benefits, it did not reveal a shortage in the company's reserves, as alleged by the plaintiff, and the complaint did not plausibly allege that the company believed its reserves were inadequate at that time. Further, the plaintiff failed to allege that the company's calculations "ran afoul of the customs and practices of the life insurance industry" or otherwise "did not comport with what a reasonable person reading the Company's financial statements fairly and in context would have expected." In addition, as to other statements by the company which the court determined to be statements of fact rather than opinion, the plaintiff failed to adequately allege scienter. Although the company's previously disclosed mortality rates were inaccurate in light of the discovery of additional unreported deaths, the complaint's allegations were "conclusory" and failed to plead facts giving rise to a strong inference that the company intended to deceive investors. The plaintiff additionally failed to allege that the company violated SEC Regulation S-K, Item 303 by failing to disclose "known uncertainties" concerning its allegedly inadequate reserves and the potential for regulatory penalties because, as discussed above, the company was not aware of the likelihood of potential fines or liabilities related to its reserves, and the court declined to "punish" the company for "failing to foresee something that [the plaintiff] has not shown was reasonably foreseeable."

Standing

District Court Dismisses Exchange Act Claims Brought Against Nonissuing Company

In re Altisource Portfolio Sols., S.A. Sec. Litig., No. 14-81156 (S.D. Fla. Sept. 4, 2015)
Click here to view the opinion.

Judge William P. Dimitrouleas of the U.S. District Court for the Southern District of Florida dismissed claims under Sections 10(b) and 20(a) of the Securities Exchange Act brought by shareholders of Altisource Portfolio Solutions, S.A.

In addition to asserting causes of action against Altisource and Altisource officers, the plaintiffs also brought Section 10(b) and 20(a) claims against another company, Ocwen. Altisource was spun off from Ocwen and, according to the plaintiffs' allegations, the two companies continued to do substantial business together following the spin-off. The plaintiffs also alleged that the companies continued to have the same chairman and chief risk officer.

Ocwen moved to dismiss the plaintiffs' claims against it for lack of standing, arguing that the plaintiffs could not assert a federal securities fraud claim against Ocwen when their alleged losses stemmed solely from their purchases of stock in Altisource. In response, the plaintiffs argued that there is an implied right of action in Section 10(b) that covers secondary actors who commit primary violations under the federal securities laws. The plaintiffs further argued that Ocwen affirmatively made statements directly to Altisource shareholders about Altisource and the relationship between the two companies. Moreover, the plaintiffs averred, the close connection between Altisource and Ocwen warranted imposition of liability on Ocwen.

The court rejected the plaintiffs' argument. While the court acknowledged the plaintiffs' attempts to distinguish case law that would otherwise foreclose Section 10(b) actions against other companies, the court noted that the plaintiffs were unable to cite any case in which a court found standing in similar circumstances. Ultimately, the court concluded that the business relationship between the two companies, though substantial, was not enough to confer standing on the plaintiffs in the absence of positive case law.

Statutes of Repose/Statutes of Limitations

Eighth Circuit Affirms Dismissal of Section 10(b) Claim Against Fund Underwriter

Zarecor v. Morgan Keegan & Co., Inc., No. 13-3315
(8th Cir. Sept. 1, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Eighth Circuit affirmed the dismissal of a Securities Exchange Act Section 10(b) claim against the lead underwriter of various mutual funds, holding that the Eastern District of Arkansas had properly ruled the claim was time-barred. The plaintiffs, individual investors, alleged that the underwriter (1) omitted material facts and misrepresented the quality of the funds in conversations with them, and (2) prepared and approved SEC filings, prospectuses and marketing materials that misrepresented and omitted important information about the funds.

In affirming the district court's dismissal of the plaintiffs' claim, the court explained that actions under Section 10(b) must be brought within two years after the violation is discovered, and that the limitations period begins to run when a reasonably diligent plaintiff would have discovered the pertinent facts. The court determined that the plaintiffs discovered the facts constituting the violation more than two years before filing suit, as they had initiated an arbitration with the Financial Industry Regulatory Authority (FINRA) raising similar allegations more than four years before bringing the claim at issue. Moreover, the court rejected the plaintiffs' argument that the FINRA arbitration tolled the statute of limitations, reasoning that the plaintiffs were not required to await the arbitration's outcome before bringing an action in court.

The plaintiffs further argued that, per the U.S. Supreme Court's ruling in *American Pipe & Construction Company v. Utah*, 414 U.S. 538 (1974), the statute of limitations had been tolled during the pendency of an earlier-filed class action brought against the defendant and predicated on the same facts. The court also rejected this argument, concluding that *American Pipe* tolling should be limited to claims filed in a later action that are exactly the same as those alleged in the putative class action. Accordingly, the Eighth Circuit affirmed the lower court's dismissal of the Section 10(b) claim on statute of limitations grounds.

District Court Dismisses Claims Against JPMorgan Chase Arising Out of Madoff Ponzi Scheme

Dusek v. JPMorgan Chase & Co., No. 2:14-cv-184-FtM-29CM
(M.D. Fla. Sept. 17, 2015)
Click here to view the opinion.

Judge John E. Steele of the U.S. District Court for the Middle District of Florida dismissed with prejudice federal securities and racketeering claims brought by 38 of Bernie Madoff's former investors against JPMorgan Chase & Co. (JPMC) and numerous other defendants arising out of JPMC's relationship with Madoff and his company, Bernard L. Madoff Securities LLC (BLMIS).

The plaintiffs' first claim alleged that the defendants were liable under Section 20(a) of the Securities Exchange Act because they controlled Madoff and BLMIS, and were thus derivatively liable for the primary securities law violations Madoff and BLMIS committed. The court rejected this claim for three independent reasons.

First, the court found that the plaintiffs' claims were barred because they violated the statute of repose for Section 20(a) claims. Under 28 U.S.C. § 1658(b), a private action under Section 20(a) must be brought within five years of the primary violation. Under the plaintiffs' allegations, the final violation of Section 20(a) occurred on or before December 11, 2008, the date of Madoff's arrest and BLMIS' closure. Thus, the plaintiffs' right to bring a control person claim under Section 20(a) expired on December 11, 2013. However, the plaintiffs did not initiate the action until March 28, 2014. To avoid this result, the plaintiffs argued that the statute of repose should have been tolled under the rule enunciated in the U.S. Supreme Court case *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974), because of the pendency of a related class action from which the plaintiffs here were ultimately excluded as class members. Although *American Pipe* applied to statutes of limitations, the plaintiffs argued the reasoning of *American Pipe* should apply to the statute of repose at issue here. The court first noted the difference between statutes of limitations and statutes of repose and explained the difficulty with tolling a statute of repose. A statute of repose is a judgment that defendants should be free from liability after the legislatively determined period of time, beyond which the liability will no longer exist and will not be tolled for any reason. In that way, statutes of repose create a substantive right for would-be defendants. That is critical because statutes of repose cannot "abridge, enlarge or modify" a person's substantive rights. Accepting the plaintiffs' argument would have the effect of abridging the defendants' substantive rights. In any event, the court also concluded that the holding in *American Pipe* is equitable — rather than "legal" — in nature and therefore does not extend to the statute of repose provision in 28 U.S.C. § 1658(b).

Second, even if the plaintiffs' claims were timely, the plaintiffs failed to allege that JPMC "controlled" Madoff, BLMIS or the Ponzi scheme as a matter of law. The court noted the plaintiffs' allegations that Madoff refused to allow JPMC to conduct due diligence on his operations; those allegations alone undermine any claim that JPMC controlled Madoff. The court also reasoned that there are no plausible allegations as to why the defendants would knowingly involve themselves in Madoff's inevitably doomed Ponzi scheme in order to earn routine banking fees.

Third, the court found that the plaintiffs failed to allege that they suffered actual damages. Section 28(a) of the Securities Exchange Act limits recovery in any private damages action brought under the act to "actual damages." Here, however, the plaintiffs alleged that they were all net winners, meaning that they withdrew funds from BLMIS in an amount that exceeded their initial investments and subsequent deposits. The plaintiffs also failed to allege any facts that would permit them to recover any losses other than out-of-pocket losses.

The plaintiffs also asserted a federal Racketeer Influenced and Corrupt Organizations Act (RICO) cause of action, alleging that the defendants violated 18 U.S.C. § 1962(c) "by knowingly participating in Madoff's racketeering enterprise." However, the court concluded that this claim was precluded by the PSLRA. Under the PSLRA, "no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of section 1962." Moreover, "[a] plaintiff cannot avoid the RICO bar by pleading other specified offenses, such as mail or wire fraud, as predicate acts in a civil RICO action if the conduct giving rise to those predicate offenses amounts to securities fraud." Here, the plaintiffs' underlying allegations of mail and wire fraud were integrally related to the purchase and sale of securities. Thus, the RICO claims are barred under the PSLRA.

After dismissing both the Section 20(a) and RICO claims with prejudice, the court declined to exercise supplemental jurisdiction over the remaining state law claims and dismissed those without prejudice.

D. Conn. Holds That HERA Extender Statute Applies to Statutes of Repose

Fed. Hous. Fin. Agency v. Royal Bank of Scotland Grp. PLC, No. 3:11-cv-01383 (AWT) (D. Conn. Aug. 21, 2015)
Click here to view the opinion.

Judge Alvin W. Thompson of the U.S. District Court for the District of Connecticut denied a motion for summary judgment filed on claims by the Federal Housing Finance Agency (FHFA) that a bank violated Section 11 and Section 12(a)(2) of the Securities Act by making misrepresentations in offering documents about certain mortgage-backed securities. Although the action was otherwise time-barred by state and federal statutes of repose, the FHFA argued that the Housing and Economic Recovery Act of 2008 (HERA) extender statute overrode those statutes, even though HERA's language addresses only statutes of limitations. The court held that the extender statute applied, even though the U.S. Supreme Court in *CTS Corp. v. Waldburger*, 134 S. Ct. 2175 (2014), had recently held that an analogous extender statute did not apply to statutes of repose because the language of that statute mentioned only statutes of limitations. Although the Court in *Waldburger* identified legislative history (with respect to the statute at issue) demonstrating intent to distinguish between statutes of repose and limitations, Judge Thompson found "nothing comparable in the legislative history of HERA." Further, Judge Thompson rejected the defendants' argument that HERA's reference to an accrual date — a concept used only in the context of statutes of limitations — meant that HERA did not intend to displace statutes of repose. The court determined that HERA "adopts a broader framework in determining the date on which a claim accrues," which permits the limitations period to begin when the injury occurs or when the FHFA is appointed conservator, whichever is later — creating, in the court's view, a "new exclusive time framework" under federal law. The court found the reasoning of the Fifth and Tenth circuits persuasive, each of which determined that an extender statute was intended to create a new federal limitations period displacing conflicting statutes of limitations and repose. *See Nat'l Credit Union Admin. Bd. v. Nomura Home Equity Loan Inc.*, 764 F.3d 1199, 1229 (10th Cir. 2014); *F.D.I.C. v. RBS Sec. Inc.*, 798 F.3d 244, 258-59 (5th Cir. Aug. 10, 2015). In addition, although the court acknowledged the general preference against pre-empting state law, that principle did not apply in this case because unlike *Waldburger*, which involved torts — an area traditionally governed by states — HERA pertains to policing fraud involving federal agencies.

Venue

Second Circuit Affirms Dismissal of Claims Against US-Based Bank on *Forum Non Conveniens* Ground

Rentokil-Initial Pension Scheme v. Citigroup Inc., No. 14-2545-cv (2d Cir. Aug. 25, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims against an investment bank that allegedly violated certain provisions of Luxembourg's Civil Code by misrepresenting the quality of certain euro notes and failing to disclose the associated investment risks. The plaintiff, a United Kingdom-based pension fund, had originally alleged violations of U.K. law and then amended its pleading to include violations of Luxembourg's Civil Code. The Second Circuit held that the district court correctly applied the three-part test — set forth in *Iragorri v. United Technologies. Corp.*, 274 F.3d 65 (2d Cir. 2001) — for *forum non conveniens* challenges, concluding that the United Kingdom would be a more convenient forum to adjudicate the action. The plaintiff was afforded less deference to its choice of forum because it was based in the U.K. In addition, the U.K. was an adequate alternative forum because it permits litigation on statements made in connection with the offering of securities. Lastly, other factors weighed in favor of the U.K., including that (1) the most relevant fact witnesses were in the U.K., (2) the U.K. was a member of the governing body that enacted rules on prospectus disclosures, (3) the euro notes were denominated in pounds sterling, not U.S. dollars, and (4) the issues involved foreign law.

Whistleblower Protections

Second Circuit Finds That Dodd-Frank Whistleblower Protections Apply to Employees Who Initially Report Misconduct Internally Rather Than to the SEC

Berman v. Neo@Ogilvy LLC, No. 14-4626 (2d Cir. Sept. 10, 2015)
Click here to view the opinion.

The U.S. Court of Appeals for the Second Circuit reversed the dismissal of claims that a company violated Dodd Frank's whistleblower protections by retaliating against a former employee after he reported certain illegal accounting practices to management. The former employee was allegedly terminated six months after he reported the misconduct internally, and he thereafter reported the accounting practices to the SEC. The Second Circuit held that the employee could state a whistleblower claim, even though he did not first report the information to the SEC, and one part of the statute defines a "whistleblower" as "any individual who provides ... information relating to a violation of the securities laws *to the Commission*." The Second Circuit acknowledged the "tension" between the whistleblower definition under that part of the statute and a different subsection that generally prohibited employers from retaliating against whistleblowers who make disclosures protected by the Sarbanes-Oxley Act. However, the court determined that the whistleblower definition was not intended to "sharply" limit the statute's protections, but rather appeared to be a late addition to the bill that "no one noticed" did not "fit together neatly" with the other provisions. Applying the rule only to individuals who first reported the conduct to the SEC would eliminate protection for certain professionals, such as auditors or attorneys, who are required by other laws to report violations internally before going to an agency. Nevertheless, because the court could not be certain as to the legislature's intent, the Second Circuit held that it was appropriate to defer to the SEC's interpretation of the provision — as set forth by SEC Rule 21F-2 — which interprets the law in a way that provides protection to "an employee who reports internally without reporting to the Commission."

Inside the Courts
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