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Inside the Courts
An Update From Skadden Securities Litigators

Class Certification

SDNY Certifies Two Subclasses of Investors in Connection With IPO of Social Network Company

In re Facebook, Inc. IPO Sec. and Derivative Litig.,
No. 1:12-md-2389-RWS (S.D.N.Y. Dec. 29, 2015)
Click here to view the opinion.

Judge Robert W. Sweet granted a motion for class certification and appointment of lead counsel on behalf of a class of investors alleging that Facebook and certain of its officers violated Sections 11 and 12(a)(2) of the Securities Act by making material misstatements and omissions in the days leading up to its IPO. Specifically, the plaintiffs alleged that the company, through a series of telephone calls, selectively disclosed to some institutions and underwriters — but concealed in its Securities and Exchange Commission (SEC) filings and prospectuses — that the company had cut its quarterly and annual revenue projections due to difficulties in monetizing mobile platforms. The defendants contended, however, that all investors had access to the projections through media sources that publicized the revised projections prior to the IPO and syndicate analysts who learned about the revised projections and shared them with institutional investors. Although plaintiffs initially sought a single class, they ultimately proposed that two subclasses be certified: (i) an institutional subclass addressing the common question of whether institutions that learned about the revised projections from the media and other sources had actual knowledge of the revisions, and (ii) a retail subclass addressing the common question of whether retail investors had actual knowledge through other sources. The court certified the two classes, despite arguments by the defendants that individualized issues regarding knowledge of the projections would predominate over common issues. The court determined that "whether any investor, institutional or retail gained relevant actual knowledge from media reports" was a common question, and that as to the retail subclass, the defendants "presented much less evidence of actual knowledge." The court noted that any "class wide actual knowledge defense arguments" may be made on summary judgment or at trial, and that any individualized issues could be resolved "post-trial through an individualized phase involving separate jury trials if necessary."

SDNY Certifies Class of Investors Harmed by 'Train Wreck' Collapse of Large Derivatives Broker

Deangelis v. Corzine (In re MF Global Holdings Ltd.),
No. 1:11-cv-7866-VM-JCF (S.D.N.Y. Oct. 14, 2015)
Click here to view the opinion.

Judge Victor Marrero certified a class of investors, alleging that certain underwriters violated Sections 11 and 12(a)(2) of the Securities Act through their role in creating offering documents that allegedly misled investors about the issuer's accounting practices and its investments in sovereign debt. The misstatements allegedly came to light when the issuer entered a "train wreck" bankruptcy, both "in its suddenness and the scope of its impact." The court found that the proposed class met the requirements of Rule 23(a): numerosity, commonality, typicality and adequacy of representation. The defendants challenged the typicality and adequacy prongs, arguing that (i) plaintiffs could not satisfy typicality because the lead plaintiff was subject to unique knowledge defenses, and (ii) the lead plaintiff, an investment fund, was not adequate because it lacked personal knowledge regarding the facts underlying the action. The defendants contended that the plaintiffs' investment manager had access to nonpublic information from a conference call with the issuer's executives before the offering, but the court determined that the evidence "taken as a whole" suggested that the issuer "made misstatements and omissions in both its pre-offering phone call and the Offering Documents." Likewise, the court found that the lead plaintiff was adequate because its board "receives monthly updates on litigation ... and is familiar with the allegations in the complaint." The court further determined that the proposed class met the predominance and superiority requirements. The court rejected the defendants' argument that the potential knowledge defenses described above would cause individual issues to predominate. Rather, the evidence demonstrated that the issuer "consistently omitted to state the full extent" of its potential risks, and thus the claims could be adjudicated on a classwide basis.

SDNY Certifies Class of Investors Allegedly Harmed by 'London Whale' Scandal

In re JPMorgan Chase & Co. Sec. Litig.,
No. 1:12-cv-03852-GBD (S.D.N.Y. Sept. 29, 2015)
Click here to view the opinion.

Judge George B. Daniels certified a class of investors, alleging that a bank violated Section 10(b) of the Securities Exchange Act by making false representations about the bank's Chief

Investment Office (CIO) unit. The CIO managed the bank's synthetic credit portfolio. One trader in the CIO's London office was known as the "London Whale" for his large position in the derivatives market that allegedly caused the bank to lose at least $6.2 billion. Plaintiffs alleged that (i) the defendants changed the CIO from a unit that managed risk to a unit that participated in trading activities, (ii) the defendants knowingly misrepresented the nature and extent of those activities during an April 13, 2012, earnings call and in a Form 8-K filed the same day, and (iii) the misrepresentations came to light in May through a series of partial corrective disclosures, the last of which was a May 21, 2012, announcement by the bank's CEO. The court granted the plaintiffs' motion to certify a class, finding that the proposed class met the four requirements of Rule 23(a) (numerosity, commonality, typicality and adequacy). Although the defendants argued that the typicality and adequacy requirements were not satisfied because some of the lead plaintiffs purchased stock after one of the corrective disclosures, the court determined that the "possible unique defense" was "unlikely to become the focus of litigation." The court also found that the proposed class met the two requirements of Rule 23(b): superiority (that the class mechanism would be the most efficient way to adjudicate the controversy) and predominance (that common issues predominated over individual issues). The plaintiffs satisfied the predominance requirement by way of the fraud-on-the-market theory, even though the defendants challenged the efficiency of the relevant market. The court determined that the market was efficient, applying the tests under *Cammer v. Bloom*, 711 F. Supp. 1264 (D.N.J. 1989) and *Krogman v. Sterritt*, 202 F.R.D. 467, 477-478 (N.D. Tex. 2001), which are "routinely" used in the Second Circuit. Although the defendants criticized the plaintiffs' event study — which purported to demonstrate the market's reaction to certain alleged corrective disclosures — because it did not consider the market's movements on other dates where relevant information was released, the court held that the report "need not be flawless" to support a finding that the market was efficient. The defendants further challenged the plaintiffs' ability to show "damages on a classwide basis in a manner consistent with their theory of liability," as required by *Comcast Corp. v. Behrend*, 133 S. Ct. 1426 (2013). But the court noted that *Comcast* merely required the plaintiffs to show that their damages stemmed from the defendants' actions and did not disturb Second Circuit precedent establishing that individual damages issues do not defeat class certification.

ERISA

Sixth Circuit Affirms Summary Judgment in Favor of ESOP Fiduciary

Pfeil v. State St. Bank & Trust Co., 806 F.3d 377 (6th Cir. Nov. 10, 2015)
Click here to view the opinion.

The Sixth Circuit affirmed the grant of summary judgment for defendants dismissing a class action brought under the Employee Retirement Income Security Act (ERISA) against the plan fiduciary of an Employee Stock Ownership Plan (ESOP). The plaintiffs alleged that the fiduciary breached its duty of prudence under ERISA when it continued to invest in employer stock despite overwhelming evidence in the public domain that raised serious questions concerning the employer's short-term viability. The district court granted summary judgment in favor of the defendant, reasoning that an ESOP fiduciary's decision to remain invested in employer securities is presumptively prudent.

While noting that the U.S. Supreme Court had abrogated the presumption of prudence doctrine in *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459 (2014), the Sixth Circuit affirmed the grant of summary judgment, holding "that a plaintiff claiming that an ESOP's investment in a publicly traded security was imprudent must show special circumstances to survive a motion to dismiss." Because the plaintiffs had failed to show a special circumstance, such as that the fiduciary should not have relied on the stock's market price, summary judgment was appropriate. The court, however, declined to decide whether a fiduciary's complete failure to investigate a publicly traded investment might constitute a circumstance sufficient to survive a motion to dismiss, noting that the amount of investigation done by the defendant took the case out of that realm.

Fiduciary Duties

Eastern District of Pennsylvania Dismisses Fiduciary Duty Claims, Holds That Pharmaceutical Company Did Not Mislead Shareholders or Violate Delaware Law Leading Up to Its Dissolution

Schmidt v. Skolas, No. 12-3265 (E.D. Pa. Nov. 10, 2015)
Click here to view the opinion.

The district court dismissed a shareholder derivative action brought against a defunct pharmaceutical company's directors and officers, holding that the defendants did not violate their

fiduciary duties or mislead shareholders in their actions leading up to the company's dissolution in 2009.

The plaintiff, a former shareholder, argued that the defendants breached their duties of loyalty and care by steering the company's assets toward insiders and the defendants' associates in advance of the dissolution, and by making various misrepresentations in the shareholder proxy statement issued prior to the meeting in which stockholders voted on the dissolution plan. In dismissing the case, Judge Berle M. Schiller held that (i) the plaintiffs had failed to adequately allege that any of the directors engaged in insider transactions, (ii) the business judgment rule protected the defendants' disposition of the company's assets, and (iii) the alleged misrepresentations were not misleading within the context of the entire proxy statement.

In so holding, the court found that one of the company's directors, who also served as the CEO of one of the company's two largest shareholders, did not violate his duty of loyalty when he directed the shareholding company to sell off its shares in the defendant company the day after shareholders voted on the dissolution plan. The court noted that plaintiffs failed to specify how the stock sell-off was conditional on or benefited by the defendant company's dissolution. The court then found that the remainder of the defendant directors did not engage in self-dealing when they voted for the dissolution merely because they received large severance packages upon their discharge. The court further concluded that the directors did not violate their duty of care by appointing an allegedly underqualified trustee to disperse the company's assets. That decision, the court found, was protected by the business judgment rule. Finally, the court held that statements regarding who would direct the sale of the company's assets were not misleading, because the proxy statement warned shareholders that the defendants may resign and turn the sale over to a trustee at any time. The plaintiffs have filed a notice of appeal to the Third Circuit.

Corporate Elections

Delaware Court of Chancery Invalidates Provision in Certificate Prohibiting Removal of Directors 'Without Cause'

In re VAALCO Energy, Inc., C.A. No. 11775-VCL (Del. Ch. Dec. 21, 2015) (Transcript)
Click here to view the opinion.

Vice Chancellor J. Travis Laster issued a bench ruling granting the stockholder plaintiffs' motion for summary judgment, finding that a provision in a company's certificate of incorporation that prohibited removal of a director without cause where the company did not have a staggered board was invalid under Section 141(k) of the Delaware General Corporation Law.

In June 2009, VAALCO stockholders voted to amend the company's certificate of incorporation to repeal its classified board structure. At the time, the certificate of incorporation was not amended to remove an accompanying provision prohibiting removal of directors without cause. In 2015, stockholders initiated a consent solicitation seeking to remove and replace a majority of the company's board without cause. In response, VAALCO's board took the position that until stockholders voted to amend the certificate of incorporation to remove the language prohibiting removal without cause — a vote that, under the certificate of incorporation, would require approval by two-thirds of the shares outstanding — the consent solicitation could not remove the incumbent directors without cause.

The stockholder plaintiffs filed suit, alleging that the provision prohibiting removal without cause ran afoul of Section 141(k) and was accordingly invalid. Section 141(k) provides that "[a]ny director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election of directors, except" under two enumerated exceptions, including where a corporation's board is staggered.

The Court of Chancery granted plaintiffs' motion for summary judgment, holding that the provisions in VAALCO's certificate of incorporation "which provide for only for-cause removal in the context of a nonclassified board[] conflict with Section 141(k) of the Delaware General Corporation Law and are, therefore, invalid."

Mergers and Acquisitions

Delaware Supreme Court Upholds Judgment for Aiding and Abetting Against Financial Advisor

RBC Capital Mkts., LLC v. Jervis, No. 140, 2015 (Del. Nov. 30, 2015)
Click here to view the opinion.

Justice Karen L. Valihura, writing for the Delaware Supreme Court *en banc*, affirmed the Court of Chancery's ruling in which it entered a $75.8 million judgment against a financial advisor it found post-trial had aided and abetted a target company's breach of fiduciary duties.

In post-trial decisions issued on March 7, 2014, and October 10, 2014, Vice Chancellor J. Travis Laster of the Court of Chancery found that directors of Rural Metro (who had settled fiduciary duty claims asserted against them before the case went to trial) breached their fiduciary duty of care in connection with a merger whereby Rural Metro was acquired by Warburg. The Court of Chancery found, among other things: that RBC did not disclose to Rural Metro's board that it intended to use its position as

a sell-side advisor to Rural Metro in order to secure buy-side roles with certain private equity firms bidding for Rural Metro's competitor in an unrelated transaction; because of the contemporaneous sale of Rural Metro's competitor, with which RBC was also involved, many potential strategic bidders could not participate in the sales process, resulting in fewer bidders for Rural Metro; RBC secretly attempted to provide staple financing to Warburg while also advising the Rural Metro board that Warburg's offer was fair; and RBC "worked to lower the analyses in its fairness presentation so [Warburg's] bid looked more attractive." The Court of Chancery found that RBC knowingly aided and abetted these breaches by "fail[ing] to disclose the relevant information to further its own opportunity to close a deal, get paid its contingent fee, and receive additional and far greater fees for buy-side financing work."

In upholding the Court of Chancery's ruling, the Supreme Court held that a third party, such as a financial advisor, may aid and abet a breach of the duty of care by misleading the board or creating an "informational vacuum," but also emphasized that an aider and abettor must act with scienter. Addressing RBC's argument that holding a nonfiduciary liable for an unintentional violation of fiduciary duty by a fiduciary would create an "anomalous imbalance of responsibilities," the Supreme Court explained that in the case at bar, the record supported the Court of Chancery's finding that RBC had perpetrated a "fraud on the Board," and in so doing "intentionally duped" and "purposely misled" the directors into breaching their duty of care. The Supreme Court further explained that "our holding is a narrow one that should not be read expansively to suggest that any failure on the part of a financial advisor to prevent directors from breaching their duty of care gives rise to a claim for aiding and abetting a breach of the duty of care," and emphasized that "the requirement that the aider and abettor act with scienter makes an aiding and abetting claim among the most difficult to prove." The Supreme Court concluded that in this case, "that standard was satisfied by the unusual facts proven at trial and which have not been seriously challenged on appeal."

Delaware Court of Chancery Finds Derivative Damages Claim Survives as Direct Claims Post-Merger

In re El Paso Pipeline Partners, L.P. Derivative Litig.,
C.A. No. 7141-VCL (Del. Ch. Dec. 2, 2015)
Click here to view the opinion.

Vice Chancellor J. Travis Laster denied the defendants' motion to dismiss derivative litigation, finding that a derivative claim brought on behalf of an entity that had ceased to exist independently would be treated as a direct claim to allow the plaintiff to pursue the claim and a pro rata recovery of a $171 million damages award.

Earlier in 2015, the court issued a post-trial opinion holding the general partner of El Paso Pipeline Partners, L.P. (El Paso MLP) liable for $171 million in damages on claims brought derivatively by a unitholder. The unitholder's claims concerned a series of drop-down transactions executed by El Paso Corporation (El Paso Parent), which controlled El Paso MLP through the ownership of its sole general partner El Paso Pipeline GP Company, LLC (the General Partner). Post-trial, the court awarded damages against the General Partner. While the litigation was pending, in November 2014, Kinder Morgan acquired 100 percent of the equity of El Paso Parent and thus controlled the General Partner. El Paso MLP remained a separate, publicly traded entity after the merger. After the December 2014 trial, a related-party merger caused El Paso MLP to cease existence as a separate, publicly traded entity. The General Partner moved to dismiss, arguing that the plaintiff unitholder had lost standing to pursue his derivative claims because he no longer had "continuous ownership" of El Paso MLP units.

The court denied the motion to dismiss, finding that the unitholder's derivatively pleaded claim would be viewed as having a "dual" derivative/direct nature so that "the plaintiff can continue to pursue it, and th[e] court can implement the [damages award] through a *pro rata* recovery in favor of the limited partners at the time of the [m]erger who were not affiliated with the General Partner." To find otherwise, the court explained, would "generate a windfall for the General Partner at the expense of the unaffiliated limited partners for whose indirect benefit th[e] suit originally was brought." The court noted that the Delaware Supreme Court has recognized that some claims have features of both direct and derivative claims (although noting that the cited authority is "controversial" and "stand[s] in tension with other decisions that have characterized similar claims as purely derivative"). The court went on to explain that such "dual" claims should be characterized as derivative claims at the outset of a case, when the court must determine whether a claim is subject to Rule 23.1, so that only "strong" claims succeed and entities are protected against excessive litigation. But, later in the case where a merger has terminated the separate existence of the entity on whose behalf derivative claims were brought, "Delaware law can and should prioritize the individual aspects of the claim."

The court also found that the General Partner was not prejudiced by allowing the plaintiff to implement the damages award through a pro rata recovery by unaffiliated limited partners because an investor-level recovery of the damages award was possible while El Paso MLP continued as an independent entity. The court acknowledged that while it is "rare for a court to grant an investor-level recovery on an entity-level claim, ample authority establishes that such a remedy is possible."

Foreign Corporations

SDNY Dismisses Claims by Debt Securities Purchasers Against Foreign-Based Oil Company

In re Petrobras Sec. Litig., No. 1:14-cv-09662-JSR
(S.D.N.Y. Dec. 21, 2015)
Click here to view the opinion.

Judge Jed. S. Rakoff granted in part the dismissal of claims that an oil company violated Section 10(b) of the Securities Exchange Act and Section 11 of the Securities Act by allegedly making false and misleading statements in connection with a purported multibillion dollar bribery and kickback scheme. The plaintiffs — whose claims arose from purchases of certain debt securities and who also sued the underwriters of Petrobras' debt offerings — alleged that the defendants misled investors about the scope of the bribery and kickback scandal. The court determined that the securities owned by some plaintiffs were not covered by U.S. securities law under *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010), in which the U.S. Supreme Court held that the federal securities laws extend only to securities listed on a U.S. stock exchange or purchased in the United States. The plaintiffs failed to allege that the debt instruments at issue were listed on a U.S. stock exchange because the plaintiffs purchased the debt securities through "over-the-counter transactions," not on an exchange. Further, two of the four named plaintiffs failed to adequately allege a domestic transaction as set forth by the Second Circuit in *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60 (2d Cir. 2012), which holds that a party satisfies *Morrison* where it either incurred irrevocable liability in the United States or title was passed in the United States. The two plaintiffs insufficiently pleaded that a transaction took place in the United States or that title had been transferred in the United States based on allegations that beneficial ownership was transferred when the transaction was settled through The Depository Trust Company (DTC) in New York. The court reasoned that the "mechanics of DTC settlement are actions needed to carry out transactions, but they involve neither the substantive indicia of a contractual commitment necessary to satisfy *Absolute Activist*'s first prong nor the formal weight of a transfer of title necessary for its second." The court explained that, "if all DTC-settled transactions necessarily fell under the reach of the federal securities laws[,] [t]he laws would reach most transactions, not because they occurred on a domestic exchange but because they settled through the DTC." However, the two other named plaintiffs adequately alleged a domestic transaction because they set forth that their investment managers were located in the United States and that they had purchased the notes from underwriters in New York.

SDNY Dismisses Claims Against US-Based Media Company and Its Foreign Subsidiary

Wilder v. News Corp., No. 1:11-cv-04947-PGG
(S.D.N.Y. Oct. 7, 2015)
Click here to view the opinion.

Judge Paul G. Gardephe dismissed claims that a U.S.-based media company and its wholly owned foreign subsidiary violated Section 10(b) of the Securities Exchange Act by allegedly concealing information about certain news-gathering practices at two of the company's foreign-based newspapers, including the practice of hacking celebrities' and other public figures' phones. The plaintiffs alleged that disclosure of the practices caused the media company's stock price to decline, hampering the company's plans to acquire a broadcasting company. In a prior decision, the court found that it lacked personal jurisdiction over the company's foreign subsidiary because the plaintiffs failed to allege facts demonstrating that the media company exercised extensive enough control over its wholly owned foreign subsidiary to give rise to jurisdiction in the U.S. In that decision, the court also determined that the majority of the alleged misstatements were made before the alleged class period began, and thus were not actionable. Thereafter, the plaintiffs filed an amended complaint expanding the class period to include the previously inactionable misstatements and alleging additional facts about the media company's relationship with its foreign subsidiary. The court again dismissed the action, finding that the amended allegations failed to demonstrate sufficient control by the parent to support personal jurisdiction over the foreign subsidiary under a piercing-the-veil theory. Although the plaintiffs alleged that the parent exercised some control over the subsidiary, shared some board members and officers with the subsidiary, and approved the subsidiary's yearly budget, those allegations did not demonstrate that the control exercised was beyond what a typical corporate parent might reasonably be expected to use. Further, the court found that the claims by plaintiffs included in the new expanded class period were barred by the two-year statute of limitations because those plaintiffs knew of the facts supporting their claims at least as early as when the initial action was filed, which was more than two years before the amended complaint. Further, the relation-back doctrine did not apply, because where an amended action seeks to add more plaintiffs rather than additional claims, the Second Circuit requires a showing of mistake at the time the original action was filed. The plaintiffs could not show any mistake in filing their original action with a narrower class definition.

Loss Causation

Ninth Circuit Holds That Plaintiffs Can Show Loss Causation by Announcement of SEC Investigation Followed by Revelation That Prior Disclosures Were Inaccurate

Jacksonville Police & Fire Pension Fund v. CVB Fin. Corp., No. 13-56838 (9th Cir. Feb. 1, 2016)
Click here to view the opinion.

The Ninth Circuit affirmed in part and reversed in part the dismissal of claims brought under Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder against a bank holding company, holding "that the announcement of an SEC investigation related to an alleged misrepresentation, coupled with a subsequent revelation of the inaccuracy of that misrepresentation, can serve as a corrective disclosure for the purpose of loss causation."

The plaintiff shareholder, a large union pension fund, brought suit after the defendant announced an SEC subpoena probing the defendant's underwriting practices, allegedly causing the defendant's stock price to drop. The plaintiff claimed, among other things, that the defendant had made false and misleading statements in two SEC filings when it stated that it had "no serious doubts" as to the ability of any of its borrowers to repay their loans, despite allegedly knowing that its largest borrower was on the verge of bankruptcy. The district court twice dismissed the plaintiff's suit, ruling "that the announcement of the subpoena could not constitute a corrective disclosure" establishing that the plaintiff's losses were caused by the defendant's false and misleading statements.

In reversing the district court, the Ninth Circuit held that the plaintiff had adequately alleged loss causation by citing analyst reports showing that the market understood the SEC subpoena to be directed at the defendant's alleged misrepresentations. The court noted that the fact that the defendant's share price hardly budged when the defendant later announced that its delinquent borrower could not repay its loans confirmed "that investors understood the SEC announcement as at least a partial disclosure of the inaccuracy of the previous 'no serious doubts' statements." The court further observed that "any other rule would allow a defendant to escape liability by first announcing a government investigation and then waiting until the market reacted before revealing that prior representations under investigation were false."

The court's decision follows its earlier holding in *Loos v. Immersion Corp.* "that the announcement of a government investigation, without more, cannot meet the loss causation requirement." The court held that a plaintiff can adequately plead loss causation where a defendant announces a government investigation into allegedly misleading statements and subsequently discloses that the statements were inaccurate.

The court affirmed, however, the dismissal of the plaintiff's remaining claims, holding that the defendant's statements touting its loan underwriting culture and downplaying the risks posed by the declining real estate market were nonactionable corporate puffery, and that the defendant's alleged violations of generally accepted accounting principles, standing alone, did not give rise to a strong inference of scienter.

Privilege

Second Circuit Reverses District Court's Denial of Motion to Quash IRS Summons on Privilege Ground

Schaeffler v. United States, No. 14-1965-cv (2d Cir. Nov. 10, 2015)
Click here to view the opinion.

The Second Circuit reversed the district court's denial of a defendant's petition to quash an IRS summons. The defendant had sought to acquire a minority interest in another company through a tender offer, but because the offer expired amidst the financial turmoil of September 2008, the target's stock price fell and the tender offer was significantly oversubscribed. As a result, the defendant sought to restructure and refinance its outstanding €11 billion loan from a consortium of banks. The district court held that certain memoranda prepared for the defendant by Ernst & Young and shared with the consortium, which provided advice in connection with the restructuring and refinancing, were not covered under either attorney-client privilege or the work-product doctrine. The Second Circuit reversed, holding that the defendant's disclosure of the documents to the consortium did not waive attorney-client privilege because the two entities shared a "common legal interest." The court explained that the tender offer's oversubscription threatened the defendant's solvency, which in turn created a material risk of default on the consortium's loan. But the defendant and the consortium "could avoid this mutual financial disaster by cooperating in securing a particular tax treatment of a refinancing and restructuring. Securing that treatment would likely involve a legal encounter with the IRS." Thus, both the defendant and the consortium "had a strong common interest in the outcome of that legal encounter." The court rejected the district court's determination that the two entities were joined simply in economic but not legal interests, holding that "[a] financial interest of a party, no matter how large, does not preclude a court from finding a legal interest shared with another party where the legal aspects materially

affect the financial interests." The court also rejected the district court's conclusion that the work-product doctrine did not apply because Ernst & Young would have provided the same advice independent of any anticipated litigation. The tax memorandum at issue would not have been produced in the ordinary course of business, the court reasoned. Rather, the memorandum "was specifically aimed at addressing the urgent circumstances arising from the need for a refinancing and restructuring and was necessarily geared to an anticipated audit and subsequent litigation, which was on this record highly likely." Thus, the work-product doctrine applied in addition to the attorney-client privilege.

Registration Statement Liability

SDNY Dismisses Claims Based on Allegedly Misleading Registration Statement

Stadnick v. Vivint Solar, Inc., No. 14-cv-9709
(S.D.N.Y. Dec. 10, 2015)
Click here to view the opinion.

Judge Katherine B. Forrest dismissed a putative class action complaint alleging that Vivint violated Sections 11 and 12(a)(2) of the Securities Act by allegedly failing to disclose 2014 third-quarter earnings and other information in the registration statement for the company's IPO. The court determined that the company had "no duty to report the third quarter results in the Registration Statement because the most recent financial information it reported, from the second quarter of 2014, was less than 135 days old, as required by SEC Regulation S-X." Further, the third-quarter results were not the kind of "extreme departure from anticipated range" that other courts have held necessitate disclosure despite the 135-day rule. Although earnings per share dropped in the third quarter — which the plaintiff emphasized — the court reasoned that the "volatility in net income available to stockholders and earnings per share derived not from a disastrous and unexpected shift in the Company's business but instead largely from accounting methods that were fully disclosed in the Registration Statement." The company also did not fail to disclose changes in certain assets and liabilities because the "fact that they would receive solar energy systems as assets upon their installation, was fully disclosed in the Registration Statement." The court noted that the "Plaintiff's distaste for the Company's disclosed business model is not actionable." The court likewise rejected the plaintiff's additional alleged misrepresentations because the allegedly withheld information had been disclosed or was otherwise publicly available.

In addition, the court also determined that the plaintiff lacked standing under Section 12(a)(2) of the Securities Act with respect to claims against the underwriters of the IPO because he had not bought shares directly, as required by the statute. The court rejected the plaintiff's argument that under *NECA-IBEW Health & Welfare Fund v. Goldman Sachs & Co.*, 693 F.3d 145 (2d Cir. 2012), he has standing because he shares the "same set of concerns" as absent class members. That case dealt only with the question of when a plaintiff with proper standing may represent certain absent class members and did not "create standing where standing does not exist."

Scienter

Second Circuit Affirms Dismissal of Claims Against Investment Management Firm

The R.W. Grand Lodge of Free & Accepted Masons of Pa. v. Meridian Capital Partners, Inc., No. 15-1064-cv
(2d Cir. Dec. 15, 2015)
Click here to view the opinion.

The Second Circuit, in a summary order, affirmed the dismissal of claims brought by a nonprofit fraternity alleging that an investment manager violated Section 10(b) of the Securities Exchange Act by making false and misleading statements about the adequacy of the firm's due diligence procedures in connection with Bernard Madoff's Ponzi scheme. The Second Circuit affirmed the dismissal under the heightened pleading standards for securities fraud, finding that the complaint failed to allege with particularity that the defendants acted intentionally or recklessly. The plaintiff purported to allege that the defendants (i) stood to benefit personally from their fraud, (ii) had access to facts indicating that their public statements were inaccurate, and (iii) failed to monitor for fraud. However, the court found that the allegations were too general to support a claim. The court noted that "many district courts in this circuit ... rejected similar claims" in connection with the Ponzi scheme because it was Madoff's guile — not the purported recklessness on the part of the defendants — that enabled the fraud. In addition, the court also affirmed the dismissal of the plaintiff's state law claims under the Securities Litigation Uniform Standards Act (SLUSA), which bars certain state law class action misrepresentation claims involving nationally traded securities. The court determined that the plaintiff's state law claims — fraudulent inducement, misrepresentation and negligence, among others — were based on the defendants' "representations about its investing decisions with the [funds], which explicitly purported to invest in covered securities," and thus were barred by SLUSA.

Inside the Courts
An Update From Skadden Securities Litigators

SEC Enforcement Actions

District of Minnesota Grants SEC's Motion for Default Judgment Against Investment Management Company

U.S. Sec. & Exch. Comm'n v. Markusen, No. 14-cv-3395 (MJD/TNL) (D. Minn. Nov. 10, 2015)
Click here to view the opinion.

Judge Michael J. Davis granted the SEC's motion for default judgment against an investment management company and its CEO, holding that the defendants violated the anti-fraud provisions of the Securities Act and the Securities Exchange Act. The SEC alleged that the defendants consistently billed the company's clients, two private investment funds, for out-of-pocket research expenses that the company had not actually incurred. The SEC also alleged that the defendants repeatedly marked the close of the funds' largest holding, causing the price of that stock to rise, which inflated the funds' monthly returns and allowed the company to extract larger management fees.

Accepting the SEC's factual allegations as true, the court held that by billing the funds for bogus research expenses and diverting the proceeds to the company and its management, the defendants violated the scheme liability provisions of Securities Exchange Act Rule 10b-5. Additionally, the court ruled that the defendants further violated Rule 10b-5 and Securities Act Section 17(a) by misrepresenting to investors that the alleged research fees were being paid to outside entities when the fees were actually being paid to the company and its employees. The court also held that the defendant CEO, who alone controlled the company and made all of the investment decisions for the funds, incurred secondary control person liability for these violations under Securities Exchange Act Section 20(a).

The court went on to rule that the defendants' repeated attempts to manipulate the price of the funds' largest holding also constituted a fraudulent scheme in violation of Securities Act Section 17(a) and Securities Exchange Act Rule 10b-5. Moreover, the court ruled that by inflating the funds' monthly returns, the defendants caused the funds' earnings to be materially misrepresented in monthly communications to investors, further violating Section 17(a) and Rule 10b-5. The court also held that the defendants violated Exchange Act Rule 16a-3 by failing to disclose to the SEC that, through the funds, the company was the beneficial owner of more than 10 percent of another company's stock. The court further ruled that the CEO had also incurred secondary liability for the company's acts in this scheme under Section 20(a) of the Securities Exchange Act. Accordingly, the court issued a permanent injunction preventing the defendants from violating federal securities laws and ordered disgorgement and civil penalties

Securities Exchange Act — Administrative Exhaustion

Seventh Circuit Affirms Dismissal of Securities Firms' Claims Against SROs for Failure to Exhaust Administrative Remedies

Citadel Sec. LLC v. Chicago Bd. Options Exch., Nos. 14-2912, 14-3071 (7th Cir. Dec. 11, 2015)
Click here to view the opinion.

The Seventh Circuit affirmed the dismissal of a case brought by securities firms against national securities exchanges, which operate as self-regulatory organizations (SROs), holding that the court lacked subject matter jurisdiction because the plaintiffs failed to exhaust their administrative remedies under the Securities Exchange Act.

The plaintiffs sought restitution or recovery from the defendant SROs for payment for order flow fees that were allegedly improperly applied to the plaintiffs' orders between 2004 and 2011 due to the errors of a particular broker-dealer. The district court held that the plaintiffs failed to exhaust their administrative remedies by neglecting to seek relief through the SEC. The plaintiffs argued on appeal that the defendants had acted in their private, rather than regulatory, capacity in applying the fees initially, and that therefore administrative exhaustion requirements did not apply. The plaintiffs also argued that exhaustion was not required because the SEC could not provide adequate relief.

The Seventh Circuit affirmed the decision below, holding that the plain language of Section 78s(h) of the Securities Exchange Act calls for SEC review of the plaintiffs' allegations. The panel also held that the plaintiffs had not demonstrated that exhaustion would be futile had they pursued a remedy through the SEC. The panel noted that several provisions in the Securities Exchange Act provide for monetary penalties as an administrative remedy, so monetary compensation through SEC review was at least a possibility.

Securities Fraud Pleading Standards — Misrepresentations

Northern District of California Dismisses With Prejudice Securities Fraud Claims Against Yelp

Curry v. Yelp Inc. et al, No. 3:14-CV-03547-JST (N.D. Cal. Nov. 24, 2015)
Click here to view the opinion.

The district court dismissed with prejudice securities fraud claims brought under Section 10(b) of the Securities Exchange Act and regulations promulgated thereunder against the online user-generated review service Yelp, holding that the plaintiffs failed to adequately allege an actionable misrepresentation or omission, scienter or loss causation with the requisite particularity.

The plaintiffs, seeking to represent a class of the defendant's shareholders, claimed that the defendant materially misrepresented its business practices in public disclosures by denying that it extorted advertising revenues from businesses in exchange for deleting false, misleading or malicious reviews posted by the defendant's users. The plaintiffs alleged that a *Wall Street Journal* article revealed the falsity of the defendant's statements by detailing thousands of complaints lodged with the Federal Trade Commission accusing the defendant of engaging in unfair and heavy-handed business practices.

In dismissing the claims, the court first found that the complaint's isolated examples of false or manipulated user reviews were insufficient to render the defendant's statements — regarding the general veracity of its users' reviews and denial that it manipulates them — false or misleading. The court next concluded that the plaintiffs failed to adequately allege loss causation because the *Wall Street Journal* article — the supposed loss causation event — revealed only the risk or potential of fraudulent conduct. Under recent Ninth Circuit precedent, however, such allegations are insufficient to plead loss causation. Finally, the court held that the plaintiffs failed to adequately plead scienter. The court explained that the plaintiffs could not invoke the "core operations inference" because they failed to allege that the individual defendants had sufficient knowledge regarding the authenticity of the user reviews on the website. In addition, the plaintiffs provided no context for their allegations regarding the defendants' stock sales, precluding the court from determining whether those stock sales were unusual or suspicious.

SLUSA

Northern District of California Remands Securities Act Claims, Deepens Split Over SLUSA Removal of Claims

Cervantes v. Dickerson, No. 15-cv-3825-PJH (N.D. Cal. Oct. 21, 2015)
Click here to view the opinion.

The district court has remanded a putative securities class action brought under Sections 11 and 15 of the Securities Act, joining other district courts within the Ninth Circuit that have held that SLUSA does not permit the removal of certain federal securities claims brought in state court.

Prior to the enactment of SLUSA, the Securities Act vested both state and federal courts with concurrent jurisdiction over claims arising under that statute and prohibited the removal of such actions from state to federal court. In 1998, concerned that plaintiffs were evading limitations on Securities Act claims by bringing common law fraud claims in state courts, Congress enacted SLUSA, which (i) allowed removal of certain "covered class actions," and (ii) completely barred certain securities actions brought pursuant to state law.

Courts have disagreed in recent years regarding SLUSA's impact on the removability of class claims brought under the Securities Act. After examining the language and legislative history of SLUSA's amendments, as well as *dicta* in recent Ninth Circuit cases and the U.S. Supreme Court's decision in *Kircher v. Putnam Funds Trust*, District Judge Phyllis J. Hamilton concluded that Congress intended to authorize the removal of only barred state law securities claims, and even then only for the sole purpose of having them dismissed. The court held that SLUSA did not authorize the removal of claims brought only under the Securities Act.

The court acknowledged the growing disagreement on this issue between district courts in the Ninth and Second circuits. For instance, in *Knox v. Agria Corp.*, the Southern District of New York held that SLUSA divested state courts of jurisdiction over all "covered class actions" under the Securities Act, and therefore such actions properly belonged in federal court. Judge Hamilton found *Knox*'s reasoning unpersuasive, however, concluding that the better reading of the anti-removal provisions of SLUSA confers jurisdiction of "covered class actions" in state courts. The court acknowledged that SLUSA's provisions are not a model of clarity but concluded that where doubts exist concerning removability, there is a presumption of nonremovability, and settled in favor of remand.

Statute of Limitations

Second Circuit Affirms Dismissal of Breach of Contract Action Against Mortgage Loan Originator on Statute of Limitations Grounds

Deutsche Bank Nat'l Trust Co. v. Quicken Loans Inc., No. 14-3373-cv (2d Cir. Nov. 16, 2015)
Click here to view the opinion.

The Second Circuit affirmed the district court's dismissal of a breach of contract action against defendant Quicken Loans, Inc. in connection with mortgage loans that Quicken had originated and sold pursuant to a purchase agreement in 2006. The purchase agreement contained representations and warranties about the quality of the mortgage loans and their regulatory compliance. Through a series of sales and assignments, the trustee of a securitization trust assumed the original purchaser's rights against Quicken, including certain repurchase rights the agreement set forth as a remedy to breach of the agreement's representations and warranties. The district court dismissed the trust's claims on statute of limitations grounds. The Second Circuit affirmed, citing the recent New York Court of Appeals decision in *ACE Securities Corp. v. DB Structured Products, Inc.*, 36 N.E.3d 623 (N.Y. 2015), which held that "[a] cause of action for breach of contractual representations and warranties that guarantee certain facts as of a certain date — but do not guarantee future performance — accrues on the date those representations and warranties become effective." The court held that the representations and warranties at issue were indistinguishable from those in *ACE*, which "guaranteed only 'certain facts about the loans' characteristics as of' the execution date, not how the mortgage would perform in the future." In the absence of a guarantee of future performance, the court reasoned, the trustee was entitled to demand repurchase based on a material breach immediately upon the effectiveness of the representations and warranties, and thus the cause of action accrued at that time. The court rejected the trustee's argument that the purchase agreement's requirement that the trustee make a demand for compliance in the case of a breach constituted "a substantive condition precedent to suit that delayed accrual of the cause of action." Rather, the court held that the demand was merely procedural and did not delay accrual of the cause of action. Because the complaint was filed more than six years after the representations and warranties became effective, it was time-barred.

The court further held that the extender provision under the Housing and Economic Recovery Act — which delays accrual of a cause of action brought by the Federal Housing Finance Agency (FHFA) until the date of the FHFA's appointment as conservator or receiver — did not apply, even though the FHFA had filed the precursor to this action in state court. The court reasoned that the action was not "brought by FHFA" because the subsequent federal complaint had been filed by the trustee based on diversity jurisdiction, and the FHFA had "no apparent participation."

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