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Inside the Courts
An Update From Skadden Securities Litigators

Class Certification

Colorado District Court Certifies Class of Investors in Municipal Bond Fund Case

In re Oppenheimer Rochester Funds Grp. Sec. Litig., No. 09-md-02063-JLK-KMT (D. Colo. Oct. 16, 2015)
Click here to view the opinion.

Judge John L. Kane reaffirmed a prior ruling certifying a class of investors in the Oppenheimer California Municipal Bond Fund who alleged claims under Sections 11 and 12(a)(2) of the Securities Act, after reconsidering the order in light of *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, 135 S. Ct. 1318 (2015). While the defendants conceded that certain alleged misstatements were appropriate for class treatment, they argued that the allegation that the fund failed to adhere to its investment objective was too individualized to be dealt with on a classwide basis. After an evidentiary hearing, the court found that the commonality element was satisfied because of the presence of "numerous common questions in [the] case, including whether the Fund's offering documents contain[ed] misstatements or omissions, whether those misstatements and omissions were material, and whether Class members sustained monetary losses." With regard to the typicality requirement, the court rejected the defendants' argument that the putative class representative's sophistication as an investor rendered him atypical and subject to unique defenses concerning his actual knowledge of the fund's poor performance. The court reasoned that the lead plaintiff's knowledge of the fund's performance was not unique to him but was available to the rest of the market, and that "its significance to a reasonable investor [would be] subject to common proof." The court similarly held that the plaintiff's sophistication did not render him an inadequate class representative and rejected attacks on the plaintiff's credibility. Finally, the court determined that the requirements of Rule 23(b)(3) had been satisfied because common issues predominated and were not defeated by individual investor knowledge. The court determined that, under *Omnicare*, "whether a statement is 'misleading' depends on the perspective of a reasonable investor," and proof of the misleading nature and materiality of the statements and omissions in the fund's offering documents, measured against a "reasonable investor" standard, would be common to all class members, as would be the calculation of damages. The defendants' affirmative defenses of negative loss causation and due diligence similarly did not defeat a finding predominance because they relied on "generalized proof." The court also found that the superiority prong of Rule 23(b)(3) was met, given that the class format is the "favored method" in the Tenth Circuit for litigating securities actions. The court noted that case management tools are available if the need to address any individualized issues arises.

Dodd-Frank Act

Cost-Benefit Analysis Required in Financial Stability Oversight Council's SIFI Designations, DC District Court Holds

MetLife, Inc. v. Fin. Stability Oversight Council, No. CV 15-0045 (RMC) (D.D.C. Mar. 30, 2016)
Click here to view the opinion.

Judge Rosemary M. Collyer rescinded MetLife's designation as a systemically important financial institution (SIFI) subject to enhanced supervision under the Dodd-Frank Act. The court ruled that in imposing the designation, the Financial Stability Oversight Council ignored its own guidance and failed to conduct a required cost-benefit analysis.

In designating MetLife as a SIFI, the council determined that any "material financial distress" at MetLife "could pose a threat to the financial stability of the United States." MetLife challenged its SIFI designation on the grounds that the council failed to assess MetLife's vulnerability to financial distress and the magnitude of that distress on the broader economy. The council argued that its guidance require only an evaluation of whether, and how, MetLife's vulnerabilities could impact the broader economy — not an assessment of the probability or likelihood of material financial distress. The council also argued that its guidance permits it to describe the magnitude of the potential harm in broad terms and that it was therefore unnecessary to estimate actual dollar figures. The court disagreed, ruling that the council's "straightforward" guidance required the council to evaluate the risk of financial distress and assess the magnitude of that risk based on reasoned predictions and quantified analysis.

MetLife also challenged its SIFI designation on the ground that the council ignored the costs the designation imposed on the company. MetLife argued that the designation imposed billions of dollars of regulatory compliance costs on the company, thereby increasing its financial vulnerability. The council countered that Dodd-Frank does not require a cost-benefit analysis because the statute requires only that the regulation be "appropriate." The court disagreed. Citing the U.S. Supreme Court's opinion in *Michigan v. EPA*, 135 S. Ct. 2699 (2015), the court ruled that "cost must be balanced against benefit because '[n]o regulation is "appropriate" if it does significantly more harm than good.'"

Fiduciary Duties

Books and Records

Delaware Court of Chancery Orders Production of Books and Records Subject to 'Incorporation Condition'

Amalgamated Bank v. Yahoo! Inc., C.A. No. 10774-VCL (Del. Ch. Feb. 2, 2016)
Click here to view the opinion.

Vice Chancellor J. Travis Laster issued an opinion ordering production of certain books and records to a plaintiff stockholder of Yahoo! Inc. under Section 220 of the Delaware General Corporation Law (DGCL). Post-trial, the court determined that the plaintiff had demonstrated a "credible basis" to suspect wrongdoing, including possible breaches of fiduciary duty by Yahoo's directors and corporate waste, in connection with the firing of Yahoo's chief operating officer, which triggered a nearly $60 million severance payment. As a result, the court found that certain of the documents the plaintiff sought were necessary for a meaningful investigation into such potential claims.

In addition, in what it described as an "issue of first impression," the court granted Yahoo's request that the court "condition any further production on [the plaintiff] incorporating by reference into any derivative action complaint that it files the full scope of the documents that Yahoo has produced or will produce in response to the Demand." The court reasoned that this incorporation condition "protects the legitimate interests of both Yahoo and the judiciary by ensuring that any complaint that [the plaintiff] files will not be based on cherry-picked documents." The court explained that the condition does not change the pleading standard that governs a motion to dismiss, under which a plaintiff is entitled to all reasonable inferences and must be credited with all well-pleaded factual allegations. Thus, the court concluded, "[t]he only effect of the Incorporation Condition will be to ensure that the plaintiff cannot seize on a document, take it out of context, and insist on an unreasonable inference that the court could not draw if it considered related documents." The parties have filed notices of appeal and cross-appeal to the Delaware Supreme Court, which has stayed the case below pending resolution of the appeals.

Derivative Litigation

Delaware Court of Chancery Finds Demand Is Not Excused With Respect to Challenges to Secondary Offering

Sandys v. Pincus, et al., C.A. No. 9512-CB (Del. Ch. Feb. 29, 2016)
Click here to view the opinion.

Chancellor Andre G. Bouchard dismissed a derivative claim brought by a stockholder of Zynga, Inc., finding the plaintiff did not adequately allege that demand on the board of directors would have been futile. The plaintiff brought a derivative action to recover damages allegedly suffered by Zynga, claiming the board approved certain transactions, namely exceptions to lock-up agreements and trading restrictions, that allowed directors and officers to sell shares in a secondary offering — shortly after which the company's stock price fell dramatically. By the time the plaintiff filed his action, two of the directors who sold in the secondary offering had been replaced by outside directors with no involvement in the underlying events.

The court granted the defendants' motion to dismiss pursuant to Rule 23.1, finding that presuit demand was not excused because the board at the time the complaint was filed consisted of a majority of disinterested and independent directors. The court held that demand was not excused with respect to the insider trading claim governed by *Brophy v. Cities Serv. Co.* against the secondary offering participants based on their alleged misuse of Zynga confidential information to sell shares at the time of the secondary offering. Applying the test for demand futility set forth in *Rales v. Blasband*, the court found that only two of the current board members participated in the secondary offering and were therefore likely to face a substantial likelihood of liability, and that the other seven directors were disinterested and independent. The court found that the fact that directors had "interlocking business relationships" and sat on the board of other companies together was insufficient to raise a reasonable doubt as to their independence.

The court also held that demand was not excused with respect to the plaintiff's claim that the board breached its fiduciary duties by approving the secondary offering and modifications to the lock-up agreements. The court again applied a *Rales* analysis to that claim, finding that while a majority of the members of the board in place at the time of the secondary offering were interested, and even though a majority of those board members had not been replaced, "enough of the *interested* members of that board were replaced (and an additional director was added) so that the [board existing at the time the suit was filed] had a majority of directors (seven of nine) who derived no personal financial benefit from the challenged transaction" (emphasis in original). Thus, the court found that "it makes no sense under these circumstances to focus any aspect of the demand futility inquiry on the board that approved the underlying transaction," and that "demand here should not be excused if a majority of the Demand Board can impartially consider a demand, even when less than a majority of them were replaced." The court also found that even if entire fairness applied to the board's decision to approve the secondary offering, the plaintiff had not stated any nonexculpated claims against a majority of the board in connection with the secondary offering, because the plaintiff did not make particularized allegations that the disinterested directors "knowingly failed to inform themselves about the Secondary Offering or otherwise consciously disregarded their directorial

duties, as is required to allege a non-exculpated claim against them." The court also found that demand was not excused with respect to the plaintiff's *Caremark* claim that the defendants failed to ensure that Zynga maintained adequate controls regarding its public disclosures and failed to disclose material information. The court found that two of the directors were disinterested and independent because they joined the board after the alleged *Caremark* violations occurred, and that the three other independent directors did not face a substantial likelihood of liability for the *Caremark* violations because the plaintiff did not plead particularized facts linking the alleged "red flags" to the outside directors' knowledge or actions.

Delaware Court of Chancery Declines to Dismiss Claim Alleging Controlling Stockholder 'Extract[ed] a Non-Ratable Benefit' Through Consulting Agreement

In re EZCORP Inc. Consulting Agreement Derivative Litig., C.A. No. 9962-VCL, slip op. (Del. Ch. Jan. 25, 2016)
Click here to view the opinion.

Vice Chancellor J. Travis Laster issued a memorandum opinion granting in part and denying in part the defendants' motions to dismiss derivative claims for breach of fiduciary duty challenging certain consulting agreements entered into between EZCORP and an advisory firm, Madison Park, which was affiliated with EZCORP's controlling stockholder. After determining that a demand on the EZCORP board of directors would have been futile because it was not sufficiently independent and disinterested, the court found that the complaint stated a claim for breach of fiduciary duty related to the challenged transactions that would be governed by the entire fairness standard of review. The court explained that Delaware courts have historically applied the entire fairness framework broadly, not just in the squeeze-out merger context but to any transaction in which a controller allegedly "extracts a non-ratable benefit," including "compensation arrangements, consulting agreements, services agreements, and similar transactions between a controller or its affiliate and the controlled entity."

Mergers and Acquisitions

Delaware Court of Chancery Declines to Approve Disclosure-Based Settlement

In re Trulia, Inc. Stockholder Litig., C.A. No. 10020-CB (Del. Ch. Jan. 22, 2016)
Click here to view the opinion.

Chancellor Andre G. Bouchard declined to approve a disclosure-based settlement of deal litigation arising from Zillow's $3.5 billion acquisition of Trulia. Shortly after the proposed merger was announced, stockholder plaintiffs filed suit, engaged in expedited discovery and ultimately settled the claims in exchange for additional disclosures in a supplemental proxy statement. The court found that the additional disclosures were not "material" or even "helpful" to stockholders. In addition, the court explained that the settlement's release, which had been narrowed following the settlement hearing, was overbroad because it released all claims relating "in any conceivable way" to the merger.

In refusing to approve the settlement, Chancellor Bouchard stated that "the Court's historical predisposition toward approving disclosure settlements needs to be reexamined" but stopped short of saying that future disclosure-based settlements will be automatically rejected. Instead, Chancellor Bouchard explained that disclosure-based settlements will be met with "continued disfavor ... unless the supplemental disclosures address a plainly material misrepresentation or omission, and the subject matter of the proposed release is narrowly circumscribed to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sale process, if the record shows that such claims have been investigated sufficiently." Chancellor Bouchard elaborated that in "using the term 'plainly material,'" he meant "that it should not be a close call that the supplemental information is material as that term is defined under Delaware law." The court also left open the possibility that if the information was not plainly material, it may be appropriate to appoint an *amicus curiae* to "assist the Court in its evaluation of the alleged benefits of the supplemental disclosures, given the challenges posed by the non-adversarial nature of the typical disclosure settlement hearing."

Insider Trading Claims

SDNY Denies Motion for Summary Judgment on Insider Trading Claims

SEC v. Payton, 14 Civ. 4644 (S.D.N.Y. Dec. 28, 2015)
Click here to view the opinion.

Judge Jed S. Rakoff denied a defense motion for summary judgment filed on claims by the Securities and Exchange Commission (SEC) that certain individuals violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder by trading on inside information they had obtained downstream from a lawyer who worked on an acquisition. Specifically, the court noted that under Rule 10b5-2, there is a duty of trust and confidence where "the person communicating ... material nonpublic information and the person to whom it is communicated have a history, pattern, or practice of sharing confidences." The court recounted the history of sharing confidences between the lawyer who worked on the transaction and the lawyer's friend with whom the lawyer shared the allegedly inside information, and between and among the lawyer's friend and certain

other friends and colleagues several degrees removed from the original source of the allegedly inside information, including the defendants. The court noted that, for the defendants to be liable, the SEC would have to demonstrate that (1) the lawyer's friend owed a duty of trust to the lawyer, (2) the lawyer's friend breached that duty by disclosing it to others receiving a personal benefit thereby, and (3) the defendants understood the information was confidential and the lawyer's friend obtained a personal benefit by breaching a confidence. Regarding the first element, the court concluded that it was a genuinely disputed material fact whether a duty of trust existed between the lawyer and his friend because there was competing evidence on either side of the issue. Regarding the second element, the court likewise noted that, based on competing evidence, "a reasonable jury could find that" the lawyer's friend provided the tip for a personal benefit under the "quid pro quo" standard set forth by *United States v. Newman*, 773 F. 3d 438 (2d Cir. 2014) because the lawyer's friend and the tippee to whom he disclosed the allegedly inside information had a history of mutual favors. Regarding the third element, the court concluded that the remote tippees, *i.e.*, the defendants, had reason to know that the allegedly inside information was obtained by breaching a confidence because, among other reasons, they were sophisticated and had been in the securities industry for several years.

Interpreting *Omnicare*

Second Circuit Affirms Pre-*Omnicare* Dismissal of Securities Act Claims Based on a Pharmaceutical Company's Opinions

Tongue v. Sanofi, Nos. 15-588-cv, 15-623-cv (2d Cir. Mar. 4, 2016)
Click here to view the opinion.

The Second Circuit affirmed the dismissal of claims that Sanofi violated Sections 11 and 12(a)(2) of the Securities Act by concealing information about the company's clinical trials of a multiple sclerosis drug. The plaintiffs alleged that the Food and Drug Administration (FDA) repeatedly expressed concerns about the company's use of a single-blind study rather than a double-blind study, but that the company concealed those concerns from investors, and the FDA subsequently denied the drug application. The district court had dismissed the claims because the alleged misstatements were statements of opinion and the plaintiffs failed to sufficiently allege that the defendants did not genuinely believe the statements when made. The Second Circuit affirmed the district court's determination that the plaintiffs had failed to plead misstatement claims, but — in light of the Supreme Court's opinion in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, 135 S. Ct. 1318 (2015) — also reviewed whether the plaintiffs had sufficiently alleged that the company failed to disclose information in connection with the opinions.

Under *Omnicare*, the plaintiffs failed to state a claim: The court determined that the company had not improperly concealed information about the FDA's interim feedback because the company had a legitimate basis to expect approval based on the positive results of the trials, and sophisticated investors should be aware that a drug application will necessarily entail some dialogue between the company and the FDA. In addition, the offering documents included "numerous caveats," including one that addressed the reliability of the company's projections of the drug's success. Further, the FDA had publicly disclosed its general preference for double-blind clinic tests. The court reiterated that investors were "not entitled to so much information as might have been desired to make their own determination about the likelihood of FDA approval by a particular date," and the company need not have disclosed additional information "merely because it tended to cut against their projections." *Omnicare* requires only that the opinion "fairly align[]" with the information in the issuer's possession at the time.

Jury Trial

Eleventh Circuit Affirms Jury Instruction in Civil Securities Fraud Trial, Holds That Rule 10b-5(b) Does Not Impose Duty to Disclose All Material Information

Fried v. Stiefel Labs., Inc., No. 14-14790 (11th Cir. Mar. 1, 2016)
Click here to view the opinion.

The Eleventh Circuit affirmed a jury instruction given in a rare civil securities fraud trial, holding that Rule 10b-5(b) promulgated under Section 10(b) of the Securities Exchange Act "does not prohibit a mere failure to disclose material information."

The plaintiff, a former executive at the defendant company, brought suit against the defendant and its president after the defendant announced that it had been acquired at a sizable per-share premium by a large pharmaceutical manufacturer. The plaintiff claimed that the defendants committed securities fraud because, among other things, the president failed to notify the plaintiff of the pending sale during a conversation in which the officer advised the plaintiff to cash out his stock options in the defendant. Before trial, the district court refused to issue the plaintiff's proposed jury instruction that the defendants had a "duty to disclose all material information" to the plaintiff. The jury returned a verdict in favor the defendants.

In affirming the district court, the Eleventh Circuit held that the plaintiff's proposed jury instruction misstated the law. Rule 10b-5(b) imposes a duty only "to update prior statements if the statements were true when made, but misleading or deceptive if left unrevised." It does not require individuals to disclose material facts if the individual never made affirmative

statements that would be misleading if left uncorrected. The plaintiff's jury instruction thus misstated the law, because the defendant's only duty was to disclose information necessary to prevent prior statements from being misleading, not to disclose all material information to the plaintiff. Accordingly, the court held that the district court correctly refused to issue the plaintiff's proposed jury instruction and affirmed the judgment in favor of the defendants.

Securities Fraud Pleading Standards

Northern District of California Dismisses Securities Fraud Class Action Against Apple Supplier for Failure to Plead False or Misleading Statements

In re Invensense, Inc. Sec. Litig., No. 15-cv-00084-JD (N.D. Cal. Mar. 28, 2016)
Click here to view the opinion.

District Judge James Donato dismissed a securities fraud class action brought against a technology company that supplies iPhone parts to Apple, finding that the plaintiff failed to plead with particularity that the defendant made false or misleading statements.

The plaintiff, representing a putative shareholder class, brought suit under Sections 10(b) and 20(a) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder, alleging that the defendant and its officers waited too long to write down the value of certain obsolete inventory and made inflated estimates about the company's gross margins. Specifically, the plaintiff alleged that the defendant had overstated the value of its inventory and presented unrealistic gross margin projections in various earnings calls.

In dismissing the complaint, the court concluded that while the plaintiff had presented substantial and detailed evidence that the defendant's statements relating to the value of its inventory were false and misleading, the plaintiff had nonetheless failed to meet the heightened pleading requirements of the Private Securities Litigation Reform Act (PSLRA) and Federal Rule of Civil Procedure 9(b) because it did not allege the source of its knowledge. The court further concluded that the defendant's gross margin projections were forward-looking statements protected by the PSLRA's safe harbor provision and were thus inactionable as a matter of law. Accordingly, the court dismissed the plaintiff's inventory-related claims with leave to amend but dismissed the gross margin-related claims with prejudice.

Finally, because the Section 20(a) claims against the defendant's officers were predicated on the plaintiff's Section 10(b) claims, those claims were likewise dismissed.

Misrepresentations

Southern District of California Dismisses Securities Fraud Class Action Against SeaWorld Arising From Alleged Mistreatment of Captive Killer Whales

Baker v. SeaWorld Entm't, Inc., et al., No. 14cv2129-MMA (KSC) (S.D. Cal. Mar. 31, 2016)
Click here to view the opinion.

District Judge Michael M. Anello dismissed a putative securities fraud class action brought against SeaWorld, its officers and its underwriters, finding that the plaintiffs had failed to plead with particularity that SeaWorld made false or misleading statements, as required by the Private Securities Litigation Reform Act and Federal Rule of Civil Procedure 9(b).

The plaintiffs, seeking to represent a class of SeaWorld shareholders that purchased shares in various public offerings, brought claims under Sections 11, 12 and 15 of the Securities Act and under Sections 10(b) and 20(a) of the Securities Exchange Act. They alleged that SeaWorld and its officers committed securities fraud by publicly denying that the documentary "Blackfish" — which severely criticized SeaWorld's orca breeding program — had an adverse impact on the theme park's attendance. Plaintiffs alleged, among other things, that the documentary must have caused attendance to decline because attendance did decline during the class period, SeaWorld's competitors' attendance rose during the class period, "Blackfish" caused SeaWorld tremendous negative publicity and the California legislature considered a bill banning SeaWorld's orca breeding program.

In dismissing the Exchange Act claims as well as the claims brought under Sections 11 and 15 of the Securities Act, the court concluded principally that the plaintiffs had failed to plead with particularly that SeaWorld's denials were false or misleading because the plaintiffs failed to plead the existence of reports or data analyzing SeaWorld's attendance figures and attributing the decline in attendance to the negative publicity and pending legislative action following the release of "Blackfish." The court further concluded that the plaintiffs' other evidence of falsity — including the comparisons to SeaWorld's competitors — was fatally flawed, because factors other than "Blackfish," including increased competition and poor weather, may have been responsible for SeaWorld's attendance decline.

Finally, the court dismissed the Securities Act Section 12(a)(2) claims against all defendants, though for different reasons. The court dismissed the 12(a)(2) claims against SeaWorld and its directors because the plaintiffs did not adequately allege that these defendants sold or solicited purchases of SeaWorld shares.

And it dismissed the 12(a)(2) claims against the underwriter defendants because the plaintiffs failed to allege that they purchased shares from any of the underwriters specifically.

Northern District of Illinois Dismisses Former Employees' Securities Fraud Claims for Failure to Meet Heightened Pleading Standard

Cornielsen v. Infinium Capital Holdings, LLC, No. 14-cv-00098 (N.D. Ill. Mar. 3, 2016)
Click here to view the opinion.

Judge Andrea R. Wood dismissed without prejudice securities fraud claims brought under Section 10(b) of the Securities Exchange Act against a diversified alternative asset and risk management firm as well as certain officers and board members. The plaintiffs, former employees of the firm, claimed that the defendants made material misrepresentations and omissions regarding an employee program through which the plaintiffs' loans to the firm were converted into equity.

In dismissing the claims, the court concluded that the plaintiffs failed to adequately plead actionable misstatements under the heightened pleading standard of Rule 9(b) of the Federal Rules of Civil Procedure. The court reasoned that several of the plaintiffs' allegations failed because the plaintiffs did not identify the specific defendants who made the alleged misrepresentations or omissions, or the allegations were made "upon information and belief" with no supporting facts, as required by Rule 9(b). With respect to the omissions, the court reasoned that the plaintiffs failed to allege facts establishing that any defendant had a duty to speak. The court explained that there is generally no affirmative duty for a company to disclose all information that could potentially affect share prices, unless such silence renders an affirmative statement misleading. Finally, the court concluded that the plaintiffs failed to state with particularity how the alleged omissions rendered any affirmative statement misleading.

Colorado District Court Denies Motion to Dismiss Securities Fraud Claims Against Mining Corporation

In re Molycorp, Inc. Sec. Litig., No. 12-CV-00292-RM-KMT (D. Colo. Jan. 20, 2016)
Click here to view the opinion.

Judge Raymond P. Moore declined to dismiss, in large part, claims that a mining company violated Section 10(b) of the Securities Exchange Act and Sections 11 and 12(a) of the Securities Act by allegedly stating that a particular mine contained deposits of heavy rare earth elements (HREEs) (the company's "principal" products), while daily analysis of the mine demonstrated that there were no HREEs present. The court found that three types of allegations raised a plausible inference that the defendants acted with scienter: (1) information from a former analytical chemist (a confidential witness) about daily ore analysis that was entered into a computerized system, to which senior management had access, (2) the discrepancy between certain defendants' sales of the company's stock during and after the class period, and (3) the position of certain senior executives within the company, which gave them access to and knowledge of the information concerning the daily ore analysis and absence of HREEs. The court also found that the plaintiffs had sufficiently pleaded loss causation because they alleged that the stock suffered an abnormal decline in value following a senior executive's disclosure at a conference that the company had not found any HREEs in the mine. However, the court held that the complaint failed to state a claim against the individual defendants for insider trading because it did not sufficiently allege that those defendants had knowledge concerning the absence of HREEs at the mine. The court also determined that the complaint stated a claim under Section 11 of the Securities Act for material misrepresentations in the company's registration statement. The court further held that the complaint stated a claim under Section 12 of the Securities Act against the underwriter defendants. Although the court noted the "express privity requirement" under Section 12 and observed that plaintiffs might not ultimately prevail on their claim, it nevertheless found that the plaintiffs had sufficiently pleaded that they had "purchased ... shares [of] Molycorp common and preferred stock in the February and June 2011 Offerings pursuant to the February and June 2011 [p]rospectuses" and that the "Underwriter Defendants were sellers, offerors, and/or solicitors of sales of the common and preferred stock" offered in connection with the registration statements at issue.

Omissions

Second Circuit Affirms Dismissal of Claims Against Online Video Advertisement Company

Medina v. Tremor Video, Inc., No. 15-2178-cv (2d Cir. Feb. 8, 2016) (Summary Order)
Click here to view the opinion.

The Second Circuit affirmed the dismissal of claims brought by a putative class of investors alleging that an online video advertisement company violated Section 11 of the Securities Act by purportedly failing to disclose in a registration statement for the company's initial public offering certain material trends or uncertainties regarding delays in upfront ad buys, demographic pricing and ad buying. The plaintiffs alleged that the trends and uncertainties became apparent when the company released its quarterly financial results several months later. The court also

affirmed the denial of the plaintiffs' request for leave to amend their complaint as futile. Reviewing those rulings *de novo*, the Second Circuit held that the complaint failed to allege sufficient facts to give rise to a plausible inference that defendants omitted material trends or uncertainties, and it noted that the registration statement included adequate cautionary language. The Second Circuit also held that the proposed amended complaint was flawed because it failed "to plausibly allege that defendants *knew* of the alleged uncertainties and trends at the time of the Registration Statement." The court rejected the plaintiffs' argument that because publicly available information placed defendants in a "position to know" that their statements were false or misleading, that actual knowledge could therefore be imputed to defendants. The court concluded that although "[w]ith the benefit of hindsight," those trends were apparent by the time the company released its financial results, the plaintiffs could not use "hindsight alone" to impute to the defendants knowledge that certain events that constituted the trends "were omens of future material problems."

SDNY Dismisses Putative Securities Fraud Class Action for Failure to State Claim

In re China Mobile Games & Entm't Grp. Ltd. Sec. Litig., No. 14-CV-4471 (KMW) (S.D.N.Y. Mar. 7, 2016)
Click here to view the opinion.

Judge Kimba M. Wood granted the dismissal of claims that a Chinese developer and publisher of mobile games violated Sections 10(b) of the Securities Exchange Act by allegedly making false or misleading statements concerning the company's involvement in a bribery scheme and by failing to disclose certain related-party transactions. The plaintiffs alleged that the company assured investors in its offering documents that it had disclosed all material weaknesses of the company's operations but in fact failed to disclose that the company was paying bribes to maintain good relationships with its distributors and that the company's president's former company was one of the distributors receiving the alleged bribes. The court determined that the plaintiffs failed to sufficiently allege that the company's statements made in SEC filings were false at the time they were made because they were made more than three months before news articles and analysts reports speculated that the company had terminated employees for engaging in alleged bribery. Further, the court discredited the plaintiffs' confidential witness because the witness worked for the company's subsidiary, not the company itself.

In addition, although the court held that the company was under a duty to disclose related-party transactions, it determined that the plaintiffs failed to sufficiently allege facts showing that the company's president controlled his former company after he had sold his entire interest in it. The court also determined that the plaintiffs failed to adequately plead scienter. The plaintiffs' conclusory allegations that the company had a desire to conceal the alleged bribery and related-party transactions failed because the plaintiffs did not offer any factual support that the company benefited in some concrete or personal way from the alleged schemes or that the company concealed the alleged schemes in an effort to shore up its offering. Further, with respect to the alleged related-party transactions, the court determined that the company's president had divested all interest in his former company before joining the company, and no facts supported the allegation that the president's divestment was a sham. The court also reasoned that the plaintiffs failed to show that the company concealed the alleged bribery because the company did an independent investigation into the market's speculation of bribery and no misconduct was identified. Finally, the court found that the plaintiffs' reliance on the core operations doctrine failed because the mere fact that the company's publishing department was at the core of the company's business, without more, was insufficient to find an inference of scienter.

Eastern District of Michigan Dismisses Securities Fraud Claims Against Bank Holding Company and Its Officers

Lubbers v. Flagstar Bancorp. Inc., No. 14-cv-13459 (E.D. Mich. Feb. 10, 2016)
Click here to view the opinion.

Judge Bernard A. Friedman dismissed a federal securities class action against a holding company and two corporate officers. The court held that the plaintiff failed to plead any actionable misstatements or omissions under Section 10(b) of the Securities Exchange Act and therefore also failed to state a Section 20(a) control person liability claim against the two corporate officers.

The plaintiff alleged that the defendants misrepresented or failed to disclose certain information in public filings, including: (1) the existence of regulatory investigations into the company's mortgage servicing practices, (2) the effect of cost reductions in the company's mortgage servicing business, and (3) the ongoing risk of liability notwithstanding its sale of certain of its mortgage servicing rights.

The court held that the company's disclosures were adequate, noting that the company was not required to disclose every fact that may have been of interest to potential investors. The court further stated that the plaintiff failed to show particular statements were misleading because the allegedly omitted information was not logically related to the subject of the statements.

SDNY Dismisses Putative Securities Fraud Class Action for Failure to State Claim

In re Sanofi Sec. Litig., No. 14-cv-9624 (PKC) (S.D.N.Y. Jan. 6, 2016)
Click here to view the opinion.

Judge P. Kevin Castel granted a motion to dismiss a putative class action that alleged claims under Sections 10(b) and 20(a) of the Securities Exchange Act. The plaintiffs' claims arose from an alleged illegal marketing scheme whereby defendant Sanofi purportedly funneled millions of dollars to third-party consultants who "served as middlemen in a scheme to induce pharmaceutical retailers and hospitals to favor Sanofi's diabetes drugs over competing drugs." In reliance on a whistleblower's report, the complaint alleged that Sanofi undertook an internal investigation into nine potentially fraudulent contracts, which confirmed violations of internal policies and federal laws, but that the defendants nonetheless misrepresented Sanofi's legal compliance and corporate integrity. The complaint further alleged that the failure to disclose the alleged scheme boosted sales of Sanofi's diabetes products, but that once the company abandoned the scheme, sales of the products dropped off considerably.

The court first found that the plaintiffs had failed to allege the presence of an illegal scheme — or that Sanofi had conducted an internal investigation that confirmed the existence of the scheme — with the requisite particularity. Although the plaintiffs had pleaded that the whistleblower had learned that her co-workers had processed "improper inducement payments," they had pleaded no facts concerning the specific circumstances surrounding how the whistleblower had gained this knowledge. The plaintiffs also failed to identify the contracts in question or plead facts demonstrating that consultants had actually engaged in unlawful referral services on behalf of Sanofi, or that drug retailers and hospitals in fact received kickbacks. The court next determined that the complaint had not alleged that the defendants had made any material misstatements or omissions: Statements made on conference calls and in SEC filings about "efforts toward transparency, accountability, and disclosure" were mere "corporate puffery," too general to induce reliance. Furthermore, the CEO's Sarbanes-Oxley certification that the reports did not contain any untrue or misleading statements or omissions was not actionable because the plaintiffs did not allege that the CEO did not believe what he said. And although the plaintiffs complained of allegedly misleading statements made in SEC filings, press releases and conference calls concerning growth in diabetes products, "the allegation that a corporation properly reported income that is alleged to have been, in part, improperly obtained is insufficient to impose Section 10(b) liability." The court also held that the plaintiffs had failed to plead scienter. Knowledge of the alleged scheme could not be imputed to the CEO by virtue of his managerial position and the operation of corporate policies that would have, in the abstract, given him access to allegations concerning such a scheme. Finally, the court held that the plaintiffs had failed to allege loss causation because they had not pleaded any facts showing that Sanofi's alleged scheme in fact materially inflated sales of diabetes products. Because the complaint failed to state a primary violation of Section 10(b), it also did not state a claim under Section 20(a).

Scienter

Eighth Circuit Reverses Dismissal of Investors' Securities Fraud Claims Against Professional Services Company

Rand-Heart of New York, Inc. v. Dolan, No. 15-1838
(8th Cir. Feb. 10, 2016)
Click here to view the opinion.

The Eighth Circuit affirmed in part and reversed in part a district court ruling dismissing a class action brought against the officers of a professional services company for alleged violations of Sections 10(b) and 20(a) of the Securities Exchange Act. The plaintiff investors alleged that, in a press release and during a conference call with analysts regarding second-quarter results, the company omitted material facts about the financial stability of its subsidiary, predicting double-digit growth while failing to disclose the subsidiary's loss of its largest customer. The plaintiffs sought to recover for losses they sustained between the date of the allegedly misleading statements and the date the company announced its appointment of a chief restructuring officer. The district court granted the defendants' motion to dismiss, reasoning that the plaintiffs failed to adequately allege scienter and establish loss causation for the second half of the period at issue.

The Eighth Circuit reversed the district court's ruling that the plaintiffs failed to adequately plead scienter, holding that the investors sufficiently alleged that the company's failure to disclose its subsidiary's loss of its largest customer was reckless. Pointing to the plaintiffs' allegation that the customer had formerly provided more than 50 percent of the subsidiary's business, the court concluded that the financial instability caused by this loss was so obvious that the defendants must have been aware of it. The court rejected the defendants' argument that the company's statements were protected by the Securities and Exchange Act's safe harbor provision, holding that the "boilerplate" cautionary language accompanying the statements was not "*meaningfully* cautionary" because it did not include "company-specific warnings based on a realistic description of the risks applicable to the particular circumstances."

The court affirmed the district court's ruling that the plaintiffs failed to adequately plead loss causation for the period between the company's second press release during the alleged time period, which disclosed the company's financial hardships and the lost customer, and its announcement that it had appointed a chief restructuring officer. Emphasizing that corrective disclosures must actually present new information to the market, the court concluded that announcing the appointment of a restructuring officer did not correct a misrepresentation but merely elaborated on the company's previously disclosed plan to restructure.

Fifth Circuit Sets Forth 'Special Circumstances' Under Which Officers' Positions May Give Rise to Inference of Scienter

Local 731 I.B. of T. Excavators & Pavers Pension Trust Fund v. Diodes, Inc., No. 14-41141 (5th Cir. Jan. 13, 2016)
Click here to view the opinion.

The Fifth Circuit affirmed the dismissal of a securities class action against a semiconductor manufacturer and two of its officers, holding that the complaint failed to plead facts giving rise to a strong inference of scienter.

Plaintiffs alleged that the semiconductor manufacturer and its CEO and chief financial officer violated Section 10(b) of the Securities Exchange Act by failing to disclose that the company's labor policies exacerbated a labor shortage at the company's Shanghai facility. The plaintiffs alleged that the officer defendants must have known about the policies due to their executive positions. In response to defendants' motion to dismiss, the plaintiffs argued that although an officer's position alone does not suffice to create a strong inference of scienter, "special circumstances" taken together with an officer's position may support the requisite inference of scienter.

The Court of Appeals observed that the "'special circumstances' cases exhibit some combination of four considerations that might tip the scales in favor of an inference of scienter": (1) whether a company is small, such that the executives would be familiar with the intricacies of day-to-day operations, (2) whether the transaction at issue is critical to the company's vitality, (3) whether the alleged misrepresentation or omission would have been readily apparent to the speaker, and (4) whether the defendant's statements were internally inconsistent. The court held, however, that none of these factors was present in this case. First, the company had more than 4,000 employees at locations around the world, and it was not clear that senior executives in Dallas would be aware of labor policies in Shanghai. Second, the plaintiffs did not allege that the labor shortage jeopardized the company's existence. Third, the plaintiffs did not plead facts showing that the impact of Shanghai's labor policies would have been readily apparent to the officer defendants. Finally, the court held that the officers' statements were not inconsistent — the officers repeatedly informed investors of the labor shortage and accurately predicted the impact the shortage would have on the company's financial performance.

Northern District of California Dismisses Securities Fraud Class Action Against Electronic Payment Company

In re Verifone Sec. Litig., No. 5:13-cv-01038-EJD (N.D. Cal. Mar. 29, 2016)
Click here to view the opinion.

District Judge Edward J. Davila dismissed securities fraud claims brought against a leading provider of secure electronic payment services, finding that the plaintiffs failed to adequately allege either the misrepresentation or scienter elements of their claims.

The plaintiffs, representing a putative shareholder class, brought suit under Sections 10(b) and 20(a) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder, alleging that the defendants hid and misrepresented the failure of the company's transition from a product-oriented to service-oriented business model. Specifically, the plaintiffs alleged that the defendants misled the market by claiming to have achieved "record revenues and record profit" during the transition period, even though the defendants knew that the company's business model transition was a failure. The plaintiffs also claimed that the defendants failed to disclose transition-related decreases in the defendant's research and development budget, among other things.

In evaluating the plaintiffs' claims, the court found that the plaintiffs adequately pleaded that the "record revenues and record profits" statement could constitute a material misrepresentation because such statements were capable of objective verification. The court nevertheless dismissed the plaintiffs' claims based on those statements, concluding that the plaintiffs had failed to establish a strong inference that the defendants made that statement with scienter. First, the timing of the statement — 10 weeks before the defendant announced its actual financial results — did not give rise to the inference that the defendants must have known that the company would not achieve record revenues and profits when the statement was made. Second, the termination of key company employees more than two months after the statement was made did not support an inference of scienter in context, because the terminations were not obviously related to revelations of fraud. Finally, the plaintiffs' allegations regarding certain internal statements made by the defendant officers were insufficient to establish scienter because the plaintiffs failed to plead the time, place and context in which the statements were made.

The court then dismissed the claims predicated on the defendant's research and development budget, reasoning that the defendants had not made any affirmative statements that required the defendants to disclose its disinvestment in research and development in order to avoid misleading the market.

After dismissing the plaintiffs' Section 10(b) claims for failure to adequately plead falsity and scienter, the court dismissed the plaintiffs' Section 20(a) claims, which were predicated on the underlying 10(b) claims.

Northern District of California Refuses to Dismiss Securities Fraud Claims, Finds That Magnitude of Accounting Violations Created Strong Inference of Scienter

Thomas v. Magnachip Semiconductor Corp., No. 14-cv-01160-JST (N.D. Cal. Mar. 4, 2016)
Click here to view the opinion.

District Judge Jon S. Tigar refused to dismiss securities fraud claims against a South Korean technology manufacturer, finding among other things that the plaintiffs pleaded sufficient facts to create a strong inference that the defendant made false or misleading statements with scienter.

The plaintiffs, a group of investors, brought suit principally under Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder, alleging that the defendant consistently inflated its financial results over a two-year period from 2011 to 2013 through widespread accounting irregularities. For example, in 2014, the defendant restated its earlier financial results, to report that it suffered a roughly $11 million loss in net income in 2011 rather than gained nearly $22 million, as it had previously reported. The plaintiffs alleged that the magnitude of the defendant's accounting violations, which the defendant admitted were "illegal," combined with the resignations of two top employees, were sufficient to show a strong inference that the company's accounting violations were committed with scienter.

In denying the defendant's motion to dismiss, the court found that because the accounting violations "dramatically affected" the defendant's financial results in ways that strongly suggested "a typical corporate executive should have noticed them," the plaintiffs had pleaded facts sufficient to create a strong inference of scienter. The court further reasoned that the defendant company's admission that its management was responsible for the accounting errors, combined with the magnitude of the errors, was enough to suggest that the individual officer defendants were at least reckless in reporting the company's financial results. Moreover, the court found that the resignation of two of the defendant's top employees soon after the purported wrongdoing came to light contributed to an inference of scienter.

While the court allowed the plaintiffs' Section 10(b) claims to proceed, it found that the plaintiffs' additional claims under the Securities Act were time-barred because the plaintiffs failed to file those claims within one year after a reasonably diligent plaintiff would have discovered facts constituting the violations.

Inside the Courts
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