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Skadden

Inside the Courts
An Update From Skadden Securities Litigators

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Appraisal

Delaware Court of Chancery Finds Fair Value Is 28 Percent Higher Than Merger Price

In re Appraisal of Dell Inc., C.A. No. 9322-VCL
(Del. Ch. May 31, 2016)
Click here to view the opinion.

Vice Chancellor J. Travis Laster of the Delaware Court of Chancery issued a 114-page post-trial opinion in an appraisal action, finding that the fair value of Dell Inc.'s common stock at the time of its merger with Michael Dell and Silver Lake Partners was $17.62 per share, compared to the final merger consideration of $13.75 — approximately 28 percent higher than the merger consideration.

In the opinion, the court rejected the argument that the merger consideration was the best evidence of the company's fair value. While acknowledging that the negotiated price was a relevant factor in determining fair value, the court noted three factors that lead merger prices to deviate from fair value: (i) the passage of time between agreement on price and the closing of the merger, (ii) the relative thinness of the M&A market relative to public trading markets, and (iii) the existence of synergies, which are not considered in an appraisal action. While finding that the merger would "sail through" if reviewed under enhanced scrutiny in a fiduciary duty action and that the special committee did "many praiseworthy things," the court found that the sale process did not result in a fair value for the company for appraisal purposes, even though the deal price represented nearly a 30 percent premium to market. The court identified three factors in the presigning phase of the merger that contributed to its determination that the deal price did not represent fair value. First, the court found that the merger price was limited by the buyer's leveraged buyout pricing model, under which the merger consideration was set based on Silver Lake's need to obtain certain internal rates of return. Second, the court found "widespread and compelling evidence" of a significant "valuation gap" between the long-term value of Dell and the market price of Dell stock, finding the public market undervalued Dell's stock, resulting in an undervalued bid. Third, the court found there was not "meaningful" presigning price competition and criticized the special committee's decision not to engage prior to signing with other strategic and financial parties, even though they were ultimately contacted during the post-signing "go shop" period. Having concluded that Dell failed to establish by a preponderance of the evidence that merger price offered the most reliable evidence of fair value, the court reviewed the discounted cash flow analyses of both parties' experts. Using its own inputs for each of the discounted cash flow valuation factors, the court concluded that the fair value of Dell stock on the date of the merger was $17.62 per share.

Class Certification

Eighth Circuit Reverses Class Certification of Securities Fraud Claims Against Consumer Electronics Retailer and Officers/Directors

IBEW Local 98 Pension Fund v. Best Buy Co., Inc., No. 14-3178
(8th Cir. Apr. 12, 2016)
Click here to view the opinion.

The 8th Circuit reversed the District of Minnesota's ruling certifying a class of investors that alleged claims against a consumer electronics retailer under Section 10(b) of the Securities Exchange Act and Rule 10b-5, concluding that the plaintiffs failed to satisfy the predominance requirement for class certification. The plaintiffs claimed that the defendants made fraudulent or recklessly misleading public statements in a public conference call, inflating the company's publicly traded stock price. To satisfy the predominance requirement for class certification, the plaintiffs relied on the fraud-on-the-market presumption to demonstrate that common questions predominated in their 10(b)-5 action.

The 8th Circuit agreed with the district court's ruling that the plaintiffs had made a *prima facie* showing of the fraud-on-the-market presumption of reliance to demonstrate that common questions predominated. However, the court concluded that the district court misapplied the price impact analysis required by the U.S. Supreme Court's decision in *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398 (2014) (*Halliburton II*). The 8th Circuit noted that *Halliburton II* clarified that there is an additional question at the class certification stage: whether the 10(b)-5 defendant can rebut the fraud-on-the-market presumption with evidence showing an absence of price impact — that is, evidence that "severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at fair market price." Contrary to the district court, the 8th Circuit concluded that the defendants presented strong direct evidence, citing the opinions of both sides' experts to show the absence of price impact. Relying on the plaintiffs' own expert's event study, which showed no additional price impact from the allegedly misleading statements in the company's conference call when compared to the price impact after a truthful press release the company issued two hours earlier, the court concluded that the defendants successfully rebutted the fraud-on-the-market presumption of reliance. The court rejected the plaintiffs' argument that the drop in the stock price after the corrective disclosure statements evidenced price impact, finding that this argument did not refute the defendants' evidence of no price impact. Thus, the court reversed the district court's decision to certify the class.

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Demand Futility

Ninth Circuit Rejects Shareholder Suit Against Casino Magnate for Failure to Establish Demand Futility

La. Mun. Police Emps. Ret. Sys. v. Wynn, No. 14-15695 (9th Cir. July 18, 2016)
Click here to view the opinion.

The 9th Circuit affirmed the dismissal of a shareholder derivative suit alleging breach of fiduciary duty claims against a well-known casino magnate and his fellow directors, holding that the shareholders failed to establish demand futility.

The plaintiffs, shareholders of the corporation that runs the Wynn Resorts in Las Vegas, brought suit against the company's board of directors, alleging that the directors breached their fiduciary duties by paying a massive bribe to Chinese government officials and then forcing out a fellow director at great cost to the company when he demanded an investigation into the bribe. The plaintiffs did not demand that the board of directors direct the company to bring the suit. Instead, the plaintiffs argued that such a demand would have been futile because (i) the chairman of the board was an interested party in the disputed transaction, and a majority of the board was beholden to him, making them incapable of rendering impartial judgment about the suit, (ii) the directors faced a substantial likelihood of personal liability from the transaction, and (iii) the directors could not be impartial because there was a reasonable doubt as to whether their decision to force out the complaining director would have been given the benefit of the business judgment rule if it were challenged in court. The district court rejected these arguments and dismissed the suit.

In affirming the district court, the 9th Circuit first held that fewer than half of the board's directors were beholden to the board's chairman. Analyzing three directors in particular, the court held that (i) the chairman's donation to a director's political campaign in the 1990s did not render the director beholden to the chairman, (ii) the fact that a second director had been employed by the chairman for many years was likewise not sufficiently material to make him beholden, and (iii) the ownership stake given to a third director to compensate him for having to close accounts he managed at a private equity fund before joining the board was also insufficient to make the director beholden to the chairman. The court, moreover, rejected the plaintiffs' generalized theory that the chairman dominated the entire board because he "hand-picked" each director, holding that the theory was too speculative to pass muster under Nevada and Delaware law.

The court next rejected the plaintiffs' arguments that the directors could not be independent because they faced personal liability from the alleged bribe — the complaint had alleged that the directors were negligent in approving the bribe, when intentional misconduct was necessary to create liability under Nevada law.

Finally, the court rejected the plaintiffs' arguments that the decision to oust the complaining director would not receive the benefit of the business judgment rule after analyzing Nevada law and determining that ousting the director would not threaten the company's gaming license, notwithstanding the plaintiffs' arguments to the contrary.

Derivative Litigation

District of Minnesota Dismisses Derivative Cyber Breach-Related Claims Against Retail Corporation's Officers, Directors Upon Recommendation of Special Litigation Committee

Davis v. Target Corp., et al., No. 14-cv-203 (PAM/JJK) (D. Minn. July 7, 2016)
Click here to view the opinion.

Judge Paul A. Magnuson, relying on the report of a special litigation committee and the absence of opposition from the plaintiffs, granted the motions of the special litigation committee (SLC) and the corporation's director and officer defendants to dismiss a consolidated shareholder derivative action filed against the corporation's directors and officers.

In late 2013, cyber criminals breached a retailer's data systems and gained access to up to 70 million customers' credit card and other private information. Beginning in February 2014, the corporation's shareholders filed several derivative lawsuits, alleging that the company's directors and officers breached their fiduciary duties by failing to oversee the company's information security program and by failing to give the corporation's customers prompt and accurate information in disclosing the data breach. The various lawsuits were consolidated.

In response to the complaints, the corporation's board of directors formed a two-member SLC, which investigated and evaluated the claims asserted in the derivative complaints. In March 2016, the SLC released a 91-page report in which it concluded that it was not in the corporation's best interest to pursue the claims. The SLC notified the shareholder plaintiffs that the corporation would not pursue an action against the company's directors and officers, and filed a motion to dismiss the consolidated shareholder litigation. The director and officer defendants likewise filed motions to dismiss. In its report and related motion papers, the SLC noted that, under Minnesota law, courts defer to a special litigation committee's conclusions if the committee's members are disinterested and independent, and if its methodology reflects that its decision was the product of a good faith investigation. The shareholder plaintiffs did not oppose the motions to dismiss.

In a two-page order, the Minnesota district court granted the motions to dismiss. Although the order did not explain the court's reasoning, the court noted that the plaintiff shareholders stipulated that they did not oppose the motions, except to retain the right to move for legal fees and expenses.

Fiduciary Duties

Caremark Liability

Delaware Court of Chancery Dismisses Derivative *Caremark* Claims, Finding Alleged Antitrust Violations Did Not Constitute Red Flags

Melbourne Mun. Firefighters' Pension Trust Fund v. Jacobs, C.A. No. 10872-VCMR (Del. Ch. Aug. 1, 2016)
Click here to view the opinion.

Vice Chancellor Tamika Montgomery-Reeves granted the defendants' motion to dismiss derivative claims alleging that certain Qualcomm officers and directors damaged the company by repeatedly allowing and causing it to violate international antitrust laws. According to the complaint, Qualcomm paid approximately $2 billion in government fines and litigation settlements relating to alleged violations of antitrust laws in the United States, Korea and China. The stockholder plaintiff sought to hold certain Qualcomm directors and officers liable for these damages under a so-called *Caremark* failure of oversight theory. The plaintiff argued that the Qualcomm board members were on notice of the alleged antitrust violations and consciously disregarded their fiduciary duty to remedy or prevent that misconduct. The plaintiff further alleged that documents produced by the company in response to a Section 220 demand showed that a majority of the board members knew of pending investigations and regulatory actions related to alleged antitrust violations, but that no 220 documents evidenced any effort or actions by the board to address these alleged violations.

The Court of Chancery granted the defendants' motion to dismiss, finding that the complaint's allegations did not demonstrate that the board actually knew that the underlying business practices violated antitrust laws. Instead, the allegations indicated that "the [b]oard, at all times, was under the impression that its conduct did *not* violate applicable antitrust laws." According to the court, the complaint acknowledged that the board monitored the alleged antitrust violations and "consistently expressed — both verbally and through its actions — its view that its business practices were not violative of international antitrust laws and elected to address the relevant legal actions by focusing on educating industry participants and government officials as to why its practices were legal and by pursuing appeals." As a result, the court held that the plaintiff failed to plead conduct that constituted bad faith by the members of the Qualcomm board, and its claims were dismissed.

Mergers and Acquisitions

Delaware Court of Chancery Finds Stockholder Plaintiffs' Challenge to Extinguishment of Derivative Claims Via Merger Is Direct

In re Riverstone Nat'l, Inc. Stockholder Litig., Consol. C.A. No. 9796-VCG (Del. Ch. July 28, 2016)
Click here to view the opinion.

Vice Chancellor Sam Glasscock III refused to dismiss claims brought by a stockholder post-merger, finding such claims were direct. The plaintiffs alleged that a board of directors disloyally facilitated a merger, which forestalled a suit against them by stockholders acting derivatively on behalf of the company. That potential litigation, threatened but not yet pending as of the merger date, involved an alleged usurpation of corporate opportunity by a majority of directors. The merger was consummated, and the acquirer waived the right to pursue such action in the merger agreement. Thus, according to the ex-stockholder plaintiffs, the corporate asset was lost and was not accounted for in the merger consideration, which as a result was unfair. At the same time, the plaintiffs alleged that the defendant directors — to the extent they were stockholders — received the same benefit as the other stockholders as well as an additional benefit not so shared: They were relieved of potential liability they faced in the usurpation claim.

In largely denying the defendants' motion to dismiss, the court noted that the plaintiffs' claims were typical direct claims challenging the fairness of the merger and alleging the directors were interested in it. The court found that the complaint alleged particularized facts with respect to the individual directors showing that an action existed, premerger, against a majority of the directors for usurpation of corporate opportunity, and that had such a claim been brought derivatively before the merger, it would have survived a motion to dismiss. The court further found that premerger, stockholders had threatened such an action, and such a threat was known to the board at the time the company contemplated and negotiated the merger. The court also found that the implied liability was material to the threatened directors, and the merger agreement eliminated both the threatened derivative suit by operation of law and any pursuit of the matter as a corporate asset purchased by the acquirer. The court thus held "the complaint adequately alleges, under these particular facts, that a majority of the Defendant directors received a material benefit from the merger not shared by the common stockholders.

Since this majority was interested in the transaction, they must demonstrate that the merger was entirely fair to the stockholders, in light of a plausible allegation of unfair price. This matter, therefore, involves a direct attack on the fairness of the merger." The court found that it was reasonably conceivable that the merger was not entirely fair, because the price of the merger did not include the value of the foregone derivative claims and thus largely denied the defendants' motion to dismiss.

Insider Trading Claims

First Circuit Affirms Adequacy of Indictment Charging Insider Trading Under Misappropriation Theory

United States v. Parigian, No. 15-1994 (1st Cir. May 26, 2016)
Click here to view the opinion.

The 1st Circuit affirmed the denial of a motion to dismiss an indictment charging insider trading under a misappropriation theory. The indictment alleged that the defendant had received material nonpublic information from his friend (McPhail), who had in turn received it from his friend, a corporate insider. While expressing doubt as to whether the government would prevail at trial, the court held that the indictment alleged sufficient facts to apprise the defendant of the nature of the offense charged. The court held that the indictment adequately alleged that the defendant knew or should have known that his friend had breached a duty of trust and confidence owed to the corporate insider. The court reasoned that the friendship between McPhail and the insider gave rise to a "duty of trust and confidence" within the meaning of Rule 10b5-2, which requires a "history, pattern, or practice of sharing confidences, such that the recipient of the information knows or reasonably should know that the person communicating the material nonpublic information expects that the recipient will maintain its confidentiality." In this case, the information was on its face highly confidential, the disclosures by the insider to McPhail continued over a long period of time, and there was no indication that the insider knew that McPhail was passing information to others.

For his part, the defendant knew or should have known that McPhail had breached a duty, as evidenced by McPhail's admonition to him to keep the information quiet (he signed off an email with "SHHHHHHHHHHHHH!!!!!!!!!!!!!!!!!"). While recognizing a circuit split on the issue of whether, under the misappropriation theory, the indictment had to allege a personal benefit to the tipper — an issue on which the U.S. Supreme Court has granted *certiorari* review — the court held that the indictment had in any event alleged that the tipper had received a benefit in exchange for the tips in the form of assorted luxury entertainment.

In *dicta*, however, the court expressed skepticism that the "knew or should have known" standard that applies in civil cases is applicable to criminal prosecutions. The court observed that, in criminal cases, a "knew or should have known" standard is at odds with the principle that the government must prove that the defendant knew facts that made his conduct illegal. Although the court was concerned with the indictment's inconsistent reference to different *mens rea* standards — both that the defendant had acted "knowingly and willfully" and that he "knew or should have known" certain facts — the court ruled that the defendant had waived any objection to this inconsistency by failing to raise the issue before the district court or in his opening appellate brief.

Interpreting *Janus*

Ninth Circuit Holds That Attorney Was 'Maker' of Statements on Behalf of Client in Connection With Alleged Securities Fraud Scheme

ESG Capital Partners, LP v. Venable LLP, No. 13-56684 (9th Cir. July 11, 2016)
Click here to view the opinion.

The 9th Circuit reversed the dismissal of a securities fraud claim against an attorney who allegedly aided a client in committing securities fraud, holding that the attorney was the "maker" of the fraudulent statements under the U.S. Supreme Court's decision in *Janus Capital Group, Inc. v. First Derivative Traders*. *Janus* held that securities fraud liability lies with the "maker" of a false or misleading statement, which is "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it."

The plaintiffs, a group of investors formed to purchase pre-IPO Facebook shares, brought suit under Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder against the defendant law firm, alleging that one of the firm's attorneys assisted alleged con artist Tony Stratos in committing securities fraud. According to the plaintiffs, Stratos, using an assumed name, falsely claimed to have access to millions of Facebook shares and collected fees for shares he never delivered. The plaintiffs alleged that the defendant attorney committed securities fraud by setting up a shell company to hide Stratos' activities and falsely representing to the plaintiffs' agent that (i) Stratos was who he claimed to be, (ii) Stratos was legitimate, (iii) the attorney would provide documentation for the transaction, and (iv) Stratos was in contact with Facebook executives and had access to millions of shares. The district court dismissed the suit for failure to state a claim.

In reversing the district court, the 9th Circuit reasoned that the attorney went beyond merely communicating his clients' false statements and made false statements himself when he personally vouched for and detailed his relationship with Stratos. The court rejected the attorney's argument that his disclaimer before each of the allegedly false statements — that he was reporting the shell company's "understanding" of the deal — insulated him from liability, in light of his other statements personally vouching for Stratos.

The court next held that attorneys have a duty to tell the truth in making representations to prospective purchasers, even if they are not representing sellers of securities. Accordingly, the court rejected the attorney's argument that he was merely the "middleman" in Stratos' scheme and therefore had no duty to correct Stratos' false statements.

Finally, the court held that the plaintiffs had adequately pleaded scienter because the attorney had more than 100 phone conversations and 25 in-person meetings with Stratos before the scheme, and had access to facts that should have given him a strong suspicion that Stratos was using an assumed name.

Reliance

SDNY Holds for the Third Time That an Investor in *Vivendi* Is Not Entitled to a Presumption of Reliance

In re Vivendi Universal, S.A. Sec. Litig., No. 02-cv-5571 (SAS) (S.D.N.Y. Apr. 25, 2016)
Click here to view the opinion.

Judge Shira A. Scheindlin determined that a sophisticated class member bringing a claim under Section 10(b) of the Securities Exchange Act in connection with Vivendi's purported liquidity crisis was not entitled to a presumption of reliance. A jury had previously found for the plaintiffs on liability, and Judge Scheindlin established a procedure for challenging — on an investor-by-investor basis — the reliance element of a Section 10(b) claim. Although plaintiffs may avail themselves of the presumption of reliance at the class certification stage under certain circumstances, entitlement to the presumption may be challenged and rebutted by defendants in later stages. Judge Scheindlin determined that the evidence demonstrated that the sophisticated investor had "pursued an investment strategy that relied on his own, carefully researched evaluation of Vivendi's assets and liquidity" and not the market price. In addition, the investor had "regular meetings and telephone conversations with Vivendi's senior management" and thus likely had an understanding of Vivendi's liquidity risks. Because the investor was "indifferent" to the alleged fraud's impact on market price, the court determined that the defendants had successfully rebutted the presumption of reliance with respect to that investor.

SEC Administrative Proceedings

Eleventh Circuit Holds That Litigants May Not Collaterally Attack SEC Administrative Proceedings on Constitutional Grounds in Federal District Court

Hill v. Sec. & Exch. Comm'n, No. 15-12831 (11th Cir. June 17, 2016)
Click here to view the opinion.

The 11th Circuit vacated the district court's order enjoining the SEC's administrative enforcement proceedings, holding that litigants may not bring collateral constitutional challenges to SEC administrative proceedings in district court but rather must raise those challenges through the administrative process itself.

SEC administrative enforcement proceedings begin when the SEC serves the defendant with an order instituting proceedings. The SEC then delegates the proceedings to an administrative law judge, who holds an evidentiary hearing and renders an initial determination. That determination can be appealed first to the SEC, then to the federal courts of appeals on a petition for review. Administrative law judges are appointed by the SEC itself.

In this case, the petitioner was accused of insider trading and served with an order instituting proceedings. After receiving his order, he brought a collateral suit in federal district court, requesting a preliminary injunction and arguing that the SEC's administrative enforcement process is unconstitutional because the SEC's administrative law judges are inferior constitutional officers and therefore must be appointed by the president, head of an executive department or a federal court. The district court agreed with the petitioner and enjoined the SEC from having the petitioner's case heard by an administrative law judge.

On appeal, the 11th Circuit reversed, holding that the district court lacked jurisdiction to entertain the petitioner's collateral challenge. The court first held that Congress' appellate scheme — which permits litigants to challenge all SEC orders through a petition for review in a federal court of appeals — evinced Congress' intent to preclude parallel litigation in federal district courts. Next, the court held that the scheme provided the petitioner with meaningful judicial review, because he had an opportunity to develop an adequate factual record before the SEC and then have his case heard in federal court through a petition for review. Finally, the court held that the petitioner's constitutional challenges were within the SEC's expertise, since it was well practiced in interpreting its own authorizing statutes.

Securities Fraud Pleading Standards

Misrepresentations

SDNY Denies Motion to Dismiss Section 10(b) Claims Against Pharmaceutical Manufacturer That Allegedly Misled Investors About Drug Inventory Levels

In re Salix Pharm., Ltd., No. 14-CV-8925 (KMW) (S.D.N.Y. Apr. 22, 2016)
Click here to view the opinion.

Judge Kimba M. Wood denied a motion to dismiss Section 10(b) claims brought under the Securities Exchange Act against a pharmaceutical manufacturer alleging that the company made false or misleading statements concerning the inventory levels for certain drugs. The plaintiffs alleged that the manufacturer employed several unlawful schemes to artificially boost inventory levels of its drugs, causing the company's financials to be inflated. The plaintiffs alleged that as a result of these alleged schemes, the company made several false or misleading statements accompanying their press releases and SEC filings concerning the drug inventory levels. The court first determined that the plaintiffs had adequately alleged a material misrepresentation or omission as to the inventory levels. The court explained that under the Private Securities Litigation Reform Act's (PSLRA) safe harbor provision, plaintiffs asserting securities fraud claims based on forward-looking statements must show that the "statements were made with actual knowledge of their falsity by the speaker." The court determined that the company's statements of future inventory levels contained misrepresentations of present fact and thus were "not subject to the PSLRA safe harbor." The court explained that the company's statements expressing an expectation that inventory levels of certain drugs "would return to 'typical' levels by the end of the following quarter" were "predicated upon representations that current inventory levels" were not "typical."

The court also explained that the PSLRA's safe harbor provision "does not protect material omissions." The court found that the company's later-discovered omission that it would take several years to return wholesale inventory levels to normal was material because it "led analysts to believe that inventory levels were merely slightly outside of the range that [the company] described as 'normal' and could be returned to that level within about three months." In addition, the court determined that the company's cautionary language "was inadequate to warn of the specific risk" of inventory build-up. The court found that the company's "brief and generic" disclaimers were insufficient to satisfy the PSLRA's cautionary language requirement. The court noted that the risk about inventory levels was mentioned only once in more than 12 pages of cautionary statements and thus failed to alert a reasonable investor about (i) "the much broader risk of inventory build-up at issue" or (ii) "the lack of management review of inventory levels to monitor the risk." The court further found that the company's failure to update this cautionary language over time supported the conclusion that the company's language was "merely boilerplate." The court therefore held that the company's representations and omissions concerning current inventory levels constituted actionable misstatements.

Finally, the court found that the plaintiffs had raised a strong inference of scienter. Allegations that potential acquirers were able to determine the company's real inventory levels during standard due diligence procedures supported an inference that the company either knew or was reckless in not knowing that the statements it made about inventory levels were false. The court further determined that the magnitude of the alleged fraud and the fact that it involved the core operations of the company supported a strong inference of scienter.

Scienter

Sixth Circuit Affirms Dismissal of Misrepresentation Claims Against Industrial Cable Manufacturer, Control Liability Claims Against Two Executives

Doshi v. Gen. Cable Corp., No. 15-5621 (6th Cir. May 24, 2016)
Click here to view the opinion.

The 6th Circuit affirmed a district court ruling dismissing a class action brought against an industrial cable manufacturer and certain executives for alleged violations of Sections 10(b) and 20(a) of the Securities Exchange Act. The class action plaintiffs alleged that the manufacturer and its CEO and chief financial officer acted at least recklessly in issuing and approving the company's financial statements, which were materially false due to accounting errors and a theft scheme in its Brazilian operations. The district court granted the defendants' motion to dismiss after determining that the defendants were unaware of the accounting errors and scheme at the time of the alleged misstatements and therefore lacked the requisite state of mind to defraud.

The 6th Circuit affirmed the dismissal, concluding that the plaintiffs' allegations of scienter did not meet the heightened pleading standards of Rule 9(b) of the Federal Rules of Civil Procedure. The court reasoned that, while the knowledge of the Brazilian executive was imputed to the company, the state of mind of the executive was not. The court then applied the factors announced in *Helwig v. Vencor, Inc.* to determine that a strong inference of scienter did not exist for the company or its executives. 251 F.3d 540, 552 (6th Cir. 2001). The court determined that only two of the nine *Helwig* factors — (i) the divergence between internal reports and external statements on financial data and (ii) the disregard for the most current factual information before making public financial statements — were present in the case of the company and only the second of those two factors was present for the executives. The court reasoned that the inference that the defendants acted negligently was stronger than the inference that the defendants acted recklessly by issuing the public financial statements.

The 6th Circuit also affirmed the district court's denial of one plaintiff's Rule 59(e) motion to amend the complaint, concluding that the proposed amendments would not cure the deficiencies in the complaint and therefore, amendment would be futile.

Statutes of Repose/Statutes of Limitations

Eleventh Circuit Holds That SEC Actions for Injunctive Relief Are Not Subject to Five-Year Civil Statute of Repose

Sec. & Exch. Comm'n v. Graham, No. 14-13562
(11th Cir. May 26, 2016)
Click here to view the opinion.

The 11th Circuit affirmed in part and reversed in part the district court's dismissal of an SEC civil enforcement action, holding that the five-year statute of repose for actions to enforce "any civil fine, penalty, or forfeiture," 28 U.S.C. § 2462, bars untimely actions for declaratory relief and disgorgement but does not apply to injunctive relief.

The SEC brought a civil enforcement action against the defendant real estate investors, alleging that the defendants violated federal securities law by selling condominiums that were de facto securities while failing to pay out the returns they promised. The SEC's action sought declaratory and injunctive relief, and disgorgement of profits. The SEC brought the action more than five years after the alleged conduct occurred, and the defendants raised the federal civil statute of repose as an affirmative defense. The district court dismissed the suit, concluding that all three remedies sought by the SEC were precluded by the statute of repose.

In partially affirming and partially reversing the district court, the 11th Circuit held that, in determining whether a type of relief is a "penalty" subject to the statute of repose, courts will look to whether the civil suit seeks forward-looking or backward-looking relief. Because the declaratory relief sought would only have determined whether past actions were unlawful, the court held that such relief was backward-looking, and therefore the SEC's request for declaratory relief was time-barred. The court similarly held that an action seeking disgorgement is functionally identical to an action seeking forfeiture, and therefore the SEC's claim for disgorgement was time-barred as well. In contrast, the court held that, because injunctions are inherently forward-looking, they are not "penalties," and therefore the court reversed the district court's determination that the SEC's injunctive relief was time-barred.

Sixth Circuit Affirms Dismissal of Investors' Securities Claims Holding Claims Barred by Statutes of Repose

Stein v. Regions Morgan Keegan Select High Income Fund, Inc.,
Nos. 15-5903, 15-5905 (6th Cir. May 19, 2016)
Click here to view the opinion.

The 6th Circuit affirmed the dismissal of two actions brought against five investment funds for alleged violations of Sections 11, 12(a)(2) and 15 of the Securities Act, Sections 10(b) and 20(a) of the Securities Exchange Act, and SEC Rule 10b-5. In two cases, plaintiff investors alleged that they relied on the same defendant funds' material misrepresentations in deciding to invest in the funds. The plaintiffs brought these claims more than five years after the alleged misconduct occurred but argued the claims were timely based on an application of *American Pipe* tolling. *American Pipe & Construction Co. v. Utah,* 414 U.S. 538 (1974), holds that the commencement of a class action lawsuit tolls the statute of limitations for class plaintiffs who file claims after the denial of class certification. The 6th Circuit agreed with the district court that, under controlling 6th Circuit precedent, *American Pipe* tolling did not apply to the plaintiffs' securities claims against certain defendants, because those claims were brought before, not after, the denial of class certification in the earlier case. The court recognized that the 6th Circuit's rule is a minority view among the circuits.

Because the court's first holding did not necessarily result in the dismissal of claims against all defendants, the court next reviewed whether *American Pipe* tolling applies to statutes of repose and not merely statutes of limitations. The court held that it does not. Acknowledging a split among the other circuit courts, the 6th Circuit rejected the plaintiffs' argument that *American Pipe* tolling applies to statutes of repose. Reasoning that statutes of repose give defendants a substantive right to be free of liability after a certain absolute period of time, the court concluded that judicially created tolling doctrines, such as *American Pipe* tolling, do not apply to statutes of repose. Thus, the court held that the plaintiffs' claims were time-barred.

Second Circuit Reverses District Court's Finding That FDIC's Claims Were Time-Barred Pursuant to Recent Supreme Court Decision

Fed. Deposit Ins. Corp. v. First Horizon Asset Sec., Inc., et al., No. 14-3648-cv (2d Cir. May 19, 2016)
Click here to view the opinion.

The 2nd Circuit vacated the dismissal of claims brought under Sections 11 and 15 of the Securities Act by the Federal Deposit Insurance Corporation (FDIC) as receiver for a distressed bank against various financial institutions that had sold certain residential mortgage-backed securities (RMBS). The court found that the claims were not time-barred by the Securities Act's statute of repose. The claims arose from nine RMBS that the bank had purchased between June and October 2007 that were issued or underwritten by the defendants. On August 10, 2012, within three years of being appointed as receiver — but almost five years after the bank had bought the RMBS — the FDIC sued the defendants, alleging that the prospectus supplements pertaining to the RMBS contained misstatements. The defendants moved for judgment on the pleadings because the claims were brought more than three years after the securities were offered to the public and thus were untimely under the Securities Act's statute of repose. The FDIC, however, asserted that because the claims were brought within three years of the FDIC being appointed as the receiver, they were timely under the FDIC Extender Statute pursuant to *Federal Housing Finance Agency v. UBS Americas Inc.*, 712 F.3d 136 (2d Cir. 2013), which held that a similar extender statute applicable to actions brought by the Federal Housing Finance Authority displaced the Securities Act's statute of repose. The defendants argued that UBS was abrogated by the subsequent U.S. Supreme Court decision in *CTS Corp. v. Waldburger*, 134 S. Ct. 2175 (2014), which held that another similar extender statute did not pre-empt a state's statute of repose. The 2nd Circuit reversed the district court's dismissal, holding that the rationale of *UBS* was not overruled by the Supreme Court's holding in *CTS*. Rather, the *CTS* decision was "firmly rooted in a close analysis" of a different extender statute's "text, structure, and legislative history" and thus did not apply to the statute at issue in this case.

SDNY Dismisses Time-Barred Class Claims Against Bank Used by Madoff

Friedman v. JP Morgan Chase & Co., et al., No. 15-cv-5899 (JGK) (S.D.N.Y. May 18, 2016)
Click here to view the opinion.

Judge John G. Koeltl dismissed putative class claims against a financial holding company and certain of its subsidiary banks and investment banks, and certain employees of those institutions brought under Section 20(a) and Section 10(b) of the Securities Exchange Act. The plaintiffs — investors in Bernard Madoff's Ponzi scheme who allegedly withdrew more funds than they had invested — alleged that Madoff and his company conducted business with the defendants, including depositing and withdrawing billions of dollars, and creating structured financial products for certain of Madoff's feeder funds. The plaintiffs alleged that many of these transactions raised red flags, which the defendants ignored. The defendants contended that the claims were untimely, arguing that (i) Madoff's Ponzi scheme was revealed in 2008, (ii) the plaintiffs initiated their action in 2014, and (iii) pursuant to the Sarbanes-Oxley Act, private actions under Sections 10(b) and 20(a) are subject to a five-year statute of repose.

The plaintiffs contended that the statute of repose did not apply to their Section 20(a) claim because the statute of repose under Sarbanes-Oxley applies only to claims involving fraud, and Section 20(a) is not a fraud claim. The plaintiffs also argued that, even if the statute of repose applied, the period was tolled by the filing of a prior class action pursuant to *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974). The court rejected that argument, holding that the statute of repose barred claims under Section 20(a) because the primary alleged violations under Section 10(b) involved fraud. In addition, the court rejected the plaintiffs' tolling argument because, under 2nd Circuit precedent, tolling applies only to statutes of limitation and not statutes of repose. Further, Judge Koeltl also noted that, even if the statute of repose could be tolled, it would not help the plaintiffs because the prior class action involved only state law claims and was settled on behalf of a class of investors who had deposited more money into the Ponzi scheme than they had withdrawn (unlike the plaintiffs). Thus, the court found that the plaintiffs were not part of the class and could not rely on that action to toll the limitations period.

Inside the Courts
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