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U.S. SUPREME COURT

Amgen Inc. v. Conn. Ret. Plans & Trust Funds, No. 11-1085 (U.S. June 11, 2012)

Click here to view the Ninth Circuit opinion.

Supreme Court Grants *Cert.* to Review Securities Fraud Class Action Circuit Split

The U.S. Supreme Court granted defendant Amgen Inc.'s petition for a writ of *certiorari* to review whether a securities fraud plaintiff alleging fraud on the market must establish materiality in order to obtain class certification. The Ninth Circuit, in *Connecticut Retirement Plans & Trust Funds v. Amgen Inc.*, 660 F.3d 1170 (9th Cir. 2011), had held that such a plaintiff need not establish the materiality of an alleged fraudulent statement in order to obtain class certification. Rather, according to the Ninth Circuit's ruling, it is enough to show that the security in question was traded in an efficient market and that the alleged fraudulent statement became public. Having made that showing, the plaintiff could represent a class of shareholders, notwithstanding the defendant's objection that issues pertaining to individual reliance would predominate the action. The Ninth Circuit joined the Third and Seventh Circuits, but deepened a split with three other Courts of Appeals on the issue.

Amgen's successful petition posed two questions: "(1) [w]hether, in a misrepresentation case under SEC Rule 10b-5, the district court must require proof of materiality before certifying a plaintiff class based on the fraud-on-the-market theory"; and "(2) [w]hether, in such a case, the district court must allow the defendant to present evidence rebutting the applicability of the fraud-on-the-market theory before certifying a plaintiff class based on that theory." The case will be heard during the October Term 2012 and a decision is anticipated by the end of June 2013.

AUCTION RATE SECURITIES

In re Merrill Lynch Auction Rate Sec. Litig., No. 09 MD 2030 (LAP) (S.D.N.Y. June 4, 2012)

Click here to view the opinion.

SDNY Dismisses Claims That Merrill Lynch Made Misrepresentations and Omissions About the ARS Market

Chief Judge Loretta A. Preska of the U.S. District Court for the Southern District of New York dismissed claims that Merrill Lynch violated Section 12(a)(1) of the Securities Act and Section 10(b) of the Securities Exchange Act by allegedly making misrepresentations and omissions about the market for auction rate securities. Consistent with the U.S. Court of Appeals for the Second Circuit's ruling in *Wilson v. Merrill Lynch & Co., Inc.*, 671 F.3d 120 (2d Cir. 2011), the court dismissed the Section 10(b) claims because, taking judicial notice of articles demonstrating the information available to the market, the ARS purchases at issue occurred after Merrill Lynch disclosed to the market and on its website that it periodically intervened to support ARS auctions to prevent auction failure. As to the Section 12(a)(1) claim, that claim was time-barred by both the one-year limitations period and the three-year statute of repose because the action was filed more than one year after the ARS purchases occurred and more than three years after the ARS were first offered to the public. In addition, the complaint did not state a claim for violation of Section 12(a)(1) because Merrill Lynch could have reasonably concluded that the purchaser was a qualified institutional buyer and therefore, under SEC Rule 144A, the ARS offering was exempted from the Securities Act registration requirements, including Section 12(a)(1).

CLASS ACTIONS

Certification

Tsereteli v. Residential Asset Securitization Trust 2006-A8, No. 08 Civ. 10637 (LAK) (S.D.N.Y. June 29, 2012)

Click here to view the opinion.

SDNY Certifies Class of Investors; Plaintiffs' Only Claim Was That Underwriter Failed to Make a Reasonable Inspection of Offering Documents

Judge Lewis A. Kaplan of the U.S. District Court for the Southern District of New York certified a class of investors alleging that an underwriter of a residential mortgage-backed securities (MBS) offering violated Sections 11 and 12(a)(2) of the Securities Act. Because the court had previously dismissed all other claims, the plaintiffs' only claim was that the underwriter failed to make a reasonable inspection of the offering documents, which did not disclose the offerer's alleged abandonment of its underwriting standards. The court initially determined that Rule 23(a)'s numerosity requirement must be met on an "offering-by-offering" basis, rather than "tranche-by-tranche" as the underwriter argued. Rule 23(a)'s commonality and typicality requirements were satisfied because all proposed members purchased securities in the same offering and allegedly relied on the same offering documents that contained the same purported misstatements or omissions. And although the lead plaintiff did not show that it had not received principal or interest payments, it adequately alleged that its claims arose from the "same course of events" as other class members' claims, and so it met the typicality requirement. Further, Rule 23(a)'s adequacy requirement was satisfied, even though the lead plaintiff lacked knowledge about the claims, because lead plaintiffs may rely heavily on their counsel's knowledge. In addition, the underwriter did not show that the various investors had acquired individualized knowledge of the securities at issue, and the general information about MBS markets that might have put the investors on inquiry notice of a potential fraud were subject to generalized proof, satisfying Rule 23(b)(3)'s predominance requirement. The court also determined that the foreign identity of certain proposed class members, including the proposed lead plaintiff, did not make other forms of litigation superior to a class action because any unique issues of foreign law were minor or nonexistent.

In re Pfizer Inc. Sec. Litig., Nos. 04 Civ. 9866 (LTS) (HBP), 05 MD 1688 (LTS) (S.D.N.Y. Mar. 29, 2012)

Click here to view the opinion.

SDNY Certifies Investor Class in Case Against Drugmaker

Judge Laura Taylor Swain of the U.S. District Court for the Southern District of New York certified a class of investors claiming that Pfizer violated Section 10(b) of the Securities Exchange Act by allegedly making material misstatements and omissions concerning the safety of two drugs. Although the proposed institutional lead plaintiff's investments had been made by sophisticated investment advisers, it satisfied Rule 23(a)'s typicality requirement because those advisers presumably relied on market information, and Pfizer presented no evidence that the advisers relied on nonpublic information. In addition, the proposed institutional lead plaintiff's failure to establish a litigation hold on electronic communications did not render it inadequate because Pfizer did not show that relevant e-mails ever existed. Further, because the plaintiffs adequately alleged that Pfizer's statements regarding the drugs' safety were material and that its stock traded in an efficient market, the plaintiffs were entitled to the fraud-on-the-market presumption, and did not need to establish individual reliance.

Settlements

In re Lehman Bros. Sec. & ERISA Litig., No. 09 MD 2017 (LAK) (S.D.N.Y. May 3, 2012)

Click here to view the opinion.

SDNY Declines to Approve Settlement With Former Lehman Directors and Officers

In a securities fraud class action, Judge Lewis A. Kaplan of the U.S. District Court for the Southern District of New York declined to approve a proposed class settlement with certain former directors and officers of Lehman because the lead plaintiff did not provide sufficient information about the defendants' ability to pay a judgment higher than the proposed settle-

(continued on next page)

ment amount. Under the proposed settlement, the plaintiffs would receive $90 million, all paid from the defendants' D&O insurance. In support of the settlement, the plaintiffs commissioned an independent study performed by a former S.D.N.Y. judge, which obtained information on the defendants' liquid and illiquid assets, and concluded that the liquid net worth of the defendants was "substantially less than $100 million." The court determined that restricting this information to only "liquid" assets was insufficient to determine the defendants' ability to pay, a factor in determining the reasonableness of a class settlement, and required the defendants to turn over all materials provided to the independent investigator for *in camera* review, including information regarding the defendants' illiquid assets.

In re Lehman Bros. Sec. & ERISA Litig., Nos. 08 Civ. 5523 (LAK), 09 MD 2017 (LAK) (S.D.N.Y. May 24, 2012)

Click here to view the opinion.

SDNY Subsequently Rules Class Action Settlement Is Fair Despite Lack of Any Contribution by Former Lehman Directors and Officers

Judge Lewis A. Kaplan of the U.S. District Court for the Southern District of New York subsequently ruled that a class action settlement with the former directors and officers of Lehman Brothers was fair, reasonable and adequate. Under that settlement, certain insurers would pay $90 million without contributions from Lehman's former officers and directors. Following an *in camera* review of the value of the personal assets of the former directors and officers, the court concluded that a guaranteed $90 million from insurance policies was reasonable when compared to the risk of an unsuccessful outcome at trial, even though some investors may have been concerned at the lack of any contribution by the former directors and officers.

Waivers

Charles Schwab & Co. Inc. v. Fin. Indus. Regulatory Auth. Inc., No. C-12-518 EDL (N.D. Cal. May 11, 2012)

Click here to view the opinion.

Northern California Federal Court Refuses to Reach Broker-Dealer's Argument That FINRA's Ban on Class Action Waivers Is Preempted by the Federal Arbitration Act

Magistrate Judge Elizabeth LaPorte of the U.S. District Court for the Northern District of California dismissed with prejudice Charles Schwab & Co.'s (Schwab) action for a declaratory judgment against the Financial Industry Regulatory Authority, Inc. (FINRA). The dispute concerned whether Schwab had to exhaust administrative remedies before it could argue that FINRA's rule forbidding class action waivers is preempted by the Federal Arbitration Act under the U.S. Supreme Court's recent holding in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011). Schwab argued that under *AT&T* the Federal Arbitration Act preempts even federal laws that interfere with interpreting arbitration agreements according to their terms.

The district court explained that, under the Securities Exchange Act, FINRA has the power, under the SEC's supervision, to regulate broker-dealers. Pursuant to its regulatory authority as "a key part of the interrelated and comprehensive mechanism for regulating securities markets, including market participants such as [Schwab]," the court said, FINRA issued Rule 2268(d), which purports to prevent broker-dealers from making arbitration agreements with class action waivers. Because Schwab's customer agreement contained a class action waiver, FINRA began enforcement actions against it. Schwab had not, however, elevated its preemption argument through the five-layered administrative process for challenging FINRA enforcement actions. The court ruled that the failure to exhaust remedies was jurisdictional and dismissed Schwab's request for declaratory relief. The question of whether broker-dealers can agree with their customers to waive the right to proceed as a class remains undecided.

CONSENT ORDERS

Sec. & Exch. Comm'n v. Am. Int'l Grp., Inc., No. 04-2070 (GK) (D.D.C. Apr. 16, 2012)

Click here to view the opinion.

D.C. Federal Court Grants Third Party's Motion to Unseal Reports Related to SEC-AIG Settlement Agreement

Judge Gladys Kessler of the U.S. District Court for the District of Columbia granted a third party's motion to unseal the reports of an independent consultant appointed pursuant to an SEC-AIG settlement agreement. The court determined that the reports were judicial records subject to the common law right of access because the court might rely on the reports in enforcing the consent order, and the reports played a central role in the operation of the consent order. The court then ruled that the public's interest in viewing the documents outweighed the SEC's and AIG's interests in maintaining confidentiality. Although the SEC and AIG had jointly sought an order sealing the report, they did so 18 months after filing the initial consent order, which according to the court indicated that confidentiality was not a significant consideration in the initial agreement. In addition, AIG's concerns that the reports contained competitive information could be addressed by redacting the reports.

DEMAND FUTILITY

Akanthos Capital Mgmt., LLC v. CompuCredit Holdings Corp., No. 11–13227 (11th Cir. Apr. 25, 2012)

Click here to view the opinion.

Eleventh Circuit Rejects a Proposed 'Majority Ownership' Exception to a Contractual Demand Requirement

A unanimous panel of the U.S. Court of Appeals for the Eleventh Circuit upheld a contractual "no-action clause" against a challenge brought by bondholder plaintiffs who failed to make a pre-suit demand. The defendant corporation issued the bonds using a standard "no-action clause" barring bondholders from suing for any remedy with respect to the securities. Rather, the sole remedies belonged to the trustee. There was an exception to the no-action clause for bondholders who first made an appropriate pre-suit demand on the trustee, but it was undisputed that no such demand had been made.

The district court had denied the issuing corporation's motion to dismiss because, among other reasons, the plaintiffs comprised a majority of the bondholders. The lower court had reasoned that no-action clauses are intended to prevent the poor judgment of a minority interest from overwhelming the best collective interests of the bondholders.

The Eleventh Circuit rejected what it called the "novel proposition" that the no-action clause could be avoided by a majority of bondholders. "Although one purpose of the no-action clause is to deter suits brought by the minority, other purposes of the clause are to 'prevent rash, precipitate, or harassing suits by bondholders who disrupt corporate affairs,' ... and to protect the issuer from a multiplicity of lawsuits. ... Majority ownership offers no guarantee that those purposes are fulfilled," the court said. The panel reversed and remanded with instructions to dismiss the bondholders' suit.

DIRECTORS AND DIRECTORS' DUTIES

Zucker v. Andreessen, C.A. No. 6014-VCP (Del. Ch. June 21, 2012)

Click here to view the opinion.

Court of Chancery Dismisses Complaint Accusing HP Directors of Committing Waste in Connection With Termination Severance Payments to CEO

Vice Chancellor Donald F. Parsons Jr. of the Delaware Court of Chancery dismissed a derivative complaint for failure to adequately allege demand futility. The derivative complaint, brought on behalf of Hewlett-Packard, accused certain HP directors of committing waste in connection with the termination severance payments to then-CEO Mark Hurd and of breaching their duty

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of care by failing to implement a long-term succession plan. The court found that the plaintiff had not pleaded demand futility as to his waste claim because the plaintiff had failed to allege adequately that the severance agreement was so one-sided as to constitute waste. The court remarked that matters of executive compensation and severance are within the "essence of business judgment." The court found that, in exchange for the severance agreement, "at least some consideration runs to HP," including Hurd's agreement to extend certain confidentiality agreements, not to disparage the company, to cooperate with respect to transition and succession, and to release all claims he had against the company. Moreover, the court found that at least some portion of the severance could represent reasonable compensation for Hurd's past performance. While the "amount of Hurd's severance may appear extremely rich or altogether distasteful for some," the court held that the value of such benefits "is a matter best determined by the good faith judgments of disinterested and independent directors, men and women with business acumen appointed by shareholders precisely for their skill at making such evaluations," and not by the courts.

In dismissing the plaintiff's claim that the HP board's decision not to have a succession plan was a breach of the duty of care, the court applied the *Rales* test for evaluating demand futility because the claim challenged board inaction, rather than board action. The court explained that because HP's charter contained an exculpatory provision, for the HP directors to suffer a disabling likelihood of personal liability to satisfy the *Rales* test, "the alleged breach of care for failing to implement a succession plan must rise to the level of bad faith, such as a conscious disregard of a known duty to act." The court stated that it was not aware of any Delaware precedent finding that failure to adopt a long-term succession plan amounts to a breach of duty, and that there was "no basis on which to find demand futility, regardless of whether Delaware, as a normative matter, should adopt an express requirement that corporate fiduciaries must implement long term succession plans."

La. Mun. Police Emps.' Ret. Sys. v. Pyott, C.A. No. 5795-VCL (Del. Ch. June 11, 2012)

Click here to view the opinion.

Court of Chancery Denies Motion to Dismiss Derivative Claims, Refusing to Give Collateral Estoppel Effect to a California Court's Dismissal of Related Claims

Vice Chancellor J. Travis Laster of the Delaware Court of Chancery denied a motion to dismiss derivative claims asserted on behalf of Allergan, Inc. In so doing, the court refused to give collateral estoppel effect to a California court's dismissal of related claims.

Derivative actions were filed in the Delaware Court of Chancery and in the U.S. District Court for the Central District of California. The federal court dismissed claims in the California action pursuant to Rule 23.1 with prejudice. In the Court of Chancery action, the defendants moved to dismiss claims arguing that, among other grounds, the district court's dismissal operated as collateral estoppel, requiring dismissal. The Court of Chancery disagreed, and denied the defendants' motion to dismiss.

As an initial matter, the Court of Chancery determined that "whether successive stockholders are sufficiently in privity with the corporation and each other is a matter of substantive Delaware law governed by the internal affairs doctrine." Thus, whether the California judgment acted as collateral estoppel in the Delaware action would be evaluated under Delaware law. The Court of Chancery found that while a growing body of precedent holds that a Rule 23.1 dismissal has preclusive effect on other derivative complaints, controlling Delaware Supreme Court precedent makes clear that until a Rule 23.1 motion has been denied, a derivative plaintiff whose litigation efforts are opposed by the corporation does not have the authority to sue in the name of the corporation. Consequently, at the time of the first Rule 23.1 dismissal, other stockholders are not in privity with the stockholder plaintiff in the first derivative action, and the decision granting a Rule 23.1 dismissal cannot have preclusive effect. According to the Court of Chancery, while the first dismissal would constitute persuasive authority, it does not preclude the second action.

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Moreover, the court found that the plaintiffs in the district court action did not adequately represent Allergan, a finding that provided an independent basis for refusing to give collateral estoppel effect to dismissal of the federal court action. The Court of Chancery explained that it presumes that "a fast-filing stockholder with a nominal stake, who sues derivatively after the public announcement of a corporate trauma in an effort to shift the still-developing losses to the corporation's fiduciaries, but without first conducting a meaningful investigation, has not provided adequate representation." Thus, the court concluded that "[b]y leaping to litigate without first conducting a meaningful investigation, the California plaintiffs' firms failed to fulfill the fiduciary duties they voluntarily assumed as derivative action plaintiffs. Rather than seeking to benefit Allergan, they sought to benefit themselves by rushing to gain control of a case that could be harvested for legal fees. In doing so, the fast-filing plaintiffs failed to provide adequate representation." Thus, on those bases, the court found that the California judgment did not have preclusive effect on the Delaware litigation, and proceeded to deny the defendants' motions to dismiss under Rules 23.1 and 12(b)(6). The court held that, read as a whole, the particularized allegations supported a reasonable inference that the board consciously approved a business plan predicated on violating the federal statutory prohibition against off-label marketing, and that one can not loyally act as a corporate director by causing the corporation to violate the positive laws it is obliged to obey. The Delaware Supreme Court has accepted an interlocutory appeal of the decision.

DUTY TO DISCLOSE

Pub. Pension Fund Grp. v. KV Pharm. Co., No. 10-3402 (8th Cir. June 4, 2012)

Click here to view the opinion.

Eighth Circuit Reinstates Investors' Claims That KV Pharmaceutical Failed to Disclose FDA Problems

The U.S. Court of Appeals for the Eighth Circuit reversed in part, and affirmed in part, the dismissal of an action against KV Pharmaceutical relating to statements made about the company's compliance with FDA regulations between 2003 and 2009. The plaintiffs alleged that KV failed to disclose numerous warnings received from the FDA that its facilities were not in compliance with FDA regulations, including by ignoring manufacturing deficiencies that produced defective products and packaging. These deficiencies eventually led KV to shut down its manufacturing activities altogether. The plaintiffs also alleged that KV made false and misleading statements about its earnings from sales of these defective products. Shortly after the district court dismissed the initial complaint for failure to plead claims with enough specificity, a KV business unit pleaded guilty to two felony counts and paid more than $27 million in penalties. The district court thereafter denied the plaintiffs' motion to vacate dismissal and for leave to file an amended complaint.

On appeal, the Eighth Circuit reversed in part, holding that the plaintiffs adequately set forth the reasons that KV's statements about its material compliance with FDA regulations were false and misleading. The court determined that receipt of warnings from the FDA indicated that the company was not in material compliance with FDA regulations and that this information would be material to a reasonable investor. The court found KV's argument that investors could have obtained these FDA warnings by filing a FOIA request unpersuasive, noting that, once KV chose to represent that it was in compliance with FDA regulations, it was obligated to make full disclosure of all material facts. By contrast, the court affirmed the dismissal of the plaintiffs' claim that KV made false and misleading statements about its earnings, noting that the company did not undertake a duty to speak about its manufacturing problems solely by reporting historical financial results. In addition, the court affirmed the dismissal of claims against two executives under a theory of scheme liability, adopting new precedent that requires more than mere misrepresentations or omissions for liability in a scheme. Finally, the court determined that the district court abused its discretion in denying the plaintiffs' motion to

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amend the complaint, as the new allegations related to the guilty plea provided further support for the allegations in the plaintiffs' initial complaint.

Richman v. Goldman Sachs Grp., Inc.,
No. 10 Civ. 3461 (PAC)
(S.D.N.Y. June 21, 2012)

Click here to view the opinion.

SDNY Dismisses Claims Against Goldman Sachs Relating to Disclosure of Wells Notices

Judge Paul A. Crotty of the U.S. District Court for the Southern District of New York dismissed claims that Goldman Sachs violated Section 10(b) of the Securities Exchange Act by failing to disclose its receipt of Wells notices from the SEC regarding its role in a collateralized debt obligation (CDO) offering. Although Goldman Sachs had previously disclosed that it was being investigated, it did not have a duty to specifically disclose the Wells notices, because those notices merely confirmed that investigations were ongoing. Goldman Sachs' press release following a *New York Times* article on CDOs also did not trigger a duty to disclose because it did not address the issue of governmental investigations. The court also determined that Item 103 of Regulation S-K does not create a duty to disclose a Wells notice, because litigation is not substantially certain to occur at that point. Goldman's failure to disclose the Wells notices received by two of its employees under FINRA Rule 2010 and NASD Conduct Rule 3010 was insufficient to support the plaintiffs' claims because such rules do not confer private rights of action.

INTERLOCUTORY APPEALS

Fed. Hous. Fin. Agency v. UBS Ams., Inc.,
No. 11 Civ. 5201 (DLC)
(S.D.N.Y. June 19, 2012)

Click here to view the opinion.

SDNY Grants Motion to Permit Expedited Appeal of Ruling Denying Dismissal of Claims Brought by the FHFA on Behalf of Fannie Mae and Freddie Mac

Judge Denise Cote of the U.S. District Court for the Southern District of New York granted UBS's motion to permit expedited appeal of the court's earlier ruling denying dismissal of claims brought by the Federal Housing Finance Agency on behalf of Fannie Mae and Freddie Mac as untimely under Sections 11 and 12(a)(2) of the Securities Act. The court had concluded that the Housing & Economic Recovery Act of 2008 (HERA) displaced the three-year statute of repose on Securities Act claims brought by the Federal Housing Finance Authority, even though the express language of that act addressed only the one-year statute of limitations on Securities Act claims. Although a reversal of the court's decision might not fully end the litigation, it would significantly narrow the classes of securities at issue and limit discovery, and so constituted a "controlling question[] of law." Appellate review would also materially advance the litigation's termination, because a reversal would end or significantly restrict the litigation's scope, and an affirmance would clarify the parties' bargaining positions, facilitating settlement. In addition, resolution of the timeliness issue would facilitate the resolution of 17 similar actions filed by the Federal Housing Finance Agency against various defendants. Finally, UBS's citation to two previous district court decisions interpreting statutes with substantially similar language to that at issue, both of which reached conclusions contrary to the court's decision, suggested that there were grounds for a difference of opinion on the question to be appealed. Thus, the court certified for review by the U.S. Court of Appeals for the Second Circuit the question whether it was an error to conclude that HERA displaces the statute of repose that generally governs claims under the Securities Act.

INVESTMENT COMPANY ACT

Santomenno v. John Hancock Life Ins. Co. (U.S.A.), No. 11-2520 (3d Cir. Apr. 16, 2012)

Click here to view the opinion.

Third Circuit Affirms Dismissal Because Plaintiffs Did Not Maintain Continuous Ownership of Fund

The U.S. Court of Appeals for the Third Circuit affirmed the dismissal of claims that John Hancock violated Sections 36(b) and 47(b) of the Investment Company Act by allegedly charging excessive fees on annuity contracts held by an employees' retirement fund because the plaintiffs did not maintain continuous ownership in the fund. The court held that, because Section 36(b) is derivative in nature, plaintiffs must own shares in the fund when they file suit and must hold the fund's securities throughout the entire litigation in order to maintain standing. Because all of the plaintiffs had sold their securities before filing their amended complaint, which was the operative pleading, the plaintiffs did not have standing to sue under Section 36(b). The plaintiffs' Section 47(b) claims also failed because that section creates a remedy rather than a separate cause of action, and the plaintiffs could not rely on John Hancock's alleged violations of Section 26(f) to create a claim because Section 26(f) does not provide for a private right of action.

LOSS CAUSATION

Fencorp, Co. v. Ohio Ky. Oil Corp., Nos. 09-4317/4320/4321/4322 (6th Cir. Apr. 4, 2012)

Click here to view the opinion.

Nolfi v. Ohio Ky. Oil Corp., Nos. 09-4315/4316/4323 (6th Cir. Apr. 4, 2012)

Click here to view the opinion.

Sixth Circuit Upholds Decisions on Securities Fraud Claims, Award of Rescissory Damages and Imposition of Discovery Sanctions

The U.S. Court of Appeals for the Sixth Circuit affirmed the district court's judgment and directed the reinstatement of the verdict in two companion cases involving federal securities claims brought against Ohio Kentucky Oil Corporation (OKO). The dispute arose from various investments made by Frederick E. Nonneman and Fencorp, the family investment corporation he formed, in oil drilling ventures with OKO. In personal letters to Nonneman, OKO touted the virtues of a drilling joint venture and included grandiose promises of rich rewards but did not temper those promises with any cautions or warning that the exploratory drilling had a low chance of success. Further, the investment terms provided that if no oil was found, OKO would keep any excess funds invested. Ostensibly for this reason, OKO did not drill in areas where it was likely to strike oil, thereby allowing OKO to avoid the costs of completing the well and keep the remainder of any investments. After learning of these facts, the plaintiffs filed suit against OKO alleging violations of Section 10(b) of the Securities Exchange Act, Section 12(a)(1) of the Securities Act, Ohio Blue Sky laws, common law fraud, breach of fiduciary duties and breach of contract. After the jury found that OKO had violated various federal securities claims and awarded rescissory damages, OKO appealed.

On appeal, the Sixth Circuit rejected OKO's argument that the plaintiffs' loss causation theory was not actionable under Section 10(b) because an inflated purchase price is not an actionable economic loss. The Sixth Circuit distinguished the purchase of stock in a company traded on the open market, as occurred in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), from a partnership with an oil company that has no intention of actually finding oil. As the Sixth Circuit explained, the stockholder in *Dura* received stock at a price that may have been inflated but retained real value. The investors in OKO, however, purchased interests in oil drilling ventures from a company that was not actually interested in drilling for oil and whose interests are now completely worthless. The Sixth Circuit also affirmed the district court's ruling that the OKO investments — fractional undivided interests created by OKO for the purpose of sale — are securities as a matter of law.

The Sixth Circuit also rejected OKO's various challenges to the jury instructions. OKO argued, among other things, that the jury instructions incorrectly stated that the measure of damages

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for Section 10(b) claims is the purchase price, *i.e.*, rescission. In considering this argument, the Sixth Circuit once again distinguished this case from *Dura*, where the pleadings did not let the defendants know what the causal connection might be between the loss and the misrepresentation. In this case, there was no question that the misrepresentation caused the complete loss of the plaintiffs' entire investment because the wells were worthless and the investments were fraudulent. As the Sixth Circuit explained, a private sale of worthless investments by a company intending to keep the profits by drilling dry wells is in no way analogous to the public sale of stock by a major corporation. Since the misrepresentations caused the plaintiffs to lose their entire investment, rescissory damages were appropriate. The Sixth Circuit emphasized, however, that rescission is a fact-dependent remedy for a Section 10(b) claim and likely only appropriate in rare or unusual circumstances.

The Sixth Circuit also upheld the dismissal of the Section 12(a)(1) claims as barred by the statute of limitations, even though the plaintiffs contended that equitable tolling should extend the statute of limitations period. The Sixth Circuit, however, concluded that Congress intended to negate equitable tolling in this context because Congress expressly mentioned a discovery rule for Section 12(a)(2) claims but not for Section 12(a)(1) claims.

The Sixth Circuit also affirmed the district court's decision to impose discovery sanctions and grant summary judgment against OKO on its federal preemption defense to state securities claims. Although OKO argued that these were "drastic" discovery sanctions, the Sixth Circuit noted that the facts demonstrated the reasonableness of the district court's action. The district court found that the defendants had disobeyed three separate discovery requests for documents related to OKO's general solicitation and refused to produce material that the court deemed discoverable. Moreover, at a later hearing, an OKO official testified that although the material requested still existed, there had been a companywide order to destroy the documents and no official had ordered that the documents be made available to the plaintiffs. Based on these facts, the Sixth Circuit upheld the district court's decision to impose discovery sanctions and found that OKO had engaged in general solicitation, rendering OKO's federal preemption defense void.

MATERIALITY

Sec. & Exch. Comm'n v. Morgan Keegan & Co., Inc., No. 11-13992 (11th Cir. May 2, 2012)

Click here to view the opinion.

Eleventh Circuit Rules That a Misstatement by an Individual Broker to an Individual Investor Can Be Included in 'Total Mix' of Information Available to Reasonable Investor

The U.S. Court of Appeals for the Eleventh Circuit held *per curiam* that, in an enforcement action brought by the SEC, misstatements made by an individual broker to an individual investor can be considered in a court's materiality analysis. The SEC brought suit against Morgan Keegan & Co., alleging that the company falsely stated that auction rate securities were "cash equivalents," and that the securities were liquid investments despite auction failures and other trouble in the relevant markets. The SEC proffered testimony from individual customers who said they had *not* read the publicly available materials, but had received misstatements from their brokers directly. The district court had granted Morgan Keegan summary judgment on the basis of a lack of materiality, holding that "the SEC must do more than show a few isolated instances of alleged broker misconduct to obtain the relief it seeks."

The Eleventh Circuit reversed, noting that under U.S. Supreme Court case law, a misstatement or omission is material if there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having altered the "total mix" of information available. Applying this test to the one-on-one alleged misrepresentations at issue, the appellate court ruled that the lower court erred in finding no materiality as a matter of law. The private communications were part of the total mix: "In other words, the materiality test requires the court to consider *all* the information available to the hypothetical reasonable investor, which necessarily includes private communications," the court said.

MISREPRESENTATIONS

In re Wilmington Trust Sec. Litig., No. 10-990 (D. Del. Mar. 29, 2012)

Click here to view the opinion.

Delaware Federal Court Dismisses Claims Against Bank for Failure to Plead Any Misrepresentations

Judge Sue L. Robinson of the U.S. District Court for the District of Delaware dismissed claims that a bank violated Section 10(b) of the Securities Exchange Act and Sections 11 and 12(a)(2) of the Securities Act, because the plaintiffs did not adequately plead any misrepresentations. The plaintiffs' complaint listed numerous alleged misstatements and purported misconduct, but it failed to tie the statements and conduct together. In addition, the alleged misstatements consisted only of a series of quotes, without any documentation or context. Because the plaintiffs did not explain why each statement was false or misleading, they did not satisfy either the PSLRA's heightened pleading standards or state claims under the Securities Act.

MORTGAGE-BACKED SECURITIES

Fulton Cnty. Emps. Ret. Sys. v. MGIC Inv. Corp., No. 11-1080 (7th Cir. Apr. 12, 2012)

Click here to view the opinion.

Seventh Circuit Affirms Dismissal of MBS Securities Fraud Action

The U.S. Court of Appeals for the Seventh Circuit upheld the dismissal of a putative securities class action against mortgage insurer MGIC Investment Corp., holding that the plaintiffs failed to plead fraud in connection with statements made about the financial health of an MGIC affiliate prior to the subprime mortgage crisis. The plaintiffs filed four class action suits under the Securities Exchange Act related to the steep fall in the price of MGIC securities after it announced that its investment in affiliate C-BASS (Credit-Based Asset Servicing and Securitization LLC) was materially impaired. These suits were consolidated in Wisconsin federal court, where the judge concluded that the consolidated complaint failed to meet the requirements of the PSLRA and subsequently denied leave to amend the complaint. One plaintiff appealed one claim, related to alleged fraud that occurred in connection with an MGIC earnings call in which MGIC stated that C-BASS had "substantial liquidity" to meet margin calls. The plaintiff argued that certain statements made by C-BASS's executives during this call were fraudulent and that MGIC was either vicariously or directly liable for these statements.

On appeal, the Seventh Circuit affirmed dismissal of the action, holding that "the 'substantial liquidity' statement was true, both absolutely," because C-BASS at the time held cash reserves of $150 million, "and relative to the needs of C-BASS's business." As a result, the plaintiff "flunked the PSLRA's requirement for pleading *scienter*" because MGIC could plausibly argue that its reserves were adequate without raising an inference of fraud. The court further noted that MGIC made this statement in the context of warning that C-BASS's reserves might be insufficient, and that "MGIC had no duty to foresee the future" collapse of the subprime mortgage market. The Seventh Circuit also rejected the plaintiff's claim that MGIC was vicariously liable for statements made by C-BASS executives under Section 20(a) of the Securities Exchange Act. Although MGIC owned 46 percent of C-BASS shares, another 46 percent was owned by a separate entity, with the remaining 8 percent owned by C-BASS managers. Thus, MGIC could not control C-BASS without the assent of a third party. Finally, the court rejected the plaintiff's attempt to hold MGIC managers directly liable for the statements of C-BASS under Section 10(b) and Rule 10b-5. The plaintiff's argument that MGIC had a "duty to correct" erroneous statements made by C-BASS executives conflicted with the central holding of *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), in which the U.S. Supreme Court determined that only the person with ultimate authority over the language is the "maker" of a statement under Section 10(b).

Syncora Guarantee Inc. v. EMC Mortg. Corp., No. 09 Civ. 3106 (PAC) (S.D.N.Y. June 19, 2012)

Click here to view the opinion.

SDNY Partially Grants Summary Judgment in Favor of CDO Insurer

Judge Paul A. Crotty of the U.S. District Court for the Southern District of New York partially granted summary judgment in favor of a collateralized debt obligation (CDO) insurer and against the mortgage servicer EMC Mortgage on claims that the mortgage servicer allegedly breached the representations and warranties in the mortgage loan purchase agreement. Those representations and warranties covered both transaction-level warranties (including about EMC Mortgage's operations) and loan-level warranties (*e.g.*, about the mortgage underwriting and servicing process). The court reasoned that the agreement did not require that the insurer be injured by any breaches of the representations or warranties, and therefore that the insurer was not required to prove that any of the alleged breaches actually injured it. In addition, looking to New York Insurance Law Section 3106(b), the court concluded that the insurer only needed to prove that the alleged breaches of the representations and warranties increased the insurer's risk of loss.

PSLRA DISCOVERY STAY

Dipple v. Odell, No. 12-1415 (E.D. Pa. May 2, 2012)

Click here to view the opinion.

Pennsylvania Federal Court Denies Motion to Lift PSLRA Automatic Discovery Stay for Failure to Show Undue Prejudice

Judge William H. Yohn Jr. of the U.S. District Court for the Eastern District of Pennsylvania denied a motion to lift the PSLRA automatic discovery stay because the plaintiffs did not show it was necessary to avoid undue prejudice. The plaintiffs alleged that an automotive repair company had made false and misleading statements in its proxy statement in connection with a proposed transaction that would take the company private. The court determined that the PSLRA automatic stay applied to individual actions as well as proposed class actions, and that the plaintiffs were required to show both particularized discovery specific to the claims asserted and undue prejudice before the court could lift the stay. The court ruled that some of the plaintiffs' discovery requests were particularized, but the plaintiffs failed to show undue prejudice. The plaintiffs' inability to review documents prior to a shareholder vote on the transaction was not undue prejudice because it was inherent in the effects of the stay, and the plaintiffs could still receive damages as a remedy. In addition, although the stay might put the plaintiffs at a disadvantage compared to parallel state court litigation (which the plaintiffs withdrew from in order to press similar claims in federal court), where discovery was ongoing, that did not amount to "undue prejudice" because it was a result of the plaintiffs' own strategic choice of forum and of Congress' decision that actions subject to the PSLRA should be treated differently than other actions.

SCIENTER

Auto. Indus. Pension Trust Fund v. Textron Inc., No. 11-2106 (1st Cir. June 7, 2012)

Click here to view the opinion.

First Circuit Affirms Dismissal of Claims Related to Alleged Misrepresentation of the Significance of an Order Backlog

The U.S. Court of Appeals for the First Circuit (with retired Associate Justice David Souter on the three-judge panel) affirmed the dismissal of claims that Textron violated Section 10(b) of the Securities Exchange Act by allegedly misrepresenting the significance of a backlog of orders for planes sold by a Textron subsidiary. Although the district court dismissed the complaint on materiality grounds, the First Circuit affirmed on the ground that the plaintiff did not plead facts justifying a reasonable inference of scienter. Specifically, the complaint failed to plead a compelling inference that Textron's officers believed or were recklessly unaware that the backlog's significance had been undermined. Further, although the individual defendants

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sold some stock during the putative class period, the complaint did not explain that those sales were unusual (*e.g.*, by comparison to sales outside of the putative class period) and therefore the fact of the sales did not contribute to a finding that the plaintiffs had pled a compelling inference of scienter.

Plumbers & Pipefitters Local Union 719 Pension Fund v. Zimmer Holdings, Inc., No. 11-1471 (7th Cir. May 21, 2012)

Click here to view the opinion.

Seventh Circuit Affirms Dismissal of Zimmer Hip Implant Securities Suit

The U.S. Court of Appeals for the Seventh Circuit upheld the dismissal of a putative class action regarding statements made by Zimmer Holdings Inc. about an allegedly faulty hip implant, holding that the plaintiffs failed to adequately plead fraud. The plaintiffs filed suit claiming that, in 2008, Zimmer and its top executives made false statements about the high failure rate one surgeon experienced with a hip implant product called the Durom Cup. The plaintiffs further claimed that Zimmer downplayed the significance of quality control problems at one of its plants. The district court dismissed the complaint, finding that it failed to meet the heightened pleading requirements of the PSLRA. On appeal, the Seventh Circuit affirmed the dismissal of the action. The court held that scienter could not be inferred under the circumstances, because the plaintiffs could not prove that Zimmer's explanation — that the surgeon's high rate of failure was due to improper surgical technique — was false, let alone knowingly false. The court further determined that Zimmer did not mislead the market when it failed to disclose certain quality control problems at one of its plants, as it had no duty to disclose every problem. Moreover, the plaintiffs' contention that one could infer scienter because Zimmer managers had financial incentives to make the company appear profitable was too generic an allegation, since a similar assertion could be made about any company.

SEC ENFORCEMENT

Rapoport v. Sec. & Exch. Comm'n, No. 11-1082 (D.C. Cir. June 19, 2012)

Click here to view the opinion.

District of Columbia Circuit Vacates SEC Default Order for Failure to Apply Rule Consistently

The U.S. Court of Appeals for the District of Columbia Circuit vacated an SEC default order and remanded because the SEC failed in this instance to apply a rule allowing it to set aside default orders for good cause consistently with prior SEC precedent. The SEC had denied the petitioner's motion under Rule 155(b) to set aside a default judgment because the petitioner did not make his motion within a reasonable amount of time and his reasons for failing to defend against the claims lacked merit. The court determined that the SEC's refusal to consider the petitioner's proposed defenses (a third requirement of Rule 155(b)) was not consistent with the SEC's previous application of the rule, and so was arbitrary. The SEC also made a "vague and indecisive" interpretation of what constituted a "reasonable" amount of time to move to vacate a default order. It stated multiple different dates from which to begin calculating what constitutes a "reasonable" time, and it did not state with clarity what amount of time would be considered unreasonable. In addition, the court held that the SEC had not supported its imposition of second-tier penalties on the petitioner because it did not parse the alleged violations committed by the petitioner and his company, and its allegations that the petitioner "willfully" violated Section 15(a) of the Securities Exchange Act were too conclusory to justify imposing second-tier penalties.

Sec. & Exch. Comm'n v. Goble, No. 11-12059 (11th Cir. May 29, 2012)

Click here to view the opinion.

Eleventh Circuit Overturns Injunction Ordering Defendant to Comply With Certain Sections of the Exchange Act

The U.S. Court of Appeals for the Eleventh Circuit overturned an injunction ordering defendant Richard Goble not to violate the terms of Sections 15(c)(3) and 17(a) of the Securities Exchange Act. The SEC had successfully brought an enforcement action against Goble based on his

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alleged orchestration of a scheme to manipulate the amount of reserves his company was required to keep to protect customer assets. Goble appealed. The SEC's claim against Goble for aiding and abetting withstood review, but he also challenged the injunctive remedy issued by the district court as constituting an impermissible "obey-the-law" injunction, *i.e.*, an injunctive order that does nothing but tell the defendant to follow the dictates of a statute.

The injunction against Goble merely cross-referenced the language of the applicable statutes and regulations and ordered him not to disobey. The appellate court explained that under the Federal Rules of Civil Procedure an injunction must contain enough specificity that the subject can understand what he must do to avoid contempt by looking at the four corners of the injunction. Although other courts had given the SEC leeway in crafting relatively broad injunctions, in this instance, the bare language of the relevant securities laws could not deliver the requisite specificity, given the complexity of those laws and interpreting precedent from the courts. The court said, "[A] defendant reading the injunction would have little guidance on how to conform his conduct to the terms of the injunction. Indeed, that defendant would need to review hundreds of pages of the Federal Reporters, law reviews, and treatises before he could begin to grasp the conduct proscribed[.]" The court remanded with instructions to draft an injunction that specified what Goble must not do.

SECURITIES ACT CLAIMS

Panther Partners Inc. v. Ikanos Commc'ns, Inc., No. 11-63-cv (2d Cir. May 25, 2012)

Click here to view the opinion.

Second Circuit Vacates Denial of Leave to Amend Complaint Relating to Manufacturer's Alleged Failure to Disclose Known Defects in Its Semiconductor Chip

The U.S. Court of Appeals for the Second Circuit vacated a denial of a putative lead plaintiff's leave to amend its complaint alleging violations of Sections 11 and 12(a)(2) of the Securities Act. The proposed amended complaint alleged that a manufacturer and various of its officers, directors and underwriters violated Sections 11 and 12(a)(2) by allegedly failing to disclose known defects in the manufacturer's semiconductor chip. The complaint plausibly pleaded facts suggesting that the defendants knew that a large quantity of the manufacturer's semiconductor chips sold to its largest customers were defective. If true, the manufacturer had an affirmative duty to disclose these facts under Item 303 of SEC Regulation S-K, which requires the disclosure of "known uncertainties" that could materially impact revenues. Although the manufacturer did not know the actual defect rate at the time of its offering and had not yet issued a product recall, the court held that, like the materiality standard articulated in *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309 (2011), Item 303's disclosure obligations regarding "uncertainty" do not turn on purely quantitative inquiries. Rather, the court held that a plausible inference arose from the allegations that, "at a time when it was receiving an increasing number of calls from these customers and its Board of Directors was discussing the issue, Ikanos was aware of the 'uncertainty' that it might have to accept returns of a substantial volume, if not all, of the chips it had delivered to its major customers. It goes without saying that such 'known uncertainties' could materially impact revenues."

In re Gen. Elec. Co. Sec. Litig., No. 09 Civ. 1951 (DLC) (S.D.N.Y. Apr. 18, 2012)

Click here to view the opinion.

On Motion to Reconsider, SDNY Dismisses Claims Against GE

On a motion to reconsider, Judge Denise Cote of the U.S. District Court for the Southern District of New York dismissed claims that GE and its underwriters violated Sections 11 and 12(a)(2) of the Securities Act in GE's offering documents for a public stock offering because the plaintiffs did not allege any actionable misstatements or omissions. The court's earlier opinion had erroneously relied on statements in a GE 8-K that had not been incorporated into offering documents. In addition, GE's statements in its 10-Ks, although incorporated into the offering documents, were superseded by subsequent statements included in the offering's prospectus.

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Statements by GE's CEO that GE could continue to meet its commercial paper needs were not actionable because the complaint did not allege that the CEO knew the statements were false when made. Although the plaintiffs adequately alleged that GE overvalued its assets in violation of GAAP, these alleged misstatements were not actionable because the plaintiffs did not allege how much the valuation was inflated, and so they did not adequately allege materiality. But the court upheld claims that GE violated Section 10(b) of the Securities Exchange Act because, although the alleged misstatements were opinions, the plaintiffs adequately alleged that GE's CFO knew the alleged misstatements were false when he made them.

SECURITIES FRAUD PLEADING STANDARDS

City of Omaha, Neb. Civilian Emps.' Ret. Sys. v. CBS Corp., No. 11-2575-cv (2d Cir. May 10, 2012)

Click here to view the opinion.

Second Circuit Affirms Dismissal of Claims That CBS Improperly Delayed Impairment Testing of Its Intangible Assets

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims that CBS allegedly violated Section 10(b) of the Securities Exchange Act by improperly delaying impairment testing of CBS's intangible assets (such as goodwill). The court had previously held, in *Fait v. Regions Financial Corp.*, 655 F.3d 105 (2d Cir. 2011), that statements regarding estimates of goodwill are statements of opinion. Although *Fait* involved claims under Sections 11 and 12 of the Securities Act, the court extended that holding to Section 10(b) claims, because all such claims shared a material misstatement or omission element. Under *Fait*, plaintiffs must allege that defendants were aware of facts that should have resulted in earlier impairment testing *and* that defendants did not believe the statements regarding goodwill at the time those statements were made. These plaintiffs did not adequately allege that CBS knew that conducting impairment testing would reveal that it had overvalued its goodwill. The plaintiffs also failed to allege that CBS did not believe that its goodwill valuations, which are statements of opinion, were overvalued. Finally, the plaintiffs failed to allege that CBS's price was inflated, because all of the purported "red flags" the plaintiffs pointed to were public knowledge, and it was publicly known that CBS had not conducted an impairment test since before the appearance of those red flags.

Urman v. Novelos Therapeutics, Inc., No. 10-10394-NMG (D. Mass. June 11, 2012)

Click here to view the opinion.

Massachusetts Federal Court Dismisses Claims Relating to Allegedly Misleading Statements About Cancer Treatment Drug

Judge Nathaniel M. Gorton of the U.S. District Court for the District of Massachusetts dismissed claims that Novelos violated Section 10(b) of the Securities Exchange Act by allegedly making overly optimistic statements during the clinical trial of its cancer treatment drug. The plaintiffs alleged that Novelos had no basis for making the statements, which relied on the drug's success in previous phases of the trial, because Novelos had allegedly made material changes to the drug between phases. The court determined that the plaintiffs failed to show scienter because it was implausible that Novelos would knowingly make fundamental changes to the drug when it had been successful in previous trial phases. Also, on 16 occasions in its prior SEC filings, Novelos had made statements similar to those now alleged to be misleading, making it doubtful that the alleged misstatement caused its stock to be artificially inflated only due to the latest disclosure.

STATUTES OF REPOSE

Fed. Hous. Fin. Agency v. UBS Ams., Inc., No. 11 Civ. 5201 (DLC) (S.D.N.Y. June 26, 2012)

Click here to view the opinion.

SDNY Determines Claims Brought by the FHFA on Behalf of Fannie Mae and Freddie Mac Were Not Barred by Section 13's Statute of Repose

Judge Denise Cote of the U.S. District Court for the Southern District of New York determined that claims brought by the Federal Housing Finance Agency on behalf of Fannie Mae and Freddie Mac were not barred by the three-year statute of repose in Section 13 of the Securities Act. Section 13's statute of repose is triggered when there is a bona fide public offering of the securities in question. Although the securities were marketed pursuant to shelf registrations that became effective more than three years before the agency took Fannie Mae and Freddie Mac into receivership, this was not a bona fide public offering, because later updates to the shelf registration resulted in a fundamental change to the registration statement.

Hall v. Variable Annuity Life Ins. Co., No. H-11-3639 (S.D. Tex. May 31, 2012)

Click here to view the opinion.

Texas Federal Court Limits Equitable Tolling From Order Vacating Class Certification

Judge Sim Lake of the U.S. District Court for the Southern District of Texas concluded that equitable tolling ceased on the date a court vacated a class certification order. The plaintiffs contended that claims were tolled past the court order vacating certification because the order did not amount to a denial of certification. According to the plaintiffs, the court never issued a final judgment on class certification.

The court concluded that equitable tolling did not apply past the order vacating class certification and dismissed the purported class action. Because the plaintiffs' claim would be barred even if the repose period were tolled, the court assumed, without deciding, that the state of repose was subject to tolling under *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974). Under *American Pipe*, the initiation of the class action suspended the statute of repose. The tolling ended, however, when class certification was denied. Thus, the issue before the district court was whether the order vacating certification amounted to a denial of certification. In reaching the decision, the court noted that the court used the label "vacated" but made it clear that the case would not proceed as a class action. The plaintiffs could not prove a classwide measure of damages because its witnesses had been struck. In short, the court determined that class certification was no longer appropriate. Accordingly, the court concluded that the order vacating class certification functioned as a denial of certification and any tolling ceased on the date of that order.

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