Securities Litigation Alert

Ninth Circuit Affirms District Court's Dismissal of Securities Class Action

December 8, 2008

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On November 26, 2008, the US Court of Appeals for the Ninth Circuit affirmed the dismissal of a securities fraud lawsuit brought by Glazer Capital Management against InVision Technologies, Inc. and two of its executive officers. *In Re InVision Technologies, Inc. Securities Litigation*, U.S.D.C., N.D. Cal., C-04-3181. Click here [http://www.fenwick.com/docstore/court/2008-11-26_Decision_on_Appeal.pdf] to read the Ninth Circuit's opinion.

A team from Fenwick & West LLP led by Susan Muck represented InVision in the Northern District of California and the United States Court of Appeals for the Ninth Circuit. The decision is significant in several respects.

First, the decision rejects application of the collective scienter theory on the facts alleged.

Second, the decision makes it more difficult for plaintiffs to base securities fraud claims on regulatory proceedings or settlements absent factual allegations demonstrating a strong inference of scienter by the named defendants.

Third, the decision rejects an officer's SOX certification as evidence of scienter absent facts showing the officer was severely reckless.

Finally, the decision rejects "personal profit" as a basis for pleading scienter of an officer for merger-related representations.

FACTS

On March 15, 2004, InVision announced that it would be acquired by General Electric for $50 per share. The merger agreement included InVision's representation that it was "in compliance in all material respects with all laws" and in particular, with the books and records requirements and anti-bribery provisions of the Securities Exchange Act (including the FCPA). The agreement was signed by InVision's CEO, among others.

A few months later, InVision announced that it was conducting an internal investigation into possible violations of the FCPA and had reported the investigation to the DOJ and SEC. InVision warned that the investigation could delay or cause the termination of the merger. Following the announcement, InVision's stock price fell by $6, and plaintiff filed a class action alleging that InVision had misrepresented that it was in compliance with the FCPA.

Ultimately, the GE merger was consummated on the terms originally disclosed. InVision entered into a non-prosecution agreement with the Department of Justice and agreed to pay an $800,000 fine in connection with alleged FCPA violations. In addition, InVision entered into a settlement agreement with the SEC, which alleged that InVision had authorized payments to foreign sales agents despite knowing there was a "high probability" that those funds would be used to make improper payments to local government officials.

SIGNIFICANCE OF THE NINTH CIRCUIT'S OPINION

Collective Scienter inapplicable

The Court first addressed the question of whether plaintiff was required to plead facts indicating that the CEO, who had signed the merger agreement containing the alleged misstatements, acted with scienter, or whether Glazer could instead rely on a theory of "collective scienter." The "collective scienter" theory permits a plaintiff to allege "a strong inference of corporate scienter without being able to name the individuals who concocted and disseminated the fraud." Although the Court noted that Ninth Circuit law "does not foreclose the possibility that, in certain circumstances, some form of collective scienter pleading might be appropriate," the Court rejected collective scienter given the nature of the alleged misstatements and facts alleged:

> [Under plaintiff's theory,] so long as *any* employee at InVision had knowledge of the violation of *any* law, scienter could be imputed to the company as a whole. This result would be plainly inconsistent with the pleading requirements of the PSLRA.

As a result, the Court held that plaintiff was required to plead scienter with respect to the specific individual who made the alleged misstatement.

FCPA violations do not satisfy standard for pleading scienter

In an era in which FCPA investigations are on the rise, the **InVision** decision should make it more difficult for plaintiffs to plead securities fraud lawsuits that piggy-back on the disclosure of FCPA investigations or similar regulatory proceedings. Absent the application of collective scienter, plaintiffs will have to plead specific facts demonstrating that the individuals responsible for the alleged misstatements knew about the FCPA violations. As the Ninth Circuit noted, this will be difficult because "the surreptitious nature of the transactions creates an equally strong inference that the payments would have been deliberately kept secret – even within the company." Indeed, the alleged improper payments "were not, by their nature, the type of transaction of which it would be 'hard to believe' senior officials were unaware." The Court also noted that the DOJ and SEC settlements were insufficient to raise an inference of scienter, since the mere fact that someone at the company may have had actual knowledge of improper transactions was insufficient to raise a strong inference that the defendant officers had such knowledge.

Sox Certifications do not plead scienter

Since the enactment of SOX, plaintiffs in securities fraud lawsuits routinely attempt to show scienter by pointing to SOX certifications signed by company executives. Glazer attempted this, arguing that the officers' SOX certifications were sufficient to infer defendants' knowledge of FCPA violations. The Court disagreed. Following decisions in other circuits, the Ninth Circuit held for the first time that a SOX certification "is only probative of scienter if the person signing the certification was severely reckless in certifying the accuracy of the financial statements."

"Personal profit" insufficient to plead scienter

Glazer attempted to raise an inference of scienter by arguing that the officers were motivated to make false statements because they would profit personally from the merger. Joining several other circuits, the Ninth Circuit held that evidence of a personal profit motive on the part of officers and directors contemplating a merger is insufficient to raise a strong inference of scienter.

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