SECURITIES

JUDGE JED S. RAKOFF OF THE SOUTHERN DISTRICT OF NEW YORK MADE HEADLINES LAST DECEMber when he rejected a $285 million settlement between the SEC and Citigroup, stating that the commission's failure to require the bank to admit or deny the charges left him unable to determine if the settlement was fair. The decision comes amidst accusations that the SEC needs to be tougher on financial institutions. Our panel of experts discusses the impact of Rakoff's decision, Chinese reverse mergers as well as the U.S. Supreme Court's decisions in *Morrison* and *Janus*. They are Joseph Tabacco of Berman DeValerio; Michael Celio of Keker & Van Nest; Jordan Eth of Morrison & Foerster; Michael Torpey and Jim Kramer of Orrick, Herrington & Sutcliffe; and Mary Blasy of Scott + Scott. The roundtable was moderated by *California Lawyer* and reported by Rick Galten of Barkley Court Reporters.

EXECUTIVE SUMMARY

MODERATOR: How will Judge Rakoff's decision to reject the SEC's settlement with Citibank change the SEC's approach to cases?

CELIO: I'm concerned about individual defendants. If this decision is applied widely, SEC litigation will begin to look a lot more like criminal litigation (*S.E.C. v. Citigroup Global Markets Inc.*, 2011 WL 5903733 (S.D.N.Y)). Individuals will face situations where they forfeit their D&O insurance or their indemnification from their corporate employer if they admit to wrongdoing. This will put pressure on individual defendants to settle cases quickly. It would be ironic if that were the outcome, since Judge Rakoff's decision wasn't about an individual defendant. Citi has the wherewithal to fight, where an individual defendant might not.

TORPEY: If it is followed, it will have a substantial impact, but I don't see why it would cause earlier settlements—fewer settlements, perhaps. As an individual, there are lots of consequences to actually admitting to a 10(b), which would cause more cases to go to trial.

CELIO: The potential for financial ruin is high. As a controller or a corporate vice president, you have had the comfort of knowing that your legal fees will be paid. But if that changes, defendants must take that into account early in the litigation process. You wouldn't spend time testing theories and filing a motion to see how it turns out. It could be similar to a criminal case in that way: There's a binary path where you either settle fast or fight to the end. Our current approach may end if what Judge Rakoff suggests becomes the trend, which has strong implications for the plaintiffs bar.

ETH: I don't see it leading to more trials, because a loss at trial risks losing your insurance and indemnification. If you can settle in a manner consistent with Rakoff—he pointed to one where a statement that "mistakes were made" was sufficient—maybe that would be enough. Is there something you could say that would satisfy the Rakoffs of the world but at the same time not jeopardize your indemnification and insurance?

Also, I don't yet see other judges picking up on this. Probably the SEC is going to avoid the Southern District of New York. They'll go administratively if they can or file elsewhere.

CELIO: Robert Khuzami issued a news release taking exception to the decision. But I've got a number of cases with the SEC where people are now wondering whether they're able to settle and who needs to be involved. I believe this decision is a one-off. People need a way to settle that will not jeopardize their ability to get indemnification or insurance. It would tilt the scales so far against the deterrent effect of settlements that other courts will not jump on the bandwagon.

TABACCO: In both *Citigroup* and *Bank of America* Judge Rakoff is reacting to the fact that the SEC forces the current shareholders to help fund the settlements (*S.E.C. v Bank of America Corp.*, 2010 WL 624581 (S.D.N.Y.) (*Bank of America II*)). He's sending a clear message that probably resonates with the Occupy movement. The SEC is not the regulator it should be. It's the last line of defense with remedies unavailable to the plaintiffs bar, and yet Congress will not give the SEC the resources it needs to do its job effectively.

TORPEY: Be careful what you wish for. Right now almost every judge in America will approve almost any settlement presented to it. If there's a strong movement for judges to more aggressively review these, the first place to get hit will be M&A settlements. We're already seeing some judges take a much closer look at settlements. Most judges give total deference. If they stop doing that, there will be fewer and different settlements.

ETH: We're talking about Judge Rakoff, but there's a larger context in which the SEC is being attacked for not being tough enough. Obama is supporting new legislation so that "recidivists"—and that definition may wind up including any financial institution and most public companies—will face stronger penalties and fines. The SEC is likely looking for more power from Congress, but they're also being more aggressive and they've got public sentiment behind them. Note that Robbins Geller filed an amicus brief in *Citibank* pushing for a more aggressive SEC.

TABACCO: The relationship between the plaintiffs bar and the SEC has not always been smooth. They have tools that we don't, and they are looking for our help, but we rarely get anything in return. Further, defendants use any pending SEC investigations or action as an excuse to stay or slow down private litigation.

CELIO: That trend will only continue. If defendants have to admit to wrongdoing, we're going to fight like crazy to put the brakes on private litigation. You have to treat it like a criminal case if at the end you're going to be forced to admit that you violated the securities laws in order to settle.

BLASY: Judge Rakoff's decision focuses heavily on the SEC's request for injunctive relief. Citing several instances, including a class action against VeriFone, the investors demonstrated that, "Defendants in securities actions routinely seek to use the termination of an SEC investigation or the bringing of non-fraud charges to argue that the SEC charging decisions negate an inference of scienter with respect to such conduct." (The Union Central Life Ins. Co., Ameritas Life Ins. Corp. and Acacia Life Ins. Co.'s Notice of Motion and Motion for Leave to file *Amicus Curiae* Brief Responding to Court's October 27, 2011 Order, *SEC v. Citigroup Global Markets, Inc.*, S.D.N.Y. No. 11-CV-07387, ECF 23 at 12 (citing *In re VeriFone Holdings, Inc.* Sec. Litig., 2011 WL 1045120, at *9 (N.D. Cal.).

I wish the Court had focused more on that particular practice in its decision because it's a real problem where the evidence the SEC has reviewed is not made available to private litigants.

ETH: As someone who represented one of the defendants in VeriFone, under the Supreme Court's decision in *Tellabs*, you can consider everything (*Tellabs, Inc. v. Makor Issues & Rights, LTD.*, 551

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U.S. 308 (2007)). If there's an SEC complaint filed, the plaintiffs will put that in their complaint. So why can't we then say, "We've resolved that and they never brought up fraud charges. Judge, you can consider that along with everything else?"

BLASY: There's actually a recent decision holding that we can't even allege in our complaint what's been pled in a "settled" SEC complaint because such allegations do not constitute findings of fact. (*Footbridge Ltd. v. Countrywide Home Loans, Inc.*, 2010 WL 3790810, at *5 (S.D.N.Y.).) But back to Judge Rakoff's finding that the dollars didn't sufficiently penalize the company, it appears that in addition to the injunctive relief the SEC sought, the discussion about the penalty was driven by what really would have an impact on that individual defendant and what was that individual defendant's financial situation. The Rakoff decision suggests the dollars are just too small.

TORPEY: He didn't say that, although it feels like that's the case. He said that he couldn't tell from the evidence whether they did something wrong, and was uncomfortable with the allegations followed by "we will neither admit nor deny." It would be a better decision to say, "I don't think the dollars match the allegations and have rejected it on that basis."

TABACCO: Judge Rakoff pointed out that Goldman actually admitted wrongdoing as part of their deal. He's saying, "If Goldman admitted wrongdoing why not Citibank?" Also significant to the current atmosphere is the Bloomberg FOIA request, which revealed that the Fed has pumped up the top ten banks with $1.2 trillion dollars. The TARP money pales by comparison. A $33 million fine—you can't even calculate that as a fraction of $1.2 trillion.

CELIO: But the SEC penalties worked in the sense that it is not a criminal action. You have the civil burden of proof, so the SEC's only got to show that the evidence favors them 51 percent to 49 percent. But a criminal action, which is what this could become, essentially ends careers for individuals.

TORPEY: Khuzami has made it very clear that he wants the SEC enforcement division to be much more like the DOJ. Tangentially, he wants all individuals separately represented, which makes people more likely to turn somebody else in. He's right, and it also makes it much more expensive. Did you see *SEC v. Tang* (2012 WL 10522 (N.D. Cal.)?

CELIO: I represent one of the co-defendants in that case. The SEC's position was wrong for a number of reasons. Fenwick—the challenged counsel—filed a motion notifying all parties of the potential conflict when it arose. The SEC said nothing and then waited nine months, until right before discovery closed, to complain. Judge Spero had a lot of reasons to rule as he did.

TORPEY: I agree, but he finds that they don't have standing, and if that sticks, then the push for separate counsel evaporates. Maybe that's a good thing.

KRAMER: Mike [Torpey], if you assume that Rakoff will be the law of the land and the admit/deny settlements are going away, does the SEC bring fewer cases? Does it impact their ability to bring cases? Do you necessarily have to have an increase in their budget? I think it means that the SEC ends up trying more cases.

TORPEY: Their style is to litigate until summary judgment, and then wait to make a real settlement offer between summary judgment and trial. By that time the clawback is so large that most of the defendants will go to trial. Their style of litigating will backfire because they're going to be so overwhelmed.

KRAMER: You're likely to see more settlements occur before formal litigation is filed. It would be interesting to see whether you can settle something on a "neither admit nor deny" or whether you lose that opportunity.

MODERATOR: What has been the impact of the U.S. Supreme Court's decision in *Janus* (*Janus Capital Group, Inc. v. First Derivative Traders* (131 S.Ct. 2296 (2011))?

ETH: This is a decision about what it means to make a statement, authored ironically by a justice known for not making statements during argument. It will lead to a lot of motions by a lot of individuals who say, "It's not me, it was somebody else." For a long time we've advised clients that they might be responsible for an analyst statement. Justice Thomas said the SEC hasn't adopted all the EDGAR (Electronic Data-Gathering, Analysis, and Retrieval) filings, so why couldn't you now argue, "I have no ultimate authority over what that analyst says." It's something I never would have thought of before *Janus*.

TABACCO: *Janus* is one more nail in the coffin of protection of investor rights. It is a hyper-technical decision by the Court that has lead some to try every means to wiggle out of the holding. But the Ninth Circuit in the BP exploration case recently came down with a decision that when you have two distinct entities, *Janus* applies and that's the end of the case, even though it was clear that the culpable statements were made and directed by people who now can get off the hook (*Reese v. BP Exploration (Alaska) Inc.*, 643 F.3d 681 (9th Cir. 2011)). *Janus*, simply put, makes it harder for the attribution argument to stick.

TORPEY: *Janus* doesn't hurt you that much because the plaintiffs bar had previously acquired the discipline not to name non-speakers. Almost all your complaints were company, CEO, CFO. The group hurt most by *Janus* is the SEC because they're still in the mood to bring lots of action against non-speakers. They fight on *Janus* pretty hard because they don't want to fall back to aiding and abetting because it raises the mental state.

KRAMER: It's a crisper issue on summary judgment when the record's fully developed as to who's making the allegedly false statement. The pleading stage is not going to be as powerful, primarily for the reasons Mike [Torpey] articulated.

ETH: But who actually makes a press release? Is it a committee? Is it a board of directors? Is it a chairman of the board?

KRAMER: It's the company. Jordan [Eth] the point you raise is important, as a practical matter. If the companies are going to be named in these cases more often, then when a company is renewing its D&O insurance, it should consider getting side C coverage. For years brokers are saying you don't need side C coverage.

ETH: About Joe [Tabacco]'s story about how the Supreme Court is destroying investor rights. It is also true that *Merck*, *Matrixx*, *Halliburton*, and *Tellabs* were all seen as plaintiffs' victories. On many cases they're coming out pro-plaintiff. (*Merck & Co., Inc. v. Reynolds*, 130 S. Ct. 1784 (2010); *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309 (2011); *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011).)

TABACCO: I would be the first to agree bad facts made bad law. But with *Janus* you almost didn't see it coming because the way mutual funds are organized is peculiar to that industry. You get a crazy result with a trust that's separate from the entity that actually controls the trust that does the drafting and management. So maybe the advice to securities issuers is "set up a sub to issue your press releases."

CELIO: The fact pattern of *Janus* was a surprising one for the Court to use to reach this particular result.

KRAMER: For years we've been making that argument, when dealing with the SEC at least, on the speaker piece. The person didn't sign, so they're not a speaker. We typically see the SEC fall back to aiding and abetting or substantial participation. It was interesting to see that someone actually read the statute and said you actually have to speak, and defined what that means.

CELIO: When you represent an outside director, you've got a defense now. In a 10b(5) claim, it's a huge advantage.

BLASY: *Janus* and *Morrison* were both decisions where the Supreme Court ruled on very narrow, obscure factual issues and then made a big, giant law that stymies investors' rights to recovery on issues that weren't considered, briefed, or argued (*Morrison v. National Australia Bank Ltd.*, 130 S.Ct. 2869 (2010)).

MODERATOR: What are the implications of recent litigation in the wave of Chinese reverse merger class actions?

TABACCO: A distinct minority of people who play in the securities markets are dishonest and take advantage of loopholes. If you had aiding and abetting back on the books, it would go a long way to curbing the abuses taking place with Chinese reverse mergers. There is virtually no ability to get discovery in China. Indeed, it's against the law for accountants in China to give you their books and records. It's extremely difficult for private prosecutors to pursue these claims. In the absence of substantial assets in the U.S., the shareholder's are left with no effective redress. The SEC is now looking at the problem. There isn't too much the private bar can do. It's real fraud. At a minimum, in these circumstances, courts should allow an adverse inference instruction.

TORPEY: Have you ever had a Chinese reverse merger case in which you recovered any money?

TABACCO: No, but we had a case against one of the largest solar panel manufacturers in China that had serious accounting issues. But it was a real company; it wasn't a shell. We had a great deal of difficulty because most of the assets were in China. The case was here in the N.D. CA, and the court could see the problems and frustration we experienced in getting meaningful discovery. Even with the court trying to level the playing field, it was virtually impossible to circumvent the discovery hurdles imposed by China.

BLASY: Same experience. Some of these companies came into the U.S. financial markets very easily, and some of them walk away just as easily. They literally stop filing SEC filings. They impose a "come and find me" approach to getting served. And getting documents from them is ridiculously hard. The resulting mess is shocking.

Unfortunately, *Central Bank* keeps us from going after the people who are culpable for helping them get the U.S. listing in the first place. A lot of these shell companies originated in Nevada, and many third parties were involved in inviting them here. They're now walking out our doors with the investors' money just as easily as they came in, which presents a real problem. We can't go after the very people who opened the door to them. It's hard to believe the guys in China dreamt up the idea of doing reverse mergers on their own.

CELIO: For a while these cases were a quarter of all the securities filed in the country. But it seems like it has stopped.

TABACCO: With maybe one exception—we at Berman DeValerio have looked at most of those cases and said, good luck. You've got a great fraud and no ability to collect.

TORPEY: We currently have a matter with one of the Big Four accounting firms where the SEC has asked for documents from an affiliated accounting firm in China. To audit a U.S. public company, you have to agree to be monitored by the PCAOB and follow certain protocols, one of which is to produce documents when asked. These accounting firms are in a really tricky place. The Chinese government has told them, "don't produce documents." The U.S. government has told them to produce documents. That specific dispute will effect how the whole thing goes for the private bar.

TABACCO: All they have to do is list their shares in Beijing and

they're off the hook.

ETH: This is an area where business and the law are just miles apart. We've heard forever about globalization, the efficiency of capital, and money flows around the world in nanoseconds. And we're talking about service of process, personal jurisdiction, enforceability of judgments, and whether you can even propound discovery. The legal system doesn't fit with this reality.

KRAMER: I expect that the plaintiffs bar is going to get pretty creative. And rather than suing someone based in China, find some U.S.-based entity, bank, some other entity against whom a claim can be asserted. I haven't seen it yet but am interested if you agree.

TABACCO: The structure of these deals is designed to thwart that. People have thought through the fraud well before the plaintiffs bar can get there. The people behind these deals stay in the shadows. You have an offering, you don't have a registration; you don't have anything that gives you a hook. That's the sinister beauty of this crime.

KRAMER: But are there other claims available under state law where you could get some relief?

BLASY: I attempted to stop the executives of one of these Chinese reverse merger companies from removing assets from the U.S. via a state court action recently. The judge overseeing the federal securities case immediately stayed discovery in my state court action under SLUSA pending resolution of the motions to dismiss in his case. I can still try to get injunctive relief, but would be forced to do so on an incomplete factual record.

MODERATOR: How have the courts treated plaintiff attempts to limit the impact of *Morrison v. Australia National Bank?*

TABACCO: We've had a lot of litigation since *Morrison*, and pretty much all of it, from the point of view of the plaintiffs, has gone badly. We were in the Toyota case and our institutional plaintiff had the largest purchase of shares of common stock. The court said, "Sorry, you didn't buy those shares in the U.S., even though the plaintiff is in the U.S." Of interest is what the SEC will say about *Morrison* in its upcoming report.

There will be attempts to circumvent *Morrison* because if there won't be a class certified for foreign shares under federal law maybe there are other remedies and maybe individual actions will be filed. If your losses are big enough for an individual action you may have a chance to recover, but if you're a little investor, you're screwed.

TORPEY: Have cases filed in foreign jurisdictions gotten a class certified, used the fraud-on-the-market theory, gotten a settlement, and a distribution out to the class?

TABACCO: A qualified yes. The Ontario Securities Act, which was amended in 1990s, opened the door for class actions in Canada. Most commonwealth jurisdictions have loser-pays provisions, but in Ontario they set up a trust to cover loser-pays and encourage class actions. It took them about 15 years to sort out fraud in the market. There are lawyers in Toronto who have dedicated their practice to both securities fraud and antitrust class actions on the plaintiff side.

BLASY: You can certify a global class up there. In *IMAX* they did (*Silver v. IMAX Corp*. 66 B.L.R. (4th) 222 (2009) (leave to commence proceedings under the Ontario Securities Act), 86 C.P.C. (6th) 273(2010) (certification of class proceedings; refusal to dismiss claims of common law misrepresentation) and 2010 Carswell Ont. 5663 (costs awarded)).

ETH: You can say this is cutting back on investor rights, but you didn't see a lot of these cases until ten years ago. It has always struck me as bizarre that U.S. securities law should cover transactions by someone in a foreign country on a foreign exchange, and that a judge in San Jose should be able to use the 10(b) implied private right of action to do that.

BLASY: But companies like Shell, BP, and Vivendi come here and register. They might continue to trade a lot of their ordinary shares on their foreign exchange, but they register an ADR here as well. If you're CalPERS, you're trying to decide, whether to trade early in the day when the stock is trading overseas at a good price or to wait until the U.S. market opens so the trade is protected by the U.S. securities laws but the price is worse?

ETH: From CalPERS' point of view, if you're trading on a foreign exchange, why do you think American law is going to cover you? If I get mugged in Frankfurt, I'm not calling the San Jose Police.

KRAMER: I'm surprised we're not seeing more litigation outside the U.S. Ten years ago the prediction was for more class action litigation in Europe.

BLASY: My firm just prosecuted an action against an Irish issuer where by far the substantial majority of the stock was purchased by U.S. citizens in the form of ADRs or ordinary shares, regardless of where they transacted. Almost all of the company's real operations were in the U.S., and it was their failure to obtain U.S. FDA approval of a product that brought its stock price down. Even there, *Morrison* precluded recovery. The SEC or Congress can and must do something because the doors of U.S. courts should not be closed to its citizens. ■